Annex 1: Qualifying Instruments, Benchmarks and Investment Mandate

Amendment No.15

The Management Agreement between the Ministry of Finance and Banco Central de Timor-Leste is hereby modified by replacing Annex 1 with the following. Implementation will start on 1 July 2021.[1]

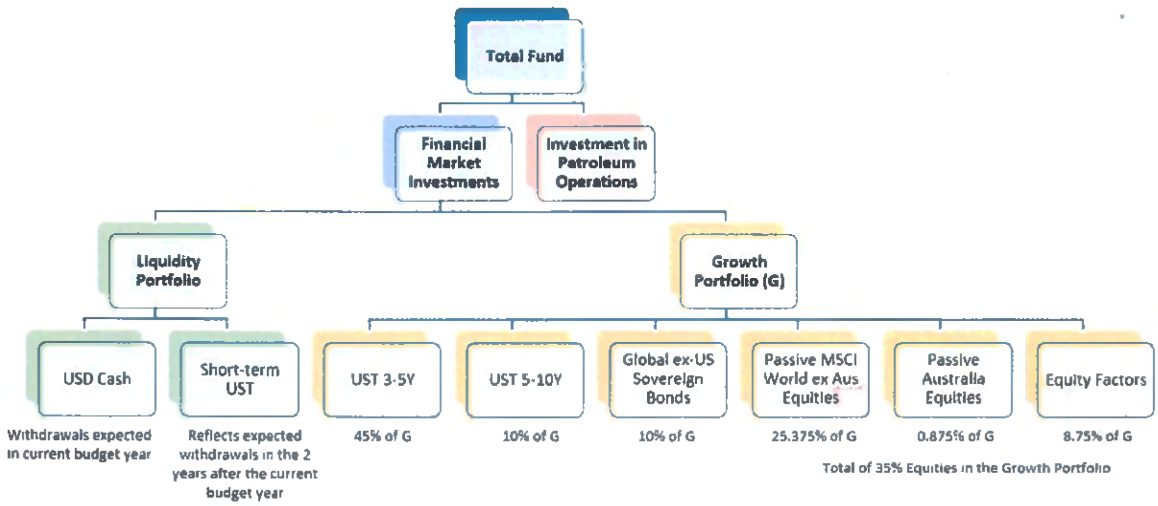
This mandate has a hierarchical structure. The Global Mandate in Section 1 describes the Minister's overall investment strategy for the Petroleum Fund in terms of the portfolios, asset allocations, benchmarks, and eligible instruments, including applicable constraints and limitations. It also specifies the transfer rule and rebalancing policy to be applied by the BCTL.

Section 2 describes in more detail the manner in which the Minister expects the Fund's investments to be implemented. It describes the Individual Mandates to be implemented by the BCTL, including, where appropriate, the benchmark against which the performance of each individual mandate shall be measured and reported, the style of investment management, expected performance and risk tolerance, as well as the approved managers.

1. Global Mandate

The Central Bank of Timor-Leste is responsible for the operational management of the aggregate Fund according to the following Global Mandate, which is illustrated in Figure 1.

Figure 1: Overview of the Global Mandate



[1] It may take up to two weeks to fully implement the changes in Amendment No. 15. Performance of the aggregates and individual mandates may deviate from the benchmark during this transition period.

1.1 Composition of the Global Mandate

The Petroleum Fund's investments are divided into two categories:

1. Investment in Petroleum Operations.

The Petroleum Activities Law was amended by Parliament in 2019 to allow the 5% allocation in "other eligible investments" provided for in Article 15.4 of the Petroleum Fund Law to be applied to investments in petroleum operations in national territory or abroad.

The Petroleum Fund entered into loans totalling $650 million with Timor Gap E.P. and its subsidiaries in April 2019. The 5% exposure limit in Article 15.4 of the Petroleum Fund Law applies to this investment as well as any "other eligible investments" executed in the future in accordance with the process required by Article 15.4. Any additional investment in petroleum operations would need to be approved by the Minister of Finance.

2. Financial Markets Investments.

The Fund's Financial Market Investments are invested in offshore, financial assets - namely, fixed interest securities, listed equities and other eligible investments - that meet the criteria in the Petroleum Fund Law.

The holdings in Financial Market Investments are divided into a Liquidity Portfolio and a Growth Portfolio.

i) Liquidity Portfolio

The purpose of the Liquidity Portfolio is to fund the expected withdrawals from the Petroleum Fund over the next three years. The projections for withdrawals and the size of the Liquidity Portfolio are provided by the Ministry of Finance in the first quarter of each year, as described in Section 1.4.

The Liquidity Portfolio is comprised of two mandates, USD Cash and US Government Short-term Treasury Notes, which are described in Table 1.

Table 1: Composition of the Liquidity Portfolio

Mandate	**Allocation**	**Benchmark**
USD Cash	Dollar value set at the beginning of each year equal to the expected withdrawals for the current budget year	ICE Bank of America Merrill Lynch 3 Month US Treasury Bill Index
US Government Short-term Treasury Notes	Remainder of the Liquidity Portfolio	ICE Bank of America Merrill Lynch 1-3 Year US Treasury Index

The USD Cash mandate finances the Government's withdrawals during the year.

ii) Growth Portfolio

The Growth Portfolio is the residual value in Financial Market Investments after deducting the value of the Liquidity Portfolio.

The Growth Portfolio follows the allocations and benchmarks specified in Table 2.

Table 2: Composition of the Growth Portfolio

Asset class	Allocation	Benchmark
US Government Treasury Notes 3-5 Years	45%	ICE Bank of America Merrill Lynch 3-5 Year US Treasury Index
US Government Treasury Notes 5-10 Years	10%	ICE Bank of America Merrill Lynch 5-10 Year US Treasury Index
Global Developed Market Sovereign Bonds, Hedged	10%	Bloomberg Barclays Global Treasury Developed Market ex US, 10% Country and 30% Eurozone Capped. Measured on a hedged basis
Developed Market Equities	35%	MSCI World Index Net Dividends Reinvested

1.2 Performance reporting and aggregate benchmarks

The BCTL shall report the realised performance of:

- i) The Total Fund;
- ii) The Financial Market Investments (FMI), comprised of the Liquidity and Growth Portfolios;
- iii) The Liquidity Portfolio;
- iv) The Growth Portfolio;
- v) The investment in Petroleum Operations; and
- vi) The other individual mandates described in Section 2.

The corresponding benchmark performance is to be calculated according to Table 3.

Table 3: Aggregate benchmarks

	Benchmark
The Total Fund	Composite of the aggregate benchmark for FMI and the benchmark for Investments in Petroleum Operations with monthly weights calculated according to market values at the end of the prior month.
Financial Market Investments (FMI)	Composite of the aggregate benchmarks for the Liquidity and Growth Portfolios with monthly weights calculated according to market values at the end of the prior month.
Liquidity Portfolio	Composite of the benchmarks of the USD Cash and US Short-term Treasury mandates with monthly weights calculated according to actual market values at the end of the prior month.
Growth Portfolio	Composite of the asset class benchmarks with monthly rebalancing to the fixed weights specified in Table 2.
Investment in petroleum operations and the other individual mandates	Benchmarks specified in each individual mandate (Section 2).

1.3 Eligible Instruments

The Eligible instruments are specified in the Petroleum Fund Law, which can be summarised as follows:

Asset Class	**Allocation**
A. Qualifying Fixed Interest Investments under Article 15.2 of the Petroleum Fund Law	Up to 100% but no less than 50%
B. Equity Instruments meeting the conditions in Article 15.3 of the Petroleum Fund Law	No more than 50%
C. Qualifying other investments under Article 15.4 of the Petroleum Fund Law. Article 15.4 is to be read in conjunction with the Petroleum Activities Law, which was amended in 2019 to allow for investments in Petroleum Operations in national territory or abroad.	No more than 5%

The exposure limits in the Petroleum Fund Law relate to the percentage weights in the Total Fund.

Eligible currencies shall be determined by the composition of the benchmark indices unless otherwise specified in the Individual Mandates in Section 2.

External Managers are permitted to use derivative instruments as specified in the Individual Mandates and in compliance with Article 15.7 of the Petroleum Fund law.

An investment that was eligible when acquired but which subsequently becomes ineligible may continue to be held for a period if an immediate sale is not practicable or is not in the best interests of the Petroleum Fund. The BCTL shall notify the Ministry of Finance in that event and outline the plans for disposal.

1.4 Transfer rules and rebalancing

Projections for the next three years of expected withdrawals and instructions on the size of the Liquidity Portfolio will be provided in writing by the Ministry of Finance to the BCTL as early as possible in the first quarter of each year. Upon receipt of the instructions, the BCTL shall then:

- Transfer an amount from the Growth Portfolio to the Liquidity Portfolio so that the Liquidity Portfolio equals the amount instructed by the Ministry of Finance.
- Rebalance the Growth Portfolio towards the target weights specified in Table 2 when financing the transfer to the Liquidity Portfolio.
- Adjust the Liquidity Portfolio so that the size of the Cash Mandate equals the withdrawals in the current budget year.

In the event that the budget law is not promulgated and published in the *Jornal da República* by the end of March, the Ministry of Finance will provide instructions on the size of the Liquidity Portfolio based on its best estimates of withdrawals. If instructions are not received by the end of March, the BCTL shall notify the Minister of Finance in writing that the Growth Portfolio will be rebalanced towards the target weights in Table 2 starting in the first week of April.

During the year, government withdrawals are financed from the Cash Mandate. Where the Cash Mandate is exhausted, the Short-term US Treasury mandate may then be used.

When instructing the BCTL on the amount to be transferred each year, the Ministry of Finance will apply the following rules:

Growth portfolio's annual return in the prior year equals 0-6%: transfer 100% of the Shortfall

Growth portfolio's annual return in the prior year is negative: transfer 50% of the Shortfall

Growth portfolio's annual return in the prior year is greater than 6%: transfer 150% of the Shortfall

where the Shortfall = 3 years of expected withdrawals – Value of the Liquidity Portfolio at year-end.

2. Individual Mandates

2.1 Financial Market Investments - Liquidity Portfolio

Liquidity Portfolio: MANDATE 1

Asset Class	**USD Cash**
Allocation	The Ministry of Finance instructs the BCTL on the initial value of the mandate at the start of each year according to Section 1.4. The initial allocation equals the withdrawals expected in the current budget year. The mandate finances government withdrawals during the year.
Benchmark	ICE Bank of America Merrill Lynch 3 Month US Treasury Bill Index (Bloomberg code "G0O1 Index")
Eligible Instruments	US Dollar denominated deposits or debt instruments with a maturity of less than one year and a minimum credit rating of investment grade or equivalent. This includes US Government Treasury bills; US Government Treasury bonds; securities issued by supranationals; repurchase agreements and deposits with banks having an S&P short-term issuer rating of A-1 or equivalent; and deposits with the Bank for International Settlements (BIS) and securities issued by the BIS.
Mandate Objective	The primary objective is to fund withdrawals by the Government as they are required. The composition shall account for the withdrawal projections provided by the Ministry of Finance's Treasury Department. The mandate is also used to meet the Petroleum Fund's management expenses and receives petroleum receipts.
Approved Manager	Banco Central de Timor-Leste

Liquidity Portfolio: MANDATE 2

Asset Class	**US Government Short-term Treasury Notes**
Allocation	The Ministry of Finance instructs the BCTL on the initial value of the mandate at the beginning of each year. The initial allocation reflects expected withdrawals in the two years that follow the current budget year as specified in Section 1.4.
Benchmark	ICE Bank of America Merrill Lynch 1-3 Year US Treasury Index (Bloomberg code "G1O2 Index")
Eligible Instruments	US Government fixed interest instruments with maturities of 0-5 years. BIS instruments (FIXBIS and Medium-Term Instruments) with maturities of 0-5 years. Other eligible instruments in the USD Cash mandate.
Mandate Objective	The objective is to finance the expected withdrawals in the two years that follow the current budget year by investing in low-risk assets. The composition of the mandate may need to depart from the benchmark index after accounting for the timing and size of expected withdrawals in the following two years. The manager also has the discretion to account for yield differentials.
Approved Manager	Banco Central de Timor-Leste

2.2 Financial Market Investments - Growth Portfolio

Growth Portfolio: MANDATE 1

Asset Class / Management Style	**US Government Treasury Notes 3-5 years/ Passive**
Allocation	45% of the value of the Growth Portfolio.
Benchmark	ICE Bank of America Merrill Lynch 3-5 Year US Treasury Index (Bloomberg code "G2O2 Index")
Eligible Instruments	US Government fixed interest instruments
Mandate Objective	The investment objective shall be to passively manage the portfolio close to the benchmark. The indicative tracking error shall be less than 25 basis points. The difference in the modified duration between the portfolio and the benchmark shall be less than 0.2 years.
Approved Manager	Banco Central de Timor-Leste

Growth Portfolio: MANDATE 2

Asset Class / Management Style	**US Government Treasury Notes 5-10 years/ Passive**
Allocation	10% of the value of the Growth Portfolio.
Benchmark	ICE Bank of America Merrill Lynch 5-10 Year US Treasury Index (Bloomberg code "G6O2 Index")
Eligible Instruments	US Government fixed interest instruments
Mandate Objective	The investment objective shall be to passively manage the portfolio close to the benchmark. The indicative tracking error shall be less than 50 basis points. The difference in the modified duration between the portfolio and the benchmark shall be less than 0.2 years.
Approved Manager	Banco Central de Timor-Leste

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Internal Reporting	BCTL will provide quarterly performance reports for the mandate to the Ministry of Finance.

Growth Portfolio: MANDATE 3

Asset Class / Management Style	**Global Developed Market Sovereign Bonds / Enhanced Passive**
Allocation	10% of the value of the Growth Portfolio.
Benchmark	The benchmark is a composite benchmark rebalanced at the end of each month to the following weights: (a) 90% -- the Bloomberg Barclays Global Treasury Developed Market ex-US 30% EUR 10% country cap Total Return Index Hedged USD (Bloomberg code: H30453US Index) (b) 10% - the ICE Bank of America Fed Funds Effective Rate Index (Bloomberg code: LFFE Index). The base currency for valuation and performance reporting will be USD.
Eligible Instruments	Securities (including inflation linked securities) issued by any sovereign issuer included in the Benchmark or the US Department of Treasury (collectively, "Sovereign Issuers"); securities issued by any international organisation, Sovereign Issuer-related sub-sovereign issuer or agency that is rated at least AA- (or its equivalent); bond futures contracts, provided the underlying securities are issued by a Sovereign Issuer; interest rate futures in any Authorised Currency; foreign exchange spot, forward and swap transactions in any Authorised Currency; cash balances and deposits in Authorised Currencies with the Approved Manager and the Custodian. Assets included in the portfolio may be denominated in Authorised Currencies. "Authorised Currencies" are currencies in which instruments in the Benchmark are denominated and the United States Dollar. The minimum rating eligibility threshold shall be determined using the ratings of the applicable issuer available from

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Standard & Poor's, Moody's Investors Service and Fitch Ratings, where the lower of the two highest ratings applies. If a rating is only available from one of the three rating agencies, this single rating will apply.

Mandate Objective

The portfolio shall be managed in an enhanced passive indexing style.

The target *ex-ante* tracking error of the portfolio with the benchmark shall be less than 50 basis points

The expected outperformance of the portfolio gross of management fees is 15 basis points over the benchmark performance, on an annual basis over a rolling three-year period.

Approved Manager

Bank for International Settlements

Growth Portfolio: MANDATE 4

Asset Class / Management Style	**MSCI Developed Market ex Australia Equities / Passive**
Allocation	25.375% of the value of the Growth Portfolio.
Benchmark	MSCI World Index ex Australia Net Dividends Reinvested (Bloomberg code "NDDUWXA Index").
Eligible Instruments	All securities in the benchmark index, securities expected to be in the benchmark index within the next 3 months, securities that were in the benchmark index in the preceding 3 months, cash instruments, equity index futures and currency forwards.
Mandate Objective	The portfolio shall be managed in a passive indexing style with the objective to seek to closely match the Performance Benchmark, and maintained within an *ex ante* tracking error relative to the benchmark that does not normally exceed 35 basis points. The tracking error shall be reviewed at the end of each month, and if it should exceed 35 basis points, the manager shall reduce the tracking error within 30 days.

Approved Managers	State Street Global Advisors BlackRock Investment Management

Growth Portfolio: MANDATE 5

Asset Class / Management Style	**MSCI Australian Equities / Passive**
Allocation	0.875% of the value of the Growth Portfolio.
Benchmark	MSCI Australia Index Net Dividends Reinvested (MXAU) (Bloomberg code "NDDUAS Index").
Eligible Instruments	All securities in the benchmark index, securities expected to be in the benchmark index within the next 3 months, securities that were in the benchmark index in the preceding 3 months, cash instruments, Australian exchange traded funds and currency forwards.
Mandate Objective	The portfolio shall be managed in a passive indexing style with the objective to seek to closely match the Performance Benchmark. The indicative tracking error shall be less than 50 basis points.
Approved Manager	Banco Central de Timor-Leste

Growth Portfolio: MANDATE 6

Asset Class / Management Style	**Equity Factors**
Allocation	8.75% of the value of the Growth Portfolio.
Benchmark	MSCI World ex Australia Index Net Dividends Reinvested. (Bloomberg code "NDDUWXA Index"). This applies for each manager and also the mandate's aggregate benchmark.
Eligible Instruments	Developed market listed equities ex Australia, cash instruments, equity index futures and currency forwards.

Mandate Objective	The investment objective is to obtain exposure to a combination of the following systematically rewarded equity factors: Value, Quality (which includes Profitability), Low Volatility and Size. The mandate's residual exposures to sectors and countries relative to the benchmark are to be constrained. The *ex-ante* tracking error for the aggregate equity factor mandate is expected to be less than 300 basis points.
Approved Managers	State Street Global Advisors Schroders Investment Management Limited
Internal reporting	The BCTL shall provide the Ministry of Finance and the Investment Advisory Board quarterly reports showing the performance of the managers and the aggregate mandate relative to the benchmark. The quarterly reports shall include the factor exposures of each manager and the aggregate mandate using agreed style analysis tools. Residual, non-factor exposures such as relative exposures to sector and countries are also to be reported.

2.3 Other eligible investments – Investment in petroleum operations

Other eligible investments: MANDATE 1

Asset Class	**Private debt instrument for Petroleum Operations**
Allocation	Up to 5% of the value of the Fund, according to the Petroleum Fund Law. This investment is separate from the Financial Market Investments Portfolio.
Key investment terms	Private debt instruments with Timor Gap, E.P. or its wholly owned subsidiaries. Interest rate of 4.5% p.a. 18 years maturity. No repayments during the first 8 years.

	Amortized over the following 10 years.
Benchmark	Contracted interest rate of 4.5% p.a.
Eligible Instruments	Private Debt Instrument issued by Timor Gap, E.P. or its wholly owned subsidiaries for Investments in Petroleum Operations through Timor Gap, E.P. according to the Petroleum Activities Law No. 13/2005 as amended by Law No. 1/2019. Timor Gap E.P.'s investments are governed by the Rules and Criteria approved by the Ministerial Diploma No.4/2019, as of 1 March.
Mandate Objective	Financing the acquisition by the State of participating interests in Petroleum Operations. The financial return from the Petroleum Fund's investment accounts for the development objectives listed in the Rules and Criteria approved by the Minister of Finance.
Approved Manager	Banco Central de Timor-Leste

Dili, 30 June 2021

GABINETE DO MINISTRO
MINISTÉRIO DAS FINANÇAS
MINISTRO

Rui Augusto Gomes
Minister
Ministry of Finance

Abraão de Vasconcelos
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