



# TLPF 2016

## Timor-Leste Petroleum Fund

### Pillar 1: Legal

Legal framework, objectives, and coordination with macroeconomic policies

#### Principle 1

1. The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

1.1. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.

1.2. The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

Timor-Leste Petroleum Fund was established to fulfil the requirement of the Constitution that mandates the establishment of mandatory financial reserves from the exploitation of the natural resources.

The legal framework for the Petroleum Fund is detailed in the Petroleum Fund Law No. 9/2005, of 3 August as amended by the Law No. 12/2011, of 28 September.

The Fund is formed as an account of the Ministry of Finance held in the Central Bank of Timor-Leste (BCTL, Banco Central de Timor-Leste), rather than as a separate legal entity.

The Petroleum Fund Law specifically:

- provides mechanisms that assist Timor-Leste to sustainably manage its petroleum revenue,
- details the parameters for operating and managing the Petroleum Fund,
- defines the asset allocation guidelines and risk limits,
- governs the collection and management of the receipts,
- regulates transfers to the State Budget,
- defines clear roles and responsibilities of entities involved in the management of the Fund and,
- provides for government accountability and oversight of these activities.

The Operational Management Agreement signed between the Ministry of Finance and the Operational Manager (BCTL) on 12 October 2005 with later amendments goes further to account the key functions and competencies of the Ministry of Finance, with the responsibility for the overall management of the Fund, and the BCTL, which has the responsibility for the operational management of the Fund.

The legal framework and other supporting documentations on the Petroleum Fund are publicly available at the Ministry of Finance and BCTL websites.

<https://www.mof.gov.tl/budget-spending/petroleum-fund/?lang=en>

<http://www.bancocentral.tl/PF/laws.asp>

<http://www.eiti.tl/>

## Principle 2

The policy purpose of the SWF should be clearly defined and publicly disclosed.

The preamble of the Petroleum Fund Law states that the purpose of establishing the Petroleum Fund, which accumulates revenues from the exploitation of natural resources, is to contribute to a prudent management of the petroleum resources for the benefit of both current and future generations.

The Fund is also a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given the long-term interest of Timor-Leste's citizens.

The Ministry of Finance, through the publication of the Petroleum Fund Annual Report and regular public consultation, continues to emphasise and remind the stakeholders of the objectives of establishing the Petroleum Fund.

The Petroleum Fund Law further describes how the Petroleum Fund contributes to the achievement of these objectives.

## Principle 3

3. Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

The Petroleum Fund Law does not allow the Fund to invest domestically. The Petroleum Fund only has significant direct domestic macroeconomic implications arising from the transfers made to the State Budget to finance government's budget deficit.

The Petroleum Fund, as a tool of fiscal management, is integrated into the State Budget.

The amount transferred to the State Budget from the Fund is guided by the Estimated Sustainable Income (ESI). This is designed to be the amount that can be transferred from the Fund without depleting the long-term real value of petroleum wealth, ensuring the sustainability of the Fund.

The Ministry of Finance coordinates the activities of line ministries, other entities and relevant departments within the Ministry during the preparation, discussion and execution of the government's budget.

<https://www.mof.gov.tl/budget-spending/budget-treasury-documents/?lang=en>

## Principle 4

4. There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

4.1. The source of SWF funding should be publicly disclosed.

4.2. The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

The Petroleum Fund Law clearly defines what constitutes petroleum fund receipts and sets out the mechanisms for handling these receipts and requirements for withdrawals.

Detailed information about receipts and transfers to government is publicly disclosed in the Petroleum Fund Annual Reports, and the General State Budget from the Ministry of Finance, as well as in the Petroleum Fund's quarterly and monthly reports from the BCTL. These reports were audited by an external reputable international accounting firm.

A complete list of all entities making payments to the Petroleum Fund is published annually. Timor-Leste was accepted as an EITI (Extractive Industries Transparency Initiative) compliant country on 1 July 2010.

<https://www.mof.gov.tl/budget-spending/budget-treasury-documents/?lang=en>

<http://www.bancocentral.tl/PF/Reports.asp>

<http://www.eiti.tl/>

#### Principle 5

5. The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

Transparency is a fundamental principle of the Petroleum Fund Law. The Law sets out the requirements for all entities involved in the management of the Fund to provide and publish the reports pertaining to the activities of the Fund.

The Ministry of Finance prepares the Petroleum Fund Annual Report, Petroleum Fund financial statements and general state budget statement for the National Parliament.

The BCTL, on a quarterly basis, provides reports to the Minister on the Fund's performance over the quarter. BCTL also, on its own initiative, issues to the public a monthly performance report for the Fund.

The Law requires an international accredited auditor to issue and publish an annual audit report on the Fund's financial statements. All this information is publicly available on both the MoF and BCTL websites.

<https://www.mof.gov.tl/budget-spending/petroleum-fund/?lang=en>

<http://www.bancocentral.tl/PF/Reports.asp>

#### Pillar 2: Institutional

Institutional Framework and Governance Structure.

#### Principle 6

6. The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

The Petroleum Fund Law clearly defines the roles and responsibilities of all entities involved in the management of the Fund. No single institution or individual is responsible for making and implementing the investment decisions as are all mutually accountable for their role in the decision-making process.

Parliament has established the Petroleum Fund Law. The Law limits the broad asset allocation and risk tolerance.

The Ministry of Finance sets the investment policy and monitors the Fund's performance. The Investment Advisory Board (IAB) provides advice for Minister on investment policy and sets the investment benchmarks for the Fund. BCTL, the Operational Manager, is responsible for the Fund's operations including implementing the investment mandates set by the Minister of Finance. The BCTL appoints external managers and monitors their performance.

#### Principle 7

7. The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

Parliament, representing the people, sets the objectives of the Fund in the Petroleum Fund Law. The Petroleum Fund Consultative Council (PFCC) is a statutory body appointed to provide advice to Parliament on matters relating the Petroleum Fund.

The Ministry of Finance, responsible for the overall management of the Fund, sets the investment policy, investment guidelines, including detailed risk limits and exercise of oversight. The Prime Minister appoints members of the IAB on the advice of the MoF.

The operational management is delegated to the Central Bank. The Operational Manager appoints the external managers, in accordance with international tendering procedures, to manage part of the Fund provided that the Minister is satisfied that the managers fulfil certain requirements in the Law.

#### Principle 8

8. The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

Further to the discussion in GAPP 7, the Minister of Finance is accountable to the Parliament and is required to provide relevant reporting. In carrying out her functions, Minister of Finance is required to seek advice from the IAB. The Law determines at least three of the IAB members must have significant knowledge and experience in financial investment.

The composition, role and authority of the PFCC aim to safeguard the proper management of the Petroleum Fund.

#### Principle 9

9. The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

The Petroleum Fund Law clearly defines the roles and responsibilities of the Operational Manager. As an independent institution appointed by the Parliament, the BCTL has statutory legal, operational, administrative, and financial autonomy from any other person or entity, including the government, to be able to fulfill its operational management responsibilities in an independent manner.

## Principle 10

10. The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

Accountability arrangements are detailed in the Petroleum Fund Law and the Management Agreement. The Petroleum Fund law delegates the operational responsibility to the Operational Manager. Subject to the Minister's consent, the Operational Manager may delegate further certain operational mandates to external managers.

The Minister of Finance reports to the Parliament on the performance of the Fund on annual basis and is required to publish all advice received from the IAB unedited in the Annual Report.

The Operational Manager reports to the Minister on the Fund's performance on a quarterly basis. These reports are published and available on the Central Bank's website.

## Principle 11

11. An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

The Petroleum Fund Law requires the government to prepare and submit to the Parliament an annual report of the Fund's operation and performance for the fiscal year, including financial statements prepared to International Financial Reporting Standards and audited by an internationally recognised auditor, at the same time as the annual financial statements of that year.

The Director of Treasury of the Ministry of Finance is responsible for maintaining the Petroleum Fund accounts and records and preparing financial statements, in accordance with the International Financial Reporting Standards.

## Principle 12

12. The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

The Petroleum Fund Law requires the accounts, records and other documents relating to the Petroleum Fund to be audited every six months by the bodies responsible for internal audits of each entity involved.

The Law further requires the annual financial statements to be audited by an internationally recognised accounting firm. The audited financial statements are submitted to the Parliament together with the Petroleum Fund Annual Report.

## Principle 13

13. Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

The professional and ethical standards for the Ministry of Finance's staff are defined by the Public Service Law no.8/2004, as amended by Law no.5/2009. All the staff of the Operational Manager is bound by the BCTL's Code of Ethics.

The Petroleum Fund Law also requires members of the IAB, on the occasion of their appointment, and as appropriate, when providing advice to the Minister to signify in writing an affirmation that their appointment or advice does not represent a conflict of interest with any of their other interest. The Minister of Finance may request members of the IAB, as necessary, to submit a declaration concerning their assets to avoid any conflict of interest. The IAB has established its own Standard of Conduct.

<http://www.cfp.gov.tl/index.php/pt/>

<http://www.bancocentral.tl/en/cconduct.asp>

<http://www.bancocentral.tl/Download/IAB/PF%20Operational%20regulation.pdf>

#### Principle 14

14. Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

The Operational Manager is responsible for the selection and subject to Minister of Finance's consent, the appointment of the external manager. The law requires the Minister to be satisfied that each external manager has sufficient equity, guarantees and insurances, a sound record of operational and financial performance, and has business references and a reputation of the highest standard.

The requirements are based on professional and commercial standards, while the responsibility of the external manager is to maximise the return of the Petroleum Fund, taking into account the appropriate risk as set out in the Law and the investment mandate.

The external managers and other service providers are required to be selected and contracted subject to rigorous, fair and transparent tendering procedures and in compliance with the substantive provisions of Timor-Leste's laws.

#### Principle 15

15. SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

The Petroleum Fund Law requires the management of the Petroleum Fund to be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which the investments are made.

#### Principle 16

16. The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

The governance framework and objectives of the Ministry of Finance and Operational Manager, as well as the IAB and the PFCC, are set out in the Petroleum Fund Law and in the Petroleum Fund Annual Report. The framework clearly establishes the roles, independence and accountability arrangement between the entities.

<http://www.mof.gov.tl/category/documents-and-forms/petroleum-fund-documents/petroleum-fund-legal-framework/?lang=en>

<https://www.mof.gov.tl/budget-spending/petroleum-fund/?lang=en>

## Principle 17

17. Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

Petroleum Fund Annual Report and audited financial statements are prepared by the Ministry of Finance and submitted to the Parliament. The reports are also distributed to key stakeholders and publicly available in the Ministry of Finance website.

In addition, the Operational Manager also issues quarterly and monthly updates on the Fund's investment performance for the Minister of Finance. This is made available to the general public on the BCTL's website.

The Ministry of Finance, on its own initiative and/or as requested, conducts public information sessions with the general public including public servants, NGOs and students to update on the Fund's activities, operation and performance.

<http://www.mof.gov.tl/category/documents-and-forms/petroleum-fund-documents/petroleum-fund-annual-reports/?lang=en>

<http://www.bancocentral.tl/PF/Reports.asp>

<http://www.mof.gov.tl/category/documents-and-forms/petroleum-fund-documents/petroleum-fund-seminars-presentations/?lang=en>

## Pillar 3: Investment

### Principle 18

18. The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

18.1. The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

18.2. The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

18.3. A description of the investment policy of the SWF should be publicly disclosed.

The Ministry of Finance, on behalf of the government, sets out the investment policy, pursuant to the IAB's advice, reflecting the risk preference of the Timor-Leste people. The investment policy is publicly disclosed. The Petroleum Fund Law defines the broad asset allocation guidelines as the risk profile, the investment universe, investment principles, and other issues related to the overall investment policy.

The advice of the IAB is based on its publicly disclosed Investment Beliefs and Principles.

The selection of external investment managers is based on professional and commercial criteria. The external managers are given and are measured by clearly defined mandates, where the goal is to achieve highest possible risk-adjusted return.

The investment policy is summarised into the investment mandate, which is annexed to the Management Agreement and discussed at length in the Petroleum Fund Annual Report. These documents are publicly

available.

## Principle 19

19. The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

19.1. If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

19.2. The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

The government's obligation to seek to maximise risk-adjusted financial returns is established in the Petroleum Fund Law and subject to an overriding requirement that the Fund be managed prudently.

The road map toward this goal is further detailed in the operational management agreement and external investment mandate under the legislation. To date, all investment mandates have been developed on economic and financial grounds.

## Principle 20

20. The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

The Petroleum Fund Law does not permit the Fund to be invested domestically and the implementation of the investment mandate by the Operational Manager (BCTL) is independent from the setting of investment policy by the Minister of Finance. The Fund is not privy to any privileged information or inappropriate influence by broader government.

## Principle 21

21. SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

A separate policy on shareholder ownership rights has not been established yet.

The current practice is that the Fund exercises its shareholder ownership rights based on the ISS voting guidelines when appropriate to protect the financial interest of the Fund's assets, this is done through external managers upon the instructions from the Operational Manager.

## Principle 22

22. The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

22.1. The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

22.2. The general approach to the SWF's risk management framework should be publicly disclosed.

#### Principle 23

23. The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

The Petroleum Fund Law requires the Operational Manager (BCTL) to report to the Minister of Finance, on a quarterly basis, the performance and activities of the Petroleum Fund relative to the benchmark. Performance reporting is prepared by a third party who asserts that the reports are GIPS compliant.

This report is published within 40 days of the end of every quarter to the public.

<http://www.bancocentral.tl/PF/Reports.asp>

#### Principle 24

24. A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

The Fund conducted its fifth review in 2014. The sixth review, based on the current document, will be published in the 2015 Petroleum Fund Annual Report. The Fund intends to review its implementation of the GAPP annually.