Timor-Leste Petroleum Fund

Discussion of sovereign wealth fund models
Petroleum Fund Management Seminar

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May 2010

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Sovereign Wealth Fund models

	Contingent	Fixed	Mixed	Open-ended
What?	Stabilisation funds set up to smooth out budget revenues / expenditures, sterilise excess liquidity and protect the economy from overheating	Funds set up to meet a fixed liability of the sovereign 20 to 30 years out into the future. Liability is typically projected shortfall in public pension systems.	Endowment type future-generation funds. Liabilities are contractual obligations to make regular transfer into the budget, but the funds are open-ended at the same time.	Investment authorities and corporations. They do not have readily identifiable or contractually defined obligations. There are no spending rules or liability shortfall targets.
Investment management style	Very constrained due to volatile and unpredictable liabilities	Very flexible at inception, but much more constrained as they mature	Less flexible at inception, but becomes less constrained as time goes by	Very flexible, with long investment horizon and greatest capacity for risk-taking
Examples	Trinidad and Tobago's Heritage and Stabilisation Fund	Australia's Future Fund	Norway and Russia	Singapore's GIC and Temasek

- The Timor-Leste Petroleum Fund is closest in nature to the mixed SWF type, making Norway and Russia's operating models the most appropriate as case studies (these examples are also appropriate as the primary source of revenue to the Norwegian and Russian SWFs is receipts from petroleum operations)
- Operating models for SWFs are not static and evolve over time depending on various factors. For example, Norway and Russia's models changed in 2006 and 2009 respectively due to pension reforms in these countries.

Evolution of Russia's operating model

In 2004

- The Oil Stabilisation Fund was established to accumulate oil tax and duty revenues, and finance the federal budget deficit
- **Transfer rule:** Allowed if the Fund size is above RUR 500 bn, the transfer size was subject to federal budget law for the fiscal year
- **Allowable assets:** Sovereign and AAA-rated debt with maturity of 0.25 to 3 years and denominated in USD, EUR and GBP. Domestic assets not allowed.

In 2009

- The Reserve Fund replaced the Oil Stabilisation Fund, and the National Wealth Fund was created to co-finance voluntary pension savings.
- Sources of revenues to the funds were expanded to include revenues from gas and oil products.
- **Transfer rule:** Prioritised above target Fund size, the transfer size is linked to future target inflation and expressed in terms of GDP
- **Allowable assets:** For the Reserve Fund, similar to those of Oil Stabilisation Fund but with a lower threshold credit rating and longer maturities allowed. For the National Wealth Fund, similar to those of the Reserve Fund but extended to include domestic assets (including equities and currency).

- The change in operating model was triggered by the introduction of a voluntary employee savings program on 1 January 2009. The program proved to be popular among employers as it does not need special infrastructure or a pensions committee.
- Norway was used as case study in the development of the new Russian model due to its significant oil revenues and well-developed social security system

Russia's current operating model

- The following diagram shows how accumulated oil and gas revenue is distributed, in order of priority

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Federal Office stipulates target transfer size as well as uses and spending for both funds in federal regulations as part of federal budget assets.

Ministry of Finance is responsible for transfer management and funds accumulation.

Petroleum revenues in excess of budget transfer are paid into the Reserve Fund until maximum size reached

Residual petroleum revenues transferred to National Wealth Fund

4.5% GDP in 2010

Also considers desired level of inflation to decide percentage

Oil & Gas Transfer to federal budget

Used to meet federal budget deficit in the corresponding fiscal year. Transfer amount reducing to 3.7% of GDP for 2011 onwards.

Fund size capped at 10% GDP

At the moment funded to nearly 1/3 of the desired size

Reserve Fund (USD 52.9 bn at 1/4/2010)

Used to maintain federal budget balance in the event of a decline in petroleum revenues and for early foreign national debt repayment

Approx. 6-7% GDP

Maximum level of liquidity reserve to pay matching savings contributions

National Wealth Fund (USD 89.6 bn at 1/4/2010)

*Used to co-finance citizens' voluntary pension savings and to reduce deficit in the Pension Fund of the Russian Federation**

** PFRF offers pay-as-you-go and savings pension to Russian citizens, funded by employers. The new initiative (to fund additional pensions by employees and matching contributions paid by the state) is planned for the next 10 years and should be supported by the NWF.*

Comments on Russia’s operating model

- The annual transfer to the federal budget under the Russian model is similar in concept to Timor-Leste’s Estimated Sustainable Income
  - The difference is that under the Russian model, the transfer is set at a % of GDP, whereas in the case of Timor-Leste the transfer is set as a % of total Petroleum Wealth
  - Under the Russian model the maximum transfer from the Reserve Fund is specified in the federal budget law, similarly the maximum transfer from the Timor-Leste Petroleum Fund is specified in the Petroleum Law
- The Russian model has established two separate funds for two different purposes – one to “smooth out” variations in annual petroleum revenues to ensure a more stable level of spending through the federal budget, and one to finance retirement savings for individuals
  - Timor-Leste does not yet have a well established national savings system, therefore the first objective is the key priority and in our view there is at this stage no compelling reason to operate multiple sovereign wealth funds within Timor-Leste
- The universe of allowable investments for the Russian Reserve Fund is similar to that for the Timor-Leste Petroleum Fund under the current Petroleum Fund Law (although the Petroleum Fund is permitted a small allocation to non-fixed interest investments)
  - We note that under the proposed amendments to the Petroleum Fund Law the Petroleum Fund will have greater scope to invest in a wider range of assets, however we view this as a necessary evolution of the investment strategy if the Petroleum Fund is to be able to sustainably provide for ESI at a level of 3% of Petroleum Wealth
- We can conclude that Timor-Leste’s Petroleum Fund has a similar purpose and is operated on principles consistent with that of the Russian SWF model

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