

Minutes of Meeting

Petroleum Fund of Timor-Leste Investment Advisory Board

Held on 19th December 2008

At the offices of the World Bank

Present:

Olgário de Castro (by teleconference)
Abraão de Vasconcelos
Tørres Trovik (by teleconference)
Kevin Bailey (by teleconference)
Subodh Kumar Mathur, as alternate for Mr Manuel Monteiro

In attendance:

Venancio Alves Maria, Executive Director of the PF Department, BPA
Gastão de Sousa, Chief Economist, BPA (Secretary)
Vidar Ovesen, Fiscal Policy and Petroleum Fund Advisor, Ministry of Finance
Torgrim Roll, Advisor for PF Department, BPA

The Chairman declared the meeting open at 9.15 hours.

Apologies were received from Mr. Manuel Monteiro as he will attend a meeting convened by the Minister of Finance at the same day. Mr. Subodh Kumar Mathur, the Advisor of Treasury, was present as his alternate.

The agenda for the meeting was approved without amendments.

Notes on diversification of the Petroleum Fund portfolio – response to the Minister's letter of 21 May 2008

The Board has requested the Secretariat at the last IAB meeting to revise the paper on the diversification of the Petroleum Fund portfolio. The secretariat has revised the paper and presented to the Board for discussion. This paper addresses the next step to be taken for further diversification of the portfolio beyond the contract with the BIS, as the BIS is expected to be appointed shortly as the first external manager of the Petroleum Fund in Timor-Leste.

Mr. Vidar informed the Board that the Secretariat has amended the paper in accordance with comments provided by the Board. He also informed the Board that the Secretariat has included two options regarding whether the investment mandates should be limited to passive management only or also include a small part for active management.

The Board discussed the revised paper presented by the Secretariat. One of the members, Mr. Abraao de Vasconcelos, made an observation that to facilitate Government's desire to diversify the Fund for long term higher returns, it would be reasonable to also consider a small portion of active management to gain experiences. He underlined that gaining experience from a small portion of active management would facilitate a transition to future complex asset classes diversification in the future.

Other members of the Board underlined the importance of limiting the investment mandates for the time being to passive management only, as active management is complex and requires skills, resources and experience and that the skills and experience in the Central Bank and Ministry of Finance are better suited to managing a broader portfolio of passively invested instruments. They also underlined that returns from active management will only be achieved through successful selection of asset managers which requires long time experience and skills. Active management can be revisited at any point when the prospect of active management is the best marginal extension of the investment policy.

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On this basis the Investment Advisory Board recommends the following for Minister's consideration:

- A portion of 4±1% of the Petroleum Fund (approximately \$200 million based on the current PF value) be invested in a global equity mandate, benchmarked by the following index:
 - MSCI World Free Index (Developed countries)
- An amount of 15±3% of the Petroleum Fund (approximately \$600 million) be invested in a more diversified fixed interest mandate, benchmarked by a composite index as follows:
 - 63% Merrill Lynch 0-5 years index.
 - 12% Merrill Lynch 5-10 years index
 - 16% Merrill Lynch US Government and Supranational (GS10)
 - 9% Merrill Lynch US Dollar foreign government (GS20)
- The initial stage of the investment diversification strategy be in the form of adding passively managed (indexed and enhanced index) portfolios, based on a tracking error of 100 basis points for the equity mandate and 50 basis points for the fixed income mandate.
- The management of the new mandates to achieve the diversification of the Fund be assigned by the BPA to external commercial managers.
- The numeraire of the Petroleum Fund should be the United States dollar. However, the Board recognizes the need to revisit this issue at some time in the future.

- In light of the above recommendations a new global benchmark will be required for the Fund. The Board will further consider this issue.

Other Business

The Board got an update from the BPA on the progress of the contract negotiations with the BIS and that the contract negotiations were finalized. The Minister will receive a report assessment from the BPA in due course regarding a conclusion of contract negotiation with the BIS.

It was resolved that the next meeting would take place on February 12, 2009. As there were no other businesses the Chairman declared the meeting closed at 10.50 hours.

Chairman

Secretary