

DEMOCRATIC REPUBLIC OF TIMOR-LESTE

Petroleum Fund of Timor-Leste Operational Management Agreement

This Agreement is made in accordance with paragraph 3 of the Article 11 and paragraph 4 of the Article 12 of Law No. 09/2005 – on the Petroleum Fund (“Law”) on October, 12 2005 between

- the Minister of Finance (“Minister”) representing the Government of Timor-Leste, and
- the Banking and Payments Authority (“Central Bank”) of Timor-Leste

hereinto referred to as the “Parties”,

Whereas the Minister will exercise the key functions and competencies of the Government, which has been assigned overall responsibility for the management of the Petroleum Fund (“Fund”) and the Banking and Payment Authority has been assigned the responsibility of the operational management of the Fund;

Whereas the requirement established by law that the Minister shall enter into an agreement with the Central Bank for the operational management of the Fund;

And whereas this Agreement shall replace the Operational Management Agreement between the Ministry of Finance and the Banking & Payments Authority signed 12th October 2005.

It is therefore agreed between the parties

1. The Central Bank shall undertake the operational management of the Fund and shall be accountable for its operational management of the Fund to the Minister.
2. The Government shall be responsible for the overall management of the Fund, which shall include the following functions to be exercised by the Minister:
 - a. To establish the overall policies and guidelines for the investment of the capital of the Fund, including the determination of the overall investment objective, the asset allocation strategy, and the investment mandate comprising an overall financial mandate and subsidiary mandates with such benchmarks, financial targets, performance and risk measures as may be necessary to convey the Minister’s intentions to the Central Bank for the investment and anticipated return on the Fund.



- b. No less than fifteen (15) days prior to the commencement of each calendar quarter, to provide a forecast of the monthly cash requirements of government for that quarter, including the projected timings and amounts to be transferred from the Fund;
 - c. To provide the regulatory framework for the management of the Fund, and to consult with the Central Bank concerning proposed changes to this framework;
 - d. To provide documentation as necessary to clarify the tax position of capital and income from the Fund that has been invested abroad;
 - e. To ensure that requests by the Central Bank for guidance on ad hoc policy decisions to enable it to implement the operational management of the Fund are responded to clearly and in a timely manner;
 - f. To consult with the Central Bank concerning information to be released to the public;
 - g. To appoint the independent auditors of the Fund and to arrange for their remuneration from the State budget.
3. The Central Bank shall be responsible for the operational management of the Fund, which shall include the following functions:
- a. The investment of the capital of the Fund in financial instruments as set out in this Agreement, including exercising all the rights and complying with all obligations associated with the ownership of the Fund's assets;
 - b. Receiving and accounting for the investment income and other revenues of the Fund;
 - c. Without prejudice to the responsibilities of the proper authorities for administering tax and royalty payments, maintaining a register of all payments made as Petroleum Fund receipts;
 - d. Maintaining the books of account for the Fund and all financial and asset records in accordance with international best practice on behalf of the Director of Treasury;
 - e. Appointing and dismissing banking correspondents, dealers, brokers, custodians and other financial intermediaries necessary for the proper management of the Fund;
 - f. Identifying and selecting the most appropriate portfolio managers to implement the investment objectives, asset allocation and investment mandate defined under Article 2 (a), and making proposals for the appointment of such managers to the Minister;



- g. Evaluating all external managers on a continuous basis and proposing corrective action through appropriate channels, if necessary, and being in a position at all times to be able to explain the rationale behind any external manager's deviations from the benchmark.
 - h. Preparing quarterly performance reports to the Minister, including inter alia a summary of the performance of the Fund relative to the aggregate benchmark and the performance of each manager and sub-mandate against its respective benchmark.
 - i. Supplying information to the Minister and the Director of Treasury necessary for the drafting of reports and statements relevant to the management of the Fund, including all reports relating to the management of the Fund required by law, with all such information being available to the recipients at least ten working days prior to any legislated publication date unless otherwise agreed between the parties;
 - j. Meeting all the operational expenses relating to the management of the Fund, which shall be compensated for from the annual management fee;
 - k. Implementing systems, procedures, risk management practices, and development of human resources in accordance with best international practice to minimise the risk of operational loss to the Fund;
 - l. Advising the Minister of all significant events affecting the value of the Fund and other matters considered to be urgent or of importance relating to the management of the Fund;
 - m. Providing the public with such information concerning the Fund as may be determined by the Minister;
 - n. Assisting the Minister in the preparation of the Annual Report of the Fund;
4. The Central Bank shall maintain the Secretariat of the Investment Advisory Board ("the Board"), which shall include the following functions:
- a. Preparation of notices of meeting to the members of the Board;
 - b. Preparation, in consultation with the Minister, of reports, financial accounts, recommendations, background papers and other information to be submitted to meetings of the members of the Board;
 - c. Preparation, in consultation with the Minister, of technical advice and recommendations to the Board, including special reports on the operations of the Fund as may be requested by the Board;
 - d. Arrangement of facilities to hold the meetings of the Board;



- e. Preparation and distribution of minutes of meetings of the Board;
 - f. Administering the meeting expenses of the Board, including remuneration of the members, the cost of which unless otherwise agreed shall be met from the State budget.
5. The Minister and the Central Bank shall jointly undertake the following functions with respect to the Consultative Council ("the Council"):
- a. Preparation of such technical advice and reports as may be requested by the Council in the course of performing its duties;
 - b. Preparation of such commentaries on the operations and performance of the Fund as may be requested from time to time by the Council.
6. The Central Bank shall implement the operational management of the Fund through the adoption of the following principles:
- a. The assets of the Fund shall be maintained in the name of the Banking and Payments Authority of Timor-Leste, but shall at all times be segregated from the assets of the Central Bank in such a manner as shall allow the beneficial ownership of the assets and the income associated with those assets to be clearly determined at any time;
 - b. The books and records of the Fund shall be maintained separately from the books and records of the Central Bank to the maximum extent practicable;
 - c. The Central Bank shall make the books and records relating to the operational management of the Fund available at any time on request to the Minister, staff authorised by the Minister, and the auditors of the Fund.
 - d. The Central Bank shall ensure that all staff associated with the management of the Fund shall be bound by a code of ethics and rules to avoid conflicts of interest.
7. The Minister has determined the investment mandate set out in Annex 1 to this Agreement, and the Central Bank hereby accepts the mandate and shall undertake to execute it to the best of its ability.
8. The performance of the Fund shall be measured periodically against the benchmark set out in Annex 1, and will be the subject of periodic reports under Article 13 of the Petroleum Fund Law.
9. The Minister shall give the Central Bank at least four week's notice before implementing any change to the mandate or benchmark as set out in Annex 1, and the Central Bank shall advise the Minister as to the anticipated length of time it will take to effect the new requirements.



10. The remuneration of the Central Bank shall be subject to Annex 2 to this Agreement, and shall be payable in monthly instalments from the assets of the Fund.
11. The earmarked receipts account of the Fund required by Article 5.2 of the Law shall be account number 021080973 held by the Central Bank at the Federal Reserve Bank of New York, with further details as set out in Annex 3 to this Agreement.

For the purposes of receiving and reinvesting investment income the Central Bank shall be permitted to open bank accounts in places and in currencies it deems appropriate into which investment income may be deposited, provided that such accounts shall be maintained solely for the purposes of managing Petroleum Fund transactions and shall at all times be kept under proper management and control.

The Central Bank shall periodically and in any case not less than once per calendar month clear the investment receipts (or for receipts denominated in foreign currencies the equivalent value in United States dollars) into the earmarked receipts account.

12. The single state budget account referred to in Article 7.1 of the Law shall be account 2-3711 held by the Ministry of Finance at the Central Bank.
13. The Central Bank shall undertake the appointment of external portfolio managers, under the following conditions:
 - a. The Central Bank shall undertake the procurement process in a fair and transparent manner according to its internal procedures;
 - b. The Central Bank shall make a written recommendation of the appointment to the Board, including but not limited to information about the services to be provided, the proposed level of fees, the investment mandate and the benchmark, the levels of insurance cover maintained against negligent losses, and such information concerning the procurement process as is necessary to inform the Board that the process was undertaken in accordance with the law;
 - c. The Minister shall issue a written decision to the Central Bank concerning the recommendation to appoint the proposed portfolio manager;
 - d. The Central Bank shall enter into a contract with the portfolio manager in its own name.
14. Should the Central Bank wish to terminate the contract of an external portfolio manager, the Central Bank shall consult with the Minister as follows:



- a. The Central Bank shall provide a written recommendation to the Minister concerning the termination of the portfolio manager's contract, and send a copy to the President of the Board;
 - b. The Minister may, within five working days of receiving the recommendation, seek the advice of the Board concerning the proposed termination of the portfolio management contract;
 - c. The Minister shall confirm in writing the decision within 30 working days of receiving the Central Bank's recommendation, failing which the Central Bank's recommendation shall be deemed to be approved.
15. The Central Bank shall not be liable for losses arising from the investment operations of the Fund unless such losses arise from the negligent acts or omissions of the Central Bank or its employees. The Minister shall provide with at least five working days' notice written payment instructions to transfer amounts from the Fund to the government's account referred in Article 13, that shall include the following information:
- a. The amount or amounts to be transferred;
 - b. The date or dates on which the transfer(s) are to take place;
 - c. The parliamentary appropriation reference under which the transfer is authorised;
 - d. A statement that the provisions of Articles 8 to 10 of the Law have been complied with, including such supporting documentary evidence as may be relevant;
 - e. The signature of the Minister;
 - f. The signature of the Director of Treasury.
16. All formal communications between the Minister and the Central Bank required under this agreement shall be in writing, and the communications shall be delivered as follows:
- a. To the Minister: Minister of Finance,
Building 5
Palácio do Governo,
Dili
 - b. To the Central Bank:

The General Manager
Banking & Payments Authority of Timor-Leste



Avenida Bispo Medeiros
Dili

Either party may at its discretion provide copies of formal communications to the Board.

17. This agreement may be amended by the parties at any time, provided that such amendments shall not be effective except in writing and signed by both parties. The Minister shall at the Central Bank's request delay the publication of amendments to this agreement concerning changes in portfolio allocations, benchmarks or other aspects that may affect the value of the Fund until the Central Bank has substantially completed the related market operations.

This agreement shall enter into force on 25 June 2009.

Signed on 25 June 2009



Emilia Pires
Minister of Finance



Abraão Fernandes de Vasconcelos
General Manager

Annex 1: Qualifying Instruments, Benchmark and Investment Mandate

This mandate has a hierarchical structure.

The Global Mandate describes the Minister's overall investment strategy for the Petroleum Fund in terms of a benchmark and eligible instruments, including applicable constraints and limitations.

The Sub Mandates describe in more detail the manner in which the Minister expects the investment of the Fund to be implemented. They describe the management structure of investment portfolios that shall be created, including the style of investment management, risk tolerances, and benchmark against which the performance of each sub-mandate shall be measured and reported, and as at the date of the Management Agreement, the managers appointed to manage the sub-mandates.

A. Global Mandate

The BPA is responsible for the operational management of the aggregate Fund according to the following mandate;

Aggregate Benchmark

The benchmark for the global mandate is the weighted ratio of the two benchmarks included in Mandate 1 and 2 below

- 80 per cent of the benchmark defined under Mandate 1
- 20 per cent of the benchmark defined under Mandate 2

Eligible Instruments

Asset Class	Allocation
A. Qualifying Fixed Interest Investments under Article 15.1 of the Petroleum Fund Law	Up to 100%
B. Fixed Interest Instruments meeting the conditions in Article 14 of the Petroleum Fund Law	No more than 10%

Eligible currencies for fixed interest investments shall be United States dollars, Australian Dollars, Euro, Great Britain Pounds, and Japanese Yen.

B. Sub mandates

An initial portfolio of \$1 billion shall be assigned to the Bank for International Settlements, and the balance thereafter shall be maintained between 19% and 21% of the value of the Fund, excluding amounts held for cash management purposes.

MANDATE 1

Manager	Banking & Payments Authority of Timor-Leste
Benchmark	Merrill Lynch US Government Bond 0-5 years index
Eligible instruments	US Government fixed interest instruments
Objective	<p>The investment objective shall be to passively manage the portfolio close to the benchmark, so that in normal circumstances the objective shall be to achieve a return within 25 basis points¹ of the benchmark.</p> <p>The difference in the modified duration² between the portfolio and the benchmark shall be less than 0.2 year.</p>

MANDATE 2

Manager	Bank for International Settlements
Benchmark	<p>The following group of indexes will, together, form the composite benchmark for the Portfolio:</p> <ul style="list-style-type: none">(a) 52% Merrill Lynch 0-5 Years US Treasury Notes and Bonds Index ("GVQA");(b) 10% Merrill Lynch 5-10 Year US Treasury Notes and Bonds Index ("G6O2");(c) 7% Merrill Lynch Australian Governments Index ("G0T0");(d) 7% Merrill Lynch EMU Direct Government Index ("EG00");(e) 2% Merrill Lynch U.K. Gilts Index ("G0L0");(f) 2% Merrill Lynch Japanese Governments Index ("G0Y0");(g) 13% Merrill Lynch US Dollar Foreign Government and Supra National, AAA Rated

¹ 100 basis points are the same as 1 percentage point.

² By "modified duration" is meant a measure of the percentage decline (increase) in the market value of the Petroleum Fund due to a 100 basis point increase (decline) in the level of interest rates.



Index ("GS10"); and

- (h) 7% Merrill Lynch US Dollar Foreign Government and Supra National, AA Rated Index ("GS20").

Eligible instruments BIS must invest at least 80 % of the portfolio in accordance with the qualifying instruments defined in Article 15.1 of the Petroleum Fund Law.

The BIS may invest a maximum of 20% of the Portfolio in deposits with, or debt instruments denominated in Australian Dollar (AUD), Euro (EUR), Japanese Yen (JPY) and Pounds Sterling (GBP) and issued by, entities that have been designated with a long-term foreign currency rating of Baa3 or higher by the Moody's rating agency or BBB- or higher by the Standard & Poor's rating agency, provided that the debt instruments are issued outside of Timor-Leste, are liquid and transparent, and traded in a financial market of the highest regulatory standard.

Objective The expected outperformance of the portfolio gross of management fees is 25 basis points over the Benchmark performance, on an annual basis over a rolling three year period, while maintaining the ex ante tracking error within 100 basis points.

C. Cash management

Short-term liquidity may be maintained by the Fund for operational purposes but shall be limited to cash received pending investment or allocation to external managers, cash and securities in transition to or between external managers and short-term instruments held to fund appropriations to the state budget account.

The Central Bank shall be accountable for the return on these instruments.



Annex 2: Remuneration of the Central Bank

1. The remuneration of the Central Bank shall be calculated on the basis of the costs incurred with the management of the Fund.
2. The upper limit for the remuneration calculated for the period 1 January-31 December 2009 shall be *three million US dollars* (US\$ 3,000,000), including direct external management costs and custodian fee of *one million five hundred and ninety three thousands US dollars* (\$1,593,000).
3. The remuneration may be drawn in monthly installments from the assets of the Fund.
4. In addition to recovering the costs limited to the value of remuneration set forth in paragraph 2 of this Annex, the Central Bank shall receive remuneration for fee associated with future commercial external managers' arrangements.



Annex 3: Settlement Instructions for Earmarked Receipts Account

The following instruction is applicable for transfers in United States dollars to the Petroleum Fund of Timor-Leste:

Bank:	The Federal Reserve Bank of New York 33 Liberty Street New York, NY 10045
SWIFT Code:	FRNYUS33
Account Name:	Banking and Payments Authority of East Timor - Petroleum Fund Account
Account Number/ABA:	021080973
Details:	1. Name of taxpayer 2. Taxpayer Identification Number 3. Details/reference of payment

