

Minutes of Meeting

Petroleum Fund of Timor-Leste Investment Advisory Board

Held on 23rd October 2008

At the BPA's Board Room

Present:

Olgário de Castro
Tørres Trovik (by teleconference)
Kevin Bailey

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

The Chairman declared the meeting open at 9.45 hours.

Apologies were received from Mr. Abraão de Vasconcelos as he is not well. Mr. Venancio Alves Maria, the Executive Director of the PF Department, was present as his alternate. Apologies were also received from Mr. Manuel Monteiro as he is out of the country.

The Chairman welcomed Mr. Kevin Bailey as a new member of the IAB. Mr. Kevin has been appointed by the Minister according to article 17.1 (c) and (d) in the PF Law. He is a Managing Director of the Money Managers Ltd and as an Honorary Consul General for Timor-Leste in Australia.

The agenda for the meeting was approved without amendments.

Minutes of Previous Meetings

The approval of minutes of the previous meetings held on 27th August 2008 was postponed until the next IAB meeting.

Business arising from the minutes

The Board asked the BPA to provide an update on the process of hiring Bank for International Settlements (BIS) as an external investment manager to the Petroleum Fund, the progress on the contract negotiations, remaining issues that need to be resolved and the anticipated appointment date. Mr. Venancio briefed

the Board on the negotiations and informed that the process is still on progress as the draft Investment Management Agreement is now with the BIS for comments.

Mr. Venancio also informed the Board that there are still many unresolved issues, including legal issues such as limitation of liabilities that need to be addressed before the parties can settle the deal. With regard to the appointment date, Mr. Venancio explained that the BPA's anticipated appointment date has already been passed. The BIS has proposed a meeting during November to discuss the settlement and therefore it is anticipated that the appointment would be during November 2008 subject to the settlement of the contract negotiations. The Board underlined the importance of concluding this process as soon as possible and encouraged the BPA to ensure that the process is finalized shortly.

The chairman also raised an issue regarding the Sovereign Investments Partnerships (SIP) Program and referred to the letter that the BPA has received from the World Bank on the matter. He requested the BPA to give an update on the issue and whether the BPA has responded to the letter. He also underlined the BPA and Ministry of Finance may consider a coordinated response to the World Bank. Mr. Venancio explained that the letter does not specify whether Timor-Leste still be able to participate in the SIP Program. This is an issue he needs to discuss further with the BPA Management before a response can be given.

Update information on the PF performance for quarter ended 30 September 2008

Mr. Venancio gave a brief presentation on the performance of the Petroleum Fund for the quarter ended 30 September 2008. He described that the quarterly return of PF portfolio was 1.64%, while the return of the benchmark was 1.71%.

He informed that the methodology for calculating the performance numbers has been changed from time weighted rate of return to the Modified Dietz Method based on last price valuation.

Cash received during the quarter was USD 619.87 million, and the total capital as of the end of the quarter was USD 3,738.35 million. The annualized return for the last 12 months (1 October 2007 – 30 September 2008) was 6.29% for the PF and 6.33% for the benchmark.

The modified duration of the Petroleum Fund portfolio was maintained within the mandate.

One member raised a concern related to the future global inflation as a consequence of the current financial crisis and measures undertaken by various governments as responses to the current situation. If the global inflation increases in the future, the real rate of return on the PF investments may be modest, as the long term nominal return on US Government bonds is moderate due to the low risks associated with such an investment strategy. This is an issue that the Board needs to bear in mind when giving advice on the future investment strategy.

The Board appreciated the information provided by Mr. Venancio and noted the performance report for the quarter ended 30 September 2008 given by the BPA.

Further diversification of the PF portfolio – response to the Minister’s letter of 21 May 2008

At the IAB-meeting on 27 August 2008, the Board discussed a study provided by Mercer on External Investment Management Implementation Options, and subsequently requested the IAB-Secretariat to prepare a draft recommendation paper based on options 1: 100% fixed assets and option 2: 90% fixed assets and 10% equities of Mercer’s report with comments provided by Mr. Torres Trovik on the report.

A draft paper prepared by the Secretariat is presented to the Board for discussion. The draft paper considers four alternatives for the Board’s discussion. Two alternatives are based on active management mandates and two other alternatives based on index management mandates. In each category there are one alternative based on fixed interest mandates only and one alternative with a combination of equity and fixed interest mandates.

The draft paper recommends allocating \$150 million (approximately 4%) of the PF to be invested in a global equity mandate in accordance with art. 14 of PF Law, while \$500 million to be invested in more diversified fixed interest mandate in accordance with art. 15.

The Board appreciated the work undertaken by the Secretariat and underlined that the draft paper was a good basis for the Board’s discussion of further diversification.

The Board agreed that the amount allocated to the various investment mandates should be determined as a percentage of the total portfolio and not as a specific dollar amount. As the value of the PF increases, the amount allocated to the various external managers can thus be adjusted accordingly. Furthermore, the Board discussed which global equity index that would be most relevant to include as the benchmark in the equity mandate and the tracking error defined in the mandate.

The Board noted the conclusions proposed by the Secretariat and requested the Secretariat to review the paper based on the discussion in the Board. The Secretariat was requested to explore alternative passive mandates and the Board encouraged the Secretariat to contact various institutional investors to obtain relevant information about the tracking error needed to track a global index passively without facing operational inflexibility. Members of the Board volunteered to assist the Secretariat in order to provide input to the further discussion.

IAB members declaration of assets and income

The Secretariat, according to Art 17.4 of the PF Law, has prepared and presented to the Board for discussion a form of the members' declaration of assets and income.

The Board generally accepted the purpose of the declaration form presented but requested the Secretariat to review certain elements of the draft form, such as whether family members' assets should be included and declared assets limited to financial assets only.

The Board members, which have not yet submitted a declaration to the Minister, agreed on submitting an interim declaration of assets and incomes to the Minister while the Secretariat is working on an updated declaration form.

Other Business

The Chairman informed the Board that there is an expectation from the Ministry of Finance that any transfer of funds to external managers can take place without crystallizing a loss. Mr. Venancio said that how to transfer funds to external managers is an operational issue and the BPA is currently analyzing the most proper way to undertake such a transfer. He further said that a transaction cost of transition to external managers including the BIS is an avoidable operational issue. The BPA will give its recommendation together with the final proposal regarding the BIS contract to the Minister. The Board agreed to leave to the BPA to present to the Minister its recommendation how to transfer funds to the BIS.

It was resolved that the date of the next meeting will be determined at a later stage.

As there were no other businesses the Chairman declared the meeting closed at 13.00 hours.

Chairman

Secretary