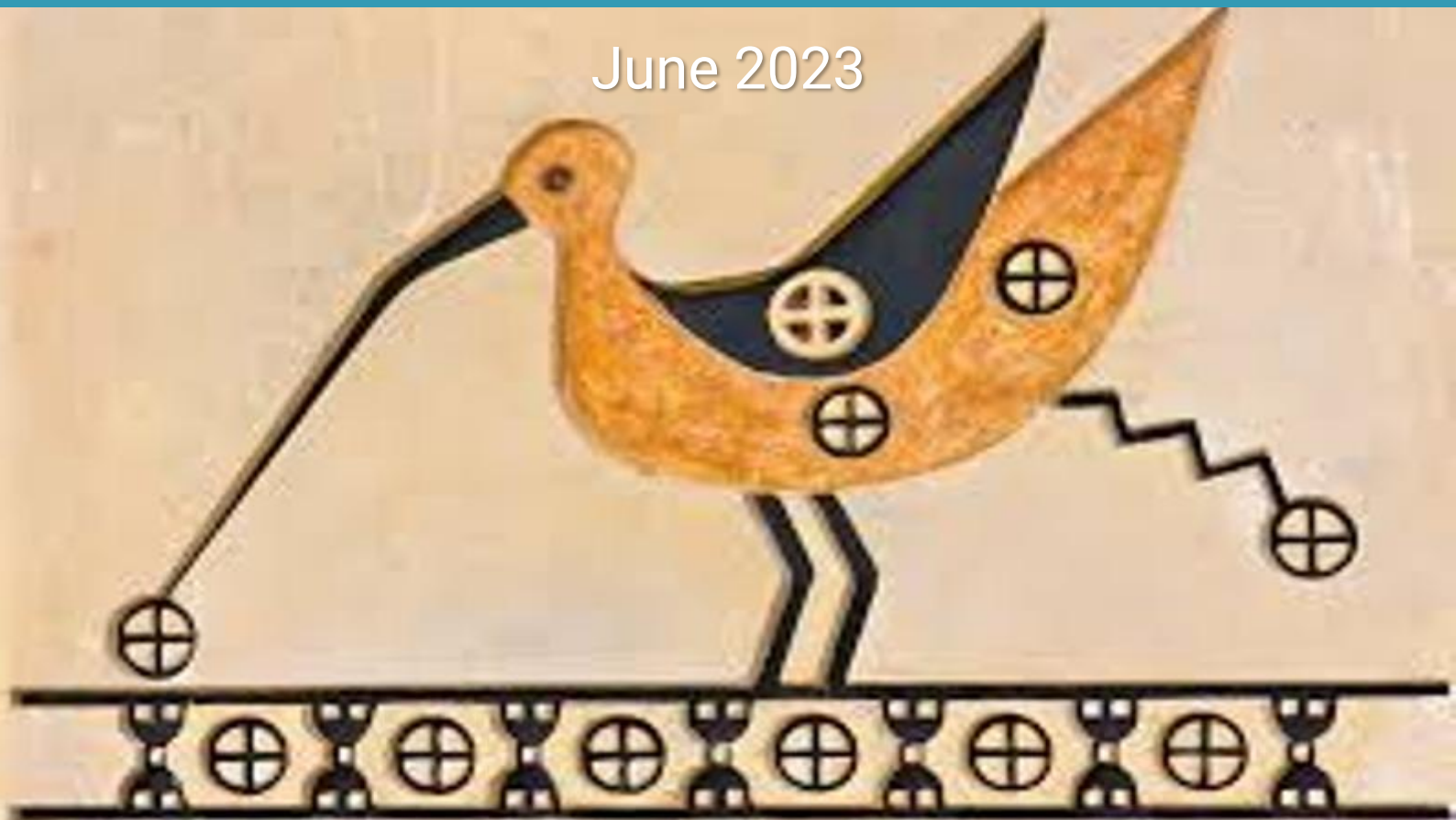




5th Follow-Up Report

Mutual Evaluation of Palau

June 2023





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

PALAU

5TH ENHANCED (EXPEDITED) FOLLOW-UP REPORT 2023

I. INTRODUCTION

1. The mutual evaluation report (MER) of Palau was adopted in 2018. Previous FURs were adopted in 2019, 2020, 2021 and 2022.

2. This FUR analyses the progress of Palau in addressing the technical compliance requirements of the recommendations being re-rated. Technical compliance re-ratings are given where sufficient progress has been demonstrated.

3. This report does not analyse any progress Palau has made to improve its effectiveness.

4. The assessment of Palau's request for technical compliance re-ratings and the preparation of this report was undertaken by the following experts:

- *Joseph Dixon, Financial Transactions & Reports Analysis Centre of Canada, Canada*
- *Matthew Shannon, the Department of Finance, Canada*
- *Shelly Hsu, Securities and Futures Bureau, Chinese Taipei*
- *Sumera Baloch, Financial Monitoring Unit of Pakistan, Pakistan*

5. The preparation of the report was supported by Sylvia Deutsch and Margaret Stone from the APG Secretariat.

6. Section III of this report summarises the progress made to improve technical compliance against Palau's requested Recommendations and against Recommendations that has changed since Palau's MER in 2018. Section IV contains the conclusion and a table illustrating Palau's current technical compliance ratings.

II. FINDINGS OF THE MUTUAL EVALUATION REPORT

7. The MER rated¹ Palau as follows:

IO.1	IO.2	IO.3	IO.4	IO.5	IO.6	IO.7	IO.8	IO.9	IO.10	IO.11
Mod	Sub	Mod	Mod	Low	Mod	Mod	Mod	Low	Mod	Low

R.	Rating
1	PC
2	LC
3	LC
4	LC

R.	Rating
21	C
22	NC
23	PC
24	NC

¹ There are four possible levels of technical compliance: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC). Effectiveness ratings for the 11 Immediate Outcomes are: Low, Moderate (Mod), Substantial or High. Palau has not been re-rated on any Recommendations in previous FURs.

R.	Rating	R.	Rating
5	LC	25	PC
6	LC	26	PC
7	NC	27	C
8	NC	28	NC
9	C	29	LC
10	PC	30	LC
11	C	31	LC
12	PC	32	LC
13	PC	33	LC
14	NC	34	PC
15	PC	35	PC
16	PC	36	NC
17	PC	37	LC
18	C	38	LC
19	PC	39	LC
20	LC	40	LC

8. Given these results and the effectiveness ratings, Palau is on enhanced (expedited) follow-up.²

III. PROGRESS TO IMPROVE TECHNICAL COMPLIANCE

9. In keeping with the APG ME Procedures, this FUR considers progress made up until 1 June 2023 and considers progress to address the deficiencies identified in the MER and the entirety (all criteria) of each Recommendation under review, noting that this is cursory where the legal, institutional, or operational framework is unchanged since the MER or previous FUR. This report does not address the progress Palau has made to improve its effectiveness.

10. This section summarises the progress made by Palau to improve its technical compliance by:

- implementing requirements in place at the time of the MER, and
- implementing new requirements where the FATF Recommendations have changed since the MER was adopted.

3.1. Progress to address technical compliance deficiencies identified in the MER.

11. Palau requested re-ratings of R.22, R.23, R.28 and R.36.

² There are three categories of follow-up based on mutual evaluation reports: regular, enhanced and enhanced (expedited). For further information see the APG Mutual Evaluation Procedures.

12. The APG welcomes the steps that Palau has taken to improve its technical compliance. As a result of this progress, Palau has been re-rated on R.22, R.23, R.28 and R.36.

Recommendation 22 [R.22] (Originally rated non-compliant)

13. Palau was rated NC for R.22 in its 2018 MER. Deficiencies included 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.

14. **Criterion 22.1** is *mostly met*: As outlined in the MER, Section 3312 of the Money Laundering and Proceeds of Crime Act (MLPCA), indicates that DNFBPs (except accountants) are required to apply CDD. These are further detailed in the new DNFBP Regulation as follows:

15. **Criterion 22.1(a)** is *mostly met*: While gambling is illegal in Palau (17 PNCA Chapter 50) and there are no casinos in Palau, DNFBP Regulation Part II (2.1.1.) obligates casinos to apply CDD measures as detailed below under c.22.1(d) without any minimum financial transaction.

16. **Criterion 22.1(b)** is *mostly met*: DNFBP Regulation Part II (2.1.1) obligates real estate agents in Palau when involved in transactions for clients concerning buying and selling real estate to apply CDD measures as detailed below under c.22.1(d). As discussed in the MER, there are under five real estate agents in Palau.

17. **Criterion 22.1(c)** is *mostly met*: DNFBP Regulation Part II (2.1.2) obligates dealers in precious metal and stones in Palau when involved in transactions above USD 10,000.00 to apply CDD measures as detailed below under c.22.1(d).

18. **Criterion 22.1(d)** is *mostly met*: DNFBP Regulation Part II (2.1.4) obligates lawyers, notaries and other independent legal professional and accountants in Palau when involved in transactions for their clients (consistent with the FATF Standards). CDD obligations for all DNFBPs are outlined in the DNFBP Regulation Part II (2.1.1.) as follows:

- c.10.1 – DNFBPs are prohibited from keeping anonymous accounts or accounts in obviously fictitious names (MLPCA Sec. 331; DNFBP Regulation Part III (6.2)).
- c.10.2 - DNFBPs are required to apply CDD consistent all sub-criteria of c.10.2 (MLPCA Sec. 3312; DNFBP Regulation Part III (4.4.1 and 4.4.2)) with the exception of c.10.2(c). The DNFBP Regulation prescribes a transaction threshold of USD 10,000 for wire transfers. This is significantly higher than the required threshold of USD 1,000.00.
- c.10.3 - DNFBPs are required to identify and verify natural and legal persons and legal arrangements using reliable, independent source documents, data, or information (DNFBP Regulation Part III (4.5), (4.6.1) – (4.6.2(a))).
- c.10.4 - DNFBPs are required to verify that any person purporting to act on behalf of the non-natural person customer is so authorised and identify and verify the identity of that person (MLPCA Sec. 3312; DNFBP Regulation Part III (4.6.2.(b))). This requirement is not application to customers that are natural persons.
- c.10.5 - DNFBPs are required to identify the beneficial owner and take reasonable measures to verify the identity of the beneficial owner, using the relevant information or data obtained from a reliable source, such that the financial institution is satisfied that it knows who the beneficial owner is (MLPCA Sec. 3312; DNFBP Regulation Part III (4.6.2(c))). This requirement is not applicable to customers that are natural persons.

- c.10.6 - DNFBPs are required to understand and, as appropriate, obtain information on, the purpose and intended nature of the business relationship (DNFBP Regulation Part III (4.6.2(f) and (g)); however, this is only applicable for non-natural persons.
- c.10.7 - DNFBPs are required to ensuring that documents, data or information collected under the CDD process is kept up-to-date and relevant, by undertaking reviews of existing records, particularly for higher risk categories of customers (DNFBP Regulation Part III (4.6.3) and scrutinising transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the financial institution’s knowledge of the customer, their business and risk profile, including where necessary, the source of funds (DNFBP Regulation Part III (4.6.2 (g)); however, obligations cover scrutinising transactions are only applicable for non-natural persons.
- c.10.8 – for non-natural person customers, DNFBPs are required to understand the nature of the customer’s business and its ownership and control structure (DNFBP Regulation Part III (4.6.2 (d) to (f)).
- c.10.9 – for non-natural person customers, DNFBPs are required to identify the customer and verify its identity through information outlined in c.10.9(a) to (c) (DNFBP Regulation Part III (4.6.2 (a)).
- c.10.10 – Under MLPCA Sec. 3301(b) beneficial ownership is defined as “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those natural persons who exercise ultimate effective control over a legal person or arrangement.”. Under DNFBP Regulation Part III 4.5, a DNFBP “must verify the identity of each client and beneficial owner when establishing a business relationship or conducting transactions for occasional client. There are no requirements to give effect to c.10.10(b) and (c).
- c.10.11 – Under MLPCA Sec. 3301(b), beneficial ownership includes “the natural person(s) who ultimately controls a customer and/or the person on whose behalf a transaction is being conducted.” The provision does not cover beneficiaries or classes of beneficiaries. In a trust, the settlor and trustee would be captured under “the natural person(s) who ultimately controls a customer,” while the beneficiary would be captured under “the person on whose behalf a transaction is being conducted.” Furthermore, DNFBP Regulation Part III (4.6.2) broadly requires “any client who is not a natural person” to comply with the DNFBP CDD measures in DNFBP Regulation Part III (4.6.2). The only exclusion is where the client is a natural person. Thus, although there is no explicit reference to trusts, beneficial ownerships related to trusts are captured by the MLPCA and DNFBP Regulations. There are no explicit requirements covering BO of other types of legal arrangements.
- c.10.12 and c.10.13 – Palau has no requirements to give effect to these criteria.
- c.10.14 and c.10.15– Palau does not allow delayed verification (DNFBP Regulations Part III (4.6.4).
- c.10.16 – DNFBPs are required to apply new CDD requirements to all new customers and existing customers on the basis of circumstances outlined in DNFBP Regulations Part III 4.6(a) to (f). These circumstances include transactions (including linked transactions) above 10,000.00, change in customers documentation, change in the nature of the relationship with the customer, lack of information or concerns of accuracy of the information of the customer, STR reported, subpoena or production order, of negative information on the customer. In the context of Palau, these requirements are considered consistent with c.10.16.
- c.10.17 - DNFBPs are required to apply EDD for higher risk categories of customers, business relationships or transactions (DNFBP Regulation Part III (5)).

- c.10.18 – Palau does not allow simplified CDD for DNFBPs.
- c.10.19 – Where a DNFBP is unable to comply with CDD requirements, it shall not open the account, commence business relations, or perform the transaction (DNFBP Regulation Part III (4.6.4)). Where the CDD requirements for existing business relationships, due to refusal of the customer to comply or unacceptable delays, the DNFBP is required to terminate the relationship and consider making an STR (DNFBP Regulation Part III (4.6.5)). The obligations to consider making an STR is only applicable to existing business relationships (DNFBP Regulation Part III (4.6.5)), and CDD in the context of legal persons and arrangements (MLPCA § 3322(b)).
- c.10.20 – Palau has no requirements for covering tipping-off.

19. **Criterion 22.1(e)** is *mostly met*: In line with the MER, Palau has no trust and company service providers (TCSPs). Lawyers, notaries, other independent legal professionals, and accountants providing TCSP services are to apply CDD measures as detailed below under c.22.1(d) (DNFBP Regulation Part II (2.1.4)).

20. **Criterion 22.2** is *mostly met*: As outlined in the MER, record keeping is covered by MLPCA § 3326 and require DNFBPs (except accountants) to maintain all books and records with respect to customers and transactions as listed in MLPCA § 3326(a)-(b) for five years although there is a specific carve-out to protect attorney-client confidentiality and attorney privilege under MLPCA § 3326. The DNFBP Regulation Part IV (6) update these requirements (see below) and apply them to all DNFBPs.

- c.11.1 – DNFBPs are required to maintain all necessary records on transactions, both domestic and international, for at least six years following completion of the transaction (DNFBP Regulation Part IV (6)).
- c.11.2 – DNFBPs are required to keep all records obtained through CDD measures, account files and business correspondence, and results of any analysis undertaken, for at least six years following the termination of the business relationship or after the date of the occasional transaction (DNFBP Regulation Part IV (6.1 and 6.3)).
- c.11.3 – Under DNFBP Regulation Part IV (6.1), transaction records must be sufficient to permit reconstruction of individual transactions.
- c.11.4 – DNFBPs are required to ensure that all CDD information and transaction records are available swiftly to domestic competent authorities upon appropriate authority (DNFBP Regulation Part IV (6.7)). Regarding the lawyer carve-out, the guidance for lawyers clarifies that there is no exception from the record keeping requirements for lawyers including that lawyers are required to maintain appropriate record keeping sufficient to provide proof to the FIU of compliance with their Preventative Measures and Monitoring requirements. The exception relates to the provision of non-STR and non-CTR related records to the FIU. As such this information would not be available swiftly to the FIU and police would require a search warrant, which is unlikely to result in the information being provided swiftly.

21. **Criterion 22.3** is *mostly met*: As discussed in the MER, PEPs are defined under MLPCA Sec. 3301(q), which includes foreign and domestic peps. The definition is, “. . . any type of 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 at a national or state-owned company or a senior political party official. This definition is deemed to include categories of family members and business associates as set forth by regulations promulgated by the Financial Intelligence Unit (FIU). Detailed requirements for DNFBPs are set out in the DNFBP Regulations as follows:

- c.12.1 – DNFBPs are required to have in place risk management systems to determine whether a customer or the beneficial owner is a PEP (DNFBP Regulation Part III(3.1)) obtain senior management approval before establishing (or continuing, for existing customers) such business relationships (DNFBP Regulation Part III(5.6)), take reasonable measures to establish the source of wealth and the source of funds of customers and beneficial owners identified as PEPs (DNFBP Regulation Part III(5.7(a)), and conduct enhanced ongoing monitoring on that relationship (DNFBP Regulation Part III(5.7(b))).
- c.12.2 - DNFBPs are required to put in place appropriate risk management systems to determine if a customer or the BO is a domestic PEP DNFBP Regulation Part III (3.1). However, consistent with the MER 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 (Palau’s PEP definition does not cover person entrusted with a prominent function by an international organisation). All requirements discussed above under c.12.1 as applicable to domestic PEPs.
- c.12.3 – As set out in the MER, the definition of PEPs in the MLPCA § 3317 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.
- c.12.4 – Palau has no requirements to give effect to this criterion.

22. **Criterion 22.4** is *partly met*: As set out in MLPCA § 3316(a), DNFBPs are required to “have in place measures to prevent the misuse of information technology in the commission of an offense and to address any specific risks associated with the conducting of business relationships or executing transactions for clients that are not physically present.” In addition, DNFBP Regulation Part III (3) obliges DNFBPs to “adequately assess its [ML/TF] risk in relation to its clients, its business, products and services, and appropriately define and documents its Risk-Based Approach.” Inherent in having to assess the risk associated with its business, products and services is the use of the technology associated with the business, products, and services. Additionally, under DNFBP Regulation Part III (5.1), DNFBPs must “ensure it is aware of new or developing technologies that might favour anonymity and take measures to prevent their use for the purpose of Money Laundering and Terrorist Financing.” In the context of Palau, these requirements are sufficient to require DNFBPs to identify and assess the ML/TF risks related to new technologies and take appropriate measures, but there is no explicit requirement to undertake risk assessments prior to launch.

23. **Criterion 22.5** is *mostly met*: As outlined in the MER, MLPCA § 3315 allows DNFBPs to rely on third-party FIs or DNFBPs for some elements of CDD. For DNFBPs this is detailed in the DNFBP Regulation Part III (7). While is not clear if the third-party is permitted to undertake ongoing due diligence, ultimate responsibility for CDD measures should remain with the DNFBP relying on the third party (DNFBP Regulation Part III(7.3)), and the DNFBP can obtain immediately the necessary information concerning CDD (DNFBP Regulation Part III(7.1)), take steps to satisfy itself that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the third party upon request without delay (DNFBP Regulation Part III(7.2), the third party must be “duly regulated and supervised in the country where they are based and incorporated.” (DNFBP Regulation Part III (7)).

24. Regarding c.17.2, while there are no explicit requirements that DNFBPs should have regard to information available on the level of country risk when determining in which countries a third party that meets the conditions can be based, they must be based and incorporated in a country which is “duly regulated and supervised.” DNFBPs also have a general obligation to assess and manage risk associated with clients, its business, products, and services (DNFBP Regulation Part III (3)).

25. Regarding c.17.3, in line with the MER, there are no financial groups in Palau.

Weighting and Conclusion

26. Since the MER, Palau has issued the DNFBP Regulation, which provides DNFBPs specific preventative measures requirements in addition to those set out in the MLPCA. The moderate shortcoming in Palau's compliance relates to requirements to comply new technologies requirements. In line with the MER, this has been given less weight. There are minor shortcomings in DNFBP's CDD, record keeping, PEPs and reliance on third parties' requirements (there are no financial groups in Palau). ***Recommendation 22 – the rating is re-rated to largely compliant.***

Recommendation 23 [R.23] (Originally rated partially compliant)

27. Palau was rated PC for R.23 in its 2018 MER. Deficiencies included that while Palau provides for general requirements in relation to reporting of STRs (though the MLPCA 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. Furthermore, Palau had not established internal controls as per R.18 and no regulations have been issued to address these requirements.

28. **Criterion 23.1** is *mostly met*: As discussed in the MER, Palau's STR obligation is set out in the MLPCA and applies to all DNFBPs except accountants. While the section number within the MLPCA has changed to 3321, the STR obligation remains unchanged including minor shortcomings highlight in the MER (see R.20). Since the MER, Palau has issued the DNFBP Regulation, which applies the STR requirements in the MLPCA to accountants and provides additional details to support DNFBPs file STRs. Palau's STR obligation on DNFBPs applies to all transactions (see R.20 in MER) and is not subject to the qualifications set out in c.23.1(a) to (c).

29. **Criterion 23.2** is *met*: DNFBP Regulations have addressed the obligations required for DNFBPs to implement ML/TF prevention programs, such as internal policies, procedures, and controls. The DNFBP Regulations require the appointment of a compliance officer at the management level (DNFBP Regulations Part II (3.1.2) and Part III (1.2)), the establishment of compliance management arrangements (DNFBP Regulation Part III (2)), and the implementation of effective procedures for customer identification, record keeping, transaction monitoring, and reporting suspicious transactions (DNFBP Regulations Part II (3.1.5) and Part III (1.6)). DNFBPs are also required to put in place appropriate screening procedures to ensure high ethical standards when hiring employees and to establish ongoing and up-to-date relevant AML/CFT employee trainings (DNFBP Regulation Part II (3.1.6); DNFBP Regulation Part III (1.4); and DNFBP Regulation Part IV (5)). Additionally, DNFBPs must establish an audit function to test their anti-money laundering procedures and systems and put in place independent controls that will test and assess the effectiveness of the compliance program with these regulations on a risk-based basis with a defined minimum frequency (DNFBP Regulation Part II (3.1.3) and Part III (1.5)).

30. As outlined in the MER, there are no financial groups or enabling legislation DNFBPs to establish foreign branches with c.18.2 and c.18.3 rated not applicable in the MER.

31. **Criterion 23.3** is *not met*: While Palau has EDD requirements for DNFBPs, Palau lacks the legal authority to impose the countermeasures when called upon to do so by the FATF, independently of any call by the FATF, and there are no measures in place to ensure that FIs are advised of concerns about weaknesses in the AML/CFT systems of other countries.

32. **Criterion 23.4** is *met*: Tipping-off and confidentiality requirements remain unchanged from the MER with the relevant requirements now under section 3322(c), (g) and (h). These requirements are further detailed in DNFBP Regulation Part IV (2) and (3) and apply to all DNFBPs.

Weighting and Conclusion

33. Palau's STR obligations remains unchanged from the MER with minor shortcomings, but now apply to all DNFBPs. Palau has major shortcoming in requirements on high-risk countries – this have been given less weight due to the strong domestic focus of DNFBP business in Palau. **Recommendation 23 – the rating is re-rated to largely compliant.**

Recommendation 28 [R.28] (Originally rated non-compliant)

34. Palau was rated NC for R.28 in its 2018 MER. deficiencies existed 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.

35. **Criterion 28.1** is *mostly met*: Gambling is illegal in Palau (17 PNCA Chapter 50) and there are no casinos in Palau. Under the recently passed Gaming Business Act, Palau can issue two concessions and licenses to virtual pachinko concessions and two concessions and licenses to internet virtual lottery game concessions. As discussed, DNFBP Regulation Part II (2.1.1) obligates casinos to apply CDD measures as detailed under c.22.1(d) without any minimum financial transaction. There are no fit and proper requirements for potential casinos.

36. **Criterion 28.2** is *met*: MLPCA § 3328 designates the FIU the powers and duties to monitor and supervise DNFBPs with the MLPCA and any regulation. The DNFBP Regulation Part II (3.1.8) stipulates that the FIU will conduct compliance audits of DNFBPs to assess compliance with the MLPCA and regulations, making it the competent authority for DNFBP AML/CFT supervision.

37. **Criterion 28.3** is *partly met*: The FIU is designated as the DNFBP supervisors under MLPCA and DNFBP Regulations has issued the FIU Rulebook (Procedures for Administrative Violations of the Money Laundering and Proceeds of Crime Act (“MLPCA”) and Designated Non-Financial Businesses and Professionals (“DNFBP”) Regulation) and Guidance for lawyers, and at the time of this FUR was in the process of onboarding lawyers for AML/CFT supervision. However, Palau lacks a monitoring system to ensure compliance with AML/CFT obligations by all DNFBPs and at the time of this FUR, DNFBP supervision had not commenced.

38. However, the authorities have taken steps towards implementing a mechanism to impose administrative sanctions on DNFBPs by introducing the FIU Rulebook. The Rulebook outlines a procedure for handling administrative violations of the MLPCA and DNFBP regulations. As per MLPCA §§ 3327(c), 3328, and 3329; and DNFBP Regulation Part V, the FIU has the authority to issue administrative enforcement and sanctions measures.

39. **Criterion 28.4** is *mostly met*.

40. **Criterion 28.4(a)** is *met*: In line with the 2018 MER, supervising authorities (including the FIU) have adequate powers to perform their functions under MLPCA § 3328 and with the issuing of the DNFBP Regulation, it is clear that the FIU can exercise these powers to perform its AML/CFT monitoring function on DNFBPs (DNFBP Regulation Part II (3.1.8)).

41. **Criterion 28.4(b)** is *mostly met*: The Supreme Court of Palau governs the administration of the legal and judicial professions under ROP Constitution Art. X Sec. 14, following the American model. The Supreme Court of Palau Rules are located at the Supreme Court website under Rules & other Publications and under Palau Bar Association at <http://www.palausupremecourt.net/>. The Rules of Admission for Attorneys and Trails Counsellors includes measures to prevent criminals being professionally accredited (Rule 2). While the Supreme Court is not an SRB for AML/CFT purposes, it is appropriate and consistent with the Constitution and tenants of American law that it oversees the admission of attorneys. To be admitted to practice in Palau, one must provide information on character and fitness, follow the ABA Model Rule of Ethics, and be approved by the Supreme Court. The Bar Association is a self-regulating body, where attorneys are expected to ensure their peers adhere to the ethical standards set by the association. In some cases, ethics violations must be reported by an attorney.
42. Accountants are required to be registered for a practicing certificate with the Office of the Public Auditor (Section 1 (b) of RPPL) and the Palau Board of Accountancy able to refuse granting a practicing certificate on the basis of “good character” (Section 5(a) Palau Board of Accountancy Rules and Procedures). “Good Character” is defined as “lack of history of dishonest or felonious acts.” It is unclear if the Board has additional internal guidelines or procedures for applying this thresholding, particularly in regard to criminal association.
43. There are no fit and proper measures for dealers in precious metals and stones and real estate agents, but these are very small sectors in Palau.
44. **Criterion 28.4(c)** is *met*: As outlined in the 2018 MER, sanctions under the MLPCA are applicable to DNFBPs. The DNFBP regulations clarifies the FIU as the AML/CFT supervisors with the power/authority to impose sanctions (Part V).
45. Sanctions under the MLPCA are Section 3319(a) provides criminal penalties for non-compliance with Subchapter II (MLPCA §§ 331 -3318) and any regulation implement by the FIU in furtherance of the Chapter. Subchapter II covers Anonymous accounts, customer due diligence, measures to identify politically exposed persons, complex patterns in transactions, third party due diligence, misuse of information technology, physical presence of financial institutions, wire transfers.
46. Conviction by any persons (defined in MLPCA § 3302(p)) of intentionally or through criminal negligence failing to comply with the provisions must result in a Class C felony or a maximum fine of ten thousand dollars (\$10,000), or both. Under MLPCA § 663 a C Felony can result in imprisonment for up to five years.
47. In addition, MLPCA § 3319(b) stipulated that if found guilty the person may also be “banned permanently or temporarily from pursuing the business or profession which provided opportunity for the offense to be committed.”
48. MPLCA Section 3327(a-b) provides for the same penalties as MLPCA § 3319 for Subchapter III (MLPCA §§ 3321 – 3326), which covers reporting of suspected terrorism, reporting of transactions, structuring, foreign branches, internal monitoring and bookkeeping and related regulations. In addition, MLPCA § 3327(c) provides that DNFBPs who fail to comply with the obligations under Chapter 33 or any of its regulations may also be subject to measures and sanctions provided in MLPCA § 3329. MLPCA § 3329 provides a list of possible administrative measures and sanctions.
49. 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.
50. **Criterion 28.5** is *not met*: While the DNFBP Regulations establishes the FIU as the supervisors, it does not require risk-sensitive supervision. In practice, Palau is targeting its AML/CFT supervision resources towards lawyers but frequency and intensity of AML/CFT supervision is yet to be determined by characteristics of the DNFBPs and risk profile.

Weighting and Conclusion

51. The risks and context of Palau's DNFBP sectors are consistent with the MER - there are no operating casinos, lawyers are the highest risk sector and accountants, DPMD and real estate are small. There are no TCSPs.

52. Since the MER Palau has clearly designated the FIU as the AML/CFT supervisor for the DNFBP with appropriate powers (including to apply sanctions) and functions; however, Palau has not yet commenced programmes of risk-based supervision of DNFBPs. There are some gaps with fit and proper controls for lawyers and no fit and proper measures for dealers in precious metals and stones and real estate agents, but the latter are very small sectors in Palau. **Recommendation 28 – the rating is re-rated to partially compliant.**

Recommendation 36 [R.36] (Originally rated non-compliant)

53. Palau was rated NC for R.36 in its 2018 MER. Deficiencies included Palau is yet to ratify the Palermo and Vienna Conventions and has not implemented any of these conventions.

54. **Criterion 36.1** is *met*: Palau became party to the Vienna Convention and Palermo Convention in 2019. As outlined in the MER, Palau is party to the terrorism financing convention and the Merida conventions.

55. **Criterion 36.2** is *mostly met*: While Palau is party to all four Conventions, there are minor deficiencies with implementation of requirements in the conventions that have been discussed in R3, R.4, R.5, R.20, R.32, R.37 and R.38. There are moderate shortcomings with R.10 and R.12.

Weighting and Conclusion

56. Palau is party to the Palermo Convention, Vienna Convention, the Convention Against Corruption, and the Terrorist Financing Convention. There are minor deficiencies in implementing the requirements in the conventions (R.3, R.4, R.5, R.20, R.32, R.37, and R.38) and moderate shortcomings with R.10 and R.12. **Recommendation 36 – the rating re-rated to largely compliant.**

3.2. Progress on Recommendations which have changed since adoption of the last FUR or MER.

57. The APG welcomes the steps that Palau has taken to improve its technical compliance with Recommendations which have changed since adoption of last FUR or MER. Palau remains rated compliant for R.2, R.18 and R.21 and remains non-compliant for R.7. R.15 is re-rated to non-compliant.

Recommendation 2 [R.2] (Originally rated largely compliant)

58. Palau was rated LC for R.2 in its 2018 MER. The MER noted 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.

59. **Criterion 2.1** is *mostly met*: In keeping with the analysis in the MER, the MLWG is driving Palau's national AML/CFT policy guided by Palau risks although a written national AML/CFT policy/s is not in place.

60. **Criterion 2.2** is *met*: Analysis in the MER stands with the MLWG the responsible mechanism for national AML/CFT policies.

61. **Criterion 2.3** is *met*: Analysis in the MER stands with the MLWG's functions encompassing both policy-making and operational coordination functions. As a result of Palau's amendment to

Executive Order 406, which comprises section (b)(5) mandating the prompt sharing of information between pertinent government agencies pertaining to suspected money laundering and financing of terrorism activities and associated signs of such activities, no inadequacy has been identified under this sub-criterion.

62. **Criterion 2.4** is *not met*: The gap identified in the MER remains unresolved with Palau having no cooperation or coordination mechanism in place to combat the financing of proliferation of weapons of mass destruction.

63. **Criterion 2.5** is *met*: The MLWG is the coordination and cooperation mechanisms that Palau would use to ensure compatibility of AML/CFT requirements with Data Protection or Privacy rules. However, there are no significant Data Protection or Privacy regulations implemented in the Republic of Palau.

Weighting and Conclusion

64. In October 2018, Rec.2 was amended to require countries to have cooperation and coordination between relevant authorities to ensure compatibility of AML and counter-terrorist financing (AML/CFT) requirements with a domestic mechanism for exchange of information, Data Protection and Privacy rules and other similar provisions. Palau has no significant Data Protection or Privacy legislation and the Executive Order that provides for the Money Laundering Working Group allows for exchange of information between government agencies. **Recommendation 2 – the rating remains largely compliant.**

Recommendation 7 [R.7] (Originally rated non-compliant)

65. Palau was rated NC for R.7 in its 2018 MER. The MER noted 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.

66. **Criterion 7.1 to 7.5** is *not met*: Palau is in the process of seeking technical assistance to support its implementation of R.7 and address deficiencies identified in its 2018 MER.

Weighting and Conclusion

67. Palau has not taken the necessary measures to implement obligations associated with Recommendation 7. **Recommendation 7 – the rating remains non-compliant.**

Recommendation 15 [R.15] (Originally rated partially compliant)

68. Palau was rated PC for R.15 in its 2018 MER. The MER noted 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.

69. **Criterion 15.1** is *partly met*: The gap identified in the MER remains unresolved with Palau's not having identified and assessed ML/TF risks related to new technologies and there are no requirements that require FIs to identify and assess the ML/TF risks related to new technologies.

70. **Criterion 15.2** is *not met*: The gap identified in the MER remains unresolved with no requirements in Palau for FI to undertake risk assessments prior to launch and take appropriate measures.

71. **Criterion 15.3** is *not met*: Palau is in the very early stages of commencing a process to assess the money laundering and terrorist financing risks emerging from virtual asset activities or operations

of VASPs. On 27 June 2023, Palau released a press statement notifying the public that VASPs are required to comply with the Money Laundering and Proceeds of Crime Act and Regulations under Palau's current definition of financial institution. At best this may capture transfer of virtual assets, but not the other limbs of the FATF definition of VASP.

72. **Criterion 15.4** is *not met*: There is no licensing or registration regime for VASPS including under the current regime for FI in Palau. As such there are no measures in place to prevent criminals and their associates from holding or being the BOs of, a significant or controlling interest, or a management function in a VASP.

73. **Criterion 15.5** is *not met*: Palau has no mechanism in place to identify unlicensed VASPS and no sanctions. Given Palau's risk and context a complex mechanism to identify VASPS is not required, and it is noted under c.15.1 that Palau is in the very early stages of commencing a process to assess the money laundering and terrorist financing risks emerging from virtual asset activities or operations of VASPs.

74. **Criterion 15.6** is *not met*: Palau has not established a risk-based AML/CFT supervision regime including that there is not a designated AML/CFT supervisor for VASPS. Palau has not assessed the presence of VASPs in Palau

75. **Criterion 15.7** is *not met*: Palau has not established guidelines or provided feedback to VASPS. Palau has not assessed the presence of VASPs in Palau.

76. **Criterion 15.8** is *not met*: VASPS are not obligated to comply with preventative measures (R.10 to R.21). Therefore, sanctions outlined in the MER at R.35 do not apply.

77. **Criterion 15.9** is *not met*: VASPs are not obligated to comply with requirements outlined in Recommendations 10 to 21.

78. **Criterion 15.10** is *partly met*: In Palau, all natural and legal persons to report to the FIU on assets frozen within 24 hours. Therefore, any VASPs currently operating in Palau (unlicensed or/and unregistered) would be required to comply with this requirement. Any VASPs in Palau is not required to comply obligations under 6.5(d), 6.5(g) and R.7 is rated NC.

79. **Criterion 15.11** is *mostly met*: While Palau does not have a regulatory regime for VASPs. In the context of Palau, the FIU, and Financial Institutions Commission as AML/CFT supervisors (Palau is rated C with R.27) and LEAs all (Palau is rated LC with R.31) have adequate powers to obtain information and Palau has adequate mechanisms for international cooperation (Palau is LC with R.37 to R.40).

Weighting and Conclusion

80. Palau has not implemented the new requirements on VASPs including that Palau is in the initial steps of assessing VA/VASP activity in Palau. **Recommendation 15 – the rating is re-rated to non-compliant.**

Recommendation 18 [R.18] (Originally rated compliant)

81. Palau was rated C for R.18 in its 2018 MER.

82. **Criterion 18.1** is *met*: Analysis in the MER stands.

83. **Criterion 18.2** is *not applicable*: Consistent with the 2018 MER, there are no financial groups or enabling legislation for such structures in Palau.

84. **Criterion 18.3** is *not applicable*: Consistent with the 2018 MER, there are no financial groups or enabling legislation for such structures in Palau.

Weighting and Conclusion

85. Consistent with the 2018 MER, Palau does not have any financial groups with foreign branches and majority-owned subsidiaries, therefore the rating of this recommendation remains unchanged as Compliant. **Recommendation 18 – the rating remains compliant.**

Recommendation 21 [R.21] (Originally rated compliant)

86. Palau was rated C for R.21 in its 2018 MER.

87. **Criterion 21.1** is *met*: Analysis in the MER stands with the protections now under section 3322(g) and (h) of the MLPCA.

88. **Criterion 21.2** is *met*: Analysis in the MER stands with the prohibition to prevent tipping off now under section 3322(c) MLPCA. Palau does not have financial groups.

Weighting and Conclusion

89. Tipping-off and confidentiality provisions remain unchanged from the 2018 MER allowing for sharing within FIs and Palau does not have financial groups. **Recommendation 21 – the rating remains compliant.**

IV. CONCLUSION

90. Overall, Palau has made progress in addressing the technical compliance deficiencies identified in its MER and has been re-rated to LC on R.22, R.23, and R.36, and PC for R.28. Palau remains rated compliant for R.18 and R.21, largely compliant for R.2, and non-compliant for R.7. R.15 is re-rated to non-compliant.

91. A summary table setting out the underlying deficiencies for each of the recommendations assessed in this report is included at Annex A.

92. Overall, in light of the progress made by Palau since its MER was adopted, its technical compliance with the FATF Recommendations as follows as of the reporting date 1 June 2023:

R.	Rating	R.	Rating
1	PC (2018 MER)	21	C (2018 MER) (2023 FUR)
2	LC (2018 MER) (2023 FUR)	22	NC (2018 MER) ↑ LC (2023 FUR)
3	LC (2018 MER)	23	PC (2018 MER) ↑ LC (2023 FUR)
4	LC (2018 MER)	24	NC (2018 MER)
5	LC (2018 MER)	25	PC (2018 MER)
6	LC (2018 MER)	26	PC (2018 MER)
7	NC (2018 MER)	27	C (2018 MER)
8	NC (2018 MER)	28	NC (2018 MER) ↑ PC (2023 FUR)
9	C (2018 MER)	29	LC (2018 MER)
10	PC (2018 MER)	30	LC (2018 MER)

R.	Rating
11	C (2018 MER)
12	PC (2018 MER)
13	PC (2018 MER)
14	NC (2018 MER)
15	PC (2018 MER) ↓ NC (2023 FUR)
16	PC (2018 MER)
17	PC (2018 MER)
18	C (2018 MER) (2023 FUR)
19	PC (2018 MER)
20	LC (2018 MER)

R.	Rating
31	LC (2018 MER)
32	LC (2018 MER)
33	LC (2018 MER)
34	PC (2018 MER)
35	PC (2018 MER)
36	NC (2018 MER) ↑ LC (2023 FUR)
37	LC (2018 MER)
38	LC (2018 MER)
39	LC (2018 MER)
40	LC (2018 MER)

93. Palau has 23 Recommendations rated C/LC. Palau is moved to enhanced follow-up.

Summary of Technical Compliance – Deficiencies underlying the ratings³

Compliance with FATF Recommendations		
Recommendation	Rating	Factor(s) underlying the rating ⁴
2. National cooperation and coordination	LC (MER 2018) (2023 FUR)	<ul style="list-style-type: none"> In keeping with the analysis in the MER, the MLWG is driving Palau's national AML/CFT policy guided by Palau risks although a written national AML/CFT policy/s is not in place. Although the MLWG is the coordination and cooperation mechanisms that ensure compatibility of AML/CFT requirements with Data Protection or Privacy rules, however, there are no significant Data Protection or Privacy regulations implemented in Palau. There is no cooperation or coordination mechanism in place to combat the financing of proliferation of weapons of mass destruction
7. Targeted financial sanctions related to proliferation	NC (MER 2018) (2023 FUR)	<ul style="list-style-type: none"> No specific measures for the purposes of implementing targeted financial sanctions related to proliferation in order to comply with UNSCRs
15. New technologies	PC (MER 2018) NC (2023 FUR)	<ul style="list-style-type: none"> No clear mandates that risks related to new technologies must be identified and assessed prior to launch of new technologies, There is no specific requirement that FIs are obliged to take measures to manage and mitigate the risks when launching or using new technologies. Lack of implementation of the new requirements on VASPs.
22. Designated Non-Financial Businesses and Proessions (DNFBP): Customer Due Diligence	NC (MER 2018) LC (2023 FUR)	<ul style="list-style-type: none"> Major shortcoming in Palau's compliance relates to requirements to comply new technologies requirements. Minor shortcoming in DNFBP's CDD, record keeping, PEPs and reliance on third parties' requirements.
23. DNFBPs: Other measures	PC (MER 2018) LC (2023 FUR)	<ul style="list-style-type: none"> Minor shortcoming in STR obligations in line with the MER. No requirements on higher-risk countries are covered by the MLPCA.
28. Regulation and supervision of DNFBPs	NC (MER 2018) PC (2023 FUR)	<ul style="list-style-type: none"> Palau lacks a monitoring system to ensure compliance with AML/CFT obligations by all DNFBPs and at the time of this FUR, DNFBP supervision had not commenced. In practice, Palau is targeting its AML/CFT supervision resources towards lawyers but frequency and intensity of AML/CFT supervision is yet to be determined by characteristics of the DNFBPs and risk profile. No fit and proper measures for dealers in precious metals and stones and real estate agents, even though these sectors are very small in Palau
36. International instruments	NC (MER 2018) LC (2023 FUR)	<ul style="list-style-type: none"> Minor deficiencies with implementation of requirements in the conventions as outlined in the R3, R4, R5, R20, R32, R37, and R38 of the MER. Moderate shortcomings with implementation of requirements in the conventions as identified in R.10 and R.12 of the MER.

³ Ratings and factors underlying the ratings are only included for those recommendations under review in this FUR.

⁴ Deficiencies listed are those identified in the MER unless marked as having been identified in a subsequent FUR.

