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Law No. 12/2011 of 28 September

First amendment to Law No. 9/2005 of 3 August, the Petroleum Fund Law

Preamble

The Petroleum Fund was established in 2005 with the aim of contributing to the effective management of oil resources and a sustainable fiscal policy. Law no. 9/2005 of 3 August will regulate the operational management and investment policy of the Petroleum Fund, including the deposit and management of oil revenues, transfers to the State Budget and the supervisory regime and accountability.

With this law is intended to change the rules and principles of investment, allowing greater flexibility in terms of diversifying the investment portfolio to increase in future investment returns, within a clear definition of the limits exposure to risk.

This Act also hosts the “Generally Accepted Principles and Practices”, also known as “Santiago Principles”, proposed by the International Working Group on “Sovereign Wealth Funds” and represent an effort of international cooperation for the identification of best practices in governance and investment policy, to ensure that Timor-Leste will continue to be an example as regards the management of these funds.

Thus, Parliament has decreed under article 95.1 of the Constitution of the Republic, to become law, the following:

Article 1 Amendments to the Law No 9/2005 of August 3

Articles 2, 5, 9, 11, 12, 13, 14, 15, 16, 17, 20, 24 and 33 of Law No 9/2005 of 3 August, are revised as follows:

“Article 2 Definitions

1. For purposes of this Law, unless the context requires a different interpretation:
 - a) Agreement by Exchange of Notes means
 - i. Agreement by Exchange of Notes between the Government of Australia and the United Nations Transitional Administration in East Timor (UNTAET) in February 10, 2000, or
 - ii. The Agreement for Exchange of Notes between the Government of Timor-Leste and the Government of Australia, May 20, 2002.
 - b) Financial Year means the financial year corresponding to the budgetary year of twelve months between 1 January and 31 December each year.
 - c) Independent Auditor means the internationally recognized auditing firm, hired with the aim of an external audit of government accounts, as precepts in the law of Timor-Leste, until the time when a hierarchy of administrative tax and audit courts is created in Timor-Leste, or thereafter, an internationally recognized auditor, contracted in accordance with Article 34.
 - d) Petroleum authorization means:
 - i. An access authorization, a petroleum contract, a prospecting authorization or a drilling authorization, or any agreement made in respect of such authorization or contract, granted or done under the Petroleum Activities Act, or
 - ii. A permit or production sharing contract, or any agreement made in respect of such authorization or contract, granted or done under the Code;

- e) Central Bank means the authority established under Article 143 of the Constitution of the Republic;
 - f) Code means the Interim Petroleum Mining Code adopted under Article 7 of the Treaty, including any withdrawals, exemptions, modifications and additions that will be made, and the regulations issued thereunder;
 - g) Petroleum Fund means the Petroleum Fund of Timor-Leste established under Article 5;
 - h) Investment Manager means the Operational Manager or person designated as investment manager under Article 12;
 - i) Operational Manager means the Central Bank or other public entity created by Act of Parliament which is given responsibility for operational management of the Petroleum Fund;
 - j) Petroleum Activities Act means Law No 13/2005 of 2 September - Petroleum Activities Act, including any withdrawals, exemptions, modifications and additions that will be, and the regulations issued under its scope;
 - k) Minister means the Minister who is assigned the supervision of public finances;
 - l) Petroleum Operations means petroleum activities authorized under a Petroleum Authorization;
 - m) State Budget means the State Budget which is referred to in Article 145 of the Constitution of the Republic;
 - n) Paying / taxpayer means an entity which has an obligation to make a payment to the Petroleum Fund;
 - o) Parliament means the National Parliament of Timor-Leste;
 - p) Petroleum has the meaning given to it by Law No 13/2005 of 2 September - Petroleum Activities Act;
 - q) Investment Policy means a public statement on the principles that should be subject to the investment, the desired risk profile, asset allocation, the universe of investments, portfolios and benchmarks, or other issues related to general investment policy.
 - r) Petroleum Fund Receipts has the meaning given to it in Article 6;
 - s) Tax Receipts means any tax or duty imposed under the law of Timor-Leste;
 - t) Estimated Sustainable Income in a given financial year means the amount calculated by applying the formula set out in Annex I;
 - u) Timor-Leste means the Democratic Republic of Timor-Leste, and
 - v) Treaty means the Timor Sea Treaty between the Government of Timor-Leste and the Government of Australia signed on May 20, 2002, with the possible withdrawals, exemptions, modifications and additions that have been done.
2. Other terms of the current law which are defined in the national law on Budget and Financial Management should be read with the meanings given to them by that law.

Article 5

Petroleum Fund of Timor-Leste

1. This law establishes a fund known as the Petroleum Fund of Timor-Leste.
2. The Petroleum Fund, including investments made in accordance with the present law, and any accounts for revenues legally earmarked for the Petroleum Fund, and in the custody of any entities a financial nature, including external investment managers, are always titled in the name of the operational manager and, according to a market mandate, move in their name, in strict compliance with Article 15, credited them with petroleum revenues as detailed in Article 6.
3. The Petroleum Fund has no legal personality.
4. Transfers may be made from the Petroleum Fund only pursuant to the terms of Articles 7 to 10.
5. The information and details that identify the single State Budget account referred to in Article 7.1 and

accounts referred to in paragraph 2 of this Article must be made public through the publication of the operational management contract of the Petroleum Fund which is referred to in Article 11.3.

Article 9 **Transfers in excess of the Estimated Sustainable Income**

No transfers from the Petroleum Fund in excess of the Estimated Sustainable Income can be made in any fiscal year unless the Government presents in advance to the National Parliament:

- a) The reports referred to in paragraphs a) and b) of the preceding article;
- b) A report estimating the amount the Estimated Sustainable Income for fiscal years thereafter will be reduced, by virtue of a transfer from the Petroleum Fund which exceeds the Estimated Sustainable Income.
- c) An auditor's report which certifies the estimates of reduction in the Estimated Sustainable Income referred to in paragraph b) of this Article;
- d) Justification of the reasons that it is considered in the long-term interest of Timor-Leste, to transfer an amount greater than the Estimated Sustainable Income.

Article 11 **Fund management**

1. The Government is responsible for overall management of the Fund.
2. The Minister cannot make any decisions concerning the investment strategy and management of the Petroleum Fund without first seeking the advice of the Investment Advisory Board in accordance with Article 16.
3. The Minister contracts with the Operational Manager for the operational management of the Petroleum Fund, which will be responsible to the Government for such management.
4. The Petroleum Fund is managed prudently in accordance with the principles of good governance for the benefit of current and future generations.

Article 12 **External Investment Managers**

1. The Operational Manager may propose to the Minister, on its initiative or at the request of the Minister, the hiring of one or more External Investment Managers who will be mandated, in terms of the contract, the responsibility for managing investments made from the external Petroleum Fund.
2. The Operational Manager may select and contract with one or more external investment managers under the preceding paragraph and pursuant to the following paragraph as soon as the Minister confirms that the following requirements have been met:
 - a) That the External Investment Manager is a legal person with share capital, guarantees and insurance adequate to the operational risks involved;
 - b) That the External Investment Manager has demonstrated an optimum record of operational and financial performance, and
 - c) That the commercial references and international reputation for the external Investment Manager, in the management of financial funds, are of the highest standard.
3. In cases where the External Investment Manager is a national Timor-Leste legal entity, the requirements referred to in b) and c) above may be waived if the Manager satisfies, and the Minister confirms, that the risk of not meeting the criteria outlines above is safeguarded, and the Minister submits the confirmation of the External Investment Manager for approval by the Council of Ministers.
4. Under paragraph 1 of this Article, the Operational Manager will be responsible for international tendering procedures required by the type and amount of the contract, according to the substantive provisions of the

law of Timor-Leste, as well as in the same terms, with respect to any acquisition of additional services under the operational management agreement referred to in Article 11.3.

5. The operational management contract referred to in Article 11.3, signed by the External Investment Manager, shall establish the terms and procedures for terminating the contract.
6. The Investment Manager has a duty to maximize the return on the Petroleum Fund investments, adjusting the portfolio's risk in terms of investment instruments authorized by Article 14 and 15 thereof, the provisions on subsidiary rules, or statements issued by the Minister in the operational management contract referred to in Article 11.3.

Article 13

Quarterly reports on the Petroleum Fund

1. The Operational Manager provides quarterly reports to the Minister on the activities and performance of the Petroleum Fund, according to the benchmarks of the overall investment performance, within 20 working days after the end of each quarter.
2. The Operational Manager ensures the publication of its reports within 40 days from the end of each quarter.
3. The Operational Manager will ensure that, in providing such reports or responding to queries, it takes the appropriate steps to prevent the disclosure of any confidential information.

Article 14

Investment Policy

1. The Minister establishes the investment policy of the Petroleum Fund by applying the principles of portfolio diversification, in order to maximize the financial return on the Petroleum Fund depending on the level of risk assumed, taking into account the purpose of the Fund, the constraints in which it operates and the capacity of Timor-Leste to support risk.
2. The investment policy that has governed the allocation of the portfolio must at all times, integrate liquid assets sufficiently in order to respond immediately to requested transfers to the State Budget or fit the profile of investments depending on the tolerated level of risk.
3. The Minister and the Operational Manager must develop and maintain policies, systems and procedures to ensure identification, monitoring and managing risks associated with implementing the investment strategy.
4. The Petroleum Fund must comply with regulatory obligations, including mandatory publications, which are in force in the market and the country where the investment is made.
5. The Minister presents to the National Parliament a summary of its proposed investment policy of the Petroleum Fund together with the Petroleum Fund Annual Report or before making any decisions involving changes in the allocation of key assets.
6. The Annual Report will also include a public statement about how the provisions of this and the following articles were accomplished during the past year.

Article 15

Investment Rules

1. Under the criteria in this article, to qualify as eligible investment, the investment instrument must be issued or the investment be located abroad, in an internationally recognized jurisdiction.
2. No less than 50% of the Petroleum Fund should be invested in eligible investments in bank deposits or debt instruments that are interest bearing, namely, bonds and other fixed and variable rate debt instruments, or other fixed income assets of equivalent interest and provided that:
 - a) It is determined that the debt instruments have at least an investment grade rating, or
 - b) The deposits are held in financial institutions with credit rating that corresponds to at least

investment grade.

3. No more than 50% of the Petroleum Fund will be invested in eligible investments in the form of variable income securities, namely listed shares, and provided that:
 - a) The investments of equities are traded in regulated financial markets, and
 - b) The participation does not exceed 5% of the capital issued by the issuer.
4. No more than 5% of the Petroleum Fund should be invested in other eligible investments, provided that:
 - a) The Minister has included such other asset class, which is part of the investment, in the proposed distribution of portfolios submitted to the National Parliament under Article 14.5, and
 - b) The rules and criteria for selection, management and evaluation of each individual financial instrument within a certain asset class, have been approved by the Minister and published.
5. The exposure of the Petroleum Fund to:
 - a) Any company or the issuing entity for the eligible instruments, with the exception of sovereign states, can never exceed 3% of the total value of the Petroleum Fund;
 - b) Any asset class should, in net terms, be positive.
6. Without prejudice to Articles 20.1 and 20.2, charges relating to any securities transactions in the market by the Fund or participation in lending transactions of any short-term instruments are not considered liens or encumbrances on the Petroleum Fund, provided they are conducted in accordance with the principles of prudent asset management.
7. A derivative is only qualified as eligible investment if:
 - a) Is used to reduce the risk to the Fund arising from the use of the instrument or instruments underlying the derivative instrument, or to facilitate the desired exposure of an asset is efficiently achieved, and
 - b) The risk arising from the use thereof is not higher than would result from direct exposure to underlying assets which are specified in this Law, and
 - c) The Minister has established conditions for the legality of their operational use.
8. The Minister determines the period during which the Investment Managers have to sell the derivative, when it ceases to be an eligible investment under the amendment of its or its issuer's credit rating.

Article 16 **Investment Advisory Board**

1. An Investment Advisory Board is created, responsible to:
 - a) Prepare benchmarks for the Minister in order to evaluate the performance and return on investments made from the Petroleum Fund and the adequacy of risk;
 - b) Advise the Minister on the instructions given by this investment to investment managers of the Petroleum Fund appointed pursuant to Article 12;
 - c) Advise the Minister on the performance evaluation of External Investment Managers and in this context to make recommendations concerning the adoption or termination of their contracts, and
 - d) Advise the Minister on the need for changes in investment policy or management of the Petroleum Fund;
2. Without prejudice to Article 18, the Minister shall seek the opinion of the Investment Advisory Board before deciding on any matter relating to the investment strategy or management of the Petroleum Fund.
3. Any opinion issued by the Investment Advisory Board, on the investment policy or management of the Petroleum Fund, shall take into account:
 - a) The overall objective that the Petroleum Fund, which consists of revenue earned from the

exploitation of non-renewable petroleum resources, to benefit present and future generations;

- b) The current conditions, opportunities and constraints in investment markets, and the constraints under which the Operational Manager and other relevant institutions in Timor-Leste operate; and
 - c) The need to ensure the adequacy of liquid assets to satisfy, when requested, the transfer referred to in Article 7.
4. The Investment Advisory Board shall adopt its own rules of operation.

Article 17

Structure of the Investment Advisory Board

1. The Investment Advisory Board consists of five or more members appointed by the Prime Minister, on the advice of the Minister, and at least three must have considerable experience in investment management.
2. The Director of the Treasury and a representative of the Operational Manager are entitled to participate, without vote, in meetings of the Investment Advisory Board.
3. The Operational Manager shall act as Secretariat of the Investment Advisory Board and provide all the support that the Board needs for the full exercise of its functions, with the Minister designating the Ministry's representative in this organ.
4. Under paragraph 1 of this article, the order of appointment of members of the Investment Advisory Board determines by law the compensation to which they are entitled.
5. Before taking office, members of the Investment Advisory Board shall submit a written declaration that the appointment has no conflict with other personal or family interests, and the same document, provide a written statement declaring their assets at the date of investiture.

Article 20

Encumbrances on the assets of the Petroleum Fund

1. Any amount that is invested in accordance with Articles 14 and 15 is, independently of the form which is invested, the property of the State of Timor-Leste.
2. By contract or agreement it is possible to encumber the assets of the Petroleum Fund, up to 10% of the total value of the Petroleum Fund as of the date of the creation of the encumbrance or charge, provided that the principles in the general system of creation, issuance and management of public debt are respected.

Article 24

Information contained in the annual report

1. The Petroleum Fund Annual Report is prepared in a form suitable to its prompt dissemination to the public, containing specifically, the following information for the Financial Year:
 - a) Audited financial statements certified by independent auditor, including:
 - i. Documented accountability for expenditure, including investment and revenues;
 - ii. A map of the financial statement and the results of investment, including the list of the market value of instruments eligible for the Petroleum Fund;
 - iii. Details of all appropriations from the Petroleum Fund, including those relating to transfers to the State Budget and
 - iv. Where appropriate, notes to financial statements.
 - b) A report of the Minister, describing the activities of a financial nature developed by the Petroleum Fund in the past year, including all opinions issued by the Investment Advisory Board, any reports prepared by the Independent Auditor under Article 35, and issues or specific matters, which in the opinion of the Minister deserve the care or interest of Parliament;

- c) A report on the investment policy in accordance with the provisions of Article 14.5;
 - d) A statement by the Director of the Treasury on any accounting issues or practices that reading the report has caused, which may affect materially the interpretation of the securities or financial instruments referred to therein;
 - e) Income earned during the financial year from the investment of Petroleum Fund assets, and its comparison with yields obtained in the three immediately preceding years;
 - f) A comparison between the nominal yield obtained with the investment of Petroleum Fund assets with regard to their real income after adjusting for inflation;
 - g) A comparison of nominal income obtained by investing the Petroleum Fund assets with the performance benchmarks that have been referred to, provided to the Minister pursuant to Article 16.1;
 - h) A comparison of the Estimated Sustainable Income for the current financial year with the total transfers from the Petroleum Fund in that year;
 - i) In the event of borrowing by the Government with the corresponding debt guaranteed by this Fund, a contingent liability that is reflected in the report and accounts of the Petroleum Fund in order to be rigorous and show the real financial picture regarding the expected net financial position of assets and savings rate, sovereign wealth; and
 - j) A list of office holders that are relevant to the effective operation of the Petroleum Fund and its performance, including:
 - i. The Minister;
 - ii. The Director of Treasury;
 - iii. Members of the Investment Advisory Board;
 - iv. The external investment managers;
 - v. The President of the entity designated as Operational Manager;
 - vi. Members of the Petroleum Fund Consultative Council.
2. The sources of information indicated in the preceding paragraph, including all reports and statements therein, in whatever form, are to be attached to the Annual Report in their original unedited version.

Article 33 **Payments to the Petroleum Fund Account**

1. For all purposes of the law, an obligation to pay into the Petroleum Fund will only be considered fully complied with, at the time the amount owed has been deposited, free of any conditions, into the single account designated for revenue assigned to the Petroleum Fund.
2. Notwithstanding the preceding paragraph and Article 5.2, the obligation to deposit, free of any conditions, the revenue from the investment of Petroleum Fund assets will be considered fully complied with as soon as this receipt is credited in a bank account held by the Operational Manager assigned to the sole purpose of managing the Petroleum Fund.

Article 2 **Operational Manager**

Reference to the Central Bank in articles 6, 7, 26, 31 and 32 is replaced by Operational Manager.

Article 3 **Republication**

The Petroleum Fund Law, approved by Law No 9/2005 of 3 August, with the changes now introduced, is republished in annex as an integral part of this law.

Article 4 **Entry into force**

This law shall come into force on the day following its publication.

Approved on August 23, 2011

The President of the National Parliament.

Fernando La Sama de Araújo

Promulgated on September 19, 2011.

To be published.

The President of the Republic,

José Ramos - Horta

ANNEX I

CALCULATION OF ESTIMATED SUSTAINABLE INCOME FOR A FINANCIAL YEAR

- I. The Estimated Sustainable Income for a financial year is the maximum amount that may be appropriated from the Petroleum Fund in a given financial year, leaving sufficient resources in the Petroleum Fund for an amount equal to the current value to be withdrawn forever, subject to appropriation in following financial year calculated in accordance with the formula contained in the following paragraphs II and III.
- II. Estimated Sustainable Income for a financial year is calculated according to the following formula:

$$r \times \text{petroleum wealth}$$

where:

r is the estimated real rate of return, on the investments of the Petroleum Fund, assumed to be 3% for the purposes of this calculation.

- III. In this annex, "Petroleum Wealth," is calculated using the following formula:

$$V + \text{valor actualizado } (R_0, R_1, \dots, R_n) = V + \sum_{t=0}^n \frac{R_t}{(1+i)^{t+0.5}}$$

Where: [valor actualizado = "net present value"]

V is the estimated value of the Petroleum Fund at the close of the previous financial year

R0 R1, etc. are published official projections of the expected annual revenues to the Petroleum Fund, minus the amounts obtained in the current financial year (**R0**) and in future financial years (**R1, etc.**) related to return on investment

i is the nominal yield estimated long-term to the current portfolio of investments for the Petroleum Fund, according to their terms.

n Number of years estimated for the exploitation of sovereign petroleum resources, after which that source of revenue to the Petroleum Fund is exhausted.

The wealth will be calculated at the beginning of the financial year, assuming that revenues will be received mid-year.

- IV. The assumptions on which these calculations are made in paragraphs II and III above shall be clearly stated and explained, and in subsequent calculations, any changes in such assumptions must be clearly stated and explained.
- V. The assumptions made, without exception, shall be prudent, reflecting international best practice and based on internationally recognized norms.
- VI. The amount determined in accordance with the formula contained in paragraphs II and III above shall be certified by an Independent Auditor.