

Modernizing Palau's Financial System:

Opportunities and Risks

Ricardo Davico and Yuanyan Sophia Zhang

SIP/2026/010

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on January 13, 2026. This paper is also published separately as IMF Country Report No 26/023.

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Modernizing Palau's Financial System: Opportunities and Risks; Republic of Palau
Prepared by Ricardo Davico and Yuanyan Sophia Zhang (APD)

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ABSTRACT: Palau's financial system faces structural challenges that inhibit effective financial intermediation, mobilization of domestic savings, and payment system efficiency. The authorities have been striving to address these challenges through digital initiatives. While these initiatives are intended to modernize the payment system and retain domestic savings, they also entail significant risks that need to be carefully managed with enhanced supervision and regulations. Policy options need to be well tailored to suit the specific financial sector challenges, economic scale, and resource considerations in Palau, starting with a comprehensive financial sector modernization and domestic payment strategy.

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| Author's E-Mail Address: | rdavico@imf.org , yzhang@imf.org |

SELECTED ISSUES PAPERS

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Republic of Palau

Prepared by Ricardo Davico and Yuanyan Sophia Zhang (APD)



REPUBLIC OF PALAU

SELECTED ISSUES

January 13, 2026

Approved By
**The Asia and Pacific
Department**

Prepared By Ricardo Davico, Yuanyan Sophia Zhang (APD), with inputs from Kieran Murphy and Jeanne Verrier (MCM), Grace Jackson, Stephanie Forte (LEG), and guidance from Jennifer Elliott (MCM), and Harald Finger (APD).

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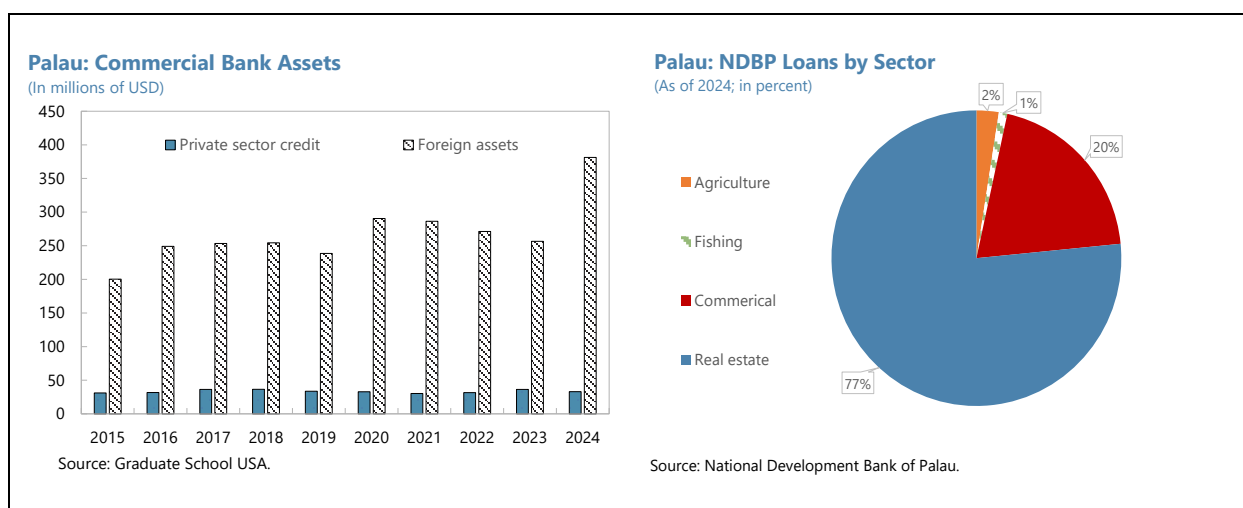
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MODERNIZING PALAU’S FINANCIAL SYSTEM: OPPORTUNITIES AND RISKS

Palau’s financial system faces structural challenges that inhibit effective financial intermediation, mobilization of domestic savings, and payment system efficiency. The authorities have been striving to address these challenges to support their economic diversification efforts through fintech and digital initiatives. While these initiatives are intended to modernize the payment system and retain domestic savings, they also entail significant risks that need to be carefully managed with enhanced supervision and regulations. Policy options need to be well tailored to suit the specific financial sector challenges, economic scale, and resource considerations in Palau.

A. Background of Palau’s Financial System: Overview of Key Impediments

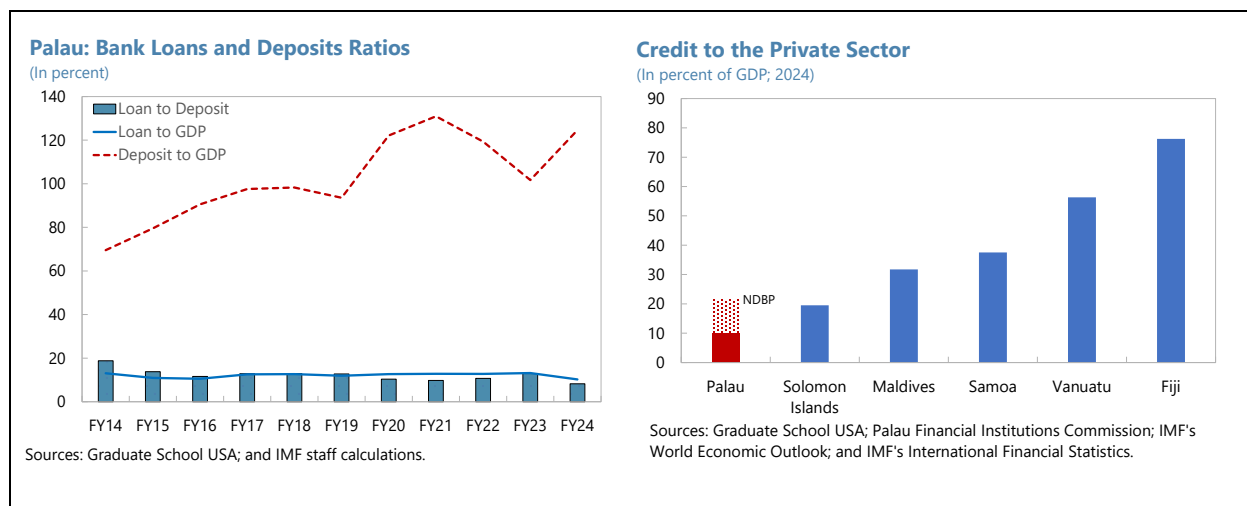
1. Access to private credit remains limited in Palau due to the unique features of its banking system. Palau’s banking system comprises three branches of U.S. FDIC-insured banks, two small non-FDIC-insured banks and one state-owned development bank. The U.S. FDIC-insured banks (the Bank of Guam, the Bank of Hawaii, and Bank Pacific) dominate the commercial banking sector, accounting for 98 percent of total deposits. Given their access to U.S. capital markets, the U.S. branches invest mostly offshore, resulting in very limited lending to local businesses or households.¹ Net foreign assets amount to nine times greater than domestic private sector credit. The National Development Bank of Palau (NDBP) does not take deposits as it is mostly funded by the government and external lenders, but it lends domestically (Box 1).² Despite a growing deposit base, total bank credit in Palau is around 25 percent of GDP and slightly over 10 percent of GDP for commercial banks, which remains one of the lowest ratios among its Pacific Island peers.



¹ U.S. branches deposit in headquarters which then invest from a central fund. The branches earn a profit from those investments.

² The NDBP is not currently formally licensed and supervised by the FIC.

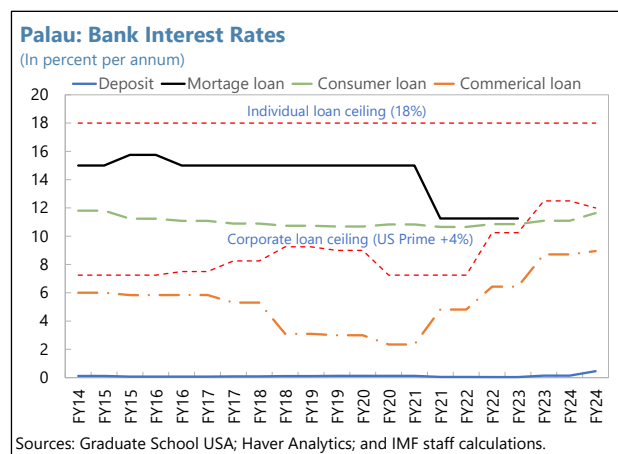
2. The NDBP plays a crucial role in addressing the credit gap caused by the limited involvement of commercial banks in financial intermediation, but its lending remains constrained by funding sources. Credit from the NDBP accounts for about half of total domestic credit, one of the highest shares among the Pacific Islands. Around three quarters of the NDBP’s portfolio consists of housing loans, with the remainder allocated to aquaculture projects (2 percent) and commercial loans (20 percent). The NDBP is well capitalized and has one of the lowest non-performing loan ratios (less than one percent as of FY2025) among the development banks in Pacific Islands before the Pandemic. Nonetheless, the NDBP faces funding constraints because it is not licensed to take deposits and has been funded primarily through long-term borrowings and loan repayments. As a state-owned development bank, the NDBP’s lending decisions reflect Palau’s development objectives and are not solely commercial-based³.



3. Ineffective financial intermediation can be partly attributed to deep-rooted structural issues within the banking system. Commercial bank lending in Palau has been significantly lower than that of its peers, with a primary focus on unsecured, small-sized loans to individuals. While common constraints among small and micro-state economies –such as limited business demand for credit and a small, undiversified economic structure –partly explain the low level of bank credit, Palau-specific legal and structural issues may also play a significant role.

³ NDBP is a state-owned bank with an independent board.

4. Lending Cap: Under the usury law, the interest rate on commercial lending is capped at the U.S. prime rate plus 4 percentage points — which amounted to 11 percent as of November 2025. The cap restricts lenders' ability to appropriately price risk, making lending in Palau less attractive compared to investment opportunities in the U.S. Furthermore, the interest rate on individual or personal loans—capped at 18 percent by the law, a less binding constraint than the commercial lending cap—stood at 11.6 percent in FY2024, prompting banks to focus more on consumer lending. Although the NDBP is exempt from the usury law, it still maintains its lending rates within the ceilings faced by other foreign branches.



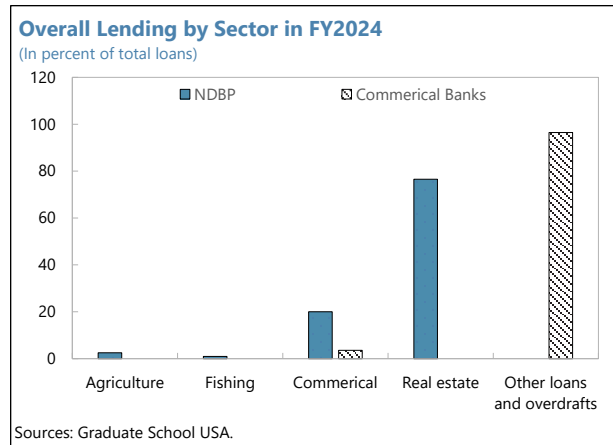
- Information Asymmetry:** Small firms in Palau often lack the capacity to implement appropriate accounting practices, making it difficult for banks to properly assess their creditworthiness. Lending requirements at U.S. bank branches are set by their head offices, which require borrowers to possess a U.S. FICO score to qualify for loans. This creates a significant barrier for local borrowers who do not have a U.S. Social Security number, as their loan repayment information is not recorded in their credit history once a loan is paid off. Establishing a credit registry, an ongoing effort with assistance from ADB, could help bridge this information gap, but it would need to be integrated with the U.S. system to be effective. Additional challenges for small and medium-sized enterprises (SMEs) include lender requirements for two years of audited financial statements. Many SMEs in Palau operate with insufficient financial records and underdeveloped business plans. However, the implementation of tax reforms in 2023— particularly the Business Service Tax —has encouraged Palauan SMEs to enhance their business documentation. This progress could, in turn, facilitate better access to loans from commercial banks.
- Collateral:** The ability to use fixed property as collateral is limited, as only residents can hold land titles with limited exceptions, and repossession by foreign banks is complicated in the event of default. Communal landownership and the relatively small numbers of fee-simple properties present additional challenges for lenders.⁴ Consequently, the Financial Institutions Commission (FIC) reports that approximately two-thirds of total loans and advances from commercial banks are unsecured. To promote secured lending and facilitate business and consumer transactions, the authorities enacted the Secured Transaction Act in 2012, which ensures the enforceability of security interests in personal property, excluding land. However, this reform has not led to a significant increase in collateralized lending by commercial banks. Instead, as the only financial institution accepting land as collateral, the National Development Bank of Palau (NDBP) provides housing loans and expands financing options for small and medium-sized enterprises (SMEs).

⁴ Fee-simple means that title holder of the property has full legal rights to the land and structures on it.

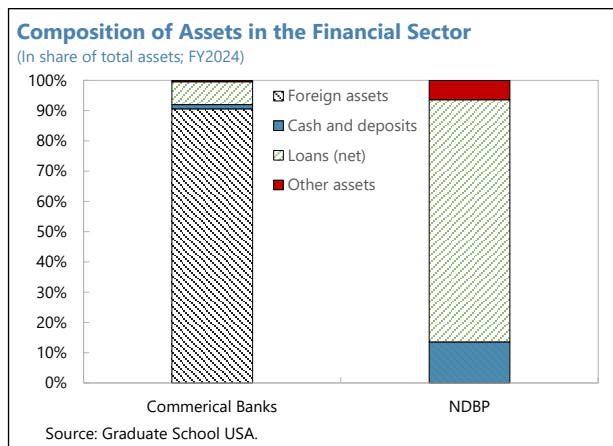
Box 1. Overview of Palau’s Banking System

Palau’s commercial banking system consists of two domestic banks and three branches of U.S. banks. The three U.S. based banks – The Bank of Guam, The Bank of Hawaii, and Bank Pacific – are FDIC insured, while the domestic banks –Palau Investment Bank and Asia and Pacific Commercial Bank—are not. In addition, Palau has a state-owned bank, the National Development Bank (NDBP), which operates as a lending institution but does not accept deposits.

As of end-FY2024, total assets of the commercial banks amounted to USD 416 million, dominated by the three US branches, who invest their assets mostly in relatively safe securities and assets abroad. Because these U.S. bank branches have FDIC deposit insurance, they are not required to maintain capital or assigned capital in Palau. The system is highly liquid, with nearly 90 percent of assets held as balances due from headquarter to branches in Palau.¹ The return on assets (ROA) of the commercial banks is relatively healthy, averaging 3.28 percent in FY2023, while the rate of nonperforming loans (NPL) remains low at 0.38 percent in the same year. Commercial bank lending primarily consists of unsecured loans, which account for roughly half of total bank credit.

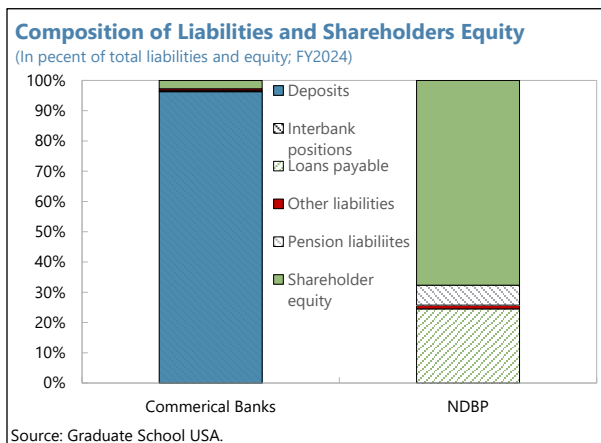


The National Development Bank of Palau does not accept deposits but operates as a lending institution, providing nearly half of all credit to the private sector. In FY2024, NDBP held USD 44.7 million in assets, equivalent to 11 percent of commercial banks’ assets. Despite its relatively small size, the loan portfolio of the NDBP surpassed that of commercial banks, accounting for 51.4 percent of overall private sector credit. In FY2024, NDBP returned to profitability, earning USD 1.3 million after consecutive years of losses and achieved a return on assets (ROA) of 2.94 percent.



Box 1. Overview of Palau's Banking System (concluded)

Rather than competing directly with commercial banks, the NDBP lends to sectors typically not serviced by commercial banks, mainly real estate, SMEs, agriculture, and fishing. As a locally owned institution, NDBP can accept land as collateral when issuing loans. Its financing structure relies on direct borrowing from the government and external lenders to support its operations. Loans liabilities account to 76 percent of total liabilities. Aside from new borrowing, expansion in NDBP lending depends on additional loan liabilities and organic growth. However, a history of relatively high nonperforming loans (NPLs) underscores the need for improved credit quality and proactive loan management, which the NDBP has been addressing through governance reforms.



¹ Palau Banking Sector Annual Report, 2021–2023, Palau Financial Institutions Commission.

5. There is scope to improve the efficiency of Palau's payment system. Palau does not have a national currency and instead uses the U.S. dollar. The country lacks a domestic payment system and depends on the financial market infrastructure of the United States.⁵ Under this arrangement, clearing checks in Palau typically takes four to five business days. Transaction costs are reportedly high, especially for cross-border wire transfers. Cash and checks dominate retail transactions, although credit and debit cards are widely accepted in tourist establishments. The reliance on traditional payment methods is partly explained by relatively low internet penetration—57.5 percent compared to around 80 percent globally in 2025—despite a high rate of mobile connectivity, with over 25,000 mobile subscriptions, equivalent to 144 percent of the population (vs. 105–110 percent globally).⁶ While overall bank access compares favorably to peer countries, residents of remote islands still face challenges in accessing bank services. As one of the smallest markets among the PICs, Palau struggles to attract Payment Service Providers (PSPs). Cross-border payments remain limited, at around 0.7 percent of GDP as of 2023, and are largely channeled through correspondent banking and international money transfer operators (e.g. Western Union/Wise) or card schemes (e.g. Visa/MasterCard, etc.) for retail transactions.

⁵ U.S. branch banks, which are regulated in the U.S. and FDIC-insured, can access U.S. payment systems. This means they can initiate and receive payments via Fedwire (the Federal Reserve's real-time gross settlement system for large-value payments) and private clearing houses for electronic payments and checks.

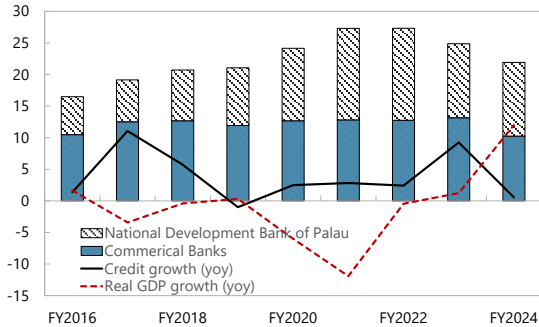
⁶ DataReportal (2025). *Digital 2025: Palau*. We Are Social and Meltwater, based on data from GSMA Intelligence and Kepios. Available at: <https://datareportal.com/reports/digital-2025-palau>

Figure 1. Palau's Banking System

Private sector credit remains low ...

Palau: Credit and Economic Growth

(In percent of GDP)

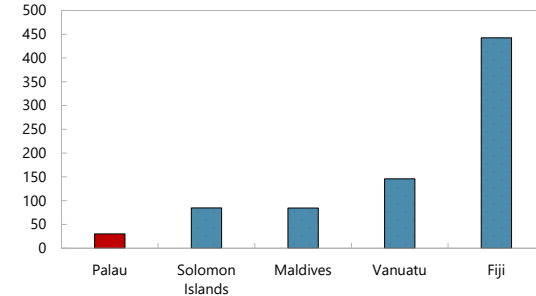


Source: Graduate School USA.

...and with most investment financed through non-bank channels.

Credit to Investment Ratio

(In percent; 2024)

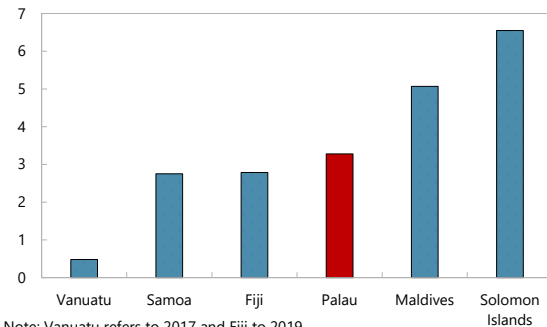


Sources: World Economic Outlook; IMF's International Financial Statistics; and staff estimates.

Commercial banks in Palau maintain a robust return on assets.

Return on Assets of the Banking Sector

(Net income to total assets, 2023)

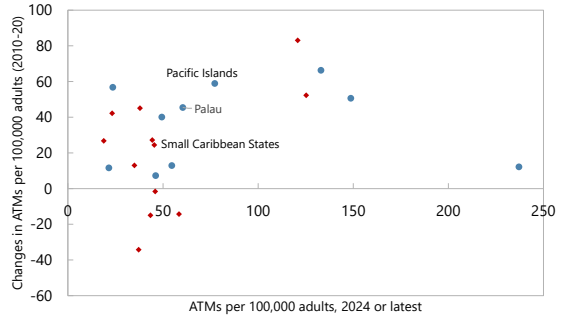


Note: Vanuatu refers to 2017 and Fiji to 2019
Source: IMF's Financial Soundness Indicators database.

Palau's overall financial access compares favorably with the peers, albeit concentrated around the capital city of Koror.

ATMs per 100,000 Adults

(Percent change)

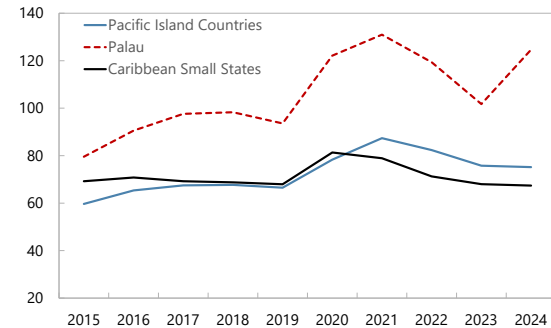


Source: IMF's Financial Access Survey database.

Deposit level is above regional averages in comparator markets.

Outstanding Deposits as a Share of GDP

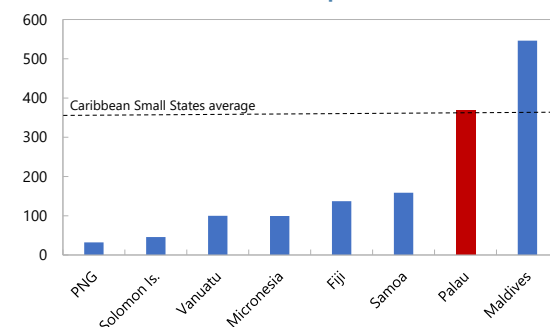
(In percent of GDP)



Source: IMF's Financial Access Survey database.

Loan account availability is high, even though nearly all commercial bank loans are allocated to overdrafts and other lending.

Commercial Bank Loan Accounts per 1,000 Adults, 2024



Note: Data refers to 2024 or the latest available.
Source: IMF's Financial Access Survey database.

B. Opportunities and Risks of Fintech and Digital Initiatives

Blockchain-based Palau Savings Bond

6. Palau plans to introduce the Palau Savings Bond (PSB) to mobilize savings based on the Japanese model. The Government of Palau's aim is for the Palau Savings Bond to provide citizens additional options to save and invest, and to retain and mobilize bank deposits for the domestic economy. With deposit rates in Palau historically averaging around 1 percent, there is scope to expand the options of savings instruments. Funds raised by the government are expected to be channeled through NDBP to finance infrastructure, housing and small businesses. The planned retail system will use blockchain-based distributed ledger technology to record transactions, with support from Japan and the blockchain firm Soramitsu. A pilot of the blockchain-based retail platform for issuing and managing the PSB transactions was demonstrated in late FY2024, but the bond has not yet been issued. Several operational, legal, and regulatory safeguards still need to be established before the official launch of the PSB.

7. While PSB provides opportunities to mobilize credits to support domestic economy, it also entails risks and operational challenges. The Government of Japan is currently supporting the development costs for the PSB. Nevertheless, as a small island nation, Palau faces significant fiscal costs in maintaining the digital platform including investments in cybersecurity protection, external legal scrutiny, and other operational costs. Additionally, since the raised funds are channeled through NDBP, which is currently not formally supervised or regulated by FIC, fiscal and systemic risks could arise. This requires extra caution for NDBP to strengthen its risk management practices to ensure timely identification, monitoring, and mitigation of these risks, thereby maintaining financial stability and safeguarding public resources. Formalizing supervision of NDBP by FIC is also recommended. For PSB to be effective, widespread digital and financial literacy will be essential. This will require extensive public education to ensure broad participation, supported by clear disclosures and a strong public understanding of the associated risks.

Tokenized Dollar

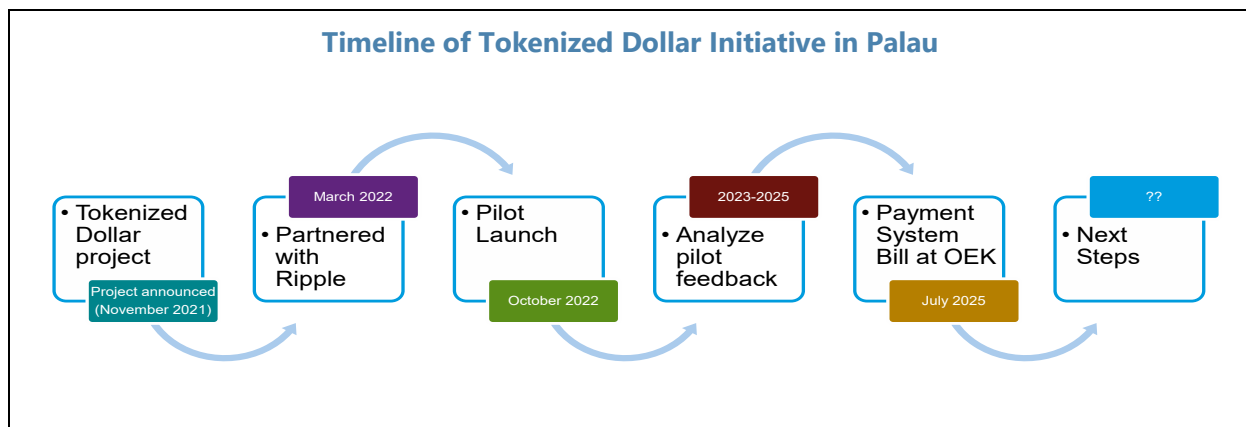
8. Various forms of digital payments are emerging in Palau, but adoption remains limited. While payments in Palau are still primarily cash-based, commercial banks do offer online and mobile banking options. However, uptake of these options has been modest, largely due to user preferences for physical cash and operational issues. Money Transfer Operators (MTOs) are operating in Palau, including two from the Philippines, as well as Western Union, Wise, and MoneyGram. Payment apps like WePay and PayPal have also recently entered the payment space. There are ongoing initiatives to develop mobile money solutions for domestic payments, both through the national telecom operator (PNCC) and partnerships with foreign mobile money providers. These efforts should address challenges related to poor telecom infrastructure and the cost-benefit trade-offs associated with the country's small population size.

9. Palau has been exploring the government-backed tokenized dollar as an option to improve payment efficiency and modernize its payment system. The initiative started with a

pilot project for a U.S dollar-backed stablecoin, fully backed by the government, and developed in partnership with the U.S. payment firm Ripple. The pilot, launched in FY2023, involved 200 government employees who were provided with 100 PSC each to make purchases at select local retailers. Since the pilot, the initiative had been put on hold, given difficulties in finding a custodian bank. Progress resumed when the Palau Digital Service Bill (PDSB) was submitted to the congress, outlining a modernized national payment system involving the “tokenized dollar (TD)”. If implemented, the tokenized dollar would be issued by the Ministry of Finance, redeemable on a 1:1 basis to the U.S. dollar, and fully backed by reserves (cash, treasury securities, and other safe assets) managed by the Ministry of Finance. If pursued, it would require approval of the legal bill, development of supporting regulations, and confirmation of a partnership with a custodian bank.

Despite its intended benefits, the TD presents operational challenges and may not fully justify the use cases.

The primary objective of the Palauan tokenized dollar is to make payments easier and more affordable, improve financial inclusion, and support the development of a more modern and efficient digital economy. In theory, the TD could potentially make payments cheaper, faster, and more convenient. However, the cost-sharing model among users, PSPs, and the government remains unclear. Several factors may limit the uptake of TD, including a stronger preference for cash, lack of buy-in from the two main commercial banks, and inadequate IT infrastructure. The proposed use cases – such as retail transactions (person-to-business, P2B), government payments (including customs), and P2P transfers –may not be fully justified. From a P2B perspective, the tokenized dollar could potentially reduce fees for users, depending on the cost-sharing arrangement. While it might make the P2P payments more convenient, other options, such as mobile money and improvement of the existing payment system, could offer similar benefits. Unlike other Pacific Island Countries (PICs), remittances are not a lifeline for Palau, as outflows dominate. In this context, outward remittances can continue to benefit from existing payment methods. Moreover, using the tokenized dollar for cross-border transactions would require close collaboration and legal agreements between Palau and other jurisdictions. The issue of financial inclusion at the national level is not as pressing as in other countries with similar economic development. Additionally, financial inclusion concerns in the remote islands may not be adequately addressed by the tokenized dollar, given the lack of banking facilities for redemptions.



10. Tokenized dollars entail significant risks. Without robust regulation, TD can attract illicit activities and pose considerable AML/CFT and associated financial integrity risks. Poor execution may also lead to reputational risks, undermining public confidence and hindering effective adoption. Additional concerns include cybersecurity vulnerabilities and an overreliance on specific vendors and technologies. The use of public ledgers for financial transactions raises privacy concerns for users, as transaction details may become publicly accessible and subject to misuse, compromising the confidentiality of personal financial data. Furthermore, operational costs for infrastructures, salaries, energy implications, and the government's backing of reserves can create budgetary challenges and fiscal risks. More specifically, if reserves are inadequate, stability of the peg may not be guaranteed and hence the tokenized dollars can be vulnerable to speculative attacks. Given the critical roles of the Financial Institutions Commission (FIC) and the Ministry of Finance (MOF) in managing the risks of tokenized dollars, their institutional capacity needs to be significantly strengthened.

C. Policy Issues

Enhancing Financial Intermediation and Mobilizing Domestic Credit

11. Addressing structural impediments and enhancing supervision and regulations in the banking system are key priorities. With support from the ADB, work is underway to establish a centralized credit bureau to collect borrowers' credit histories, which will help banks better assess risks and encourage responsible lending. To overcome legal and structural barriers related to using land as collateral, the authorities could consider clarifying legal uncertainties for foreign banks regarding land titles and foreclosure procedures. The Usury Law, which imposes a lending rate cap, could also be re-evaluated. Additionally, bringing NDBP under the supervision by the FIC would help safeguard financial stability and facilitate more efficient resource reallocation. Meanwhile, concerted efforts to diversify the domestic economy and improve the business environment are essential for developing the private sector and creating new business opportunities, which in turn will improve demand for bank credit.

12. Implementation of the blockchain-based Palau Savings Bond needs to be supported by well-established institutional arrangements, as well as a robust legal and regulatory framework. While the PSB offers benefits by channeling funding towards domestic economic development, the costs associated with the digital platform, fiscal risks stemming from on-lending to NDBP, and spillover effects of interest rates paid on the PSB to other loans made by the NDBP, and potential AML/CFT risks, particularly if cross-border investments are allowed, need to be carefully assessed and managed. Appropriate safeguards, including the legal, supervisory and regulatory frameworks (e.g. AML/CFT framework), need to be put in place. The recently established debt management office should be well-equipped with the necessary resources and mandate to manage debt issuance, conduct risk assessment and ensure consistency with the overall debt management strategy. Fiscal risk assessment needs to fully integrate the implications of PSB. Institutional arrangements should be clarified regarding oversight of investment decisions and supervision of fund transfers. For PSB to succeed, Palauans must possess sufficient digital and financial literacy to use the platform effectively. Extensive public education will be required to ensure all citizens can participate. The prospectus should clearly outline institutional arrangements for bond

management, redemption, and the transfer of funds between the treasury and NDBP. Infrastructure setup –including the issuance platform, settlement system, central securities depository (CSD), and debt recording system –should be thoroughly planned and costed. Finally, coupon rates and maturity structure must balance considerations of demand and fiscal costs, while mitigating maturity mismatches.

Improving Payment System Efficiency with Policy Options Tailored to Country Circumstances

13. Developing a sound legal framework to govern the national payment system is critical.

The Palau Digital Service Bill (PDSB) was submitted to the Congress for review. The bill aims to modernize Palau’s payment system by introducing fintech initiatives, including the tokenized dollar. While developing a legal framework for the payment system is a good start, some key building blocks of the payment system need to be better clarified in the bill (¶14), with technical support from the World Bank and IMF. Additional work is needed to ensure comprehensive preparation in addressing the risks and operational challenges that may arise from the fintech initiatives. In this context, a comprehensive domestic payment strategy would be valuable before launching individual digital and fintech initiatives.

14. Significant infrastructure, legal, and regulatory gaps remain and need to be addressed before launching the tokenized dollar prematurely.

The 2023 and current Article IV consultation emphasized the importance of evaluating risks and vulnerabilities, identifying gaps in legal and regulatory frameworks, managing reserve assets, ensuring cybersecurity, and rigorously testing all relevant scenarios in the pilot while benchmarking against international standards. Although achieving these critical steps can be resource-intensive, they are essential for maintaining financial stability and integrity. Key preparations are summarized below:

- **Legal Framework:** A robust legal framework is essential to mitigate risks and provide certainty on the tokenized dollar’s legal status and its implications. While the PDSB is a good start, several gaps remain to be addressed. They include clarifying potential conflicts of interest and resource constraints of Ministry of Finance (MoF), as well as defining the roles and responsibilities of other entities, such as the custodian bank holding reserve assets, and wallet providers. Additionally, bankruptcy laws, privacy and data protection laws, and cybercrime bill all need to be developed.⁷
- **Prudential and Conduct Frameworks.** Prudential regulations should be comprehensive as components that perform key functions in the stablecoin ecosystem are both sources of risks and vulnerabilities. Thus far, prudential and conduct regulations to mitigate risks have not received adequate attention. Key areas are (i) reserve asset management including composition and investments to ensure safety and liquidity of reserves, custody and concentration risks, (ii) stabilization mechanism to safeguard the peg (ensure that reserves cover the stablecoins issued and stablecoins are redeemed at par), (iii) segregation policies for reserve assets, (iv) disclosure and periodic independent audits, (v) lack of clarity on redemption policies, (vi) regulations

⁷ Bankruptcy laws: rights of holders in the event of insolvency of financial intermediaries, such as wallet provider.

governing wallets, exchanges and financial institutions exposures, (vii) regulations not benchmarked against international standards (international standards for stablecoins, FSB/IOSCO) to identify gaps, (viii) outsourcing regulations, (ix) the supervisory framework for operational resilience, (x) capacity to enforce compliance with regulations, (xi) storage of private keys.

- **Governance and Institutional Arrangement.** The absence of a central bank or alternative governance arrangements presents additional complexities. The TD reserves should be strictly ringfenced from any potential fiscal use. The authorities need to explore viable options to strengthen oversight mechanisms to ensure proper governance of the tokenized dollar, ensure MoF or the designed agency adequately assume central bank functions such as transparency in reporting on issuance and activity.
- **AML/CFT Measures and Supervision.** Tokenized dollars function as stablecoins and present specific vulnerabilities such as anonymity, rapid cross-border transfers, and potential use for layering illicit funds. A thorough ML/TF risk assessment for tokenized dollars is required to guide appropriate mitigation measures and necessary amendments to the legal framework. The legal framework governing tokenized dollars should explicitly address their unique ML/TF risks with clear provisions for customer due diligence, transaction monitoring, suspicious transaction reporting, and controls to prevent misuse. Notably, the framework must align with the FATF Recommendations on virtual assets (VAs) and virtual asset service providers (VASPs). It should also clearly identify the entity responsible for supervising the assigned agency for compliance with its AML/CFT obligations as issuer and manager of tokenized dollars, and ensure that this entity has sufficient capacity to undertake the supervisory role.
- **IT Operational and Cyber Risk Framework.** There has been notable progress in developing the IT operational and cyber risk framework; however, significant gaps and possible implementation challenges remain. The adoption of the ISO27001 standard for information security in its early stages, and cyber-crime bill remains in draft form. Overreliance on vendors or third parties for end-to-end solutions can create fragmentation and increased vulnerabilities. Gaps in arrangements for responding to cyber security events pose major risks. Deficiencies in cyber and digital resilience of eco-system participants could introduce vulnerabilities that may lead to fraud or system downtime. Low banking penetration could also mean low levels of digital literacy that create vulnerabilities and expose the stablecoin ecosystem to cyber risks. Suboptimal access to internet connectivity in remote islands would also result in limited roll-out.
- **Resources:** Ensuring smooth implementation requires resources to maintain the resilience of infrastructure, technology and human capital. Infrastructure considerations include access, stability, and availability of critical national systems, the adequacy of enablers such as Digital IDs the efficiency and stability of Internet and broadband connectivity, and the establishment of threshold requirements for sectoral participants regarding security controls and governance. On technology, core systems should be fit-for-purpose, managed according to industry best practices, appropriately governed, scalable, secure, and efficient. Effective technology governance and assurance, IT management, access and identity controls, incident response, and

business continuity arrangements are all essential. Threshold requirements for all participants – including supply chain and outsourcing partners – should be established and enforced through regulatory and legal frameworks. Human capital is equally important. Raising risk awareness is critical as onboarding individuals who are unaware of cyber and other digital risks can widen the attack surface for cyber events.

- **Feasibility and Cost-benefit Analysis:** A feasibility study to identify risks, assess market demand, evaluate available technology and infrastructure, review the legal and regulatory framework, and determine financial viability and operational capacity is an important prerequisite. To avoid conflicts of interest, this analysis should preferably be conducted by an independent agency as MoF manages the tokenized dollar project.
- **Public Trust:** Before proceeding on any future digital or fintech projects, the authorities need to ensure that all associated agreements are certified, and funds are properly approved. Risks and vulnerability identified from the pilots in the Public Auditor report also need to be thoroughly addressed.
- **Reserve Management:** Palau's tokenized dollar is backed by the government, the government bears the ultimate responsibility for redemption, implying fiscal risks. Hence, establishing a transparent and verifiable system for managing the reserves is particularly important.
- **Capacity of FIC.** FIC needs to play a critical role in ringfencing the risks, for example by supervising creditworthiness of a custodian bank, etc. So far, FIC faces capacity and resource constraints.

15. Establishing a national payment system, suitable to Palau's size and resources, is the key priority which would benefit from developing a comprehensive domestic payment strategy. A national payment system comprises a set of arrangements, technical infrastructure, instruments, and processes that enable individuals, businesses, governments, and other organizations to transfer funds, usually held in an account at a financial institution or on a technical device, to one another. Developing such a system requires starting with a strategy that assesses the strengths and weaknesses of the current setting, identifies the components of payment infrastructure that Palau urgently needs, and explores options best suited to the country's economic size and capacity constraints. The payment system should foster competition and require robust physical infrastructure, supported by policies that enhance financial and digital literacy, improve telecom infrastructure, and establish a strong legal and regulatory framework. Alternative options to the tokenized dollar should be considered, for example, fast payment systems or mobile money. Licensing and promotion of mobile money operators (MMOs) could be beneficial, as Palau has good mobile connectivity, equivalent to 144 percent of the population. MMOs tend to have greater reach than bank accounts, especially in rural and hard-to-reach areas. Having said that, e-money issuers should be properly supervised to ensure AML/CFT compliance and address cyber concerns. The case study on the Solomon Islands (Box 2) offers lessons on mobile money, including early achievements and remaining challenges.

Box 2. Advancing Digital Payments in the Solomon Islands

With a population dispersed across more than 1,000 islands, Solomon Islands has faced many payment system challenges observed in other Pacific economies, such as Palau. In 2020, cash remained the dominant payment method, accounting for about 80 percent of transactions. Financial access was limited, with bank branches and ATMs concentrated in the capital, Honiara. Regulatory gaps persisted in key areas, including cybersecurity, anti-money laundering (AML) measures for digital transactions, and financial consumer protection.¹

Recognizing these impediments, the authorities adopted a series of national strategies and reforms to promote digitalization. A cornerstone of these efforts was the Payment System Act (2022), which empowered the Central Bank of Solomon Islands (CBSI) to oversee the sector. In April 2024, CBSI launched the Solomons Automated Transfer System (SOLATS).²

SOLATS is a payment system managed by the CBSI that enables third-party providers to develop innovative payment tools and products. It comprises two core components:

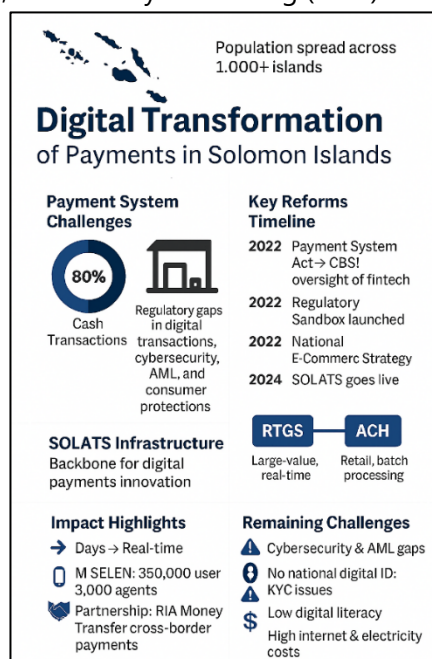
- Real-Time Gross Settlement (RTGS) for immediate settlement of large-value and time-critical transactions.
- Automated Clearing House (ACH) for batch processing of retail and low-value payments.

Since its launch, SOLATS has improved payment efficiency to some extent. It has replaced cash and check-based transactions, reducing settlement times from days to real time, and has facilitated new products and services for unbanked and underbanked populations. In addition to this initiative, the CBSI has been collaborating with its partners to support private sector innovation in the digital payments platforms, including in mobile money. A notable example is M-SELEN, a mobile money platform that now serves over 350,000 registered users (i.e. half of the population) and operates through 3,000 agents across the islands, including rural areas. M-SELEN provides account holders with instant person-to-person (P2P) and person-to-business (P2B) payment capabilities, complemented by cash-in and cash-out services through its nationwide agent network. M-SELEN recently partnered with RIA Money Transfer to enable cross-border remittances.

Despite these achievements, regulatory gaps persist in cybersecurity, AML compliance, fintech oversight, and data protection. The absence of a national digital ID system complicates know-your-customer (KYC) processes. Low digital and financial literacy, limited connectivity, and high costs of internet and electricity continue to hinder adoption, while many businesses still rely on cash and checks.

¹ Central Bank of Solomon Islands. *Assessment of Retail Payment System*. October 2023.

² Apicella, J., and G. Ventura. *Solomon Islands' Automated Transfer System (SOLATS): Financing in the Future*. Inclusive Digital Economies Blog, August 11, 2025, Griffith Asia Institute.



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