

Natural Resource Funds



Timor-Leste

Petroleum Fund of Timor-Leste



Market Value

Petroleum Fund of Timor-Leste
\$13.5 billion



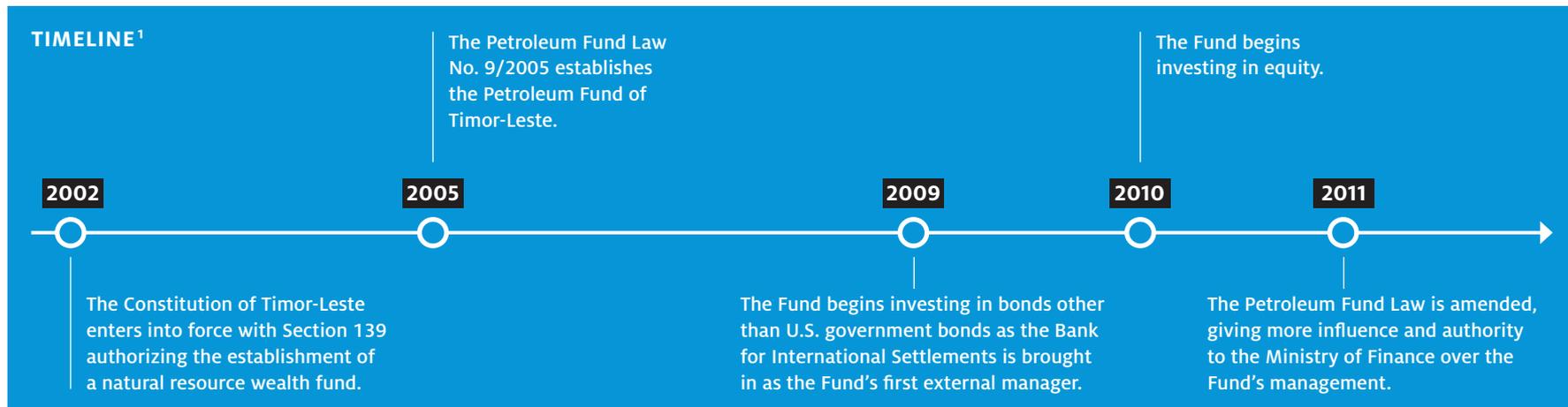
Good Governance Fundamentals	
Clear Deposit Rules	yes
Clear Withdrawal Rules	yes
Clear Investment Rules	yes
Transparent	yes
Publicly Available Audits	yes
Effective Oversight	yes

Fund Highlights

- The Petroleum Fund of Timor-Leste was established in 2005. It functions as a savings and stabilization fund.
- The Fund’s strong transparency and oversight provisions, which include a Petroleum Fund Consultative Council that monitors fund activity and published external audits, help safeguard the Fund’s assets.
- Withdrawals from the Fund are based on a calculation of Estimated Sustainable Income, which limits government spending from oil revenues to the interest earned on the

country’s petroleum wealth (the value of fund assets plus the value of oil under the ground). However, the rule is flexible; withdrawals in excess of the rule are allowed if justified to parliament.

- The Fund has a minimum 3 percent annual real return target on its investments. Strict investment rules help minimize risk of losses and year-to-year volatility in the Fund’s value.



Fund Inception

- The Petroleum Fund of Timor-Leste was established by the **Petroleum Fund Law No. 9/2005** in August 2005.²
- The Petroleum Fund Law was amended in 2011 to increase the influence and authority of the Ministry of Finance over the Petroleum Fund's management.³

Fund Objectives

According to the Petroleum Fund Law, the Fund shall:

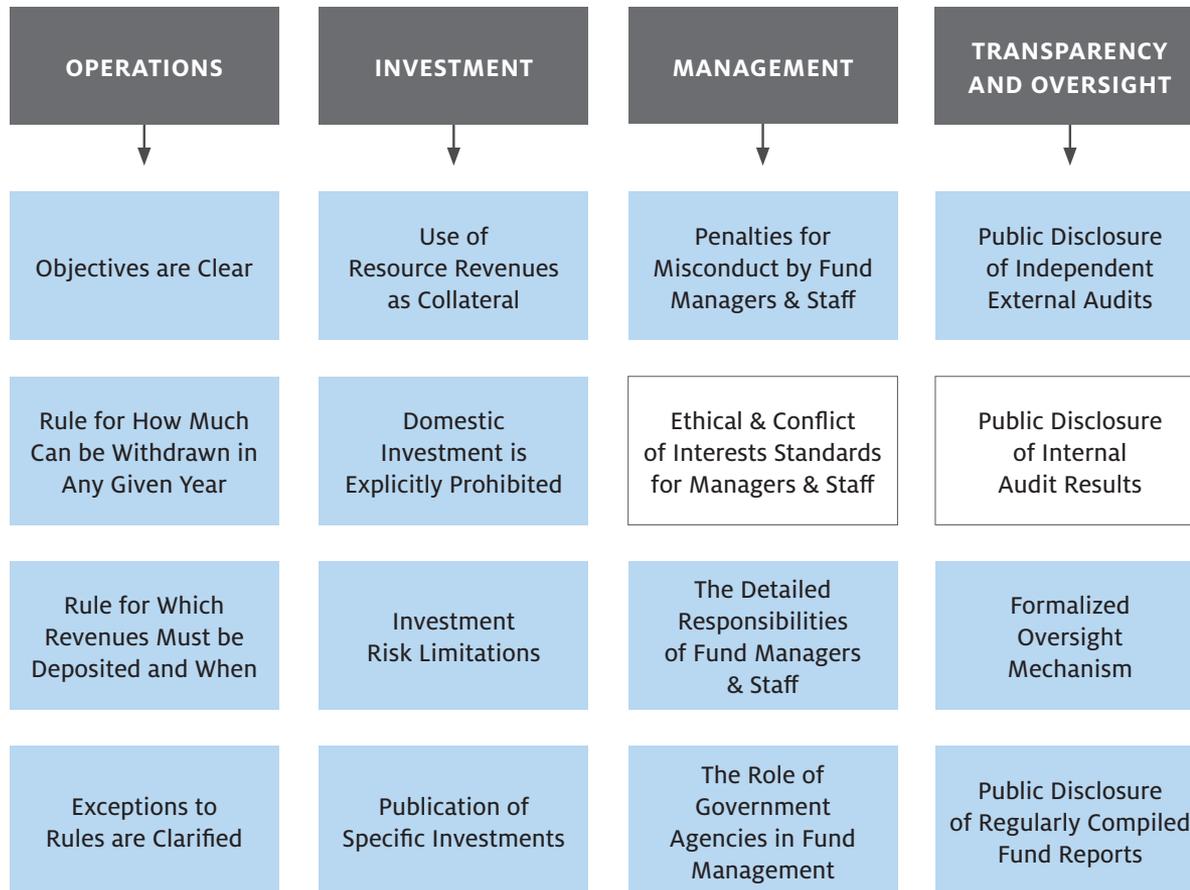
- Contribute to wise management of petroleum resources for the benefit of both current and future generations, establishing a fund of income from the exploitation of non-renewable petroleum resources; and
- Contribute to sound fiscal policy, with appropriate weight and consideration given to the long-term interests of Timor-Leste's citizens.⁴

Good Governance Standards and Gaps in Regulation

Each box represents a regulatory standard essential for promoting consistent use of and safeguarding resource revenues. White boxes highlight regulatory gaps in fund governance.

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Good Governance Standards Met



Presence of Regulation
 Absence of Regulation

Timor-Leste has some of the world's most detailed deposit and withdrawal rules. They help improve government accountability and macroeconomic stability.

Fund Deposit Rules⁵

Funds deposited into the Petroleum Fund consist of:

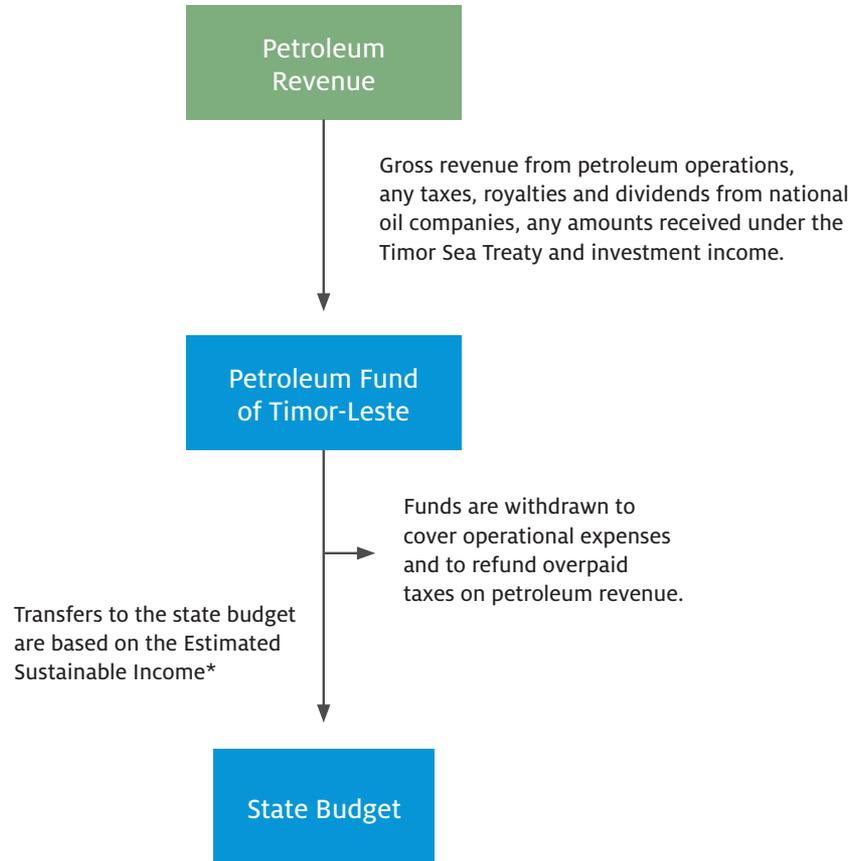
- Gross revenue, including from taxes, from any petroleum operations including prospecting, exploration, development, exploitation, transportation, sales and exports of petroleum by the government of Timor-Leste.
- Any taxes, royalties, dividends or other amounts paid by a national oil company from petroleum operations.
- Any amount received under the terms of the Timor Sea Treaty between Timor-Leste and Australia.
- Any income from the Fund's investments.
- Any other amounts received that are directly related to petroleum resources, but not already covered by the categories listed above.

Fund Withdrawal Rules⁶

- Funds can only be withdrawn from the Petroleum Fund for three purposes:
 - Transfers from the Petroleum Fund to the state budget.
 - Covering the operational expenses of the Fund's operational manager, the Central Bank of Timor-Leste.
 - Refunding any overpaid taxes received as part of petroleum revenue.
- The size of transfers to the state budget is determined using a formula called the Estimated Sustainable Income (ESI), which is currently defined as 3 percent of the value of Timor-Leste's petroleum wealth. The government cannot withdraw more than the ESI in any given year unless a justification is made to parliament. This withdrawal rule is designed to limit government spending from oil revenues to the interest earned on the country's petroleum wealth (the value of fund assets plus the value of oil under the ground).⁷
- The government must justify to parliament any transfers to the budget that exceed the ESI. In this case, the government must also explain how excess withdrawals will be offset by reductions in transfers in subsequent years.

Operational Laws, Rules and Policies

Flow of Funds



*Currently defined as 3 percent of the value of Timor-Leste's petroleum wealth.

Investment Laws, Rules and Policies

Investment Authority

The Ministry of Finance sets investment policy. The Central Bank of Timor-Leste is responsible for investing the Fund's assets under the guidance of the Ministry of Finance.⁸

Investment Objectives

The Fund's assets are expected to generate a real rate of return of at least 3 percent per year. At the same time, the Fund should meet its sustainability objective by minimizing investment risk and maintaining a constant real long-term value.⁹

Investment Allocation

The benchmark asset allocation as of March 2013 is 72.5 percent fixed income and 27.5 percent equity. According to the Minister of Finance, the benchmark allocation for equity will gradually be increased to 40 percent by June 2014.¹⁰

Investment Strategy¹¹

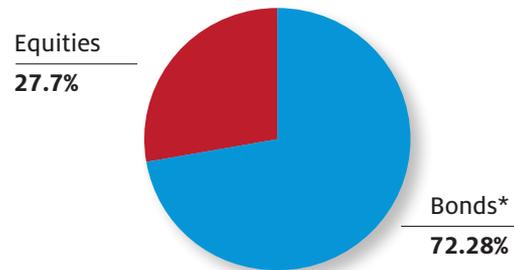
- At least half of the Fund is to be invested in bonds, fixed-income securities and deposits held with financial institutions that have credit ratings of at least a BBB- or Baa3 according to Standard and Poor's, Fitch and Moody's.
- No more than half of the Fund is to be invested in listed equities, which must be traded in a regulated financial market. The Fund should not hold more than 5 percent of the stock of any one company.
- No more than 5 percent of the Fund can be invested in other types of investments. Such investments must be approved by the Minister of Finance.
- No more than 3 percent of the Fund can be invested in any one company or issuer of debt, unless it is sovereign debt.
- Investments in derivatives are only allowed for reducing risk.

Policy on In-State Investments:

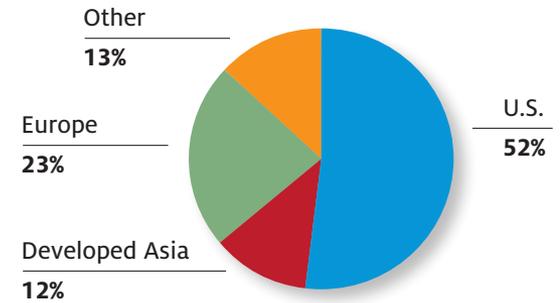
Fund assets may not be invested in Timor-Leste.¹²

Investment Laws, Rules and Policies

Allocation by Asset Class¹³



Equity Allocation by Geographic Region¹⁴



*All bond investments as of March 2013 are in U.S. Treasuries.

Management and Accountability

Management and internal accountability

Parliament passed the legislation creating the Petroleum Fund of Timor-Leste and receives reports from the government.

The Ministry of Finance is responsible for the overall management of the Funds and sets the Fund's investment and management policies.

The Investment Advisory Board advises the Ministry of Finance on investment and management policies.

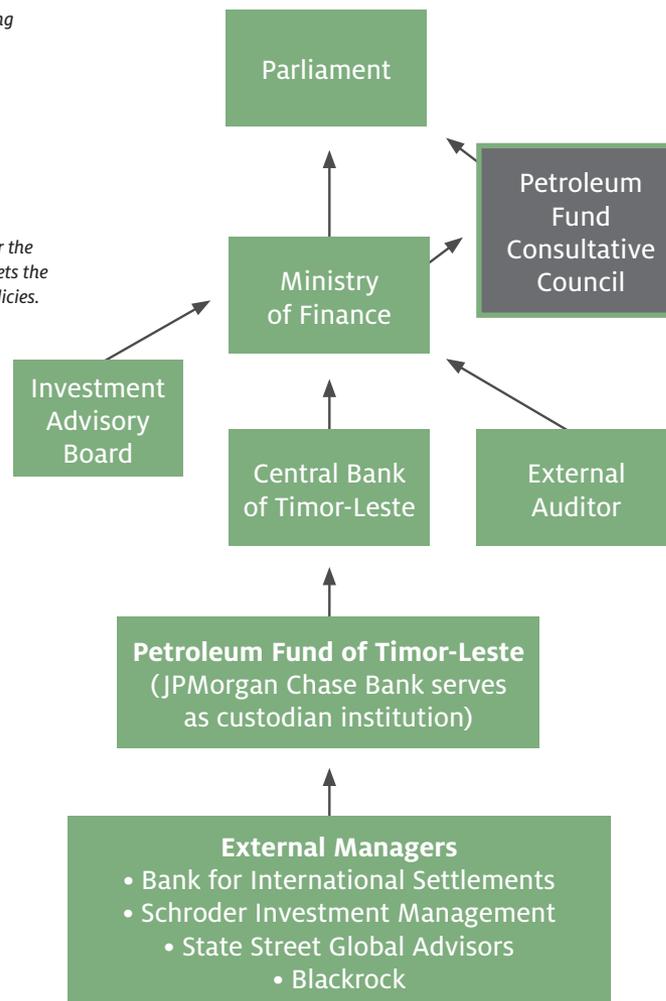
As operational manager, the Central Bank is responsible for day-to-day management of the Fund.

20% of bond investments and all equity investments are managed externally with the rest managed by the Central Bank of Timor-Leste.

External accountability

The Consultative Council advises the parliament on the Fund's operation and performance and contains members selected from civil society, the private sector and former government officials. The Ministry of Finance must provide the Council with any information it requests in its monitoring of the Fund.

An independent auditor is selected and submits audited reports that are included in the Ministry of Finance's annual report.



Oversight and Safeguards

The Petroleum Fund is subject to multiple sources of independent oversight, which encourages good financial management.

Oversight Mechanisms

- The **Petroleum Fund Consultative Council**, which includes former government officials as well as representatives of civil society and the private sector, is empowered by the law to monitor Fund activity, ensuring compliance with the regulations governing the Fund.
- Finances are subject to **regular and comprehensive internal audits**.
- Arbitrary withdrawals from the Funds are not allowed; all spending from petroleum revenues must be **approved by the Parliament**.
- Fund finances are subject to a **regular and independent external audit** that meets international standards.
- The Minister of Finance must seek the advice of the **Investment Advisory Board** before making any changes to investment and management policy.
- The IMF routinely monitors fund performance through their Article IV consultations which are annual reports that evaluate macroeconomic policy.

Common Oversight Mechanisms or Safeguards Not Present in Timor-Leste

- Funds are not managed **separately from** the country's **international reserves**.

Transparency Laws, Rules and Policies

There is public disclosure of the following:

When or how often Fund reports are published and made publicly available	yes	
Which individuals or organizations are responsible for publishing Fund reports	yes	
Size of the Fund(s)	yes	
Deposit and withdrawal amounts	yes	
Returns on investments	yes	
Detailed asset allocation – geographic location	yes	
Detailed asset allocation – asset class	yes	
Detailed asset allocation – specific assets	yes	
Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules		no

Annex: List of Applicable Laws

Constitution of the Democratic Republic of Timor-Leste

http://timor-leste.gov.tl/wp-content/uploads/2010/03/Constitution_RDTL_ENG.pdf

Petroleum Fund Law No. 9/2005

http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf

Petroleum Fund Management Agreement

<http://www.mof.gov.tl/wp-content/uploads/2011/09/Management-Agreement-25-June-2009-English.pdf>

Law No. 12/2011 of 28 September

<http://www.laohamutuk.org/Oil/PetFund/revision/LeiRevisionFundoPetroleu28Sep2011En.pdf>

1. <http://www.mof.gov.tl/budget-spending/petroleum-fund/>
2. <http://www.mof.gov.tl/budget-spending/petroleum-fund/>
3. Banking and Payments Authority of Timor-Leste Submission on Proposed Amendments to the Petroleum Law p. 1. Available at: http://www.bancocentral.tl/Download/Publications/BPA_Comments_Amendment_PFL_en.pdf
4. Petroleum Fund Law No.9/2005 Preamble. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
5. Petroleum Fund Law No.9/2005 Article 6. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
6. Petroleum Fund Law No.9/2005 Article 7-10. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
7. Petroleum Fund Law No.9/2005 Schedule 1. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
8. Petroleum Fund Management Agreement June 2009. Available at: <http://www.mof.gov.tl/wp-content/uploads/2011/09/Management-Agreement-25-June-2009-English.pdf>
9. Investment Advisory Board Statement of Investment Beliefs and Principles September 2010 p. 4. Available at: http://www.mof.gov.tl/wp-content/uploads/2011/11/IAB_Investment_Beliefs_and_Principles.pdf
10. Petroleum Fund of Timor-Leste Quarterly Report March 2013 p. 2. Available at: http://www.bancocentral.tl/Download/Publications/Quarterly_Report31_en.pdf
11. Petroleum Fund Law No.9/2005 Article 15. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
12. Petroleum Fund Law No.9/2005 Article 15.1. Available at: http://www.bancocentral.tl/Download/Publications/PFund%20Law%202011%20Consolidated_en.pdf
13. Petroleum Fund of Timor-Leste Quarterly Report March 2013 p. 4. Available at: http://www.bancocentral.tl/Download/Publications/Quarterly_Report31_en.pdf
14. Petroleum Fund of Timor-Leste Annual Report 2011 p. 20. Available at: http://www.mof.gov.tl/wp-content/uploads/2012/10/Petroleum_Fund_Annual-Report_2011-EN.pdf