

# Trust Funds in the Pacific: Operation and Performance Update

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Christopher Edmonds, Senior Economist  
presenting upon behalf of coauthors R. Boumphrey and R. Francisco

- Types of Funds:  
Resources and Uses
- Best practices in fund mngt.
- Governance & Performance
  - Performance Indicators
  - Funds during the GEC 2008-09
  - Issues in selected funds
- Final points and questions

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**Basics -- who, what, how, and why**

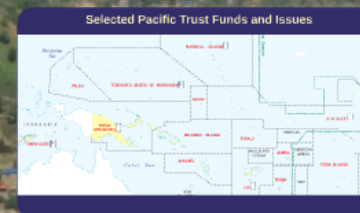
Donor  
Trust Fund  
Government  
Private Sector  
Civil Society  
Beneficiaries

**Internationally Accepted Best Practice: Santiago Principles**  
Performance of selected Pacific Funds

Seven basic areas of the 31 Santiago Principles

1. Legal framework
2. Governance and policy process - clearly defined and publicly disclosed
3. Domestic institutional arrangements
4. Investment policy and management
5. Disbursement framework
6. Fund structure and fund conditions, statutory and public responsibility
7. Transparency in TFF operations

Donor  
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**Closing questions**

Bar chart showing three bars of increasing height.

- **Types of Funds:  
Resources and Uses**
- **Best practices in fund mngt.**
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  - **Funds during the GEC  
2008-09**
  - **Issues in selected funds**
- **Final points and questions**

## Basics -- who, what, how, and why

### Types of Trust Funds by Principal Purpose

1. **Endowments or true trust funds** are invested in financial markets and only returns on investments can be withdrawn for beneficiaries' use according to the fund's distribution policy

2. **Revolving funds** have limited or conditional terms and the principal capital of a revolving fund is usually not held in perpetuity. It is consumed along with any investment income, and requires periodic replenishment until dissolution. Dissolution is typically triggered once the predetermined goals or conditions stipulated in the terms of the fund are satisfied.

3. **Sinking funds** are pools of funds drawn down over the pre-determined and fixed time period stipulated in the terms of the trust.

Each of these funds is referred to as a "trust" because they involve transferring (or entrusting) responsibilities over the management and use of funds to trustees.

## Management Structures

Three main parties: (i) **Trustors**, also known as grantors or donors, provide resources, (ii) **Trustees** are legally responsible for managing the trust fund's assets, and (iii) **beneficiaries**, or the economic entities entitled to the trust's income and/or principal.

Trustees usually hire and monitor various service providers (e.g., investment advisors and managers, fund custodians, auditors) whose expertise is needed to manage, monitor, and administer trust funds.

### Goals of Trust Funds

- **Inter-temporal (incl. Intergenerational) saving and wealth transfer**
  - Ensuring transfers of income over time
  - Saving for retiree old age income
- **Source of funds for addressing fiscal resource gaps encountered when government revenues (e.g., revenues linked to falling global prices) or expenditure needs (e.g., disaster recovery) fluctuate**
  - Providing a hedge against risks in public financial management
  - Facilitate longer-term fiscal planning
- **Account in which to hold foreign assistance**
  - Promoting long-term budgetary self-reliance
- **Foster macroeconomic stability**
  - Minimize adverse macroeconomic effects of "booms"

### Accepted Objectives for Funds

- (i) To help maintain a stable global financial system and free flow of capital and investment;
- (ii) To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;
- (iii) To invest on the basis of economic and financial risk and return-related considerations; and
- (iv) To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.

| Country          | Domestic Contributions<br>(1950–present) | United States<br>Recesses | Other Sources |
|------------------|--|---------------------------|---------------|
| Cook Islands     | Domestic contributions<br>(1950–present) | —                         | —             |
| Fiji             | Domestic contributions<br>(1950–present) | —                         | —             |
| Maldives         | Domestic contributions<br>(1950–present) | —                         | —             |
| Marshall Islands | Domestic contributions<br>(1950–present) | —                         | —             |
| Norfolk Island   | Domestic contributions<br>(1950–present) | —                         | —             |
| Pitcairn Islands | Domestic contributions<br>(1950–present) | —                         | —             |
| Samoa            | Domestic contributions<br>(1950–present) | —                         | —             |
| Tonga            | Domestic contributions<br>(1950–present) | —                         | —             |
| Vanuatu          | Domestic contributions<br>(1950–present) | —                         | —             |

| Country          | Source of Funding                                |  |  |
|------------------|--|--|--|
|                  | Pension Contributions                            | Mineral Resources                                      | Other Sources                              |
| Papua New Guinea | Markham's Super (1964 = continuing)              | Mineral Resources<br>Solidification Fund (1974 = 2000) |  |
| Samoa            | Samoa National Provident Fund (1972 = present)   |  | —  |
| Timor-Leste      | —  | Petroleum Fund of Timor-Leste (2002 = present)         |  |
| Tonga            | —  |  | Tonga Trust Fund (1988 =)                  |
| Tuvalu           | Tuvalu National Provident Fund (1974 = present)  |  | Tuvalu Trust Fund (1987 = present)         |
| Vanuatu          | Vanuatu National Provident Fund (1916 = present) |  | Endeavour Trust Fund (2000 1999 = present) |

Table 2: Assets, Income, and Expenses of Selected Pacific Trust Funds

| Item                      | FNFP             |         | Nambawan       |         | Petroleum Fund  |          |
|---------------------------|------------------|---------|----------------|---------|-----------------|----------|
|                           | 2013             | 2014    | FY2013         | FY2014  | 2013            | 2014     |
|                           | (% of assets)    |         | (% of assets)  |         | (% of assets)   |          |
| Net Income                | (3.2)            | (2.0)   | 8.5            | 7.8     | 5.8             | 3.0      |
| Income                    | 6.4              | 5.2     | 10.2           | 10.3    | 5.9             | 3.2      |
| Expenses                  | 9.6              | 7.3     | 1.7            | 2.4     | 0.1             | 0.2      |
| Management/administration | 9.7              | 7.0     | 1.3            | 1.8     | 0.1             | 0.1      |
| Withholding tax           | (0.1)            | 0.3     | 0.4            | 0.6     | 0.0             | 0.1      |
|                           | (in F\$ million) |         | (in K million) |         | (in \$ million) |          |
| Assets                    | 4,172.8          | 4,528.4 | 4,810.2        | 4,323.9 | 14,952.1        | 16,538.6 |
| Net Income                | (135.2)          | (92.8)  | 409.5          | 338.2   | 864.9           | 501.6    |
| Income                    | 266.1            | 237.7   | 491.2          | 443.7   | 879.5           | 527.4    |
| Expenses                  | 401.3            | 330.5   | 81.8           | 105.5   | 14.6            | 25.8     |
| Management/administration | 406.0            | 316.7   | 64.1           | 77.7    | 9.6             | 16.6     |
| Withholding tax           | (4.7)            | 13.8    | 17.7           | 27.8    | 5.0             | 9.3      |

FNPF = Fiji National Provident Fund, F\$ = Fiji dollar, K = kina

- Due to the complexity of trust funds, it is important that trust fund proponents (i.e., Pacific DMC leaders, development partners, etc.) are well versed in the mechanics of asset management, capital markets, forecasting, and other technical issues.
- Trusts fund should be locally owned—arrived upon through an internal needs-assessment and consultative process—rather than through external prescription (as has happened in the Pacific in the past).

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### Goals of Trust Funds

- Inter-temporal (incl. intergenerational) saving and wealth transfer
  - Ensuring transfers of income over time
  - Saving for retiree old age income

**Table 1: Selected Trust Funds in the Pacific by Source of Capital**

| Country                     | Source of Funding   |   |   |
|-----------------------------|---|---|---|
|                             | Pension Contributions   | Natural Resource Revenue                                      | Other Sources   |
| Cook Islands                | Cook Islands National Superannuation Fund (2000 – continuing) | —   | —   |
| Fiji                        | Fiji National Provident Fund (1966 – continuing)              | —   | —   |
| Kiribati                    | Kiribati Provident Fund (1977 – continuing)                   | Kiribati Revenue Equalization Reserve Fund (1956 – present)   | —   |
| Federal State of Micronesia | FSM Social Security (1968 – continuing)                       | —   | FSM CTF (2003 – present);<br>FSM Trust Fund (1986 – present)                                  |
| Rep. of Marshall Islands    | Marshall Island Social Security Fund (1999 – present)         | —   | RMI CTF (2003 – present);<br>Marshall Islands Nuclear Claims Fund (1986 – 2009 <sup>a</sup> ) |
| Nauru                       | —   | Nauru Phosphate Royalties Trust (1968 – present) <sup>b</sup> | —   |
| Palau                       | Palau's Civil Service Pension Plan (1987 – continuing)        | —   | PAL CTF (1995 – present);   |

**Table 2.1: Selected Trust Funds in the Pacific by Source of Capital** (continued)

| Country            | Source of Funding                                |  |   |
|--------------------|--|--|---|
|                    | Pension Contributions                            | Natural Resource Revenue                           | Other Sources                                       |
| Papua New Guinea   | <u>Nambawan Super</u> (1962 – continuing)        | Mineral Resources Stabilization Fund (1974 – 2001) |   |
| Samoa              | Samoa National Provident Fund (1972 – present)   | —  | —   |
| Timor <u>Leste</u> | —  | Petroleum Fund of Timor-Leste (2005 – present)     | —   |
| Tonga              |  |  | Tonga Trust Fund (1988 –)                           |
| Tuvalu             | Tuvalu National Provident Fund (1984 – present)  | —  | Tuvalu Trust Fund (1987 – present)                  |
|                    |  |  | <u>Falekaupule</u> Trust Fund (2000 1999 – present) |
| Vanuatu            | Vanuatu National Provident Fund (1986 – present) | —  | —   |

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- Foster macroeconomic stability
  - Minimize adverse macroeconomic effects of “booms”

|         |  |   |  |
|---------|--|---|--|
| Vanuatu | Vanuatu National Provident Fund (1984 – present) | — | Falekaupule Trust Fund (2000 1999 – present) |
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- Account in which to hold foreign assistance

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Withholding tax

Assets

Net Income

Income

Expenses

Management/ad

Withholding tax

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# Internationally Accepted Best Practice: Santiago Principles

## Performance of selected Pacific Firms

### Seven thematic areas of the 24 Santiago Principles

1. Legal framework
2. Objectives and policy purpose --clearly defined and publicly disclosed.
3. Domestic economic implications
4. Investment policy and investment risk management
5. Governance framework
6. Professional and ethical standards, fiduciary and public responsibility
7. Transparency in SWF operations

#### Santiago Principles or Generally Accepted Principles and Practices

1. Sound legal framework
2. Public disclosure of framework
3. Compliance with relevant regulations.
4. Clearly defined policy purpose(s)
5. Public disclosure of policy purpose(s)
6. Clearly defined and publicly disclosed approaches to funding, withdrawal, spending, and investment policies
7. Management considers macroeconomic impacts
8. Consider potentially advantageous position in competing with domestic private entities
9. Investment policies based on sound portfolio management
  - a. Maximize risk-adjusted financial returns
  - b. Risk exposures guidance
  - c. Use of leverage
  - d. Arrangements with external investment managers.
10. Disclosure of any non-financial or non-economic basis for investment decisions
11. Disclosure of general approach to selecting investments

#### Santiago Principles or Generally Accepted Principles and Practices

12. Mindful of the potential conflicts of interest
13. Division of roles and responsibilities between owner and governing body.
14. Frameworks governing operational management and risk.
15. Use of an accountability framework
  - a. Regular independent audits of operations and financial statements
  - b. Reporting of investment performance and financial statements,
  - c. Reporting on dealings with third parties
  - d. Apply Generally Accepted Accounting Principles
16. Disclosure of overall governance frameworks and objectives.
17. Governing bodies to act in funds best interests
  - a. Adopt a set of professional and ethical standards for those working for fund
18. Disclosure of fund's risk management framework
19. Greater transparency to enhance accountability and facilitate its dealings with other entities

| Category   | TLPF    | RERF    | FSM and RMI CTFs | Tuvalu Trust Fund |
|--|---------|---------|------------------|-------------------|
| 1. Legal framework   | Good    | Good    | Good             | Good              |
| 2. Objectives and policy purpose   | Good    | Neutral | Good             | Good              |
| 3. Domestic economic implications  | Good    | Good    | Neutral          | Good              |
| 4. Investment policy and risk management                                   | Good    | Poor    | —                | —                 |
| 5. Governance framework  | Good    | Neutral | Good             | Good              |
| 6. Professional and ethical standards, fiduciary and public responsibility | Neutral | Poor    | Poor             | Poor              |
| 7. Transparency  | Good    | Poor    | Neutral          | Neutral           |

TLPF = Timor-Leste Petroleum Fund; RERF = Republic of Equatorial Guinea's Sovereign Wealth Fund; FSM and RMI CTFs = Federated States of Micronesia and Republic of Marshall Islands Compact of Free Association Trust Funds; — = data not available; Good, Neutral, Poor = 100% compliance with the principle; Good = 80% compliance; Neutral = 60% compliance; Poor = 40% compliance.

Appendix Table: Performance of selected Pacific Trust Funds against Santiago Principles

| Performance Category   | Trust Fund and Performance Rating (Good, Neutral, Poor)  |
|--|--|
| 1. Legal framework   | Timor-Leste Petroleum Fund<br>Good. Formed by the enactment of the Petroleum Fund Law Number 9/2005 promulgated in August 2005.  |
| 2. Objectives and policy purpose   | Good. The high-level purpose of the fund is to ensure that petroleum fund revenues benefit both current and future generations. This is currently implemented by stipulating withdrawals of 3% of estimated petroleum wealth (including oil reserves as well as the TLPF balance) per annum. |
| 3. Domestic economic implications  | Good. The TLPF does not invest domestically, so there is no direct effect of its investing activities on the domestic economy. It provides a source of funding for the government, which is of course dealt with within the budgeting process.   |
| 4. Investment policy and risk management                                   | Good. TLPF performs quite well in this category, having established investment policies that fulfill the key requirements stipulated by the Principles.  |
| 5. Governance framework  | Good. The TLPF scores well on this category due to, for example, the roles of the government and management being well defined, comprehensive reporting, and regular independent audits.   |
| 6. Professional and ethical standards, fiduciary and public responsibility | Neutral. The Central Bank of Timor-Leste and the Ministry of Finance, the organizations responsible for the management of the TLPF, have codes of conduct and ethics. However, whether these are brought to the attention of staff and used is not clear.                                    |
| 7. Transparency in SWF operations  | Good. The TLPF is highly transparent, with prompt publishing of audits and regular comprehensive reports on the fund's investments, as well as publicly available information on the fund's legal framework, funding, and use of funds.  |
| Santiago Compliance Index score <sup>a</sup>                               | "A" (Fully Compliant, the highest rating category)   |
| 2012 SWF Scoreboard score (out of 100) <sup>b</sup>                        | 85. The SWF Scoreboard comprises a set of criteria that aim to measure similar aspects as the Principles.  |
| Santiago Principles score by Bagwell & Truman <sup>c</sup> (out of 100)    | 80. This rating is based only on those Santiago Principles that correspond to the SWF scoreboard elements.   |

# Internationally Accepted Best Practice: Santiago Principles

## Performance of selected Pacific Fint

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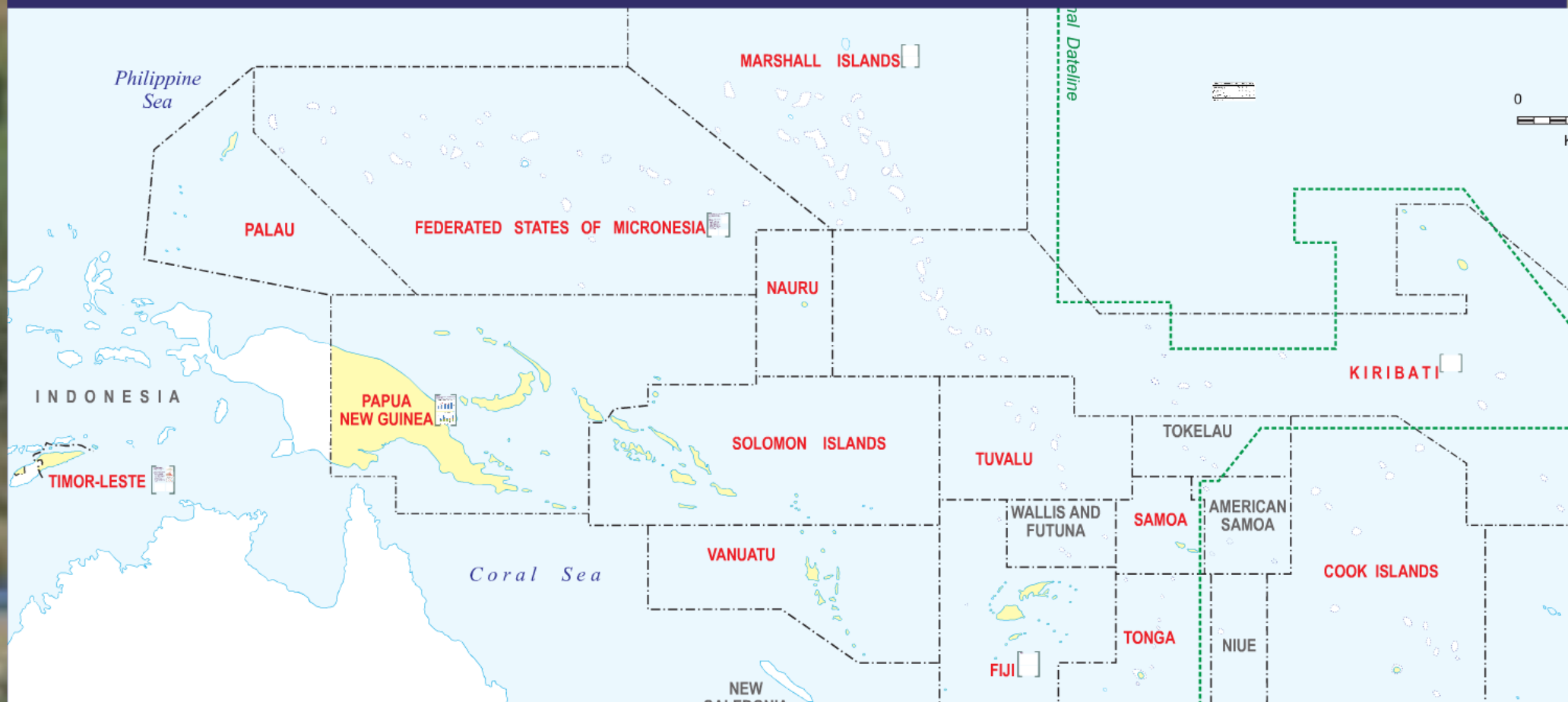
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| 4. Investment policy and risk management                                   | Good    | Poor    | —                | —                 |
| 5. Governance framework*   | Good    | Neutral | Good             | Good              |
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| 3. Domestic economic implications  | Good. The TLPF does not invest domestically, so there is no direct effect of its investing activities on the domestic economy. It provides a source of funding for the government, which is of course dealt with within the budgeting process.   |
| 4. Investment policy and risk management                                   | Good. TLPF performs quite well in this category, having established investment policies that fulfill the key requirements stipulated by the Principles.  |
| 5. Governance framework  | Good. The TLPF scores well on this category due to, for example, the roles of the government and management being well defined, comprehensive reporting, and regular independent audits.   |
| 6. Professional and ethical standards, fiduciary and public responsibility | Neutral. The Central Bank of Timor Leste and the Ministry of Finance, the organizations responsible for the management of the TLPF, have codes of conduct and ethics. However, whether these are brought to the attention of staff and used is not clear.                                    |
| 7. Transparency in SWF operations  | Good. The TLPF is highly transparent, with prompt publishing of audits and regular comprehensive reports on the fund's investments, as well as publicly available information on the fund's legal framework, funding, and use of funds.  |
| Santiago Compliance Index score <sup>22</sup>                              | "A" (Fully Compliant, the highest rating category)   |
| 2012 SWF Scoreboard score (out of 100) <sup>23</sup>                       | 85. The SWF Scoreboard comprises a set of criteria that aim to measure similar aspects as the Principles.  |
| Santiago Principles score by Bagnall & Truman <sup>45</sup> (out of 100)   | 80*. This rating is based only on those Santiago Principles that correspond to the SWF scoreboard elements   |

# Selected Pacific Trust Funds and Issues



**Table 5.1: Return on Fund investments during the global financial crisis**  
(%)

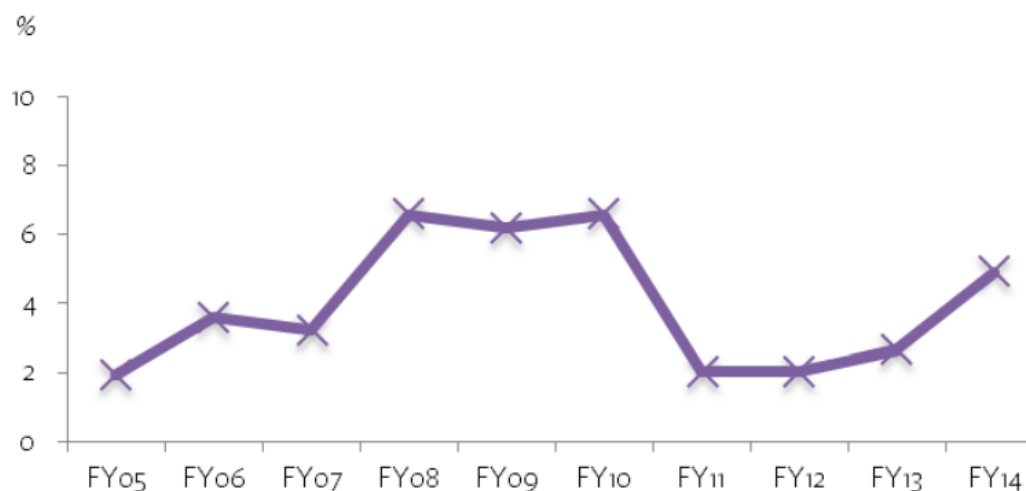
|   | FY2006 | FY07 | FY08   | FY09  | FY10 |
|---|--------|------|--------|-------|------|
| FSM Compact Trust Fund                          | 7.7    | 17.9 | (20.1) | (0.2) | 11.3 |
| RMI Compact Trust Fund                          | 12.0   | 14.9 | (21.8) | 1.3   | 8.8  |
| Tuvalu Trust Fund                               | 10.4   | 9.7  | (8.6)  | (1.7) | 1.8  |
| Petroleum Fund                                  | 4.3    | 7.5  | 7.1    | 0.7   | 3.6  |
| Fiji National Provident Fund                    | 6.2    | 5.5  | 4.9    | 4.8   | 5.5  |
| PNG's <u>Nambawan</u>                           | 10.9   | 27.0 | 7.4    | 8.7   | 10.4 |
| Marshall Islands Social Security Administration | 9.1    | 11.6 | (9.9)  | 5.1   |      |
| Palau Civil Service Pension Plan                | 5.7    | 14.3 | (13.5) | 7.1   | 5.7  |

FSM=Federated States of Micronesia, RMI = Republic of Marshall Islands, PNG = Papua New Guinea.  
Sources: Annual Reports.

# Fiji

Figure 4.3: Financial Indicators for FNPF

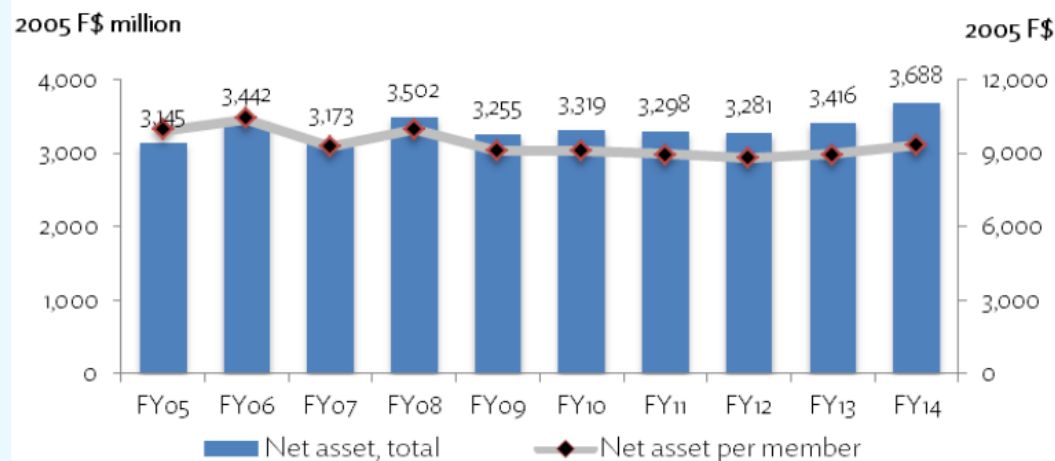
## A. Real Return on Investment (3-Year Moving Average)



Source: FNPF Annual Reports FY2005-FY2014.

Note: Consolidate investment income refers to income from investments of the Fund and its subsidiaries.

## B. Net Total Assets



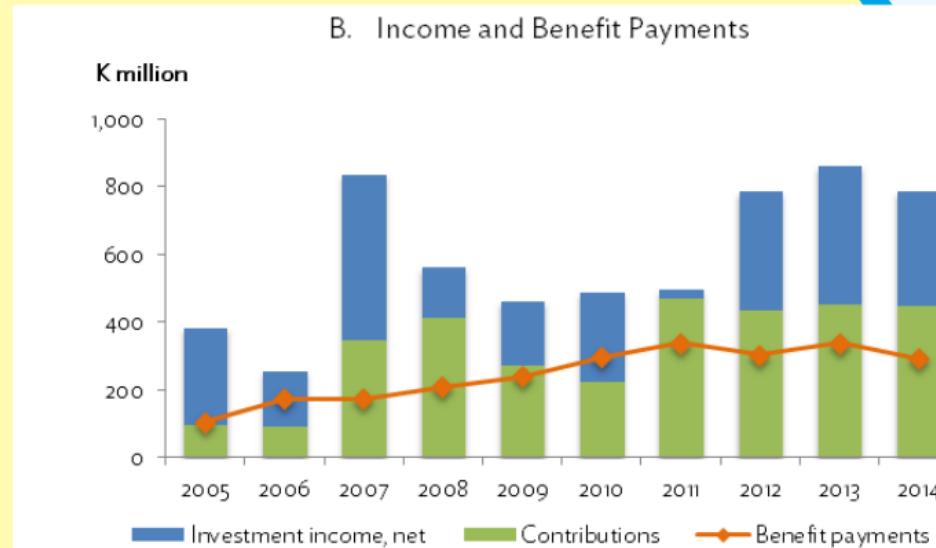
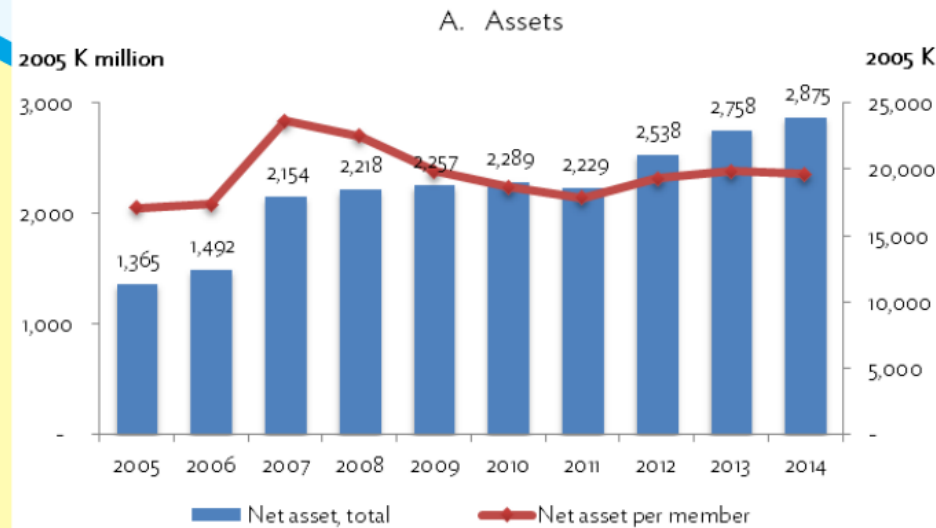
Source: FNPF Annual Reports FY2005-FY2014.

Note: Consolidate investment income refers to income from investments of the Fund and its subsidiaries.

# PNG

- Have not established a SWF that would meet standard definition for LNG
- Longstanding pension fund (Nambawan Super Fund)

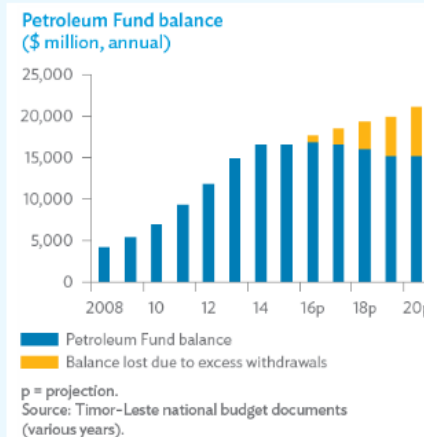
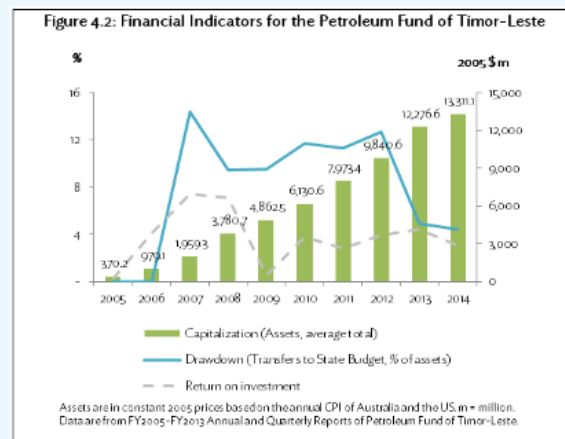
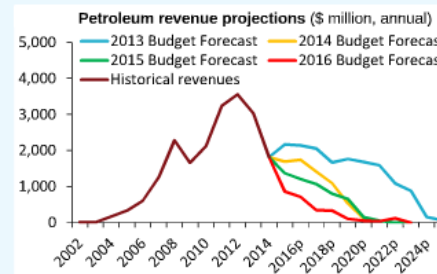
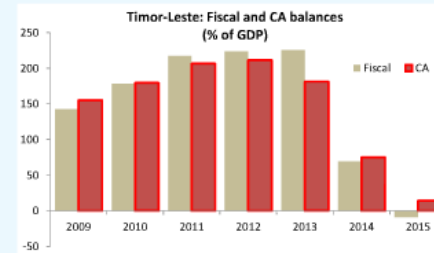
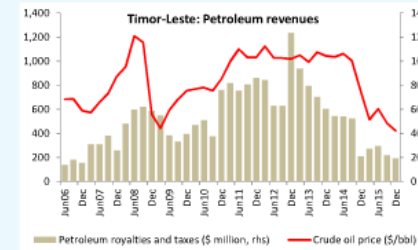
Figure 4.5: Financial Indicators for Nambawan Super Fund



Source: Nambawan Super Annual Reports, 2005 and 2009.

# Timor-Leste

- Established at the start of oil exports
- Large accumulated holdings
- Adherence to international best practice
- Challenges in most recent years
  - Falling petroleum production
    - Main oil field approaching depletion by 2021 -- worsening impact of low energy prices
    - Low oil prices and low investment returns hurting government revenues
  - Petroleum royalties down
  - Fiscal deficit now expected in 2015 (!)
  - Previously substantial fiscal and current account surpluses rapidly falling



# Federated States of Micronesia

- Long-term fiscal challenges -- scheduled decrements in US grants
- Strong fiscal performance in recent years
  - Projected FY2015 fiscal surplus of \$19.8 million (6.9% of GDP)
  - For FY2016 project fiscal surplus of about 5% GDP
  - 11% increase in revenues (grants and fishing licenses)
  - Increasing contributions to FSM Trust Fund

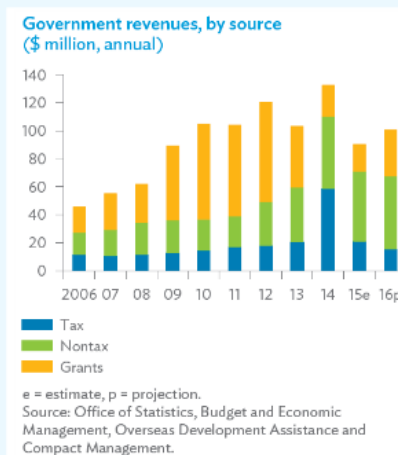
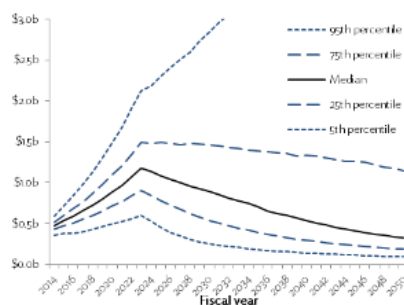
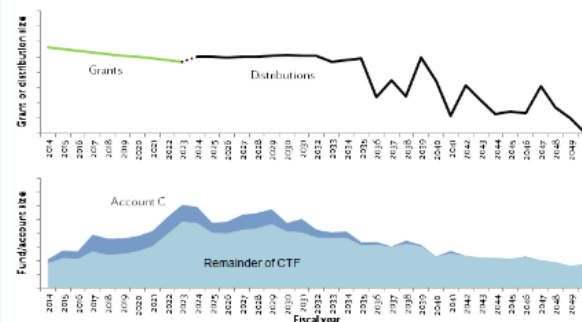


Figure 5.4: Size and Structure of the FSM Compact of Free Association Trust Fund (constant prices)



Source: ADB (2015)

Figure 5.5: Stylized Illustration of Drawdowns and Size of the FSM Compact of Free Association Trust Fund, current structure

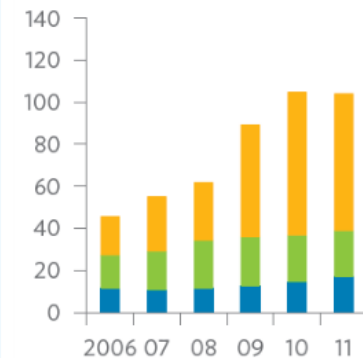


CTF = Compact of Free Association Trust fund.  
Source: ADB (2015)

# Federated States of Micronesia

- Long-term fiscal challenges -- scheduled decrements in US grants
- Strong fiscal performance in recent years
  - Projected FY2015 fiscal surplus of \$19.8 million (6.9% of GDP)
  - For FY2016 project fiscal surplus of about 5% GDP
  - 11% increase in revenues (grants and fishing licenses)
  - Increasing contributions to FSM Trust Fund

Government revenues, by source (\$ million, annual)



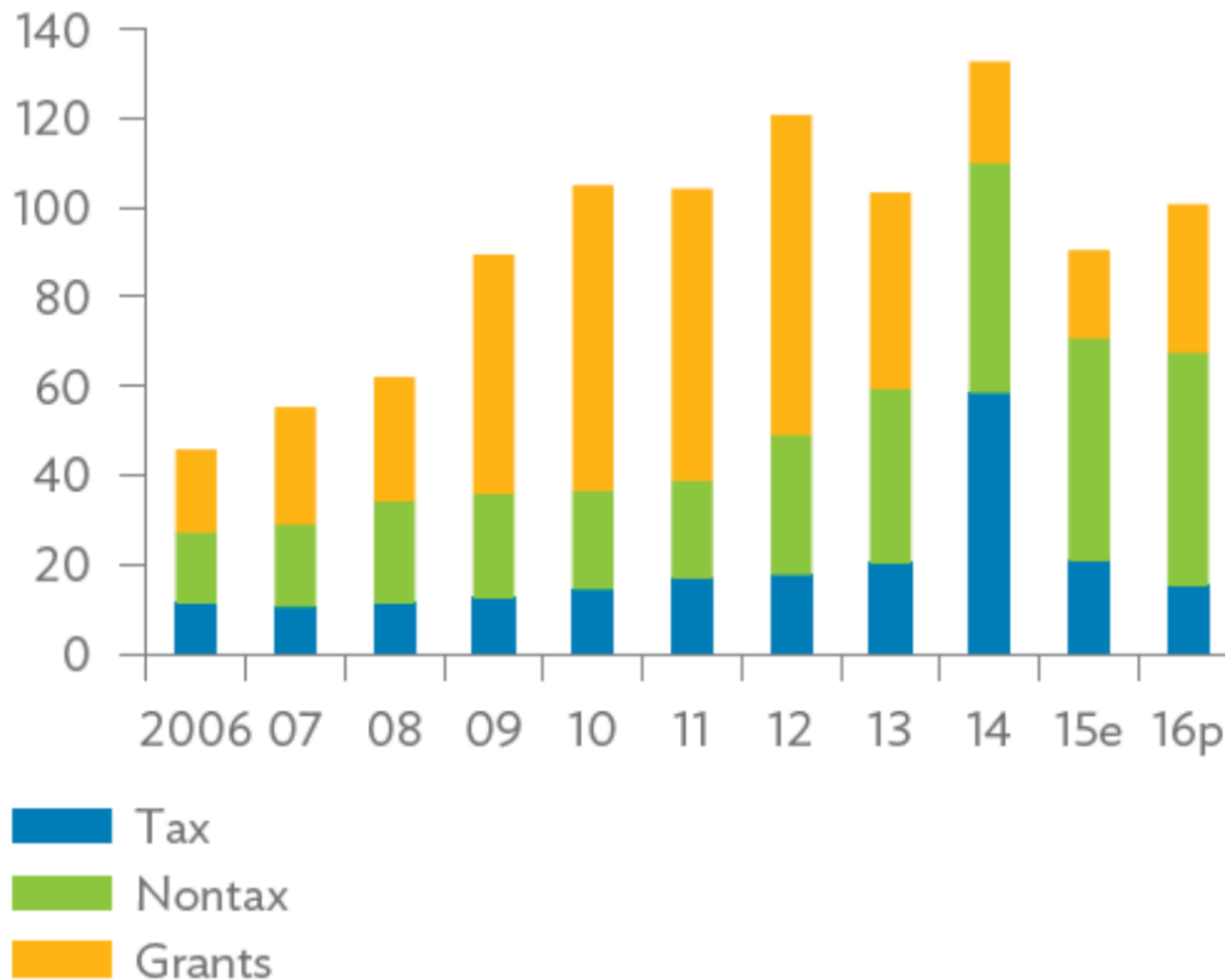
■ Tax  
■ Nontax  
■ Grants

e = estimate, p = projection.  
Source: Office of Statistics, Budget Management, Overseas Development Compact Management.

Figure 5.4: Size and Structure of the FSM Compact of Free Association Trust Fund (constant prices)

Figure 5.5: Stylized Illustration of Drawdowns and Size of the FSM Trust Fund, current structure

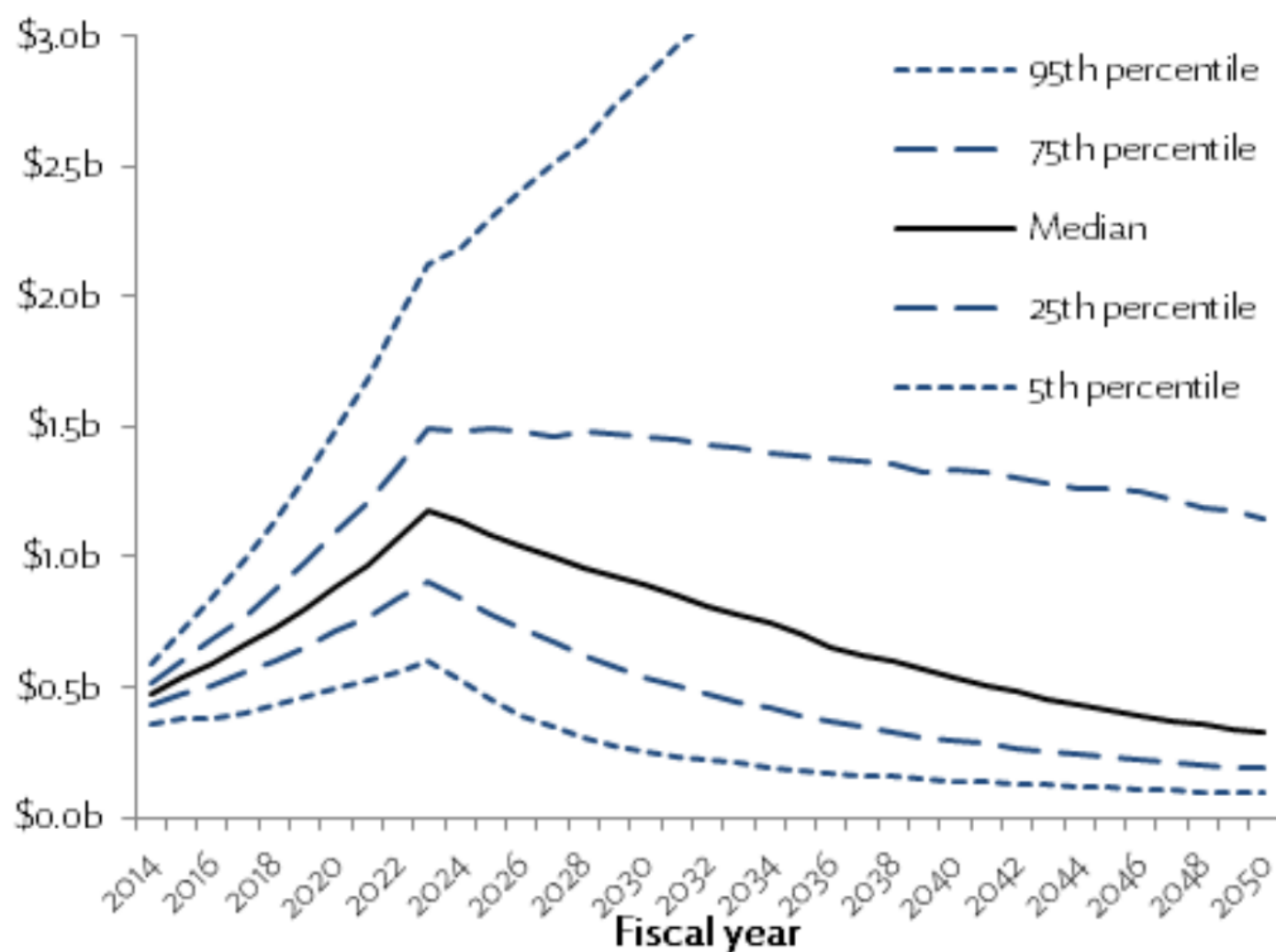
## Government revenues, by source (\$ million, annual)



e = estimate, p = projection.

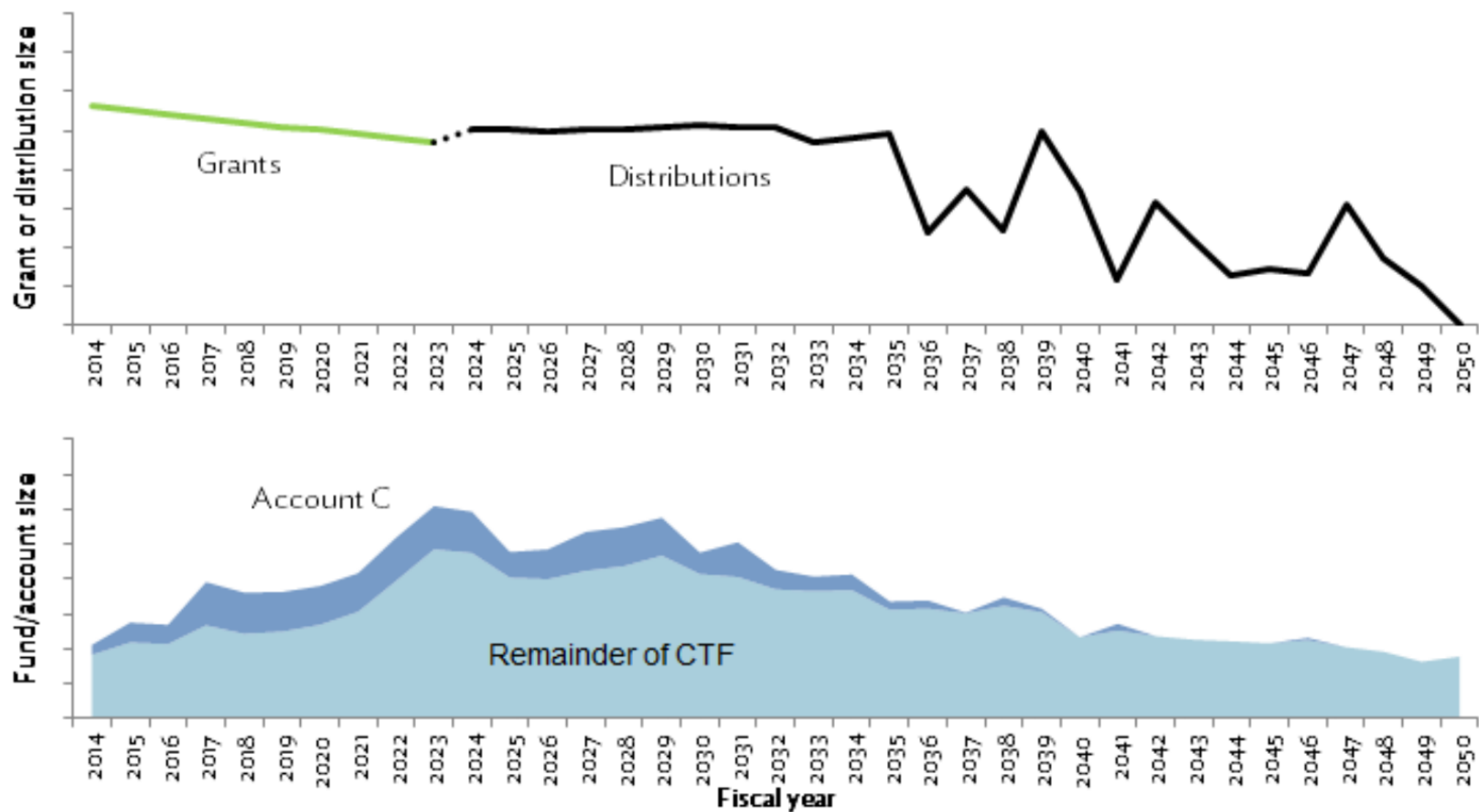
Source: Office of Statistics, Budget and Economic Management, Overseas Development Assistance and Compact Management.

**Figure 5.4: Size and Structure of the FSM Compact of Free Association Trust Fund**  
(constant prices)



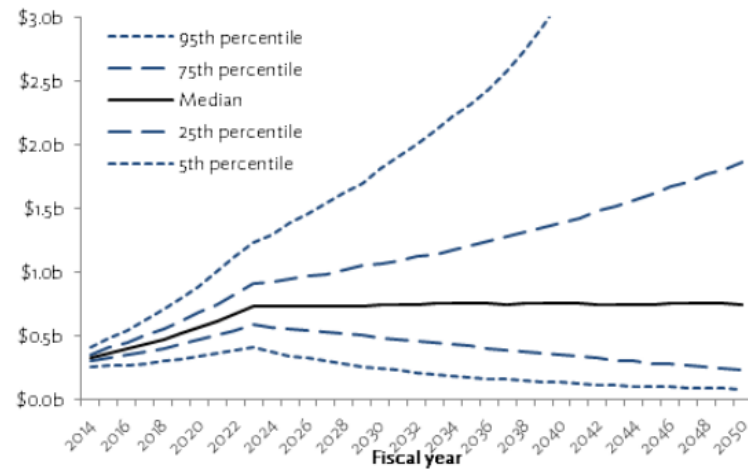
Source: ADB (2015)

Figure 5.5: Stylized Illustration of Drawdowns and Size of the FSM Compact of Free Association Trust Fund, current structure



CTF= Compact of Free Association Trust Fund.  
Source: ADB (2015)

Figure 5.6: Size and Structure of the RMI Compact of Free Association Trust Fund  
(in constant prices<sup>a</sup>)

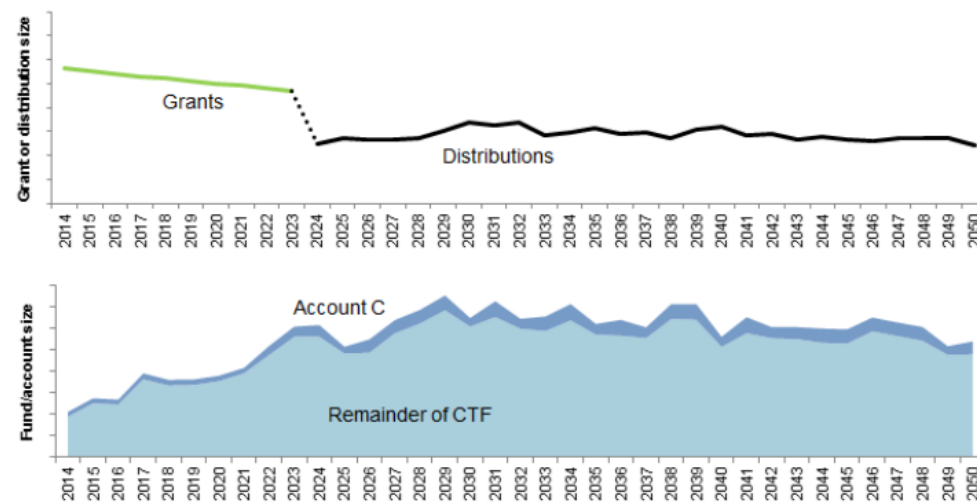


CTF = Compact of Free Association Trust Fund.

<sup>a</sup> The inflation rate (the GDP deflators for RMI and FSM) are projected to 2023 and used to calculate fund returns in real terms.

Source: ADB (2015)

Figure 5.7: Stylized Illustration of Drawdowns and Size of the RMI Compact of Free Association Trust Fund, Alternative Structures



CTF = Compact of Free Association Trust Fund.

Source: ADB (2015)

# Closing questions

Better understanding of the current status and recent performance of Pacific Sovereign Wealth and Public Trust Funds?

Understanding of good management practice in trust funds?

How these funds fit into overall public financial management in selected Pacific economies?

Enticed to read the full report?

Kam Rabwa, Sulang, Tangkyu, Vinaka



# Kam Rabwa, Sulang, Tangkyu, Vinaka



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Asian Development Bank  
6 ADB Avenue, Mandaluyong City  
1550 Metro Manila, Philippines  
Tel + 632 632 4444