

ANNUAL REPORT

2021



NATIONAL RESERVE BANK OF TONGA



Annual Report
For year ended 30 June 2021

National Reserve Bank of Tonga





National Reserve Bank of Tonga
Sālote Road
Nuku'aloa
Kingdom of Tonga

Issued by:

Economics Department
National Reserve Bank of Tonga
Private Mail Bag No. 25
Post Office
Nuku'aloa
Kingdom of Tonga

Subscription:

Private Mail No. 25
Post Office
Nuku'aloa
Kingdom of Tonga

Postal Address:

Phone: (676) 24-057
Facsimile: (676) 24-201
Email: nrbt@reservebank.to

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Governor's Foreword



I am pleased to present the annual report for the financial year 2020/21, another challenging year as the COVID-19 pandemic continues to impact the Tongan economy. 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 2021.

The International Monetary Fund (IMF) World Economic Outlook update in July 2021 forecasts global growth to rebound by 6% in 2021 from a negative growth of 3.2% in 2020. This sharp recovery in 2021 reflects the impacts of sizeable fiscal support in major economies, particularly the US and the Euro area. In addition, the COVID-19 vaccine roll-out across countries is expected to strengthen business confidence, underpinned by expansionary policy actions supporting overall growth for 2021. Tonga's major trading partners' economies in the first quarter of 2021 also showed recovery. The New Zealand economy rose by 1.6% and the Australian economy by 1.1%.

During the 2020/21 year, the COVID-19 pandemic's impact on the global economy had adverse effects on the domestic economy. The extension of the travel restrictions resulted in the weak performance in the service sector as well as lower primary sector exports. The Reserve Bank therefore projects that the Tongan economy will contract in 2020/21 by 2.9% then recover with a positive 2.1% growth in 2021/22. These projections reflect the assumption that the borders will open in 2022 and exports via air cargo and activities within the service sector, particularly tourism-related activities, thrive. The positive economic activities in the agriculture and fisheries sectors are also incorporated into the projections.

At the end of June 2021, the annual headline inflation remained low at 1.2%, well below the 5% reference rate. This is due to the decline in domestic prices reflecting the recovery efforts of growers, government assistance following Tropical Cyclone Harold, and households engaging in subsistence farming, resulting in abundance of food supply in the market. Imported prices rose substantially reflecting the rise in the prices of oil, food items and gas and other fuel. The impact of COVID-19 and the increase in food prices in Tonga's major trading partners contributed to the increase. Higher shipping costs and delays in shipments due to the COVID-19 restrictions across borders and additional quarantine requirements

affected the availability of imported goods and are estimated to have contributed to higher imported prices.

The official foreign reserves rose to \$715.2 million at the end of June 2021, equivalent to 12.5 Months of Import Cover (MOI), from \$543.8 million (9.2 MOI) last year, remaining above the minimum level of 3 MOI. The increase in the foreign reserves is mainly due to receipts of budget support from donor partners, loan drawdown, and grants for COVID-19 preparations and TC Harold relief funds. Private remittances also rose strongly over the year by 31.5% further supporting the high foreign reserves. The exchange rate basket currencies also fluctuated on the more robust economic outlook amid the COVID-19 vaccination roll outs. At the end of the year, the Tongan pa'anga nominal and real effective exchange rates decreased compared to the June 2020 levels reflecting an improvement in Tonga's trade competitiveness and further supporting foreign currency receipts. At the same time, inflationary pressure may result from the decline in the nominal effective exchange rate through higher import prices.

The accommodative monetary policy stance was maintained throughout the year to encourage banks to lend while maintaining liquidity in the banking system at high levels. Although the risks to financial stability have elevated, the financial system was assessed to be safe and sound, supported by the banks' strong capital position, excess liquidity, adequate profits, and an improvement in the banks' overall assets with non-performing loans decreasing over the year. The additional policy measures to mitigate the impact of the COVID-19 pandemic on the domestic economy were maintained while ensuring the banks remained resilient against the emanating risks to financial stability.

During the year, the Reserve Bank continued to strengthen its supervisory framework and modernise the financial infrastructure through developing the automated National Payment System, Know Your Customer System and the credit registry system. The Reserve Bank continued with its functions of effectively licensing, regulating and supervising of financial institutions both banks and non-bank financial institutions (NBFIs) and issued 3 new prudential statements.

In response to COVID-19, the commercial banks assisted impacted customers by extending the COVID-19 loan relief packages while maintaining compliance with prudent lending

practices. Over the year, bank loans decreased by 2.1% to T\$482.4 million as at June 2021. The contraction in credit growth reflects the 4.8% decline in lending to businesses, which offset the 0.1% growth in household loans. Total lending stood at T\$492.9 million at the end of June 2020, an increase of 1.4% compared to the previous year. In line with the accommodative monetary policy, interest rates on bank loans declined mainly those offered to businesses in the construction, utilities, agriculture, fisheries, and the services sectors. Similarly, interest rates offered on individual personal loans also fell contributing to the decline in lending rates. Bank deposit interest rates also declined for all deposit types and the banking system saw a significant increase in the volume of deposits.

To promote access to finance, enhance inclusive economic growth and in anticipation of the banks becoming risk averse due to the ongoing high vulnerability to natural disasters and the recent COVID-19 pandemic, the Reserve Bank continued to develop the non-banks financial institutions to provide a viable alternative to bank loans. During the year improvements to the legal and regulatory environment for NBFIs continued to protect the borrowers while also encouraging the development of new financial solutions or products. Lending activities in the NBFIs also declined in the year to June 2021 by 1.5% (\$1.6 million) to T\$105.2 million, largely reflecting the repayments of loans during the year.

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. During the year, the FIU ensured the foreign exchange dealers were compliant with their anti-money laundering obligations, engaged with law enforcement agencies, contributed to the review of the National Risk Assessment report as well as Tonga's mutual evaluation by the Asia Pacific Group on money laundering. Due to the COVID-19 travel restrictions this evaluation process resumed in November 2020.

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 continued to fall coinciding with the fall in Overseas Exchange (OET) payments as well as applications for sending of foreign cash across the 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 which was attributed to an increase in demand for notes and coins for Christmas spending, end of year celebrations and development groups' savings distributions.

On the financial performance, the Reserve Bank is reporting a net profit of T\$0.2 million for the 2020/21 financial year, lower than T\$4.27 million in the previous year. The lower net profit is attributed to the COVID-19 pandemic's 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 Reserve Bank. On the expenditure side, total expenditure declined by 10% compared to the 2019/20 level. The decline in expenses was attributed to the COVID-19 border restrictions resulting in the deferment of overseas official meetings and training as well as technical assistance for the annual maintenance services of the building, plant and equipment.

During the year, the Chairman of the Board Mr. Steve Edwards retired after serving the bank for 10 years. The Directors continued to carry out their functions outlined in the NRBT Act and reviewed and approved the achievement of 93% of the corporate plan targets for 2020/21 as well as the Corporate Plan for 2021/22. Targets were also set to maintain the stable and well capitalised financial system by ensuring banks are resilient against the impact of COVID-19 and an economic downturn, while at the same time continue to be an effective driver of economic growth.

At the end of another challenging financial year 2020/21, the Bank has achieved its principal objectives and functions outlined in the NRBT Act of maintaining 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 Reserve Bank and the responses 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 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 & 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:

- (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;

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

OUR VISION

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

OUR 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.

OUR VALUES

Integrity

Being professional and exercising sound judgement

Innovation

Continually improving what we do

Team Work

Working together for a more effective Bank

Excellence

Producing high quality work

STRATEGIC PRIORITIES

Strategic Priority #1:

Set a Platform for Tonga Becoming a High-Growth Economy

Strategic Priority #2:

Develop Tonga's Financial Markets

Strategic Priority #3:

Become the Employer of Choice

Strategic Priority #4:

Modernize the Operations of the Bank

Governance



Key Decision Makers

The Board of Directors comprises of the Chairman (non-executive Director), the Governor, the Secretary for Finance, and five 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, the Chairman of the Board, Mr. Steve Edwards, retired from the Board after serving as Chairman for ten years and as a member of the Audit Committee for three years. Consequently, at the end of June 2021, two director positions remained vacant.

In accordance with the Act, the Board must meet at least ten times during the calendar year to discuss and formulate the Bank's policies and monitor its operations. The Board Finance Committee also met regularly to discuss and vet all Board matters well before every Board meeting and fulfill any requirements for further consideration at the Board. While the Board Finance Committee met ten times during the financial year, the Board also met nineteen times to formulate the policy of the Bank, monitor the Bank's operations and provide strategic direction and advice to the Governor.

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 continued to monitor and discuss the economic impact of COVID-19 pandemic on the Tongan economy and adopted the monetary policy stance with additional policies which was published monthly. These additional measures to assist

with the COVID-19 and the accommodative monetary policy stance was 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. The foreign reserve management policy was also discussed and amendments to the risk parameters were endorsed. The directors also considered and supported the Government request for disbursement under the IMF Rapid Credit Facility.

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 3 new prudential banking standards on operational risk management, cybersecurity and Syndicate lending. Through the updates to the Board the directors monitored the progress on implementing the Moneylenders Act and the licensing process and procedures. The Directors also endorsed the credit union bill. They continued to monitor the progress on developing the legislation on regulating the provident fund and insurance companies in Tonga. Special projects were also monitored to enhance the financial stability policies of the Bank, these projects included the development of the Tonga National Payment System, the Know Your Customers Customer and the credit bureau project. During the year, the Directors also endorsed the press release warning the public that pyramid schemes were illegal.

To ensure financial stability was maintained and that depositors' funds are protected at all times, the Directors discussed the commercial bank's liquidity, capital, credit growth and profitability 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 Directors approved amendments to the Financial Institutions Act, renamed as the Banking Act, to strengthen the process on controlling or closure of a bank and redefine banking business to exempt private placements of bonds, notes, and other securities. The Directors also discussed the lending by non-bank financial institutions, the indebtedness of businesses and individuals, its impact on financial stability, and the effectiveness of the credit bureau to mitigate these risks. Tonga's APG Mutual Evaluation report was discussed and the effect of this evaluation on the anti-money laundering regime and its implications for de-banking and de-risking on the financial system. The Directors also noted a non-compliant non-bank financial institutions license that was revoked. To further support the financial system's stability, the Directors approved the Payment and Settlement Systems Oversight Regulations 2020.

The Directors ensured the annual financial statements were prepared in accordance with internationally accepted accounting standards.

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 also approved a major project to upgrade the NRBT Central Air Condition System.

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. The Directors also endorsed the 2021/22 annual budget and the organization chart of the Bank, the Program Output Budget and Corporate Plan 2021/2022, as well as the Annual Report for 2019/20.

Board of Directors



Mr. Steve Edwards *
Chairman



Mr. Richard Prema
Deputy Chairman



Mrs. Joyce Mafi
Director



Mrs. Sinai Tu'itahi
Director



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

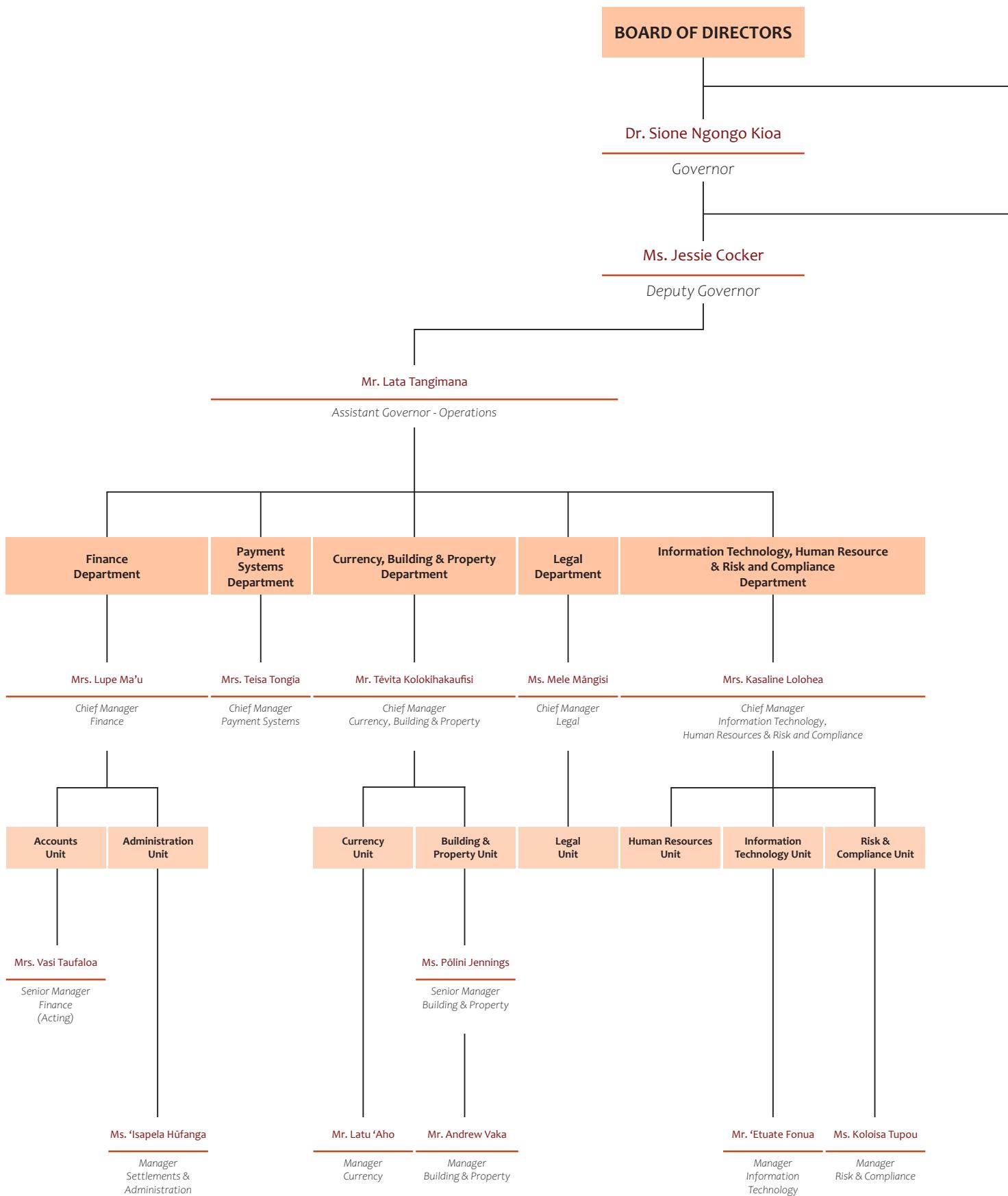


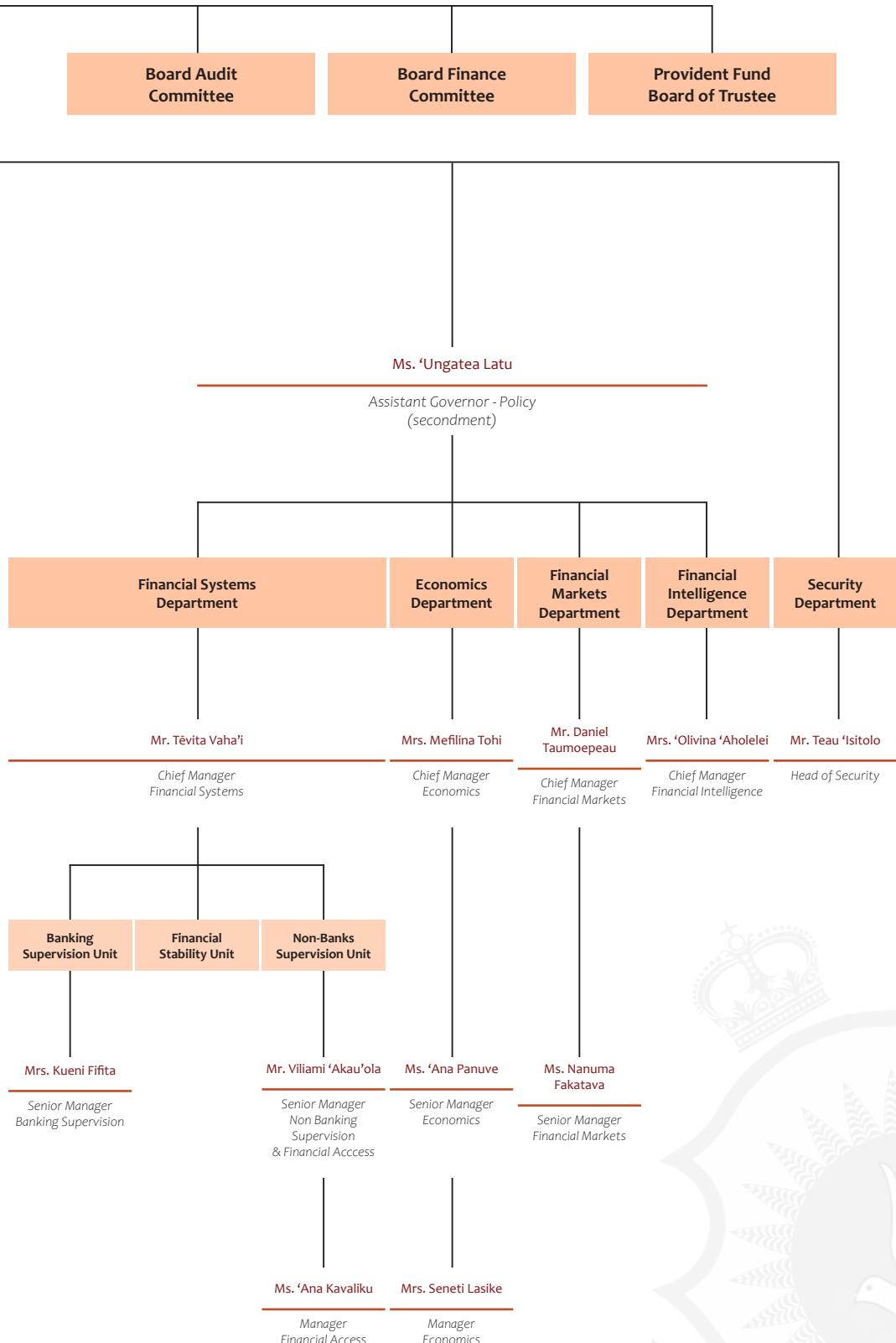
Dr. Sione Ngongo Kioa
Governor

* Retired February 2021

Organizational Structure

June 2021





Corporate Plan

In May 2020, the Board of Directors approved the revised Reserve Bank's Corporate Plan for 2020/21 with 400 measurable targets. The corporate plan was reviewed at the end of March 2021 and it showed that overall the Bank had achieved 90% of the 400 Corporate Plan targets for 2020/2021. However, at the end of June 2021, 93% of the 400 targets were achieved.

The staff continued incorporating the balanced scorecard as an 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.

400 Measurable Targets

93% Achievement Level



The criteria are;

1. **Quality:**
weighted at 75%; which takes into consideration
 - *Accuracy*
 - *Completion and*
 - *Comprehensiveness;*
2. **Timeliness:**
weighted at 45% and refers to
 - *Promptness of response and*
 - *Meeting deadlines;*
3. **Compliance:**
weighted at 30% relating in terms of
 - *Legislation,*
 - *Policies,*
 - *Procedures and*
 - *Protocols.*

The 93% achievement level is a significant milestone as it was attained during challenging times.

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 global economy is projected to rebound by 6.0% in 2021 from a negative growth of 3.2% in 2020, according to the IMF July 2021 World Economic Outlook (WEO) update. The sharp recovery for 2021 reflects the impacts of sizeable fiscal support in major economies, particularly the US and the Euro area. In addition, the COVID-19 vaccine roll out across countries is expected to strengthen business confidence, underpinned by expansionary policy actions supporting overall growth for 2021.

For advanced economies, growth is projected to recover by 5.6% in 2021, compared to an estimated decline of 4.6% in 2020, following positive signs of recovery in the second half of 2020. This is attributed to the quick recovery in business activities, supported by ongoing COVID-19 vaccination programs, higher consumption spending and investments. The US economy expanded at an annual rate of 6.4% in the first quarter of 2021 (US Bureau of Economic Analysis), driven by higher household spending and private investments. Hence, growth in the US is expected to rise by 7.0% in 2021, supported by substantial fiscal packages to stimulate recovery in economic activities. Similarly, the Australian economy rose in the year to March 2021 by 1.1%, as reported by the Australian Bureau of Statistics. Meanwhile, the New Zealand (NZ) economy rose by 1.6% in the first quarter of 2021 due to the recovery in the services and manufacturing sectors, although it declined at an annual rate of 2.3% (Statistics NZ).

Commodity prices are expected to rise significantly, pushing up headline inflation. This is due to the recovery in the global oil market, while non-oil commodity prices are projected to increase by around 30% compared to 2020. In line with the resumption of construction activities and manufacturing in China, higher metal prices are expected to put upward pressure on inflation levels.

World oil prices averaged around US\$55.64 per barrel in the year to June 2021, higher than the US\$51.22 per barrel in the year to June 2020, as reported by Reuters. The average oil price for June 2021 was US\$73.28 per barrel, which was significantly higher than the average of US\$40.47 per barrel recorded in June 2020. This increase in global oil prices is in line with the recovery in the global economy fuelling high demand as restrictions begin to lift and global travel resumes with the ease of COVID-19 restrictions, particularly across

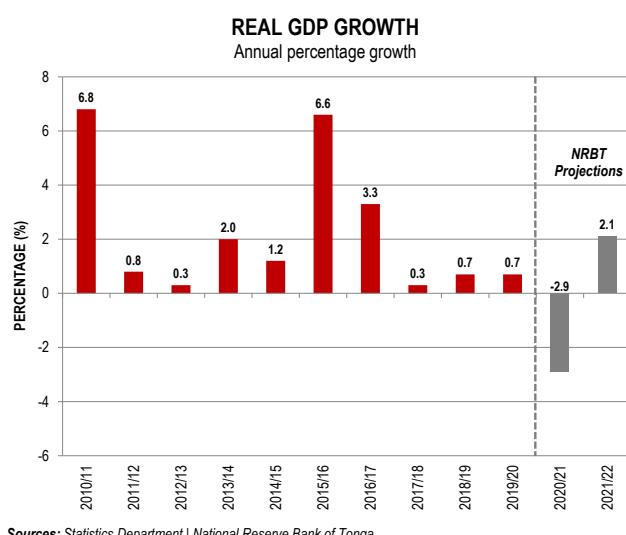
The Reserve Bank forecasts a positive 2.1% growth in 2021/22 ...

Asian economies. The reduction of oil production from OPEC+ (including Russia and other non-OPEC oil exporters) contributed significantly to the higher global oil prices. The IMF projected global oil prices to increase by 60% compared to the 2020 low base.

Developments in the Domestic Economy

The Tonga Statistics Department estimated a 0.7% economic growth for the financial year 2019/20, similar to that of the previous year. This growth was largely attributed to the human health and social work activities instigated to combat the pandemic and the vibrant activities prior to the COVID-19 outbreak in the wholesale and retail industry and other service industries.

FIGURE 1: REAL GDP GROWTH



Sources: Statistics Department | National Reserve Bank of Tonga

The NRBT projects a contraction in economic growth by 2.9% in 2020/21, mainly driven by the impact of the pandemic and the weak performance in the service sector, given the extension of the lockdown restrictions and lower primary sector exports over the year. However, the NRBT forecasts a positive 2.1% growth in 2021/22, assuming that the borders will open in 2022 and exports via air cargo and activities within the service sector, particularly tourism-related activities, thrive.

The primary sector is forecasted to decline by 3.0% in 2020/21 compared to a 0.8% growth in 2019/20, driven by the expected negative 15.0% growth in the fisheries sector

and a negative 1.5% growth in the agricultural sector during 2020/21. Over the year to June 2021, the marine export volumes fell by 457.1 tonnes (23.9%), reflecting the setback in exports via air cargo due to the prolonged lockdown of borders. At the same time, marine export proceeds also declined by \$4.0 million (46.2%). The agricultural sector also recorded a fall in its export volumes over the year to June 2021 by 2,639.5 tonnes (20.0%). Main contributors to this decline were the unfavourable squash harvest season during the year and lower coconut exports. The decreasing coconut exports reflected the damages caused by TC Gita and TC Harold on coconut plantations, resulting in a coconut shortage in the local markets. Consequently, the agricultural proceeds declined over the year to June 2021 by \$1.2 million (15.1%). Nevertheless, the sector is still supported by the Government's ongoing replanting and recovery initiatives from TC Gita and TC Harold, government projects to promote local production of agricultural products to ensure food security during the pandemic, and favourable weather conditions.

The industry sector is expected to increase by 1.1% in 2020/21 compared to the negative growth of 2.9% in 2019/20. This projected growth is driven mainly by the resumption of major infrastructure and construction projects, coinciding with the increase in lending to the related sectors over the year to June 2021. Government and private projects supported the construction sector over the year, despite the impact of COVID-19 that resulted in the delay in completing some of the scheduled construction projects. These projects include the TC Gita and TC Harold reconstruction of school buildings, new Queen Sālote Wharf Custom Brokers Office, and the new warehouse for Tonga National Emergency Management Office (NEMO), to name a few. Lending to construction businesses rose by 67.6%, while lending for housing also rose by 0.9% which supported activity in the construction sector. The 68.7% increase in the import payments for construction materials also contributed to the sector's growth. The mining and quarrying sector tracked the recovery in the construction sector. The utility sector is expected to partially move in line with the slowdown in economic activities over the year.

However, the Nuku'alofa Upgrade Project of the Tonga Power Ltd (TPL) and the implementation of few upgraded water supply system projects under Grant Assistance for Grassroots Human Security Projects supported the sector's growth. In July 2020, the electricity tariff was 61.02 cents per kWh compared to 79.90 cents in July last year. The electricity tariff was 66.47 cents per kWh on average over the 2020/21

financial year due to the plummeting of global oil and diesel prices during the pandemic. In November 2020, the electricity tariff started to rise along with the recovery in the global prices of oil and diesel yet still remained below pre-COVID level. Despite the rise in tariff, over the year to June 2021, production and consumption of electricity both increased by 2.2 million kWh (3.3%) and 1.6 million kWh (2.2%) respectively. The number of electricity consumers also rose by 744 consumers (3.0%), reflecting the implementation of projects to effectively and efficiently increase the supply of electricity and the rise in the number of new houses constructed, supported by the Government's Cyclone Gita Recovery Project.

The service sector remains the most affected sector by the pandemic. It is estimated to have contracted by 3.3% in 2020/21, following a 0.9% growth in 2019/20. The extension of lockdown restrictions and ongoing uncertainties primarily contributed to this negative growth as activities within the sector, including wholesale and retail trading activities, transportation services, accommodation and food services, arts & entertainment and recreation, and real estate activities, continued to be either slowed or halted. The prolonged lockdown of borders and the cancellation of major celebrations and events over the year resulted in a slowdown in tourism-related services, transportation services, and total aggregate demand of households. There were no cruise ships, and the number of cargo ships arriving fell by 7.5%, while gas and oil tankers also fell by 18.2% and 13.2%, respectively. Air transport was directly affected by the border lockdown, especially for international travel. Air arrivals and departures fell by 96.5% and 96.3% respectively. The number of international flights recorded fell by 90.3%.

Furthermore, indicators for the wholesale and retail sector showed mixed signs. Container registrations rose over the year to June 2021 by 723 containers (6.5%), driven by an increase in business containers of 1640 containers (24.2%). Import payments excluding oil increased, and vehicle registrations also rose by 179 vehicles (5.9%). However, tax data show that total consumption sales tax fell by 6.3% over the year. Against this background, the wholesale and retail sector is estimated to have contracted by 1.0%. However, the Government's COVID-19 Financial Assistance packages were rolled out during the year, and commercial banks offered financial assistance through moratoriums on loans, which would support businesses combating the impact of the pandemic.

The pandemic markedly affected the jobs market. According to the Reserve Bank's survey on job advertisements, total number of job vacancies advertised in local newspapers websites, and the Tonga government portal, dropped by 44.4% (180 vacancies) over the year to June 2021. This was mainly driven by lower job vacancies advertised in the public administrations of 149 vacancies (49.5 %), reflecting a freeze in Public Services recruitment over the year. In

February 2021, Tonga launched its first Labour Mobility Policy to ensure effective labour mobility program and engagement thus promoting more job opportunities for the unemployed and unskilled labour force. In fact, Tonga received higher demand for seasonal workers from Australian farmers over the year to June 2021.

Monetary Policy Formulation

Monetary Policy Actions

The Reserve Bank maintained its accommodative monetary policy stance throughout 2020/21 in support of Tonga's macroeconomic growth amidst the global pandemic. The Tongan economy experienced sluggish growth, and indicators suggest a downturn in the medium term. Although the annual headline inflation slowly rose during the year, it remained below the reference rate of 5%. Foreign reserves are still very comfortable and above the minimum level of 3 months of import 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. A few additional measures were also introduced throughout the year to mitigate the impacts of the COVID-19 pandemic on 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.

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.

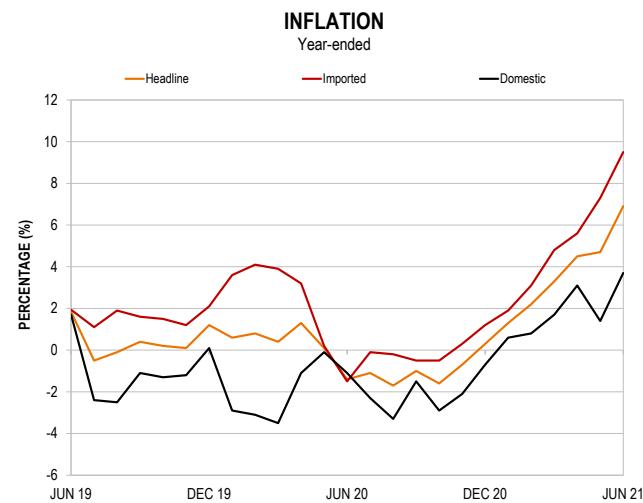
Monetary Policy Outcomes

The Reserve Bank's monetary policy objectives were observed during the 2020/21 financial year.

Inflation

The average annual headline inflation remained low at 1.2% during the year to June 2021. Tonga's annual headline inflation remained negative for 6 consecutive months from June to November 2020, before gradually rising from December 2020 to reach 6.9% in June 2021. The gradual increase in prices for the first 5 months of 2021 largely reflects the recovery in the global oil market as trade and transportation activities resumed with the ease of COVID-19 restrictive measures across countries.

FIGURE 2: INFLATION

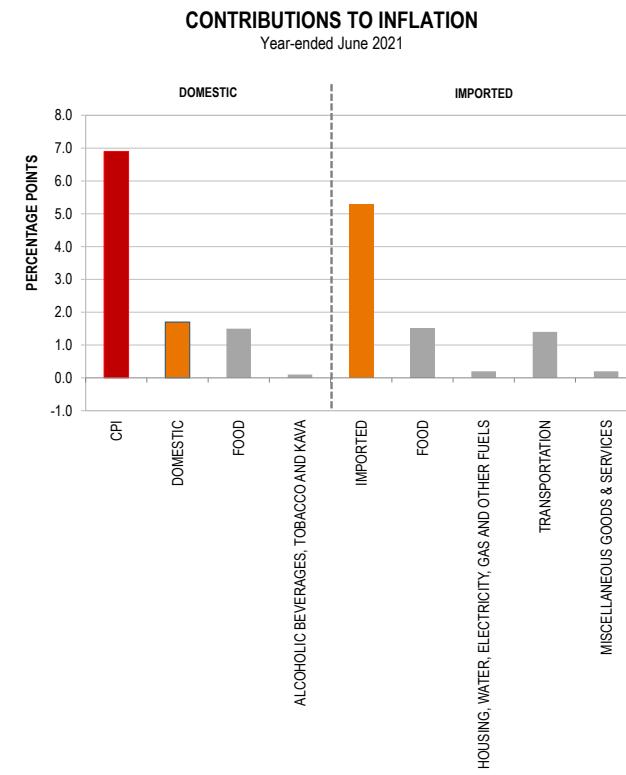


Sources: Tonga Statistics Department | National Reserve Bank of Tonga

The annual local prices averaged at -0.2% in the year ended June 2021, which largely stemmed from the consistent decline in prices for kava Tonga, food items and fuel. Hence, domestic prices fell for 12 consecutive months since January 2020. The lower prices in the second half of 2020 reflected the recovery efforts of growers and assistance from the Government following the aftermath of Tropical Cyclone (TC) Harold. Households also engaged in subsistence farming as preparatory measures for the uncertainties of the COVID-19 pandemic, which may have resulted in the abundance of food supply in the market. However, local prices slowly rose since January 2021 up to June 2021 due to higher food prices and electricity prices.

Import prices substantially rose by 9.5% over the year to June 2021, which was attributed to the rise in prices of oil, food items and gas & other fuels by 46.4%, 6.6% and 7.1%, respectively. The increase in food prices in Tonga's major trading partners, particularly New Zealand and Australia, flowed through to higher local prices. Higher shipping costs and delays in shipments due to the COVID-19 restrictions across borders and the additional quarantine requirements affected the availability of imported goods and are estimated to have contributed to the higher imported prices.

FIGURE 3: CONTRIBUTIONS TO INFLATION



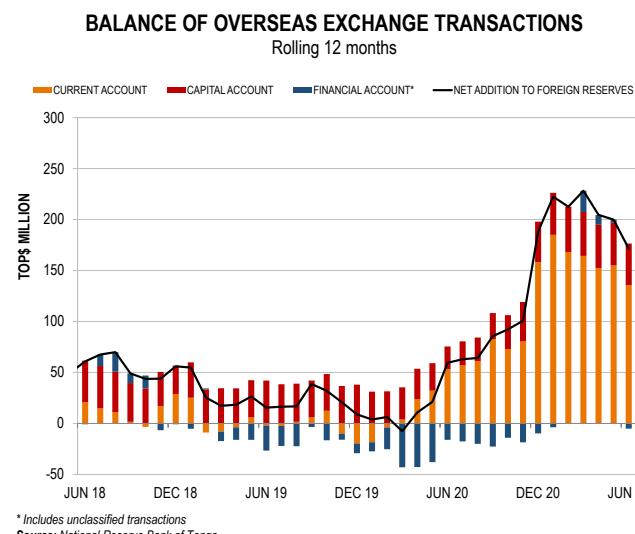
Sources: Tonga Statistics Department | National Reserve Bank of Tonga

The amendment of excise taxes on imported goods such as tobacco and mutton flaps, effective July 2020, may have contributed to the higher price margins imposed on these goods. This is part of the Government's ongoing initiatives to combat Non-Communicable Diseases (NCDs). Moreover, the vulnerability of Tonga's economy to external shocks, exchange rate volatility and supply chain disruptions due to the uncertainties surrounding the COVID-19 pandemic may contribute to the rise in headline inflation in the near future.

Balance of OET

The overall Overseas Exchange Transaction (OET) balance recorded a substantial surplus of \$171.4 million for the year ended June 2021 compared to a \$59.5 million surplus in June 2020. The higher overall balance was underpinned by an increase in the current account surplus on the back of higher private transfer receipts, official transfer receipts, and income receipts. The surplus in the capital account stemmed from higher official and private capital receipts. The financial account also improved over the year due to the lower outflow of investments mostly for interbank transfers and offshore investments.

FIGURE 4: BALANCE OF OVERSEAS EXCHANGE TRANSACTIONS



The total OET receipts rose substantially over the year to June 2021 by \$110.1 million (13.1%) to \$948.2 million. This was mainly attributed to higher private transfer receipts and official transfer receipts of budget support, project funds, and financial assistance for TC Harold and COVID-19 preparations. The rise in private transfers was driven by the 31.5% rise in private remittances mostly for family support and receipts from seasonal workers. Tonga's remittance receipts continue to hold up despite the negative impacts of COVID-19 on our source remitting countries. The continuance of the seasonal worker programme (SWP) in Australia also contributes to the higher seasonal worker receipts. However, total OET

payments fell by \$12.8 million (1.8%) to \$710.2 million over the year ended June 2021. This was largely underpinned by a decline in payment for services, primarily personal travel, professional & management services, airfreight services and maintenance & repair services. This was followed by lower payments for interbank transactions, direct investments and portfolio investments. The lower payments over the year is attributed to the COVID-19 disruptions and border closure.

Official Foreign Reserves

The official foreign reserves increased significantly to \$715.2 million in June 2021 (12.5 months of import cover) from \$543.8 million in June 2020, equivalent to 9.2 months of import cover. The annual growth stemmed mainly from higher receipts of budget support, loan drawdown, official grants mainly for COVID-19 preparations and TC Harold relief funds from development partners, in addition to remittances. The level of foreign reserves has remained firm during the 2020/21 financial year, maintaining the months of import coverage above the Reserve Bank's minimum level 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.

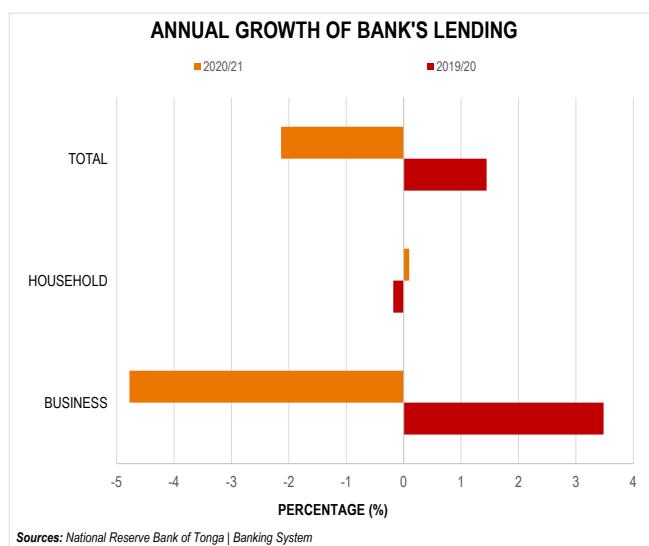
Exchange Rates

The New Zealand Dollar, Australian Dollar, the Great Britain Pound and the Euro generally appreciated against the United States Dollar over the year to June 2021. As such, the Tongan Pa'anga weakened against the majority of Tonga's major trading currencies mainly the Australian Dollar, New Zealand Dollar, Great Britain Pound, Euro, Fijian Dollar and Chinese Yuan but appreciated against the United States Dollar and the Japanese Yen. As a result, both the Nominal Effective Exchange Rates (NEER) and Real Effective Exchange Rates (REER) fell over the year by about 4% and 6%, respectively. The lower REER indicates an improvement in Tonga's trade competitiveness with trading partners, further supporting foreign currency receipts. However, the lower NEER poses pressure on inflation to increase through higher imported prices.

Lending Balances

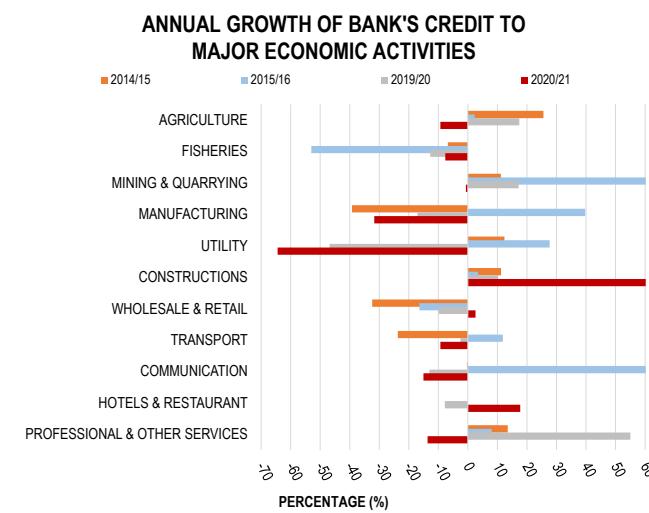
The uncertainties of the COVID-19 pandemic resulted in a negative credit growth of \$10.5 million (2.1%) in the year ending June 2021, bringing the total lending balances to \$482.4 million, compared to a \$7.0 million (1.4%) growth in the previous year. Lending to businesses declined over the year by \$11.2 million (4.8%) and offsets a \$0.2 million (0.1%) growth in household loans. The decline in business loans is attributed to loan run-offs by public enterprises as well as businesses within the professional & other business services, manufacturing, and transport sectors. On the other hand, higher other personal and vehicle loans drove the annual rise in household loans.

FIGURE 5: ANNUAL GROWTH OF BANK'S LENDING



Lending balances in the non-bank financial institutions fell by \$1.6 million (1.5%) in the year to June 2021 to \$105.2 million, reflecting the repayments made on these loans during the year.

FIGURE 6: ANNUAL GROWTH OF BANK'S CREDIT TO MAJOR ECONOMIC ACTIVITIES



On the outlook, the Reserve Bank continues to expect credit growth to remain subdued in the near term, with non-performing loans projected to rise for both businesses and households. This is mostly a result of uncertainties surrounding the COVID-19 pandemic, which is expected to lead to weak investment appetite, and softening of aggregate demand. However, the Reserve Bank will continue to closely monitor non-performing loans to ensure adequate provisions to absorb any shocks to the financial system.

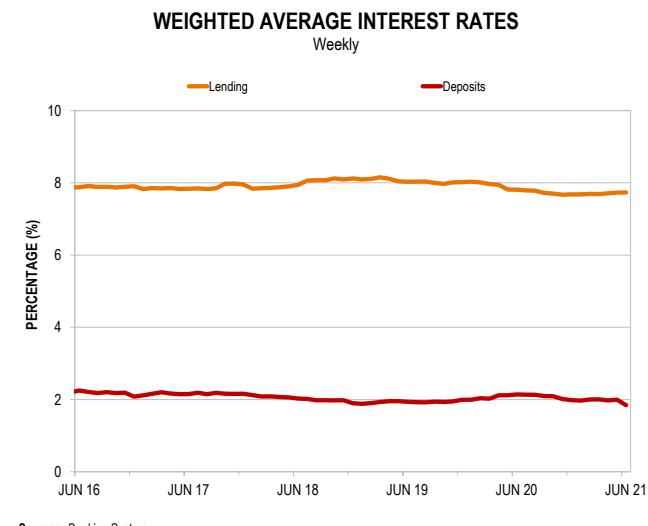
Deposit Balances

The total banks' deposits grew significantly over the year to June 2021 by \$69.1 million (9.5%), to a new high of \$799.9 million. All categories of deposits increased, with demand deposits rising the most by \$112.4 million, underpinned by higher deposits from the Government, public enterprises, and private businesses. Saving deposits followed with an increase of \$38.1 million, driven mostly by higher deposits made by the retirement funds and individuals. Time deposits also rose by \$30.3 million, owing largely to more deposits from churches, schools, Government, and private businesses.

Interest Rates

In the year to June 2021, the weighted average interest rates spread widened by 22.6 basis points from 5.67% to 5.89%. This was due mainly to a decline in the weighted average deposit rate by 30.0 basis points more than the 7.4 basis points decline in the weighted average lending rate. The lower weighted average deposit rate resulted from the fall in rates of all of the three categories of deposits. Lower interest rates on banks loans offered to businesses in the construction, utilities, agriculture, fisheries, and the services sectors drove the decline in lending rates. Additionally, the households' other personal loans rates also fell contributing to the decline in lending rates.

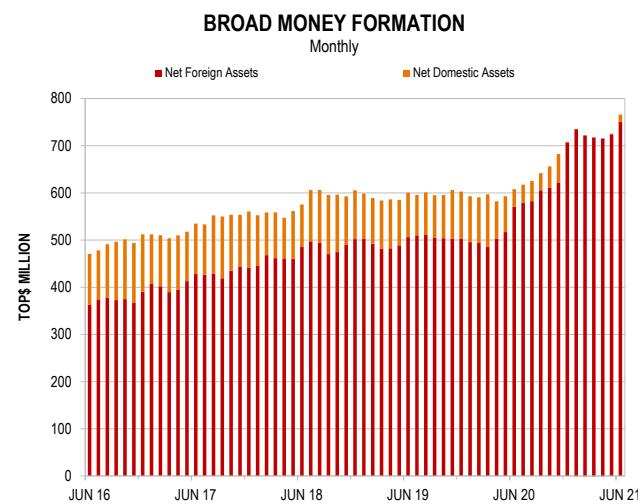
FIGURE 7: WEIGHTED AVERAGE INTEREST RATES



Broad Money Balances

Broad money rose further in the year to June 2021 by \$158.1 million (26.1%) to a new high of \$765.2 million, solely driven by the higher net foreign assets. This was due mainly to an increase in the foreign reserves due to higher receipts of official funds as external loans, budget support, project development funds, and financial assistance for COVID-19. However, these receipts also led to an increase in the Government deposits resulting in lower net domestic assets annually.

FIGURE 8: BROAD MONEY FORMATION



Sources: National Reserve Bank of Tonga | Banking System

In the approved revised Reserve Bank's Corporate Plan for 2020/21, the Economics Department was allocated with 29 specific measurable targets. A review of the financial year corporate plan was carried out in April 2021, which revealed that the Department achieved 25 targets while 4 targets were still a work in progress. These targets are related to meeting deadlines for publishing of economic reports such as the Monetary Policy Statement, Quarterly Bulletins and Monthly data flashes. The Economics Department continues to strive to ensure that the publications put out from the Reserve Bank are correct and provided in a timely manner.



Financial Stability



The National Reserve Bank of Tonga Act section 39A lists the overarching Supervisory functions of the Reserve Bank on financial institutions (Banks and Non-Banks). For the Bank Supervision Team specifically, section (1) – (2)(f) of section 39A covers the main functions. This sets out the structure of the Banking Act 2020, which is implemented by the 12 Prudential Statements of the Reserve Bank. These requirements ensure banks can effectively manage their risks given their risk appetites and operate in a safe and sound environment. In addition, the requirements are stipulated to ensure banks' customers are protected (consumer protection).

The Banking Supervision Department license, regulate and supervise banks in Tonga. The Banking Act 2020 and (12) Prudential Statements provide minimum requirements for the banks to comply with. The team supervises the compliance of the banks with offsite reports regularly submitted to the Reserve Bank. The reports provide a snapshot of their operation, their asset quality, liquidity, capital, and financial position. The Banking Supervision team conducts regular assessments on these reports to determine the safe and sound operation of the banks. Furthermore, regular spot checks and onsite visits to the bank premises are undertaken to verify the accuracy of ALL reports and compliance with the minimum requirements. The Banking Supervision team holds regular meetings with banks to discuss any arising issues/risks or update the banks' operation and plans. A tripartite meeting is held annually with the banks, their external auditors, and the Reserve Bank to verify any issues or risks during the operations of the banks within each financial year.

Financial Sector

The Reserve Bank continued to promote a sound and efficient financial system during the 2020/21 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 through projects such as the automated National Payment System project. The Reserve Bank continued to effectively license, regulate, and supervise

financial institutions, both banks and non-bank financial institutions (NBFIs).

As of the end of June 2021, there were 4 banks licensed to operate in Tonga. The Bank of South Pacific (BSP) Tonga Limited continued to build on its outreach programs with increased access points, mainly for agents/in-store banking and ATMs. BSP's number of agents/ in-store banking facilities increased from 31 in the previous year to 34 this year. The ATMs for BSP also increased over the year by one while ANZ, on the other hand, had fewer ATMs compared to the year before.

TABLE 1: BANKING SERVICES IN TONGA

Banking Services	ANZ	BSP	MBf	TDB
Branches ¹	2	4	2	8
Agents/In-store banking	-	34	-	-
ATMs	11	15	-	-
EFTPOS	121	324	-	-
Internet Banking	Yes	Yes	No	Yes
Money Transfer Services	Yes	Yes	No	Yes

All banks maintained their head offices in Tongatapu. MBf Bank Limited and BSP Bank also maintained their branches and sub-branches in Vava'u. In contrast, ANZ officially closed their Vava'u branch in November 2020. Tonga Development Bank (TDB) continued to be the only bank serving all the outer islands of Ha'apai, Vava'u, and 'Eua and the two Niuas (Niutoputapu 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.

Commercial banks in Tonga, during the financial year 2020/21, introduced the following products and services: The Tonga Development Bank extended their 'Ave Pa'anga Pau platform to Australia in September 2020 and the ANZ Fast Deposit Envelope service was extended to deposit cash (previously the service was for cheques deposit only) not exceeding TOP 10,000 in October 2020. This is part of improving the bank's services that are secure and convenient to all its customers. All banks continued to improve their various banking systems

and processes over the year.

Banking System Supervision and Regulation

During 2020/21 years, Tonga's financial system continued to be impacted by the global pandemic COVID-19. The Reserve Bank continued to ensure that the banks continued to conduct prudent practices in Governance and management of banking activities, especially asset quality and operational risks over the year. As of June 2021, some banks' continued to extend their COVID-19 package to some of their customers on a case by case basis based on their assessment of their customers' ability to service the loan.

The lack of lending opportunities for the banks over the year, and the ongoing build-up of commercial banks' liquidity resulted in all banks not being able to adhere to the minimum requirement for the loan to deposit ratio of 80%. The lower loan to deposit ratio reflected the ongoing increase in deposits attributed to the influx of foreign aid funds to the Government related to the impact of Tropical Cyclone Harold and the COVID-19 pandemic, in addition to remittances received for the non-profit institutions (i.e. churches and Tonga High School Ex-student fundraising) whilst banks recorded minimal credit growth over the year to June 2021. The Reserve Bank continues to monitor the banks' loans/deposit ratio.

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 conducted risk-based onsite visits to 2 banks in September 2020 and October 2020. The onsite examinations focused on ensuring that banks' internal controls for processing their loans were in place and followed effectively. This was also focused on ensuring banks were in compliance with international best practice on credit risk. 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 and the Reserve Bank's requirements. Furthermore, spot checks were conducted to verify banks' compliance with the requirements of Prudential Statement No.4 on Disclosure on Interest rates and Fees & Charges, as these are common issues that directly affect the public.

The Reserve Bank continued to prioritize improving the

¹ Including Head Office at Nuku'alofa

quality of banks' reports for offsite monitoring and to form the basis of the Reserve Bank's policy decisions. Therefore, enhanced checking of banks' reports to the Reserve Bank, included mapping source data to reporting templates followed by technical meetings as part of the data quality assurance process. The banks continued to collaborate with the Reserve Bank reflected the ongoing improvement in the quality of their reports with minimal issues. The returns will be reviewed in the next financial year to ensure all information continue to be effectively relevant to both the local context and the international best practice as well. This review will be in collaboration with the International Monetary Fund (IMF) as per the Reserve Bank's Technical Assistance request to review Banking Act, Prudential Banking Standards and the Prudential Returns.

The Banking Act 2020 was gazetted in January 2021 which replaced the Financial Institutions Act. The changes in the Banking Act 2020 mainly cover enhanced licencing and supervisory powers of the Reserve Bank, as well as strengthening of enforcement powers particularly for resolving of a bank that is problematic. The Reserve Bank continued to ensure the Prudential Banking Standards incorporate necessary changes for more effective banking supervision given recent developments in the financial system. The Reserve Bank Board of Directors have approved three (3) new Prudential Banking Standards during the year. These are Prudential Banking Standards No. 13 (Syndicate Lending), No. 14 (Operational Risk Management), and No. 15 (Cybersecurity) which were issued to Banks for consultation. The 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.

During the year, the Reserve Bank confirmed exemption of the Single Borrower Limit with the provided Group Guarantee within a given timeframe, pursuant to Section 34 (i) of the Banking Act 2020. This was due to anticipated transactions that would support economic growth.

Ongoing 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. Due to the pandemic and border restrictions, virtual audits require more time to verify information made available and have resulted in delays in meeting the due date for the submission of the audited accounts to the Reserve Bank. 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 \$1,178,525.67 as per section 94(3) of the Banking Act 2020. This gives customers the 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 \$62,132.98 was forfeited to the Government's account pursuant to sections 94 (7) & (8) of the Banking Act 2020.

Banking System Financial Performance

Financial Position

The total assets of the banking system reached a record high of \$1 billion since January 2021. Total assets stood at \$1,081.4 billion by the end of June 2021, a growth of \$192.7 million (21.7%) over the year 2020/21. This resulted mainly from higher banks' Exchange Settlement Account (ESA) balances at \$170.8 million (104.0%) coupled with a rise in the Nostro accounts by \$12.4 million (50.3%), mainly due to the receipt of operational funds and services charges to public enterprises, over the year. Additionally, the holdings of government bonds increased by \$1.9 million (5.5%), and accrued interest receivable rose by \$2.5 million (30.6%). This was partially offset by the \$10.0 million (2.1%) contraction in credit growth reflecting minimal lending opportunities over the year, coupled with the ongoing loan run-offs.

Private Business loans as a percentage of total loans fell over the year to 45.6%, reflecting subdued economic activities and the businesses capacity to borrow during the year resulted from risks and impact of COVID-19. As at June 2021, majority of the business loans were for the distribution (wholesale & retail) sector, businesses in the professional & other services, tourism, and construction. On the other hand, private individual loans continued to hold more than half of the total loan portfolio at 54.3% (\$257.3 million). Housing loans continued to dominate the bulk of the banking system loan portfolio at 43.5% (\$206.4 million), which reflects the banks risk appetite and the eligibility of borrowers for housing loans. Most of these eligible borrowers are Government civil servants who are not financially impacted by the COVID-19.

Sector lending summary – Key points:

- *Total housing loans rose by \$1.7 million (0.9%) in June 2021, a decline compared to the increase of \$3.4 million (1.7%) last year. This decline in housing loans was driven by the decline in housing lending offered by banks, and may reflect the*

impact COVID-19 restrictions mainly on the private sectors excluding civil servants.

- Public Enterprises annual loan growth significantly dropped by \$11.3 million (18.4%) to June 2021. This reflected the loan run offs by the two large utility companies with no further borrowing during the pandemic.

The 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 2021 was at \$8.2 million compared to \$8.7 million in June 2020. Of the total outstanding loan as of June 2021, 51.6% was lent to the agricultural sector followed by the education and fisheries sectors at 16.6% and 14.3%, respectively.

TABLE 2: FINANCIAL SECTOR DEPOSIT ACCOUNT

	2019/20	2020/21
Demand Deposits		
Number of Accounts	44,977	48,822
Value of Deposits (\$m)	243.6	356.0
Saving Deposits		
Number of Accounts	48,932	49,088
Value of Deposits (\$m)	113.0	151.1
Time Deposits		
Number of Accounts	1,884	1,877
Value of Deposits (\$m)	262.6	292.9
Total Number of Accounts	95,793	99,787
Total Value of Deposits (\$m)	619.2	799.9

Total banks' liabilities rose over the year by \$189.9 million (27.2%). Total deposits significantly increased mainly by the demand deposits rising by \$112.4 million (46.2%), reflecting

mainly the receipt of government donor fund assistance for COVID-19 and project funds, the on-going deposits from private non-financial corporations and rise in the non-profit institutions (due to collections of Church donations, Ex-students alumni, Kava Idol and outer islands rugby competitions held throughout the year. Savings and Time deposits also grew by \$38.1 million (33.7%) and \$30.3 million (11.5%), respectively. This reflected proceeds from selling of land and properties, disbursement of housing loans to individuals saving accounts, the build-up in statutory non-bank financial corporations, and investment by Churches due from higher collection of donations over the year.

The total number of deposit accounts reported by banks increased over the year by 4.2% to 99,787 while the total value of deposits increased by \$180.8 million (29.2%) to \$799.9 million.

Profitability

The total banking system profitability had declined in 2020/21 compared to the previous financial year. The banks recorded an after-tax profit of \$18.504 million for the year ended June 2021, which is equivalent to 1.9% of average assets, and compared to an after-tax profit of \$20.452 million for the previous year, which was equivalent to 2.3% of the average assets. The net interest income was lower by \$5.016 million (13.0%) over the year and had been the main driver of the bank profits. In addition, the non-interest income also declined by \$3.550 million over the year mainly driven by the impact of COVID-19 border closure on the volume of foreign card transactions which declined. The main risk to bank profits would be the COVID-19 virus spreading resulting in a complete lock-down impacting the operations of both private and Government Business, jobs and loan repayments.

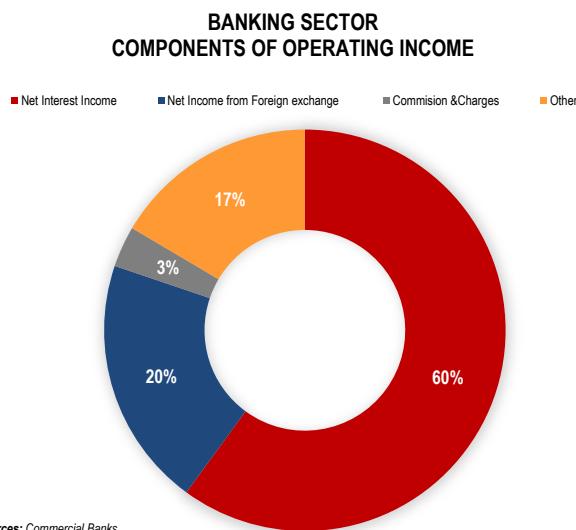
TABLE 3: FINANCIAL PERFORMANCE

	2019/20	2020/21
Pre-tax Net Profit (% average total assets)	3.1%	2.5%
After-tax Net Profit (% average total assets)	2.3%	1.9%
Total Operating Income (% average total assets)	7.3%	5.7%
Net Interest Income (% average total assets)	4.4%	3.4%
Non-Interest Income (% average total assets)	2.9%	2.3%
Net Interest Margin	4.0%	3.0%
Total Operating Expenses (% average total assets)	3.6%	2.9%
Consolidated Risk-weighted Capital Ratio (%)	31.6%	31.4%

The total assets of the banking system reached a record high of \$1 billion since January 2021

Over the year, Net Interest Income was maintained at 60% of bank's operating income. On the other hand, Net Income from Foreign Exchange declined while Other Income increased as a portion of operating income from 14% in June 2020 to 17% in June 2021. The increase in other income was attributed to commissions as agents of foreign exchange services.

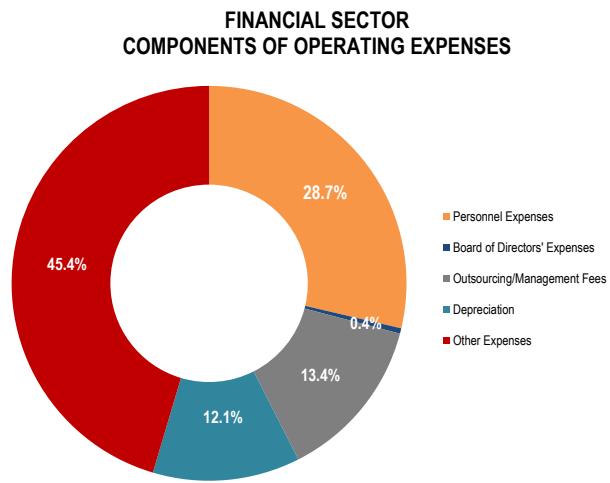
FIGURE 9: BANKING SECTOR - COMPONENTS OF OPERATING INCOME



Sources: Commercial Banks

Total operating expenses fell and comprised mainly of other expenses at 41.7% followed by Personnel Expenses at 31.4% and Depreciation on fixed assets at 14.2% compared with 45.4%, 28.7%, and 12.1% respectively in the previous year.

FIGURE 10: FINANCIAL SECTOR - COMPONENTS OF OPERATING EXPENSES



Sources: Commercial Banks

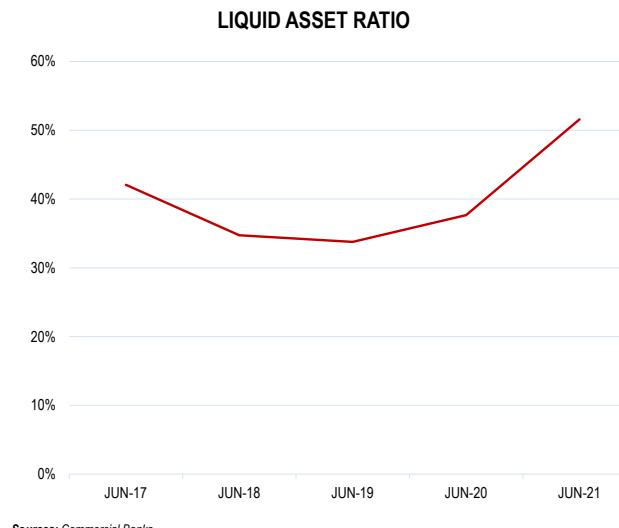
The Reserve Bank expects the profitability of the banks to deteriorate going forward given the ongoing uncertainties related to the COVID-19 global pandemic. The quality of the bank's assets is also expected to weaken over the year. On the other hand, the banks are expected to ensure that

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 liquidity of the banking system continued to build-up over the year. The increase in eligible liquid assets by \$187.0 million over the year, was mainly due to the higher Exchange Settlement Accounts due to the influx of Government donor aid funds. Total loans as a proportion of deposits fell to 59.3% in June 2021 from 78.2% recorded in June 2020. This was driven by the rise in deposits particularly the Government, Non-profit Institutions, and the pension funds which outweighed the loans run-off of the Public Enterprises over the year. The Liquid Asset Ratio substantially increased to 51.6% in June 2021 compared to 37.7% in June 2020 continuing to remain well above the Reserve Bank's minimum requirement of 5%.

FIGURE 11: LIQUID ASSET RATIO

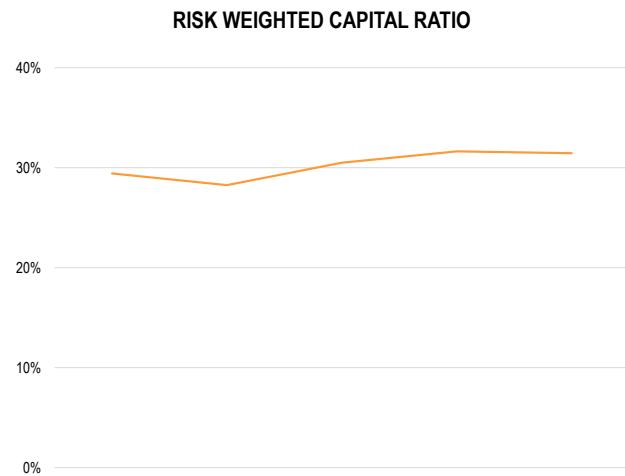


Sources: Commercial Banks

Capital

The Banking system's capital position remained strong over the year, with the Risk-weighted Capital Ratio (RWCR) comfortably above the statutory minimum requirement of 15%. The consolidated risk weighted capital ratio for the banks slightly declined to 31.4% at the end of June 2021 from 31.6 % in June 2020. The annual growth in eligible capital funded by the previous year's earnings of around \$17 million in January 2021 was mostly offset by repatriation of dividends over the year followed by raising of provisions for the big banks. Eligible Capital slightly fell by \$0.5 million (0.3%) while Risk Weighted assets rose by \$1.6 million (0.3%). The risk to capital adequacy would be from a further deterioration in banks' asset quality after the expiry of the COVID-19 loan package and the continuous impact of the border restriction. This is mainly for tourism, distribution (retail and wholesale), and other sectors impacted by the global pandemic.

FIGURE 12: RISK WEIGHTED CAPITAL RATIO



Sources: Commercial Banks

Asset Quality

The overall quality of the banks' assets improved over the year to June 2021. Total non-performing loans decreased by \$4.2 million (21.0%) to \$15.8 million at the end of June 2021, which represented 3.3% of total loans compared to 4.1% in June 2020. The forestry sector also contributed to the non-performing loans over the year due to deferred government projects. In view of the prolonged COVID-19 pandemic, some sectors (Distribution Retail and Wholesale) will be monitored closely given the negative impact of the border closures and the ongoing spread of COVID-19 in the Pacific neighbouring countries such as Fiji.

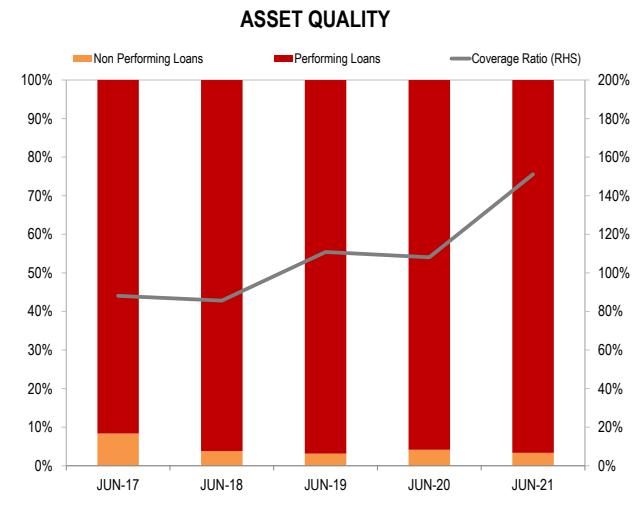
Despite COVID-19 challenges some private business continued to improve and were upgraded from non-performing loans due to business opportunities from Government projects (Construction Sectors) during the COVID-19 Pandemic. Banks COVID-19 relief packages provided private businesses an opportunity to recuperate and meet their loan repayment agreement after the COVID-19 loan packages term expired.

Household loans continued to account for the highest share of the total non-performing loans in June 2021 at 55.8% (\$8.8 million), a decline from 69.4% (\$13.9 million) in June 2020, while the remaining 44.2% (\$7.0 million) was for private business loans. Housing loans accounted for 39.3% (\$6.1 million) compared to 56.4% (\$11.3 million) in the previous year.

Total provisions against loans increased by \$2.7 million (12.2%) to \$24.5 million which was mainly due to the rise in general provision. The coverage ratio of the non-performing loans compared to total loan loss reserves, remained high at 151.2%, also higher than 108.1% in June 2020. The Reserve Bank continued to work closely with banks to monitor the COVID-19 impacted customers. Stress tests on the likely impact of COVID-19 on the banking system capital, provisions

and non-performing loans to ensure Financial Stability is maintained was reported to the board on a monthly basis.

FIGURE 13: ASSET QUALITY



During the year, the Banking Supervision Team commenced the following co-jointed projects:

- (a) *Collaboration with Technical Assistance team from the Pacific Technical Assistance Committee (PFTAC) in reviewing the current 12 Prudential Statements and the current Banking Act and related regulations. This is to ensure the supervisory framework continues to align with the international best practice. The Development of Consumer Protection Prudential Statements for supervision of banks.*
- (b) *The finalization of the consultation of the three (3) new Prudential Banking Standards to be effective before the end of 2021. This will also be discussed with the Technical Assistance from PFTAC if their timeframe permits.*
- (c) *Collaboration with Development Partners (World Bank and ADB) and other Central Banks in the Pacific in developing a Regional Know Your Customer (KYC) system to address Anti-Money Laundering requirements.*
- (d) *The development of the in-house National KYC database to harmonize related information, ensure data integrity as well as effective data processing.*
- (e) *The development of the in-house Credit Registry System to assist banks credit checks and address household and corporate indebtedness, but most importantly to promote performing exposures. This project is mainly to address household and corporate indebtedness through borrowings from banks. The long term plan is to include the non-banks as members of these credit registry so that indebtedness can be managed especially during the pandemic.*

(f) Finalization of the Domestic Electronic Payment System (DEPS) documentation to become effective once the banks comments have been incorporated.

The Banking Supervision Team also continued to support the Mutual Evaluation by APG with ongoing discussion with IMF on the finalized report and outcome.

Non-Bank Financial Institutions Supervision

The non-banking supervision unit is responsible for regulating and supervising of non-banks financial institutions in Tonga as well as protecting its financial consumers which will contribute to the achievement of the Reserve Bank's mandate in;

- Promoting financial stability and
- Promoting sound and efficient financial system

Since the addition of non-bank financial institutions to the mandate of the Reserve Bank in 2014, the continuous development of an adequate legal framework for regulating and supervising non-bank financial institutions is a priority. The non-bank financial institutions play an essential role in driving inclusive economic growth, although it accounts for only a small portion, it may pose a risk to the overall financial system if it's not monitored closely. Therefore, the establishment of a robust supervisory framework would mitigate such potential risks.

Licensing & Supervision of Foreign Exchange Dealers

The licensing and supervision of foreign exchange dealers continued under the Foreign Exchange Control (FEC) Act 2018. During the year, there were three (3) new foreign exchange dealer license Type B that were licensed during this financial year which were Nikua Money Transfer, Joy Trading Company Limited and Tokowireless Limited and two (2) license Type A issued (one to existing foreign exchange dealers with license Type B, Toumu'a Money Transfer and one for a new foreign exchange dealer Maka Mo'ui Trading Services). However, in November 2020, one (1) foreign exchange dealer (S.A.V Money Transfer) license was cancelled due to non-compliant with its license conditions. During the year, the Reserve Bank continued to assist local foreign exchange dealers in sustaining its business by ensuring that they still comply with all legal and regulatory requirements, especially AML/CFT requirements and the compliance of the licensed non-bank financial institutions. Technical meetings, ongoing quarterly spot checks, annual compliance check visit, providing training and advisories to the authorized foreign exchange dealers will not only contribute to improve and have a better understanding on the compliance of licensed non-banks financial institutions but also to strengthening their

Anti-Money laundering/Counter-Terrorist Financing (AML/CFT) compliance status. These activities were conducted by the Reserve Bank to address de-banking risks and support the domestic banks in retaining the foreign exchange dealers' accounts.

TABLE 4: FOREIGN EXCHANGE DEALERS BY LICENSE TYPE

License Type	2019/20	2020/21
Type A (Inward and Outward Transfer)	10	10
Type B (Inward Receipts and Local Disbursement Only)	2	5
Type C (Currency Conversion Only)	1	1
Total	13	16

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. The Reserve Bank also continued to raise awareness over the year with key stakeholders and the general public on the requirements of the Foreign Exchange Control Act 2018.

All banks are authorized under their banking license to conduct foreign exchange business. BSP continued to hold agency arrangements with MoneyGram while TDB continued to offer its 'Ave Pa'anga Pau (product) as another platform for receiving and sending remittances.

Provisions of the Microfinance Act 2018, section 3 gives the National Reserve Bank of Tonga the authority to license anybody incorporated as a Microfinance Institution. South Pacific Business Development (SPBD) is the only microfinance institution in Tonga that was licensed on the 24th February 2020 and has operated for 11 years since its inception in July 2009. The Reserve Bank continued to consistently assess and monitor the SPBD's financial reports. The Reserve Bank now collects quarterly reports instead of monthly reports. Furthermore, the Reserve Bank will also conduct a quarterly spot check as part of monitoring SPBD prudent performance in the near future. These activities are in place to ensure SPBD's financial soundness and its compliance to ensure its business continuity to continue to provide financial services. In addition, by licensing this microfinance institution, it will also enable the NRBT to assess the level of accessibility and availability of financial services to households for policy formulation to promote financial inclusion.

The Reserve Bank started implementing the Moneylenders Acts 2018 in late 2020 through publishing press releases informing the public regarding the Moneylenders Act and stock-take by registering all moneylending businesses. Early this year, more than 120 moneylending businesses

were registered and 90% of the total moneylenders are from Tongatapu. However, some of the registered moneylenders are exempted from being licensed as a moneylender licensing the financial services they provide do not fully meet the definition of moneylending business. These exempted moneylenders' will be referred to the relevant non-bank financial institution legislations i.e. credit unions. Furthermore, the Reserve Bank is currently working on licensing these registered moneylenders. Table 5 below reflect the status of moneylender's license application and the number of licensed moneylenders. The 19 moneylenders who are still pending for approval are mainly those who require to provide further information in order to process their application. However, for the 53 who have not submitted their license application, the Reserve Bank will continue to liaise with them until they submit their applications.

TABLE 5: STATUS OF MONEYLENDERS LICENSE APPLICATION

License Type	Number of Moneylenders
Licensed	48
Pending for approval	19
Registered but not yet submitting any license application	53
Total	120

The consultation on the Insurance Bill 2018 and Pension Fund Bill Commenced with comments on both Bills from relevant stakeholders. These comments are being reviewed and a consultation meeting will be held to respond to these comments before the end of the year 2021. A draft Credit Union Bill is in progress and is currently being discussed with relevant stakeholders.

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 fifteen (15) foreign exchange dealers (FEDs), one (1) microfinance institutions and four (4) insurance companies who are submitting reports on a quarterly basis while two (2) retirement funds submit their financial reports on a monthly 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 position and performance to ensure they remain solvent whilst the work on each respective Bill is underway.

Financial Inclusion Initiatives

Slight decline in Access Indicators over the year

Over the year ended June 2021, the number of cash in and cash out access point indicators appeared to have fallen compared to the year ended June 2020. Compared to the previous year, the decline was mainly driven by the bank's EFTPOS terminals and agents (refer Table 6) in 2021. This reflected the impact of COVID-19 and the closing of the borders on the Tourism sector. These merchants were inactive during the year due to border closure.

TABLE 6: ACCESS POINT PER 10,000 ADULTS – BANKS & NON-BANKS

Access Indicators	2021	2020	2019 ²	2015 ³
Number of cash-in and cash-out points per 10,000 adults ⁴	136	154	144	32
Number of branches per 10,000 adults	10	10	11	2
Number of ATMs per 10,000 adults	4	4	4	1
Number of EFTPOS per 10,000 adults	69	86	77	26
Number of Agents per 10,000 adults	53	54	52	3

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

In terms of constituency, Tongatapu 2 and Tongatapu 4 drove the decline in the total number of access points mainly due to the lower number of EFTPOS in these two constituencies. According to the banks, the decrease in the number of EFTPOS over the year was mainly due to the removal of some of the inactive EFTPOS terminals at some store merchants due to low usage by customers compared to the operational maintenance cost of these inactive terminals. Although Table 7 includes the access points for both Pension Funds since December 2020, no information has been obtained from the Pension Funds for Table 10.

The lower number of branches in Vava'u 15 reflected the closing down of the ANZ branch in November 2020 and the removal of their ATM machine. In the Ongi Niua 17, one of the Foreign Exchange Dealers' branches was closed before the end of 2020 due to TDB terminating the agency agreement. The total number of EFTPOS terminals declined by 92 terminals, mostly Bank of South Pacific's EFTPOS terminals (refer to Table 8). On the other hand, the number of agents increased reflecting the continuous outreach program by Bank of South Pacific as they extend their financial services out to the rural and remote areas.

² Commencement collecting Non-Banks data

³ Tonga's Financial Inclusion Benchmark

⁴ Total access points including Non-Bank access points

TABLE 7: SUMMARY OF BANKS & NON-BANKS ACCESS POINTS IN TONGA BY CONSTITUENCY

Constituency	June 2021					June 2020					YoY Change	
	Total Access Points	No. of Branches	No. of Agents	No. of EFTPOS	No. of ATMs	Total Access Points	No. of Branches	No. of Agents	No. of EFTPOS	No. of ATMs	Volume	Change (%)
Tongatapu 1	46	1	19	25	1	55	1	22	31	1	-9.0	-16
Tongatapu 2	239	24	29	168	18	271	22	24	207	18	-32.0	-12
Tongatapu 3	50	1	15	34	0	57	1	15	41	0	-7.8	-14
Tongatapu 4	159	3	22	134	0	192	4	22	166	0	-32.2	-17
Tongatapu 5	35	1	25	9	0	38	2	24	12	0	-3.0	-8
Tongatapu 6	41	1	33	6	1	39	1	33	5	0	2.0	5
Tongatapu 7	34	1	22	11	0	36	1	23	12	0	-1.9	-5
Tongatapu 8	34	0	22	12	0	39	0	24	14	1	-4.1	-11
Tongatapu 9	40	5	24	10	1	43	6	21	15	1	-3.0	-7
Tongatapu 10	28	0	28	0	0	31	0	31	0	0	-3.0	-10
'Eua 11	40	7	27	5	1	36	8	23	4	1	4.0	11
Ha'apai 12	21	8	9	3	1	24	9	7	7	1	-3.0	-13
Ha'apai 13	17	0	14	3	0	18	0	15	3	0	-1.0	-6
Vava'u 14	18	0	17	1	0	20	0	17	3	0	-2.0	-10
Vava'u 15	52	11	16	24	1	63	13	14	34	2	-11.0	-17
Vava'u 16	15	0	15	0	0	15	0	15	0	0	0.0	0
Ongi Niuas 17	3	2	1	0	0	7	5	2	0	0	-4.0	-57
Total	872	65	338	445	24	983	73	332	553	25	-111.0	-11

TABLE 8: BANKS' ACCESS POINTS IN TONGA BY CONSTITUENCY

Commercial Banks	June 2021					June 2020					YoY Change	
	Total Access Points	No. of Branches	No. of Agents	No. of EFTPOS	No. of ATMs	Total Access Points	No. of Branches	No. of Agents	No. of EFTPOS	No. of ATMs	Volume	Change (%)
ANZ	132	2	0	121	9	165	3	0	149	13	-33	-20
BSP	377	4	34	324	15	437	4	31	388	14	-60	-14
MBf	2	2	0	0	0	3	3	0	0	0	-1	-33
TDB	8	8	0	0	0	8	8	0	0	0	0	0
Total	519	16	34	445	24	613	18	31	537	27	-94	-15

Usage indicators showed a positive outcome

The usage indicators showed a positive outcome over the year ended to June 2021 with an increase in both the total number of individual deposit accounts and the individual loan accounts (refer to Table 9). The increase is attributed to banks' services that facilitate customer's continuously direct deposits of remittances to their bank account to access the ATMs or EFTPOS machines. These services include MoneyGram and 'Ave Pa'anga Pau financial services which are convenient for remittance purposes for families abroad during the COVID-19 lockdown. Moreover, some individuals have contracts with various government projects that require them to open an account with the banks to receive the government funds. In addition, the increase in the total individual number of loan accounts was due to the continuous banks' loan campaign and marketing activities through radio programs and websites.

TABLE 9: USAGE OF FINANCIAL SERVICES INDICATORS - BANKS

Indicators	2021	2020	2019 ⁵	2015 ⁶
Number of regulated deposit accounts per 10,000 adults	16,184	15,801	15,024	5,604
Number of regulated credit accounts per 10,000 adults	2,233	2,205	2,006	521

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

Usage of financial services increase

Despite the balanced proportion of shares of the total number of male and female individual deposit accounts, the increase in the total number of individual deposit accounts was driven by the rise in the number of individual deposit accounts owned by females compared to the decrease in the number of individual deposit accounts owned by a male. On the contrary, the increase in the number of individual loan accounts was driven by male-owned loan accounts, which reflects the access by males to eligible security such as land, a key collateral for loans (refer to Table 10).

TABLE 10: SUMMARY OF USAGE OF FINANCIAL SERVICE BY GENDER

Banks & Non-Banks	June 2021			June 2020			Year ended June 2021	
	Total	Male	Female	Total	Male	Female	Change	Change (%)
No. of Deposit Accounts	103,699	58,490	45,209	101,248	59,364	41,884	2,451	2.0
No. of Loan Accounts	14,305	5,636	8,669	14,127	4,609	9,518	178	1.0

5 Adult population (15 years old +) - 64,076 - Census Report 2016

6 Tonga's Financial Inclusion Benchmark

Tonga's access to financial services presented a mixed outcome over the year ending June 2021 with a decline in financial services access points and an increase in the usage of financial services. It is noted that the financial products and services that meet the customers' needs are provided mainly by the banks. During COVID-19, the bank's products have contributed to the improvement in the usage of financial services such as online banking, ATMs and EFTPOS terminals. The banks' financial products have expanded the outreach of financial services through digital or electronic means, which continues to support the Reserve Bank's objectives of inclusive economic growth and promote financial stability. In that regard, the Reserve Bank will continue to liaise with the banks and non-banks to monitor the level of financial inclusion in Tonga to ensure that the public has access and usage of financial products.

Micro, Small and Medium Enterprises (MSMEs) Report

Over the year ended June 2021, the MSMEs outstanding loans fell by \$4.1 million (16%) to T\$21.3 million compared to the year ended June 2020. This was mainly due to the decline in outstanding loans to agriculture, wholesale, retail, and manufacturing sectors (Table 11). According to banks, the lower MSMEs outstanding loans was due to loan settlement by some of the MSMEs. The closing of international borders and the travel restrictions have resulted in families sending funds to their MSMEs families in Tonga to assist with their businesses. The Government Stimulus Packages also helped MSMEs in repaying their loans.

Furthermore, due to the border lockdown, consumers are spending on local activities which has supported the MSMEs sector. According to the Non-Banks financial institutions, the decline in the MSMEs outstanding loans was due to the expiry of the COVID-19 stimulus package. The decline in MSME loans outstanding was predominantly driven by banks which it shares is about 70% of the total MSMEs outstanding loans. Tongatapu 2 constituent is the main contributor to the decline in the total MSMEs outstanding loan balance for both wholesale, retail and manufacturing loan sector. On the other hand, Tongatapu 1 was the major contributor to the decline in the total MSMEs outstanding loan balance.

TABLE 11: BANKS & NON-BANKS MSMES SECTOR GROWTH

Types of Sector	June 2021		June 2020		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 (%)
Overall Total	2,102	21.3	2,467	25.4	-364	-14.8	-4.1	-16.1
Agriculture	1,050	6.5	1,137	8.4	-87	-7.7	-1.9	-22.8
Construction	5	0.5	17	0.6	-12	-70.6	-0.1	-24.4
Fisheries	94	2.1	121	1.8	-27	-22.3	0.3	15.1
Forestry	1	0.02	4	0.02	-3	-75.0	-0.001	-3.9
Manufacturing	733	5.8	881	6.7	-148	-16.8	-1.0	-14.3
Other Services	94	2.0	65	1.5	29	44.6	0.5	37.5
Tourism	20	1.8	26	1.7	-6	-23.1	0.1	7.6
Transport	20	0.8	38	0.9	-17	-45.9	-0.1	-9.8
Wholesale/Retail	85	1.8	178	3.7	-9.3	-52.2	-1.9	-51.3

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

Number of MSME Loans Declined over the year

Simultaneously, the number of MSMEs that have a loan also decreased by 364 (15%) to 2,102 MSMEs due to the significant decrease in the number of MSME loans in the manufacturing, wholesale, retail, and agriculture sectors. The decline in the number of MSME bank loans was mainly in the manufacturing and agriculture sector. In contrast, the Non-Banks showed a significant decline in the number of MSMEs for wholesale and retail sector. One of the small banks MSME customers and also Government Development Loans customers also drove the lower number of MSME loans caused by the settlement of loans over the year.

The decline in the number of MSMEs is consistent with the decrease in the MSMEs total outstanding loans. Vava'u 16 and Vava'u 14 constituencies were the major contributors to the decline in the number of MSMEs loans for the agriculture sector, Tongatapu 2 constituency was the main contributor to the decline in the number of MSMEs for the manufacturing sector, and Tongatapu 1 contributed the most to the decline in the number of MSMEs for wholesale retail sector.

MSMEs are proportionately owned by male and female. About 52% of the total number of MSMEs are owned by females and 48% are owned by males (refer to Table 12). The female-owned MSMEs drove the manufacturing sector, mainly in activities such as weaving mats/ta'ovala, tapa making, and handicrafts. The main bulk of the total number of MSMEs is predominantly owned by men in the agriculture sector. This is attributed to land ownership which is the main collateral for loans in the agriculture sector.

Over the year to June 2021, there was a decline in the number of MSME loans and total outstanding loans. MSME loans in the agriculture and manufacturing sector contributed to this decline, reflecting the COVID-19 pandemic uncertainties resulting in MSMEs and financial service providers becoming more risk-averse. In addition to the financial crisis, the squash season has also been poor since 2020.

TABLE 12: BANKS & NON-BANKS TOTAL NUMBER OF MSMES BY GENDER

Types of Sector	June 2021				June 2020			
	No. of MSMEs				No. of MSMEs			
	Male	Female	Male/ Female	Total	Male	Female	Male/ Female	Total
Overall Total	1,006	1,090	6	2,102	1,291	1,174	2	2,467
Agriculture	726	324	-	1,050	874	263	-	1,137
Construction	5	-	-	5	11	6	-	17
Fisheries	62	32	-	94	81	40	-	121
Forestry	1	-	-	1	4	-	-	4
Manufacturing	117	616	-	733	158	723	-	881
Other Services	26	64	4	94	44	21	-	65
Tourism	14	4	2	20	19	5	2	26
Transport	14	6	-	20	24	14	-	38
Wholesale/Retail	41	44	-	85	76	102	-	178

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

Local Money Transfer

Over the year ended June 2021, the inward transfers continued to decline by T\$0.2 million (2.0%) to T\$11.7 million, mainly due to a decline in the local inward transfer from Tongatapu to Vava'u, Ha'apai and 'Eua. The decline in family support and gifts contributed to the decrease in the local inward transfer. The continuous impact of the COVID-19 pandemic on economic activity contributed to the annual decline. Family support and remittances in kind (shopping) drove the decline over the year ended to June 2021.

Financial Systems Corporate Plan Targets

At the end of the financial year, the Banking Supervision department achieved 26 corporate plan targets out of 27 measurable targets in 2020/21. The Financial Systems team utilized 32% of their annual budget, given some recruitments were deferred during the year. In addition, the setup of a new department (Financial Stability) was deferred due to COVID-19 Pandemic and border closures. For the 2021/22 Financial Year Corporate Plan, 66 measurable targets were set under 10 Programmes. This includes the new projects (Credit Registry, National KYC, Regional KYC), and additional duties. In addition to the supervision of banks and non-banks, the department will take on AML Risk Supervision, Financial Inclusion, Consumer Protection, Household Indebtedness etc. The Non-Banking Supervision department also committed to 13 targets in the 2020/21 corporate plan, in which 12 were successfully achieved. During the 2019/20 corporate plan review, new targets were added to guide the department in delivering its expected output. This resulted in a total of 13 targets for 2020/21.

Payment Systems

The Payment Systems Department is responsible for the settlement of interbank obligations arising from the conduct of Exchange Settlement Accounts (ESA), the National Reserve Bank of Tonga's own trading activities, and undertaking of banking business and depository for the Government. This financial year the bank's is modernising Tonga's payment and settlement system by introducing the Domestic Electronic Payment system (DEPS) where transactions between banks are settled in real-time.

Domestic Electronic Payment System Project

By the end of June 2021, the Reserve Bank has progressed well with the Domestic Electronic Payment System development project. Continuous trainings with the Commercial Bank's users were successfully conducted during the year, with several consultations and meetings held for clarification purposes. The project is currently in Phase 5 which is the final phase to completion. The Commercial banks had requested more time to familiarise themselves to be more comfortable with the system. So while the documents are being finalised, the Reserve Bank had commenced engaging the Commercial Banks in performing the daily interbank cheque clearance on the DEPS at the NRBT premises. Each bank's settlement officer perform their respective bank's cheque clearance in the Automatic Clearing House Module (ACH) while the Reserve Bank oversees and approves the process for the time being. All banks will perform the RTGS module at NRBT before the deployment of the workstations to the respective banks. In the meantime, the NRBT performs the RTGS module for the Banks using their authorised advice received. This enables updating the Bank's ESA daily. Daily ESA balances will be available to Banks online when the system is fully running.

Interbank Daily Cheque Clearance

A total of 139,404 cheques were presented for clearance at the Reserve Bank during the financial year 2020/2021, a decrease by 4.4% from the previous year. The reduction in the number of cheques presented for clearance was driven by the broader usage of electronic transfer payments such as internet banking and EFTPOS machines. The clearance of cheques continued, and all participants were committed to settle their dues on time.

Cross Border Payments

One of the core functions of the Reserve Bank is to be the principal banker for Government for its counterparties overseas, the offshore payments on behalf of both Government and Banks were successfully conducted with no issue. Cross border payments via SWIFT are closely managed with the enforcement of strict controls administered by the IT department to mitigate any operational risks or financial loss. Internal controls through the reconciliation of the account balances to ensure safety and security of the Reserve Bank's assets overseas continued to be undertaken. To keep updated on the latest technology developments and best practice that other central banks adopt, the Settlement and IT staff attended virtual meetings on the expected migration from the current system to the ISO20022, which will commence in March 2022.

Fiscal Agent for Government

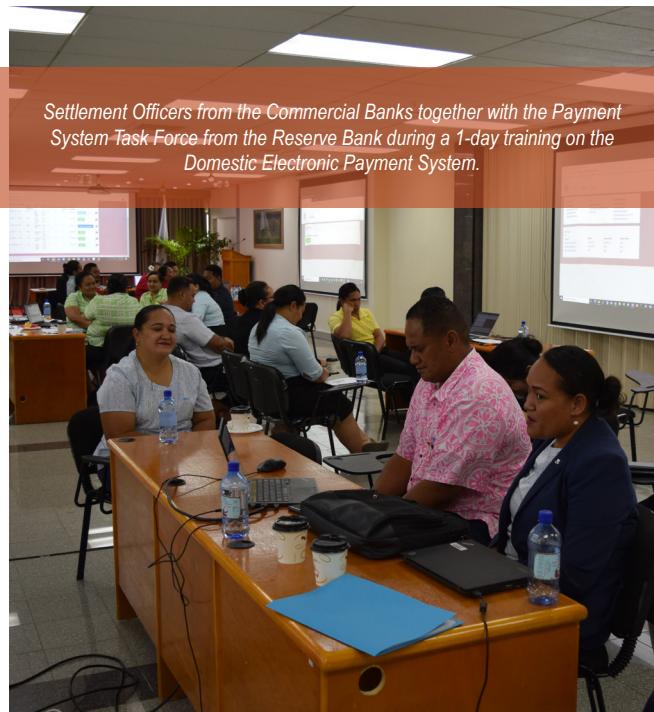
During the year, the Reserve Bank continued to facilitate government payments and receipts both locally and overseas from its accounts at the Reserve Bank. Meetings with the Ministry of Finance was held during the year to discuss improvements to the services provided.



Payment System Corporate Plan Targets

During the year, the Payment System Department participated in the review of the 2021 Corporate Plan. The department was assigned 22 measurable targets, which were all achieved. The measurable targets were related to promoting an efficient settlement and secured payments system and the modernisation of the operations of the Reserve Bank. The review also set 42 measurable targets for the Department for FY2021/22, under 5 major programs. The additional targets 20 targets compared to last year, stem from the DEPS projects.

A total of 139,404 cheques were presented for clearance at the Reserve Bank during the financial year 2020/21



Financial Intelligence Unit

The National Reserve Bank of Tonga (NRBT) is the Transaction Reporting Authority (TRA), which functions as Tonga's Financial Intelligence Unit (FIU). The roles and functions of the TRA are provided under the Money Laundering and Proceeds of Crime (MLPC) Act. As one of the leading agencies in Tonga, the TRA is responsible for the detection and prevention of money laundering and terrorist financing activities. This enables the NRBT to meet its objective of promoting a safe and sound financial system.

Receipt and Analysis of Financial Information

A key function of the department is to analyse suspicious transaction reports (STRs) and other financial transaction reports that it receives from reporting entities and other agencies in Tonga. During the year, the department received 18,119 financial transactions and other reports. These reports consisted of suspicious transaction reports (STR); currency transaction reports (CTR), and border currency reports (BCR).

TABLE 13: NUMBER OF REPORTS RECEIVED

Types of Reports Filed	2017/18	2018/19	2019/20	2020/21
Suspicious Transaction Reports (STRs)	31	23	39	21
Currency Transaction Reports (CTRs)	8,668	14,068	12,944	18,096
Border Currency Reports (BCRs)	80	97	63	2
Total	8,779	14,188	13,046	18,119

Details of the financial transaction reports received during the year are provided below.

Suspicious Transaction Report

The FIU received 21 STRs during the year, an average of 2 STRs per month compared to 39 STRs reported in the previous year.

TABLE 14: SUSPICIOUS TRANSACTIONS REPORTED

STR(s)	2017/18	2018/19	2019/20	2020/21
Suspicious Transaction Reports (STRs)	31	23	39	21

Financial Institutions and Cash Dealers are required under section 14 of the MLPC Act to report suspicious transactions to the TRA. A suspicious transaction is a transaction or attempted transaction in which a reporting entity has reasonable grounds to suspect that it may be relevant to the investigation or prosecution of a serious offence or terrorist financing.

FIGURE 14: SUSPICIOUS TRANSACTION REPORTS



The dominant STR indicator were reports relating to a large scale of cash transactions followed by reports related to using of a personal account for business purposes. In the "Other" category, was a report related to the suspected operation of a pyramid scheme in Tonga.

TABLE 15: SUSPICIOUS TRANSACTION REPORTS BY TYPE

STR(s) by Type	2017/18	2018/19	2019/20	2020/21
Unusual significant transaction	12	5	4	2
Largely Rapid movement of Funds	7	3	4	0
Using personal accounts for business purposes/ possible tax evasion	7	5	4	5
Possible avoidance of regulatory requirements ⁷	2	6	4	1
Large scale of cash transaction	-	-	21	12
Scams	0	0	1	0
Others	10	4	1	1
Total	38	20	39	21

Currency Transaction Reports

The FIU received 18,096 CTRs during the year, an average of 1,508 CTRs per month. This is an increase of 28 percent compared to 12,944 CTRs reported in the previous year.

TABLE 16: CURRENCY TRANSACTION REPORTED

CTR(s) by Type	2017/18 (TOP\$M)	2018/19 (TOP\$M)	2019/20 (TOP\$M)	2020/21 (TOP\$M)
Movement of Transactions				
Inwards	183.4	243.2	234.0	372.9
Outwards	84.8	139.2	118.0	155.4
Purpose of Transactions				
Business	144.4	250.9	229.0	363.3
Personal	123.8	131.5	122.5	165.1
Type of Transactions				
TT	28.9	34.7	26.16	39.3
Cash	132.8	163.4	156.3	194.6
Cheque	54.9	103	109.3	207.3
Other ⁸	38.2	55.4	34.8	66.5
Cash/Cheque	13.4	25.9	25.2	40.4

Financial Institutions are required under MLPC Regulation 23 to report to the TRA currency transactions involving currency of any country of a value greater than \$10,000. A transaction in currency includes deposits, withdrawal, and exchange of currency, other payments or transfers.

Border Currency Reports

During the year, the FIU received only 2 BCRs. This is a decrease of 96 percent compared to 63 BCRs received in the previous year. This decrease is due to the COVID-19 border restrictions which drastically reduced the number of travellers to and from Tonga during the year.

⁷ EC, Reporting & Other Requirements

⁸ Other type of transactions includes transfer between accounts, exchange of currency and other type of payment not specified above

TABLE 17: BORDER CURRENCY DECLARATIONS

BCR(s) by Type	2017/18 (TOP\$M)	2018/19 (TOP\$M)	2019/20 (TOP\$M)	2020/21 (TOP\$M)
Movement of Transactions				
Inwards	0.8	1.0	0.7	0
Outwards	42.3	43.4	42.2	1.4
Purpose of Transactions				
Business	42.0	43.5	42.6	1.4
Personal	1.1	0.9	0.3	0

Section 19 of the MLPC Act requires any person who enters or leaves the Kingdom with cash amounting to more than \$10,000, shall make a declaration to an authorised officer. This reporting is administered by the Ministry of Revenue & Custom at the airport and copies of the reports are sent to the TRA.

Reports and Intelligence Development

According to section 11A (b) of the MLPC Act requires the department to analyse and assess all reports and information that it receives. The FIU uses its standard operating procedure to analyse all STRs and develop intelligence of possible money laundering or other serious offences. Other reports such as CTRs and BCRs provide critical information which is used to analyse the STRs.

Enquiries with Reporting Entities

Under section 11A (c), (f) & (q) of the MLPC Act, the FIU has powers to obtain information from financial institutions and cash dealers. As part of its analysis process, the FIU made several enquiries to the reporting entities. Some queries were aimed at developing further intelligence on information filed in the STRs. Some queries were in relation to ongoing investigations of financial crimes and other serious offences. During the year, the FIU made 18 enquiries primarily to banks and foreign exchange dealers. The majority of queries sent were for:

- customer transaction history,
- customer identification details, and
- customer account details.

TABLE 18: ENQUIRIES TO REPORTING ENTITIES

Request for Information (RFI)	2017/18	2018/19	2019/20	2020/21
Number of Individuals & Businesses	9	26	44	18

Dissemination of Financial Intelligence

Intelligence Reports to Law Enforcement Agencies

The FIU analyses suspicious transactions and other financial transaction information such as CTR and BCR to develop financial intelligence. The results of the FIU's analysis of STRs are disseminated to relevant law enforcement agencies in a dissemination report. Disseminating financial intelligence to law enforcement agencies is a core function of the FIU. Financial intelligence enables our law enforcement agencies to investigate predicate crimes, money laundering and terrorist financing activities. The FIU's intelligence reports also provide profiling of suspected proceeds of crime and proceeds linked to tax evasion. Subsequent to the analysis of the 21 STRs received during the year, 13 reports were disseminated to law enforcement agencies for further investigations.

TABLE 19: NUMBER OF DISSEMINATED REPORTS

Number of Disseminated Report(s)	2017/18	2018/19	2019/20	2020/21
Disseminated Reports	14	9	28	10

About 75 percent of the dissemination reports were referred to the Ministry of Revenue & Customs and 25 percent were passed to Police for further investigation of possible offences. Majority of the STRs received were retained for future references.

TABLE 20: DISSEMINATED REPORTS TO LAW ENFORCEMENT AGENCIES

Number of Disseminated Report(s)	2017/18	2018/19	2019/20	2020/21
Ministry of Police	7	7	5	2
Ministry of Revenue & Customs	14	7	27	8
Ministry of Foreign Affairs (Immigration)	1	0	0	0
Ministry of Trade & Economic Development	3	0	0	0

Investigative Assistance Provided to Law Enforcement Agencies

The FIU responded to 18 requests for information from law enforcement agencies such as 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 predicate offences.

TABLE 21: REQUEST FOR INVESTIGATIVE ASSISTANCE

Request Report(s)	2017/18	2018/19	2019/20	2020/21
Number(s) of Request for Investigative Assistance	9	15	28	18

Dissemination of Information to Foreign FIUs

The FIU responded to 1 request for information from the FIU of Australia and have made 2 requests for information to the FIU of New Zealand. Information request made and received from foreign FIUs adds value and assists with the FIU's financial intelligence analysis function.

TABLE 22: DISSEMINATION OF INFORMATION TO FOREIGN FIUS

Dissemination of Information to Foreign FIUs	2017/18	2018/19	2019/20	2020/21
Request Made	1	1	5	2
Request Received	0	1	1	1
Total	1	2	6	3

Due Diligence

During the year, the department conducted background checks on 145 individuals and entities. The department also responded to surveys from the Reserve Bank's correspondent banks on the bank's AML/CFT procedures.

TABLE 23: REQUESTS FOR BACKGROUND CHECKS 2021

Background Checks	2017/18	2018/19	2019/20	2020/21
Customer of Interests/ Business of Interests Numbers	80	194	250	145

Supporting and Supervising Reporting Entities

Compliance Reviews

In collaboration with the Non-Banks Division, compliance visits were conducted to all FEDs in July and December 2020. The results were generally compliant. In terms of AML/CFT related obligations, a few non-compliances were noted in areas such as record-keeping and reporting obligations. The FIU continues to follow up with these FEDs on areas of concern to assist them in getting them compliant for the next round of compliance reviews.

Training and Awareness for Reporting Entities

The FIU also conducted an AML/CFT training upon request from one of the FEDs to assist them with awareness and understanding of their AML/CFT related obligations. During the FEDs semi-annual meeting in July 2021, the FIU conducted a refresher training for all participants as a reminder of their AML/CFT obligations.

Domestic Coordination and Engagement

Working Group on Serious Financial Crimes

In October 2020, Cabinet endorsed to appoint the Attorney General's Office to its Co-chair position it previously held in 2018. Pursuant to that Cabinet decision, the Working Group held its first meeting in November 2020 to progress with the matters relating to Tonga's Mutual Evaluation process. The department continued to contribute to the coordination of the national AML/CFT efforts through its role as the secretariat of the Working Group. This included taking the lead role in coordinating Tonga's mutual evaluation process and the finalisation of the mutual evaluation report. Several meetings were held throughout the year to complete the information required for Tonga's mutual evaluation and to review the report before its finalisation in July 2021.

National Risk Assessment

Tonga's first national risk assessment was initiated in 2015 and completed in 2018. Tonga's mutual evaluation in 2019 noted that Tonga's NRA report was out-of-date and needed to be updated. In May 2021, the Working Group on Serious Financial Crimes sub-committee was formed to revise the NRA and the National AML/CFT Policy. The NRA was updated with statistics and information up to 2021 and incorporated into the national policy that will drive the priorities of the relevant agencies in policies and capacity developments. Consultations with the private sector is yet to be completed before the NRA can be published.

Engagement with Law Enforcement Agencies

The FIU continued to meet with law enforcement agencies such as Revenue, Customs and Police to obtain feedback on the reports referred for investigation. During this meeting, the agencies involved discussed current active cases and requested further information to assist with the investigation process. The reports from the law enforcement agencies are incorporated into the department's feedback to the reporting entities.

International Engagement and Contribution

Mutual Evaluation of Tonga

Tonga's mutual evaluation process was put on hold since March 2020, due to the COVID-19 pandemic. The process resumed in November 2020, with Tonga providing feedback on its 2nd draft report. During the pause of the process, Tonga agreed to proceed with its assessment process and the plenary meeting in virtual format. Following the 3rd draft report review, Tonga held its face-to-face meeting with the assessors in February 2021. The meeting discussed key priority issues raised by Tonga and the assessors relating to the 3rd draft report. Tonga also had the opportunity to make further submissions and provided arguments on areas where the members of the Working Group felt were not accurately reflected on the draft report. Tonga received its 4th draft report in March 2021. Key issues were then raised to the APG to be discussed in the Mutual Evaluation Committee meeting scheduled to be held in July 2021, prior to the discussion of Tonga's report at the plenary.

Asia Pacific Group on Money Laundering

Tonga has been a member of the APG since 2005. The APG is an autonomous and collaborative international organisation comprising of 41 member jurisdictions. As Tonga's designated lead agency, the FIU liaised closely with the APG during the year on various national outputs. During the year, the FIU participated in the following key APG activities;

- *Pacific representative to the Governance Committee*
- *liaising with APG on the coordination of Tonga's mutual evaluation process and*
- *Mutual Evaluation Committee*

The FIU continued to liaise with the APG on various AML/CFT issues relevant to Tonga during the year.

AUSTRAC

AUSTRAC is Australia's Financial Intelligence Unit. During the year, the FIU benefited from its engagement with AUSTRAC through sharing AML/CFT information and intelligence. AUSTRAC also provided the FIU with AML/CFT technical assistance and training.

TABLE 24: TECHNICAL ASSISTANCE AND TRAINING PROVIDED BY AUSTRAC 2021

Technical Assistance & Trainings	Status
Financial Intelligence Analysis Course - Phase 1	Completed
Financial Intelligence Analysis Course - Phase 2	TBC
Funding of World-Check One Refinitiv Solution	Ongoing
Cyber Week	Completed
Video Conference Kit	In Progress
Trade Base Money Laundering Workshop	In Progress
IT System Solution	In Progress

Financial Intelligence Unit Corporate Plan Targets

For 2020/21, the department set 20 targets to achieve. These targets aim to effectively supervise reporting entities, ensure a well-informed regime, and comply with global AML/CFT related requirements. The department contributes to the first strategic priority of the Reserve Bank in setting a platform for Tonga to become a high growth economy.



Financial Market Operations



The Financial Market Department's mandate is to manage the official foreign reserves, manage the foreign exchange operations and implement monetary policy to assist Management and the Board of Directors to achieve the Reserve Bank's principal objectives of:

- *Maintaining internal and external monetary stability;*
- *Promoting a sound and efficient financial system; and*
- *Supporting macroeconomic stability and economic growth.*

The department is divided into 3 main divisions namely:

- *Foreign Reserves Management;*
- *Foreign Exchange Operations; and*
- *Domestic Operations; which includes being the fiscal agent.*

During the financial year 2020/21 the Financial Markets continued to implement its targets to achieve its objectives.

BANKING SYSTEM LIQUIDITY
\$365.6m

End of June 2021

June 2020: 196.9m

OFFICIAL FOREIGN RESERVES
\$715.2m

End of June 2021

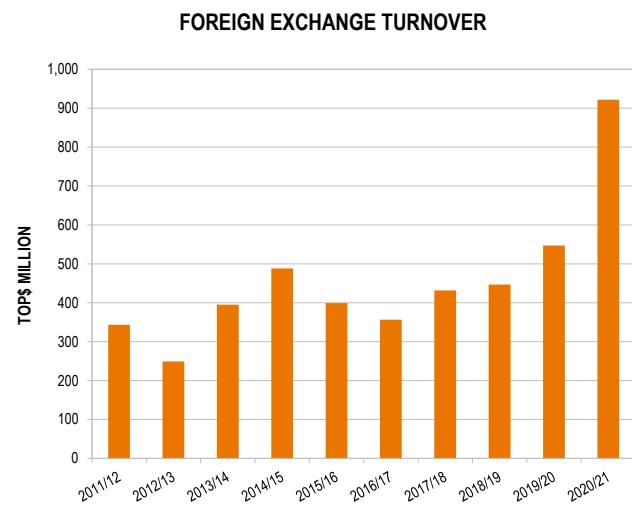
12 Months of Import cover

June 2020: \$543.8m

Foreign Reserves Management

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\$721.0 million during June 2021 before levelling at T\$715.2 million on 30 June 2021, equivalent to 12 months of import cover compared to T\$543.8 million (9.2 months of import cover) as at 30 June 2020. The significant increase in foreign reserves was attributed mainly to receipts of government budget support, loan disbursements, and project funds. The Reserve Bank continues to monitor the banks' compliance with their respective Nostro limits and excess foreign exchange that is sold to the Reserve Bank. This is one of the foreign reserves management tools to ensure an adequate level of foreign reserves is maintained.

FIGURE 15: FOREIGN EXCHANGE TURNOVER

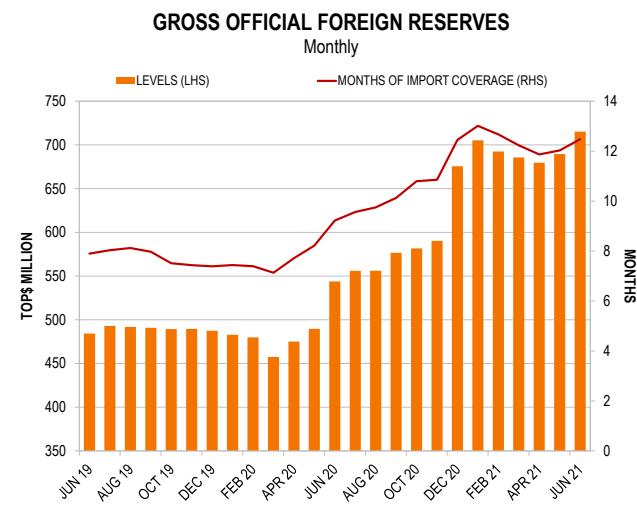


During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$546.6 million exceeded sales of T\$375.2 million giving a total foreign exchange turnover for the year of T\$921.8 million. This is an increase from T\$547.0 million last year due mainly to a rise 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 to maximize income and maintain the value of the foreign reserves. The currency composition exposes the Bank to exchange rate and interest rate risks. 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 \$171.4 million over the year, income on the investment of the foreign reserves decreased by \$5.8 million compared with the previous year, which is in line with the lower interest rates in the global markets. In this regard, the Board approved a new correspondent investment bank to help maximize the return on the increasing investible foreign reserves.

FIGURE 16: GROSS OFFICIAL FOREIGN RESERVES



The Reserve Bank continued to comply with the 2018 Reserve Management Policy during the year except for the performance index, the average annual yield on investible reserves. The protracted low-interest rates that dominate the global markets meant that maturing high-interest investments were rolled over into lower interest rates. Investments were held with banks rated above the Board approved minimum "A" rating by international credit rating agencies while also minimizing the concentration of investments in one bank.

Foreign Exchange Control Operations

The Reserve Bank continued to implement the requirements of the new Foreign Exchange Control (FEC) Act 2018 that was enacted in June 2018, by ensuring compliance with the Exchange Control Directive, which became effective on 1 November 2018. Given the high level of foreign reserves, the outlook for the foreign reserves to remain at comfortable levels and the current accommodative monetary policy stance, the Reserve Bank did not introduce any new restrictions on the Exchange Control Requirements in 2020/21.

As such, the Reserve Bank processed 546 exchange control applications for current and capital payments. This included 43 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\$211.5 million in 2020/21 (of which 13.2% were classified as capital transactions) compared to the 773 exchange control applications (of which 13.5% were capital transactions) processed in 2019/20, amounting to T\$266.5 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 documentation 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, customers who repatriate their dividends/operating profit 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 four (4) applications for the removal of cash (both Tongan pa'anga and foreign currency notes totaling T\$10,000 and above) across the border, which amounted to a total of T\$2.6 million. There was a markedly decrease in the volume and value of applications for the removal of cash compared to 58 applications that were processed and approved last year, totaling T\$45.2 million. The significant decline is attributed to the COVID-19 pandemic border lock-down and travel

restrictions. The approval for the 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 prior to 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 of other reports continued for reports such as the Overseas Exchange Transactions (OET), Foreign Exchange Transactions with a value equivalent to and above T\$50,000, Forward Exchange Contracts (FEC) and the Foreign Currency Accounts (FCA). During the year, the Reserve Bank provided awareness through press releases posted on the website and training for the banks and authorized restricted foreign exchange dealers to keep them informed of the revision to the exchange control directive and also to raise issues identified from the spot checks. To enhance compliance with the FEC Act, the Reserve Bank continued to issue a list for those who are close to or have reached the gift delegated limit of T\$50,000. In addition, a list of those who have breached the limit on Travel allowance of T\$20,000. These non-compliant customers were referred to the Reserve Bank to process and approve all their foreign exchange payments. Close monitoring of these non-compliant customers to ensure consistent compliance with the exchange control requirements and that payments are bonafide transactions to strengthen the Reserve Banks anti-money laundering initiatives.

Setting the Exchange Rate

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.

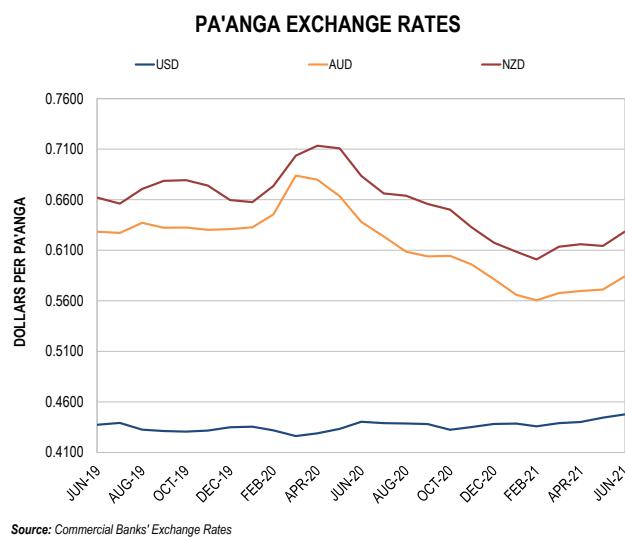
The Reserve Bank is currently reviewing the basket of currencies in accordance with the latest trend in bilateral trades with our major trading partners.

The Reserve Bank monitored the movement of the rate of exchange of the pa'anga against other currencies 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.

Over the year ended June 2021, the Tongan pa'anga (TOP) fluctuated against the Australian dollar (AUD) & New Zealand

dollar (NZD) in wider bands, compared to last year. This reflected increased volatility in the AUD & NZD. At the same time, TOP fluctuated against the US dollar (USD) in a narrower band than last year, reflecting decreased volatility in the USD during the year. The USD weakened against the NZD and AUD mainly on optimism in the world economy and global outlook amid vaccination rollouts. The AUD and the NZD appreciated against the weak USD due to relatively more robust economic prospects in Australia and New Zealand. Consequently, the USD depreciated while the AUD & NZD appreciated against the TOP over 2020/21.

FIGURE 17: PA'ANGA EXCHANGE RATES



Source: Commercial Banks' Exchange Rates

The Reserve Bank also continued to monitor the commercial banks' exchange rate spreads to ensure that they complied with the Reserve Bank's approved limits. Despite the introduction of the levy on foreign exchange transactions in June 2016, the spread limits were not revised. In collaboration with the Association of Banks in Tonga (ABT), it was agreed that banks not pass on the levy burden to customers. These directives meant that the banks would absorb the levy burden within their profit margin instead of passing it to the public. The Reserve Bank paid T\$1.5 million in levy tax to the Ministry of Finance during 2020/21.

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, to assist the public with their financial decisions.

Fiscal Agent and Policy Advice Support

As the Registrar of Government Securities, 4 bond series matured over the financial year in which 3 bond series were rolled over while 1 bond series was paid out. Of the rollover bonds, 2 were oversubscribed, and 1 was undersubscribed, indicating there is still a strong demand for investment in

Government bonds due to lower interest rates offered on bank deposits. The Reserve Bank continued to offer an electronic transfer of principal and interest on maturing bonds to customers' bank accounts and provide bond statements upon request.

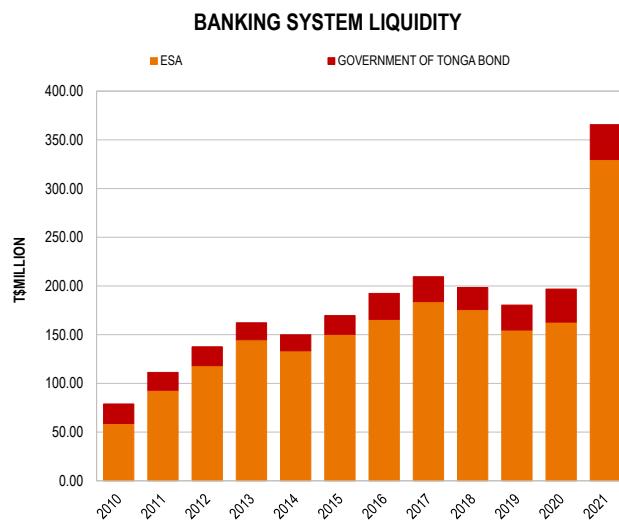
The Reserve Bank also continued to provide incentives on Government foreign exchange transactions by offering competitive exchange rates and extensions of cut off times for foreign exchange deals. On the last day of the month, weekly and monthly exchange rates are also sent to the Ministry of Finance and the Ministry of Customs and Revenue to assist with the ministries' functions.

Implement Monetary Policy and Develop Tonga's Financial Market

The Reserve Bank's accommodative monetary policy stance continued during the financial year 2020/2021. 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 2021, the banking system liquidity rose to \$365.6 million from \$196.9 million at the end of June 2020. The banking system liquidity comprised mainly of \$329.8 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$35.8 million of Government of Tonga Bonds held by the banks. The increase in liquidity was in line with the increase in foreign reserves and government bonds held by the banks.

FIGURE 18: 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, to allow the balance above \$10 million in the Revaluation Reserve Account to cover the Reserve Bank's monetary policy costs, enhances the Reserve Bank's ability to issue NRBT notes to implement the monetary policy and develop the domestic market.

Financial Market Corporate Plan Targets

A review of the 2020 corporate plan and targets was also conducted during the financial year. The review showed that the Financial Markets Department (FMD) had achieved 43 out of the 45 targets with two target that is still work in progress. As a result of the review, the FMD's corporate plan was restructured with 47 targets for the financial year 2021/2022.

Risk Management & Compliance

During the financial year 2020/2021, 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 eighteen incidents reported during the financial year with only one reported incident 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, only one complaint was lodged with the Reserve Bank against a licensed financial institution. There was no complaint against the Reserve Bank regarding its services and/or functions.

Business Continuity and Disaster Recovery Management

The continuity of critical business functions before, during and after a disruptive event is a key area of focus for the Reserve Bank. The Reserve Bank continues to refine its Business Continuity and Disaster Recovery Plan during these unprecedented times of National State of Emergency due to the worldwide pandemic outbreak COVID-19.

Risk Management Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 2020/21, the Risk Management Unit was allocated with nineteen specific measurable targets. A review of the financial year corporate plan was carried out in March 2021 which revealed that the Unit achieved fourteen targets while five targets were current work in progress. These five targets are related to draft Risk Management Policy, review of Enterprise Risk Profile, conducting key control testing of Information Systems and Technology high risk areas, drafting Business Continuity and Disaster Recovery Plans for critical functions as well as updating and reviewing the Unit's internal operating procedures.

Legal Unit

The Legal Department in the financial year 2020/2021 continued to focus on implementing its strategic targets to managing legislative risks. This is through the risks arising from the Reserve Bank's legislations or other legislations.

By the end of June 2021, the Reserve Bank submitted the following draft Bills to the Legislative Assembly:

Banking Bill 2021

- *This Bill was passed in February 2021, replacing the Financial Institutions Act 2004 (the “FI Act”).*
- *The purpose of the Bill is to differentiate the regulation of banks from non-banks, whereby “financial institutions” is defined to encompass both banks and non-banks alike.*
- *It also aims to address issues identified in the implementation of the FI Act particularly on resolution of problem banks (controllership/receivership) and enhancement of corrective measures.*

Credit Unions Bill 2021

- *The Bill focuses on prudential matters with specific emphasis on safety and soundness of credit unions and will be administered by the Reserve Bank.*
- *It intends to support the private sector with the intention of providing low interest lending rates and high interest deposit rates.*
- *With this in mind the Reserve Bank shall undertake periodic reviews of the legislation in consultation with the credit union sector.*

The Reserve Bank continues to develop its legal framework in the regulation and supervision of financial institutions and have drafted several draft legislation in the FY2020/2021. These draft Bills are in the process of consultations with the relevant stakeholders and industries. These include –

Payment and Settlement Systems Oversight Regulations 2021

- *The Regulations stipulate criteria and relevant factors based on which the Reserve Bank will determine whether a payment system should be registered.*
- *The policy objective is to ensure that operations of a payment system are safe, sound and efficient and would contribute to the financial and payment system stability of Tonga;*

Pension Funds Bill 2021

- *The Reserve Bank is the regulator of pension schemes, as they are defined as a non-bank financial institution.*
- *Its statutory objectives are set out in the Bill, one of which is to protect the benefits of members of such schemes.*
- *To do so, the Reserve Bank shall work with trustees and employers of pension schemes in the private and public sectors, to help them understand their legal duties and the standards expected under the Bill;*

Insurance Bill 2021

- *The development of the Insurance Bill was based on the Insurance Law developed by the Monetary and Capital Markets Department under the IMF in line with the Insurance Core Principles, and that will provide a robust and prudent framework for regulating the insurance industry while at the same time having the flexibility to promote and widen the insurance markets.*
- *The Bill specifies the objects of insurance law including identifying powers and discretions required by the Reserve Bank to effectively oversee the operation of the insurance industry and to ensure its continued stable development in the interests of policy owners.*

Capital Markets Development Regulations 2021

- *The purpose of the Regulations is to provide for the establishment of the market infrastructure including the stock markets, issuance of licenses to market intermediaries, regulation of issue of securities to public, the establishment of the Investor Compensation Fund for the purposes of granting compensation to investors who suffer pecuniary loss resulting from the failure of the licensed broker or dealer to meet its contractual obligations.*
- *New rules have been developed and are now being implemented worldwide to:*
 - (a) *protect investors;*
 - (b) *ensure that the markets are fair, efficient and transparent; and*
 - (c) *reduce systemic risks.*

Credit Information Reporting Bill 2021

- *The Reserve Bank is responsible for the regulating, licensing, registering and supervising credit information systems.*
- *The Bill stipulates criteria and relevant factors based on which the Reserve Bank will determine whether credit information system should be registered.*
- *The policy objective is to ensure that operations of a credit information system are safe, sound and efficient and for the purpose of improving the quality of bank credit.*

Money Laundering and Proceeds of Crime Bill

- *The Legal Department has been working closely with its Financial Intelligence Department and the Working Group on Serious Financial Crimes to amend the existing Act to meet the Financial Action Taskforce recommendations. This has been an ongoing development since Tonga's second mutual evaluation in November, 2019.*

Legal Unit Corporate Plan Targets

At the end of the financial year, the legal department achieved all of its 12 corporate plan targets. These targets were measured through nil compliance breaches by NRBT, there were no risks arising from any change of law other than the banking legislation, as well as nil issues resulting from negligence of the NRBT or any legal risks arising from its daily operations. The legal department utilized 100% of its allocated budget.



Currency Management



BANKNOTES IN CIRCULATION

\$111.0m

End of June 2021

June 2020: \$88.2m

COINS IN CIRCULATION

\$4.9m

End of June 2021

June 2020: \$4.4m

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.

The Currency department is responsible for regulating the issue of currency. The value of banknotes in circulation at the end of the financial year 2020/2021 totaled \$111.0 million, while the coins in circulation were valued at \$4.9 million. This was the second-highest figure for banknotes over the financial year 2020/2021, increasing by 25.7% over the year and falling short of the peak set in December 2020. Coins in circulation also rose by 11.1%. Notes in circulation peaked in December at \$112.4 million. They then fell to its lowest point for 2021 in February before rising steadily to its second-highest point in June. In December, Christmas spending drove the rise in the demand for notes and coins, end of year celebrations and development groups savings distributions.

The Reserve Bank focuses on maintaining an adequate supply of quality banknotes and coins by accommodating commercial banks banking operations. Over the 2020/2021 financial year, \$159.4 million of banknotes was issued to commercial banks, 21.1% more than the previous financial year. The commercial banks returned \$145.7 million worth of banknotes to the Reserve Bank to be processed. Of this \$77.8 million was deemed fit for reissue while \$67.9 million were deemed unfit. Commercial banks identify serviceable notes as fit for reissue. Once processed they are reissued to commercial banks.

Currency Corporate Plan Targets

At the end of the financial year, the currency department achieved 85% of corporate plan targets while 15% still work in progress. Despite the challenges due to the pandemic resulting in travel restriction, our technicians managed to provide the ongoing support services for the Cobra and X-Range machines in order to be able to continue with the daily counting/destruction of redeemed banknotes.

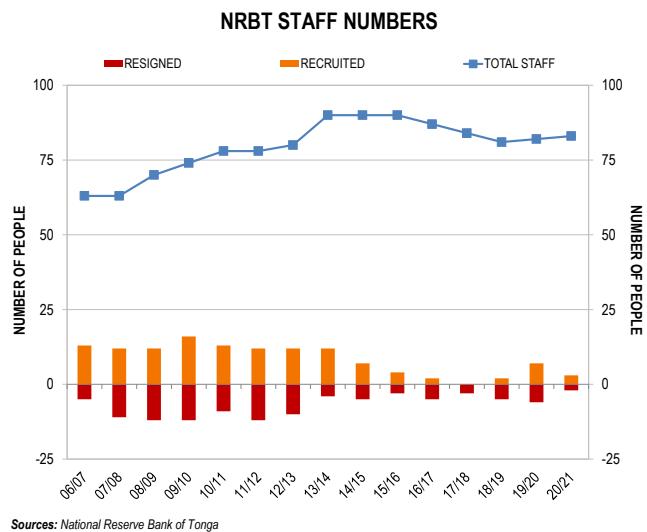
Corporate Services

Staffing

In promoting the Reserve Bank as the Employer of Choice, the Human Resources Department provides a range of services to the Bank as a whole. This includes facilitating services to maintain staff efficiency such as annual review of staff costs and job design, staff performance management, provide a competitive benefit package, recruit and select a professional team, staff training and development, provide an attractive professional development opportunities and promote a healthy organization by initiating health programs to reduce absenteeism. The Department also ensures compliance with all legal, statutory, organizational policies and the review of the Reserve Bank Employment policies. In the 2020/21 financial year, the Human Resources Department continued to implement its corporate strategic targets to develop, maintain and retain high standard of quality employees.

At the end of June 2021, the Reserve Bank maintained a total staff of 82 employees, 33 per cent on fixed term contract, 67 per cent permanent employees and 4 per cent were new recruits. The staff on fixed term contract increased by 3% 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 82 staff, 54 per cent are women and 46 per cent are men. The staff turnover in 2020/21 financial year decreased from 7% in 2019/20 financial year to 2% where 2 employees exited the Bank due to various reasons.

FIGURE 19: NRBT STAFF NUMBERS



To achieve the functions of the bank and the increase in targets set out in the corporate plan, the Reserve Bank recruited 3 employees in 2020/21 financial year to strengthen staff capacity in the Financial Systems Department, Economics and Payment Systems Department. With 82 employees onboard, the Bank continued to facilitate and deliver its core responsibilities to achieve the Bank's objective and Strategic priorities.



Training and Development

The facilitation of overseas professional trainings declined in the financial year 2020/2021 due to the impact of the COVID-19 pandemic that affected travelling worldwide. The Reserve Bank with its technological capability managed to facilitate online virtual trainings through zoom video conferences and other online supported applications for staff. The Bank continued to support staff training through short courses, on-the-job training and part time correspondence studies to ensure upskill and develop their capabilities and competencies. The Bank again provided financial support to staff on part time correspondence studies at the University of the South Pacific, Tonga. In February 2021, 1 employee (part-time studies) completed her Bachelor's degree of Commerce in Accounting and Economics. In 2021, the Bank welcomed 2 employees, 1 employee completed a Bachelors degree of Business from the Auckland Institute of Studies, New Zealand in January 2021 and 1 returned scholar completed a Master's degree in International Development from the Nagoya University, Japan by end of May 2021.

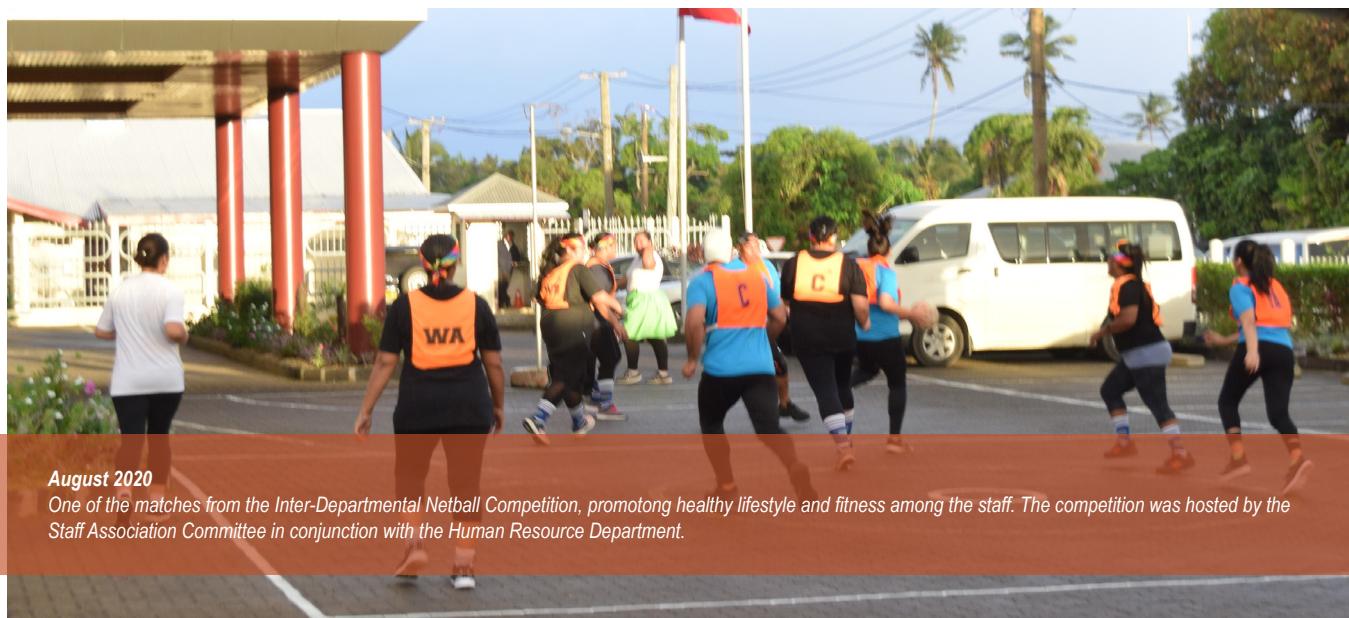
The Bank is investing in capturing key development goals of its employees and provides support for specific actions that will enable them to successfully deliver on the department's agreed objectives and to support the staff's progress more broadly. Discussions are held between the staff and their supervisor to identify and work on development areas that will add the greatest value to their performance in their current role.

Organizational Health and Safety

In 2020/21 financial year, the Bank continued to promote and encourage a healthy work 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 Resource Corporate Plan Targets

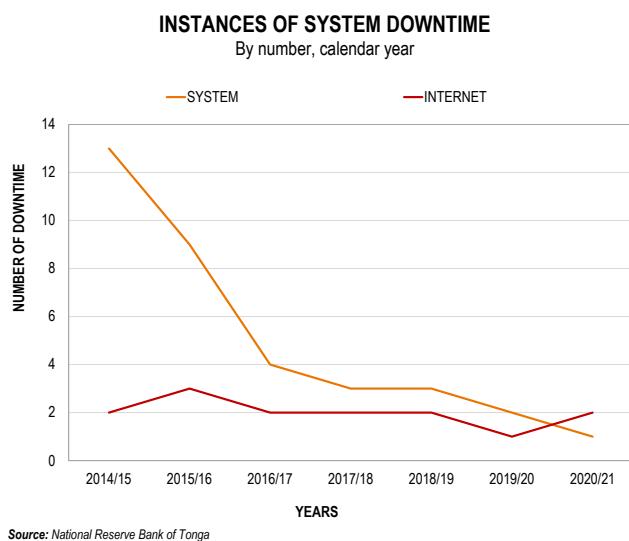
The Human Resource Department was assigned with twenty Corporate Plan targets under the Reserve Bank's Corporate Plan for 2020/21. A review of the calendar year corporate plan was carried out in April 2021 showed that fifteen targets (75%) were achieved, 2 targets (15%) were currently work in progress and the remaining two targets (10%) 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 2021/22 financial year.



Information Technology

The Information Technology (IT) Department provided support to the Bank in achieving its core functions, while maintaining a high level of uninterrupted information and communication technology (ICT) services. The department also provided a secure, reliable, and robust system to support the Reserve Bank's Strategic Priorities. The department continued to enforce the alignment of its processes and its project implementation to international best practices, with an emphasis on preventing and managing cyber-risks.

FIGURE 20: INSTANCES OF SYSTEM DOWNTIME



Similar to recent years, the IT department also worked on implementing controls within the SWIFT System to comply with the requirements of the SWIFT Customer Security Programme. TongaCERT has contributed to the department's efforts of mitigating risks regarding cybersecurity, by sending several cybersecurity initiatives during the year.

By the end of June 2021, the IT Department completed the upgrade of all the servers' Windows operating system from Windows Server 2012 to Windows Server 2016 due to the former reaching its End-of-Life deadline. The Bank's email system was also upgraded from Microsoft Exchange 2010 to Microsoft Exchange 2016 where the former has also reached its End-of-Life deadline. These upgrades were vital for the department's operation, which ensures that our operating system and email system are receiving the latest security updates from the vendors. The department also completed the File Restructuring Project, where the shared drive allocation are identical to every staff within the Bank. The development of the Domestic Electronic Payment System (DEPS), a collective effort within the departments of the Reserve Bank is ongoing and is expected to be completed later in 2021/2022.

The team has also put forward key projects for 2021/2022, including the upgrade of the backup system; and the enabling of the mail archive facility; and the replacement of staff workstations. The department is also focusing on cyber security in the next financial year, as the department is well aware of the ever-growing risks from cyber threats and cyber-attacks all around the world. The department is also planning to host an In-house Cyber Security Week to strengthen staff's awareness of cyber security.

Due to the ongoing COVID-19 pandemic, the department resorted to on-the-job training, self-learning, and free online training videos for the development of its staffs' technical skills.

Information Technology Corporate Plan Targets

In the 2020/21 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 14 of its 21 targets. 5 of the targets were rolled over to the 2021/22 financial year.



Building & Property

The Building and Property Unit are responsible for property and plant management, maintenance and oversight of the Reserve Bank's physical assets for the effective operation of the Bank. Key activities include managing projects, building and property maintenance, fixed asset management, physical and electronic security system maintenance, efficient support to the Tenants, and marketing of the Conference Centre. The Unit also plays a key role in implementing the Bank's business continuity and disaster recovery plan.

In the 2020/2021 financial year, the Building and Property Unit continued to maintain the Bank's building, property, plant, and equipment standards to promote a safe and secure working environment to its staff and tenants. This involved carrying out a number of refurbishment projects, including the following:

- *Completion of the NRBT plumbing system upgrade for all the bathrooms at Level 1 to Level 3;*
- *Phase one of the upgrade works towards the centralized air condition system and automation control;*
- *Installation of temporary split air condition unit to accommodate for Tenants and ensure NRBT staff working environment is comfortable while awaiting on the centralized air condition upgrade project;*
- *Renovating Suite 4 at the 3rd Floor after National Identity Card Office vacating the premises;*
- *Redesign and upgrade of the Bank's car park layout;*
- *Review of the Tenant's agreement and rental rate;*
- *Upgrading the Conference Centre's equipment at the 4th Floor to enable video conferencing given the global pandemic situation which majority of the conference are conducted virtually;*

- *Installation of the security barbed wire on top of the existing boundary wall at the high security area as precautionary measure to safeguard NRBT compound from unauthorized access from the Ministry of Health's COVID-19 quarantine facility located at Tanoa Hotel.*

During the year, the Building and Property Unit managed to maintain and service the elevators, standby generator, fire alarm system, centralized and split air condition system, physical and electronic security system internally due to the COVID-19 pandemic border closure and travel restriction, which is limiting any visit from overseas Contractors. Also continued to work closely with external contractors and third parties to carry out a specific task where the Bank lacks specialized expertise to investigate and diagnose an issue. These services ensure that the Bank provides high uninterrupted building services for its staff, tenants and minimize risk to the Bank's daily operation. Also successfully managed the operation of the Conference Centre to meet the expectation of the Clients.

Building & Property Corporate Plan Targets

The Building and Property Unit's Corporate Plan targets for the year ended 2020/21 resulted in achieving 90% targets. The remaining 10% of the targets were reviewed and revised to complete in the next financial year 2021/2022. This includes drafting the Department Disaster Recovery Plan (DRP) and Business Continuity Plan (BCP), reviewing the fire alarm system, exploring a high-quality electronic security camera system, and phase two of the centralized air condition system upgrade project. Also the development of the Knowledge Base Database for capturing building plant and equipment maintenance.



General Administration

In 2020/2021 financial year, the Administration Unit continued to provide support services to the other departments through its responsibilities for procurement of goods, organizing events, premises security access, 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.

General Administration Corporate Plan Targets

During the year, the Administration Unit participated in the review of the 2020/21 Corporate Plan. The Unit was assigned twelve measurable targets which were all achieved. The measurable targets were related to the modernization of the operations of the Reserve Bank.

Security Unit

The security unit mission is to provide a supportive roles to align, enhance and maintain appropriate physical security for the Bank and its assets at all times to ensure the objectives of the Bank are achieved effectively and efficiently. To achieve this mission, the security unit must be vigilant and visible at all times.

Security Corporate Plan Targets

During the 2020/21 financial year the security unit was able to carry out its responsibilities by ensuring the building, plant and equipment of the Bank are operational at all times. The security unit also assisted the safeguarding of the currency operations and consignments. At the end of the 2020/21 financial year, the security unit achieved 87% of its corporate plan targets. This was the results of consistently upholding its vision and mission.



Financial Performance

The Finance Department is responsible for the National Reserve Bank's financial statements, reporting obligations, prepares the Bank's budget and provides a range of support services including keeping records of staff provident fund, staff gratuity fund, staff insurance fund, payroll, and corporate payments.

The gross income from operations for the year ended 30 June 2021 amounted to \$7.95 million, compared to \$12.84 million of the previous year. Compared to last year, the 61% decline in gross income 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.

On the other hand, COVID-19 had a positive impact on income from foreign exchange deals which increased by 30% due to the increase in the number and volume of Government foreign transactions. This is due to the increase in Government fund receipts for budget support and grants, mainly for COVID-19 and funds from developing partners for development projects.

Total Expenditures incurred during the year was \$7.75 million compared to \$8.56 million in the previous year. The 10% decrease was due to the COVID-19 border lockdown, which resulted in the deferment of overseas official meetings and training as well as visits by the technical assistance for the annual maintenance services of building, plant and equipment.

The Bank's total assets stood at \$775 million as at 30 June 2021, representing a 22% increase due to the increase in short term investments and current accounts as a result of Government fund receipts for budget support and grants, mainly for COVID-19 as well as funds from developing partners for development projects. The increase is mainly reflected in the build-up of local demand deposits, commercial banks' statutory required reserves, and currency in circulation on the liabilities side.

The net profit for the year ending 30 June 2021 was \$0.20 million, compared to \$4.27 million of the previous year. 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\$0.14 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 2020/21, the Finance department was allocated 68 specific, measurable targets. A review of the financial year corporate plan was carried out in April 2021, which revealed that the department achieved 97% of its targets. These targets are related to the strategic priority to modernize the operations of the reserve bank.



Financial Statements

For year ended 30 June 2021

National Reserve Bank of Tonga



Director's Report

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 2021, 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 (*retired February 2021*)
- Mr Richard Prema – Acting Chairman (started February 2021)
- Dr Sione Ngongo Kioa-Governor
- Mrs Sinaitakala Tu'itahi
- Mrs Balwyn Fa'otusia
- Mrs Joyce Mafi

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;*

Director's Report

- 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 2021. 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 unprecedent 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.

4. Trading Results

The net profit of the Bank for the year ended 30 June 2021 was \$200,050 (2020: \$4,273,964).

5. General Reserves

In accordance with Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$60,015 (2020: \$1,282,189) 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 \$140,035 (2020: \$2,991,775) is payable to the Government of the Kingdom of Tonga.

7. 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.

Director's Report

8. Provisions

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

9. 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.

10. Directors' 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.

11. 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.

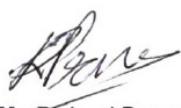
12. Other Circumstances

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.

13. 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 this 29th day September, 2021



Mr. Richard Prema
Acting Chairman



Mr. Sione Ngongo Kioa
Governor

Statement by Directors

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 2021;*
- 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 2021;*
- 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 2021;*
- 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 2021; 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 2021.*

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 29th day of September, 2021.



Mr. Richard Prema
Acting Chairman



Mr. 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 2021, 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 2021 (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.

PricewaterhouseCoopers, Level 8 Civic Tower, 272 Victoria Parade, Suva, Fiji.
GPO Box 200, Suva, Fiji.
T: (679) 3313955 / 3315199, F: (679) 3300981 / 3300947

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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 on the other information that we obtained prior to the date of this auditor's report, 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, except that not all other information was available to us at the date of our signing.

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 management's 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 represent 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 cursive script that reads "Brant House Coopers".

PricewaterhouseCoopers
Chartered Accountants

30 September 2021
Suva, Fiji

National Reserve Bank of Tonga Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

Balance Sheet

As at 30 June 2021	Notes	2021 (\$)	2020 (\$)
ASSETS			
Foreign Currency Assets			
Short Term Investments and Current Accounts	8	686,665,621	515,769,539
Accrued Interest		4,493,599	9,248,464
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		11,036,073	10,868,542
- Special Drawing		17,512,174	17,150,506
Local Currency Assets			
Cash on Hand	18	219,493	31,327
Accrued Interest		55,009	-
Other Assets	10	11,142,910	12,623,557
International Monetary Fund - Currency Subscription	9	33,624,675	32,651,853
Property, Plant and Equipment	11	10,620,901	9,985,118
Total Assets		775,370,455	608,328,906
LIABILITIES			
Foreign Currency Liabilities			
Accrued Interest		380	1,873
Demand Deposits	12(a)	48,992,080	73,301,723
IMF Special Drawing Rights Allocation	9	21,132,939	20,812,134
Local Currency Liabilities			
Payable to Government	13	140,035	2,991,775
Demand Deposits	12(b)	449,720,078	290,338,235
Accrued Interest		15,307	30,814
Other Liabilities	16	3,606,944	3,438,889
Currency in Circulation	14	115,893,273	92,713,587
Statutory Reserve Deposits	15	67,883,000	56,010,000
International Monetary Fund - Currency Subscription	9	33,624,675	32,651,853
Employee Provisions	17	122,590	174,929
Total Liabilities		741,131,301	572,465,812
NET ASSETS		34,239,154	35,863,094
CAPITAL & RESERVES			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves		16,472,994	16,412,979
Revaluation Reserve Account		12,766,160	14,450,115
TOTAL CAPITAL AND RESERVES		34,239,154	35,863,094

The above Balance Sheet should be read in conjunction with the accompanying notes.

National Reserve Bank of Tonga Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

Statement of Comprehensive Income

Year Ended 30 June 2021	Notes	2021 (\$)	2020 (\$)
Income			
Interest Income	4	4,915,851	10,602,711
Other Income	5	3,029,240	2,235,778
Total Operating Income		7,945,091	12,838,489
Expenses			
Interest Expense	6	82,375	273,921
Administration and Other Expenses	7	7,658,522	8,269,361
Allowance for impairment losses		4,144	21,243
Total Operating Expenses		7,745,041	8,564,525
Net Profit available for Distribution		200,050	4,273,964
Net (losses) arising from the translation of foreign currency balances to local currency		(1,683,955)	(3,569,456)
Other comprehensive income for the period		(1,683,955)	(3,569,456)
Total Comprehensive (Loss)/Income		(1,483,905)	704,508

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

National Reserve Bank of Tonga Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

Statement of Distribution

Year Ended 30 June 2021	Notes	2021 (\$)	2020 (\$)
Net Profit Available for Distribution		200,050	4,273,964
Distribution as follows:			
Transfer to General Reserves as required under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	60,015	1,282,189
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2014	13	140,035	2,991,775
		200,050	4,273,964

The above Statement of Distribution should be read in conjunction with the accompanying notes.



National Reserve Bank of Tonga Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

Statement of Changes in Equity

Year Ended 30 June 2021	Paid Up Capital (\$)	General Reserves (\$)	Revaluation Reserve Account (\$)	Total (\$)
Balance 30 June 2019	5,000,000	15,130,790	24,614,555	44,745,345
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	1,282,189	-	-	1,282,189
Balance 30 June 2020	5,000,000	16,412,979	14,450,115	35,863,094
Net losses arising from the translation of foreign currency balances to Tongan currency	-	-	(1,683,955)	(1,683,955)
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	-	60,015	-	60,015
Balance 30 June 2021	5,000,000	16,472,994	12,766,160	34,239,154

The above Statement of Changes in Equity should be read in conjunction with the accompanying notes.

National Reserve Bank of Tonga Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

Statement of Cash Flows

Year Ended 30 June 2021	Notes	2021 (\$)	2020 (\$)
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest Received		9,615,708	12,988,116
Rental Income		603,574	514,671
Numismatic Sales		64,058	37,284
Other Income		2,409,225	1,624,005
Purchase of currency		(1,318,123)	(1,591,788)
Interest Paid		(99,374)	(278,364)
Payments to suppliers and employess		(3,853,519)	(5,375,288)
Net Cash Inflow from Operating Activities		7,421,549	7,918,636
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(1,228,271)	(1,010,847)
Net movement in IMF accounts		(529,199)	(63,042)
Net movement in staff loans		(115,341)	(1,208,741)
Net Cash used in Investing Activities		(1,872,811)	(2,282,630)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net movement in Currency in Circulation		23,179,686	2,039,238
Net movement in Demand Deposits		166,900,331	8,129,183
Net movement in Statutory Deposits		11,873,000	(724,000)
Net movement in Government of Tonga account		(34,819,907)	49,573,657
Net movement in funds held for clearance		(232,199)	(26,189)
Net movement in IMF SDR Allocation		320,805	-
Net transfer from Revaluation Account		-	(1,594,984)
Net Cash Flow from Financing Activities		167,221,716	57,396,905
NET INCREASE IN CASH		172,770,454	63,032,911
CASH AND CASH EQUIVALENT AT BEGINNING OF FINANCIAL YEAR		515,826,862	456,363,406
NET EFFECT OF CHANGE IN EXCHANGE RATE	2(b)	(1,683,955)	(3,569,455)
CASH AND CASH EQUIVALENT AT END OF FINANCIAL YEAR	18	686,913,361	515,826,862

The above Statement of Cash Flows should be read in conjunction with the accompanying notes.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

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 29th day of September 2021.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

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 \$1,683,955 (2020: decrease by \$3,569,456).

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) – Expected credit losses
- Note 2 (j) – 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 2021. 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 2021 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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

(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:

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

- 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 evaluated 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.

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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS*****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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

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 as per the rating by Standard & Poors.

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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

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 its 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
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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

(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:

• <i>Leasehold and buildings</i>	1.01% - 2%
• <i>Furniture and fittings, computer and office equipment</i>	6.67% - 25%
• <i>Motor vehicles</i>	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 discount 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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS****(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*

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS

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) Transfer from Revaluation Reserves

Section 33 (4) of the National Reserve Bank (Amendment) Act 2017 allows the Bank to utilize the Revaluation Reserve Account for its Monetary Policy responsibilities. In anticipation of the impact of the COVID 19 on the Bank and its statutory responsibilities, the Board approved in May 2020, to transfer \$1.595m from the Revaluation Reserve Account to fund the 2020/21 Development Budget. During the financial 2020/21 a total of \$806k of assets were acquired while \$789k remains unused.

The Bank follows the income approach framework related to Government grant accounting to account for the assets acquired under this initiative. Assets are recorded at cost when acquired while a deferred development fund account (DFA) is set up as a liability in the Balance Sheet. This deferred liability account is reduced on a systematic basis over the useful life of the assets necessary to match with the assets' related depreciation costs.

(r) Functional and Presentation Currency

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

(s) Rounding

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

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

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:

	2021 (\$)	2020 (\$)
Foreign Currency Assets		
Short Term Commercial Paper and Current Accounts	686,665,621	515,769,539
Local Currency Assets		
Staff Loans	4,386,298	4,270,957
Total Financial Investments	691,051,919	520,040,496

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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

3. FINANCIAL RISK MANAGEMENT

	Rating	2021 (\$)	2020 (\$)
Australia	AAA	907,112	782,684
	AA-	164,598,584	149,465,133
	A+	109,099,596	110,116,087
New Zealand	AA+	13,715,388	649,723
	AA-	147,376,807	140,020,185
United States of America	AA+	15,819,979	46,694,414
	AA	380,584	-
Switzerland	AAA	184,529,941	67,846,399
United Kingdom	AA	334,467	205,853
Fiji	BB-	77,563	17,308
Singapore	AA-	49,857,050	-
Tonga	N/R	4,387,239	4,289,949
		691,084,310	520,087,735
		(71,031)	(83,886)
Total Financial Investment		691,013,279	520,003,849

(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.



Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

3. FINANCIAL RISK MANAGEMENT

The maturity analysis noted below includes all financial and non-financial assets and liabilities as at 30 June 2021.

Maturity Analysis as at 30 June 2021	0 - 3 Months	3 - 12 Months	1 - 5 Years	Over 5 Years	No Specific Maturity	Total
Foreign Currency Assets						
Short Term Investments and Current Accounts	31,848,766	498,044,090	156,772,765	-	-	686,665,621
Accrued Interest	4,493,599	-	-	-	-	4,493,599
IMF						
- Reserve Tranche Position	11,036,073	-	-	-	-	11,036,073
- Special Drawing Rights	17,512,174	-	-	-	-	17,512,174
Local Currency Assets						
Cash on hand	219,493	-	-	-	-	219,493
Accrued Interest	55,009	-	-	-	-	55,009
Other Assets	11,142,910	-	-	-	-	11,142,910
IMF - Currency Subscription	33,624,675	-	-	-	-	33,624,675
Property, Plant & Equipment	-	-	-	-	10,620,901	10,620,901
Total Assets	109,932,699	498,044,090	156,772,765	0	10,620,901	775,370,455
Foreign Currency Liabilities						
Accrued Interest	380	-	-	-	-	380
Demand Deposits	48,992,080	-	-	-	-	48,992,080
IMF - Special Drawing Rights Allocation	-	-	-	-	21,132,939	21,132,939
Foreign Currency Liabilities						
Payable to Government	140,035	-	-	-	-	140,035
Demand Deposits	449,720,078	-	-	-	-	449,720,078
Accrued Deposits	15,307	-	-	-	-	15,307
Other Liabilities	-	3,606,944	-	-	-	3,606,944
Currency in Circulation	-	-	-	-	115,893,273	115,893,273
Statutory Reserve Deposits	-	-	-	-	67,883,000	67,883,000
IMF - Currency Subscription	-	-	-	-	33,624,675	33,624,675
Employee Provisions	-	33,618	80,372	8,600	-	122,590
Total Liabilities	498,867,880	3,640,562	80,372	8,600	238,533,887	741,131,301
Net Assets	(388,935,181)	494,403,528	156,692,393	(8,600)	(227,912,986)	34,239,154

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

3. FINANCIAL RISK MANAGEMENT

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
Foreign Currency Assets						
Short Term Investments and Current Accounts	48,961,289	360,703,851	106,104,399	-	-	515,769,539
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
Local Currency Assets						
Cash on hand	31,327	-	-	-	-	31,327
Accrued Interest	-	-	-	-	-	-
Other Assets	12,623,557	-	-	-	-	12,623,557
IMF - Currency Subscription	32,651,853	-	-	-	-	32,651,853
Property, Plant & Equipment	-	-	-	-	9,985,118	9,985,118
Total Assets	131,535,538	360,703,851	106,104,399	-	9,985,118	608,328,906
Foreign Currency Liabilities						
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
Foreign Currency Liabilities						
Payable to Government	2,991,775	-	-	-	-	2,991,775
Demand Deposits	290,338,235	-	-	-	-	290,338,235
Accrued Deposits	30,814	-	-	-	-	30,814
Other Liabilities	-	3,438,889	-	-	-	3,438,889
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
Total Liabilities	366,664,420	3,438,889	141,311	33,618	202,187,574	572,465,812
Net Assets	(235,128,882)	357,264,962	105,963,088	(33,618)	(192,202,456)	35,863,094

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

3. FINANCIAL RISK MANAGEMENT

(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 2021 in Tonga Pa'anga equivalents.

	2021 (\$)	2020 (\$)
United States Dollar	384,141,912	322,132,046
Australian Dollar	65,187,974	46,820,937
Great Britain Pound	339,666	210,557
New Zealand Dollar	192,450,406	82,556,801
Other	7,493,763	7,229,228
Total Net Foreign Exchange Position	649,613,721	458,949,569

(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:	2021	2020
Change in equity due to a 5% appreciation/depreciation of the Tonga Pa'anga	32,480,686	22,947,478
Change in profit/loss due to a rise/drop of 1 percentage point in interest rate	44,934	92,466

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

4. INTEREST INCOME

	2021 (\$)	2020 (\$)
Overseas Investments	4,700,635	10,462,900
Staff Loans	215,216	139,811
	4,915,851	10,602,711

5. OTHER INCOME

	2021 (\$)	2020 (\$)
Numismatic Coins	64,058	37,284
Rental Income	555,957	574,490
Gain on Sale of Assets	5,840	1,470
Forex Sales/Purchases	2,213,815	1,559,208
Bank User Fees	70,560	45,666
Miscellaneous	119,010	17,660
	3,029,240	2,235,778

6. INTEREST EXPENSE

	2021 (\$)	2020 (\$)
Foreign Currency Accounts	15,495	155,364
Domestic Currency Accounts	66,880	118,557
	82,375	273,921

7. ADMINISTRATION AND OTHER EXPENSES

	2021 (\$)	2020 (\$)
Administration	1,485,481	2,282,926
Retirement Fund	545,411	497,564
Staff Costs	3,297,296	3,384,929
Audit Fees	25,000	36,181
Currency Issue (refer Note 10)	1,712,846	1,520,398
Depreciation	592,488	547,363
	7,658,522	8,269,361

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS

	2021 (\$)	2020 (\$)
Current Accounts	31,848,766	48,961,289
Short Term Investments	654,848,305	466,836,497
	686,697,071	515,797,786
Less: Impairment allowances for financial instruments	(31,450)	(28,247)
	686,665,621	515,769,539

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 2021, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2020: SDR13,800,000). Of this total amount, SDR3,436,633 (2020: 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 2021, the Special Drawing Rights holdings had a balance of SDR5,453,291 (2020: SDR5,422,990).

10. OTHER ASSETS

	2021 (\$)	2020 (\$)
Staff Loans and Advances	4,387,239	4,289,949
Currency and Numismatics	5,053,509	5,448,232
Other Assets	1,741,744	2,941,015
	11,182,492	12,679,196
Less: Impairment allowances for staff loans	(39,582)	(55,639)
	11,142,910	12,623,557

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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

11. PROPERTY, PLANT & EQUIPMENT

	Leasehold & Buildings	Computer & Office Equipment	Furniture & Fittings	Motor Vehicles	WIP	TOTAL
At 30 June 2019						
Cost	10,807,165	2,179,331	248,084	364,249	255,654	13,854,483
Accumulated Depreciation	(2,762,645)	(1,104,398)	(165,946)	(299,861)	0	(4,332,850)
Net Book Amount	8,044,520	1,074,933	82,138	64,388	255,654	9,521,633
Year Ended 30 June 2020						
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
Transfers	809,022				(809,022)	0
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
At 30 June 2020						
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)	0	(4,880,212)
Net Book Amount	8,599,257	941,820	36,001	30,794	377,246	9,985,118
Year Ended 30 June 2021						
Opening Net Book Value	8,599,257	941,820	36,001	30,794	377,246	9,985,118
Additions	344,187	88,125	6,405		789,554	1,228,271
Transfers	(153,291)	368,826	100,174		(315,709)	0
Depreciation	(290,286)	(226,874)	(44,534)	(30,794)		(592,488)
Closing Net Book Value	8,499,867	1,171,897	98,046	0	851,091	10,620,901
At 30 June 2021						
Cost	11,810,928	2,712,670	354,663	364,249	851,091	16,093,601
Accumulated Depreciation	(3,311,061)	(1,540,773)	(256,617)	(364,249)	0	(5,472,700)
Net Book Amount	8,499,867	1,171,897	98,046	0	851,091	10,620,901

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

12. (a) FOREIGN CURRENCY DEMAND DEPOSITS

	2021 (\$)	2020 (\$)
Government of Tonga	48,864,988	73,250,757
Other Institutions	127,092	50,966
	48,992,080	73,301,723

(b) LOCAL CURRENCY DEMAND DEPOSITS

	2021 (\$)	2020 (\$)
International Banks	140,157	78,166
Domestic Banks	329,804,127	162,965,787
Government of Tonga	119,775,794	127,294,282
	449,720,078	290,338,235

13. PAYABLE TO GOVERNMENT

	2021 (\$)	2020 (\$)
Amount payable to Government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	140,035	2,991,775

14. CURRENCY IN CIRCULATION

	2021 (\$)	2020 (\$)
Notes	111,003,429	88,282,603
Coins	4,889,844	4,430,984
	115,893,273	92,713,587

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.

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

16. OTHER LIABILITIES

	Notes	2021 (\$)	2020 (\$)
Other creditors and accruals		1,092,603	1,396,259
Development Budget Fund 2021/2022	(a)	788,817	1,594,984
Deferred Development Fund	(b)	783,032	-
Payable to the National Reserve Bank of Tonga Staff Provident Scheme	(c)	942,492	447,646
		3,606,944	3,438,889

(a) This relates to the remaining balance of the amounts transferred from the Revaluation Account which was approved by the Board specifically to support the Bank's 2020/21 Development budget. The movement for the year is as follows:

	2021 (\$)	2020 (\$)
Opening Balance	1,594,984	-
Transfer from Asset Revaluation Reserve	-	1,594,984
Amount utilised - Transfer to Deferred Development Fund. Refer (b) below.	(806,167)	-
Closing Balance	788,817	1,594,984

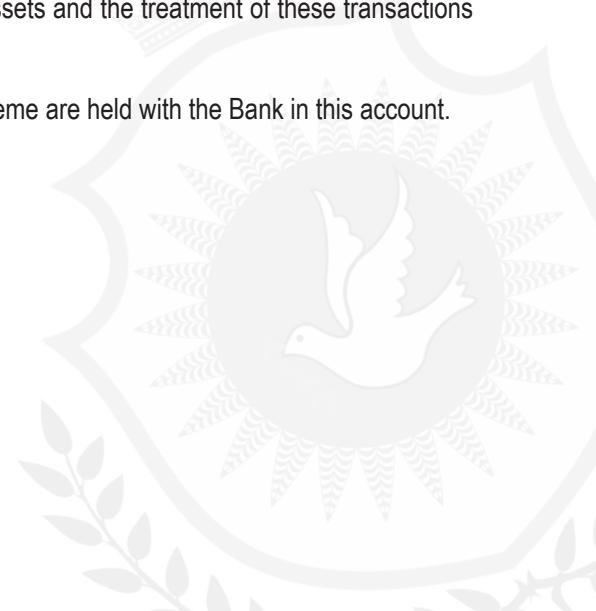
The amounts utilised represents capital expenditure incurred during the year and the treatment of these transactions is in accordance with note 2 (q) of the banks accounting policy.

(b) The balance relates to the Deferred Development Fund transferred from the Bank's 2020/21 Development budget account in (a) above.

	2021 (\$)	2020 (\$)
Opening Balance	-	-
Transfer from Development Budget Fund	806,167	-
Amount amortised	(23,135)	-
Closing Balance	783,032	-

The amounts amortised are offset against the depreciation expense on related assets and the treatment of these transactions is in accordance with note 2 (q) of the banks accounting policy.

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



Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

17. PROVISION FOR EMPLOYEE ENTITLEMENTS

	2021 (\$)	2020 (\$)
Opening Balance	174,929	164,852
Entitlements during the year	171,818	158,417
Utilised/reversals	(224,157)	(148,340)
	122,590	174,929

18. CASH AND CASH EQUIVALENTS

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

	2021 (\$)	2020 (\$)
Cash on hand	219,493	31,327
Short term investments and current accounts	686,693,868	515,795,535
	686,913,361	515,826,862

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 2021 were Steve Edwards (Chairperson) – retired February 2021, Richard Prema (Acting Chairperson) – started February 2021, 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 \$63,407 (2020: \$100,588).

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:

	2021 (\$)	2020 (\$)
Provident Fund payments made by the Bank	545,411	497,566
	545,411	497,566

The funds of the National Reserve bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.22% (2020: 3.48%) per annum. The total interest paid by the Bank for the financial year amounted to \$6,963 (2020: \$9,709). 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

Notes To and Forming Part of the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2021

19. RELATED PARTIES

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 \$231,010 (2020: \$267,352). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'.

	2021 (\$)	2020 (\$)
Executive Staff	410,541	408,838
Director's fees and allowances	146,933	139,843
	557,474	548,681

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:

	2021 (\$)	2020 (\$)
Due not later than one year	462,172	417,629
Due later than one year but not later than five years	574,599	690,384
	1,036,771	1,108,013

(b) Capital and Other Commitments

	2021 (\$)	2020 (\$)
Commitment not provided for in the financial statements are as follows:		
Capital commitment: approved and contracted	1,091,685	377,246

21. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2021 comprise:

- (i) Contracts for foreign exchange transactions was nil (2020: \$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.

Notes To and Forming Part of the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2021

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. 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 2021. 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 unprecedent 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.

24. 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.