Minutes of Meeting

Petroleum Fund of Timor-Leste
Investment Advisory Board

Held on 27th August 2008

At the conference room of the World Bank Office

Present:

Olgário de Castro
Abraão de Vasconselos
Manuel Monteiro
Tørres Trovik (by teleconference)

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
Subodh Kumar Mathur, Treasury Advisor
Sam Robinson, Advisor for BPA

Simon Eagleton, Principal of Mercer Investment Nominees Limited (by teleconference)

The Chairman declared the meeting open at 9.00 hours.

The Chairman informed that apologies were received from Mr. Cristino as he is attending a long-term academic course abroad and the Minister is seeking an appropriate candidate for the post.

The agenda for the meeting was approved without amendments.

Minutes of Previous Meetings

The minutes of the previous meetings held on 24th June 2008 were approved subject to minor amendments.

Business arising from the minutes

None.

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

As has been requested by the IAB for the BPA to present updated information regularly on the PF performance in its regular meetings, the Chairman pleased the Petroleum Fund Department of the BPA to present the PF performance for the quarter ended 30 June 2008.

Mr. Venancio, the Executive Director of the Petroleum Fund Department of the BPA, gave a brief presentation on the performance of the Petroleum Fund for the quarter ended 30 June 2008. He described that the quarterly return of PF portfolio was -1.00%, while the return of the benchmark was -1.02%. This loss of the PF value was mainly due to factors that adversely affected the market during the quarter; primarily an increase in the United States yields which cause the market prices of the bonds to fall.

Cash received during the quarter was USD 598.81 million, and the total capital as of the end of the quarter was USD 3,203.07 million. The annualized return for the last 12 months (1 July 2007 – 30 June 2008) was 7.34% for the PF and 7.33% for the benchmark.

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

The Chairman underscored the need for stakeholders to provide general information to the public about how the financial market is working and in particular the short term fluctuations, which may potentially cause negative return in the future. The Board agreed that it is a common task for the BPA and the Ministry of Finance to define a strategy for educating the public in terms of future expectations of the performance of the PF.

The Board noted the performance report for the quarter ended by 30 June 2008 given by the BPA.

Rules of Procedures of the IAB

The Board discussed the draft amendments to the Rules of Procedures of the IAB and introduced amendment to the draft presented. The Secretariat was requested to incorporate comments made by the Board members and tabled in the next IAB meeting for final approval.

Advice to the Minister as requested in the letter of 24 June 2008

The Board discussed the draft recommendation prepared by the Secretariat on the investment guidelines for the BIS, the amendments to the Management Agreement as the Minister, in her letter of 24 June 2008, had sought the advice from the Board especially on the amount of money to be allocated to BIS and the overall benchmark in the Management Agreement.

The Board resolved to advise the Minister to adopt the investment guidelines, which allow investments in government bonds in other major currencies than USD (GBP, YEN, EURO, AUD), and a corresponding benchmark reflecting a broader investment universe than the current one.

Regarding the amount of money to be allocated to the BIS, the Secretariat provided two alternative approaches and the Board discussed the alternatives presented. One alternative suggested the amount to be allocated to the Bank for International Settlements is to be submitted by the BPA as once package of the outcome of the contract negotiations once the contract negotiation with the BIS is completed. Another alternative suggested the Board to recommend allocating $1 billion to the BIS as the Minister has requested IAB's advice, and the amount to be allocated is necessary to complete the investment guidelines for the BIS and the overall investment mandate included in the Management Agreement between the MoF and the BPA.

Mr. Venancio, the Executive Director of the Petroleum Fund Management made an intervention that he understood the Minister has requested the Board to also advice the amount to be allocated to the BIS, however the Board should look at also the process although it is requested by the Minister. He argue that it is not the problem of the amount but the process of determining the amount it self. He added that it is premature to determine the amount to be allocated to BIS prior the finalization of the contract negotiations between the BPA and the BIS. The determination of amount to be allocated to BIS should based on proper analysis and factors which will only be known through contract negotiations between the BPA and the BIS. Determining the amount to be allocated to BIS in advance may prejudice the contract negotiations. He further added that the factors lead to option on outsourcing $1 billion to the BIS is not sufficient and not convincing and may place the BPA and Ministry officials as well as the Board at risk in responding to public concerns at later date. Therefore as the institution responsible for the operational management and based on previous experiences, the BPA is not in the position at this stage to support the option on outsourcing $1billion to the BIS and continue in the position to leave the amount to be allocated to the BIS to be presented by the BPA to the Minister as one package of the outcome of the contract negotiations which the Minister will seek the advice of the Board anyway.

Mr. de Vasconselos suggested the IAB should discussed overall asset allocation strategy and determine the investment mandate. He was not in favor with the amount to be allocated to BIS and continue in the position that the amount to be allocated to the BIS will be presented by the BPA who responsible for the operational management as once package of the contract negotiations with the BIS. Proper analysis needs to be done and the option on outsourcing $1billion to the BIS was not based on proper analysis. Therefore, he is not in the position at this stage to support the decision of outsourcing $1billion to BIS.

Mr Trovik argued that an agreement has been reached in talks between the Ministry and the BIS on the benchmark and risk limits of the mandate. The IAB has thus sufficient information to judge how this mandate will affect the overall properties of the Fund and can meaningfully decide on the amount to be allocated to the mandate. Furthermore, the recommendation of the IAB does not need to be disclosed to the BIS until the remaining contract negotiations have been finalized hence an IAB recommendation should not impact the remaining negotiations in any way. As the mandate has higher expected return than the current benchmark, a total market risk that is acceptable to the Ministry and is to be executed by an institution of long standing and the highest reputation, Mr. Trovik was in favor of allocating at least USD 1 Billion to the mandate. Moreover, deciding upon an amount at this stage will allow the BPA to be more explicit in its planning for the management of the remaining amount in the Fund.

The Chairman noted that the Minister requested the IAB to give an advice on this issue, the size of the investment mandate including, in her letter of 21 June 2008. He underlined the importance of accommodating the request from the Minister and to give a recommendation of the amount of money to be outsourced in accordance with the investment guidelines to the BIS. He also referred to the fact that the Minister at an early stage of the process envisaged an allocation of $1 billion to each of the non-commercial managers. $1 billion is expected to be about 30 % of the balance of the Fund at the end of the year.

Furthermore, he noted that the contract with the BIS may be terminated without penalty at any time by either party, and allows for the amount of funds under management to be changed at short notice. It was also underlined that the BIS is an institution of the highest reputation and that the $1 billion would form a very small part of its financial operations. Finally it was also emphasized that the draft investment guidelines would give a higher expected rate of return on the investments than the current portfolio composition, which will benefit the long term balance of the Petroleum Fund.

After the discussion the Board adopted the following recommendations to the Minister of Finance as a response on the request of an advice contained in the letter of 24 June 2008:

1. The Investment Advisory Board recommends that the Minister of Finance adopts the investment guidelines attached as Annex 1 as the basis for the appointment of the Bank for International Settlements (BIS) as an external manager, subject to a final legal review of the guidelines being undertaken in association with the contractual arrangements.

2. The Investment Advisory Board recommends the outsourcing of one billion US dollars to the Bank for International Settlements for management under the mandate described in point 1.

3. The Investment Advisory Board recommends that the Minister of Finance adopts the amendments to the overall investment mandate in the Management Agreement between the MoF and BPA contained in Appendix III.

The Board authorized the Chairman to sign the recommendation letter to the Minister.

Study on implementation options as requested by the Minister on 21 May 2008

Mr. Simon Eagleton, the Principal of Mercer, joint the meeting at this point.

As the Minister has sought advice of the Board on potential options that would be permitted under the current Petroleum Fund Law and in view of future PF Law changes, and further the Board has requested the BPA to assist seeking advise of external consultant (Mercer) on various implementation options based on Minister's request, Mercer has submitted its report on 14 July 2008.

Mr. Simon Eagleton, through teleconference call, made a brief presentation of Mercer's report "External investment management implementation options" of 14 July 2008.

Mercer's report suggests four implementation options in two different implementation phases, namely Initiation Phase where the Investment program complying with current Petroleum Fund Law and the Accumulation Phase where the Investment program under amended Petroleum Fund Law.

Under the Initiation Phase, the report suggested two options. Option 1 is 100% fixed interest strategy and Option 2 is 90% fixed interest and 10% equities strategy.

In the Accumulation Phase, the report suggested option 3 is 100% fixed interest with the different investment universe of Global sovereign debt, Global credit & securitized debt instruments, Global inflation-linked bonds and Emerging market debt while option 4 is 40% fixed interest and 60% global equities.

The report also recommended that Immediately pursue an Initiation Phase strategy (ie consistent with current Law) that maximizes return potential and diversification through an allocation of up to 10% in global equities, seek to amend the Law to permit as broad an investible universe as possible, explore policy development and practical implementation options in the area of Responsible Investment, addressing environmental, social and governance issues and following amendment to the Law, pursue an Accumulation Phase strategy of 60% allocation to growth-oriented assets (such as global equities).

Board members raised questions they had to the report.

Answering the more diversification for higher return, Mercer stated that more diversification is better and the Fund may have more asset classes and external managers tomorrow but Mercer acknowledged practical implementation of operational management (BPA). It would be worthwhile slowly build the exposure to other complex asset classes rather than rush.

Mercer informed the Board that they will provide responses in writing on all questions forwarded prior to the meeting. The Board appreciated and gratified the presentation provided by Mercer.

Mr. Simon left the meeting at this point.

The Board also discussed notes provided by Mr. Torres Trovik with his comments to Mercer's report prior to the meeting.

The Board requested the Secretariat to prepare draft recommendation paper based on options 1: 100% fixed assets and option 2: 90% fixed assets and 10% equities of Mercer's report together with comments provided by Mr. Torres Trovik for Board's discussion in response to Minister's request for an advice as requested in the letter of 21 May 2008 to the IAB.

Other Business

The General Manager of BPA informed the meeting that a response letter from the IBRD regarding the communication on the decision to cease the negotiation has been received.

It was resolved that the next meeting would take place on October 24, 2008. As there were no other businesses the Chairman declared the meeting closed at 12.46 hours.

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Chairman	Secretary