Financial Stability

Financial Sector

The Reserve Bank continued to be responsible for the promotion of a sound and efficient financial system. This is pursued through the licensing, regulating and supervising of financial institutions, which are the banks and authorized restricted foreign exchange dealers. The NRBT (Amendment) Act 2014 extended the mandate of the Reserve Bank to the licensing and supervision of non-bank financial institutions (NBFIs), capital markets and credit information systems in Tonga. Separate legislations are still being processed for the licensing and supervision of the individual NBFIs. A Guideline for the licencing and supervision of credit information systems (credit bureaus) was issued in March 2017 and became effective on 1 May 2017.

As of June 2017, there were 4 banks licensed to operate in Tonga, declining from 5 banks reported in June 2016. The banking licence of Pacific International Commercial Bank (PICB) was revoked in July 2016.

Bank of South Pacific increases the number of ATMs

The Bank of South Pacific Tonga Limited has focused on building their outreach programs with rapid expansion on their number of access points. BSP's branch in Vava'u has undergone major renovations, including the installation of another ATM. The branches in the outer islands of Ha'apai and 'Eua that were previously closed by the former Westpac bank were re-opened by BSP during the financial year 2016/17, thereby the agency agreement with TDB in these two outer islands ended. The number of EFTPOS and in store facilities has increased from 250 in June 2016 to 334 in June 2017. The total number of ATMs also increased to 12 as at June 2017 from 8 last year.

Table 1: Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB
Branches (including Head Office at Nuku'alofa)	3	4	2	8
Sub-branches	1	16	-	-
Agents/Instore banking	-	-	-	-
ATMs	13	12	-	-
EFTPOS	200	334	-	-
Internet Banking	Yes	Yes	No	Yes
MoneyGram Agent	No	Yes	Yes	No

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.

During the year, the banks maintained their current banking services and have also developed new banking services. BSP has set up a business center for its corporate clients in September 2016. TDB launched the 'Ave Pa'anga Pau Product in February 2017 following the piloting mode and testing in January 2017. TDB has joined ANZ and BSP in the digitization of their products by launching its internet banking product as well as the ‘Ave Pa’anga Pau product.

Banking System Supervision and Regulation

During 2016/17 the Reserve Bank continued to focus its supervisory activities on ensuring prudent management of credit risks by banks particularly with the monetary policy stance to encourage lending by banks to support economic development. In addition, much emphasis was placed on compliance checks and enforcing the legal and prudential requirements to promote a safe and sound financial system, and also ensure a level playing field in the banking system.

In light of the Reserve Bank Board’s decision in February 2017 to increase in the Statutory Reserve Deposit (SRD) Ratio from 5% to 10%, effective in the banks’ balance sheet for July 2017, to encourage prudent practices whereby a portion of the liquidity is to be set aside as precaution against the increased loan portfolio, the Reserve Bank will closely monitor the implication of this decision on banks’ liquidity. This is in addition to monitoring of banks’ compliance with the minimum requirement on the loans to deposit ratio of 80% that was to be effective in June 2017, 85% by December 2017 and 90% by June 2018. As of June 2017, only one bank achieved this target.

The Reserve Bank continued to conduct compliance checks to verify banks’ compliance wth the legal and prudential requirements. In addition, enhanced monitoring of banks’ reports to the Reserve Bank continued to ensure accuracy and timeliness of these reports to assist with the Reserve Bank’s policy decisions. Administrative penalties were imposed on breaches of the prudential requirements as well as the reporting requirements. During the year approved a temporary breach of the single borrower limit for one loan subject to conditions. Trainings were conducted by the Reserve Bank for the banks to assist banks with their awareness and implementation of the prudential and reporting requirements.

The Reserve Bank revoked the banking license of Pacific International Commercial Bank effective from 26th July 2016. This was after continuous enhanced supervision and monitoring of this commercial bank that was established in 2014 to ensure full compliance with the conditions of its licence. The Reserve Bank focused on protecting the interest of depositors and creditors by conducting the pay out of claims by PICB’s customers. To date all claims have been met. Court proceedings are in progress.

Following the introduction of the Foreign Exchange Levy Act which came into effect on 1st June 2016, the Reserve Bank discussed with the banks to ensure they are compliant with the Foreign Exchange Levy Act. Furthermore, the Reserve Bank permitted banks to charge a fee to pass on the costs of the new foreign exchange levy to their customers. This was on a cost recovery basis and to ensure banks can adjust their systems to enable them to impose this new levy. The Reserve Bank later lifted this decision and commencing in January 2017, all banks have absorbed the foreign exchange levy in order to contribute to reducing customers’ costs of foreign exchange transactions, similar to the Reserve Bank.

During 2016/17, the Reserve Bank received two new applications for banking license and meetings were held with the applicants to discuss the Reserve Bank’s requirements. There is work in progress to improve the

Economics update to Parliamentarians

sources for background checks and verifying information submitted in bank license applications.

Work is in progress to amend the Financial Institutions Act to rename as Banking Act, given its focus on bank licencing and supervision, and also to strengthen the controllership and receivership provisions for the resolution of problem banks and update of provisions to be in line with international best practices.

Revisions were also made to 4 out of the 12 Prudential Statements which became effective in April 2017. This was mainly to align the requirements of these Prudential Statements with the Financial Institutions (Amendment) Act 2014 and international best practices. This also included a revision to the calculator for the Annual Percentage Rate (APR) to incorporate feedback from the banks as well as enable the calculation of APR for loans with interest rates that are on a straight line basis.

The Reserve Bank continues to explore solutions to setting up of a credit bureau in Tonga to collect the credit information from the domestic banks which would contribute to the enhancement of the credit environment and promoting financial stability. The credit bureau based in Fiji which had serviced the domestic banks had terminated its operations in June 2017.

Pursuant to the provisions of the Financial Institutions (Amendment) Act 2014, the Reserve Bank, on 30th June 2017, for the first time forfeited unclaimed monies totalling $300,613.37 to the Government's account. These are unclaimed monies paid by the banks to the Reserve Bank for the years ending 2004 to 2011 and have remained unclaimed for more than 5 years after being paid to the Reserve Bank. Banks have been informed to advice customers of dormant accounts and any unclaimed money that has been paid to the Reserve Bank to encourage customers to make their claims prior to the due date for forfeiture of these unclaimed monies. Customers are also to claim their unclaimed money through banks in which banks are required to retain sufficient records to identify customers.

The Reserve Bank supported the Association of Banks to raise awareness and issue a public notice on safety measures to ensure they are protected from fraudulent activity or ATM skimming, particularly customers of the two largest banks. All customers that were affected by these fraudulent acts were fully reimbursed.

The Reserve Bank continued the monthly bilateral meetings with the banks as well as bi-annual meeting 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 development to ensure that they continued to operate prudently and in compliance with the Reserve Bank's requirements. Furthermore, technical meetings were carried out on specific issues mainly on reporting requirements.

The Reserve Bank Board is informed of developments in the banking system through a monthly report on banking sector development as well as other updates in the Governor's update to the Board on a monthly basis.

Banking System Financial Performance

Financial Position

The total assets of the banking system reached $769 million at the end of June 2017, a growth of $84.4 million (12.3%) over the year 2016/17. This resulted mainly from credit growth of 14.8% ($52.2 million) and a 14.6% ($32.1 million) growth in banks' deposits with depository institutions including their deposits with the Reserve Bank (Exchange Settlement Account and Statutory Reserve Deposit) which rose by $19.1 million (10%). In addition, banks' demand and time deposit holdings abroad rose by $8.9 million and $4.0 million respectively.

About 80% of credit growth over the year to June 2017 was attributed to banks' lending to individuals ($41.9 million). This consisted of mainly housing loans ($41.0 million) which reflected competitive low interest rates and housing loan packages offered by banks during the year. Banks' lending to businesses also rose during the 2016/17 financial year by $10.3 million (6.1%). Majority of loan beneficiaries were for businesses involved in retail & wholesale, manufacturing and construction indicating improvements in business confidence.

Government continued to offer its low interest rate loans through the Government Development Loan (GDL) scheme administered by TDB. The total outstanding loans under this scheme as of June 2017 was at $9.1

million compared to $6.6 million in June 2016. Of the total outstanding loan as of June 2017, 39.3% was lent to the agricultural sector followed by the fisheries and education sectors at 19.7% and 14.3% respectively.

Table 2: Financial Sector Deposit Accounts

	2015/2016	2016/2017
Demand Deposits		
Number of Accounts	27,731	17,162
Value of Deposits ($m)	208,578	242,289
Saving Deposits		
Number of Accounts	42,600	46,354
Value of Deposits ($m)	76,974	84,620
Time Deposits		
Number of Accounts	2,099	2,286
Value of Deposits ($m)	182,772	209,861
Total Number of Accounts	72,430	65,802
Total Value of Deposits ($m)	468.3	536.8

Total banks' liabilities rose over the year by $79.3 million (14.6%). Total deposits continued to fuel rises in total liabilities. All deposit categories increased with demand deposits rising the fastest by $33.7 million (16.2%), reflecting growth in private business deposits of $16.6 million and Government deposits of $15.9 million. Other liabilities increased by $8.2 million (30.5%) underpinned by Government's transfer of funds to TDB to fund its development loan scheme. In addition, an increase of $2.9 million (61.2%) in borrowings also contributed to the rise in total liabilities during the year.

The total number of deposit accounts reported by banks decreased over the year by 9.2% to 65,802 whilst the total value of deposits increased by $68.5 million to $536.8 million. This largely reflected some of the banks closing their dormant accounts which are mainly small valued accounts.

Profitability

The profitability of the total banking system improved in 2016/17 compared to the previous financial year. An after-tax profit of $18.317 million was recorded for the year ended June 2017, which is equivalent to 2.2% of average assets, compared to an after-tax profit of $16.889 million for the previous year, which was equivalent to 2.6% of average assets. This reflected a strong growth of 13.3% in total average assets over the year outweighing the improved profitability. The increase in profitability is attributed to a rise in both net interest income and non-interest income of $2.4 million and $1.9 million respectively, as well as a decline in provision expenses of $0.8 million which outweighed an increase in non-interest expenses of $3.8 million.

Table 3: Financial Performance

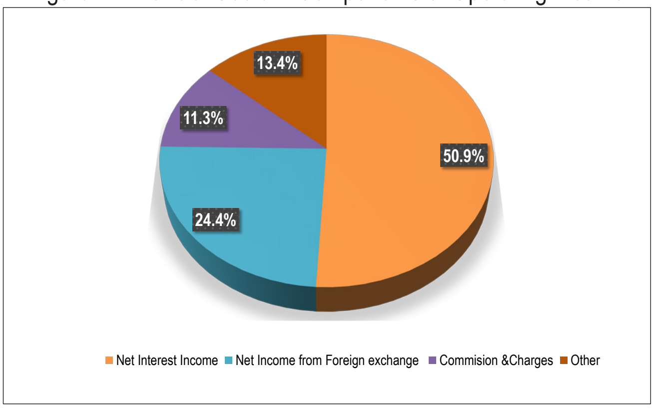
	2015/2016	2016/2017
Pre-tax Net Profit (% average total assets)	3.0%	3.2%
After-tax Net Profit (% average total assets)	2.2%	2.5%
Total Operating Income (% average total assets)	7.3%	7.0%
Net Interest Income (% average total assets)	3.7%	3.6%
Non-interest income (% average total assets)	3.6%	3.5%
Average Net Interest Margin (%)	3.7%	3.6%
Total Operating Expenses (% average total assets)	5.2%	5.4%
Consolidated Risk-weighted Capital Ratio (%)	34.0%	29.4%

Source: Licensed Financial Institution

1/Revised to reflect 12 months data

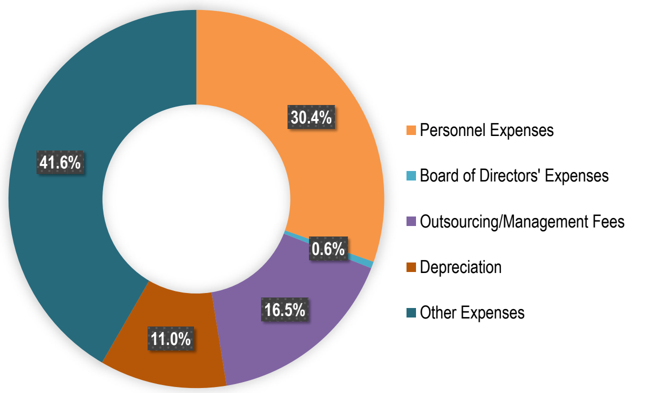
Total operating income of the banks was comprised mainly of net interest income at 50.9% followed by net income from foreign exchange at 24.4% compared with 50.5% and 25.9% respectively in June 2016. The growing net interest income is in line with the strong credit growth over the year for all banks.

Figure 7: Financial Sector - Components of Operating Income



Total operating expenses of the banks largely comprised of Other Expenses at 41.6% followed by Personnel Expenses at 32.8% and outsourcing & management fees at 16.5% compared with 40.9%, 32.8% and 13.4% respectively in the previous year. The increase in other expenses largely reflected the higher administrative expenses.

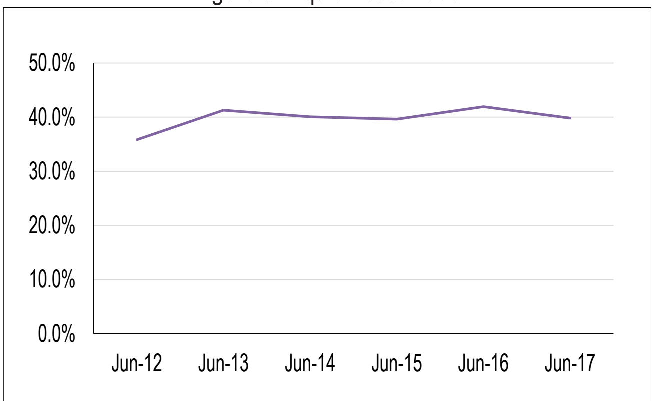
Figure 8: Financial Sector - Components of Operating Expenses



Liquidity

The banking system's liquidity continued to remain high during 2016/17. The increase in eligible liquid assets by $20.1 million over the year, mainly the higher Exchange Settlement Accounts contributed to the high liquidity which was in line with the higher foreign reserves despite the strong credit growth. Total loans as a proportion of deposits slightly increased to 75.4% in June 2017 from 75.2% that was recorded in June 2016. The Liquid Asset Ratio fell to 39.8% in June 2017 compared to 41.9% in June 2016 but continued to remain well above the Reserve Bank's minimum requirement of 5%.

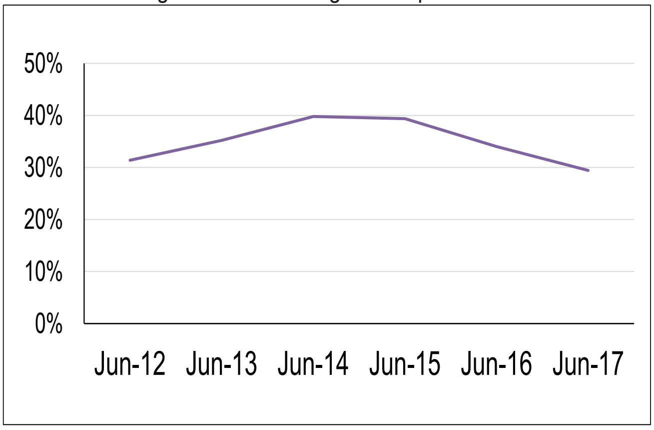
Figure 9: Liquid Asset Ratio



Capital

The capital position of the banking system remained strong during 2016/17. Despite the decline in the risk-weighted capital ratio (RWCR) at the end of June 2017 to 29.4% from 34.0% in June 2016, it remained well above the statutory minimum requirement by the Reserve Bank of 15%. The fall in the RWCR is largely due to a $67.4 million (18.0%) increase in risk-weighted assets reflecting the strong credit growth over the year ($52.2 million).

Figure 10: Risk Weighted Capital Ratio



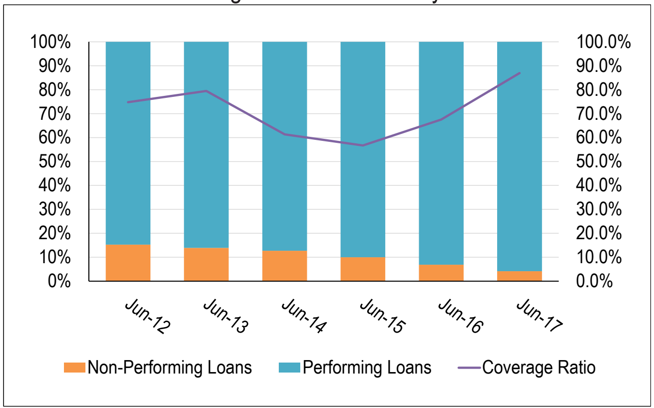
Asset Quality

The overall quality of the banks' assets improved over the year to June 2017. Total non-performing loans decreased by $7.3 million (30.1%) to $16.9 million at the end of June 2017. This largely reflected loan write offs as well as loan settlements during the year. The ratio of non-performing loans to total loans therefore improved to 4.2% from 6.9% in June 2016.

Business loans accounted for 55.6% ($9.5 million) of the total non-performing loans in June 2017 while the remaining 44.4% ($7.6 million) was in household loans. Housing loans accounted for 28.6% ($4.9 million) of total non-performing loans followed by non-performing loans from the tourism sector with 15.8% ($2.7 million [2 accounts]) and personal loans with 15.7% ($2.7 million).

The non-performing loans remained well covered by the provisions for loan losses although the total provisions fell over the year by $1.5 million (9.1%) to $14.8 million due mainly to the write off of a major loan. The coverage ratio remained high at 87.6% increasing from 67.5% in June 2016. The Reserve Bank continued to work closely with banks to ensure adequate provisions are in place as well as the accurate reporting of security values is maintained.

Figure 11: Asset Quality



The Financial Institutions-Banks department committed to 55 targets in the 2016 corporate plan in which 30 were successfully achieved and 3 were partially achieved. During the review of the 2016 corporate plan in 2017, targets were removed and revised, and new targets were added to guide the department in delivering its expected output. This resulted in a total 32 targets for 2017.

Non-Bank Financial Institutions Supervision

The supervision and oversight of all non-bank financial institutions remains work in progress. The legislations approved by Cabinet for the supervision of money lenders, credit union, microfinance institutions and foreign exchange dealers are still awaiting approval by the Legislative Assembly. The regulation of NBFIs is required to ensure the customers of these NBFIs are better informed of the risks associated with the NBFIs' products and that their interests are protected. This includes concerns with high interest rates charged by the informal lenders.

The Reserve Bank recognizes that regulation of NBFIs should be to a relatively lesser extent compared to bank supervision, as they are serving certain sectors of the economy or community whom are not serviced by the banks. The regulation of insurance companies, retirement funds and microfinance institutions are important to minimize potential systemic risks. The draft Financial Consumer Protection policy for financial service provide is being finalized, to enhance the protection of financial consumers and thereby maintain confidence in the financial system.

The authorized restricted foreign exchange dealers continued to be affected by the banks' de-risking decisions which have resulted in the closing of some of these authorized restricted foreign exchange dealers' accounts due to elevated money laundering and terrorist financing risks associated with authorized restricted foreign exchange dealers. The Reserve Bank continues to work together with the authorized restricted 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 continues to liaise with the banks to encourage them to offer alternative products for de-risking with the aim of maintaining and reducing the cost of remittances to Tonga.

Licencing and Supervision of Restricted Foreign Exchange Dealers

The licensing and supervision of foreign exchange dealers continue under the current Foreign Exchange Control Regulations, which are being amended to improve the Reserve Bank's regulatory and enforcement powers. During 2016/17, the Reserve Bank licensed one new authorized restricted foreign exchange dealer, taking the total number of licenced and registered authorized restricted foreign exchange dealers to 11.

In order to expedite the annual compliance checks of all authorized restricted foreign exchange dealers, all changes to the licensing/registration requirements were required to be submitted by the end of November, revised from end of December. The annual compliance checks found the majority of the foreign exchange dealers to be generally compliant with the conditions of the licensing / registration which formed the basis for the Reserve Bank's approval for these 11 authorized restricted foreign exchange dealers at the beginning of 2017 to continue their operations. Two of the commercial banks, namely BSP and MBf Bank continued to hold agency arrangements with MoneyGram. All banks are licensed as authorized dealers under their banking license.

Compliance spot checks, training of the authorized restricted foreign exchange dealers, stakeholder and quarterly meetings when required contributed to the improvement in the understanding and compliance with the conditions of license/ registration.

Other Non-Bank Financial Institutions

The Reserve Bank is authorized under section 4A(k) of the National Reserve Bank of Tonga (Amendment) Act 2014 to regulate and supervise financial institutions including NBFIs such as Retirement Funds, Insurance Companies, Credit Unions, Cooperative Societies, Credit Institutions, Money Lenders, Microfinance Institutions, Foreign Exchange Dealers, and Investments companies.

During the year, the Reserve Bank continued to set up the regulatory framework for each NBFI while awaiting the approval of the separate laws for the licencing and supervision of these NBFIs. Meanwhile, South Pacific Business Development (SPBD), a microfinance institution, continued to voluntarily submit financial information on their lending activities to the Reserve Bank on a monthly and annual basis.

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 that is conducted by the Settlement Unit on a daily basis is operating well.

Tongan Culture Performance at AFI 8th Annual Global Policy Forum. Nadi, FIJI

Interbank Cheques Clearance

The Reserve Bank facilitates a daily 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. A total of 156,842 cheques were presented for clearance at the Reserve Bank during the financial year 2016/2017 an increase of 1.5% from the previous year. The increase in the number of cheques presented for clearance is attributed to higher level of economic activities over the year. The clearance of cheques in the centre is running well and all participants are committed to settle their dues on time.

During the year, Settlement Unit participated in the review of the 2016 Corporate Plan. The Unit was assigned three measurable targets for the calendar year 2016 which were all achieved. The review also added on ten new measurable targets for the 2017 calendar year. These new targets were related to promoting an efficient and secured payments system and the modernisation of the operations of the Reserve Bank.

Settlement Corporate Plan Targets

The Financial Institutions-Non Banks department committed to 17 targets in 2016 corporate plan in which 12 were successfully achieved. The main reason for not achieving the remaining targets was the delay in the enactment of the laws for the licencing and supervision of NBFIs. During the review of the 2016 corporate plan in 2017, targets were revised and removed, and new targets were also added to be more practical and relevant. A total of 14 targets were approved in the 2017 corporate plan.

Financial Inclusion

2016/17 was the Reserve Bank's year for financial inclusion. The Reserve Bank winning the Maya Declaration Award in September 2016 at the first Alliance for Financial Inclusion (AFI) Global Policy Forum (GPF) to be held in the Pacific, is a milestone to reminisce. This award recognizes the Reserve Bank out of more than 100 member institutions representing over 90 nations across the globe, as the institution with clearly defined measurable targets, and the most dedicated progress reporting via the AFI Data Portal. This is the AFI's integrated global database on financial inclusion policies, regulations, and outcomes, that allows members to track and view progress made against their Maya Declaration commitments as well as key financial inclusion indicators. The Maya Declaration is the first global commitment by policymakers from developing and emerging countries to unlock the economic and social potential of the poor through greater financial inclusion.

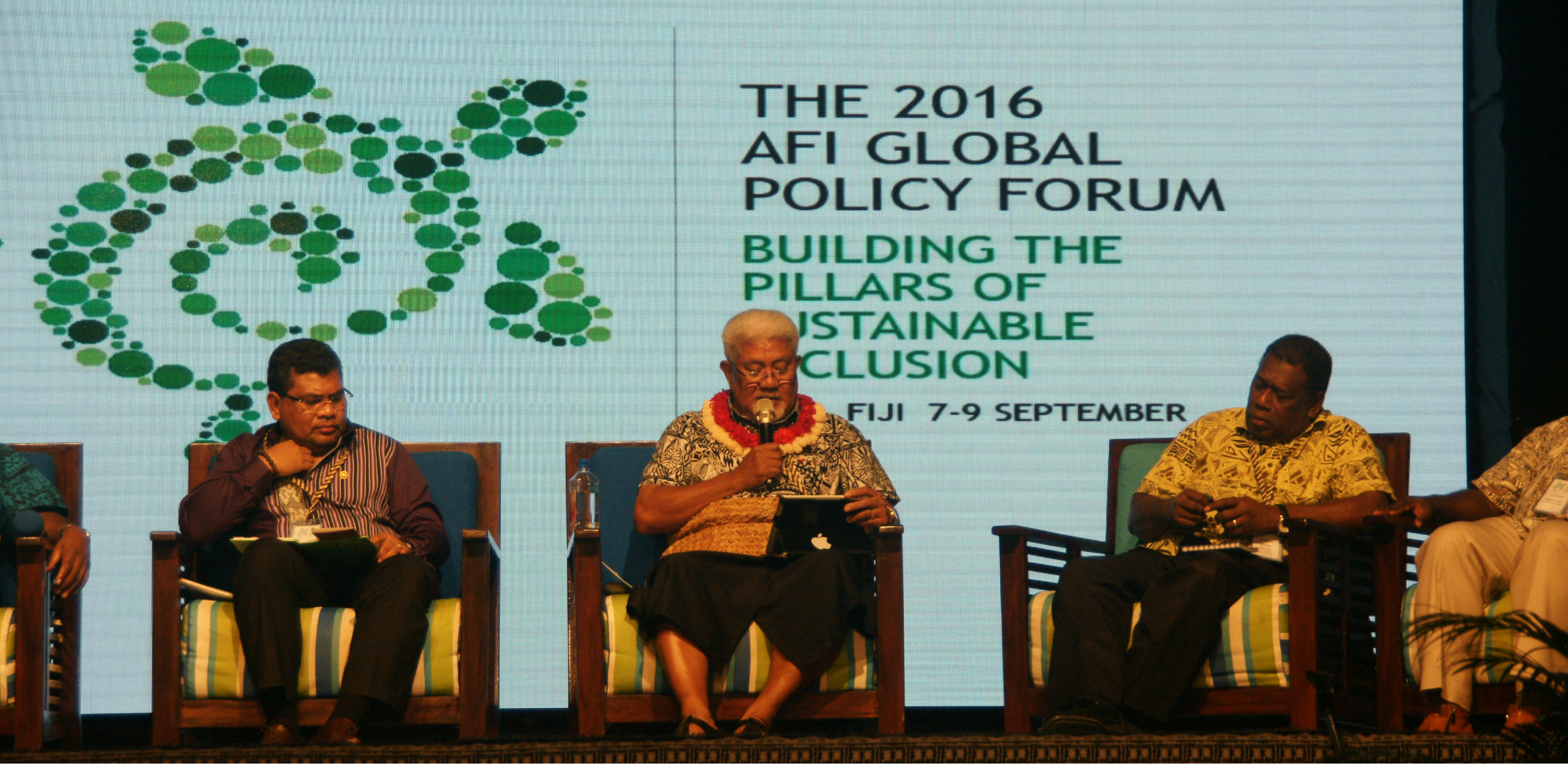
The Reserve Bank engaged relevant national and international stakeholders to support its financial inclusion journey. Coordinated efforts are being acknowledged and buy-in of important stakeholders such as the ministers, government officials as well as the private sectors will be crucial for the initiative to be effective. One-on-one consultations with key stakeholders were conducted with the assistance of the Pacific Financial Inclusion Program (PFIP) in the lead up to the formulation of a national financial inclusion strategy.

The Reserve Bank has made a commitment under the Maya Declaration to develop and improve access to finance for Micro Small and Medium Enterprises (MSMEs) by 20% in 2020, focusing on the agricultural, fisheries, tourism sectors, women and youth; and also to develop policies and regulations for MSME finance, consumer protection and financial literacy. In working towards achieving this commitment, the Reserve Bank has encountered a number of challenges which includes the lack of data or statistics on MSMEs and their access to finance. There was no uniform definition of MSMEs and therefore the data collected were not entirely on consistent basis. The Reserve Bank recognized the importance of statistics in order to measure its progress with its Maya Declaration commitment which in turn reflects the progress of SMEs' access to finance. The Reserve Bank therefore adopted the definition used by the Ministry of Commerce Consumer Trade Innovation and Labour which is based on the number of employees and sales turnover.

Another challenge encountered by the Reserve Bank was the coordination of efforts towards developing SMEs and their access to finance. The Reserve Bank hosted a MSME Workshop in November 2016 with the objectives to identify the challenges faced by MSMEs in accessing finance as well as to develop strategies to address those challenges, using the outcome of an informal survey of MSMEs access to finance conducted by the Reserve Bank as a basis for these discussions. To confirm the strategies developed at this workshop, the Reserve Bank also conducted bilateral consultations with relevant stakeholders with the view of establishing a MSME working group to drive the implementation of these strategies. Work is still in progress to re-strategize and reconsider how to be more effective in driving this initiative given the current business, economic and political conditions.

In February 2017, the Reserve Bank's mandate under section 4 of the National Reserve Bank of Tonga Act was also extended to include promoting financial inclusion, as it recognizes that this supports its role of ensuring inclusive economic growth and macroeconomic stability, and that financial inclusion is not just about the availability and sustainability of financial services in the remote areas, but also the affordability and relevance of these

NRBT workshop on improving MSME access to finance. Davina House, TONGA



Pacific Central Bank Governors at AFI 8th Annual Global Policy Forum

services to the livelihood of the people of Tonga.

Data collected by the Reserve Bank shows that access to financial services has improved over the year with all core set of indicators increasing. The number of bank branches, ATMs and bank agents per 10,000 adults increased over the year resulted in increasing deposit accounts, percentage of administrative units with at least one access point and the overall number of access points per 10,000 adults at a national level.

Table 4: AFI Core Set of Indicators

	2016	2017
Number of access points per 10,000 adults at a national level	60	89
Number of commercial bank branches per 10,000 adults at a national level	2	3
Number of ATMs per 10,000 adults at a national level	3	4
Number of agents per 10,000 adults at a national level	2	3
Percentage of administrative units with at least one access point	65	76
Number of deposit accounts per 10,000 adults	8,797	10,157

Source: Banking System

The Financial Inclusion department committed to 8 targets in the 2016 corporate plan in which 5 were successfully achieved. The main reason for not achieving the remaining targets was the need to reconsider the department's role in light of the developments in the market and stakeholders. During the review of the 2016 corporate plan, targets were revised and removed, and new targets were added to be more focused and better guide the department in delivering its expected output. A total of 31 targets were approved in the 2017 corporate plan.

Financial Intelligence Unit

The Transaction Reporting Authority is Tonga's Financial Intelligence Unit (FIU) responsible for administering the requirements of the Money Laundering and Proceeds of Crime (MLPC) Act. Amongst other anti-money laundering related functions, the FIU is responsible for receiving, analysing and dissemination of suspicious reports. The FIU is also responsible for the supervision of financial institutions and cash dealers in accordance with their obligations under the MLPC Act and Regulations. This in turn supports the Reserve Bank's objective of promoting a safe and sound financial system. The FIU's role and functions prescribed under the MLPC Act includes policy formulation and enforcement.

Supervision & Compliance

During the year, the FIU continued with its supervision and reports analysis functions in accordance with the requirements of the MLPC Act and Regulations.

To complete the annual compliance check, the FIU together with the Financial Institutions, Non-Banks Division conducted compliance visits to 13 authorized restricted foreign exchange dealers during October 2016 – December 2016. The visits were to verify compliance of these entities with their licensing conditions which also includes Anti-Money Laundering/Counter Financing of Terrorism (AML/CFT) related requirements. The findings of these visits were generally compliant; further spot checks were conducted to riskier entities in March 2017 to follow up on issues of concerns identified in the annual compliance check that was completed in December 2016.

The annual compliance checks and vigilant monitoring of the AML/CFT compliance of the authorised restricted foreign exchange dealers also supported the Reserve Bank's efforts to improve their compliance status in light of the rising concerns of de-risking. The FIU shared compliance reports of its reporting entities with one of the banks, with the endorsement of relevant authorised restricted foreign exchange dealers, to assist in the bank's review of its banking relationship with its money remitter customers. This was part of the efforts to assure the banks that foreign exchange dealers are also being actively supervised and are in compliance with AML/CFT requirements and thereby to support the banks' decision to retain their bank accounts.

In October 2016, the FIU received technical assistance from the United Nations Office on Drugs and Crime (UNODC) under the Global Program on Money Laundering assistance to Pacific countries including Samoa, Cook Islands, Niue and Tonga. The UNODC advisor visited the FIU and other domestic law enforcement agencies in April and October 2016 basically to assist with providing AML/CFT advice, training and technical assistance to build AML/CFT capacity of relevant agencies and to support the coordination mechanisms to ensure the effective implementation of Tonga's AML/CFT regime. The FIU benefitted from this assistance through the success of the "Mystery Shopper Exercise" which anonymously tested the effectiveness of the AML/CFT controls and practices in the domestic financial system in situations where criminals attempt to perform illegal transactions. Several weaknesses and breaches of the AML/CFT requirements were identified by this exercise, which assisted the FIU to address these issues and also strengthen its supervision and monitoring of the reporting entities. The FIU is looking into conducting targeted compliance visits to its reporting entities in their effort to increase its effectiveness. The Reserve Bank also benefitted from this exercise through the identification of a number of operations in Tonga who were conducting un-authorized foreign exchange dealing and required them to apply for a license from the Reserve Bank.

During the year, the FIU responded to a number of requests for financial information from Ministry of Revenue & Customs to assist with ongoing investigations and especially in relation to STRs disseminated to them. Information were collected from all the reporting entities in relation to these requests. The MLPC Act allows for collecting of any information relevant to serious offences and that FIU can instruct any financial institutions and cash dealers to take steps in relation to any information or report, to enforce compliance or to facilitate any investigation anticipated by the FIU or a law enforcement agency.

The FIU conducted its first biannual training for the year on AML/CFT requirements to all its reporting entities in February 2017. The training focused on enhancing the understanding of all reporting institutions on the obligation to identify and report suspicious activities. This was also an opportunity for the FIU to provide feedback to its reporting entities on the reports submitted by them.

In April 2017, the FIU contributed to the review of the Reserve Bank's Corporate Plan for 2017-19. 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. For this calendar year, the FIU has a total of 17 targets to achieve. The FIU's targets are aimed at effectively supervising its reporting entities, ensuring a well-informed regime and to comply with global AML/CFT related requirements.

Throughout the year, the FIU also completed all due diligence check requests from different departments within the Reserve Bank. These checks were commonly for applicants for exchange control transactions, numismatic coin collectors, suppliers and several others. The results of these checks were generally non-suspicious and were communicated to each requesting department.

Reports & Statistics

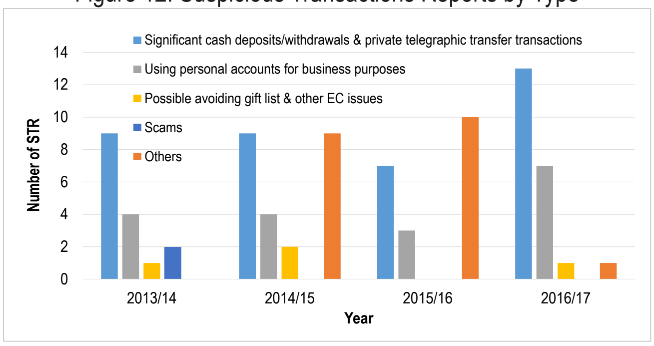
Table 5: Number of Reports Received

Types of reports filed	2014/15	2015/16	2016/17
Suspicious Transaction Reports (STRs)	24	20	22
Currency Transaction Reports (CTRs)	4,138	7,087	8,668
Border Currency Reports (BCRs)	36	52	80

The FIU received 22 STRs from the commercial banks and authorized restricted foreign exchange dealers during the year, increasing by 2 reports from the previous year. The number of CTRs increased by 18% from the previous year totaling to 8,668 reports filed in 2016/17. Total BCRs also increased this year by 35% totaling to 80 reports filed by the Ministry of Revenue & Customs. The FIU retains the information obtained in these reports to assist in its analysis function

Reports analysis & Information sharing

Figure 12: Suspicious Transactions Reports by Type



The dominant STR indicator continued to be significant transactions that were inconsistent with the customer's known background or the source of fund were undetermined. This included significant cash deposits or withdrawals as well as significant private telegraphic transfer transactions. The next dominant STR indicator was the use of personal accounts for conducting of business transactions. The remaining STRs were related to several indicators such as large and rapid movement of funds and structured payments.

Table 6: Number of STRs Disseminated

Law Enforcement Agencies	2014/15	2015/16	2016/17
Ministry of Police	5	2	1
Ministry of Revenue & Customs	6	13	8
Ministry of Foreign Affairs (Immigration)	0	0	1
MCCTIL	0	0	1

Following the analysis of the 22 STRs received, 8 STRs were disseminated to the Ministry of Revenue & Customs for further investigation of possible contravention of tax related requirements. 1 report was passed to Police for further investigation of possible serious offence, 1 report was referred to the Immigration Department given one of the issues was related to the validity of the travel documents submitted and 1 report was referred to the Ministry Commerce, Consumer, Trade, Innovation & Labour for further investigation given the involvement of some business license related issue. Given 11 out of the 22 STRs were filed by the FIU as they did not warrant any further investigation by the law enforcement authorities, this prompted the FIU to improve the effectiveness and relevancy of the trainings provided to the reporting entities, and provide more feedback to reporting entities on STR related issues to increase their awareness on suspicious indicators which will in turn raise the quality of the STRs submitted to the FIU.

Table 7: CTR Data Analysis

	2015/16 (TOP$ million)	2016/17 (TOP$ million)
Inwards	119.5	132.6
Outwards	59.6	68.7
Transaction purpose		
Business	83.5	91.6
Personal	95.6	109.7
Transaction type		
TT	34.5	25.2
Cash	72.2	103.6
Cheque	41.4	40.9
Other	26.8	25.6
Cash/ Cheque	4.2	6.0

From the 8,668 reports received this year, majority of the reports were for inward transactions which are classified into cash, cheque, telegraphic transfers and other deposits. Cash continues to be the dominant type of transaction reported over the year followed by the use of cheques and telegraphic transfers. This is similar to the one of the most common STR indicator of significant cash transactions.

Table 8: BCR Data Analysis

	2016/17 (TOP$ million)
Inbound	0.6
Outbound	36.5
Purpose of funds	
Business	36.4
Personal	0.7

The FIU received 80 BCRs this year from the Ministry of Revenue & Customs. Majority of the reports were for outbound funds and were mostly shipments of currencies for authorised restricted foreign exchange dealers and commercial banks. A very few of the outbound fund reports were for individual travellers and these were mainly travellers carrying cash sourced from their businesses or bank accounts for overseas spending. All outbound funds for authorised restricted foreign exchange dealers and commercial banks received prior approval of the Reserve Bank and a few of the individual travellers without proper approval were dealt with by authorised officers at the border. Inbound funds carried across the border were mostly for individual travellers returning or visiting Tonga. Funds of both inbound and outbound travellers who failed to make a declaration at the border were seized by the Ministry of Revenue & Customs and offending travellers were charged with penalties accordingly.

The FIU also conducted analysis of the notes conversion report from banks and authorized restricted foreign exchange dealers and making comparison with information reported from the Ministry of Revenue & Customs on the BCRs. The analysis was done on individuals converting notes/ buying Tongan Pa'anga with amounts exceeding the BCR declaration threshold of TOP$10,000 but were not reported from the Ministry of Revenue & Customs as they were not declared at the border. These information were passed on to the Ministry of Revenue and Customs to assist with the profiling of travellers. With the Inter-agency MOU in place, the FIU was able to share 7 monthly reports during the year.

The FIU continued to disseminate on a monthly basis the terrorist list from the Office of Foreign Assets Control's (OFAC) of the United States Department of the Treasury of Specifically Designated Nationals (SDN) and the dissemination list of the Non-Cooperative Countries and Territories and countries that are subject to the Financial Action Task Force's public statements.

FIU Corporate Plan Targets

In April 2017, the FIU contributed to the review of the Reserve Bank's 2016 Corporate Plan. 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. For the previous year, the FIU had a total of 10 targets with 8 achieved and 2 targets partially achieved to be completed in 2017. Following the review and setting the corporate plan for 2017-19, 1 target was removed, 2 were revised and 8 targets were added on, therefore the FIU has a total of 17 targets to achieve. The FIU's targets are aimed at effectively implementing the Money Laundering & Proceeds of Crime Act and Regulations through improving awareness and enforcing compliance with the AML/CFT requirements, improving capacity to share information with domestic and foreign counterparts, and enhanced risk based supervision. This would also contribute to addressing the de-risking and de-banking decisions by global banks due to elevated AML/CFT risks associated with smaller sized financial institutions such as money remitters, as well as banks outside of the US.