Natural Resource Funds

Timor-Leste

Petroleum Fund of Timor-Leste
TIMOR-LESTE

Synopsis

Market Value

**Petroleum Fund of Timor-Leste**
$13.5 billion

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**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.
The Constitution of Timor-Leste enters into force with Section 139 authorizing the establishment of a natural resource wealth fund.

The Petroleum Fund Law No. 9/2005 establishes the Petroleum Fund of Timor-Leste. The Fund begins investing in bonds other than U.S. government bonds as the Bank for International Settlements is brought in as the Fund's first external manager.

The Petroleum Fund Law is amended, giving more influence and authority to the Ministry of Finance over the Fund’s management.

**Fund Inception**

- The Petroleum Fund of Timor-Leste was established by the Petroleum Fund Law No. 9/2005 in August 2005.¹

- 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.²

**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.³

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¹ August 2013
² Natural Resource Funds
**Good Governance Standards and Gaps in Regulation**

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<td>Penalties for Misconduct by Fund Managers &amp; Staff</td>
<td>Public Disclosure of Independent External Audits</td>
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<td>Rule for How Much Can be Withdrawn in Any Given Year</td>
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<td>Ethical &amp; Conflict of Interests Standards for Managers &amp; Staff</td>
<td>Public Disclosure of Internal Audit Results</td>
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<td>Rule for Which Revenues Must be Deposited and When</td>
<td>Investment Risk Limitations</td>
<td>The Detailed Responsibilities of Fund Managers &amp; Staff</td>
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Each box represents a regulatory standard essential for promoting consistent use of and safeguarding resource revenues. White boxes highlight regulatory gaps in fund governance.

**14/16**

Good Governance Standards Met
Operational Laws, Rules and Policies

Fund Deposit Rules
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 Rules
- 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).

- 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

- **Petroleum Revenue**: Gross revenue from petroleum operations, any taxes, royalties and dividends from national oil companies, any amounts received under the Timor Sea Treaty and investment income.

- **Petroleum Fund of Timor-Leste**: Funds are withdrawn to cover operational expenses and to refund overpaid taxes on petroleum revenue.

- **State Budget**: Transfers to the state budget are based on the Estimated Sustainable Income*.

*Currently defined as 3 percent of the value of Timor-Leste’s petroleum wealth.
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.\footnote{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.\footnote{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.\footnote{10}

Investment Strategy\footnote{11}
- 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.\footnote{12}
**Investment Laws, Rules and Policies**

### Allocation by Asset Class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>27.7%</td>
</tr>
<tr>
<td>Bonds*</td>
<td>72.28%</td>
</tr>
</tbody>
</table>

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

### Equity Allocation by Geographic Region

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>23%</td>
</tr>
<tr>
<td>Developed Asia</td>
<td>12%</td>
</tr>
<tr>
<td>Other</td>
<td>13%</td>
</tr>
<tr>
<td>U.S.</td>
<td>52%</td>
</tr>
</tbody>
</table>

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August 2013
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.

External Managers

- Bank for International Settlements
- Schroder Investment Management
- State Street Global Advisors
- Blackrock
Oversight and Safeguards

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.

The Petroleum Fund is subject to multiple sources of independent oversight, which encourages good financial management.
## Transparency Laws, Rules and Policies

There is public disclosure of the following:

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>When or how often Fund reports are published and made publicly available</td>
<td>yes</td>
</tr>
<tr>
<td>Which individuals or organizations are responsible for publishing Fund reports</td>
<td>yes</td>
</tr>
<tr>
<td>Size of the Fund(s)</td>
<td>yes</td>
</tr>
<tr>
<td>Deposit and withdrawal amounts</td>
<td>yes</td>
</tr>
<tr>
<td>Returns on investments</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – geographic location</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – asset class</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – specific assets</td>
<td>yes</td>
</tr>
<tr>
<td>Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules</td>
<td>no</td>
</tr>
</tbody>
</table>
Annex:
List of Applicable Laws

Constitution of the Democratic Republic of Timor-Leste

Petroleum Fund Law No. 9/2005

Petroleum Fund Management Agreement

Law No. 12/2011 of 28 September
http://www.laohamutuk.org/Oil/PetFund/revision/LeiRevisionFundopetroleu28Sep2011En.pdf
Endnotes