



*Celebrating 30  
Years of Service*

# **NATIONAL RESERVE BANK OF TONGA**

**ANNUAL REPORT 2019 - 2020**

**N R B T**

# **ANNUAL** **2020** **REPORT**

for the Year Ended 30 June 2020

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A photograph of the Governor of the National Reserve Bank of Tonga, an older man with white hair and glasses, wearing a white shirt. He is standing behind a wooden podium with a microphone, speaking. To his left is a large green plant. The background is a light blue wall.

# Governor's Foreword

I am pleased to present the annual report for the financial year 2019/20, a challenging year after 2 major shocks to the Tongan economy from COVID-19 pandemic and Tropical Cyclone (TC) Harold. This annual report outlines the analysis of the economic and financial conditions, the policies adopted by the Reserve Bank, the activities of the departments as well as the audited accounts of the Reserve Bank for the year ended 30th June 2020. This is in accordance with the Principal objectives and functions outlined in the NRBT Act.

During the year, according to the International Monetary Fund (IMF) June 2020 forecast global growth was revised down to -4.9% from -3% in April due to intensifying impact of COVID-19 pandemic resulting in contraction in global trade, subdued consumption spending, and weaker investment opportunities. Advanced economies i.e. US was expected to contract by 8%, a downward revision from 6.1% previously. Tonga's major trading partners' economies in first quarter of 2020 also contracted. The New Zealand economy contracted by 1.6% and the Australian economy by 0.3%.

Although Tonga remains COVID-19 free, the impact on the global economy had adverse effects on the domestic economy. Following the onset of COVID-19, travel restrictions, supply disruptions and weak demand impacted economic activity. Furthermore, TC Harold also damaged infrastructure, dwellings, business and agriculture sector. The NRBT therefore projects that the Tongan economy will contract in 2019/20 by 2.7% and further contract by 3.7% in 2020/21. These projections reflect the uncertainty on the duration of COVID-19 and its impact on the services, industry, transport and trade

sectors. The positive economic activity in the agriculture and fisheries sector are also incorporated into the projections.

At the end of June 2020, the annual headline inflation reflected the impact of COVID-19 at an average low of 0.3% during the 2019/20 financial year, well below the 5% reference rate. In June 2020 it recorded a deflation of 1.4%, the lowest rate since December 2015. This is due to the decline in domestic prices on the increase in supply of local food i.e. root crops, fruits and vegetables and a consistent fall in price of Kava Tonga as well as lower electricity tariffs. Imported prices also fell on lower gas and fuel prices reflecting the impact of Covid-19 on global oil prices, outweighing the rise in food, tobacco and alcoholic beverage prices.

Despite the COVID-19 pandemic, at the end of June 2020, the official foreign reserves rose to \$543.8 Million equivalent to 8.2 Months of Import Cover (MOI) from \$484.3 Million (7.9 MOI) last year, remaining above the minimum range of 3 MOI. The increase in the foreign reserves is mainly due to budget support from donor partners, grants for COVID-19 preparations and TC Harold relief funds. Remittance receipts also continued to increase and contributed to the increase in foreign reserves. The increase in remittances continued despite the closing of some of the foreign exchange dealers due to COVID-19. The exchange rate basket currencies also fluctuated on the COVID-19 uncertainties and at the end of the year, the Tongan pa'anga nominal and real effective exchanges rates increased.

The accommodative monetary policy stance was considered appropriate to encourage banks to lend

and maintain liquidity in the banking system at high levels. Although the risks to the financial system have increased, the financial system was assessed to be safe and sound, supported by the banks' strong capital position, excess liquidity, adequate profits, and low non-performing loans. However, additional policy measures were introduced to mitigate the impact of the COVID-19 pandemic on the domestic economy and ensure the banks remained resilient against these risks to financial stability.

To improve the banks risk management, new prudential statements were issued, risk based onsite supervision was conducted, and projects were implemented to develop the financial infrastructure through projects such as the automated National Payment System, as well as enhancing financial intermediation by encouraging financial innovative products. The Reserve Bank continued with its functions of effectively licensing, regulating and supervising of financial institutions both banks and non-bank financial institutions (NBFIs).

In response to COVID-19, the commercial banks assisted impacted customers by providing COVID-19 loan relief packages and at the same time complied with prudent lending practices. The Banks continued to support economic growth through its loans during the year. Bank loans increased to peak at T\$504.9m in November 2019. However, credit growth slowed and total lending stood at T\$492.9m at the end of June 2020, an increase of 1.4% compared to the previous year. Despite the uncertainty of COVID-19 and TC Harold, business loans increased to the communication, professional & other services, entertainment & catering, agricultural, mining & quarrying as well as public enterprises. Furthermore, individual housing loans increased, but was offset by a decline in vehicle and other personal loans, resulting in a 0.2% decline in total lending to individuals.

In line with the accommodative monetary policy, interest rates on bank loans declined mainly on individual loans for housing and other personal loans. Bank loans to businesses such as mining & quarrying, tourism and professional and other service sectors also benefited from lower interest rates. Bank deposit interest rates increased for all deposit types and the banking system saw an increase in the volume of saving and time deposits.

To promote access to finance, enhance inclusive economic growth and in anticipation of the banks becoming risk averse due to natural disasters and the

recent Covid-19 pandemic, the Reserve Bank continued to develop the non-bank financial institutions to provide a viable alternative to bank loans. During the year improvements to the legal and regulatory environment for non-banks continued to protect the borrowers as well as encourage new financial solutions or products. At the end of June 2020, lending activities in the non-bank financial institutions also increased in the year to June 2020 by 3.1% (\$3.2 million) to T\$106.8m, largely reflecting an increase in loans to households. Similar to the banks the non-banks also provided COVID-19 relief loans to assist its customers.


The financial intelligence unit (FIU) also contributed to the stability of the financial system by carrying out its functions under the Money Laundering and Proceeds of Crime Act. To support a sound and safe financial system, the FIU coordinated Tonga's mutual evaluation by the Asia Pacific Group on money laundering. Due to the Covid-19 lockdown this evaluation has been deferred.

The COVID-19 pandemic also had an impact on the operations of the Reserve Bank. The Exchange Control department noted the number of exchange control applications fell coinciding with the fall in import payments as well as applications for sending of foreign cash cross border due to the border closure. The issuing of currency is one of the important functions of the Bank. Currency in circulation increased during the year and was attributed to the accelerated issuance of bank notes and coins on the uncertainty towards the COVID-19 Pandemic and the national lockdown.

On the financial performance, the Reserve Bank is reporting a net profit of T\$3 million for the 2019/20 financial year, lower than T\$6 million in the previous year. The lower net profit is still a notable achievement given the COVID-19 pandemic impact and the lower overseas interest rates in the US, Australia and New Zealand. This resulted in the lower income on the investment of the foreign reserves, which is the principal source of income for the Bank. COVID-19 also had an impact on the demand for numismatic bank notes and coins which is another source of income for the Bank. On the expenditures, total expenditure was only marginally higher (3% higher) than the 2018/19 level. The major expenses during the year were interest paid on government accounts and the issuing of new bank notes which are more expensive to print. Expenses also increased due to the rise in the price of some of the goods and services and the additional purchase of goods in preparation for COVID-19.

During the year, one new Director was welcomed to the Board. The Directors continued to carry out their functions outlined in the NRBT Act and reviewed and approved the achievement of 90% of the corporate plan targets for 2019/20 as well as the Corporate Plan 2020/21. Against the background of the impact of TC Harold, COVID-19 pandemic and the expected economic downturn, the Reserve Bank Corporate Plan for the year 2020/21 was set and score cards were introduced to measure outcomes in the corporate plan. Targets were also set to maintain the stable and well capitalized financial system by ensuring banks are resilient against the impact of COVID-19 and an economic downturn, at the same time continue to be an effective driver of economic growth.

At the end of this challenging financial year 2019/20, the Bank has achieved its principal objectives and functions outlined in the NRBT Act of monetary and financial stability. In this regard, I take this opportunity to thank the Chairman and the Board of Directors and the staff for their support and commitment to deliver the mandate of the NRBT and the responses at the start of 2020 year to the challenges posed by the COVID-19 global pandemic. The support of the Ministry of Finance, Government Ministries and the banks and non-bank financial institutions during this unprecedented challenging year is appreciated as well as assistance from the international organizations, development partners and the central banks in the region.



Dr. Sione Ngongo Kioa  
Governor



# Functions and Objectives

The National Reserve Bank of Tonga (Amendment) Act, 2014, Section 4 sets out the principal objectives of the Bank. It states:

## Objectives of the Bank

1. The principal objectives of the Bank shall be to maintain internal and external monetary stability.
2. Without prejudice to its principal objective, the Bank shall-
  - (a) promote financial stability; and
  - (b) promote a sound and efficient financial system.
3. Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

Maintaining internal monetary stability is pursued by the Reserve Bank through promoting low and stable inflation over the medium term. The Reserve Bank's inflation reference rate is 5% per annum.

Maintenance of external monetary stability is pursued through maintaining adequate amount of foreign currencies (foreign reserves) to meet the country's foreign currency demands to pay for imports, etc.

As such, the Reserve Bank's monetary policies aim to ensure that Tonga always has foreign reserve holdings of at least three to four months of import cover.

The National Reserve Bank Act, Section 4A also sets out the Reserve Bank's functions:

*"The principal functions of the Bank shall be, to:*

- |   |  |
|---|--|
| <i>(a) issue currency;</i>  | <i>(j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;</i>   |
| <i>(b) formulate and implement monetary policy;</i>   | <i>(k) regulate and supervise financial institutions, including non-bank financial institutions;</i>   |
| <i>(c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;</i>           | <i>(l) oversee and promote the efficient, sound and safe functioning of the payment system;</i>  |
| <i>(d) determine the foreign exchange rate and implement foreign exchange policy;</i>   | <i>(m) collect and produce statistics;</i>   |
| <i>(e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;</i> | <i>(n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;</i> |
| <i>(f) regulate as required the supply, availability and international exchange of money;</i>   | <i>(o) regulate and supervise capital markets in Tonga;</i>  |
| <i>(g) exclusively hold and manage the external reserves of the Kingdom;</i>  | <i>(p) to manage and promote financial inclusion initiatives and related activities; and</i>   |
| <i>(h) provide advisory services to the Minister on banking and monetary matters;</i>   | <i>(q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act;</i>   |
| <i>(i) be the principal banker, fiscal agent and depository of the Government;</i>  |  |

Details on how the Reserve Bank applied its functions to meet its objectives are outlined in this report and other publications.

# Corporate Plan

## VISION

To be an effective and dynamic central bank in promoting Tonga's economic prosperity.

## MISSION

To formulate and implement sound monetary policy that is conducive to economic prosperity; promote stable and efficient financial system, external stability and effective payment systems through professionalism and independence.

## VALUES

Integrity | Innovation | Team Work | Excellence

# Corporate Plan Strategic Priorities



# Governance

## Board of Directors



**Mr. Steve Edwards**  
*Chairman*



**Mr. Richard Prema**  
*Deputy Chairman*



**Mrs. Sinaitakala Tu'itahi**  
*Director*



**Mrs. Joyce Mafi**  
*Director*



**Dr. Sione Ngongo Kioa**  
*Governor*



**Mrs. Balwyn Fa'otusia**  
*Director*  
*(Secretary for Finance)*

## Key Decision Makers

The Board of Directors comprises of the Chairman (non- executive Director), the Governor, Secretary for Finance, and 5 other non-executive Directors. The Governor, who is the Chief Executive Officer of the Bank, is responsible to the Board for the management and execution of the Bank's policy. Under the NRBT Act and the Amendment Acts, the Directors are appointed for terms of up to five years by the Minister of Finance and may be reappointed. During the year, there was one new member of the Board of Directors. As at the end of June 2020, one director position remained vacant.

In accordance with the Act, the Board must meet at least 10 times during the calendar year to discuss and formulate the policies of the Bank and to monitor its operations. The Board Finance Committee also met regularly to discuss and vet all Board matters well before every Board meeting and fulfil any requirements for further consideration at the Board. While the Board Finance Committee met 12 times during the financial year, the Board also met 17 times to formulate the policy of the Bank, monitor the Bank's operations and provide strategic direction and advice to the Governor. In line with Section 54D, the Board Audit Committee met to support the Board on External Audit matters. The Audit Committee in their responsibility to oversee the internal audit function directed that, at this time, the Risk Management Office would undertake some internal audit functions and report directly to the Board. Board procedures on on-boarding new directors and conflicts of interest was also discussed.

The Board of Directors are responsible for the Reserve Bank's policy and affairs. This involves constantly reviewing the performance of the Reserve Bank in the conduct of its functions and its use of resources, and may give advice to the Governor not only to sustain the efficient and effective management of the Bank's operations but also to ensure that the Reserve Bank delivers its core functions in compliance with the NRBT Act and related Acts.

Section 9A of the NRBT Amendment Act 2014 specifies the powers and functions of the Board which may not be delegated. During the year, the Board of Directors diligently carried out these powers and functions. The Directors met frequently to discuss the economic impact of COVID-19 pandemic and the Tropical Cyclone Harold on the Tongan economy and defined and adopted the monetary policy stance with additional policies which was

published in the special press release. In accordance with the NRBT Act Section 33 (4) b., the Directors urgently considered a request from the Minister of Finance and approved the transfer of T\$5 million from the revaluation reserve account to assist with the Government COVID-19 stimulus package. Additional measures to assist with the COVID-19 and the accommodative monetary policy stance was also approved and published in the bi-annual Monetary Policy Statements. The Directors also approved the monthly economic review, data flashes and issued a press release on the Monetary Policy decisions and its implementation. During the year, the Director's also reviewed the exchange rate basket currencies and weights.

Throughout the year, the Directors also defined and adopted financial stability policies and other policies of the Bank regarding the execution of its supervisory functions. These policies included the revisions to the bank license application forms and the amendments to the Prudential Statement No. 12 on Bank Licensing Requirements which was effective on the 1st August 2019. The review of the bank license fees and annual license fees were also amended to recover the costs of undertaking these functions. The Directors also considered legislation on regulating the provident fund and insurance companies in Tonga. Special projects were also endorsed to enhance the finance stability policies of the bank, these projects included the endorsement of the National Payment System software development agreement, as well as the development of the Tonga National Payment System, the Know Your Customers Customer and the credit bureau project. One of the Directors represented the Bank at the Ministerial Counter Terrorism Financing Conference in Melbourne Australia.

During the year, to ensure financial stability was maintained and that depositors funds are protected at all times. The Directors discussed the commercial banks liquidity, capital, credit growth and profit- ability as well as their exchange rates, interest rates and fees & charges. The Directors supervised the implementation of the policies and the exercise of the functions of the Bank through management monthly updates at Board meetings. The implementation of the NRBT's functions by management was also discussed at the sub-committee meetings.

One of the Board of Directors function, is to determine the denomination and design of banknotes and coins, as such, the Directors approved the new currency bank



note concept design as well as currency notes with the new specimen signatures of the Prime Minister and Finance Minister.

The Directors ensured the annual financial statements were prepared in accordance with internationally accepted accounting standards by adopting the IFRS 9 accounting standards and approved the classification and measurement basis for the expected credit loss. In accordance with Section 53(1) of the NRBT (Amendment) Act, the Directors considered the External Audit Service tender and recommended to the Minister of Finance the new external auditors for the next 3 years.

To ensure the operations of the Bank are carried out efficiently and effectively during the year, the Directors approved the review and changes to general staff policies and internal rules applicable to the administration and operations of the bank. The Directors noted the draft

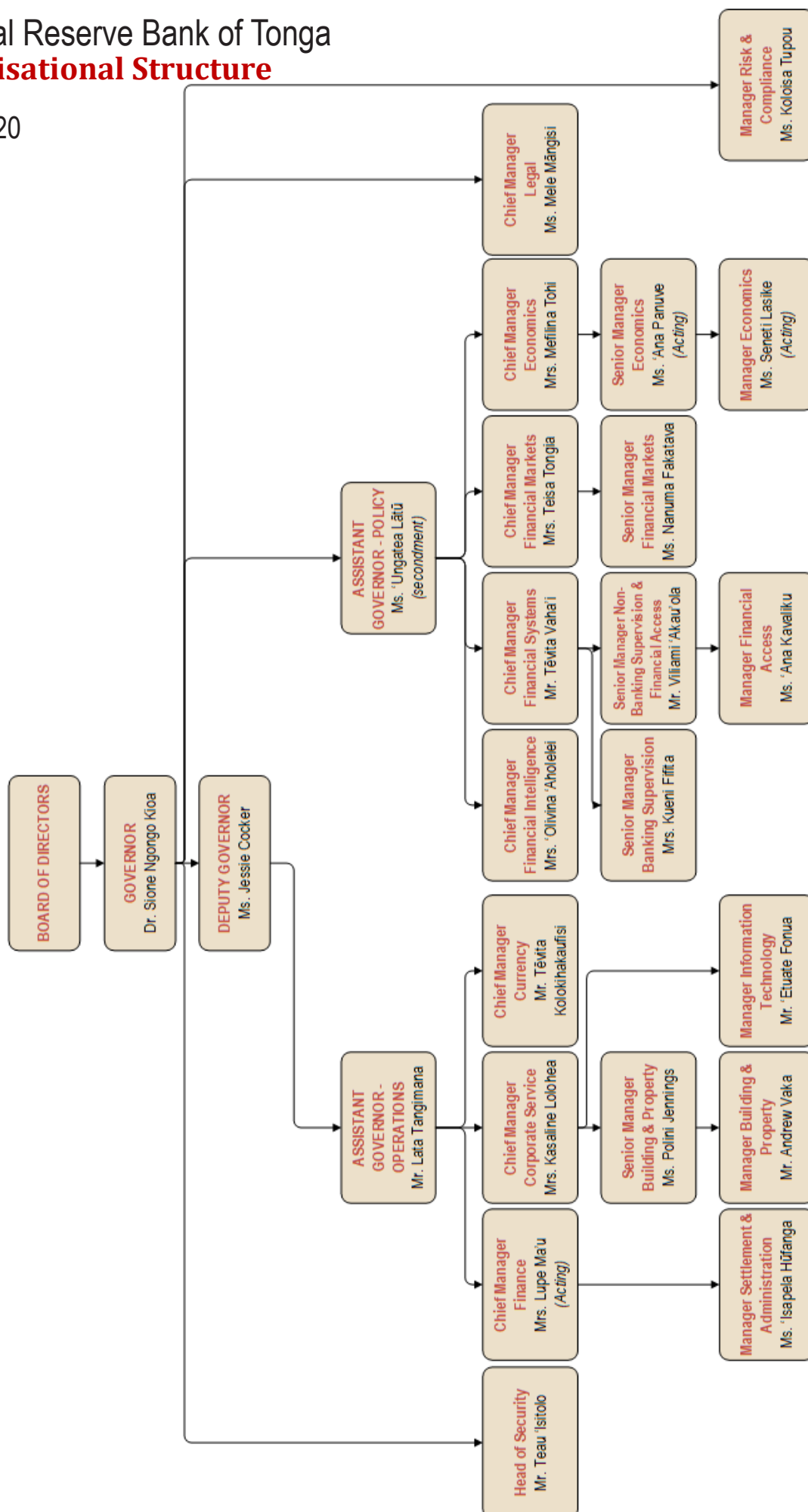
Business Continuity Plan for a Pandemic Outbreak which will continue to be updated. The Directors also discussed and approved the delegation of authority list, staff loan scheme, and staff remuneration policies. The implementation of the electronic filing restructure and database management system project was another project the Directors noted that would support the effective operations of the Bank.

The Directors also endorsed the 2020/21 annual budget and the organization chart of the Bank, the Corporate Plan 2020 as well as the Annual Report for 2018/19. Monthly financial statements comparing the actual financial outcomes against the budget were also approved by the Directors and transmitted to the Minister of Finance and the Prime Minister's Office to be published in the Government Gazette.

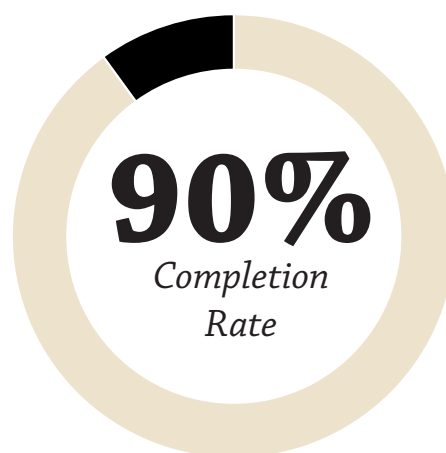
# National Reserve Bank of Tonga

## Organisational Structure

June 2020



# Corporate Plan



In April 2019, the Board of Directors approved the revised Reserve Bank's Corporate Plan for 2019/20 with 377 measurable targets. The corporate plan was reviewed at the end of February 2020 and it showed that overall the Bank has achieved 90% of the 377 Corporate Plan targets for 2019/20.

This year the staff have incorporated the balanced scorecard as a new assessment methodology in the corporate plan review.

This balanced scorecard measures the achievement of each target in terms of three criteria which are weighted according to their importance.

The criterias are;

- i. quality, weighted at 75% which takes into consideration accuracy, completion and comprehensiveness;
- ii. timeliness, weighted at 45% and refers to promptness of response and meeting deadlines; and

- iii. compliance, weighted at 30% relating in terms of legislation, policies, procedures and protocols.

The 90% achievement level is a significant improvement from the 82% achieved in the previous year.

Management will continue to align staff behaviours with the Bank's values. This is not only in maintaining a culture of high performance that supports achieving the strategic priorities set out in the Corporate Plan but also in positioning the National Reserve Bank of Tonga as an effective and dynamic central bank in promoting Tonga's economic prosperity.

# Economic Overview

## Overseas Economies

The IMF in its June 2020 World Economic Outlook (WEO) update has further revised global growth downwards to -4.9% for 2020 (compared to a -3.0% growth forecasted in the April 2020 WEO). This largely stems from the intensifying impacts and disruptions of the COVID-19 pandemic resulting in the contraction of global trade, subdued consumption spending, and weaker investment opportunities across economies.

Growth for advanced economies is expected to contract by 8.0% for 2020 (revised downwards from -6.1% from the April 2020 WEO) as the adverse impacts of the COVID-19 pandemic is much worse than anticipated in the first half of 2020. This includes some of Tonga's major trading partners such as New Zealand (NZ) and Australia reflecting contractions of 1.6% (as shared by Statistics NZ), and 0.3% (reported by the Australian Bureau of Statistics) respectively in the first quarter of 2020. Consequently, surges in unemployment rates were also observed in many countries including the United States which reported 11.1% in June 2020 (US Bureau of Labor Statistics), while Australia and New Zealand were reported at 7.4% (Australian Bureau of Labor Statistics) and 4.0% (Stats NZ) respectively.

Commodity prices are expected to remain relatively low in 2020, largely resulting from lower global oil prices arising from subdued demand amidst the COVID-19 pandemic. Lower headline inflation is projected for 2020 both for advanced and developing economies largely due to weaker demand and subdued economic activities leading to reduced commodity and global oil prices.

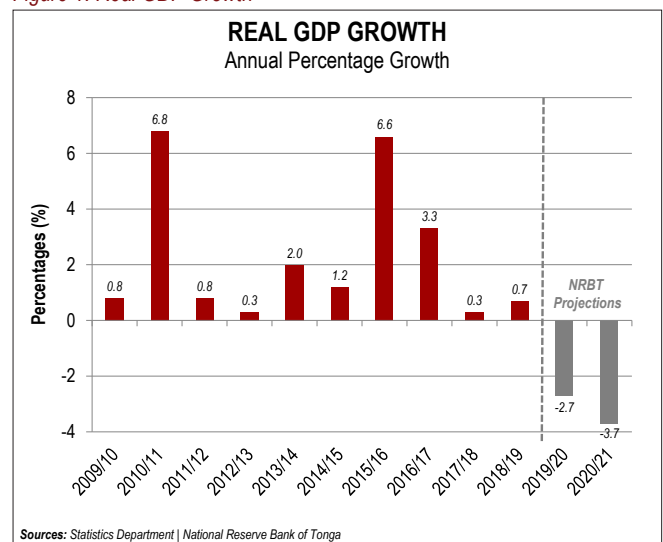
Reuters reported that world oil prices averaged around US\$51.22 per barrel in the year to June 2020 lower than the US\$68.65 per barrel in the year to June 2019. Consequently, the average oil price for June 2020 was at US\$40.47 per barrel which was considerably lower than the average US\$62.86 per barrel recorded in June 2019. This lower average price largely resulted from subdued global demand for oil due to the COVID-19 restrictions in travelling, and the closing down of many businesses and borders across economies. This is in addition to the breakdown and delayed agreement amongst the Organization of the Petroleum Exporting Countries

(OPEC) and non-OPEC countries to cut oil production in March 2020.

## Developments in the Domestic Economy

The Statistics Department rebased its National Accounts in October 2019 to 2016/17 prices, resulting in revisions to the previously published real GDP growths for Tonga. According to their preliminary estimate for 2018/19, the Tongan economy grew at 0.7% compared to 0.3% in the 2017/18. This largely reflects the recovery of the economy from the aftermath of Tropical Cyclone (TC) Gita, supported by the reconstruction activities.

Figure 1: Real GDP Growth



Prior to the Coronavirus outbreak (COVID-19), the Reserve Bank projected economic growth to be stronger in 2019/20 with the continuing recovery of the economy, favourable weather conditions, and the implementation of delayed government infrastructure projects. However, the declaration of the global pandemic in early 2020 has negatively affected economies world-wide with significant loss of human lives, travel restrictions, supply disruptions, weak aggregate demand, and acute shock to the labour market. Although Tonga remains as one of the few countries that are still COVID-19 free, it is not spared from the economic fallout of the pandemic. In April 2020, TC Harold arrived in Tonga adding further economic stress, as it left significant damages to infrastructure, dwellings, businesses and agriculture in parts of the islands of Tongatapu and 'Eua. The

latest review of the Reserve Bank's forecast projects a contraction in the Tongan economy for 2019/20 by 2.7%, and a further contraction in 2020/21 by 3.7%.

The primary sector is projected to grow by 4.1% in 2019/20 after recording a growth of 3.6% in 2018/19. The agricultural sector is expected to perform positively with agricultural exports volume rising over the year to June 2020 by 4,105.8 tonnes (45.1%). Better harvesting seasons was observed during the year especially for exports of squash, cassava, taro and kava Tonga. Favourable weather conditions, replanting and recovery efforts from TC Gita and TC Harold, and other initiatives to ensure food security during the global pandemic supports the growth in this sector. Meanwhile, agricultural export proceeds reported a decline of 19.8% (\$1.9 million) over the year to June 2020 reflecting an unsuccessful squash season in addition to possible time lags in receipt of proceeds, and under-reporting of proceeds in the Overseas Exchange Transactions (OET). The Fisheries sector also performed positively over the year despite the setback from exports via air cargo due to the COVID-19 lockdowns. The total exported volumes of fish still rose by 8.6% (152 metric tons) due to rising tuna exports, while volume of aquarium exports declined by 37.2%. The export proceeds from fish and marine products continued to rise by 9.7% (\$0.8 million) over the year.

The industry sector is expected to slow down by 1.6% in 2019/20 following a 4.6% growth in the previous year. The expected slowdown is mostly due to the impacts of COVID-19 causing further delays to major infrastructure and construction projects. Many of the technical and professional expertise required for the implementation of these projects has either been repatriated to their home countries, or unable to enter Tonga due to the border lockdown. Consequently, the activities in the mining & quarrying and the manufacturing sector will also align with the slowdown in construction, although it has benefitted from the Road Improvement projects. The utility sector is expected to be less affected by the impacts of COVID-19 given that they are essential services. Tonga Power Ltd reduced its electricity tariff in April 2020 as a result of the declining global oil prices. Additionally, their Network upgrade projects and Renewable energy projects are still on-going.

The growth of the services sector is estimated to drop markedly by 5.2% in the fiscal year 2019/20. This largely stems from the lockdown of Tonga's borders due to the COVID-19 pandemic which has brought

the tourism sector to a standstill in the last quarter of 2019/20. TC Harold also left major damages to some of the tourism businesses in Tongatapu and 'Eua which may further delay the recovery of this sector. Restricted mobility, social distancing and night curfews affected other sectors of the economy such as transport, trade, accommodation and food services, real estate activities, and entertainment businesses. Import payments declined by 5.2% over the year to June 2020, in line with the 18.2% decline in container registrations, reflecting a general slowdown in business activities and aggregate demand. Disruptions to supply chains and the cancellation of local celebrations and events such as church conferences, birthdays, weddings and funerals further contributed to softer aggregate demand. Many businesses have experienced a drop in activities, while others struggle to meet their expenses resulting in reduction of employees or work hours. The Government has issued a \$60 million stimulus package to assist the country's preparation for COVID-19 and to provide financial assistance to businesses and employees that are affected by the pandemic. The Reserve Bank also contributed to the stimulus package and reviewed its monetary policy instruments to support economic activities. The Commercial Banks provided moratoriums and other relief packages to its customers that are affected by the pandemic and TC Harold on a case by case basis.

As the search for a vaccine for COVID-19 continues, the duration of the pandemic is still uncertain with dire consequences to the economy. The Reserve Bank projects the economy to further contract in 2020/21 by 3.7% should the global pandemic continue until 2021.

According to the Reserve Bank's survey on job advertisements, the total number of vacancies advertised in local newspapers and the Matangi Tonga website declined by 25 vacancies over the year to June 2020. Recruitment intentions were mainly observed in the public administration and business services sector. Unemployment is expected to gradually rise due to the impact of the COVID-19 pandemic on businesses. Many of the seasonal workers are now unable to travel abroad for the seasonal schemes as the borders remain closed. Nevertheless, the Reserve Bank anticipates that this temporary unemployment especially in the services sector will shift to work in the primary sector such as fishing, agriculture and other informal work as their new source of livelihoods.



# Monetary Policy Formulation

## Monetary Policy Actions

The Reserve Bank maintained its accommodative monetary policy stance throughout 2019/20 in support of Tonga's macroeconomic growth and the global pandemic. The Tongan economy experienced sluggish growth, and indicators suggest a downturn in the medium-term. Annual headline inflation has remained below the minimum reference rate of 5%. Foreign reserves are still very comfortable and above the minimum of 3 months of imports cover, while exchange rates remain competitive. The financial system is sound, supported by the banks' strong capital position, excess liquidity, adequate profits, and low non-performing loans.

Given recent developments and the outlook on the monetary policy targets, the current accommodative monetary policy stance is still considered appropriate. Throughout the year, few additional measures were also introduced to assist in mitigating the impacts of the COVID-19 pandemic on the domestic economic growth. The current monetary policy measures are outlined below:

- Maintain the monetary policy rate at 0% (zero interest rate policy).
- Maintain the minimum loans/deposit ratio of 80%.
- Maintain the Statutory Reserve Deposit ratio at 10%.
- Maintain the inflation reference rate at 5%.
- Monitor the commercial banks' liquidity and adjust the SRD ratio if needed.
- Monitoring the commercial banks' capital reserves and adjust further when required.
- Ease the exchange control requirements when required.
- Continue to issue Government Bonds.
- Maintain clear channels of effective communications with the financial institutions for adequate preparedness.
- Continue to be transparent and raise awareness of its monetary policy decisions through press releases to the public.
- Closely monitor the impacts of the pandemic in the financial system for early detection of any signs of vulnerability.
- Continue to ensure both commercial banks and non-bank financial institutions adheres to all Government declarations regarding COVID-19 in the workplace while delivering essential financial services to the public.

In addition to the above measures, the following policy actions were implemented by the Reserve Bank during 2019/20 to enhance its role in promoting macroeconomic and financial stability and achieve its core objectives:

- Adjustments of the provision levels to comply with IFRS 9 was carried out to ensure adequate provisions against loan losses in place;
- Reviewed the exchange rate basket of currencies during the year and became effective in June 2020;
- A project is underway to develop and automate a national payment system that would best suit Tonga and its volume of transactions;
- To address de-risking issues, the Reserve Bank continues to work with the foreign exchange dealers as well as banks in Tonga to retain their overseas bank accounts;
- The Reserve Bank continue to develop the financial infrastructure to license and supervise Credit Bureaus;
- Implement financial inclusion initiatives on access to finance for individuals, Micro Small and Medium Enterprise's (MSME), and digital financial services;
- Tonga underwent its 2nd Mutual Evaluation by the Asia Pacific Group on Money Laundering (APG) in 2019, and the final report is due in 2020.
- Draft the Insurance Bill to license, supervise and regulate insurance companies in Tonga.
- Draft Prudential Statements for operations risk and cybersecurity risk.

The Reserve Bank during the year continued to publish its Monetary Policy Statement (MPS) every six months, as required by the National Reserve Bank of Tonga Act. The Reserve Bank also published Quarterly Bulletins, Monthly Economic Reviews and monthly data flashes on economic indicators. These publications were also submitted to Privy Council for their information. Furthermore, the Reserve Bank remains vigilant and continued to closely monitor developments for early signs of vulnerabilities.

## Monetary Policy Outcomes

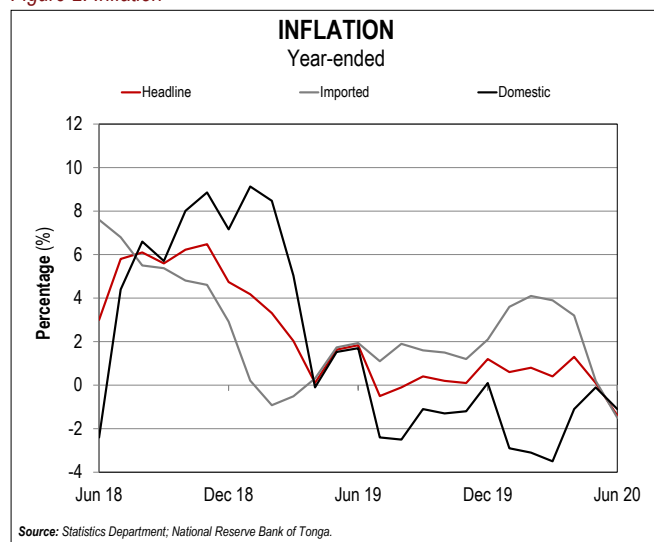
The Reserve Bank's monetary policy objectives were observed during the 2019/20 financial year.

### Inflation

The annual headline inflation averaged at a low 0.3% during the 2019/20 Financial Year (FY) well below the 5% reference rate. The annual headline inflation for June 2020 recorded a deflation of 1.4% compared to 1.8% inflation in the same period last year. This is also

the lowest inflation rate since December 2015 (-1.2%).

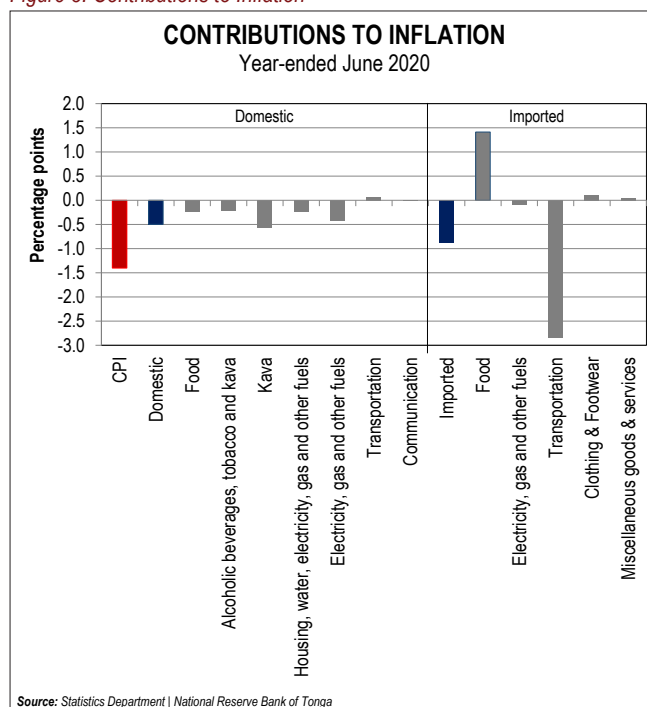
Figure 2: Inflation



Average domestic prices declined by 1.7% for the FY 2019/20 reflecting favourable weather conditions and successful recovery efforts from TC Gita and TC Harold, as evident in the abundant supply of local food products such as root crops, fruits and vegetables. This was further supported by government measures to ensure food security given the global pandemic. Similarly, the consistent decline in prices of Kava Tonga not only reflects the improvement in supply, but also the drop in demand due to curfews and cancellation of major events and festivities. Lower electricity tariffs, gas & other fuels also supported the annual decline.

Imported prices also recorded a 1.5% decline in June 2020, driven mostly by lower fuel prices which declined by 29.7% over the year to June 2020, followed by lower gas prices which fell by 4.7%, outweighing the increase in food prices, tobacco and alcoholic beverages. The lower global oil prices and the steady exchange rates kept imported inflation low, and consequently a lower headline inflation rate over the year.

Figure 3: Contributions to Inflation

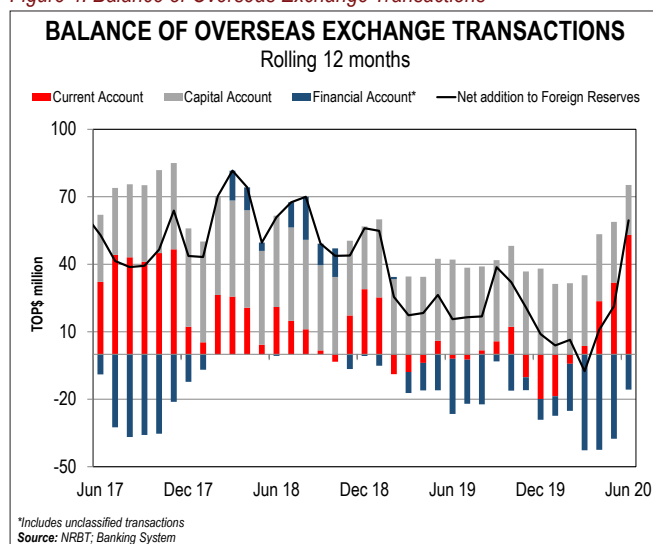


Amendments to the Customs Duty Order effective in September 2019 includes new import duties imposed on eggs and tobacco to promote a healthier lifestyle. New excise taxes for older models of motor vehicles were also effective in the same month. Rising import food prices was the main contributor to the higher import prices in the first half of 2020 specifically for meat items. The impacts of the COVID-19 restrictions across borders resulted in delayed shipments and disruptions affecting the availability of imported goods which contributed to the increase in import prices.

### Balance of OET

The overall Overseas Exchange Transaction (OET) balance recorded a higher surplus of \$59.5 million for the year ended June 2020 compared to a \$15.6 million surplus in June 2019. The higher overall balance stems from the surplus in the current account due to rising transfer receipts and lower import payments. The surplus in the Capital account declined while the financial account deficit widened, partly offsetting the improvement in the current account balance. The total OET receipts increased over the year to June 2020 by \$28.9 million (3.5%) to \$862.8 million. This was mainly due to higher official transfer receipts of budget support, project funds, and financial assistance for TC Harold and COVID-19 preparations.

Figure 4: Balance of Overseas Exchange Transactions



However, total OET payments fell by \$38.3 million to \$723.9 million (-5.0%) over the year ended June 2020. This was driven mainly by declines in import payments mainly for wholesale & retail goods, motor vehicles, and construction materials. This was followed by declines in payments for interbank transactions, services, and capital transfers. The decline in import payments over the year attributes to the disruptions from COVID-19.

### Official Foreign Reserves

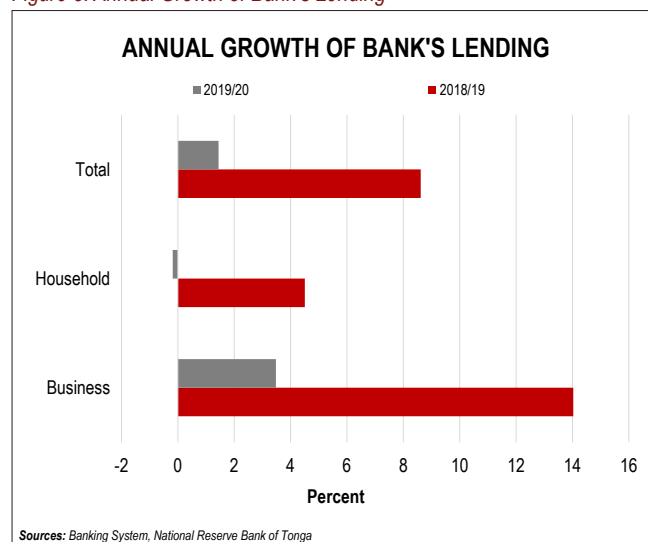
The official foreign reserves increased from \$484.3 million in June 2019 (7.9 months of import) to \$543.8 million in June 2020 equivalent to 8.2 months of import cover. The annual growth resulted mainly from higher receipts of budget support, grants mainly for COVID-19 preparations and TC Harold relief funds from development partners. Furthermore, remittance receipts also contributed to the annual increase in foreign reserves. The level of foreign reserves has remained at a very comfortable level during the 2019/20 financial year maintaining the months of import coverage above the Reserve Bank's minimum range of 3 months. The Reserve Bank continues to publish its monthly press release on the level of foreign reserves and is posted on to the website for the public's information.

### Exchange Rates

Majority of Tonga's major trading currencies have weakened against the Tongan Pa'anga over the year to June 2020, mainly the New Zealand Dollar, Great Britain Pound, Chinese Yuan, Australian Dollar, Fijian Dollar, and Euro, whilst the United States Dollar and Japanese Yen strengthened against the Tongan Pa'anga. As a result, both the Nominal Effective Exchange Rates (NEER) and Real Effective Exchange Rates (REER) rose over the year by about 2% each. The increase in the REER index

reflects Tonga's higher headline inflation rate relative to its trading partners, which may impact the international competitiveness of Tongan exports. However, this may benefit importers of goods and services.

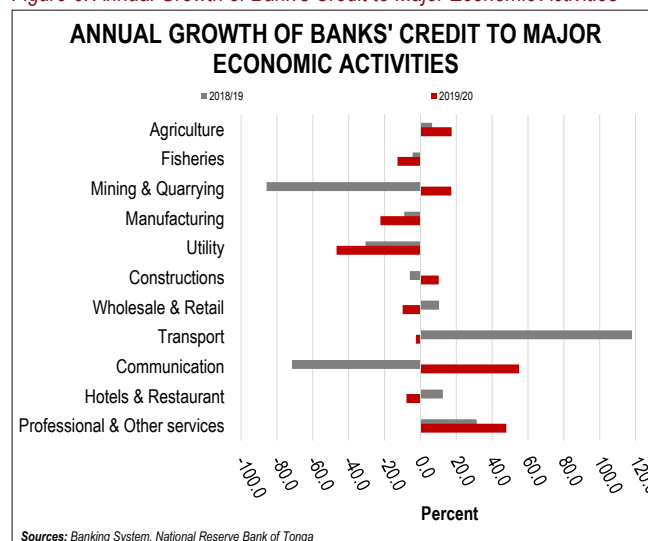
Figure 5: Annual Growth of Bank's Lending



### Lending Balances

Due to the slowdown in domestic activities starting in March 2020 owing to the impacts of COVID-19, a subdued credit growth of 1.4% (\$7.0 million) with a total lending of \$492.9 million was recorded in the year to June 2020, compared to an 8.6% growth in the previous year. Total lending was highest at \$504.9 million in November 2019. This year's growth was attributed to a 3.5% (\$7.9 million) increase in business loans, while lending to individuals fell by 0.2% (\$0.5 million) over the year as the rise in housing loans was offset by the decline in vehicle and other personal loans. The growth in lending were mostly to the agricultural, mining & quarrying, construction, communication, and professional & other services sectors.

Figure 6: Annual Growth of Bank's Credit to Major Economic Activities



Lending activities in the non-bank financial institutions also increased in the year to June 2020 by 3.1% (\$3.2 million) to \$106.8 million, largely reflecting an increase in household lending.

On the outlook, the Reserve Bank anticipates a higher annual credit growth of 8.2% in 2020/21, compared to 2019/20. This is derived mainly from the deferral of major bankable projects in the banks' lending pipeline, the utilization of the \$60 million stimulus package, and the re-opening of the border for the Pacific bubble. However, uncertainties regarding the duration of the pandemic is a downside risk to the forecast.

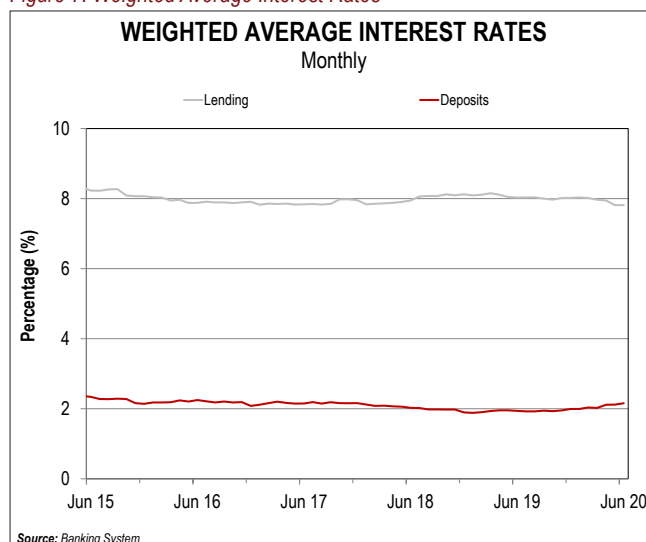
### Deposit Balances

The total banks' deposit in the year to June 2020 was \$619.2 million, a 1.3% (\$8.2 million) increase from \$611.0 million recorded in June 2019. Time deposits rose and outweighed the decline in demand and savings and deposits. The higher time deposits were mainly driven by the retirement funds, non-profit bodies, government, and private sector (businesses and individual). This resulted from the conversion of some short term investments by the government into long term investments (time deposits). This may also be due to the drawdown of demand and savings deposit as a result of the impact of COVID-19. Lower demand and saving deposit accounts was mostly driven by the central government, public enterprise, and businesses.

### Interest Rates

In the year to June 2020, the weighted average interest rates spread narrowed by 43.20 basis points from 6.09% to 5.66%. This was attributed to a decline in the weighted average lending rates by 21.42 basis points whilst the weighted average deposit rates rose by 21.78 basis points. Lower lending rates were mostly individual loans for housing, and other personal. Average business lending rates remained unchanged at 7.64% as the rise in lending rates to the utilities, agricultural, manufacturing, construction and fisheries sectors was offset by a decline particularly for the mining & quarrying, tourism, and professional & other services sectors. Higher deposit rates were for all deposit types which coincides with the annual increase in the volumes of savings and time deposits.

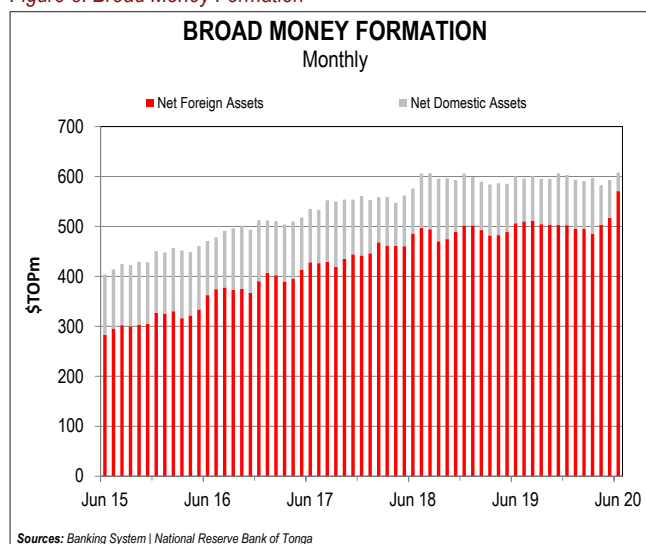
Figure 7: Weighted Average Interest Rates



### Broad Money Balances

Broad money rose in the year to June 2020 by \$7.0 million (1.2%) to a new high level of \$607.1 million, solely attributed to the higher net foreign assets. These are mainly due to the receipt of budget support, donor funded projects, financial assistance for COVID-19 preparations, and cyclone relief funds which resulted in an increase in both foreign reserves and government deposits. Hence, net domestic assets declined over the year due to the rise in government net deposits with the Reserve Bank.

Figure 8: Broad Money Formation



## Economics Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 2019/20, the Economics Department was allocated with twenty three specific measurable targets. A review of the financial year corporate plan was carried out in April 2020 which revealed that the Department achieved nineteen targets while four targets were not achieved. These targets are related to meeting deadlines for publishing of economic reports such as the Monetary Policy Statement, Quarterly Bulletins and Monthly data flashes. Delays in meeting the deadlines were mostly due to staff shortages and other work priorities that arose during the year.





# Financial Stability

## Financial Sector

The Reserve Bank continued to be responsible for the promotion of a sound and efficient financial system during the 2019/20 year, particularly with new challenges from the impact of tropical cyclone Harold, the COVID-19 pandemic and the expected economic downturn. The Reserve Bank adjusted its focus to maintain the stable and well capitalized financial system by ensuring banks are resilient against the impact of COVID-19 and an economic downturn at the same time support economic growth. To improve the banks risk management, new prudential statements were issued, risk based onsite supervision was conducted, and projects were implemented to develop the financial infrastructure. Such project includes the automated National Payment System project and enhancing financial intermediation by encouraging financial innovative products through a regulatory sandbox. The Reserve Bank continued with its functions of effectively licensing, regulating and supervising of financial institutions both banks and non-bank financial institutions (NBFIs).

New targets were also set to develop the non-bank financial institutions (NBFIs) to provide a viable alternative to bank financing if banks become risk-averse, through improving the legal and regulatory environment for non-banks and encouraging new financial solutions or products such as the South Pacific KYC Utility Regional Project. The implementation of the Foreign Exchange Control Act 2018 is ongoing and the Microfinance Act 2018 was proclaimed by Cabinet and was effective in July 2019. The Moneylenders Act awaits a declaration date by Cabinet. In addition, draft legislation for the licensing and supervision of Insurance Companies are being finalized. A credit information systems applicant has been granted a license subject to conditions and to be formally supervised under the Credit Bureau Licensing Guidelines. Work is still in progress to ensure that this applicant meets all licensing conditions before their license is finalised.

## Banking System Development

As at the end of June 2020, there were 4 banks licensed to operate in Tonga. The Bank of South Pacific (BSP) Tonga Limited continued to build on their outreach

programs with increased number of access points mainly for EFTPOS and agents/in-store banking. BSP's number of agents/in-store banking facilities increased from 26 in the year before, to 31 this year. ATMs for BSP also increased over the year by one while ANZ on the other hand had less ATMs compared to the year before. Tonga Development Bank continued to build their market share on remittances with their 'Ave Pa'anga Pau platform over the year.

All banks maintained their head offices in Tongatapu. MBf Bank Limited and ANZ Bank also maintained their branches and sub-branches in Vava'u. Tonga Development Bank (TDB) continued to be the only bank serving all the outer islands of Ha'apai, Vava'u, 'Eua and the two Niuas (Niuatoputapu and Niuafo'ou). TDB also continued to operate two other sub-branches in Tongatapu located in Tatakamotonga for the Hahake District and Nukunuku for the Hihifo District.

Table 1: Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB
Branches (including Head Office at Nuku'alofa)	3	4	2	8
Agents/Instore banking	-	31	-	-
ATMs	13	14	-	-
EFTPOS	149	388	-	-
Internet Banking	Yes	Yes	No	Yes
Money Transfer Services	Yes	No	No	Yes

BSP commenced providing EMV Chip Cards in November 2019 as part of improving the bank's services and to provide products and services that are secure and convenient to all its customers. There were no new products and services being offered by the rest of the other commercial banks in Tonga during the financial year 2019/20. However, all banks continued to improve their various banking systems and processes over the year.

## Banking System Supervision and Regulation

During 2019/20 year, Tonga's financial system was impacted by Tropical Cyclone Harold in April 2020, in addition to the global pandemic COVID-19 that led to the activation of the National State of Emergency and a one-week lockdown. The Reserve Bank focused their supervisory role in ensuring that measures implemented by the financial system are communicated to the general public through press releases during these uncertain times. Regular meetings and ongoing discussions were held with the Association of banks to ensure their impacted customers are provided financial assistance

(COVID-19 Loan Package, refer to **Table 2**). At the same time, banks maintained prudent credit lending standards to ensure that asset quality was not heavily impacted. As of June 2020, around 802 bank customers benefited from the COVID-19 loan packages. The banks therefore had to review their annual strategies and risk appetites in early 2020 to take into account the impact of COVID-19. Some banks deferred some loan projects to later in 2021. In addition, legal and prudential requirements continued to be closely monitored to maintain and promote an ongoing safe and sound financial system whilst maintaining a level playing field in the banking system.

Table 2: Banking System Relief Packages for COVID-19 and TC Harold Affected Customers

Banks	Commercial Loans	Personal Loans	Home Loans	TC Harold
BSP	3 months interest only for all sectors impacted.	i. 3 months' principal repayment suspension, only if borrower is working on reduced hours or loss of jobs. ii. Maturity term to be extended by a proportionate term.	3 months payment and interest repayment holidays on a case basis due to loss of job or impacts with reduced visitors through online booking.	Retail and SME – 3 months Principal and Interest payment holiday; Business/Corporate – 3 months 'Interest Only' repayments; Waiver of Establishment / Restructure Fee for additional funding in relation to cyclone damages; Provision of a cyclone repair, 75% of the prevailing customer interest rate – loan value up to TOP\$50,000.00.
ANZ	i. A 0.5% per annum reduction on all local currency Overdrafts – effective 6th April 2020. ii. A 0.5% per annum reduction on all local currency variable term loans – effective 1st May 2020. iii. Removal of monthly loan administration charges - effective 1st May 2020. iv. Waiver on loan restructuring fees – case by case basis. v. Reduction in repayment amounts in line with reduced interest rate.	i. A 0.5% per annum reduction on all local currency personal loans – effective 1st May 2020. ii. Removal of monthly loan administration charges - effective 1st May 2020.	i. A 0.5% per annum reduction on all local currency home loans – effective 1st May 2020. ii. Removal of monthly loan administration charges - effective 1st May 2020.	The same relief packages will be applied to customers that were affected by TC Harold.
TDB	i. Loan repayment Holidays for 3 months for impacted customers (on a case by case basis). ii. Waiver on both interest and principal repayments will be on a case by case basis.			Government Development Loans – interest payments for 3 months.
MBF	Considered on a case by case basis if borrower lose his/her employment.			

Despite the challenges over the year, the commercial banks' liquidity remained sufficient as they continued to meet the Statutory Reserve Deposit (SRD) requirement of 10%. This is in addition to their compliance with the minimum requirement on the loans to deposit ratio of 80%. As of June 2020, only one of the banks achieved this target while the other three banks continued to utilize their excess liquidity in order to achieve the 80% loan to deposit minimum requirement. The lower loan to deposit ratio reflects the influx of foreign aid funds to Government related to the impact of Tropical Cyclone Harold and the COVID-19 pandemic whilst banks recorded minimal credit growth over the year to June 2020. The Reserve Bank continues to monitor the banks' loans/deposit ratio.

During the year, the Reserve Bank approved the continuation of a temporary breach of the single borrower limit for one loan subject to conditions that provided sufficient assurance to the Reserve Bank of the regularisation of this temporary breach within the given timeframe.

Onsite examination of banks continued to be one of the core parts of the Reserve Bank's supervisory role. The Reserve Bank's examination team focused on conducting risk-based onsite visits to 2 banks in August 2019 and December 2019. The onsite examinations focused on ensuring that banks internal controls for processing of their loans were in place, and are being followed effectively. These controls will manage customers' level of household indebtedness. Furthermore, these onsite visits were to also verify the commercial banks' ongoing compliance with their internal policies as well as the Reserve Bank's requirements. In addition, spot checks were conducted over the year to verify banks' compliance with the requirements of Prudential Statement No. 4 on Disclosure of Interest rates and Fees & Charges. A spot check on disclosure requirements was conducted for the first time on bank branches in the outer islands of Vava'u. The spot check results showed that there are some improvements warranted including strengthened head office oversight over the outer island branches.

The Reserve Bank continued to prioritize improving the quality of banks' reports for offsite monitoring and to form the basis of the Reserve Bank's policy decisions. Enhanced checking of banks' reports to the Reserve Bank such as mapping of source data to reporting templates continued over the year as part of the data quality assurance process. The banks have reflected significant improvement in the quality of their reports.

Monthly bilateral meetings with the banks and their external and internal auditors as well as bi-annual meetings with the Association of Banks in Tonga (ABT) were held during the year to obtain updates on the banks strategies in light of the market developments to ensure that they continue to operate prudently and in compliance with the Reserve Bank's requirements. In March 2020, the ABT met weekly to respond to the public with regards to commercial banks operations as well as their assistance to customers during the COVID-19 pandemic. Furthermore, technical meetings were also carried out during the year on specific issues mainly on reporting requirements.

The Reserve Bank Board continued to be kept well informed of developments in the banking system through monthly reports on banking sector development as well as other updates in the Governor's Monthly Update to the Board.

In terms of unclaimed monies paid to the Reserve Bank by the commercial banks, the Reserve Bank continued to publish those accounts that remained unclaimed totalling \$973,085.05 to give customers another opportunity to place their claims for their funds before they are forfeited to the Government, if they remain unclaimed after 5 years of being paid to the Reserve Bank. During the year, an amount of \$21,399.75 was forfeited to the Government's account in accordance with the requirements of the Financial Institutions Act.

## **Banking System Financial Performance**

### **Financial Position**

The total assets of the banking system reached \$888.7 million at the end of June 2020, a growth of \$15.3 million (1.7%) over the year 2019/20. This resulted mainly from increase in holdings of government bonds by \$8.3 million (32.2%) and credit growth (excluding GDL loans) of \$6 million (1.3%) over the year. This was partly offset by the \$5.5 million (34.7%) decrease in items in transit.

Private Business loans drove the credit growth over the year reflecting the ongoing economic activities and the businesses capacity to borrow during the first half of the year. Majority of the business loans were for businesses in the professional & other services, agriculture, construction etc. As at June 2020, private individual loans on the other hand continued to hold more than half of the total loan portfolio at 53% (\$257 million). Housing loans continued to dominate the bulk of the banking

system loan portfolio at \$205 million (42.3% of the total loan portfolio), which reflected that all banks continued to compete for housing loans.

Government continued to offer its low interest rate loans through the Government Development Loan (GDL) scheme administered by TDB. The total outstanding loan under this scheme as of June 2020 was at \$8.7 million compared to \$7.7 million in June 2019. Of the total outstanding loan as of June 2020, 53.0% was lent to the agricultural sector followed by the education and fisheries sectors at 17.5% and 13.9%, respectively. Government Development Loan also offered a COVID-19 loan relief package to their borrowers by waiving loan repayments for up to 3 months.

Table 3: Financial Sector Deposit Account

	2018/19	2019/20
<b>Demand Deposits</b>		
Number of Accounts	39,664	44,977
Value of Deposits (\$m)	262.8	243.6
<b>Saving Deposits</b>		
Number of Accounts	47,976	48,932
Value of Deposits (\$m)	113.5	113.0
<b>Time Deposits</b>		
Number of Accounts	1,876	1,884
Value of Deposits (\$m)	234.8	262.6
<b>Total Number of Accounts</b>	<b>89,516</b>	<b>95,793</b>
<b>Total Value of Deposits (\$m)</b>	<b>611.0</b>	<b>619.2</b>

Total banks' liabilities rose over the year by \$3.6 million (0.5%). Total deposits continued to rise particularly time deposits increasing by \$27.8 million (11.9%), reflecting the build-up in statutory non-bank financial corporations by \$36.8 million (52.7%) and government accounts by \$15.1 million (62.0%). On the other hand, demand and savings deposits categories fell by \$19.2 million (7.3%) and \$0.5 million (0.4%) respectively. This reflected the decline in private business deposits as some foreign investors exited the financial system due to the impact of COVID-19.

The total number of deposit accounts reported by banks increased over the year by 7.0% to 95,793 while the total value of deposits increased by \$8.1 million (1.3%) to \$619.2 million.

## Profitability

The profitability of the total banking system slightly improved in 2019/20 compared to the previous financial year. The banks recorded an after-tax profit of \$20.452

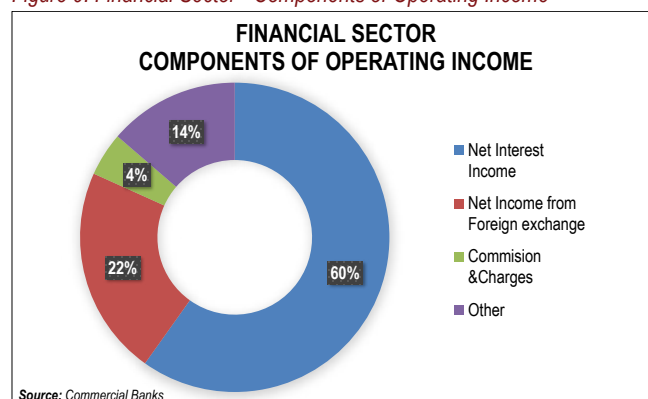
million for the year ended June 2020, which is equivalent to 2.3% of average assets, and compared to an after-tax profit of \$19.596 million for the previous year, which was equivalent to 2.2% of average assets. The rise in net interest income of \$1.538 million was the main contributor to the bank profits, which was partially offset by the decline in non-interest income of \$1.409 million. The decline in non-interest income was mainly driven by the impact of COVID-19 on the banks' volume of foreign exchange transactions.

Table 4: Financial Performance

	2018/19	2019/20
Pre-tax Net Profit (% average total assets)	3.0%	3.1%
After-tax Net Profit (% average total assets)	2.2%	2.3%
Total Operating Income (% average total assets)	7.4%	7.3%
Net Interest Income (% average total assets)	4.2%	4.4%
Non-interest income (% average total assets)	3.1%	2.9%
Average Net Interest Margin (%)	3.9%	4.0%
Total Operating Expenses (% average total assets)	3.7%	3.6%
Consolidated Risk-weighted Capital Ratio (%)	30.5%	31.6%

Total operating income of the banks comprised mainly of net interest income at 60% followed by net income from foreign exchange at 22% compared with 58% and 23% respectively in June 2019. The growing net interest income is in line with the ongoing credit growth over the year for all banks.

Figure 9: Financial Sector - Components of Operating Income

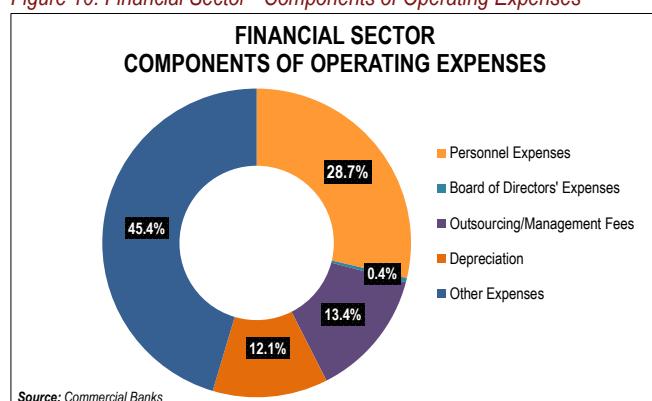


Total operating expenses declined and is largely comprised of Other Expenses at 45.4% followed by Personnel Expenses at 28.7% and outsourcing &



management fees at 13.4% compared with 50.1%, 27.8% and 12.8% respectively in the previous year.

Figure 10: Financial Sector - Components of Operating Expenses

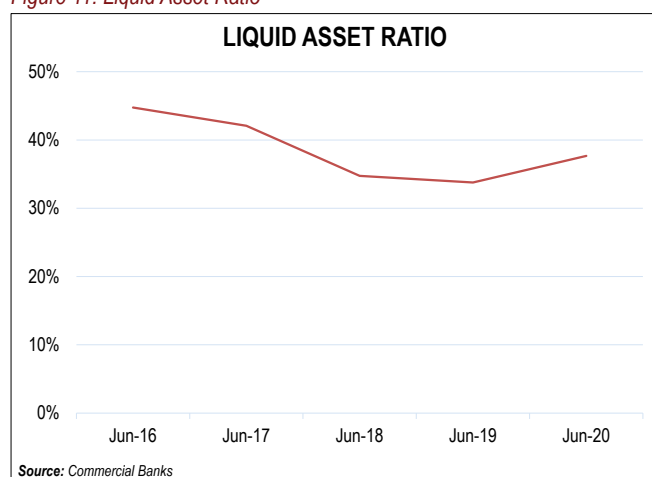


The Reserve Bank expects the profitability of the banks to deteriorate going forward given the uncertainties related to the COVID-19 global pandemic. The quality of the bank's asset is also expected to weaken over the year. On the other hand, the banks are expected to ensure that adequate loan loss provisions are in place. This will therefore put pressure on banks to review their profit projections for the next financial year.

## Liquidity

The banking system's liquidity continued to remain comfortable during 2019/20 financial year. The increase in eligible liquid assets by \$24.6 million over the year, was mainly due to the higher Exchange Settlement Accounts due to the influx of Government donor aid funds coupled with business proceeds being banked. Total loans as a proportion of deposits slightly fell to 78.2% in June 2020 from 78.3% recorded in June 2019. The Liquid Asset Ratio rose to 37.7% in June 2020 compared to 33.8% in June 2019 and continued to remain well above the Reserve Bank's minimum requirement of 5%.

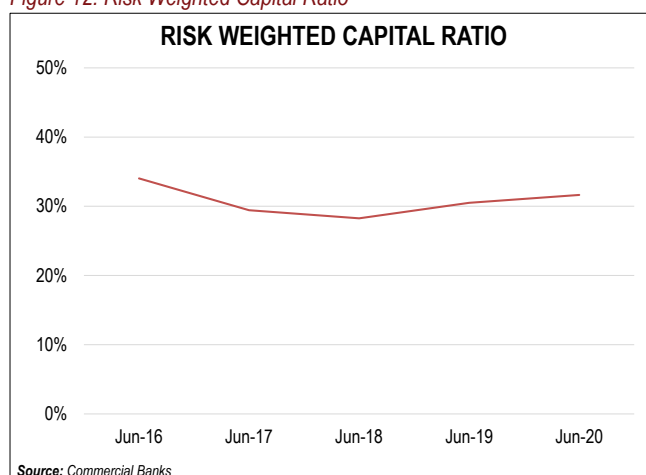
Figure 11: Liquid Asset Ratio



## Capital

The capital position of the banking system remained strong as the risk-weighted capital ratio remained well above the Reserve Bank's minimum ratio of 15%. The consolidated risk weighted capital ratio for the banks improved to 31.6% at the end of June 2020 from 30.5% in June 2019. This was mainly due to the increase in eligible capital of \$12.8 million (8.0%) due to previous year's earnings compared to the \$21.7 million (4.2%) rise in risk-weighted assets reflecting the continuous credit growth over the year.

Figure 12: Risk Weighted Capital Ratio



## Asset Quality

The overall quality of the banks' assets weakened over the year to June 2020. Total non-performing loans increased by \$4.6 million (29.3%) to \$20.2 million at the end of June 2020, which represented 4.2% of total loans compared to 3.3% in June 2019. The commercial banks offered COVID-19 relief packages to its impacted customers since April 2020 for up to 3-6 months' period. These packages are to support their customers that are directly affected by COVID-19 including businesses and individuals. Some banks recognise their COVID-19 impacted customers' as loan arrears. This in turn contributed to the increase in non-performing loans by the end of June 2020. These non-performing loans are expected to be regularised by the end of the loan relief package around the second quarter of the financial year 2020/21. In addition, some agricultural sector loans also contributed to the non-performing loans due to an unsuccessful squash season resulting in poor returns through export proceeds.

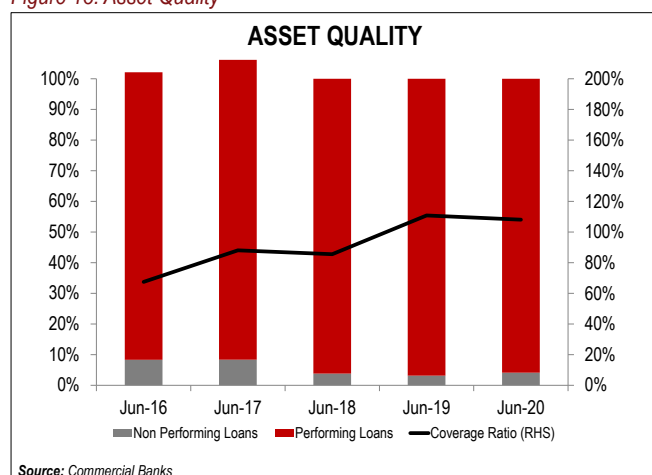
Household loans continue to account for the highest share of the total non-performing loans in June 2020 with a 69.4% (\$13.9 million), compared to 70.8% in June 2019, while the remaining 30.6% (\$6.1 million) was for



business loans. Housing loans accounted for 56.4% (\$11.3 million) compared to 52% (\$7.8 million) in the previous year. This was followed by Agricultural loans with 19.8% (\$4.0 million) and personal loans at 12.8% (\$2.6 million).

Total provisions against loans increased by \$4.5 million (26.1%) to \$21.8 million which continues to be in line with the increase in non-performing loans. The coverage ratio of the non-performing loans by total loan loss reserves, remained high at 108.1%, but lower than 110.8% in June 2019. The Reserve Bank continued to work closely with banks to monitor the COVID-19 impacted customers.

Figure 13: Asset Quality



## Non-Bank Financial Institutions Supervision

Given that promoting access to finance and protecting the interest of financial customers continued to be a priority, the Reserve Bank continues to develop an adequate legal framework for regulating and supervising

non-bank financial institutions, thus, fulfilling its objective of promoting a sound and efficient financial system, protecting financial consumers as well as contributing to economic growth. The non-bank financial institutions play an essential role in driving inclusive economic growth by providing an alternative financial services to those that the commercial banks may not lend to, although it accounts for only a small portion, it may pose a risk to the overall financial system. However, the establishment of a robust supervisory framework would mitigate such potential risks.

The Reserve Bank under Section 3 of the Microfinance Act 2018, a microfinance license was granted to the South Pacific Business Development Microfinance Tonga Limited (SPBD) to conduct a microfinance business in Tonga effective on 24th February 2020. The Reserve Bank will ensure that SPBD Tonga will continue to comply with the conditions of its license in the exercise of its operations.

The implementation of the Moneylenders Act 2018 is currently underway, starting with the proclamation of the Act in the next financial year. The Reserve Bank continued to develop an enabling financial infrastructure to license and supervise the existing credit bureau (Data Bureau (Tonga) Limited) under the Reserve Bank's Credit Bureau Licensing Guideline that was issued in July 2017. The credit bureau will contribute to the mandate of maintaining financial stability through monitoring the level of household indebtedness. It would also assist with prudential supervision to monitor systemic risks and the quality of bank assets as well as enhance access to loans.

*Delegates and representatives from the Pacific region during the Association of Financial Supervisors of Pacific Countries (AFSPC) Annual Meeting and workshop. The annual meeting and workshop was held at the National Reserve Bank of Tonga Conference Centre from 2nd - 6th September 2019.*



Over the year, the Reserve Bank participated in the Regional Regulatory Reform – Legislation technical assistance hosted by the Pacific Technical Assistance Center (PFTAC). The outputs from this technical assistance was contextualized to the Tongan market and was the basis of the draft Insurance Bill and a host of prudential standards. The consultation process on the Insurance Bill will commence in the next financial year.

## Financial Reports

The Reserve Bank continues to collect financial reports (Balance Sheet and Profit & Loss statements) from most of the Non-Bank Financial Institutions on their operations. The current reporting entities include thirteen (13) foreign exchange dealers (FEDs), one (1) microfinance institutions and two (2) retirement funds who are submitting reports on a monthly basis while four (4) insurance companies submit their financial reports on a quarterly basis. The purpose of these reporting templates is to understand the type of business that these NBFIs are conducting and also to monitor their financial positions and performance to ensure they remain solvent.

## Impact of COVID-19 and Tropical Cyclone (TC) Harold on the Non-Banking System

The COVID-19 pandemic has affected Tonga's financial system including non-bank financial institution's performance and how they operate especially the foreign exchange dealers, retirement funds, microfinance institutions and insurance companies. During the lockdown from March to May 2020, the FEDs agents on the main corridors specifically New Zealand, Australia & United States were affected.

Table 5: Impact of COVID-19 & TC Harold on Foreign Exchange Dealers

Foreign Exchange Dealers	Impact of COVID-19	Impact of TC Harold
FEXCO Tonga Limited	Normal operation except for buying of foreign currency has been on hold since the lockdown started.	No Issues.
MoneyGram Agent BSP	No issue. All services available except foreign cheque purchase.	No Issues.
Digicel Mobile Money	No issue. All services available.	Local office in 'Eua was destroyed.

Foreign Exchange Dealers	Impact of COVID-19	Impact of TC Harold
'Ave Pa'anga Pau	No issue. All services available except FX Buying and a limit were imposed on Money Transfer of \$5,000 max per transaction per remitter during lockdown.	Local office in 'Eua was affected by TC Harold, however they managed to open for business.
S.A.V Money Transfer	Closedown during lockdown.	No Issues.
Rowena Financial Services	Normal operation except for the transactions from New Zealand were ceased during lockdown.	No Issues.
KlickEx Trading Limited	No issue.	No Issues.
Manatu 'Ofa Money Transfer	Closedown during lockdown.	Local office in 'Eua was destroyed by TC Harold.
T&T Money Transfer	Closedown during lockdown.	No Issues.
Island Flexi Transfer	No issue as majority of their clients are seasonal workers which were encouraged to use internet banking.	No Issues.
Frank Money Transfer	Closedown during lockdown.	No Issues.
Tonga Post Limited	Shut down operation since lockdown - service was suspended by overseas agent due to the impact of COVID-19.	No Issues.
Jones Travel Limited	Closedown since the ban of international flight arrival.	No Issues.

The impact of COVID-19 from March to May 2020 on the insurance industry in Tonga is minimal as only one insurance company closed down its office to the public and urged the public to use digital channels for inquiries as well as making their payments. The other insurance companies were open but on a half-day basis. Some insurance companies allowed requests from clients to defer premium payments during the lockdown period. However, the performance of Insurance Companies was not affected or changed. In comparison to TC Gita that

hit Tonga in February 2018 with a claim of around \$19 million, the impact of TC Harold in terms of total claims was below \$2.6 million. However, the insurance companies have sufficient liquidity and strong reinsurance cover in place to support the pay out of these claims. The general insurer's total asset as at end of June 2020 was at \$20.4 million and recorded a net loss of \$0.8 million reflecting the impact of claims paid for TC Harold.

*Table 6: COVID-19 Relief Package offered by Retirement Funds & Microfinance*

Retirement Funds	Relief Packages
Retirement Fund Board	\$1,000 cash for each members upon application.
National Retirement Benefit Fund	<ul style="list-style-type: none"> <li>One-month advance payment of elderly people's welfare;</li> <li>Dealing with thousands of laid-off workers and affected businesses in the private sector due to the impact of pandemic to: <ol style="list-style-type: none"> <li>1. Pay their benefit under Redundancy ground;</li> <li>2. Collect their applications for the benefit from Government stimulus packages.</li> </ol> </li> <li>However, around 339 employees from 161 employers has applied and successfully paid their benefit payment from March to June 2020 under financial hardship and redundancy ground due to the impact of COVID19</li> </ul>
South Pacific Business Development (SPBD)	<ul style="list-style-type: none"> <li>One (1) month moratorium for all loan repayment;</li> <li>Offered two new loan product: <ol style="list-style-type: none"> <li>1. Restructure Loan (help extend loan term to 12 months &amp; lower required loan repayment);</li> <li>2. Business Revitalization loan.</li> </ol> </li> </ul>

In terms of de-risking, Tonga continued to face its impact since it emerged in 2016 and continued into 2020. This includes the loss of bank accounts for some of the

foreign exchange money transfer service industry's agents overseas. The annual compliance checks at the end of the year 2019 found that almost half of the foreign exchange dealers were generally non-compliant with the conditions of their license due mainly to their inability to maintain an overseas bank account. However, the Reserve Bank continued to hold technical meetings, training and discussions with foreign exchange dealers to strengthen their Anti-Money Laundering/Counter Terrorist Financing (AML/CFT) compliance status in order for the banks to retain their accounts. Furthermore, the Reserve Bank continued to work closely with other developing partners to look for a direct or indirect solutions to reduce the level of risk in the Pacific region in order to maintain the corresponding bank account.

## Licencing & Supervision of Restricted Foreign Exchange Dealers

*Table 7: Foreign Exchange Dealers by License Type*

License Type	2018/19	2019/20
Type A (Inward and Outward Transfer)	5	10
Type B (Inward Receipts and Local Disbursement Only)	6	2
Type C (Currency Conversion Only)	1	1
<b>Total</b>	<b>12</b>	<b>13</b>

The licensing and supervision of foreign exchange dealers continued under the Foreign Exchange Control (FEC) Act 2018. During the year, there was one (1) new foreign exchange dealer (Toumu'a Money Transfer) that were licensed during this financial year and four (4) license Type A issued to existing foreign exchange dealers with license Type B (Manatu 'Ofa Money Transfer, Frank Money Transfer & Island Flexi Transfer) or operating under a Banking license ('Ave Pa'anga Pau TDB Limited). However, in September 2019 one (1) foreign exchange dealer (Fietokoni Financial Services Limited) voluntarily surrendered its license certificate due to the difficulty in finding an efficient way of sending money from New Zealand to Tonga. During the year, the Reserve Bank considered possible solutions to assist local foreign exchange dealers in sustaining its business. This





*Foreign Exchange Dealers Representatives from various financial institutions after the Foreign Exchange Dealers meeting held by the Financial Institutions department at the National Reserve Bank of Tonga Conference Centre.*

included upgrading three (3) license foreign exchange dealers from Type B to license Type A. This is to facilitate the flow of remittances but at the same time ensuring they still comply with all legal and regulatory requirements especially AML/CFT requirements. Technical meetings, quarterly spot checks, providing training and advisories on the importance of improving and strengthening their Anti-Money laundering/Counter-Terrorist Financing (AML/CFT) compliance status, are conducted by the Reserve Bank to assure the banks to retain the foreign exchange dealer accounts. Furthermore, the Reserve Bank constantly liaised and urged the banks to offer alternative products for de-risking, aiming to reduce the cost of remittances to Tonga.

This then warranted further close monitoring of Foreign Exchange Dealers operations. The Reserve Bank issued over the year, 2 letters of warning under the FEC Act 2018, to unauthorized foreign exchange dealers to immediately cease their operations and apply for a license under the Act or face legal consequences. The Reserve Bank also continues to raise awareness over the year with key stakeholders and the general public on the requirements of the new Foreign Exchange Control Act.

All banks are authorized under their banking license to conduct foreign exchange business. BSP continued to hold agency arrangements with MoneyGram, while MBF no longer holds arrangements with MoneyGram. TDB

continues to offer its 'Ave Pa'anga Pau (product) as another platform for receiving and sending remittances.

Ongoing quarterly spot checks, training of the authorized foreign exchange dealers, stakeholder and quarterly meetings when required will be contribute to improving the understanding and compliance of the licensed non-bank financial institutions.

### **Financial System's Corporate Plan Targets**

The Financial System department including banks and non-bank supervision committed to 23 targets in the 2019 corporate plan in which 22 were successfully achieved. During the review of the 2019 corporate plan, targets were removed and revised, and new targets were added to guide the department in delivering its expected output. This resulted in a total of 29 targets for 2020.

### **Payment System**

The Reserve Bank continued to explore ways to improve the efficiency and sound functioning of the payment system. Meanwhile, the manual settlement system, involving the inter-bank cheque clearance, and inter-bank transfer that is conducted by the Settlement Unit on a daily basis is operating well.

During the year, the Reserve Bank monitored the developments in the payment systems and the software development agreement that was signed with KlickEx. Phase one of the project was completed and the software is currently being tested on the 2 modules the

Automated Transfer System and the Real Time Gross Settlement modules. Part of Phase Two of the project also commenced with the training of Reserve Bank and the Commercial Banks staffs and their comments are being incorporated into the draft manuals. Phase Three to Phase Five will be prioritised to the 2020-2021 financial year.

## Interbank Cheques Clearance

The Reserve Bank facilitates a daily cheque clearance service for the commercial banks to ensure a safe and efficient clearing system in Tonga. The commercial banks in Tonga signed an interbank clearing agreement to guide them in ensuring all cheques are cleared in a timely manner, and to be reviewed as and when required. A total of 145,821 cheques were presented for clearance at the Reserve Bank during the financial year 2019/2020, a decrease of 4.5% from the previous year. The decrease in the number of cheques presented for clearance was driven by the wider usage of electronic payment system such as internet banking and EFTPOS machine in Tonga. The clearance of cheques in the centre was running well and all participants were committed to settle their dues on time.

## Settlement Corporate Plan Targets

During the year, Settlement Unit participated in the review of the 2020 Corporate Plan. The Unit was assigned 22 measurable targets for the calendar year 2019 which were all achieved. The measurable targets were related to promoting an efficient settlement and secured payments system, and the modernization of the operations of the Reserve Bank.

## Access to Finance

### Financial Inclusion Initiatives

The Reserve Bank continues to encourage financial inclusion to promote inclusive economic growth and macroeconomic stability through the financial inclusion's key objectives in enhancing and monitoring the access and usage of financial products by individuals and small and medium enterprises.

#### Access Indicators slightly fall over the year

Over the year ended June 2020, the number of cash in and cash out indicators showed a slight decline compared to the same period of last year. The cash in and cash out indicators consists of banks and non-bank branches and agents, banks EFTPOS and ATMs. The slight decline in the cash in and cash out facilities was mainly due to the fall in the number of banks' EFTPOS

terminals (refer to **Table 8**).

Table 8: Access Point per 10,000 adults – Banks & Non-Banks

Access Indicators	2020	2019 <sup>1</sup>	2018	2015 <sup>2</sup>
1.0 Number of cash-in and cash-out access points per 10,000 adults <sup>3</sup>	151	152	95	32
1.1 Number of branches per 10,000 adults	11	11	3	2
1.2 Number of ATMs per 10,000 adults	4	4	4	1
1.3 Number of EFTPOS per 10,000 adults	84	86	84	26
1.4 Number of Agents per 10,000 adults	52	51	4	3

Source: Banks & Non-Banks, National Reserve Bank of Tonga

In terms of access to finance by constituency, the total number of access points declined owing mainly to a fall in the total number of EFTPOS terminals, particularly in Vava'u 15 and Tongatapu 1. These two EFTPOS terminals were recalled from inactive merchants in these constituencies to minimize operational cost for both the bank and the inactive merchants. The inactive status of these merchants is related to the impact of COVID-19 and the fall in aggregate demand especially with businesses in these two constituencies, as they are considered Central Business Districts (Nuku'alofa and Neiafu). Despite the decline in the number of EFTPOS terminal, the number of branches and agents increased (refer to **Table 9**). The rise in the number of agents reflected the banks efforts to achieve their corporate targets on increasing their footprint in remote and rural areas.

In **Table 10**, the number of Non-Banks access points slightly increased. The rise in the number of branches reflected the entrance of a new foreign exchange dealer into the market who also opened access points in the outer islands. SPBD remained the Non-Bank financial institution with the highest access points compared to other non-banks financial institutions over the year. This is consistent with the ongoing activities and services carried out by SPBD to their members in all the islands except the two Niuas.

<sup>1</sup> Commencement collecting Non-Banks data

<sup>2</sup> Tonga's financial inclusion benchmark

<sup>3</sup> Total access points including Non-Bank access points



Table 9: Summary of Banks & Non-Banks Access Points in Tonga by Constituency

Constituency	June 20					June 19 <sup>4</sup>				
	Total Access Points	No. of Branches	No. of Agents	No. of EFTPOS	No. ATMs	Total Access Points	No. of Branches	No. of Agents <sup>5</sup>	No. of EFTPOS	No. ATMs
Tongatapu 1	59	1	22	34	2	65	1	18	44	2
Tongatapu 2	206	22	24	147	13	192	21	23	139	9
Tongatapu 3	54	1	15	37	1	55	1	15	35	4
Tongatapu 4	214	4	22	184	4	204	4	22	173	5
Tongatapu 5	40	2	24	14	0	36	1	24	11	0
Tongatapu 6	37	1	33	3	0	37	1	29	7	0
Tongatapu 7	36	1	23	12	0	39	1	23	14	1
Tongatapu 8	38	0	24	14	0	39	1	21	17	0
Tongatapu 9	45	6	21	17	1	51	4	25	21	1
Tongatapu 10	34	0	31	3	0	31	2	27	2	0
'Eua 11	37	8	23	5	1	39	9	25	4	1
Ha'apai 12	28	9	7	11	1	31	9	8	13	1
Ha'apai 13	17	0	15	2	0	15	0	15	0	0
Vava'u 14	17	0	17	0	0	23	0	20	3	0
Vava'u 15	85	13	14	54	4	98	12	17	65	4
Vava'u 16	16	0	15	1	0	18	0	16	2	0
Ongo Niuas 17	7	5	2	0	0	4	4	0	0	0
<b>TOTAL</b>	<b>969</b>	<b>73</b>	<b>332</b>	<b>537</b>	<b>27</b>	<b>977</b>	<b>71</b>	<b>328</b>	<b>550</b>	<b>28</b>

Source: Banks

Table 10: Non-Banks' Access Points in Tonga by Constituency

Constituency	June 20				June 19			
	Total Access Points	No. of Branches	No. of Agents	No. of SPBD Village Centers	Total Access Points	No. of Branches	No. of Agents	No. of SPBD Village Centers
Tongatapu 1	17	1	0	16	1	1	0	16
Tongatapu 2	39	18	0	21	17	17	0	21
Tongatapu 3	16	1	0	15	1	1	0	15
Tongatapu 4	25	3	0	22	3	3	0	22
Tongatapu 5	25	2	2	21	3	1	2	21
Tongatapu 6	28	0	1	27	1	0	1	27
Tongatapu 7	21	1	0	20	1	1	0	20
Tongatapu 8	18	0	0	18	1	1	0	18
Tongatapu 9	24	4	0	20	2	2	0	20
Tongatapu 10	25	0	1	24	3	2	1	24
'Eua 11	30	6	0	24	7	7	0	24
Ha'apai 12	14	7	0	7	7	7	0	7
Ha'apai 13	14	0	3	11	3	0	3	11
Vava'u 14	19	0	0	19	0	0	0	19
Vava'u 15	24	9	1	14	9	8	1	14
Vava'u 16	16	0	0	16	0	0	0	16
Ongo Niuas 17	3	3	0	0	2	2	0	0
<b>TOTAL</b>	<b>358</b>	<b>55</b>	<b>8</b>	<b>295</b>	<b>356</b>	<b>53</b>	<b>8</b>	<b>295</b>

Source: Non-Banks – Foreign Exchange Dealers | Insurance | South Pacific Business Development

<sup>4</sup> Commence collecting Non-Banks access points

<sup>5</sup> Including SPBD Village Centres

## Usage indicators showed an increase

The usage indicators showed an increase over the year. This is mainly due to the rise in both the total number of individual deposit and individual loan accounts (*refer to Table 11*). Bank customers mainly drove the increase, with customers preferring direct deposits of remittances to their bank account to access the ATMs or EFTPOS machines. This preference may also be driven by the COVID-19 social distancing requirements. Furthermore, new customer's accounts were opened to receive government financial assistance through the COVID-19 Economic Stimulus package. Of the total number of individual's deposit accounts as of June 2020 (89,247 accounts) 57% of which are accounts belonging to male. The bulk of the individual deposit accounts are with BSP (46%) followed by MBf bank (25%). Also, the rise in the total individual number of loan accounts was due to one of the banks' loan campaign called "Toutai Campaign". This loan campaign offered customers a 50% discount on the loan establishment fees.

Table 11: Usage of financial services indicators - Banks

Indicators	2020	2019	2016 <sup>6</sup>	2015 <sup>7</sup>
Number of regulated deposit accounts per 10,000 adults	13,928	13,353	10,916	5,604
Number of regulated credit accounts per 10,000 adults	1,342	1,258	1,588	521

Source: Non-Banks, National Reserve Bank of Tonga

## Local Money Transfer Report

Local Money Transfer refers to money that is sent or transferred by the Money Transfer Operators (MTOs) to another party within Tonga. This financial service enables payments and receipts between individuals as well as facilitate business and trading between Tongatapu and the outer islands including the Ongo Niuas and vice versa. There are 3 MTOs currently providing this local money transfer services, namely Fexco, S.A.V Transfer, and Island Flexi Transfer. Over the year ended June 2020, the local (inward/outward) money transfers fell by T\$0.7 million (by 63%) compared to June 2019 (*refer Table 12*). The decline in the local transfer was mainly due to a fall in family support, gifts transfer and local kava export proceeds. The significant decline in local transfer particularly for family supports and gifts reflects the impact of COVID19, where social distancing rules cancelled majority of normal traditional events that are

usually held during the year. In addition, the fall in the price of kava in the domestic market due to excess supply of kava as well as low demand for kava due to the COVID19 night curfews.

Tongatapu, Vava'u and Ha'apai were the major contributors to the decline in the local inward transfer while Tongatapu and Vava'u are the major contributors to the decline in local outward transfer (*refer Table 13*). Tongatapu remained the main driver of outward transfer while Vava'u have the highest share in inward transfer reflecting the continuous payments for family support, gifts and kava. Local outward transfer from all islands declined over the year particularly outward transfers from Tongatapu to the outer islands. The COVID-19 restrictions and its impact on businesses, employment and individual incomes in Tongatapu may have contributed to the fall in outward transfers.

## Micro, Small and Medium Enterprises (MSMEs) Report

The enhancing of access to finance for MSMEs play an important role in job creation and promotion of exports and investment which supports inclusive economic growth. Over the year ended June 2020, the MSMEs outstanding loans fell by \$3.0 million (11%) to T\$25.4 million. This was mainly due to a decline in outstanding loans to other services, agriculture and tourism sector (*refer Table 14*). The decline was predominantly driven by the fall in the MSMEs outstanding loan for banks outweighing the rise in the MSMEs outstanding loan for Non-Banks financial institutions. The decline in MSMEs outstanding loans reflected the impact of the COVID19 pandemic. One of the side effects of COVID-19 is the fall in aggregate demand due to cancelled events may have impacted the MSMEs sectors ability to borrow. Tongatapu 2 (Kolofo'ou etc.) constituent is the main contributor to the decline in the total MSMEs outstanding loan balance mainly in the agriculture and other service loan sector. Similarly, Vava'u 15 (Neiafu etc.) drove the decline in the total MSMEs outstanding loan balance for the manufacturing sector. These loans are mainly to the women making handicrafts and due to the border closure and its impact on the tourism sector, this market is close to becoming non-existent.

On the other hand, the number of MSMEs loans, rose by 341 (16%) to 2,467 MSMEs owing to a significant increase in the number of MSMEs for manufacturing, wholesale, retail and agriculture sector (*refer Table 14*). The increase in the number of MSME loans was attributed to loans extended by Non-Banks Financial

<sup>6</sup> Adult population (15 years old +) - 64,076 - Census Report 2016

<sup>7</sup> Tonga's financial inclusion benchmark

Institutions reflecting their COVID-19 and TC Harold relief packages. Loans by Banks to MSMEs fell at the end of 2019/20. The main bulk of the number of MSME loans is in the agriculture sector and mainly to men, this

is due to land being used as collateral for agriculture loans. In contrast, the rise in the number of loans to the manufacturing sector was driven by female owned MSMEs particularly for weaving mats and handicrafts.

Table 12: Summary of Local Inward Transfer

Local Inward Transfers To	Local Inward Transfers (T\$m)		YoY Change (T\$m)	YoY Change (%)	Contribution to June 2020 (%)
	June 2020	June 2019	June 2020		
Tongatapu	0.1	0.4	-0.25	-67.0	27.9
Vava'u	0.2	0.5	-0.29	-61.7	40.5
Ha'apai	0.1	0.2	-0.13	-60.1	19.0
'Eua	0.0	0.1	-0.07	-57.6	11.2
Niutoputapu	0.0	0.0	-0.01	-54.2	1.2
Niuafo'ou	0.0	0.0	0.00	-66.8	0.3
Total Inwards	0.4	1.2	-0.74	-62.6	100.0
Source: Non-Banks Department, National Reserve Bank of Tonga					

Source: Non-Banks Department, National Reserve Bank of Tonga

Table 13: Summary of Local Outward Transfer

Table 10: Summary of Local Outward Transfers					
Local Outward Transfers To	Local Outward Transfers (T\$m)		YoY Change (T\$m)	YoY Change (%)	Contribution to June 2020 (%)
	June 2020	June 2019	June 2020		
Tongatapu	0.3	0.8	-0.46	-60.4	68.5
Vava'u	0.1	0.2	-0.14	-72.1	12.1
Ha'apai	0.1	0.1	-0.07	-56.3	12.1
'Eua	0.0	0.1	-0.06	-65.2	6.8
Niutoputapu	0.0	0.0	-0.01	-89.7	0.3
Niuafo'ou	0.0	0.0	0.00	-77.5	0.3
Total Outwards	0.4	1.2	-0.74	-62.6	100.0
Source: Non-Banks Department, National Reserve Bank of Tonga					

Source: Non-Banks Department, National Reserve Bank of Tonga

Table 14: Banks & Non-Banks MSMEs Sector Growth

Type of Sectors	June 2020		June 2019		Change over the year			
	No. of MSMEs	MSMEs Outstanding Balance (T\$m)	No. of MSMEs	MSMEs Outstanding Balance (T\$m)	No. of MSMEs		MSMEs Outstanding Balance	
					Change	% Change	Change (T\$m)	% Change
<b>Overall Total</b>	<b>2,467</b>	<b>25.4</b>	<b>2,126</b>	<b>28.4</b>	<b>341</b>	<b>16.0%</b>	<b>(3.0)</b>	<b>-10.6%</b>
Agriculture	1,137	8.4	1,082	10.3	55	5.1%	-1.8	-17.6%
Construction	17	0.6	16	1.2	1	6.3%	-0.6	-52.2%
Fisheries	121	1.8	108	2.2	13	12.0%	-0.3	-16.1%
Forestry	4	0.02	2	0.01	2	100.0%	0.01	102.7%
Manufacturing	881	6.7	682	5.4	199	29.2%	1.3	25.1%
Other services	65	1.5	66	4.1	-1	-1.5%	-2.6	-63.2%
Tourism	26	1.7	36	2.6	-10	-27.8%	-0.9	-34.0%
Transport	38	0.9	29	0.6	9	31.0%	0.3	59.2%
Wholesale/Retail	178	3.7	105	2.2	73	69.5%	1.5	69.4%

Source: Banks & Non-Banks Department, National Reserve Bank of Tonga





*Representatives from the Alliance for Financial Inclusion (AFI) during the AFI Pacific Island Regional Initiative (PIRI) Regulatory Sandbox Roadshow Day 1, together with staff from relevant departments of the National Reserve Bank of Tonga.*

The increase in the number of MSMEs in the wholesale retail sector was led by Non-Banks loans for retail stores and flea market goods. Tongatapu 10 (Lapaha, etc.) and 'Eua 11 constituencies were the major contributors to the increase in the number of MSMEs loan particularly the agriculture sector.

### AFI Membership

The Reserve Bank continues to participate in the Alliance for Financial Inclusion (AFI) meeting and projects through its AFI membership. During the year, the National Reserve Bank of Tonga together with AFI and the Pacific Islands Regional Initiatives (PIRI) which comprises of Central Banks of the Pacific Islands, established a regional regulatory sandbox. The regulatory sandbox will provide a framework that can set a safe playground for Fintechs to test their products without compromising the stability and safety of the financial system and customers. The Reserve Bank and AFI also co-hosted a roadshow where relevant stakeholders met to discuss the regulatory sandbox and its importance in the region. However, due to the COVID19 pandemic, the implementation of the sandbox has been deferred to next year.

Moreover, the Reserve Bank also participated in the

AFI Global Policy Forum that was held in Rwanda in September 2019. At the global forum, the use of technology for the inclusion of women and youth was discussed and how to leverage the technology for women and youth in order for them to become more financially inclusive. During the second half of 2019/20, all AFI Working Group related meetings and training including the PIRI meetings were conducted through virtual webinar as COVID-19 pandemic emerged.

### Financial Access Corporate Plan Targets

The Financial Inclusion department committed to 9 targets in the 2019 corporate plan in which all were successfully achieved. However early this year, the corporate plan was then reviewed, targets were revised and new targets were added to better guide the department in delivering its expected output. A total of 11 targets were approved in the 2020 corporate plan which the department is currently working towards achieving them. These targets include conducting annual stocktake of all financial products available in Tonga and reviewing commercial bank's fees and charges. In addition, the department is also working on developing a national financial inclusion strategy to assist in driving the financial inclusion in Tonga as well as providing a public awareness program.

*Representatives from the Alliance for Financial Inclusion (AFI) during the AFI Pacific Island Regional Initiative (PIRI) Regulatory Sandbox Roadshow Day 2, together with relevant local stakeholders.*





## Financial Intelligence Unit

The Reserve Bank is the Transaction Reporting Authority (TRA) under the Money Laundering and Proceeds of Crime (MLPC) Act. The TRA's functions ensure the financial system is protected from money laundering and terrorist financing activities. This in turn enables the Reserve Bank to meet its objective of promoting a safe and sound financial system. The key focus of the unit during the year was on coordinating Tonga's Mutual Evaluation by the Asia/ Pacific Group on Money Laundering.

## Supervision & Compliance

In August 2019, a delegation from Tonga was headed by Deputy Governor attended the APG Annual Meeting held in Canberra, Australia. During the folds of the annual meeting, Tonga also signed 2 Memorandum of Understandings with FIUs of Bangladesh and Taiwan. At Tonga's Technical Assistance and Training Forum, donors like Asia Development Bank (ADB) and United Nations Office on Drugs and Crimes (UNODC) were identified to assist in the country's areas of needs towards the development of its AML/CFT framework. Particularly with drafting of necessary legislative amendments and capacity building and training of operational law enforcement staff. Following the annual meeting, members of the Working Group, such as Tonga Police, Ministry of Customs and Revenue and Attorney General's Office, were encouraged to initiate contact with these interested donors and to take up this development opportunity.

As Tonga progressed with its efforts and preparation for its Mutual Evaluation, a briefing was provided to the Chairman of the Cabinet Committee on Serious Financial Crimes, the Honourable Minister of Finance, for his awareness in September 2019. A submission on

these efforts was also brought to the attention of the Cabinet. Tonga's National Risk Assessment report as well as the National AML/CFT Strategy was included in this submission for the Cabinet's endorsement.

Efforts were also combined in completing Tonga's first National AML/CFT Risk Assessment that was initiated in 2015. A draft report was disseminated to the private sector for their comments in October 2019 followed by consultation sessions held to provide an opportunity for these entities to share their understanding of the risks and to get their agreement on the risk ratings reflected in the findings of the NRA report. There was general consensus to the findings of the report which was the basis for its finalisation. The report is still being updated and formatted for publication before end of 2020.

Tonga received its team of assessors for the Mutual Evaluation onsite on 22nd October – 1st November 2019. The two weeks onsite comprised of meetings with law enforcement agencies and relevant Ministries, on the country's efforts and practices towards AML/CFT and PF. There were also meetings held with representatives from the private sector, which provided a perspective into Tonga's AML/CFT risk areas as well as the measures and processes in place to mitigate those risks. The key findings report highlighted the areas of needs for Tonga to focus on as high priority which includes necessary legislative amendments as well as developing a framework for proliferation financing. During the interval of the Mutual Evaluation onsite, the Cabinet endorsed Tonga's National AML/CFT Risk Assessment Report as well as the country's first National AML/CFT Strategy on 25th October 2019.

In January 2020, Tonga provided its response to the first draft of its ME report. Tonga was expected to have its face-to-face meeting with the assessors in late March

*Representatives from the National Reserve Bank of Tonga, with assessors from the Asia Pacific Group on Money Laundering, as well as representatives from local Ministries on the opening of Tonga's Mutual Evaluation onsite.*





2020 to further discuss the first draft report. However, due to the COVID-19 pandemic, the meeting has been deferred until further notice. The APG announced in March 2020 the cancellation of its Annual Meeting that was to be held in Bangladesh in July 2020. Tonga's ME report was planned to be tabled at this meeting for the plenary's discussion.

The Working Group met several times during the year to review and update Tonga's ME draft reports due on 25th March 2020. The Mutual Evaluation process for Tonga has been put on hold until the COVID-19 situation is resolved. The Working Group members were encouraged to continue with the review of Tonga's 2nd draft report and to note any concerns they would want raised with assessors once the process resumes.

In collaboration with the Financial System Division, compliance visits were conducted to one bank and all licensed and registered foreign exchange dealers during the year as part of the unit's compliance review process. The results of these compliance visit informs the FIU's risk based approach supervision process.

## Reports & Statistics

### Number of reports received

The FIU received 39 STRs from the banks and foreign exchange dealers during the year, increased by 16 reports from the previous year. However, total BCRs decreased this year to 63 reports filed by the Ministry of Revenue & Customs due to the current COVID-19 flight diversions. Also, the number of CTRs decrease from the previous year totalling to 12,944 reports filed from reporting entities this year. The FIU retains the information obtained in these reports to assist in its financial intelligence analysis function.

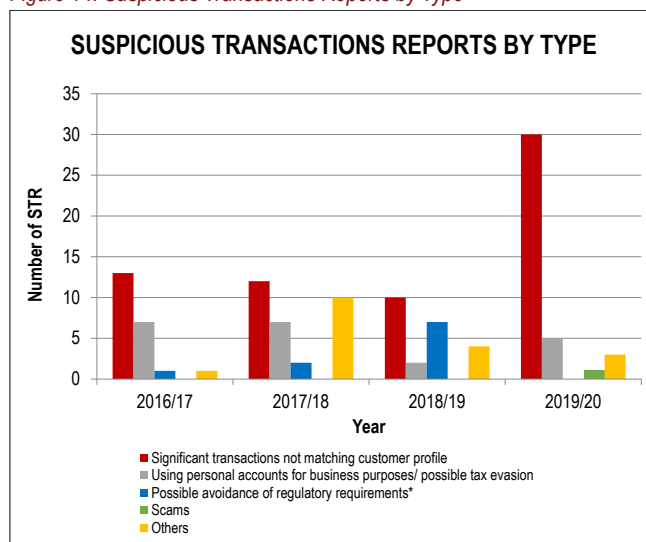
Table 15: Number of reports received

Types of reports filed	2017/18	2018/19	2019/20
Suspicious Transaction Reports (STRs)	31	23	39
Currency Transaction Reports (CTRs)	10,892	14,068	12,944
Border Currency Reports (BCRs)	108	97	63

## Reports analysis & Information sharing

### STR Analysis

Figure 14: Suspicious Transactions Reports by Type



The dominant STR indicator continued to be significant transactions that were inconsistent with the customer's known background followed by reports related to possible tax evasion. The remaining STRs were related to several indicators such as transactions of adverse media reported persons, third party transactions and atypical business transaction. Few reports filed were also related to possible avoidance of regulatory requirements such as structuring of transactions and possible avoidance of Exchange Control related requirements.

*Representatives from the National Reserve Bank of Tonga, with assessors from the Asia Pacific Group on Money Laundering, as well as representatives from local Ministries on the conclusion of Tonga's Mutual Evaluation onsite.*



### Number of STRs disseminated

Following the analysis of the 39 STRs received, 32 reports were disseminated to law enforcement agencies for further investigations. 27 of those reports were disseminated to the Ministry of Revenue & Customs for possible contravention of tax related requirements. 5 reports were passed to Police for further investigation of possible serious offences. 1 report was referred back to the reporting entity to complete further due diligence checks. The remaining 6 reports were retained with the FIU due to lack of suspicious indicators.

Table 16: Number of STRs disseminated

Law Enforcement Agencies	2017/18	2018/19	2019/20
Ministry of Police	7	7	5
Ministry of Revenue & Customs	14	7	27
Ministry of Foreign Affairs (Immigration)	1	0	0
MCCTIL	3	0	0
Other <sup>8</sup>		11	7

### CTR Data Analysis

Table 17: CTR data analysis

	2017/18 (TOP\$M)	2018/19 (TOP\$M)	2019/20 (TOP\$M)
Movement of transactions			
Inwards	183.4	243.2	234.0
Outwards	84.8	139.2	118.0
Purpose of transactions			
Business	144.4	250.9	229.0
Personal	123.8	131.5	122.5
Transaction type			
TT	28.9	34.7	26.16
Cash	132.8	163.4	156.3
Cheque	54.9	103	109.3
Other <sup>9</sup>	38.2	55.4	34.8
Cash/ Cheque	13.4	25.9	25.2

From the 12,944 reports received this year, majority of the report volume were for inward transactions which are classified into cash, cheque, telegraphic transfers and other deposits. Similar to the previous year, majority of the transactions reported were for business purposes. Cash continued to be the dominant type of transaction reported over the year followed by the use of cheques and TTs.

<sup>8</sup> Reports referred back to the reporting entity

<sup>9</sup> Other type of transactions includes transfer between accounts, exchange of currency and other type of payment not specified above

### BCR Data Analysis

The FIU received 63 BCRs this year filed from the Ministry of Revenue & Customs. Majority of the reports were for outbound funds across the border. The shipments of currencies for currency conversion companies and commercial banks are the most common type of outbound funds reported. Outbound funds for these entities have received prior approval of the Reserve Bank before transporting them across the border. Similar to the previous years, very few reports were received for outbound individual travellers. Some of these reports were for individual travellers with no proper approval in place. These funds were confiscated by the border officials prior to their travel. Inbound funds carried across the border were mostly for individual travellers returning or visiting Tonga.

The FIU responded to 29 requests for information submitted by the Ministry of Revenue & Customs, Tonga Police and the Attorney General's Office in relation to subjects previously referred for further investigation as well as subjects that are under investigations for possible tax and/or drugs offences. The FIU also responded to 1 request for information from the FIU of New Zealand on investigations relating to illicit funds generated from methamphetamine crimes in New Zealand that may have been laundered through Tonga.

Table 18: BCR data analysis

	2017/18 (TOP\$M)	2018/19 (TOP\$M)	2019/20 (TOP\$M)
Movement of transactions			
Inwards	0.8	1.0	0.7
Outwards	42.3	43.4	42.2
Purpose of transactions			
Business	42.0	43.5	42.6
Personal	1.1	0.9	0.3

### Internal Operations

During the year, the FIU also conducted background checks on more than 250 individuals and entities for: Exchange Control applicants/ suppliers; new NRBT clients; as well as bank and non-bank financial institutions licenses applicants. The FIU also responded to surveys from the NRBT's correspondent banks on the NRBT AML/CFT procedures. The FIU contributes to the first strategic priority of the bank in setting a platform for Tonga becoming a high growth economy through the prevention of money laundering.

## FIU Corporate Plan Targets

For 2019/20, the FIU had a total of 20 targets to achieve. The FIU's targets are aimed at effective supervision of reporting entities, ensuring a well-informed regime and to comply with global AML/CFT related requirements. The FIU contributes to the first strategic priority of the bank in setting a platform for Tonga becoming a high growth economy through the prevention of money laundering.



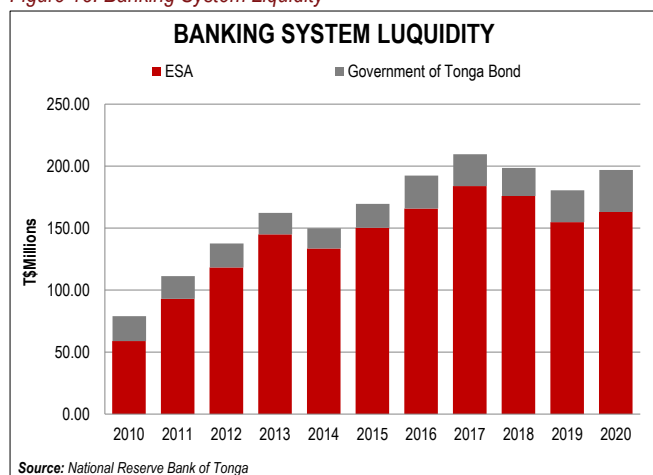
# Financial Markets Operations

## Domestic Market Operations

The Reserve Bank's accommodative monetary policy stance continued during the financial year 2019/2020. Therefore, the Reserve Bank did not issue any Reserve Bank notes as it continued to encourage banks to use the excess liquidity in the banking system for lending to support economic growth.

As of the 30 June 2020, the banking system liquidity rose to \$196.9 million from \$180.4 million at the end of June 2019. The banking system liquidity comprised mainly of \$163.0 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$33.9 million of Government of Tonga Bonds held by the banks. The increase in liquidity was in line with the higher foreign reserves and government bonds held by the banks.

Figure 15: Banking System Liquidity



The Financial Markets Department continued to review its current measures of Banks' precautionary demand to better reflect the excess liquidity in the banking system. In this regard, the Reserve Bank will continue to explore ways to reduce the excess liquidity in the system to improve its monetary policy transmission mechanism. Due to the excess liquidity in the banking system, there was no activity in the inter-bank market. Similarly, there were no applications for repurchase agreements during the year.

The Reserve Bank is also exploring options to develop the domestic market operations to be more market oriented. Amendments to the NRBT Act approved

in February 2017 allows the utilization of the excess balance in the Revaluation Reserve Account, above \$10 million, to cover the Reserve Bank's monetary policy costs. This enhances the Reserve Bank's ability to issue NRBT notes to implement the monetary policy and thereby develop the domestic market. This amendment also allowed the excess balance in the Revaluation Reserve Account to be paid to the Government upon the request of its Minister and as approved by the Reserve Bank Board. As such \$5 million was transferred from the Revaluation Reserve Account to the Ministry of Finance to assist with COVID-19 preparations in March 2020 and \$1.5 million was transferred in May 2020 to the NRBT suspense account to assist with the Reserve Bank's development budgets.

## Foreign Exchange Operations

The Reserve Bank determines the rate at which the Tongan pa'anga is exchanged for foreign currencies on a daily basis by reference to a weighted basket of currencies of Tonga's major partners in foreign trade and foreign receipts and payments transactions. The exchange rates set on a daily basis generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates.

The Reserve Bank reviewed the basket of currencies during the year in accordance with the latest trend in bilateral trades with our major trading partners. As a result, there were no change to the weights of the currencies in the basket due to the uncertain market condition that the world is currently facing.

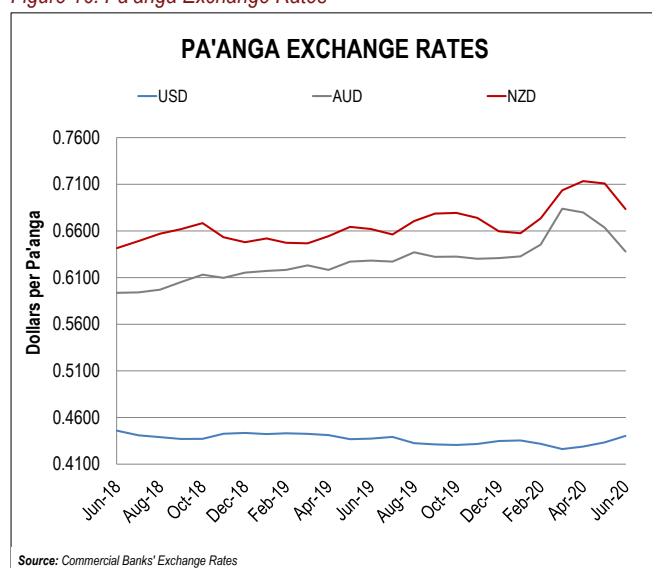
The Reserve Bank monitored the movement of the rate of exchange of the pa'anga against other currencies with a view to ensure that the country's balance of payments position and price stability are maintained at levels that are consistent with the achievement of macroeconomic stability. However, should pressure on the foreign reserves emerge, the Reserve Bank stands ready to re-evaluate the Pa'anga against the basket of currencies in order to safeguard external stability.

Over the year ended June 2020, Tongan pa'anga fluctuated against the Australian dollar (AUD) & New Zealand dollar (NZD) in wider bands, compared to



last year reflecting increased volatility in the AUD & NZD while TOP fluctuated against the US dollar (USD) in a narrower band compared to last year reflecting decreased volatility in the USD during the year. The USD strengthened against the NZD and AUD mainly on safe have demands amidst coronavirus concerns and uncertainties caused by the US-China trade tensions. The AUD and the NZD depreciated on the strong USD and also due to relatively weaker economic prospects in the respective countries. As such, the USD appreciated while the AUD & NZD depreciated against the TOP over 2019/20.

Figure 16: Pa'anga Exchange Rates



The Reserve Bank also continued to monitor the commercial banks' exchange rates spreads to ensure that they were in compliance with approved limits that were set by the Reserve Bank. Despite the introduction of the levy on foreign exchange transactions in June 2016, the spread limits were not revised. The Reserve Bank in collaboration with the Association of Banks in Tonga (ABT) also directed the banks not to pass on the levy burden to customers through an additional fee. These directives meant that the banks would absorb the levy burden within their own profit margin instead of passing it to the public. The Reserve Bank paid T\$0.9 million in levy tax to the Ministry of Finance during 2019/20.

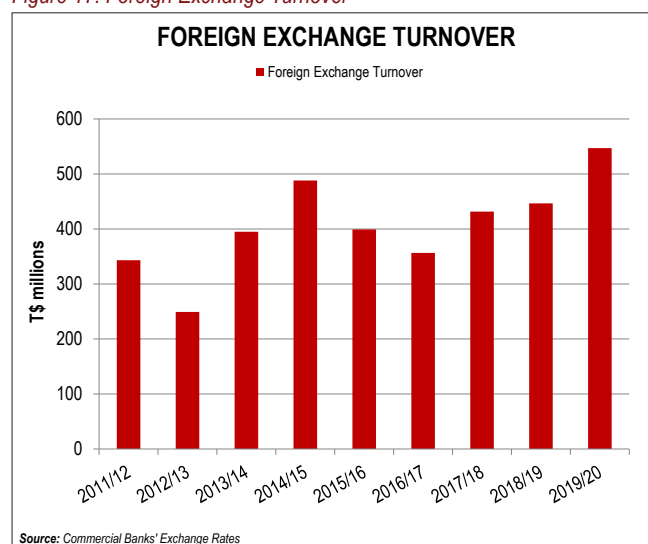
The Reserve Bank also continued to publish financial information, such as comparisons of financial institutions' daily and weekly exchange rates and fees related to foreign exchange transactions, in its efforts to assist the public with their financial decisions.

## Foreign Reserves Management

### The Reserve Bank Portfolio

The gross official foreign reserves was maintained well above the minimum 3 months of import cover. The level of foreign reserves peaked at a record high of T\$543.8 million on 30th June 2020, equivalent to 8.2 months of import cover compared to T\$484.3 million (7.9 months of import cover) as at 30th June 2019. The significant increase in the level of foreign reserves was attributed mainly to receipts of remittances, government budget support and project funds and relief grants for Cyclone Harold and Covid19. The Reserve Bank continues to monitor the banks' compliance with their respective nostro limits and that excess foreign exchange is sold to the Reserve Bank, one of the foreign reserves management tools to ensure an adequate level of foreign reserves is maintained.

Figure 17: Foreign Exchange Turnover



During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$303.2 million exceeded sales of T\$243.8 million giving a total foreign exchange turnover for the year of T\$547.0 million. This is an increase from T\$446.6 million last year due mainly to an increase in the volume of foreign exchange transactions. The Reserve Bank conducted foreign exchange operations for its customers and for its own account in a range of currencies.

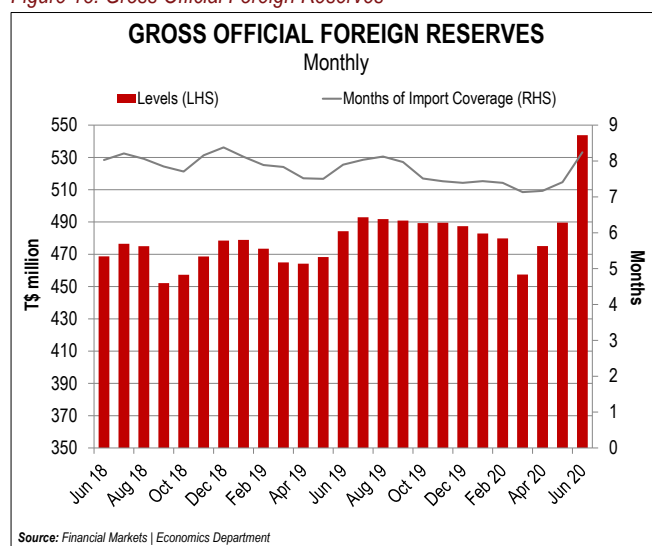
The management of the foreign reserves met the objectives of safety, liquidity and profitability. The currency composition of the foreign reserves was mainly in US dollars, Australian and the New Zealand dollars.

The Reserve Bank's investment policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value which continued



to be a challenge, given the uncertainty and volatility in the global financial markets and continued low interest rates in the trading partner countries. The currency composition therefore, deviated from the benchmark portfolio but remained within the Board approved limit, in order to maximize income and maintain the value of the foreign reserves. The currency composition exposes the Bank to exchange rate and interest rate risk. However, the Reserve Bank continued to closely monitor the implications of the movements of the exchange rates on the value of the foreign reserves. Despite the significant increase in the level of foreign reserves by \$60 million over the year, income on the investment of the foreign reserves decreased by \$1.2 million compared with the previous year which is in line with the lower interest rates in the global markets.

Figure 18: Gross Official Foreign Reserves



The Reserve Bank continued to comply with the new Reserve Management Policy which came into effect in August 2018 during the year except for Rabobank's total holdings which was above the bank limit for banks with A to A+ ratings. This breach was due mainly due to the movements in the exchange rates and was regularised in July 2020. Investments were held with banks rated above the Board approved minimum "A" rating by international credit rating agencies and minimizing concentration of investments in one bank.

## Exchange Control Operations

The Reserve Bank continued to implement the requirements of the new Foreign Exchange Control Act 2018 that was enacted in June 2018, by ensuring compliance with the Exchange Control Directive which became effective on 1st November 2018. The Reserve Bank continued to remove all requirements to provide tax clearance certificates for payments that was effective

in July 2017. This was to clarify to the banks, authorized restricted foreign exchange dealers and the general public that tax clearance requirements for outward payments are imposed and monitored by the Ministry of Revenue & Customs. Given the high level of foreign reserves, the outlook for the foreign reserves to remain at comfortable levels and the current monetary policy stance, the Reserve Bank did not introduce any new restrictions on the Exchange Control Requirements in 2019/20.

As such, the Reserve Bank processed 773 exchange control applications for current and capital payments. This included 236 applications of amounts below the delegated limit of \$100,000 mostly for customers referred to the Reserve Bank for further monitoring who were non-compliant with the exchange control requirements. The approved exchange control applications amounted to T\$266.5 million in 2019/20 (of which 13.5% were classified as capital transactions) compared to the 1005 exchange control applications (of which 14.1% were capital transactions) processed in 2018/19 amounting to T\$300.1 million. The target for a half day turnaround time for processing and approval of applications were mostly achieved, delays in approvals were mainly due to incomplete or supporting documents that did not meet all the requirements. The exchange control data on foreign currency payments by large customers including the Government, large importers particularly for oil and dairy products importers and offshore investment customers were key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions. Furthermore, the exchange control requirement for supporting documents ensures the payments are genuine transactions.

The Reserve Bank also processed and approved 58 applications for the removal of cash (both Tongan pa'anga and foreign currency notes totalling T\$10,000 and above) across the border which amounted to a total of T\$45.2 million. This was a decrease in applications and volume from the 95 applications that were processed and approved last year, totalling T\$67.2 million. The significant decline in the number of applications was directly impacted by the lock-down of borders due to the COVID-19 pandemic. The approval for removal of cash is subject to the banks and authorized restricted foreign exchange dealers repatriating these proceeds from the sale of foreign currency notes within a month of the application. The exchange control unit also notified the Ministry of Revenue and Customs of all approved applications for exports of cash, two (2) days

before the date of travel, with some exceptions due to late submission of applications from banks, authorized restricted foreign exchange dealers, and individual applicants.

Quarterly and monthly spot checks were conducted during the year to ensure banks and authorized restricted foreign exchange dealers were compliant with the exchange control directive. Internal monitoring of compliance is also carried out through other reports such as the Overseas Exchange Transactions (OET), Foreign exchange transactions with value that is equivalent to T\$50,000 and above (FX above 50K), Forward exchange contracts (FEC) and the Foreign currency accounts (FCA). Press releases were posted on the website, and the Reserve Bank provided awareness training for the banks and authorized restricted foreign exchange dealers to keep them informed of the revision to the exchange control directive and to also raise issues identified from the spot checks. The Reserve Bank continued to issue the Gift list for those who have reached delegated limit of T\$50,000 and a Caution list for those who had nearly exhausted their annual delegated limit for gift payments (T\$45,000 up to T\$50,000). In addition, a Travel list was also issued for those who have breached the delegated limit for Travel allowance of T\$20,000 per travel and an Import Referred Customer list was issued for those who have not provided the custom import entry form when the goods arrived in Tonga. Non-compliant customers were referred to the Reserve Bank for processing and approval for all their foreign exchange payments. Close monitoring of these non-compliant customers continued to ensure they consistently comply with the exchange control requirements, and that payments made are bona-fide transactions to strengthen the Reserve Banks anti-money laundering initiatives.

### **Financial Market Corporate Plan Targets**

A review of the 2019 corporate plan and targets was also conducted during the financial year. The review showed that the Financial Markets Department had achieved 44 out of the 45 targets with only one target that is still work in progress. As a result of the review, 2 new targets were added while 1 target was removed resulting in an increase in the total targets to 46 targets. The new targets added were to reflect the current practice such as to advise the exchange rate forecast to management on a monthly basis and to conduct a monthly review of the foreign reserve forecast. In addition to the Department's 46 targets, there are 5 targets which are shared with other departments.



# Risk Management

During the financial year 2019/20, the Reserve Bank continued its effort of inculcating a risk awareness culture and integrating an effective risk management framework into all policy oriented and operational activities. The Risk Management Unit under the Governor's Office work in collaboration with all Departments in identifying, assessing, managing and monitoring the many risks the Reserve Bank faces. Extensive use of Management Committees set up ensures that all risks, inherent and emerging, are considered with regular reporting to the Board of Directors.

## Corporate Risk Governance

The Reserve Bank has been operating an Enterprise Risk Management (ERM) model for a number of years. The basis for ERM is to ensure the Reserve Bank is aware of risks associated with its core functions – monetary and financial stability and a sound and efficient financial system – and has relevant policies and an effective framework to mitigate these risks.

Incident Reporting is part of the Risk Management Framework of the Reserve Bank to document events that occur and that may adversely affect the achievement of the Reserve Bank's mandate as outlined in the Act. There were twenty-six incidents reported during the financial year with five reported incidents still work in progress to be resolved.

## Internal Audit

A strong, independent and objective internal audit function is a key part of the Reserve Bank's overall commitment to good corporate governance practice. The Risk Management Unit is also tasked with the internal audit function to improve the effectiveness of internal controls, governance and risk management processes. The results of these checks and reviews on high risk areas were reported to the Board on a monthly basis.

## Delegation of Authority

All activities and expenditure in the Bank must be authorised in accordance with the respective delegations, policies and procedures. The Risk Management Unit is responsible for the annual review and updating of the delegation of authority.

## Complaints Management

The Risk Management Unit is also tasked with receiving complaints from external parties, stakeholders or the general public, in relation to the performance of the Reserve Bank's services and/or functions, as well as the services of the financial institutions that are licenced by the Reserve Bank. These financial institutions include banks, authorised foreign exchange dealers and microfinance institutions. During the year, two complaints were lodged with the Reserve Bank against licensed financial institutions and three complaints were lodged about the Reserve Bank services. The complaints about the licensed financial institutions were regarding credit product terms and conditions, and identification requirements for new client process. The complaints against the Reserve Bank were regarding Exchange Control application process, security access and the validity of our general public warning notification. To address these complaints, the Bank held meetings with complainants and the licensed financial institutions. All complaints were resolved by 30 June 2020.

## Business Continuity and Disaster Recovery Management

The continuity of critical business functions during and after a disruptive event is a key area of focus for the Reserve Bank. The Reserve Bank's Business Continuity and Disaster Recovery Plan came into play during the year when the World Health Organisation declared the coronavirus outbreak a pandemic and prompted Tonga to declare a National State of Emergency to deal with COVID-19 and a Government National lockdown was imposed for 1 week. The Reserve Bank services during the national lockdown was reduced to critical functions and most of the staff took vacation leave. In addition to the national lockdown, Tonga was hit by Severe Tropical Cyclone Harold and the NRBT business continuity and disaster recovery plans were invoked to prepare for this severe tropical cyclone. The Reserve Bank also conducted emergency evacuation drills to ensure awareness of emergency procedures by staff and tenants of the NRBT building.

## **Risk Management Corporate Plan Targets**

In the approved revised Reserve Bank's Corporate Plan for 2019/20, the Risk Management Unit was allocated with nineteen specific measurable targets. A review of the financial year corporate plan was carried out in April 2020 which revealed that the Unit achieved eleven targets while eight targets were current work in progress. These eight targets are related to draft Consumer Financial Protection policy, procedures and training, conducting Information Systems and Technology Governance Audit, drafting procedures and awareness training on critical functions are to be completed before end of the year.



# Currency Management

The National Reserve Bank of Tonga is responsible for regulating the issue of currency in the Kingdom of Tonga and maintaining an adequate supply of quality banknotes and coins in circulation to meet the public's currency needs.

The Reserve Bank redeems any banknotes or coins that are mutilated or no longer fit for circulation and destroys them accordingly.

## Currency in Circulation

As at 30 June 2020, total currency in circulation was T\$92.7 million. The value of banknotes in circulation as at 30 June 2020 rose by 2% to T\$88.2 million from the end of June 2019 (T\$86.5 million). There were 35.9 million coins, worth T\$4.4 million in circulation at the end of June 2020. The value of coins in circulation increased by 7.3% to T\$4.4 million from the end of June 2019 (T\$4.1 million). The increase in currency in circulation was mainly attributed to the accelerated issuance of banknotes and coins post COVID-19 pandemic.

During the National Lockdown Period (29th March – 12th April) the Currency Department activated its Business Continuity Plan which focused on the internal preparation to protect our employees and ensure continuity of banknote and coin supply to the Commercial Banks.

Key control measures for staff/customer safety were strictly enforced in "Getting Your Workplace Ready for COVID-19" and "General Guidelines For In-House Cash Handling During The COVID-19" resulted in the successful output of the Currency Business Continuity Plan during the COVID-19 Pandemic period.

## Note Processing Operation

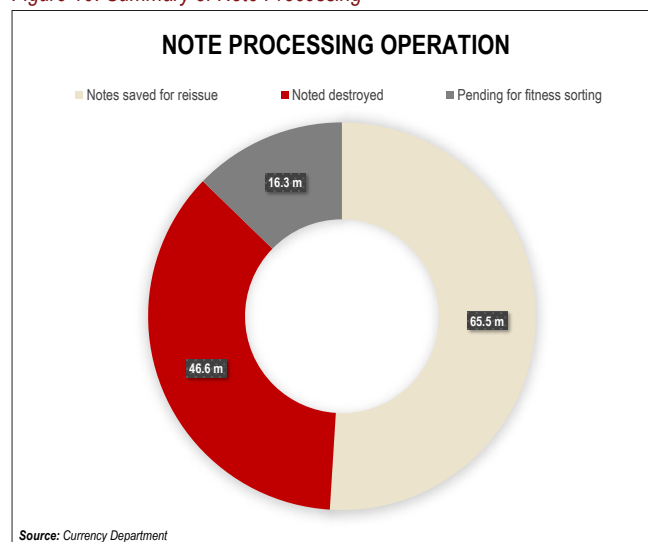
The purpose of the note processing operation is to ensure that quality banknotes are in circulation to which the public can use with confidence knowing that they are genuine.

All banknotes returned to the Reserve Bank through the Commercial Banks and public are processed and sorted for fitness by a note processing machine.

As at 30 June 2020, T\$128.4 million returned banknotes were processed. Of this, T\$65.5 million were deemed

fit for reissue while T\$46.6 million were considered unfit and subsequently destroyed. The remaining T\$16.4m were notes pending for fitness sorting.

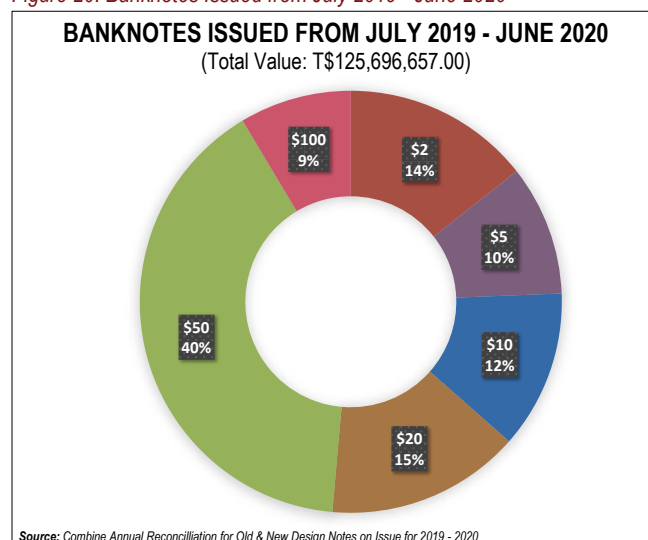
Figure 19: Summary of Note Processing



## Banking Transactions

During the financial year 2019/20, the value of currency issued to the commercial banks and public was T\$126.6 million, of which T\$125.7 million was in banknotes and T\$0.93 million in coins.

Figure 20: Banknotes Issued from July 2019 - June 2020

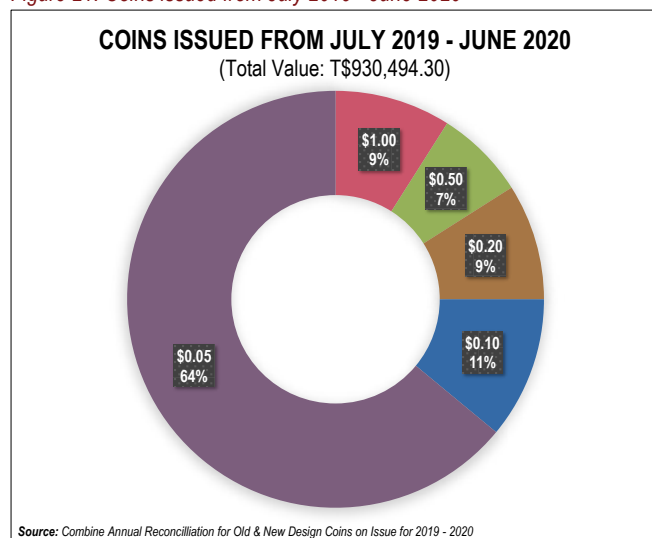


The demand for cash rose in the last quarter and was mainly driven by the people's uncertainty towards the COVID-19 Pandemic and National Lockdown. The T\$50 banknote continued to be widely used which demonstrate



the public's growing reliance on higher denominations for daily transactions and demand for higher denomination banknotes through the ATMs.

Figure 21: Coins issued from July 2019 - June 2020



## Numismatics

Numismatic or “collector” currency income as of 30 June 2020 amounted to T\$40,912.03.

The Reserve Bank continued with the sale of its existing commemorative coins, circulating banknote and coin folder sets and other currency collectable items.

## Currency Division Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 2019/20, the Currency Department was allocated with twenty specific measurable targets. A review of the financial year corporate plan was carried out in April 2020 which revealed that the Department achieved all twenty targets. The targets were related to cash management and circulation of current stock and forecast for future banknote/coin supply. In addition, the operation of the Cobra and X-Range Machines have assisted with the daily counting/destruction process of redeemed parcels received from the Commercial Banks.

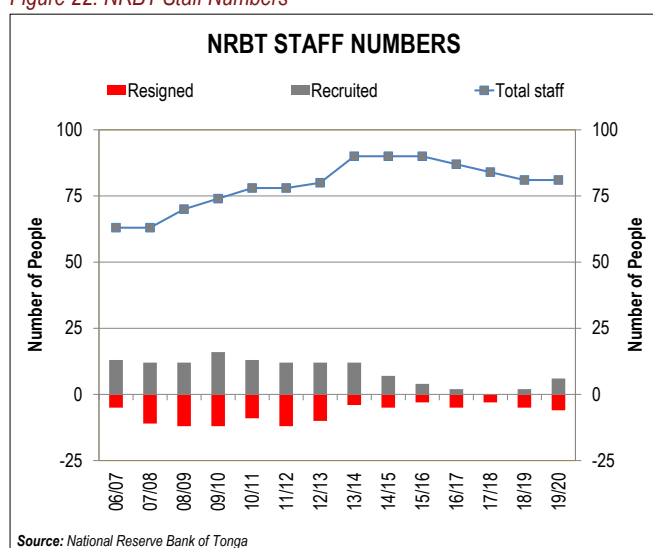


# Corporate Services

## Staffing

In the 2019/20 financial year, the Human Resources Department continued to implement its corporate strategic target to develop, maintain and retain high standard of quality employees. At the end of June 2020, the Reserve Bank maintained a total staff of 81 employees, 30 per cent on fixed term contract, 67 per cent permanent employees and 3 per cent were new recruits. The staff on fixed term contract increased by 10% over the year mainly to enhance leadership role in each department and strengthen staff capacity. The Reserve Bank also supported staff engagement in further studies via part time correspondence study, overseas professional study and secondment. Of the 81 staff, 52 per cent are women and 48 per cent are men. The staff turnover in 2019/20 financial year slightly increased to 7% where 6 employees exited the Bank due to overseas migration and various reasons.

Figure 22: NRBT Staff Numbers



To achieve the functions of the bank and the increase in targets set in the corporate plan, the Reserve Bank's recruited 6 employees in 2019/20 financial year to the Economics Department, Corporate Services and Financial Intelligence Unit. With 81 employees onboard, the Bank continued to facilitate and deliver its core responsibilities to achieve the Bank's objective and Strategic priorities.

## Rewards and Recognition

In promoting the Reserve Bank as the Employer of Choice, the Staff Performance Appraisal Form was reviewed and re-designed to capture the individual job description and also strengthen the appraisal and evaluation of staff performance. This is to ensure comprehensive and consistent staff appraisal across the Departments. The new appraisal form was also designed to be user friendly and easy for use. This review also encouraged improvements to performance and regular dialogue and feedback with their respective Manager on a monthly basis to promote a high standard of work performance.

The Reserve Bank continued to encourage staff performance through the Employee of the Month Awards and Governors Awards at the end of the year. The staff job descriptions and the organizational structure were reviewed and updated during the year to facilitate the emerging changes in the organization and its functions.

## Training and Development

During the year, the Reserve Bank supported its staff to upskill and develop their capabilities and competencies through short courses, self-training, online courses, part time correspondence studies as well as professional full-time studies overseas. In 2019/20 financial year, the Bank again provided financial support to staff on part time correspondence study at the University of the South Pacific as well as online courses. The Bank welcomed back 1 returning scholar from the University of Sydney while 2 scholars are currently studying at Nagoya University, Japan and the Auckland Institute of Studies, New Zealand. The Reserve Bank is again grateful to the Australian Award Scholarship program, New Zealand Aid Scholarship program, Japan International Cooperation Agency Scholarship Award program and the Pacific Leaders Educational Assistance for Development of States for their continuous support in providing scholarships for the Bank's employees to continue their studies overseas. The Bank also acknowledges the technical support and advisory services provided through the IMF, Pacific Financial Technical Assistance Centre (PFTAC), Asia Pacific Group (APG) and Alliance for Financial Inclusions (AFI) throughout the year.



*Mrs. Fetutuki Moleni received a Gift of Appreciation from Governor Sione Ngongo Kioa, at a special farewell function marking her retirement as a staff of the Reserve Bank.*

## Organizational Health and Safety

In 2019/20 financial year, the Bank continued to promote and encourage a healthy working environment by supporting staff to participate in corporate netball tournaments, inter departmental netball competition and various health activities during the year. The Reserve Bank believes that a healthy employee not only improves the self-confidence and health but it will also improve staff productivity and overall morale. During the COVID-19 national lockdown, the bank staff took their annual leave, meanwhile, the essential staff were maintained to test the capacity of the bank to operate its essential services, should COVID-19 reach Tonga. The staff were relocated within the building to meet the social distancing requirements. In addition, staff were kept informed on COVID-19 preventative measures as well as the purchase of protective equipment for the essential staff. One staff was locked down overseas and the Board of Directors endorsed policies to cater for staff in such situations during a pandemic.

## Human Resources Unit Corporate Plan Targets

The Human Resource Unit was assigned with twenty-one Corporate Plan targets under the Reserve Bank's Corporate Plan for 2019/20. A review of the calendar year corporate plan was carried out in April 2020 showed that sixteen targets (76%) were achieved, four targets (19%) were currently work in progress and the remaining one target (5%) was unachieved. Work in progress targets are set to be completed by end of the financial year and unachieved targets were due to other work priorities and being redefined realistically and rolled over to the 2020/21 financial year.



*Mrs. Fua Holani received a Gift of Appreciation from Governor Sione Ngongo Kioa, at a special farewell function before migrating to New Zealand with her family.*

## Information Technology

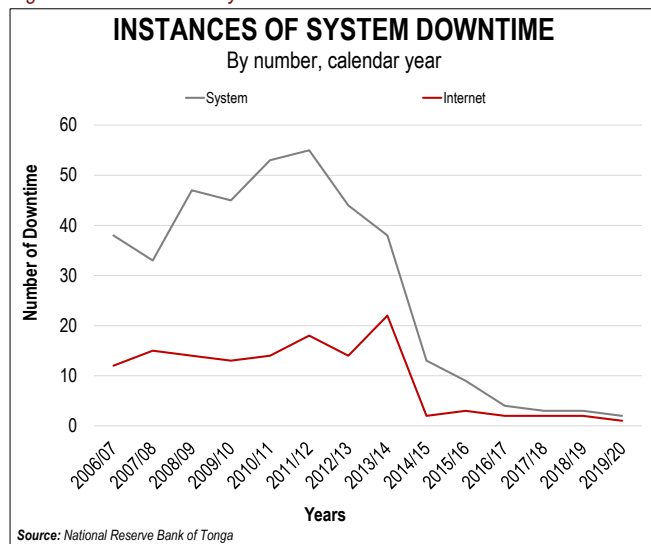
The Information Technology (IT) Department continued to support the Bank in achieving its core functions, while maintaining a high level of uninterrupted Information and Communication Technology services and also provide a secure, reliable and robust system to support the Reserve Bank's Strategic Priorities. During the 2019/2020 financial year, IT continued to enforce the alignment of its processes and its project implementation to international best practices with emphasis on preventing and managing cyber-risk. Similar to recent years, IT to implemented controls within the SWIFT System and network in order to comply with the requirements of the SWIFT Customer Security Programme. The department has also received several initiatives during the year from TongaCERT in regards to cybersecurity. The Bank's email system was further improved with additional security controls implemented during the year.

IT Projects implemented during the year includes the upgrade of the network infrastructure to improve network speed and, accessibility and also enhance network security and management. The Bank's workstation window platform was also upgraded due to the former reaching its End-of-Life deadline. The department has also put forward key projects for the 2020/2021 Financial Year including the upgrade to the Bank's email system and the implementation of its monitoring tool. The development of the Tonga National Payment System, a collective efforts within the departments of the Reserve Bank and is expected to be completed later in 2020/2021.



Due to the ongoing COVID-19 pandemic, the department resorted to on-the-job trainings, self-learning and free online training videos for the development of its staffs' technical skills in preparing for the IT requirements of the bank during a pandemic. The IT also setup and tested virtual meetings should the Reserve Bank staff be required to work from home.

Figure 23: Instances of System Downtime



## IT Corporate Plan Targets

In the 2019/20 financial year, the IT Department reviewed its level of implementation and achievement of the Department Corporate Plan targets. The review showed the IT Department achieved 89% of the targets. The remaining 11% were rolled over to the 2020/21 financial year which is to engage External Auditor for auditing of the NRBT IT infrastructure and system. This also includes the development of the Bank's Business Continuity Plan and Disaster Recovery.

## Building & Property

The Property Division continued to maintain the Bank's building, property, plant and equipment to uphold its standards and enhance a safe and secure working environment for the Bank's staff, tenants and visitors in the financial year 2019/21. During the year, there were a number of refurbishment projects executed including the completion of the building's general repair work and repainting of the exterior of the building, renovation of the Board Room at the 5th floor which was damaged by the Tropical Cyclone Gita, installed cyclone screen shutters to all the windows and doors at the 5th floor as part of the Bank's initiative to strengthen the building's natural disaster resilience, upgrading its plumbing system by refurbishing all the bathroom at Level 1 to Level 3, repair the centralized air condition system and automation



Senior Officials from the Tonga Fire Department during their 3-Days workshop held at the Reserve Bank's Conference Center.

control, completed the structural assessment of the building to ensure that it is structurally sound to withstand cyclones and earthquakes, uplifting the Bank's cleaning services to sanitize public areas as part of the COVID-19 preparations, facilitating two new tenants' offices which is the Ministry of Finance Central Services Unit and E-Government office at Level 4 Suite 2 and the Asian Development Bank and World Bank Group at Level 3 Suite 3. The Bank continued to engage contractors to maintain and service the elevators, standby generator, fire alarm system, physical and electronic security system. These services by the building and property unit ensure that the Bank continues to provide uninterrupted services both by its staff and tenants and to minimize any risk to Bank's operation.

## Building & Property Corporate Plan Targets

The Property Division Corporate Plan targets for the year ended 2019/20 result in achieving 88% targets and the remaining 12% of the targets were reviewed and revised to complete in the next financial year 2020/2021. This includes conducting the Building review and inspection of the Building following the maintenance and repair after GITA cyclone. The development of the Knowledge Base Database for capturing building plant and equipment maintenance.

## General Administration

In 2019/2020 financial year, the Administration Unit continued to provide support services to the other departments through its responsibilities for procurement of goods, organising events, as well as management of the transport services. Records management, commitment budget, electronic filing system, and corporate communications systems are also support services provided by the Administration Unit. During the year, inventory purchases were made to prepare the Reserve Bank for COVID-19 as well as increase in essential goods were stocked in case of a shortage in the supply of these goods.



## General Administration Corporate Plan

### Targets

During the year, the Administration Unit participated in the review of the 2020 Corporate Plan. The Unit was assigned twelve measurable targets for the calendar year 2019 which were all achieved. The measurable targets were related to the modernization of the operations of the Reserve Bank.

### Security Unit

The Security Unit continued to carry out its responsibilities to ensure a safe and secure workplace. During the year, the security unit continued to assist the building and property team with ensuring the security and safety of the operations of the building, plant and equipment. The security unit also plays a vital part in assisting the corporate services in conducting evacuation processes during cyclones and COVID-19 lockdown as well as conducting of fire drills. Other major achievements for the security unit during the year are the introduction of fitness tests and programs which has promoted a healthy team and reduced the high turnover and absenteeism. The security guards also secured the level 4 conference room which is available for hire to the public.

### Security Unit Corporate Plan Targets

In 2019/20 Financial Year, the Security Division had managed to achieved all of it department's corporate plan targets as a results of consistently upholding Department's Mission & Vision by maintaining the safety and security of the Bank's assets, staff & tenants and also making sure to provide conducive & secured working environment to all staff, tenants and bank's customers.



# Financial Performance

The gross income from operations for the year ended 30 June 2020 amounted to \$12.84 million, compared to \$14.33 million of the previous year. The 12% decline in gross income compared to last year was mainly driven by the decrease in income from the investment of foreign reserves overseas. This is attributed to the COVID-19 impact on overseas interest rates offered by the investment banks. In addition, there was no major numismatic sales and no other income received compared to last financial year where we received the final insurance claim for the damage done by TC Gita to the NRBT building. The fall in numismatic sales is also attributed to the COVID-19 impact on the market and the demand for numismatic bank notes and coins.

On the other hand, COVID-19 had a positive impact on income from foreign exchange deals which increased by 15% due to the increase in the number and volume of the Government foreign transactions. This is due to the increase in Government fund receipts for budget support and grants mainly for COVID-19 as well as TC Harold relief funds from development partners.

Total Expenditures incurred during the year was \$8.56 million compared to \$8.33 million, in the previous year. The 3% increase was due to the increase in currency issue as a result of issuing new mint notes of lower denominations to the public and the increase in pricing of goods and services purchased during the

year. Additional goods were purchased to prepare the Reserve Bank for COVID-19 and in case of a shortage in supply of these essential goods.

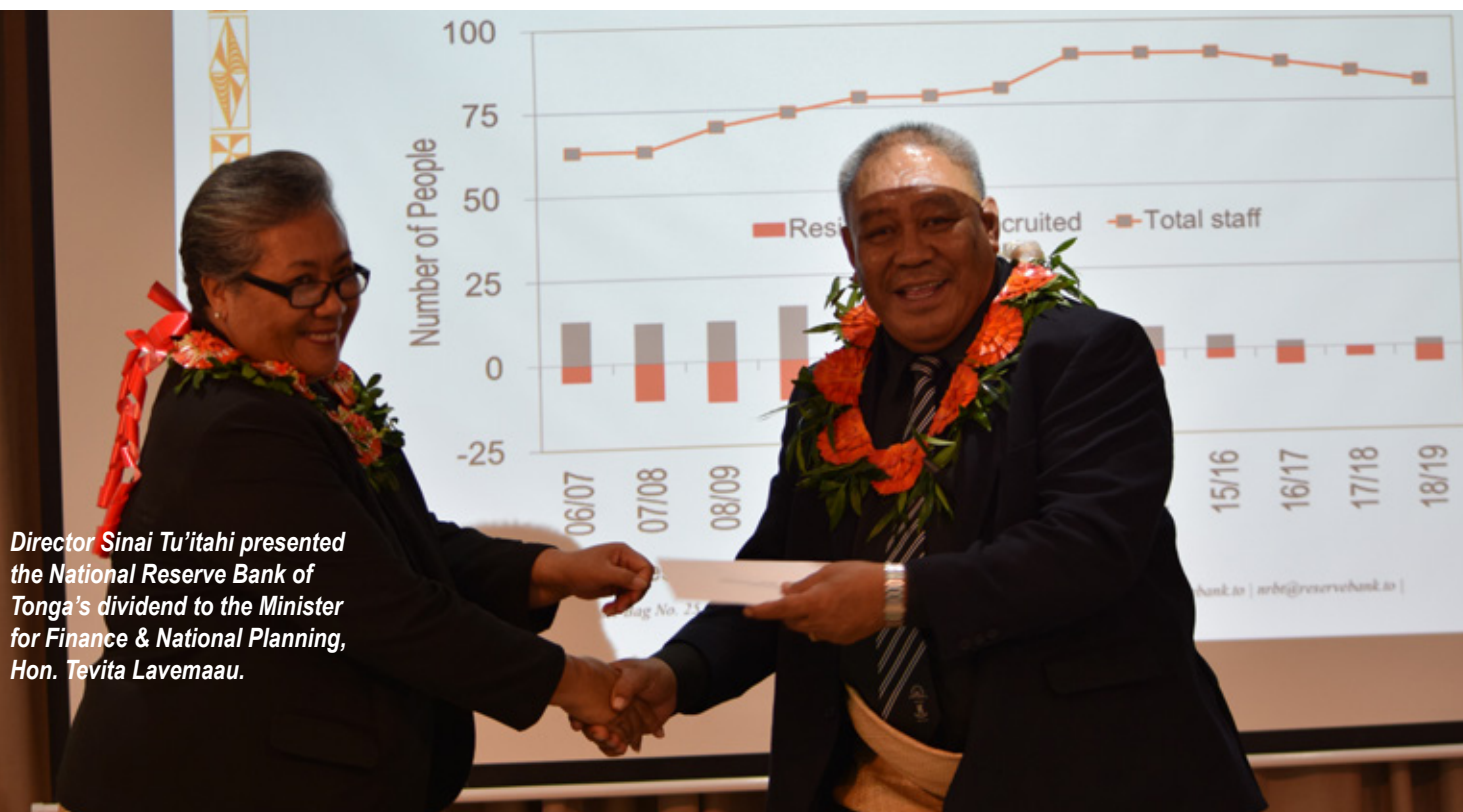
The net profit for the year ending 30 June 2020 was \$4.27 million, compared to \$6.00 million in the previous year. The financial result for 2019/2020 continued to exceed the corporate plan's annual target of \$1 million net profit per year, reflecting the effective strategies implemented during the year resulting in well managed and controlled bank's expenses.

The National Reserve Bank of Tonga according to section 8(1) of the NRBT (Amendment) Act 2014, at the end of the year will transfer 30 percent of the profit to the Bank's General Reserves and 70 percent of the profit for the year is payable to the Government. In this regard, T\$2.99 million will be transferred to the Government of the Kingdom of Tonga.

## Finance Department Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 2019/20, the Finance department was allocated with 68 specific measurable targets. A review of the financial year corporate plan was carried out in April 2020 which revealed that the department achieved all its targets.

These targets are related to the strategic priority to modernize the operations of the reserve bank.



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# National Reserve Bank of Tonga's 30th Anniversary Thanksgiving Service



*The Staff of the National Reserve Bank of Tonga before the beginning of the Reserve Bank's 30th Anniversary Thanksgiving service.*



*Left: Hon. Lord Ma'afu Tukui'aulahi, the Guest of Honor with one of the guests for the Thanksgiving Service, Ms. Robina Nakao.*

*Above Left: Director Sinai Tu'itahi (right) with guests to the Thanksgiving Service, Mr & Mrs 'Aisea Taumoepeau.*

*Above Right: ANZ Bank representatives Ms. Tessa Price and Mr. David Dudley.*



*Above Left: Mrs. Victorina Kioa with one of the guest, Mr. Brian Welch.*

*Above Middle: Mr. Tatafu Moeaki and Mr. Michael Bloomfield arriving at the Thanksgiving Service*

*Above Right: Two of the former employees of the Reserve Bank; Mrs. Kaleti Mafi and Mrs. Kalolaine Katoa.*



# National Reserve Bank of Tonga's 30th Anniversary Thanksgiving Service



*Governor Sione Ngongo Kioa delivering a historical timeline of how the National Reserve Bank of Tonga has progressed over the last 30 years.*



*Rev. Dr. Taliai Niumeitolu during his sermon to commemorate the 30th Anniversary of the Reserve Bank.*



*Above Left: Staff of the National Reserve Bank of Tonga performing the Tau'olunga for the guests during the entertainment and luncheon after the Thanksgiving Service*



*Above Middle: Security Guards performing the Mako.*



*Above Right: Staff from departments under Operations performing the Ma'ulu'ulu as part of the entertainments for the guests during the luncheon.*

*Below: Lady Tu'i Ha'angana with Former Governor Joyce Mafi and some of the former employees of the Bank with the Ceremony of the Cake. Also included are Ms. 'Isapela Hufanga (the longest serving officer of the Reserve Bank) and current Deputy Governor Jessie Cocker.*



# National Reserve Bank of Tonga

# **Financial Statements**

YEAR ENDED 30 JUNE 2020

# National Reserve Bank of Tonga Financial Statements

For the year ended 30 June 2020

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# Directors' Report

## Financial Statements - for the year ended 30 June 2020

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet of the National Reserve Bank of Tonga (the "Bank") as at 30 June 2020, and the related Statement of Comprehensive Income, Distribution, Changes in Equity and Cash Flows for the year ended on that date and report as follows:

### 1. DIRECTORS

The following were directors of the Bank at any time during the financial year and up to the date of this report:

Mr Steve Edwards - Chairman  
Mr Richard Prema  
Dr Sione Ngongo Kioa - Governor  
Mrs Sinaitakala Tu'itahi  
Mrs Balwyn Fa'otusia  
Mrs Joyce Mafi (appointed January 2020)

### 2. PRINCIPAL ACTIVITIES

The National Reserve Bank of Tonga's (the Bank) principal objectives as a central bank, as defined in Section 4 of the National Reserve Bank of Tonga (NRBT) (Amendment) Act 2014, shall be, to:

1. maintain internal and external monetary stability;
2. without prejudice to its principal objective, the Bank shall-
  - (a) promote financial stability; and
  - (b) promote a sound and efficient financial system.
3. subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- (a) issue currency;
- (b) formulate and implement monetary policy;
- (c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- (d) determine the foreign exchange rate and implement foreign exchange policy;
- (e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- (f) regulate as required the supply, availability and international exchange of money;
- (g) exclusively hold and manage the external reserves of the Kingdom;
- (h) provide advisory services to the Minister on banking and monetary matters;
- (i) be the principal banker, fiscal agent and depository of the Government;
- (j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (k) regulate and supervise financial institutions, including non-bank financial institutions;
- (l) oversee and promote the efficient, sound and safe functioning of the payment system;
- (m) collect and produce statistics;
- (n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- (o) regulate and supervise capital markets in Tonga;
- (p) to manage and promote financial inclusion initiatives and related activities; and
- (q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.



### **3. COVID-19**

The Covid-19 pandemic and the measures undertaken to contain it have dramatically changed the global economic outlook, causing large-scale economic disruption and pronounced volatility in financial markets.

The Bank carefully considered the impact of Covid-19 in preparing its financial statements for the year ended 30 June 2020. The impact of the COVID-19 pandemic may not have been significant to the Tongan economy just yet, but it has resulted in the Bank's operations experiencing challenging and uncertain times. The Bank has incorporated the effects of Covid-19 on expected credit losses.

The Bank's investment portfolio continues to be monitored, however, in the event the Covid-19 pandemic impacts are more severe or prolonged than anticipated, this may have an impact on the Bank's income. Given the unprecedented set of circumstances which are still evolving, a definitive assessment of the longer term's outcomes of the Covid-19 pandemic and the consequent economic and societal impacts is difficult at this stage.

During the year, the Bank transferred \$5,000,000 to the Government of the Kingdom of Tonga in relation to the COVID 19 pandemic preparations.

### **4. TRADING RESULTS**

The net profit of the Bank for the year ended 30 June 2020 was \$4,273,964 (2019: \$6,000,600).

### **5. GENERAL RESERVES**

In accordance with Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$1,282,189 (2019: \$1,800,180) being 30% of the current year profit, is transferred to the General Reserve at year end.

### **6. PAYABLE TO GOVERNMENT**

In accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$2,991,775 (2019: \$4,200,420) is payable to the Government of the Kingdom of Tonga.

### **7. REVALUATION RESERVE ACCOUNT**

The Board approved the following transfers from the Revaluation Reserve Account in accordance with Section 33 of the National Reserve Bank of Tonga (Amendment Act) 2017:

- Transfer of \$5,000,000 to the Government of the Kingdom of Tonga in relation to the COVID 19 pandemic preparations in accordance with Section 33 (4) (b) and:
- transfer of \$1,594,984 to the National Reserve Bank of Tonga to fund the Development Budget for 2020/21 in accordance with Section 33 (4)(a) of the abovementioned Act.

### **8. BAD AND DOUBTFUL DEBTS**

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that all known bad debts were written off and adequate provision was made for doubtful debts.

At the date of this report, the directors are not aware of any circumstances which would render the amount written off for bad debts, or the amount of the provision for doubtful debts, inadequate to any substantial extent.

## **9. PROVISIONS**

There were no material movements in provisions during the year apart from the normal amounts set aside for such items as employee entitlements.

## **8. ASSETS**

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that the assets of the Bank were shown in the accounting records at a value equal to or below the value that would be expected to be realised in the ordinary course of business.

At the date of this report, the directors are not aware of any circumstances which would render the values attributable to the assets in the financial statements misleading.

## **9. DIRECTOR'S BENEFIT**

No director of the Bank has, since the end of the previous financial year, received or become entitled to receive a benefit by reason of contract made by the Bank with the director or with a firm of which the director is a member, or with a company in which the director has substantial financial interest other than what is disclosed in the financial statements.

## **10. BASIS OF ACCOUNTING**

The directors believe the basis of the preparation of financial statements is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this statement. Accordingly the directors believe the classification and carrying amounts of assets and liabilities as stated in these financial statements to be appropriate.

## **11. OTHER CIRCUMSTANCES**

At the date of this report, the directors are not aware of any circumstances not otherwise dealt with in this report or financial statements which render any amounts stated in the financial statements misleading.

## **12. UNUSUAL TRANSACTIONS**

The results of the Bank's operations during the financial year have not in the opinion of the directors been substantially affected by any item, transaction or event of a material and unusual nature other than those disclosed in the financial statements.

For and on behalf of the Board of Directors in accordance with a resolution of the Directors dated this 23<sup>rd</sup> day of September, 2020.



Mr Steve Edwards  
Chairperson



Sione Ngongo Kioa  
Governor

# Statement by Directors

## Financial Statements - for the year ended 30 June 2020

In the opinion of the Directors:

- (a) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2020;
- (b) the accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2020;
- (c) the accompanying statement of distribution is drawn up so as to give a true and fair view of the distribution of operating profit of the Bank for the year ended 30 June 2020;
- (d) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in equity for the year ended 30 June 2020; and
- (e) the accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 30 June 2020.

For and on behalf of the Board of Directors by authority of a resolution of the Directors dated this 23<sup>rd</sup> day of September, 2020.



Mr Steve Edwards  
Chairperson



Sione Ngongo Kioa  
Governor





## Independent Auditor's Report

To the Board of Directors of National Reserve Bank of Tonga

### Report on the audit of the financial statements

#### *Opinion*

We have audited the accompanying financial statements of the National Reserve Bank of Tonga (the 'Bank'), which comprise the balance sheet of the Bank as at 30 June 2020, and the statement of comprehensive income, statement of distribution, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements are prepared, in all material respects, in accordance with the accounting policies described in Note 2 of the financial statements and in the manner required by the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, the National Reserve Bank of Tonga (Amendment) Act, 2014 and the National Reserve Bank of Tonga (Amendment) Act, 2017.

#### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Emphasis of Matter*

We draw attention to Note 2(a) and (b) to the financial statements, which refers to the reporting framework and the policy on the treatment of exchange gains and losses and its variance with IAS 21 "Effect of changes in Foreign Exchange Rates". Our opinion is not modified in respect of this matter.

#### *Independence*

We are independent of the Bank in accordance with the ethical requirements of the International Ethics Standards Board for Accountant's Code of Ethics for Professional Accountants (IESBA Code) that are relevant to our audit of the financial statements in Tonga, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

#### *Other Information*

Directors and Management are responsible for the other information. The other information comprises the information included in the Bank's Annual Report for the year ended 30 June 2020 (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

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In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

#### *Responsibilities of Directors and Management for the Financial Statements*

Directors and management are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and with the requirements of the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, the National Reserve Bank of Tonga (Amendment) Act, 2014 and the National Reserve Bank of Tonga (Amendment) Act, 2017 and for such internal control as the directors and management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors and management are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors and management either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

The directors and management are responsible for overseeing the Bank's financial reporting process.

#### *Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.



- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors and management.
- Conclude on the appropriateness of the directors and managements use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors and management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

#### **Restriction on Use**

This report is made solely to the Board of Directors of the Bank, as a body. Our audit work has been undertaken so that we might state to the Board of Directors those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Board of Directors as a body, for our audit work, for this report, or for the opinions we have formed.

A handwritten signature in blue ink, likely belonging to a representative of PricewaterhouseCoopers.

**PricewaterhouseCoopers**  
**Chartered Accountants**

**23 September 2020**  
**Suva, Fiji**

# Balance Sheet

as at 30 June 2020

	Notes	2020	2019
<b>ASSETS</b>		<b>\$</b>	<b>\$</b>
<b>Foreign Currency Assets</b>			
Short Term Investments and Current Accounts	8	515,795,535	456,351,580
Accrued Interest		9,248,464	11,598,190
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		10,868,542	10,868,542
- Special Drawing Rights		17,150,506	17,087,464
<b>Local Currency Assets</b>			
Cash on Hand	18	31,327	11,826
Accrued Interest		-	35,678
Other Assets	10	12,660,204	10,818,563
International Monetary Fund - Currency Subscription	9	32,651,853	32,662,559
Property, Plant and Equipment	11	9,985,118	9,521,663
<b>Total Assets</b>		<b>608,391,549</b>	<b>548,956,035</b>
<b>LIABILITIES</b>			
<b>Foreign Currency Liabilities</b>			
Accrued Interest		1,873	7,116
Demand Deposits	12(a)	73,301,723	52,697,631
IMF Special Drawing Rights Allocation	9	20,812,134	20,812,134
<b>Local Currency Liabilities</b>			
Payable to Government	13	2,991,775	4,200,420
Demand Deposits	12(b)	290,338,235	244,039,067
Accrued Interest		30,814	30,012
Other Liabilities	16	3,501,532	2,188,550
Currency in Circulation	14	92,713,587	90,674,349
Statutory Reserve Deposits	15	56,010,000	56,734,000
International Monetary Fund - Currency Subscription	9	32,651,853	32,662,559
Employee Provisions	17	174,929	164,852
<b>Total Liabilities</b>		<b>572,528,455</b>	<b>504,210,690</b>
<b>NET ASSETS</b>		<b>35,863,094</b>	<b>44,745,345</b>
<b>CAPITAL AND RESERVES</b>			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves		16,412,979	15,130,790
Revaluation Reserve Account		14,450,115	24,614,555
<b>TOTAL CAPITAL AND RESERVES</b>		<b>\$35,863,094</b>	<b>\$44,745,345</b>

The above balance sheet should be read in conjunction with the accompanying notes.

# Statement of Comprehensive Income

for year ended 30 June 2020

	Notes	2020	2019
<b>Income</b>		<b>\$</b>	<b>\$</b>
Interest Income	4	10,602,711	11,733,041
Other Income	5	2,235,778	2,593,500
<b>Total Operating Income</b>		<b>12,838,489</b>	<b>14,326,541</b>
<b>Expenses</b>			
Interest expense	6	273,921	312,663
Administration and other expenses	7	8,269,361	7,997,875
Allowance for impairment losses		21,243	15,403
<b>Total Operating Expenses</b>		<b>8,564,525</b>	<b>8,325,941</b>
<b>Net profit available for distribution</b>		<b>4,273,964</b>	<b>6,000,600</b>
Net gains/(losses) arising from the translation of foreign currency balances to local currency		(3,569,456)	(4,725,916)
<b>Other comprehensive income for the period</b>		<b>(3,569,456)</b>	<b>(4,725,916)</b>
<b>Total comprehensive income</b>		<b>\$704,508</b>	<b>\$1,274,684</b>

*The above statement of comprehensive income should be read in conjunction with the accompanying notes.*



# Statement of Distribution

for year ended 30 June 2020

	Notes	2020	2019
		\$	\$
<b>Net profit available for distribution</b>		<b>\$4,273,964</b>	<b>\$6,000,600</b>
<b>Distribution as follows:</b>			
Transfer to General Reserves as required under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	1,282,189	1,800,180
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2014	13	2,991,775	4,200,420
		<b>\$4,273,964</b>	<b>\$6,000,600</b>

*The above statement of distribution should be read in conjunction with the accompanying notes*



# Statement of Changes in Equity

for year ended 30 June 2020

	Paid up Capital	General Reserves	Revaluation Reserve Account	Total
	\$	\$	\$	\$
<b>Balance 30 June 2018</b>	<b>\$ 5,000,000</b>	<b>\$13,377,850</b>	<b>\$29,340,471</b>	<b>\$47,718,321</b>
IFRS 9 transition impact through retained earnings (Note 2(a))	-	(47,240)	-	(47,240)
Net losses arising from the translation of foreign currency balances to Tongan currency	-	-	(4,725,916)	(4,725,916)
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	1,800,180	-	1,800,180
<b>Balance 30 June 2019</b>	<b>\$ 5,000,000</b>	<b>\$15,130,790</b>	<b>\$24,614,555</b>	<b>\$44,745,345</b>
Transfer to the Government as assistance for COVID-19 pandemic preparation in accordance with Section 33 (4)(b) of the National Reserve Bank of Tonga (Amendment) Act 2017	-	-	(5,000,000)	(5,000,000)
Transfer as funding of the NRBT Development Budget for Financial Year 2020/21 in accordance with Section 33 (4)(a) of the National Reserve Bank of Tonga (Amendment) Act 2017	-	-	(1,594,984)	(1,594,984)
Net losses arising from the translation of foreign currency balances to Tongan currency	-	-	(3,569,456)	(3,569,456)
Transfer to General Reserves (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance (note 2n)	-	1,282,189	-	1,282,189
<b>Balance 30 June 2020</b>	<b>\$ 5,000,000</b>	<b>\$16,412,979</b>	<b>\$14,450,115</b>	<b>\$35,863,094</b>

*The above statement of changes in equity should be read in conjunction with the accompanying notes.*

# Statement of Cash Flows

for year ended 30 June 2020

	Notes	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		<b>\$</b>	<b>\$</b>
Interest received		12,988,116	10,360,694
Rental income		514,671	543,343
Numismatic sales		37,284	195,370
Other income		1,624,005	1,972,079
Purchase of currency		(1,591,788)	(1,853,242)
Interest paid		(278,364)	(303,121)
Payments to suppliers and employees		(5,375,288)	(4,471,720)
Net cash inflow from operating activities		7,918,636	6,443,403
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of fixed assets		(1,010,847)	(833,736)
Net movement in IMF accounts		(63,042)	203,215
Net movement in staff loans		(1,208,741)	(1,107,667)
Net cash used in investing activities		(2,282,630)	(1,738,188)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net movement in currency in circulation		2,039,238	3,704,649
Net movement in demand deposits		8,129,183	12,271,270
Net movement in statutory deposits		(724,000)	1,866,000
Net movement in Government of Tonga account		49,573,657	(2,107,685)
Net movement in funds held for clearance		(26,189)	252,968
Net movement in IMF SDR Allocation		-	(199,351)
Net transfer from Revaluation Account		(1,594,984)	-
Net cash inflow from financing activities		57,396,905	15,787,851
<b>NET INCREASE/(DECREASE) IN CASH</b>		<b>63,032,911</b>	<b>20,493,066</b>
<b>CASH AND CASH EQUIVALENT AT BEGINNING OF FINANCIAL YEAR</b>		<b>456,363,406</b>	<b>440,596,256</b>
NET EFFECT OF CHANGE IN EXCHANGE RATE	2 (b)	(3,569,455)	(4,725,916)
<b>CASH AND CASH EQUIVALENT AT END OF FINANCIAL YEAR</b>	18	<b>515,826,862</b>	<b>456,363,406</b>

*The above statement of cash flows is to be read in conjunction with the accompanying notes.*

# Notes To and Forming Parts of the Financial Statement

Financial Statements - for the year ended 30 June 2020

## 1. GENERAL INFORMATION

The National Reserve Bank of Tonga's (the Bank) principal objectives as a central bank, as defined in Section 4 of the National Reserve Bank of Tonga (NRBT) (Amendment) Act 2014, shall be, to:

1. maintain internal and external monetary stability;
2. without prejudice to its principal objective, the Bank shall-
  - (a) promote financial stability; and
  - (b) promote a sound and efficient financial system.
3. subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- (a) issue currency;
- (b) formulate and implement monetary policy;
- (c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- (d) determine the foreign exchange rate and implement foreign exchange policy;
- (e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- (f) regulate as required the supply, availability and international exchange of money;
- (g) exclusively hold and manage the external reserves of the Kingdom;
- (h) provide advisory services to the Minister on banking and monetary matters;
- (i) be the principal banker, fiscal agent and depository of the Government;
- (j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (k) regulate and supervise financial institutions, including non-bank financial institutions;
- (l) oversee and promote the efficient, sound and safe functioning of the payment system;
- (m) collect and produce statistics;
- (n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- (o) regulate and supervise capital markets in Tonga;
- (p) to manage and promote financial inclusion initiatives and related activities; and
- (q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.

These financial statements have been approved for issue by the Board of Directors on 23rd September 2020.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

### a) Basis of accounting

The financial statements of the Bank have been prepared in accordance with the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, and the National Reserve Bank of Tonga (Amendment) Act, 2014. The Bank's accounting policies are based on International Financial Reporting Standards ("IFRS") except where the Act requires a different treatment, as noted in Note 2 (b), in which the Act takes precedence.



The financial statements are prepared on the basis of the historical cost convention, which has no regard to changes in the levels of prices. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

#### **b) Foreign Currencies**

Foreign currencies have been translated to Tonga currency at rates of exchange ruling at year end. Exchange gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the Revaluation Reserve Account in accordance with the provisions of Section 33 of the Act and are not included in the computation of annual profits and losses of the Bank as required under International Accounting Standard 21, "The effects of changes in foreign exchange rates" (IAS 21). The impact of this in the statement of comprehensive income would be a decrease in net profit by \$3,569,456 (2019: decrease by \$4,725,916).

Net losses arising from such changes are set off against any credit balance in the Revaluation Reserve Account; if such balance is insufficient to cover such losses, Cabinet shall cause to be transferred to the ownership of the Bank non-negotiable market interest bearing securities issued by the Government to the extent of the deficiency.

Any credit balance in the Revaluation Reserve Account at the end of each year may be used by the Reserve Bank for the costs of implementing the monetary policy subject to the approval by the Board or be paid to the Government upon the request of the Minister in writing to the Reserve Bank subject to the market conditions and approval by the Board.

According to the National Reserve Bank of Tonga (Amendment) Act 2017, the Revaluation Reserve Account is to be maintained at a minimum balance of \$10,000,000 and any balance remaining in the Revaluation Reserves Account shall be carried forward to the next financial year.

#### **c) Critical accounting estimates and judgements**

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are categorised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts categorised in the financial statements are included in the following notes:

Note 2 (d) – Provisions for impairment of financial assets

Note 2 (i) – Provisions for employee entitlements

#### ***Impact of Covid-19 on expected credit losses***

The bank has carefully considered the impact of COVID-19 in preparing its financial statement for the year ended 30 June 2020. The key impact on the financial statements, including the application of critical estimates and judgments, related to the expected credit loss model. There was no significant change to the existing expected credit loss model used by the Bank at 30 June 2020 as credit ratings for counterparties have remain the same from prior year. As the pandemic will prolong to the future, the expected rise in corporate defaults, falling asset prices and liquidity issues in overseas counterpart will drive the Bank to adjust the current ECL model by revising the (PD) estimates, the loss given default (LGD), and the exposure at default (EAD) estimates to clearly reflect the effects of COVID 19 on the Bank's financial statements.

## **d) Financial Assets and Liabilities**

### **Financial instruments**

#### **i) Recognition and initial measurement**

Debt securities issued are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

#### **ii) Classification and subsequent measurement**

##### **Financial assets**

On initial recognition, a financial asset is classified as measured at: amortised cost; FVOCI – debt investment; FVOCI – equity investment; or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Bank changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt investment is measured at FVOCI if it meets both of the following conditions and is not designated as FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in the investment's fair value in OCI. This election is made on an investment-by-investment basis.

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. This includes all derivative financial assets.

On initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

##### **Financial assets: Business model assessment**

The Bank makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related

- liabilities or expected cash outflows or realising cash flows through the sale of the assets;
- how the performance of the portfolio is elevated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated - e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity.

Transfers of financial assets to third parties in transactions that do not qualify for derecognition are not considered sales for this purpose, consistent with the Bank's continuing recognition of the assets. Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL.

### **Financial assets: Assessment whether contractual cash flows are solely payments of principal and interest**

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

### **Financial assets: Assessment whether contractual cash flows are solely payments of principal and interest - continued**

In making this assessment, the Bank considers:

- contingent events that would change the amount or timing of cash flows;
- terms that may adjust the contractual coupon rate, including variable rate features;
- prepayment and extension features; and
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse features).

A prepayment feature is consistent with the solely payments of principal and interest criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for early termination of the contract.

### **Financial assets: Subsequent measurement and gains and losses**

#### *Financial assets at FVTPL*

These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

#### *Financial assets at amortised cost*

These assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

### *Debt investments at FVOCI*

These assets are subsequently measured at fair value. Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment are recognised in profit or loss. Other net gains and losses are recognised in OCI. On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss.

### *Equity investments at FVOCI*

These assets are subsequently measured at fair value. Dividends are recognised as income in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. Other net gains and losses are recognised in OCI and are never reclassified to profit or loss. The Bank does not have any financial asset under this category.

## **Derecognition**

### *Financial assets*

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

The Bank enters into transactions whereby it transfers assets recognised in its statement of financial position but retains either all or substantially all of the risks and rewards of the transferred assets. In these cases, the transferred assets are not derecognised.

### *Financial liabilities*

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire. The Bank also derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value.

On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognised in profit or loss.

## **Modifications of financial assets**

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

## **Offsetting**

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it



intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

## **Impairment**

### *Financial instruments*

The Bank recognises loss allowances for ECLs on financial assets measured at amortised cost.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, which are measured as 12-month ECL:

- debt securities that are determined to have low credit risk at the reporting date; and
- other debt securities and bank balances for which credit risk (i.e. the risk of default occurring over the expected life of the financial instrument) has not increased significantly since initial recognition.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECL, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and informed credit assessment and including forward-looking information.

The Bank assumes that the credit risk on a financial asset has increased significantly if it is more than 30 days past due.

The Bank considers a financial asset to be in default when:

- the counter-party is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held); or
- the financial asset is more than 90 days past due.

The Bank considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank considers this to be B or higher per rating agency Standards & Poor's.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument. 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of the instrument is less than 12 months).

The maximum period considered when estimating ECLs is the maximum contractual period over which the Bank is exposed to credit risk.

### *Measurement of ECLs*

ECLs are a probability weighted estimate of credit losses. They are measured as follows:

- *financial assets that are not credit-impaired at the reporting date:* as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- *financial assets that are credit-impaired at the reporting date:* as the difference between the gross carrying amount and the present value of estimated future cash flows; and
- ECLs are discounted at the effective interest rate of the financial asset.

### *Credit-impaired financial assets*

At each reporting date, the Bank assesses whether financial assets carried at amortised cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated

future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or being more than 90 days past due;
- the restructuring of a receivable by the Bank on terms that the Bank would not consider otherwise;
- it is probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

#### *Presentation of allowance for ECL in the statement of financial position*

Loss allowances for ECL are presented in the statement of financial position as follows:

- *financial assets measured at amortised cost*: as a deduction from the gross carrying amount of the assets.

#### *Write-off*

The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery. This is generally the case when the Bank determines that the debtor does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

#### **e) Currency and Numismatics Inventory**

Currency and numismatics on hand are recognised in the statement of financial position at cost. Cost includes the cost of bringing currency to the Bank's premises. Currency issuances are determined on a first-in-first-out basis. When currency is issued the value is reduced and amortisation expense is recognized in the income statement.

#### **f) Currency in Circulation**

The exclusive rights of national currency issue are vested with the Bank. Currency in circulation comprises notes and coins issued by the Bank and represent a claim on the Bank in favour of the holder. Currency in circulation relates to the issue of notes and coins and demonetized currency that have yet to be redeemed, less notes and coins redeemed. The liability for currency in circulation is recorded at face value.

#### **g) Coins sold as numismatic items**

#### **Revenue from contracts with customers**

Revenue is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a good or service to a customer. The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers.

Products and services	Nature, timing of satisfaction of performance obligations and significant payment terms	Revenue recognition under IFRS 15 (applicable from 1 July 2018)
Sale of numismatic coins	Sales include the selling of numismatic to the customer. Performance obligation is satisfied when the customer received the numismatic coins. Hence, revenue is recognised at a point in time basis.	Revenue and associated costs are recognised when the goods are provided - i.e. when the numismatic is issued to the customer and payment is due immediately when the goods are provided to the customers.

## **h) Income Tax**

The Bank is exempted from all Government taxes in accordance with Section 55 of the National Reserve Bank of Tonga Act, 1988.

## **i) Depreciation**

Fixed assets are depreciated on a straight line basis so as to write off the cost of each fixed asset over its estimated useful life. The principal annual rates in use are:

Leasehold and buildings	1.01% - 2%
Furniture and fittings, computer and office equipment	6.67% - 25%
Motor vehicles	25%

## **j) Employee Entitlements**

The Bank has its own Staff Provident Fund and all staff contribute to this scheme. The bank and staff contributions are based on the years of service. Liabilities for other employee entitlements which are not expected to be paid or settled within twelve months of the reporting date are accrued in respect of all employees at the present value of future amounts expected to be paid.

## **k) Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents includes tellers cash, current accounts and short term deposits.

## **l) Revenue**

### *Interest income*

Interest income is recognised using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

In calculating interest income, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. For financial assets measured at amortised cost, the effective interest rate method is used to measure the interest income recognised in the Statement of Profit or Loss and Other Comprehensive Income.

### *Rental income*

Rental income is recorded over the term of the tenancy agreement on a straight line basis.

### *Other income*

Other income includes numismatic sales and fees income, and are recorded when the related services are rendered.

## **m) Provisions**

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

## **n) General Reserve and Distribution of Profits**

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014 states that:

The net profits of the Bank for any financial year, after meeting all current expenditure for that year and after making provision for bad and doubtful debts, depreciation in assets and any other purposes deemed necessary by the Board shall be allocated as follows:

- (a) where the General Reserve does not exceed 50% of the authorised capital of the Bank, 100% of the net profit be transferred to the General Reserve;
- (b) where the General Reserve exceeds 50% of the authorised capital of the Bank, 30% to be transferred to the General Reserve until the sum of the General Reserve and the authorised capital of the Bank equal 10% of the total monetary liabilities of the Bank.

Provided that upon agreement between the Minister and the Bank the General Reserve may be increased.

- Section 8(2) states that subject to Section 8(1), the remainder of the net profits for the financial year shall be applied to the redemption of any securities issued under Section 6 held by the Bank.
- Section 8(3) states that the Board shall, with the approval of the Minister, subject to Section 8(1) and 8(2), allocate to the General Reserve and pay to Government's general revenue the remaining net profit.

## **o) Revaluation Reserve**

Unrealised exchange gains and losses arising from revaluation of foreign currencies are transferred to the Revaluation Reserve (refer Note 2(b)) and are not included in the computation of annual profits and losses of the Bank. Section 33 (4) of the National Reserve Bank of Tonga (Amendment) Act 2017 sets out the conditions of use of the Reserve Revaluation Account provided that a minimum balance of \$10,000,000 is maintained.

## **p) Leases**

*As a lessee*

Assets and liabilities arising from a lease are initially measured on a present value basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable
- variable lease payment that are based on an index or a rate
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The Bank does not have leases which contain the following:

- amounts expected to be payable by the lessee under residual value guarantees

The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Bank's incremental borrowing rate. Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability

Right-of-use assets are subsequently depreciated using the straight line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset, or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In



addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

Cash payments for the principal portion of the lease liabilities are presented as cash flows from financing activities. Cash payments for the interest portion are presented as cash flows from operating activities, consistent with presentation of other interest payments. Short-term lease payments, payments for leases of low-value assets and variable lease payments that are not included in the measurement of the lease liabilities are presented as cash flows from operating activities

#### *As a lessor*

When the Bank acts as a lessor, it determines at lease inception whether each lease is a finance lease or an operating lease.

To classify each lease, the Bank makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. As part of this assessment, the Bank considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

If an arrangement contains lease and non-lease components, the Bank applies IFRS 15 to allocate the consideration in the contract.

Lease income from operating leases where the Bank is a lessor is recognised in income on a straight-line basis over the lease term. The respective leased assets are included in the balance sheet based on their nature.

#### **q) Functional and Presentation Currency**

The Bank's financial statements are expressed in Tonga Pa'anga, which is the Bank's functional currency.

#### **r) Rounding**

Amounts in the financial statements are rounded to the nearest thousand dollars unless otherwise stated.

### **3. FINANCIAL RISK MANAGEMENT**

The Bank carries out a wide range of activities, from operating monetary policy to monitoring, regulating and supervising the health of the financial system, managing foreign reserves and banking system liquidity, providing payment systems and settlement services, and issuing currency, supported by a range of corporate services. These activities expose the Bank to a variety of risks. The majority of the Bank's financial risks arise from the foreign reserves management unit of the Bank's Financial Markets Department. The main financial risks to which the Bank is exposed include credit risk, liquidity risk and market risks and policies for managing these risks are outlined below.

#### **(a) Credit Risk**

Credit risk relates to the risk of loss arising from the failure of counterparty to a transaction to perform according to the terms and conditions of the financial contract.

Credit risk or safety is a key criterion in the determination of the composition of the Bank's foreign currency assets. To manage this credit risk, the Bank prescribes minimum credit ratings acceptable for investment and specifies the maximum permissible credit exposure to individual banks and countries. In addition, the number of commercial banks, with whom the Bank may deal with in foreign exchange must have minimum credit ratings of A.

The NRBT uses Standard & Poor's credit ratings of assessing the credit risk of foreign counterparties. The credit ratings of counterparties are on "watch" all the time and are updated as new market information is available.

The concentration of credit risk in the Bank's investment portfolio is as follows.

	2020	2019
	\$	\$
<b>Foreign currency assets</b>		
Short Term Commercial Paper and current accounts	515,795,535	456,351,580
<b>Local currency assets</b>		
Staff loans	4,270,957	3,048,770
<b>Total financial investments</b>	<b>\$ 520,066,492</b>	<b>\$ 459,400,350</b>

The Bank's end of year concentration of credit exposure is based on Standard & Poor's credit rating of the foreign counterparties based on the country in which the counterparty is a resident. N/R indicates the entity has not been rated by Standard & Poor's and includes exposure to Supranational.

	Ratings	2020	2019
		\$	\$
Australia	AAA	782,684	450,584
	AA-	149,465,133	141,811,842
	A+	110,116,087	85,121,654
New Zealand	AA	649,723	169,944
	AA-	140,020,185	153,749,881
United States of America	AA+	46,694,414	30,249,423
Switzerland	AAA	67,846,399	44,528,322
United Kingdom	AA	205,853	228,197
Fiji	BB-	17,308	43,689
Tonga	N/R	4,289,949	3,062,216
		<b>520,087,735</b>	<b>459,415,753</b>
Less: Allowance for impairment losses		(21,243)	(15,403)
<b>Total Financial Investments</b>		<b>\$ 520,066,492</b>	<b>\$ 459,400,350</b>

#### (b) *Liquidity Risk*

Liquidity risk relates to the difficulty in raising funds at short notice to meet commitments. Liquidity is a key criterion in the determination of composition of the Bank's foreign currency assets.

To minimize liquidity risk, the Bank maintains an adequate level of reserves and taking into consideration the transaction demand on foreign exchange, ensures that an appropriate amount is maintained in current accounts at all times. The balances of the investible reserves are placed on term investments of up to 12 months. The composition of foreign currency assets is monitored daily. The Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

The maturity analysis noted below includes all financial and non-financial assets and liabilities as at 30 June 2020.

### Maturity Analysis as at 30 June 2020

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Foreign Currency Assets</b>						
Short Term Investments and current accounts	48,961,289	360,703,851	106,130,395	-	-	515,795,535
Accrued Interest	9,248,464	-	-	-	-	9,248,464
IMF - Reserve Tranche position	10,868,542	-	-	-	-	10,868,542
- Special drawing Rights	17,150,506	-	-	-	-	17,150,506
<b>Local Currency Assets</b>						
Cash on hand	31,327	-	-	-	-	31,327
Accrued Interest	-	-	-	-	-	-
Other Assets	12,660,204	-	-	-	-	12,660,204
IMF - Currency Subscription	32,651,853	-	-	-	-	32,651,853
Property, Plant, & Equipment	-	-	-	-	9,985,118	9,985,118
<b>Total Assets</b>	<b>131,572,185</b>	<b>360,703,851</b>	<b>106,130,395</b>	<b>-</b>	<b>9,985,118</b>	<b>608,391,549</b>
<b>Foreign Currency Liabilities</b>						
Accrued Interest	1,873	-	-	-	-	1,873
Demand Deposits	73,301,723	-	-	-	-	73,301,723
IMF Special Drawing Rights Allocation	-	-	-	-	20,812,134	20,812,134
<b>Local Currency Liabilities</b>						
Payable to Government	2,991,775	-	-	-	-	2,991,775
Demand Deposits	290,338,235	-	-	-	-	290,338,235
Accrued Interest	30,814	-	-	-	-	30,814
Other Liabilities	-	3,501,532	-	-	-	3,501,532
Currency in Circulation	-	-	-	-	92,713,587	92,713,587
Statutory Reserve Deposits	-	-	-	-	56,010,000	56,010,000
IMF - Currency Subscription	-	-	-	-	32,651,853	32,651,853
Employee Provisions	-	-	141,311	33,618	-	174,929
<b>Total Liabilities</b>	<b>366,664,420</b>	<b>3,501,532</b>	<b>141,311</b>	<b>33,618</b>	<b>202,187,574</b>	<b>572,528,455</b>
<b>Net Assets</b>	<b>(235,092,235)</b>	<b>357,202,319</b>	<b>105,989,084</b>	<b>(33,618)</b>	<b>(192,202,456)</b>	<b>35,863,094</b>

The maturity analysis noted below includes all financial and non-financial assets and liabilities as at 30 June 2019.

### Maturity Analysis as at 30 June 2019

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Foreign Currency Assets</b>						
Short Term Investments and current accounts	31,746,628	330,863,046	93,741,906	-	-	456,351,580
Accrued Interest	11,598,190	-	-	-	-	11,598,190
IMF						
• Reserve Tranche position	10,868,542	-	-	-	-	10,868,542
• Special drawing Rights	17,087,464	-	-	-	-	17,087,464
<b>Local Currency Assets</b>						
Cash on hand	11,826	-	-	-	-	11,826
Accrued Interest	35,678	-	-	-	-	35,678
Other Assets	10,818,563	-	-	-	-	10,818,563
IMF - Currency Subscription	32,662,559	-	-	-	-	32,662,559
Property, Plant, & Equipment		-	-	-	9,521,633	9,521,633
<b>Total Assets</b>	<b>114,829,450</b>	<b>330,863,046</b>	<b>93,741,906</b>	<b>-</b>	<b>9,521,633</b>	<b>548,956,035</b>
<b>Foreign Currency Liabilities</b>						
Accrued Interest	7,116	-	-	-	-	7,116
Demand Deposits	52,697,631	-	-	-	-	52,697,631
IMF Special Drawing Rights Allocation	-	-	-	-	20,812,134	20,812,134
<b>Local Currency Liabilities</b>						
Payable to Government	4,200,420	-	-	-	-	4,200,420
Demand Deposits	244,039,067	-	-	-	-	244,039,067
Accrued Interest	30,012	-	-	-	-	30,012
Other Liabilities	-	2,188,550	-	-	-	2,188,550
Currency in Circulation	90,674,349	-	-	-	-	90,674,349
Statutory Reserve Deposits	-	-	-	-	56,734,000	56,734,000
IMF - Currency Subscription	-	-	-	-	32,662,559	32,662,559
Employee Provisions	-	6,379	124,908	33,565	-	164,852
<b>Total Liabilities</b>	<b>391,648,595</b>	<b>2,194,929</b>	<b>124,908</b>	<b>33,565</b>	<b>110,208,693</b>	<b>504,210,690</b>
<b>Net Assets</b>	<b>(276,819,145)</b>	<b>328,668,117</b>	<b>93,616,998</b>	<b>(33,565)</b>	<b>(100,687,060)</b>	<b>44,745,345</b>



**(c) Market Risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

**(i) Interest rate risk**

Interest rate risk refers to the risk of loss arising from changes in interest rates. The Bank limits interest rate risk by modified duration targets. The benchmark modified duration for the total portfolio is capped at 36 months. The duration of the portfolio is re-balanced regularly to maintain the target duration.

**(ii) Foreign exchange risk**

Exchange rate risk relates to the risk of loss arising from changes in the exchange rates against the Tonga Pa'anga. The Bank has adopted a currency risk management policy, which maintains the Tonga Pa'anga value of foreign reserves and minimises the fluctuations in the Revaluation Reserve Account.

The value of the Tonga Pa'anga is determined by a basket of currencies. To minimise the exchange rate risk, the weights of the currencies in the exchange rate basket is the benchmark for the composition of the Bank's foreign currency assets.

The following tables show the currency concentration of the Bank's net exposure to foreign currencies as at 30 June 2020 in Tonga Pa'anga equivalents.

	2020	2019
	\$	\$
United States Dollar	322,132,046	236,127,852
Australian Dollar	46,820,937	68,971,731
Great Britain Pound	210,557	232,989
New Zealand Dollar	82,556,801	109,853,991
Other	7,229,228	7,204,290
<b>Total Net Foreign Exchange Position</b>	<b>458,949,569</b>	<b>422,390,852</b>

**iii. Sensitivity to Foreign Currency Risk and Interest Rate Risk**

The sensitivity of the Bank's financial assets and liabilities to assume across the board changes in exchange rate and the interest rates with all other variables held constant is shown below:

Impact of:	2020	2019
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	22,947,478	21,119,543
Change in profit/loss due to a rise/drop of +/-1 percentage point in interest rate	92,466	115,911

**4. INTEREST INCOME**

	2020	2019
	\$	\$
Overseas investments	10,462,900	11,620,675
Staff loans	139,811	112,366
	\$ 10,602,711	\$ 11,733,041

## 5. OTHER INCOME

	2020	2019
	\$	\$
Numismatic coins	37,284	195,370
Rental income	574,490	426,051
Gain on sale of assets	1,470	-
Forex sales/ purchases	1,559,208	1,353,076
Bank user fees	45,666	42,603
Miscellaneous	17,660	576,400
	\$ 2,235,778	\$ 2,593,500

## 6. INTEREST EXPENSE

	2020	2019
	\$	\$
Foreign currency accounts	155,364	218,515
Domestic currency accounts	118,557	94,148
	\$ 273,921	\$ 312,663

## 7. ADMINISTRATION AND OTHER EXPENSES

	2020	2019
	\$	\$
Administration	2,282,926	2,381,704
Retirement fund	497,564	466,695
Staff costs	3,384,929	3,254,814
Audit fees	36,181	30,000
Currency issue	1,520,398	1,338,582
Depreciation	547,363	526,080
	\$ 8,269,361	\$ 7,997,875

## 8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS

	2020	2019
	\$	\$
Current accounts	48,961,289	31,746,628
Short term investments	466,836,497	424,606,909
	515,797,786	456,353,537
Less: Impairment allowances for financial instruments	(2,251)	(1,957)
	\$ 515,795,535	\$456,351,580

Allowance for impairment losses have been provided on short term investments and current accounts in accordance with the requirements of IFRS 9. The impact of Covid`-19 has been factored in the impairment allowances.

## 9. INTERNATIONAL MONETARY FUND

(i) The Bank was designated to serve with effect from 1 July 1989 as the fiscal agent of the Kingdom of Tonga

for the purposes of the International Monetary Fund (IMF) by virtue of Section 51(1) of the National Reserve Bank of Tonga Act, 1988, and assumed the financial obligations of the membership of the Kingdom of Tonga as from that date by virtue of section 36(1)(c) of the National Reserve Bank of Tonga Act, 1988.

(ii) As at 30 June 2020, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2019: SDR13,800,000). Of this total amount, SDR3,436,633 (2019: SDR3,436,633) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche Position, and the remaining balance representing the Currency Subscription portion was satisfied by crediting the demand deposit accounts of the International Monetary Fund with the Bank.

(iii) Special Drawing Rights holdings is an interest bearing international reserve asset created by the IMF and is allocated to members on the basis of their quotas in the Fund. As at 30 June 2020, the Special Drawing Rights holdings had a balance of SDR5,422,990(2019:SDR5,403,056).

## 10. OTHER ASSETS

	2020	2019
	\$	\$
Staff loans and advances	4,289,949	3,062,216
Currency and numismatics	5,448,232	5,376,842
Other assets	2,941,015	2,392,951
	12,679,196	10,832,009
Less: Impairment allowance for staff loans	(18,992)	(13,446)
	\$12,660,204	\$ 10,818,563

The amount charged to the statement of comprehensive income for currency expense is based on the total cost of notes and coins issued for circulation.

Allowance for impairment losses have been provided on the staff loans in accordance with the requirements of IFRS 9. The impact of Covid -19 has been factored in the impairment allowances.

## 11. PROPERTY, PLANT & EQUIPMENT

	Leasehold & Buildings	Computer and Office Equipment	Furniture and Fittings	Motor Vehicles	WIP	TOTAL
<b>At 30 June 2018</b>						
Cost	10,097,405	1,881,113	140,626	364,249	537,354	13,020,747
Accumulated Depreciation	(2,522,601)	(904,147)	(123,505)	(256,516)	-	(3,806,769)
<b>Net Book Amount</b>	<b>7,574,804</b>	<b>976,966</b>	<b>17,121</b>	<b>107,733</b>	<b>537,354</b>	<b>9,213,978</b>
<b>Year Ended 30 June 2019</b>						
Opening net book value	7,574,804	976,966	17,120	107,733	537,354	9,213,978
Additions	172,406	298,217	107,459	-	255,654	833,736
Transfer in/out	537,354	-	-	-	(537,354)	-
Depreciation	(240,044)	(200,250)	(42,442)	(43,345)	-	(526,080)
Closing net book value	8,044,520	1,074,934	82,137	64,388	255,654	9,521,633
<b>At 30 June 2019</b>						
Cost	10,807,164	2,179,331	248,084	364,249	255,654	13,854,483
Accumulated Depreciation	(2,762,645)	(1,104,398)	(165,947)	(299,861)	-	(4,332,850)
<b>Net Book Amount</b>	<b>8,044,520</b>	<b>1,074,934</b>	<b>82,137</b>	<b>64,388</b>	<b>255,654</b>	<b>9,521,633</b>
<b>Year Ended 30 June 2020</b>						
Opening net book value	8,044,520	1,074,933	82,138	64,388	255,654	9,521,633
Additions	3,845	76,388	-	-	930,614	1,010,847
Transfer in/out	809,022	-	-	-	(809,022)	-
Depreciation	(258,130)	(209,501)	(46,137)	(33,594)	-	(547,362)
Closing net book value	8,599,257	941,820	36,001	30,794	377,246	9,985,118
<b>At 30 June 2020</b>						
Cost	11,620,032	2,255,719	248,084	364,249	377,246	14,865,330
Accumulated Depreciation	(3,020,775)	(1,313,899)	(212,083)	(333,455)	-	(4,880,212)
<b>Net Book Amount</b>	<b>8,599,257</b>	<b>941,820</b>	<b>36,001</b>	<b>30,794</b>	<b>377,246</b>	<b>9,985,118</b>



**12. (a) FOREIGN CURRENCY DEMAND DEPOSITS**

	2020	2019
	\$	\$
Government of Tonga	73,250,757	52,646,007
Other institutions	50,966	51,624
	<b>\$ 73,301,723</b>	<b>\$ 52,697,631</b>

**(b) LOCAL CURRENCY DEMAND DEPOSITS**

	2020	2019
	\$	\$
International banks	78,166	119,000
Domestic banks	162,965,787	154,795,770
Government of Tonga	127,294,282	89,124,297
	<b>\$ 290,338,235</b>	<b>\$ 244,039,067</b>

**13. PAYABLE TO GOVERNMENT**

	2020	2019
	\$	\$
Amount payable to government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	\$ 2,991,775	\$ 4,200,420

**14. CURRENCY IN CIRCULATION**

	2020	2019
	\$	\$
Notes	88,282,603	86,565,966
Coins	4,430,984	4,108,383
	<b>\$ 92,713,587</b>	<b>\$ 90,674,349</b>

The exclusive rights of national currency issue are vested with the Bank. Currency in circulation comprises bank notes and coins issued by the Bank.

**15. STATUTORY RESERVE DEPOSITS**

The deposits represent the reserves required to be maintained by each financial institution under Section 39 of the NRBT Act 1988.

**16. OTHER LIABILITIES**

	2020	2019
	\$	\$
Other creditors and accruals	1,458,902	1,269,429
Development budget fund (a)		
(a) Payable to the National Reserve Bank of Tonga	1,594,984	-
(b) Staff Provident Scheme	447,646	919,121
	<b>\$3,501,532</b>	<b>\$ 2,188,550</b>

(a) This relates to the transfer from the Revaluation Account which was approved by the Board specifically to

support the Bank's 2020/21 Development budget.

(b) Funds belonging to the National Reserve Bank of Tonga Staff Provident Scheme are held with the Bank in this account.

## 17. PROVISION FOR EMPLOYEE ENTITLEMENTS

	2020	2019
	\$	\$
Opening balance	164,852	155,342
Entitlements during the year	158,417	237,284
Utilised/reversals	(148,340)	(227,774)
	\$ 174,929	\$ 164,852

## 18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the cash flow statement comprise the following items in the balance sheet:

	2020	2019
	\$	\$
Cash on hand	31,327	11,826
Short term investments and current accounts	515,795,535	456,351,580
	\$ 515,826,862	\$ 456,363,406

## 19. RELATED PARTIES

### *Identity of related parties*

The Bank's ultimate parent entity is the Government of the Kingdom of Tonga.

The Board of Directors during the financial year ended 30 June 2020 were Steve Edwards (Chairperson), Richard Prema, Sinaitakala Tu'itahi, Balwyn Fa'otusia, Joyce Mafi, Sione Ngongo Kioa (Governor).

During the year, the following executives were identified as key management personnel of the Bank: Sione Ngongo Kioa (Governor), Jessie Cocker (Deputy Governor) and Lata Tangimana (Assistant Governor Operation).

### *Transactions with related parties*

In the normal course of operations, the Bank enters into transactions with related parties identified above.

The transactions with the Government of the Kingdom of Tonga include banking services, foreign exchange transactions and registry transactions. The total interest paid to Government on Deposits held amounted to \$100,588 (2019: \$68,553).

The Bank contributes to the National Reserve Bank of Tonga Staff Provident Fund in accordance with the Provident Scheme Rules. The contributions in the current financial year were as follows:

	2020	2019
	\$	\$
Provident Fund payments made by the Bank	497,566	466,695
	\$ 497,566	\$ 466,695

The funds of the National Reserve bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.48% (2019: 3.42%) per annum. The total interest paid by the Bank for the financial year amounted to \$9,709 (2019: \$11,002). The Trustees of the Staff Provident Fund are indemnified by the Bank against all losses, damages or other costs which may be sustained or suffered by or made against a trustee as a result of any act or omission committed by the Trustee or Trustees which is not a breach of trust on the part of the Trustee.

The Directors are paid fees and sitting allowances for services rendered. The Directors entitlements to the retirement fund at year end amounted to \$267,352 (2019: \$244,819). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'.

	2020	2019
	\$	\$
Executive staff	257,536	257,536
Director's fees and allowances	139,843	121,900
	\$ 397,379	\$ 379,436

## 20. COMMITMENTS

### (a) Lessor Disclosure

The Bank leases its building premises under operating leases to tenants for a term of 2 to 3 years. The minimum lease payments receivable at balance date are as follows:

	2020	2019
	\$	\$
Due not later than one year	417,629	336,307
Due later than one year but not later than five years	690,384	370,688
	\$ 1,108,013	\$ 706,995

### (b) Capital and other commitments

	2020	2019
	\$	\$
Commitment not provided for in the financial statements are as follows:	\$ 377,246	\$ 255,654

## 21. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2020 comprise:

- (i) Contracts for foreign exchange transactions was nil (2019: \$nil)
- (ii) In accordance with the accounting policy in Note 2(e), numismatic coins are not brought to account in the determination of the Bank's liabilities but a liability may arise if such coins are en-cashed for their face value. The Bank is of the opinion that in the unlikely event of encashment as legal tender, no significant loss is expected to arise.

## 22. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm length transaction.

Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

### **Financial Assets and Liabilities**

The valuation of the Bank's financial assets and liabilities are discussed below:

#### ***Short term investments and current accounts***

The reported value of short term investments and current accounts is considered to be its fair value due to the short term nature of the financial assets.

#### ***Statutory Reserve Deposits***

The carrying value of statutory reserve deposits are considered to approximate their fair value as they are denominated in cash.

#### ***Demand Deposits***

The carrying value of deposits are considered to approximate their fair value as they are payable on demand.

#### ***Currency in Circulation***

The carrying value of Currency in Circulation is considered to be its fair value as reported in the accounts.

#### ***Other Financial Assets and Liabilities***

The reported values of other financial assets and liabilities are considered to be its fair value.

## **23. EVENTS SUBSEQUENT TO BALANCE DATE**

There remains significant uncertainty regarding how the Covid-19 pandemic will evolve, including the duration of the pandemic, the severity of the downturn and the speed of the global economic recovery. The Bank did not identify any subsequent events precipitated by Covid-19 related developments, which would require adjustment to the amounts or disclosures in the financial statements. Given the fluid nature of the current situation, the Bank will continue to regularly review forward looking assumptions and forecast economic scenarios.

Apart from the matters noted above, there has not arisen in the interval between the end of the financial year and the date of this report, any transactions or events of a material and unusual nature likely, in the opinion of the Board members, to affect significantly the operations of the Bank, the results of those operations or the state of affairs of the Bank.