

PETROLEUM FUND TIMOR-LESTE

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INVESTMENT ADVISORY BOARD (IAB)

IN 2009

La'o Hamutuk converted this file to text from the scanned version released by the Ministry of Finance and improved graphic quality. Some typographical errors are in the original and we may have added a few more.

For more information on Timor-Leste's Petroleum Fund, see
<http://www.laohamutuk.org/Oil/PetFund/05PFIndex.htm>

For more information on revising Timor-Leste's Petroleum Fund Law, see
<http://www.laohamutuk.org/Oil/PetFund/revision/10PFRevision.htm>

Investment Advisory Board

Date: 18th September 2009

To
H.E. Mrs. Emilia Pires
Minister of Finance
Democratic Republic of Timor-Leste

Subject: Request for an advice on depositing part of the Petroleum Fund in cash

- Dear Minister,

The Investment Advisory Board acknowledges receipt of your letter dated 15 September 2009 requesting the Board's opinion on a proposal to deposit USD1.2 billion in an account at the Hong Kong & Shanghai Banking Corporation (HSBC) in connection with an arrangement with Asian Champ Investment Ltd (ACI) described in ACI's letter dated 15 September 2009 signed by Datuk Edward Ong, whereby the Petroleum Fund would receive a return of 7.5% for one year.

The Investment Advisory Board takes this opportunity to thank the Minister for seeking the Board's advice, and advises the Minister to continue to act with the highest vigilance.

Although the Board cannot, for the reasons outlined below, recommend the acceptance of the proposal, the Board suggests that the Minister request the Banking & Payments Authority to confirm the assumptions on which the Board's conclusion was reached.

The Board has reached its recommendation taking the following matters into account:

- From the wording of the prospectus, in particular the introduction and item (i) and (ii), it is clear that Asia Champ Investments Ltd. is a party to the transaction. From items (ii) and (iii) it is understood that it is this company that promises the payment of 7.5% return and not HSBC.
- The Board has been unable to verify the existence of Asia Champ Investments Ltd in the Singapore online companies registry, and ACI has no internet presence of any kind. Although the proposed arrangement is not a formal appointment of ACI as an external manager, nor presented as an investment in ACI despite their promise of a return, it nonetheless associates ACI with the management of a significant portion of the Petroleum Fund, and therefore the law should be drawn on for guidance. The limited evidence available to the Board suggests that ACI falls far short of the conditions outlined in Article 12.2 of the Petroleum Fund law.

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- The Board notes that the interest rate of 7.5% for a one-year USD deposit is considerably in excess of market rates for cash deposits at highly rated institutions, which as of September 15 2009 are in the range from 0.6% to 1.3%. Thus, the IAB finds it very likely that the proposal contains risks not appropriately reflected in the ACI proposal.
- Although a specific branch of HSBC is mentioned as the depository, the ACI proposal contains no evidence to suggest that HSBC has agreed to be party to the proposed arrangement or to underwrite the risks associated with it. For this and the reasons stated above, the Board is of the opinion that the risks of the proposed investment are with ACI. On this presumption, the investment does not meet the investment criteria set out in Article 15 of the Petroleum Fund law.
- In the rather unlikely event that HSBC actually is the only counterpart in this proposal and is the provider of 7.5% return on a standard cash deposit, the time frame of the proposal (15 days), would normally not be sufficient to conduct a due diligence process on that firm in accordance with acceptable international standards of operational management.
- The documentation provided to the Board appears to describe arrangements under which ACI will have no access to the funds and therefore no opportunity to make a commercial profit, let alone sufficient to justify the agreed level of interest. Bearing in mind that the proposal refers to a bank account mandate, the details of which have not been provided, the Board infers that the proposed account mandate may be drafted in a manner that permits the deposit to be used as collateral for third party business arrangements. Should this be the case, the Board believes that such an arrangement would place an encumbrance on the assets in contravention of Article 20 of the Petroleum Fund law.
- The Board notes, without making any inference about the motives of the parties involved in the ACI proposal, that worldwide there have been a number of reported cases where institutional investors have fallen prey to fraudulent schemes under arrangements involving apparently secure deposits in “blocked accounts” at reputable banks, higher than market interest rates, a rapid decision-making process, and little if any documentation concerning the parties making the offer.

The IAB is of the opinion that all explicit investment decisions in the Petroleum Fund should be institutionalized, that is, the investment strategy should be determined by the Ministry of Finance and all implementation issues, including the selection of counterparties and choice of individual investments, should be managed by the operational manager of the fund in accordance with the procedures established in the Petroleum Fund law and the Management Agreement.

If in the future investment opportunities arise which are not within the existing investment policy, the Board suggests that the appropriate response would be to review the investment strategy before considering specific investment proposals.

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In light of the various uncertainties inherent in the matters listed above, adherence to due process is seen as necessary to generate supporting-documentation with evidence that a proper analysis and due diligence of proposed investments and the counterparties associated with the management of Petroleum Fund assets has been undertaken.

A handwritten signature in black ink, appearing to read "Olgario de Castro". The signature is fluid and cursive, with a prominent initial "O" and a long, sweeping tail.

Olgario de Castro
Investment Advisory Board
Chairman