



SECOND REPORT OF THE PUBLIC ACCOUNTS COMMITTEE

Heritage and Stabilisation Fund (HSF)

Fourth Session, 10th Parliament

Examination of the Financial
Statements for the years ended
September 2008 to September
2011

*Ordered to be printed by the House of
Representatives and Senate*



Public Accounts Committee

The Public Accounts Committee (PAC) established by the Constitution of the Republic of Trinidad and Tobago in accordance with Section 119(4) is mandated to consider and report to the House of Representatives on:

*“(a) appropriation accounts of moneys expended out of sums granted by Parliament to meet the public expenditure of Trinidad and Tobago;
(b) such other accounts as may be referred to the Committee by the House of Representatives or as are authorized or required to be considered by the committee under any other enactment; and
(c) the report of the Auditor General on any such accounts.”*

Current membership

| | |
|------------------------------|----------|
| Mr Colm Imbert | Chairman |
| Mrs Raziah Ahmed | Member |
| Mrs Diane Baldeo-Chadeesingh | Member |
| Mr Vasant Bharath | Member |
| Ms Donna Cox | Member |
| Dr Dhanayshar Mahabir | Member |
| Mr Collin Partap | Member |
| Ms Ramona Ramdial | Member |
| Mr Anand Ramlogan | Member |
| Mr Anil Roberts | Member |

Committee Staff

The current staff members serving the Committee are:

| | |
|------------------------------|--------------------------------------|
| Ms Keiba Jacob | Secretary to the Committee |
| Ms Khisha Peterkin | Assistant Secretary to the Committee |
| Ms Candice Williams | Graduate Research Assistant |
| Mr Ian Mural | Parliamentary Intern |
| Mrs Michelle Galera-Bleasdel | Administrative Support |

Publication

An electronic copy of this report can be found on the Parliament website: www.ttparliament.org

Contacts

All correspondence should be addressed to:

The Secretary
Public Accounts Committee
Office of the Parliament
Levels G-7, Tower D
The Port of Spain International Waterfront Centre
1A Wrightson Road Port of Spain Republic of Trinidad and Tobago
Tel: (868) 624-7275; Fax: (868) 625-4672
Email: pac@ttparliament.org

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Members of the Public Accounts Committee

TENTH PARLIAMENT,
REPUBLIC OF TRINIDAD AND TOBAGO



Mr. Colm Imbert
Chairman



Mr. Collin Partap
Member



Ms. Ramona Ramdial
Member



Mr. Anil Roberts
Member



Ms. Donna Cox
Member



Mr. Anand Ramlogan S.C.
Member



Mr. Vasant Bharath
Member



**Mrs. Diane Baldeo-
Chadeesingh**
Member



Mrs. Raziah Ahmed
Member



Dr. Dhanayshar Mahabir
Member

Glossary

In this document:

“Absolute return” - is the return that an asset achieves over a certain period of time.

“Active management” – is a strategy where the manager makes specific investments with the goal of outperforming an investment benchmark.

“Assets Under Management (AUM)” - the market value of assets that an investment company manages on behalf of investors.

“Benchmark” – is a standard against which the performance of a security, mutual fund or investment manager can be measured.

“Dividend” - money an investment fund or company pays to its stockholders, typically from profits. The amount is usually expressed on a per-share basis.

“Equity/Equities” – is a security or investment representing ownership in a corporation, unlike a bond, which represents a loan to a borrower. Often used interchangeably with “stock.”

“Global Custodian” - processes cross-border securities trades, keeping financial assets safe and servicing the associated portfolios.

“Investment Management Agreement (IMA)” - a formal arrangement between a registered investment adviser and an investor stipulating the terms under which the adviser is authorized to act on behalf of the investor to manage the assets listed in the agreement.

“Investment Policy Statement (IPS)” - this statement provides the general investment goals and objectives of a client and describes the strategies that the manager should employ to meet these objectives.

“Portfolio” - is a collection of investments such as stocks and bonds that are owned by an individual, organization, or investment fund.

“Portfolio Manager” - the individual, team or firm who makes the investment decisions for an investment fund, including the selection of the individual investments.

“Relative Return” - The return that an asset achieves over a period of time compared to a benchmark.

“Return” - the gain or loss on an investment. A positive return indicates a gain, and a negative return indicates a loss.

“Risk” - the potential for investors to lose some or all the amounts invested or to fail to achieve their investment objectives.

“Risk Tolerance” – is an investor's ability and willingness to lose some or all of an investment in exchange for greater potential returns.

“Security” – is a general term for stocks, bonds, mutual funds, and other investments.

“Stock” – is a security that represents an ownership interest in a corporation.

“Strategic Asset Allocation (SAA)” – is a policy/theoretical portfolio constructed to yield the long-term return target within an acceptable risk parameter.

“Underperformance” – means an investment that does not grow as fast as other similar investments.

“Volatility” – means the amount and frequency of fluctuations in the price of a security, commodity, or a market within a specified time period. Generally, an investment with high volatility is said to have higher risk since there is an increased chance that the price of the security will have fallen when an investor wants to sell.

Executive Summary

The Committee PAC wishes to present its Second Report of the Tenth Parliament which details its examination of the **Heritage and Stabilisation Fund (HSF)** on its Financial Statements for the years ended September 30 2008-2011.

The Report concludes with the following main recommendations:

- Amend the provisions of Section 13 and 14 of the HSF Act
- Restructure the remunerations system for fund managers.
- Create a system to provide proper checks and balances to protect the integrity of the fund when dispensing payments.
- Establish an elaborate mechanism for deeper analysis of the portfolio being managed in order to mitigate exorbitant losses and reduce performance deficiency.

Chapter 1: Presents details of the establishment of the PAC in the Tenth Republican Parliament, the Election of Chairman and determination of the Committee's Quorum.

It also includes the particulars of Meetings held with the entity under report and lists the Support Staff of the Committee.

Chapter 2: Describes the Heritage and Stabilisation Fund (HSF) and explains the evidence given to the Committee

Chapter 3: Lists the main issues; each with specific recommendations presented by the Committee, for the consideration of the Parliament.

Appendices: Contains the supporting Minutes of Meetings and Notes of evidence.

Chapter 1

The Committee

Establishment, Election of Chairman and Determination of Quorum

1. The PAC of the Tenth Republican Parliament was established by resolutions of the House of Representatives and the Senate at sittings held on Friday September 17, 2010 and Tuesday October 12, 2010 respectively.
2. The Committee held its first meeting on Tuesday October 26, 2010. At this meeting the Committee elected Mr. Colm Imbert as Chairman, in accordance with Section 119(2) of the Constitution of the Republic of Trinidad and Tobago. The Committee also resolved that its quorum should comprise of six (6) Members, inclusive of the Chairman and any other Opposition Member.
3. At the Committee's second meeting, held on Tuesday February 8, 2011, by agreement, the quorum was reduced to five (5) Members, with no change to the composition.

Changes in Membership

4. By resolution of the House of Representatives made on January 18, 2011, Mr. Terrence Deyalsingh was appointed to replace Mr. Ted Roopnarine as a Member of this Committee. On December 10, 2013, Mrs. Diane Baldeo-Chadeesingh was appointed in lieu of Mr. Terrence Deyalsingh.
5. By a similar resolution of the Senate made on October 16, 2012, Mr. Jamal Mohammed replaced Mr. Danny Maharaj as a Member of the Committee. On September 23, 2013, Mrs. Raziah Ahmed was appointed in lieu of Mr. Jamal Mohammed.

6. By another resolution of the House of Representatives made on October 19, 2012, Mr. Collin Partap replaced Dr. Rupert Griffith as a Member of the Committee.

8. By a similar resolution of the Senate made on September 23, 2013, Dr. Dhanayshar Mahabir was appointed in lieu of Mrs. Corrine Baptiste-McKnight.

Committee Secretariat Support

9. The following members of staff served the Committee through the provision of procedural, administrative and research support services:

- Ms. Keiba Jacob - Secretary to the Committee
- Ms. Khisha Peterkin - Assistant Secretary to the Committee
- Ms. Candice Williams - Graduate Research Assistant
- Mr. Ian Mural - Parliamentary Intern
- Mrs. Michelle Galera-Bleasdel - Administrative Support

10. It is to be noted that the Committee made a decision to enlist the services of a financial consultant on February 8, 2011. Given the complexity of the information that is required to be reviewed by the Committee, Members agreed that in addition to the expert assistance of the Auditor General and Officials from the Ministry of Finance and the Economy, the services of a Financial Consultant should be procured on as-needed basis, to elucidate matters of complexity and to provide related services to the PAC.

11. Invitations for proposals were sent to Pricewaterhouse Coopers, Deloitte & Touche, Ernst & Young, Montano Ramcharitar (Baker Tilly International), KPMG, BDO Trinity Ltd. and Pannel Kerr Foster Limited, by letters date May 11, 2011. Responses were received from Deloitte & Touche, Montano Ramcharitar (Baker Tilly International), PKF Limited, BDO Trinity Ltd and Pricewaterhouse Coopers. On November 22, 2011 the Committee agreed that the consultancy would be awarded to Baker Tilly Montano Ramcharitar – Chartered Accountants based on their service fee being the lowest as well as naming senior managers/partners to provide service to the

Committee while the others companies did not clearly specify who will provide the service to the Committee.

12. The following persons from this firm, Baker Tilly Montano Ramcharitar – Chartered Accountants who also assisted the Committee during the Examination of HSF were:

- Mr. Leslie Ramcharitar - Managing Partner
- Mrs. Veera Ramcharitar -Senior Consultant

Meetings

13. A public hearing was convened with representatives of the HSF on the following dates:

- Tuesday March 13, 2012 – *in public*;
- Tuesday May 22, 2012 – *in public*;

14. A request for written responses was sent on:

- Friday March 23, 2012
- Friday June 1, 2012

15. At the Meetings held *in public*, the Committee met with Officials of the HSF to examine its Audited Financial Statements for the years ended September 30, 2008 to 2011. The witnesses attending on behalf of HSF for both meetings were:

- Ms Avyann Ferguson Chairman
- Mrs. Anushkar Alcazar Governor
- Mr. Ewart Williams Governor (Central Bank)
- Mrs. Enid Zephyrine Governor (Ministry of Finance)
- Mr. Michael Raymond Economic Policy Analyst
- Mr. Alister Noel Senior Manager, Operations (Central Bank)
- Ms Marie Borely Chief Financial Officer

16. The committee was assisted by official from the Ministry of Finance at the Meeting held *in*

public on Tuesday March 13, 2012. The official attending on their behalf was:

- Ms. Radica Deonanan Treasury Accountant, Financial Management Branch

17. In addition, at the meeting held *in public* on Tuesday May 22, 2012, the committee was assisted by officials from the Auditor General’s Department and the Comptroller of Accounts Department. The officials attending on their behalf were:

The Auditor General’s Department:

- Ms Sharman Ottley Auditor General
- Ms Lorelly Pujadas Asst. Auditor General
- Ms Reahla Balroop Audit Director

The Comptroller of Accounts Department:

- Ms Ava Candida-Harris Treasury Executive I
- Ms Brenda Jones Treasury Accountant

Chapter 2

Company Profile

Establishment of HSF

18. The Heritage and Stabilisation Fund Act, Chapter 70:09 established the Heritage and Stabilisation Fund with effect from March 15, 2007 for the purpose of saving and investing surplus petroleum revenues derived from production business in order to:

“(a) cushion the impact on or sustain public expenditure capacity during periods of revenue downturn whether caused by a fall in prices of crude oil or natural gas;

(b) generate an alternative stream of income so as to support public expenditure capacity as a result of revenue downturn caused by the depletion of non-renewable petroleum resources; and

(c) provide a heritage for future generations, of Trinidad and Tobago, from savings and investment income derived from excess petroleum revenues.”

Corporate Governance

19. The Heritage and Stabilisation Fund Act provides for the appointment of a Board of Governors consisting of five members, “to be selected from among persons of proven competence in matters of finance, investment, economics, business management or law, including an officer of the Central Bank and the Ministry”.

20. The Board shall determine the governance structure and the operational and investment guidelines of the Fund. As quoted from the Ministry of Finance and the Economy’s website it states that, ‘The Central Bank will have the responsibility for the management of the Fund. Transparency and accountability is also provided for in the legislation through the submission of quarterly reports to the Board on the holdings, performance and risk of the Fund, as well as the submission of an Annual Report of the Fund together with the audited financial statements and investments report on the performance of the Fund.’

Board of Governors at the HSF

21. At the time of the Committee's examination, the members were as follows;

- Ms. Avyann Ferguson - Chairman
- Mr. Ewart Williams - Governor
- Mrs. Enid Zephyrine - Governor
- Mrs. Anushkar Alcazar - Governor

Board Secretariat

- Mr. Michael Raymond - Economic Policy Analyst, Ministry of Finance and the Economy

Enquiry of the HSF

22. At the public examination of the financial statements of the HSF on March 13, 2012, the following issues arose:

- I. Treatment of the excess deposited into the Fund. The Committee expressed a concern on the present method of accounting for excess revenue deposited into the Fund, on an annual basis, as opposed to a quarterly basis.
- II. The Committee requested the Board to seek a legal opinion as well as a detailed comparative analysis of the transfer amounts based on the two methods (annual and quarterly basis).
- III. The Committee noted that between 2009 and 2010 there were significantly large changes in the sums representing loss and gains. Members sought an explanation for the change, as well as information on the cause of the increased loss on sale of investments.
- IV. The selection of Investment Managers and control mechanisms for the efficient management of the Fund. The Committee also sought information on this and also on the financial benefits of taking the decision to hire Investment Managers and a Global Custodian.

23. The Committee requested that HSF provide responses to the following questions in writing:

- i. With respect to the decision surrounding the accounting for the excess that is paid into the Fund on an annual basis as opposed to on a quarterly basis, was any legal opinion sought in advancing this course of action? If not, please proceed to do so and inform the Committee of the details.*

HSF Response to Question 1:

In reference to question (1), the legal opinion dated November 28, 2008 is attached. (See **Appendix 1**, page 34).

ii. *Was any exercise conducted in examining the variance between making deposits into the Fund on a cumulative annual basis, and alternatively on a quarterly basis? If not, could a detailed calculation be performed, and the results submitted to the Committee?*

HSF Response to Question 2:

The Bank staff compared the actual deposit history of the Fund with a scenario that assumed a strict interpretation of the deposit and withdrawal rules on a quarterly basis. This suggests that once actual energy revenues exceed or fall short of budgeted revenues by at least 10 per cent for any quarter, a deposit or withdrawal of at least 60 per cent of the excess or shortfall would be made.

The results of the exercise indicated that the total deposits actually credited to the Fund were higher than what was derived from the “quarterly” scenario. In the quarterly scenario the aggregate net deposits calculated was TTD 11,918,906,735 compared to actual deposits of TTD 14,534,442,723. Even if one assumes that no withdrawals were made in 2009 (a year with annual and quarterly deficits) in the “quarterly” scenario, aggregate deposit was TTD 14,464,478,149. In 2007 and 2008 the total deposits credited to the Fund exceeded 60 per cent of the excess of budgeted revenue. This was the main reason for the actual funds deposited being higher than that calculated under the “quarterly” scenario.

The quarterly and annual information are presented in Table 1 below

Table 1

| Year/ Quarter | Minimum Deposit/Withdrawals (TT\$) (60% of Excess) | Actual Deposit (TT\$) | Actual % of Excess for Financial Year | Comments |
|------------------|----------------------------------------------------------|--------------------------|------------------------------------------------|-----------------------------------------------------------|
| 2007 | | | | |
| Quarter 1 | (582,615,223) | - | | Shortfall in Revenues by 22% - No withdrawal made |
| Quarter 2 | (344,207,615) | - | | Shortfall in Revenues by 14% - No withdrawal made |
| Quarter 3 | 1,430,415,668 | 503,592,830 | | Contribution was offset against prior quarters shortfalls |
| Quarter 4 | 1,245,150,225 | 1,526,607,170 | | Contribution in excess of minimum was made |
| Total 2007 | 1,748,743,055 | 2,030,200,000 | 69.7 | |
| 2008 | | | | |
| Quarter 1 | (771,451,567) | - | | Shortfall in Revenues by 31% - No withdrawal made |
| Quarter 2 | 1,907,247,002 | 1,135,795,435 | | Contribution was offset against prior quarter shortfall |
| Quarter 3 | 2,852,043,586 | 2,852,043,586 | | Contribution of the 60% minimum was made |

| | | | | |
|-----------------|-----------------|----------------|------|-----------------------------------------------------------|
| Quarter 4 | 2,505,006,046 | 2,600,000,000 | | Contribution in excess of minimum was made |
| Total 2008 | 6,492,845,066 | 6,587,839,021 | 60.9 | |
| 2009 | | | | |
| Quarter 1 | (923,786,301) | - | | Shortfall in Revenues by 30% - No withdrawal made |
| Quarter 2 | (520,385,414) | - | | Shortfall in Revenues by 19% - No withdrawal made |
| Quarter 3 | (406,111,390) | - | | Shortfall in Revenues by 17% - No withdrawal made |
| Quarter 4 | (695,288,308) | - | | Shortfall in Revenues by 28% - No withdrawal made |
| Total 2009 | (2,545,571,414) | - | 0.0 | |
| 2010 | | | | |
| Quarter 1 | - | - | | Shortfall in Revenues by 1% - Cannot withdraw shortfall |
| Quarter 2 | 677,408,471 | 659,770,446 | | Contribution was offset against prior quarters shortfalls |
| Quarter 3 | 1,415,358,343 | 1,415,358,343 | | Contribution of the 60% minimum was made |
| Quarter 4 | 951,321,338 | 951,321,338 | | Contribution of the 60% minimum was made |
| Total 2010 | 3,044,088,153 | 3,026,451,327 | 60.0 | |
| 2011 | | | | |
| Quarter 1 | - | - | | Shortfall in Revenues by 7% - Cannot withdraw shortfall |
| Quarter 2 | - | - | | Shortfall in Revenues by 5% - Cannot withdraw shortfall |
| Quarter 3 | 1,185,363,284 | 896,513,784 | | Contribution was offset against prior quarters shortfalls |
| Quarter 4 | 1,993,438,591 | 1,993,438,591 | | Contribution of the 60% minimum was made |
| Total 2011 | 3,178,801,874 | 2,889,952,375 | 60.0 | |
| Total 2007-2011 | 11,918,906,735 | 14,534,442,723 | | |

i. *What criteria did the Board use in the selection of the Investment Manager(s)?*

HSF Response to Question 3:

The main criteria used to select the Investment Managers were:

- The managers' philosophies and processes with respect to investment
- Their risk management strategies
- Compliance systems
- Client reporting practices
- Analytical Infrastructure and
- Record of performances

The Plan Sponsor Network (PSN) database (a database of various portfolios' performances) was used to source the managers for the four asset classes of the HSF. This database is quite comprehensive and provides in depth information on the managers' profiles.

In February 2008, the Bank short listed approximately 219 firms to submit Requests for Information (RFI) for the four (4) investment mandates specified in the SAA. By the deadline date of April 4th, 2008, 179 firms had responded. Following the review of the RFI responses and based on the ranking of their performances, the Central Bank invited a number of firms to submit Requests for Proposal (RFP). The RFP was designed to provide both qualitative and quantitative information about each firm's history, personnel and asset management and trading capabilities. The RFP responses were evaluated, scored and ranked and firms further shortlisted. In August 2008, on-site visits were conducted at the offices of the remaining firms where they presented a detailed description of their philosophies and processes with respect to investment, portfolio construction and risk management. In addition, firms made presentation on their compliance, client reporting and trading operational infrastructure including demonstration of their portfolio and risk management analytical systems.

After meeting with each firm and reviewing the responses to the RFP, the firms were scored and a Cost Quality Ratio was computed for each firm. Firms were ranked based on this ratio and the top two ranked firms in each mandate were recommended to provide asset management services for the HSF.

ii. What are the financial benefits gained from the employment of the Investment Managers and a global custodian to handle the assets and securities of the Fund?

HSF Response to Question 4:

The Investment Managers and the Global Custodian provide several benefits to the Fund, some of which are difficult to quantify. These benefits are in the form of increased returns, research, training, technical expertise, safe-keeping of assets and monitoring of portfolio activities.

- Firstly, the investment managers have the skills, experience, analytical infrastructure and are better positioned internationally to invest the assets of the Fund. They also have available resources and dedicated teams that specialize in investing in the various asset classes. As such, they are able to add value through outperforming their benchmarks. Since the hiring of the investment managers in August 2009 to September 2010, they have on average, outperformed their respective benchmarks by 30 basis points.

- Secondly, the investment managers help in building the technical capabilities of the staff in house by offering training in areas such as asset allocation and risk management. Training may also be customized to meet the specific needs of the Central Bank staff working on the HSF portfolio.
- Thirdly, the managers make available their published research to staff on a regular basis and they can be called upon to assist with research projects.
- Fourthly, the Custodian has a global presence, provides safekeeping of the HSF assets, settles and records trades, liaises with the external managers with regards to reconciling cash and market value positions and ensuring compliance with the investment guidelines. This is a critical layer of internal control and accountability.

iii. How does the Central Bank ensure that the assets of the Fund are being properly managed by the managers and custodians?

HSF Response to Question 5:

There are number of checks and balances in place to ensure that the asset managers administer the funds in the agreed manner. These include:

- a) The Investment Management Agreements (IMA) which clearly details the Investment Policy Statement
- b) The Global Custodian which reviews the activities of investment managers and provide reports
- c) The regular monitoring of managers' accounts via online access by Staff
- d) Diarized monthly conference calls with external managers
- e) Meetings with external managers in Trinidad at least once per year.

The performance of each external manager is reviewed on an ongoing basis as reflected in monthly, quarterly and annual reports. These reports are reviewed by the HSF Operating Committee that meets on a monthly basis. This committee consists of the two Deputy Governors, Senior Manager Operations and Chief Financial Officer. The performance is usually assessed on an absolute return level as well as relative to a benchmark. Absolute return is simply the nominal return generated over a certain period. On the other hand, relative performance is the comparison of the Fund with peers (or market). The Central Bank uses benchmark as proxy for the market. Assessment of relative return is the appropriate basis for actively managed funds.

The External Managers are guided by the Investment Policy Statement (IPS) that specifies the benchmark, the return and risk objectives, the eligible securities to invest in and restrictions and investment limits to manage risk (interest rate risk, credit risk, liquidity risk, country and foreign exchange risk). There are provisions for the reporting breaches of the guidelines and remedies, so the first layer of control is the tenets of the contract. The Central Bank and the custodian monitor the investment managers' compliance with the guidelines.

In addition, the Custodian, State Street Bank and Trust Company provides a number of functions such as settlement of trades, calculation of returns, and compliance reporting. The Custodian also liaises with external managers to facilitate the reconciliation of cash positions and monthly market values. In fact, since the custodian actually settles the managers' trade, these trading platforms are customized to prevent managers from trading in prohibited securities in keeping with the IMAs.

It should be noted that the IMAs include provisions to discontinue the service of the managers with a written notice of 30 days. While this is never the first option, these provisions are common in the industry and would be triggered due to non-performance. Given the nature of the assets under management, a reasonable period for a comprehensive assessment of the managers' portfolio performance is three years, especially in a volatile environment. As such, the Bank will conduct a comprehensive review of managers' performances later this year.

The Central Bank also makes monthly calls to the External Managers to discuss performance and attribution.

The global custodian's (State Street) policies and practices are audited annually. The last audit was conducted by Ernst and Young in 2011. The resultant Independent Service Auditor's Assurance Report is shared with the Central Bank and the Office of the Auditor General at their annual audit of the HSF operations. The report indicates the level of compliance by State Street with its procedures. The Bank reviews this document to determine the maintenance of the custodian's systems to deliver dependable service to HSF.

In summary, all three parties (Central Bank, Manager and Custodian) monitor the management of the Fund through technology and communications.

iv. What are the main contributors to the increased loss on sale of investments?

HSF Response to Question 6:

The losses on the sale of investments are an inevitable result of managers exercising nimbleness and flexibility in asset management. Particularly in a volatile market, managers are monitoring the market on an ongoing basis and are constantly making judgments about the market outlook. If they see a stock weakening they may decide to sell in order to buy one that offers the opportunities for great financial gains. As a result, a loss may be realized from the sale of the stock but overall the portfolio benefits.

Over the period 2008 to 2010 the Fund grew from US\$2.9 billion to US\$3.6 billion. The losses on sale of investments also grew over this period in absolute amounts and as a percentage of the market value of the Fund as seen in Tables 2 and 3 below. The loss on the sale of investment ranged between 0 and 2.23 per cent of the beginning net asset value of the Fund over the period 2008 to 2010. A number of factors contributed to this.

Table 2
Selected Items comprising Comprehensive Income - /US\$/

| Line Items | FY ended Sep 2008 | FY ended Sep 2009 | FY ended Sep 2010 |
|--------------------------------------------------|--------------------------|--------------------------|--------------------------|
| Gain on sale of investments | 2,020 | 9,730,989 | 101,545,318 |
| Loss on sale of investments | 0 | (3,956,831) | (66,116,648) |
| Unrealised gain/(losses) from fair value changes | 0 | 41,466,273 | 89,714,264 |
| <i>Memo Item:</i> | | | |
| Total comprehensive income for the year | 67,196,799 | 76,336,635 | 177,645,460 |
| Net Assets of the Fund – Beginning of period | 1,765,850,559 | 2,888,437,787 | 2,964,774,422 |
| Net Assets of the Fund –Ending of Period | 2,888,437, 787 | 2,964,774,422 | 3,619,764,146 |

Source: Trinidad and Tobago HSF Annual Reports.

NB: For most of the 2008/2009 Financial Year, the Fund was mainly invested in Fixed Deposits which do not realise any gains or losses.

Table 3
Selected Items comprising Comprehensive Income
/As a Per Cent of Net Assets/

| Line Items | FY ended Sep 2008 | FY ended Sep 2009 | FY ended Sep 2010 |
|--------------------------------------------------|------------------------------|------------------------------|------------------------------|
| Gain on sale of investments | 0.00 | 0.34 | 3.43 |
| Loss on sale of investments | 0.00 | -0.14 | -2.23 |
| Unrealised gain/(losses) from fair value changes | 0.00 | 1.44 | 3.03 |
| <i>Memo Items:</i> | | | |
| Total comprehensive income for the year | 3.81 | 2.64 | 5.99 |
| Net Assets of the Fund | 100.0 | 100.0 | 100.0 |

*The percentages were calculated using beginning Net Asset Value for the respective financial year.

The first relates to the composition of the Fund which would have changed materially over the period. The Fund began its transition to the SAA in August 2009 and completed it in January 2011. This meant exposure to securities such as bonds and equities which have higher volatility relative to USD fixed deposits. The accounting records illustrate this increased volatility in prices of the securities. In 2009, the losses from sale of investments reflect the cumulative amount for two months of the financial year while the increase in 2010 reflects the losses made over the twelve months of the financial year.

The second pertains to the engagement of external managers that actively manage their respective portfolios instead of a buy and hold strategy, which has introduced increased sales to the Fund. Active management is a strategy where the manager makes specific investments with the goal of outperforming the benchmark. This includes overweighting or underweighting positions in the portfolio versus the benchmarks from time to time.

Thirdly as the size of the portfolios expands the value of sales increases and if losses are realized the absolute losses would be greater.

Fourthly losses on sales maybe incurred when markets experience precipitous decline, for example in the quarter ended June 30 2010 the HSF US and Non-US equity benchmarks lost 11.15 per cent and 13.23 per cent, respectively. One would find it challenging for a portfolio manager to avoid losses in those market conditions.

While it is important to monitor the value and the reason for realised losses, these are already captured in the total returns. When the total return of the portfolio is computed, this takes into account any unrealised and realised gains and losses, dividends and coupons.

The performance of the Fund is more meaningfully gauged by the extent to which it would have met its risk and return objectives. The Fund has returned an annualized average of 4.61 per cent since inception up to September 2010 using a tracking error of 105.8 basis points, approximately half of the 200 allowable tracking errors. It should be noted that while the realised losses were US\$66 million in FY ended September 2010, the realised gains were US\$101 million. The Fund has not recorded a negative annual return since inception. This may be considered fortunate in an investment climate with historically low interest rates and rife with uncertainty.

Table 4

HSF Portfolio Returns versus Benchmark Returns

| Financial Year End | Financial Year Return | | | Annualised Return Since Inception | | |
|--------------------|-----------------------|-------------|------------|-----------------------------------|-------------|------------|
| | Portfolio % | Benchmark % | Excess bps | Portfolio % | Benchmark % | Excess bps |
| September 2007* | 2.97 | 2.95 | 1.89 | 5.48 | 5.44 | 3.50 |
| September 2008 | 3.62 | 3.50 | 12.12 | 4.34 | 4.25 | 9.37 |
| September 2009 | 2.80 | 3.18 | -37.81 | 3.81 | 3.91 | -10.01 |
| September 2010 | 6.07 | 5.75 | 31.93 | 4.61 | 4.59 | 2.29 |

24. At the second *public* examination of the HSF financial accounts by the Committee on May 22, 2012, the following issues arose out of the discussions held with the Board of the HSF:

I. Mode of Payment to Fund Managers:

The Committee queried the mode of payment made to the Fund Managers handling the non-US Core International Equities. Members were informed that the two Fund Managers engaged were paid on a commission basis, calculated as a percentage of the market value of the Fund. By this method, if the Fund incurred a net loss, the Managers would still obtain a commission. The remuneration structure for the other Fund Managers was also questioned by Members.

II. Loss on sale of investments and increases in unrealized losses between 2010 and 2011:

III. Protective systems employed to minimize or mitigate against losses:

The Committee was informed that the control mechanism to minimize or mitigate any loss against an adverse movement of the categories is the diversification of the Fund. Further, the built-in control of the Fund was cited as the strategic asset allocation that balances equity changes against movements in fixed income securities;

IV. Plans to revisit the strategic asset allocation:

Members questioned whether there was any merit in revisiting the strategic asset allocation as well as the standard deviation of 2% for returns on investments. The Central Bank Governor stated that the Board was mandated via the legislation to conduct a review of the HSF Act after five (5) years, which was currently in progress. He also stated that the decision to review the strategic asset base allocation was a decision reserved for the Minister of Finance and the Economy and the Parliament.

V. Payments to Fund Managers vis-à-vis Fund Performance:

The Committee drew to the attention of the Officials the comparative payment of US\$18.5 million to the Fund Managers in the context of a realized performance gain of US\$10 million.

VI. Correction of percentage amounts stated in Appendix II of the April 12, 2012 communication:

Members noted that in Appendix II of the response sent by the HSF Board Chairman (*see* Appendix 2, page 38) dated April 12, 2012, under the column defined as “weight” the US and Non-US Equity percentages were stated @ 17% resulting in a total of 99%. However, the Chairman stated during the course of discussion that the amount was actually 17.5%, which would total the sum to 100%. The Committee asked that the correction be made to the document submitted.

VII. Legal Opinion (of November 2008) presented to the Committee relating to the accounting for the excess paid into the Fund:

The HSF Board officials were informed that the Legal Opinion presented was both dated and did not carry an author. As a result, the Committee expressed an opinion that the advice of Senior Counsel should be procured on the subject. The Committee advised that the terms of engagement would be determined in consultation with the Attorney General (*in camera*).

25. Arising out of the discussions, the Committee informed the Board that the Secretary would write the HSF Chairman with questions raised by Members for response. The requested information is as follows:

i. The rate of commission paid to the Fund Managers attached to the non-US Core International Equity for the financial year ended 30/09/11.

HSF Response to Question 1:

The investment management fees are calculated as a percentage of the market value of assets under management. There is usually a tiered schedule of fees, where the "marginal fees" are lower, the higher the assets under management; for example, in the case of Bailard, the fee on the first \$25 million under management is 0.75%, the next \$25 million is 0.65%, the next \$50 million thereafter is 0.50% and over \$100 million is 0.40%. Table 1 below shows the actual fees paid to the managers of the non-US Core International Equity portfolio for the financial year ended September 2011. At the time of the request for proposal (RFP), the average fee of the firms that responded was approximately 61 basis points per annum.

Table 1
Portfolio Value and Fees paid for the Financial Year 2011

| Managers | Rate (%) Per Annum | Fee Paid (US\$) | Average Net Asset Value for FY 2011 (US\$) |
|---------------------------------------------------|-------------------------------|------------------------|-------------------------------------------------------|
| Wellington Management Company, LLP | 0.57 | 1,917,420 | 334,985,478.89 |
| Bailard, Inc. | 0.46 | 1,499,350 | 328,351,802.29 |

ii. What was the remuneration structure for the Fund Managers other than the two in (1) above? Was it a flat payment with a linked bonus, a progressive rate or on a commission basis linked to the performance of the Fund?

HSF Response to Question 2:

Similarly to non-US equity fund managers, the remuneration of the other managers is based on the net value of assets under management (AUM), which is one of the most widely used arrangements to compensate asset managers in the industry. The structure of rates across asset portfolios is related to the risks associated with the asset portfolio. Accordingly, short term fixed income portfolios are rewarded at the lower end and equity managers at the higher end.

Table 2 below gives a breakdown of the fee structure for the Fund Managers used for the HSF.

Table 2
Assets Managers' Fees FY 2011

| Mandate | Mangers | Actual Rate (%) | Fees Paid | Average Fees Based On RFP (%) | Average Net Assets Value for FY2011 (US\$) | Tracking Error Allowance (%) |
|------------------------------------|--------------------------------------------|-----------------|-----------|-------------------------------|--------------------------------------------|------------------------------|
| Short Duration Fixed Income | Morgan Stanley Investment Management, Inc. | 0.10 | 434,885 | 0.12 | 450,818,290.20 | 0.50 |
| | Fisher Francis Trees and Watts, Inc. | 0.10 | 459,569 | | 451,145,707.38 | |
| US Core Fixed Income | Babson Capital Management, LLC | 0.12 | 871,209 | 0.22 | 721,800,087.03 | 1.00 |
| | Goldman Sachs Asset Management, L.P | 0.19 | 1,339,561 | | 721,987,741.90 | |
| US Core Domestic Equity | JP Morgan Investment Management Inc. | 0.54 | 1,853,549 | 0.54 | 340,629,810.92 | 4.00 |
| | Morgan Stanley Investment Management, Inc. | 0.43 | 1,418,844 | | 333,618,168.58 | |

iii. Has the Board contemplated moving to an alternative remuneration arrangement for Fund Managers, e.g. pay for performance?

HSF Response to question 3:

The current fee structure was determined to be the most appropriate because it provides an incentive for managers to increase value of assets without the need to take undue risk. Accordingly, this better aligns the interests of the managers with those of the HSF (one of which is to achieve the highest possible level of return within reasonable and prudent levels of risk). The risk with using a pay for performance approach in the management of the HSF is that it could lead to higher risk in the effort to achieve higher returns especially during periods when it is not prudent.

Various fee arrangements were contemplated at the time of selection but were not considered optimal. It was concluded that this was the best arrangement for the managers that meet or outperform the target in the long-term. The Bank still has the option of discontinuing the service of any manager that consistently underperforms. As Table 2 illustrates, the current managers' fees are competitive compared to respondents to the RFP.

iv. What was the dollar value difference of the underperformance between the 0.79% composite return and that of the benchmark of 1.14?

HSF Response to question 4:

The dollar value difference of the underperformance between composite return and the benchmark amounted to US\$12.6 million in 2011. While we appreciate the review was limited to the results of the 2011 financial year, it is noteworthy that over the five year period to March 2012, the Fund generated an annualized return of 5.27 per cent matching that of the benchmark. This is in line with the longer term investment objective of the Fund.

v. What criteria are used in assessing the monitoring and/or performance of the Fund Managers and what measures have been implemented (if any) to treat with underperformance (with specific context to the Non-US Core International equities)?

HSF Response to question 5:

- The criteria used in assessing the monitoring of the performance of the Fund Managers are as follows:
 - Benchmark - The performance of various indices gives an indication of the market conditions that the HSF resources were invested.
 - Returns relative to the Benchmark - Performance of the portfolio is usually assessed relative to the benchmark.
 - Returns relative to peers - Performance is assessed relative to other asset managers who have similar benchmarks.

- Compliance with the Investment Management Agreements - This ensures that the portfolio is not exposed to any unintended risk which may adversely impact performance.
- Risk adjusted performance, using metrics like the information ratio which measures the external managers' ability to generate excess returns relative to a benchmark, but also attempts to identify the consistency of the investor.
- Custodian evaluation of managers' operational performance.
- Risk Management Strategies
- The Managers' philosophies and processes with respect to investment

Consistent underperformance relative to the above criteria will result in the termination of the external managers. Accordingly, the performance is monitored on an ongoing basis and discussed each month at the HSF Operations Committee meeting. Monthly review shows that while the underperformance relative to the benchmark has occurred from time to time for each external manager, their performances have been in line with their peers. Given the nature of the funds, a three year period may be considered an appropriate time to reassess the "value added" of managers. This is in keeping with the Bank's rules, and therefore a review of all managers for the three year period to August, 2012 will be due to the Board.

In light of the more volatile market, the Bank has had more frequent conversations with the fund managers concerning their risk strategies. Bailard has an investment philosophy that places great importance on countries' economic and investment climate in selecting stocks. Bailard has since reduced exposure to countries that were directly affected by the crisis in the Euro Zone following the poor performance to September 2011. Wellington on the other hand uses a bottom up approach to select stocks with attractive valuations, high-quality earnings, and strong price and earning momentum relative to their peers. Wellington has now reduced investments of what are considered European "value" stocks (high dividend/low price-to-earnings ratios).

No amendments were made to the guidelines during this period and since then the non-US equities market improved for the financial year to March 2012, with a return of approximately 15 per cent.

vi. Has the Central Bank or the Board considered re-assessment of the portfolio risk strategies of the Fund with a view to minimizing future revenue losses?

HSF Response to Question 6:

The short response is yes. The Board meets regularly to discuss the Fund's performance, risk and compliance. They also decide whether the risk strategies should be revised based on developments in the global economic and financial markets. The SAA is designed to generate a long term real rate of return with an expectation of short term volatility or even losses. It is expected that the market will go up and down in the short term and losses made but in the long run the portfolio gains will be much higher.

The strategic objectives for the HSF are as follows:

1. To maintain sufficient liquidity to cover annual withdrawals;
2. To preserve the long-term real value of the HSF by achieving a long-term real rate of return of 3.5 per cent over the next 5 years;
3. To constrain the risk of not meeting its performance objectives over rolling 5-year periods.

In order to meet the stated objectives, the said SAA was developed and the 2 per cent tracking error established. Five years is sufficient to assess the SAA and the risk budget. The structure and philosophy of the Fund may be impacted following the five-year review.

vii. Does the current standard deviation of 2% allow too much latitude from the benchmark, in light of both past investment returns as well as the current and projected economic climate?

HSF Response to Question 7:

The SAA process integrates the Fund's return objective, risk tolerance and investment constraints. The 2 per cent level of active risk is considered appropriate to enhance portfolio returns relative to the SAA policy benchmark generated in the optimization process. This, risk budget ensures that the levels of active risk taken are:

- appropriate for approved asset classes for the HSF portfolio
- sufficient to allow flexibility in allocating risk to strategies with higher expected return
- consistent with the Board's risk tolerance

While the risk budget is 2.0 per cent, the managers have actually been more conservative and the ex-post tracking error to September, 2011 was 1.05 per cent. This is an indication of managers investing funds closer to their respective benchmarks in volatile markets. Table 3 shows the allowable tracking error and actual tracking error to September 2011 across each mandate.

Chapter 3

ISSUES AND RECOMMENDATIONS

26. Having examined the financial statements and operations of the HSF, the Committee identified as significant the following issues and recommendations are proposed in each regard.

Issue: Treatment of the excess deposited into the fund

Recommendation:

- The Committee recommends that the HSF seek to amend the provisions of Section 13 and 14 of the HSF Act, as it pertains to how deposits to the fund are calculated to make the relevant provision clearer, thus leaving less to interpretation.

Issue: Mode of Payment to Fund Managers

Recommendation:

- The Committee recommends that the HSF re-structure their remunerations system to managers of specific funds or mandates for outperforming the benchmark as well as the inability to surpass the required target.
- Furthermore, a system should be created to provide proper checks and balances to protect the integrity of the fund when dispensing payments.

Issue: Loss on sale of investments and the increase in unrealized losses

Recommendation:

- The Committee recommends that the HSF establish an elaborate mechanism for deeper analysis of the portfolio being managed in order to mitigate exorbitant losses and reduce performance deficiency.
- The Committee also recommends that with the transition to more risky assets which have inordinate volatility, the process of ‘active management’ to outperform an investment benchmark should be reviewed by more than one manager to ensure a consensus decision

is made. This would reduce the haste decisions taken on behalf of a single manger which can be detrimental on the gains on investment.

- In addition, a policy or a protective system should be incorporated by the Board that clearly outlines the standard cut-off point for the dwindling of investment before the action of selling can be taken rather than surrendering the judgment call solely on a manager who is responsible for the specific fund or mandate.

This Committee respectfully submits this Report for the consideration of the Parliament.

Sgd

.....
Mr. Colm Imbert
Chairman

Sgd

.....
Mr. Collin Partap
Member

Sgd

.....
Ms. Ramona Ramdial
Member

Sgd

.....
Mr. Anil Roberts
Member

Sgd

.....
Ms. Donna Cox
Member

Sgd

.....
Mr. Anand Ramlogan, S.C.
Member

Sgd

.....
Dr. Dhanayshar Mahabir
Member

Sgd

.....
Mrs. Raziah Ahmed
Member

Sgd

.....
Mrs. Diane Baldeo-Chadeesingh
Member

Sgd

.....
Mr. Vasant Bharath
Member

**THE PUBLIC ACCOUNTS COMMITTEE –
SECOND SESSION, TENTH PARLIAMENT**

**MINUTES OF THE FIFTH MEETING HELD ON TUESDAY, MARCH 13, 2012 AT
10:15 A.M. IN THE ARNOLD THOMASOS ROOM (EAST) AND THE J. HAMILTON
MAURICE ROOM, OFFICE OF THE PARLIAMENT, TOWER D, INTERNATIONAL
WATERFRONT CENTRE, 1A WRIGHTSON ROAD, PORT OF SPAIN.**

Present were:

| | | |
|--------------------------------|---|---------------------|
| Mr. Colm Imbert | - | Chairman |
| Mr. Anil Roberts | - | Member |
| Miss Ramona Ramdial | - | Member |
| Mr. Anand Ramlogan, SC | - | Member |
| Ms. Donna Cox | - | Member |
| Mr. Vasant Bharath | - | Member |
| Mr. Danny Maharaj | - | Member |
| Mr. Terrence Deyalsingh | - | Member |
| Mrs. Corinne Baptiste-McKnight | - | Member |
| Mr. Ralph Deonarine | - | Secretary |
| Ms. Keiba Jacob | - | Assistant Secretary |
| Miss Indira Binda | - | Research Officer |

Absent were:

| | | |
|---------------------|---|------------------|
| Dr. Rupert Griffith | - | Member (excused) |
|---------------------|---|------------------|

Also present were:

Representatives from the National Insurance Board of T&T

| | | |
|--------------------------|---|-----------------------------------------------------|
| Mr. Sylvester Ramquar | - | Deputy Chairman |
| Mr. Seeram K. Maharaj | - | Director |
| Ms. Lorna Charles | - | Executive Director |
| Ms. Esther Charles | - | Executive Manager, Finance and Business (Ag.) |
| Mrs. Niala Persad-Poliah | - | Executive Manager, Legal Services Business (Ag.) |

Miss Karen Gopaul - Executive Manager, Insurance Operations (Ag.)

Representatives from the Board of the Heritage and Stabilization Fund of T&T

Ms. Avyann Ferguson - Chairman
Mrs. Anushka Alcazar - Governor
Mrs. Enid Zephryne - Governor (Ministry of Finance)
Mr. Ewart S. Williams - Governor (Central Bank)
Mr. Michael Raymond - Economic Policy Analyst
Ms. Marie Borely - Chief Financial Officer
Mr. Alister Noel - Senior Manager, Operations (Central Bank)

Representatives from the Ministry of Finance

Ms. Radica Deonanan - Treasury Accountant, Financial Management Branch

COMMENCEMENT

- 1.1 The Chairman called the Meeting to order at 10:15 am noting that a quorum was achieved.
- 1.2 The Chair informed Members that Dr. Rupert Griffith had asked to be excused from the meeting.

EXAMINATION OF MINUTES OF THE FOURTH MEETING

- 2.1 The Committee examined the Minutes of the Fourth meeting held on Tuesday January 24, 2012.
- 2.2 Members asked that the Minutes be amended to show the inclusion of a request made by the Committee of the Attorney General to present his opinion as to whether or not the Auditor General should be auditing the National Insurance Board.
- 2.3 There being no further omissions or corrections, the Minutes were confirmed on a motion moved by Mr. Terrence Deyalsingh and seconded by Ms. Ramona Ramdial.

MATTERS ARISING OUT OF THE MINUTES

- 3.1 Under item 3.1.3, the Committee agreed that the consultant would be engaged on the recommendation of at least any one (1) Member of the Committee, based on the entity due for examination.
- 3.2 The Secretary reported that under item 3.2.2 correspondence was sent by the Auditor General to that effect, which was passed on to the Chairman. Further the Secretary expressed an opinion that the content of the documents did not appear to be up to date, as well as the Auditor General's response did not appear to address all matters asked by the Committee.
- 3.3 The Committee agreed that the Auditor General's response should be circulated to Members, notwithstanding the concerns, and also that the Secretary write the Auditor General, expressing the Committee's need for a more comprehensive, up to date response.

- 3.4 The Committee scrutinized the response from the National Insurance Board with respect to information requested when the NIBTT appeared on 24.01.12 and determined that there were no further issues arising from the response..
- 3.5 The Committee then discussed its method of enquiry into the imminent examination of the accounts of the Heritage and Stabilization Fund for the years 2008, 2009 and 2010.
- 3.6 The Committee was informed that both the National Insurance Board of Trinidad and Tobago and the Board of the Heritage and Stabilization Fund were expected shortly and agreed to suspend the *in camera* meeting in order to hold its public examination of the accounts of these entities.

SUSPENSION

- 4.1 At 10:47 am, the Chairman suspended the *in camera* meeting to resume in the J. Hamilton Maurice Room *in public*.

RESUMPTION

Examination of the National Insurance Board of Trinidad & Tobago on the 2009 financials:

- 5.1 The Chairman welcomed the officials from the National Insurance Board of Trinidad and Tobago and asked that introductions be made for the record.
- 5.2 The Committee held follow-up discussions with the NIBTT on matters which the Committee previously sought further information, at a meeting held on January 24, 2012. Resultantly, the following new issues arose from the examination:
 - i. Generation of investment income through loans to state entities;
 - ii. Executive responsibility for investment decisions;
 - iii. Performance of the entire investment portfolio and by comparison of local equity investments to foreign and corporate/government securities;
 - iv. Rationale for asset base holdings and any associated benchmarks;
 - v. National Insurance coverage for self-employed persons;
 - vi. Posting of personnel to senior management positions;
 - vii. Auditing of employers who have not been audited for extensive periods (exceeding five years);
 - viii. Public awareness strategy/programme of the NIBTT;
 - ix. Management of the mortgage portfolio by the Trinidad and Tobago Mortgage Finance Company and the Home Mortgage Bank;
 - x. Treatment of mortgage loans which have defected;
 - xi. Status of the Audited Financials for the year ended 2010 .
- 5.3 The following information was requested from the NIBTT:

At the financial year end for 2009,

 - a) **For how many years prior to 2009 were KPMG the Auditors of the NIBTT?**
 - b) **What system was used to record and report on the investment portfolio of the NIBTT?**

- c) **Would the Auditors have reviewed those systems and procedures as part of the audit activity for 2009?**
 - d) **What internal control mechanisms were in place at the NIBTT to ensure that the information presented to the Auditors was both credible and accurate?**
 - e) **What was the rate of interest on the investment bond held with UDeCoTT, and how did this compare with market rates at that time?**
 - f) **Who determined the segmentation of investments depending on reward/risk? Was this decision made on an annual basis, quarterly basis etc? Was any monitoring of expected returns compared to actual returns conducted and if so, by whom?**
 - g) **With specific regard to the \$156 million investment in Clico Investment Bank (CIB), what was the rationale behind this decision, and who was involved in making that decision?**
 - h) **What was the individual yield on the local investments compared to the foreign investments and government securities, based on the overall yield of 6.8%?**
 - i) **How did the major components of the NIBTT investment portfolio perform, providing details?**
 - j) **What/where is the authority for the justification of a policy of privacy with respect to mortgages held with the NIBTT falling into default? If such authority is documented, please provide the relevant evidence in support of that decision.**
 - k) **As at September 30, 2009 –**
 - a. **Did the mortgage component of the NIBTT persist with respect to new mortgage loans being granted?**
 - b. **Were any Board Members of the NIBTT recipients of loans/mortgages granted by the NIBTT?**
 - c. **Was there any existing policy regarding the award of loans/mortgages to Members of the Board of the NIBTT?**
- 5.4 The Chairman informed the officials from the NIBTT that they would be written to by the Committee Secretary with the additional questions for answer and upon receipt of the 2010 financials, the Committee would communicate with the Board accordingly.

SUSPENSION

- 6.1 The Chairman suspended the Meeting for five minutes to allow for the meeting with the Board of the Heritage and Stabilization Fund (HSF). The suspension was taken at 11:54 am.

RESUMPTION

- 7.1 At 12:01 pm, the Chairman resumed the meeting and welcomed the officials from the Board of the Heritage and Stabilization Fund (HSF).

Examination of the Board of the Heritage and Stabilization Fund of Trinidad & Tobago on the 2008, 2009 and 2010 year end audited financials:

- 7.2 The Chairman asked the officials to introduce themselves and apologized for the delay in the start of the meeting, due to a prolonged meeting with the preceding entity. As a result, the Chairman indicated that the meeting would be brief, but depending on the discussion, the Committee would determine whether the HSF would be required to appear again.

- 7.3 The following issues arose out of the discussions held with the Board of the HSF:
- 7.3.1 Treatment of the excess deposited into the Fund. The Committee expressed a concern on the present chosen method of accounting for the excess revenue generated to be paid into the Fund, on an annual basis, as opposed to a quarterly basis. The concerns related to whether a legal opinion was sought in the determination of the method chosen, as well as to the absence of a comparative analysis of the transfer amounts based on both methods.
- 7.3.2 The Committee requested the Board to seek a legal opinion as well as a detailed calculation as it relates to 7.3.1 above.
- 7.3.3 The Committee noted that there were significantly large changes in the sums representing loss on investments and gains on investments between 2009 and 2010, and sought an explanation for the change, as well as information on the cause of the increased loss on sale of investments (see below).
- 7.3.4 Selection of Investment Managers and control mechanisms for the efficient management of the Fund. The Committee also sought information on this and also on the financial benefits of taking the decision to hire Investment Managers and a Global Custodian (see below).
- 7.4 Arising out of the examination, the Committee posed the following questions to the Board of the HSF for written response:
- a) With respect to the decision surrounding the accounting for the excess that is paid into the Fund on an annual basis as opposed to on a quarterly basis, was any legal opinion sought in advancing this course of action? If not, please proceed to do so and inform the Committee of the details.
 - b) Was any exercise conducted in examining the variance between making deposits into the Fund on a cumulative annual basis, and alternatively on a quarterly basis? If not, could a detailed calculation be performed, and the results submitted to the Committee?
 - c) What criteria did the Board use in the selection of the Investment Manager(s)?
 - d) What are the financial benefits gained from the employment of the Investment Managers and a global custodian to handle the assets and securities of the Fund?
 - e) How does the Central Bank ensure that the assets of the Fund are being properly managed by the managers and custodians?
 - f) What are the main contributors to the increased loss on sale of investments?
- 7.5 The Committee enquired on the status of the 2011 Audited Financials and were informed that the financials were received by the Ministry of Finance and pending the approval by Cabinet, would then be forwarded to the Parliament.

ADJOURNMENT

- 8.1 The Chairman indicated to all present that in the interest of time and the imminent sitting of the Senate that the proceedings had to be adjourned.
- 8.2 The Chairman thanked the officials from the Board of the Heritage and Stabilization Fund, indicating that they would receive communication from the Secretary on the information requested and also whether the Committee would wish to meet with them again.

8.3 The Chairman thanked everyone else present for their attendance and adjourned the Meeting to a date to be fixed.

8.4 The adjournment was taken at 12:38 p.m.

We certify that these Minutes are true and correct.

CHAIRMAN

SECRETARY

March 26, 2012

**THE PUBLIC ACCOUNTS COMMITTEE –
SECOND SESSION, TENTH PARLIAMENT**

**MINUTES OF THE SEVENTH MEETING HELD ON TUESDAY, MAY 22, 2012 AT
10:45 A.M. IN THE ARNOLD THOMASOS ROOM (EAST) AND THE J. HAMILTON
MAURICE ROOM, OFFICE OF THE PARLIAMENT, TOWER D, INTERNATIONAL
WATERFRONT CENTRE, 1A WRIGHTSON ROAD, PORT OF SPAIN.**

Present were:

| | | |
|--------------------------------|---|---------------------|
| Mr. Colm Imbert | - | Chairman |
| Miss Ramona Ramdial | - | Member |
| Ms. Donna Cox | - | Member |
| Mr. Anand Ramlogan, SC | - | Member |
| Mr. Vasant Bharath | - | Member |
| Mr. Danny Maharaj | - | Member |
| Mr. Terrence Deyalsingh | - | Member |
| Mrs. Corinne Baptiste-McKnight | - | Member |
| | | |
| Mr. Ralph Deonarine | - | Secretary |
| Ms. Keiba Jacob | - | Assistant Secretary |
| Miss Indira Binda | - | Research Officer |

Absent were:

| | | |
|---------------------|---|------------------|
| Dr. Rupert Griffith | - | Member (excused) |
| Mr. Anil Roberts | - | Member (excused) |

Also present were:

BAKER TILLY MONTANO RAMCHARITAR – Chartered Accountants

| | | |
|------------------------|---|-------------------|
| Mr. Leslie Ramcharitar | - | Managing Partner |
| Mrs. Veera Ramcharitar | - | Senior Consultant |

**BOARD OF THE HERITAGE AND STABILISATION FUND OF TRINIDAD AND
TOBAGO**

| | | |
|-----------------------|---|------------------------------------|
| Ms. Avyann Ferguson | - | Chairman |
| Mr. Ewart Williams | - | Governor (Central Bank Rep.) |
| Mrs. Anushkar Alcazar | - | Governor |
| Mrs. Enid Zephyrine | - | Governor (Min. of Finance Rep.) |

| | | |
|---------------------|---|---------------------------------------------|
| Mr. Alister Noel | - | Senior Manager, Operations, Central Bank |
| Ms. Marie Borely | - | CFO, Central Bank |
| Mr. Michael Raymond | - | Economic Policy Analyst, Central Bank |

AUDITOR GENERAL'S OFFICE

| | | |
|---------------------|---|-----------------------|
| Ms. Sharman Ottley | - | Auditor General |
| Ms. Lorelly Pujadas | - | Asst. Auditor General |
| Ms. Reahla Balroop | - | Audit Director |

COMPTROLLER OF ACCOUNTS

| | | |
|------------------------|---|----------------------|
| Ms. Ava Candida-Harris | - | Treasury Executive I |
| Ms. Brenda Jones | - | Treasury Accountant |

COMMENCEMENT

- 1.3 Although a Quorum had been attained at 10:30 a.m., Members agreed to await the arrival of other Members who were expected. Upon their arrival, the Chairman called the Meeting to order at 10:45 a.m.
- 1.4 The Chairman informed Members that Dr. Rupert Griffith and Mr. Anil Roberts had asked to be excused from the Meeting.

EXAMINATION OF MINUTES OF THE SIXTH MEETING

- 2.1 The Committee examined the Minutes of the Sixth Meeting held on Tuesday April 10, 2012.
- 2.2 There being no omissions or corrections, the Minutes were confirmed on a motion moved by Mrs. Corinne Baptiste McKnight and seconded by Mr. Terrence Deyalsingh.

MATTERS ARISING OUT OF THE MINUTES

- 3.1 At paragraph 3.1, the Chairman asked the Attorney General to lead the Committee in discussing the legal opinion presented, on the matter of whether the Auditor General should be auditing the annual accounts of the National Insurance Board. The deliberations of the Committee are summarized as follows:
 - 3.1.1 The Committee considered Section 25(2) of the NIB Act, Chap. 32:01 which states, "The accounts of the Board shall be audited annually by auditors appointed by the Board or under the supervision of the Auditor General in accordance with the Exchequer and Audit Act."
 - 3.1.2 The Committee also considered Section 31(1) of the Audit and Exchequer Act which states, "Notwithstanding anything to the contrary contained in any other written law, the accounts of any statutory body shall be audited by the Auditor General if Parliament by resolution so directs."

- 3.1.3 There was a general agreement by Members that given the legislation cited above, notwithstanding the wording of Section 25(2) of the NIB Act and the resource constraints placed on the Auditor General, the audit responsibility for the accounts of the NIB should be placed solely on the Auditor General, in accordance with Section 31(2)(b) of the Audit and Exchequer Act Chap. 69:01.
- 3.1.4 The Secretary was asked to investigate the procedure for the Committee proposing such a Resolution to Parliament, and to prepare a draft the Resolution for the Committee's consideration.
- 3.2 At paragraph 3.2, the Chairman informed Members that responses were received from the Heritage and Stabilization Fund (HSF) and National Insurance Board of Trinidad and Tobago (NIBTT) respectfully. The Committee considered the response received from the HSF and agreed to the following:
- 3.2.1 *Clarification would be sought on the matter of how the Fund's Managers are paid, whether out of the principal of the Fund, or from the gains based on performance and whether the Managers are compensated notwithstanding the performance of the Fund;*
- 3.2.2 *The question of whether the principal criterion for management of the Fund was principal preservation and whether such criteria are established by the HSF Board would be raised;*
- 3.2.3 *To seek clarification as to what accounted for the remaining 1%, based on the summation of the asset total to 99% as stated in Appendix II, page 14 of the response;*
- 3.2.4 *The legal opinion dated November 28, 2008 prepared by the Process Review Team of the Ministry of the Attorney General was discussed. Members agreed that the Committee would direct the HSF to seek the opinion of an attorney, selected by the Attorney General and at fees negotiated by the Attorney General (not to exceed \$250,000.00 was proposed).*
- 3.3 The Chairman then invited Members to make comments on the response from the National Insurance Board however, some Members expressed that they were not as yet familiar with the document and the Committee as a consequence agreed to postpone that matter to a subsequent meeting.
- 3.4 Notwithstanding the foregoing paragraph, the Chairman asked the Secretary to write the NIB, requesting a status update on the 2010 accounts, which were past the due date indicated to the Committee.
- 3.5 The Committee thereafter proceeded to examine the Baker Tilly Montano Ramcharitar Report and discuss a method of inquiry for the imminent meeting with the HSF *in public*.
- 3.6 Before the Chairman suspended the meeting, he drew the attention of Members to a letter received from the Bookmakers Association of Trinidad & Tobago, citing their expressed discontent on statements made by Mr. Kama Maharaj, Chairman of the Betting Levy Board at the 6th Meeting of the Committee.

- 3.7 The Committee agreed to the request made by the Bookmakers Association for an audience with the relevant authorities, to receive their evidence. The Secretary was asked to draft the requisite reply to the Bookmakers Association, inviting them to the next meeting of the Committee, which by agreement was scheduled for Tuesday June 12, 2012.
- 3.8 The Chairman asked Members to consider a proposed alternative to the existing P.A.C reporting format; that instead of producing an omnibus report, the Committee would report per entity examined. The motion obtained the full support of Members present.
- 3.9 Members then discussed the Committee's work plan for the remainder of the calendar year 2012 and agreed to the following in order of priority:
- i. Betting Levy Board (Bookmakers Association);
 - ii. Unit Trust Corporation;
 - iii. National Insurance Board; and
 - iv. Tobago House of Assembly.

SUSPENSION

- 4.1 At 11:55 am, the Chairman suspended the *in camera* meeting to resume in the J. Hamilton Maurice Room *in public*.

RESUMPTION

Examination of the Board of the Heritage and Stabilization Fund (HSF) of Trinidad & Tobago on the audited financial statements as at September 30, 2011:

- 5.1 The Chairman welcomed the Officials from the Heritage and Stabilization Fund and apologized for the late start, citing that the Committee was engaged in extensive discussions on the 2011 Financial Statements of the HSF *in camera*.
- 5.2 The Chairman asked that the invited Officials introduce themselves for the record (see attendance list on pages 1 & 2).
- 5.3 The Committee then proceeded with its examination of the Heritage and Stabilization Fund audited financial statements as at 30/09/11. The following discussion points emanated from the deliberations held:

5.3.1 *Mode of Payment to Fund Managers:*

The question was raised as to the mode of payment made to the Fund Managers handling the non-US Core International Equities. Members were informed that the two Fund Managers engaged were paid on a commission basis, calculated as a percentage of the market value of the Fund. By this method, if the Fund incurred a net loss, the Managers would still obtain a commission. The remuneration structure for the other Fund Managers was also questioned by Members (see questions at paragraph 5.4 below);

5.3.2 *Loss on sale of investments and increase in unrealized losses between 2010 and 2011*(see paragraph 5.4 below);

5.3.3 *Protective systems employed to minimize or mitigate against losses:*

The Committee was informed that the control mechanism to minimize or mitigate any loss against an adverse movement of the categories is the diversification of the Fund. Further, the built-in control of the Fund was cited as the strategic asset allocation that balances equity changes against movements in fixed income securities;

5.3.4 *Plans to revisit the strategic asset allocation:*

Members raised the question of whether there was any merit in revisiting the strategic asset allocation as well as the standard deviation of 2% for returns on investments. The Central Bank Governor stated in his reply that the Board was mandated via the legislation to conduct a review of the HSF Act after five (5) years, which was currently in progress. He also stated that the decision to review the strategic asset base allocation was a decision reserved for the Minister of Finance and the Parliament.

5.3.5 *Payments to Fund Managers vis-à-vis Fund Performance:*

Relative to paragraphs 5.3.1 and 5.3.3 above, the Committee drew to the attention of the Officials the comparative payment of US\$18.5 million to the Fund Managers in the context of a realized performance gain of US\$10 million. Based on this, Members posed the relevant questions for response (see paragraph 5.4 below);

5.3.6 *Correction of percentage amounts stated in Appendix II of the April 12, 2012 communication:*

Members noted that in Appendix II of the response sent by the HSF Board Chairman dated April 12, 2012, under the column defined as “weight” the US and Non-US Equity percentages were stated @ 17% resulting in a total of 99%. However, the Chairman stated during the course of discussion that the amount was actually 17.5%, which would total the sum to 100%. The Committee asked that the correction be made to the document submitted.

5.3.7 *Legal Opinion (of November 2008) presented to the Committee relating to the accounting for the excess paid into the Fund:*

The HSF Board officials were informed that the Legal Opinion presented was both dated and did not carry an author. As a result, the Committee expressed an opinion that the advice of a Senior Counsel should be procured on the subject. The Committee advised that the terms of engagement would be determined in consultation with the Attorney General (*in camera*).

5.4 Arising out of the discussions, the Committee informed the Board that the Secretary would write the HSF Chairman presenting those questions raised by Members for response. The requested information is as follows:

- 1) The rate of commission paid to the Fund Managers attached to the non-US Core International Equity for the financial year ended 30/09/11;
- 2) What was the remuneration structure for the Fund Managers other than the two in (1) above? Was it a flat payment with a linked bonus, a progressive rate or on a commission basis linked to the performance of the Fund?
- 3) Has the Board contemplated moving to an alternative remuneration arrangement for Fund Managers, e.g. pay for performance?
- 4) What was the dollar value difference of the underperformance between the 0.79% composite return and that of the benchmark of 1.14%?
- 5) What criteria are used in assessing the monitoring and/or performance of the Fund Managers and what measures have been implemented (if any) to treat with underperformance (with specific context to the non-US core international equities)?
- 6) Has the Central Bank or the Board considered re-assessment of the portfolio risk strategies of the Fund with a view to minimizing future revenue losses?
- 7) Does the current standard deviation of 2% allow too much latitude from the benchmark, in light of both past investment returns as well as the current and projected economic climate?

ADJOURNMENT

- 6.1 The Chairman thanked those in attendance and with no further matters for discussion, adjourned the meeting.
- 6.2 The adjournment was taken at 12:53 p.m.

We certify that these Minutes are true and correct.

CHAIRMAN

SECRETARY

May 28, 2012

APPENDIX II

Notes of Evidence

VERBATIM NOTES OF THE PUBLIC ACCOUNTS COMMITTEE HELD IN THE ARNOLD THOMASOS ROOM (EAST), AND J. HAMILTON MAURICE ROOM, 2ND LEVEL, MEZZANINE FLOOR, TOWER D, THE POS INTERNATIONAL WATERFRONT CENTRE, 1A WRIGHTSON ROAD, PORT OF SPAIN, ON TUESDAY, MARCH 13, 2012, AT 10.15 A.M.

PRESENT

| | | |
|---------------------------------|---|-------------------------|
| Mr. Colm Imbert | - | Chairman |
| Mr. Anand Ramlogan SC | - | Member |
| Mr. Anil Roberts | - | Member |
| Mr. Danny Maharaj | - | Member |
| Ms. Ramona Ramdial | - | Member |
| Mrs. Corinne Baptiste-Mc Knight | - | Member |
| Miss Donna Cox | - | Member |
| Mr. Vasant Bharath | - | Member |
| | | |
| Mr. Ralph Deonarine | - | Secretary |
| Miss Keiba Jacob | - | Procedural Clerk |
| Miss Indira Binda | - | Graduate Research Asst. |

ABSENT

| | | |
|---------------------|---|------------------|
| Dr. Rupert Griffith | - | Member (Excused) |
|---------------------|---|------------------|

Also present were:

OFFICIALS OF THE TRINIDAD AND TOBAGO

HERITAGE & STABILIZATION FUND

| | | |
|----------------------|---|---------------|
| Miss Avyann Ferguson | - | Chairman, HSF |
| Mrs. Anushka Alcazar | - | Governor, HSF |

| | | |
|------------------------|---|-------------------------------------------|
| Mrs. Enid Zephryne | - | Governor, HSF (Ministry of Finance) |
| Mr. Ewart S. Williams | - | Governor, HSF (Central Bank) |
| Mr. Michael L. Raymond | - | Research Analyst, (Ministry of Finance) |
| Miss Marie Borely | - | Chief Financial Officer (Central Bank) |
| Mr. Alister Noel | - | Senior Manager, Operations (Central Bank) |

Mr. Chairman: Good afternoon, I would like to welcome the officials from the Board of the Heritage and Stabilization Fund to appear before the Public Accounts Committee. It is probably the first time you are ever appearing before us.

Mr. Bharath: In this term.

Mr. Chairman: Us. Could I ask the members of the Board of HSF to introduce themselves, please?

[Introductions made]

Mr. Chairman: We will have to break. I must apologize, we tried to do a little too much today. We thought that we would be finished with the NIB, but some of the Government Members got a little excited, as you may have seen. We will meet with you for half an hour and we would call you back if we need any more clarification.

We have had a look at your accounts for the years 2008, 2009 and 2010. Mr. Bharath, do you want to start the ball rolling?

Mr. Bharath: Yes, Chairman, thank you very much. It is an issue that has been longstanding. I have raised it in Parliament previously. I think I may have raised it at a previous meeting with the Heritage and Stabilization Fund Board, that is the position that seems to be at odds with regard to accounting for the excess that goes into the fund on a quarterly basis, as opposed to the annual basis. It has continually created a situation for the Auditor General who has commented on it since 2008, in almost every annual report. I just wondered whether in fact the board has taken any steps to get legal advice on this matter. Clearly, depending on how you account for

those funds, you could actually be putting less into the account than you ought to be doing, particularly if you are not actually—although you may be accounting on a quarterly basis—putting funds in on a quarterly basis and therefore, the net result at the end of the year or when you do account may actually be less because, clearly you would have quarters when you have over and then you have quarters when you may not reach the target.

12.05 p.m.

Section 13 seems to be a little different from what section 14 says so, therefore, I just wondered, in fact, you had the opportunity to seek legal advice on this matter, because it has been outstanding, and it has been brought up by the Auditor General on three consecutive occasions.

Ms. Ferguson: The Governor will elaborate, but just to direct you to section 22 a review provision which will be effective this year, at this juncture we are looking to review these sections to provide greater clarity in terms of the accounting.

Mr. Williams: Okay. Yes Sir, you are correct, there is a lack of clarity in the legislation. Let me clarify, however, that on an annual basis the provisions of the legislation were adhered to in the sense that at least 60 per cent of the excess was transferred, so the underlying rationale of the legislation was adhered to. Having said that, there is some inconsistency or lack of clarity inside the Act, you are correct and the issue was raised several times by the Auditor General. We have gotten legal advice and essentially the advice was that we should seek to clarify these regulations. We have made these representations to the Ministry of Finance, but it was not convenient to take that to Parliament or to pursue the amendment. The decision was then taken to pursue the amendment along with other amendments at the time of review of the legislation, which comes up after five years—March or April 2012. So yes, you are right there is a lack of clarity in the legislation.

I must clarify, however, that the underlying objective of the fund has been adhered to, to the extent that in each year at least 60 per cent of the excess has been put in. In fact, if I might clarify, the fund would have allowed a drawdown in one year, 2009 or 2010, because there was a shortfall in actual revenues compared to expected revenues, and the Government decided not to drawdown. So the underlying rationale of the fund has been adhered to, but the amendment is required and the plan is to do it in the context of the overall review in the next—when the time comes in March or April.

Mr. Bharath: Mr. Chairman, if I could continue the discussion just for a moment. So,

Governor, you are then admitting or are you suggesting that the underlying rationale is that the accounting takes place essentially on an annual basis?

Mr. Williams: On accumulative basis, because the legislation says that for the year as a whole no less than 60 per cent of the shortfall should be put into the fund. And, therefore, the rationale was that the transfers be calculated on accumulative basis, but you have this section 13—I think it is, you are correct—that also talks about transferring on a quarterly basis, and that is where the inconsistency comes in.

Mr. Chairman: Governor, if you look at section 14 of the Act, it speaks to the aggregate of the excess revenues, and the Auditor General has made the point to us that this section does not clearly specify whether shortfalls in petroleum revenue for previous quarters, should be taken into account in the determination of the excess petroleum revenue for a quarter. It seems to imply if there is an excess, you have to deposit it into the fund but if there is a shortfall you cannot net it off.

Mr. Williams: No. I interpreted that to mean, if you took the section literally, it would mean for that quarter 60 per cent of the excess should be put in without any consideration having to do with what happened in the last quarter and that is the problem. The problem is, if it was very clear that the calculations had to be done on an accumulative basis then you would be able to make adjustments for any excess or shortfall in the previous quarter; that is the correction which needs to be made.

Mr. Chairman: You are suggesting that it needs to be made clear that it is the total for the year?

Mr. Williams: Sure. Well, cumulatively.

Mr. Chairman: And not whether you had an excess in a particular quarter, then a shortfall in the next quarter, you could only put the excess in but take no account of the shortfall?

Mr. Williams: Sure.

Mr. Chairman: You are saying it should be clarified that it is the aggregate for the whole year. Is that what you are saying?

Mr. Williams: Yes.

Mr. Chairman: Mr. Bharath, you have a question?

Mr. Bharath: Well, I would like to know when or by whom that underlying rationale would have been determined.

Mr. Chairman: I think what the Minister is saying and we had this in our private meeting, is if you have some legal advice could you share it with us please?

Mr. Williams: Okay. But let me clarify—the overriding consideration in the Heritage and Stabilisation Fund (HSF) is that you make a projection for energy revenues—*[Interruption]*

Mr. Bharath: Governor, just for a moment, let me just say this. I am not for a moment disagreeing with the position you may have been taking with regard to the underlying rationale. I am just asking that based on the Auditor General’s continued comments with regard to this matter, I think it is a matter of urgency that we do get this matter clarified; that is all. And I clearly understand what you are saying, revenues and expenditure are proposed for a specific time frame of generally a year and, therefore, one would expect that this would run concurrently with that time frame. So I do not think we disagree with your position that that should be the underlying rationale, but we are saying that it has been ongoing for three years and I think we need to have it clarified.

Mr. Williams: Okay. Then I guess I should clarify that each time it was raised, it was brought to the attention of the Ministry of Finance, and the issue was whether we went to the Parliament with an amendment then, or whether we waited until there was a plan for the more comprehensive review, and I suspect that the decision was to wait for the time of the comprehensive review which is upon us now.

Mr. Chairman: The suggestion being made is if the Central Bank or the fund, let us say the fund—I should not say Central Bank—is of the view that you should use the cumulative total for the year, then you cannot be doing that whimsically, it must be based on advice, that was what came out of our meeting, and you have advise that you should be doing it on an annual basis rather than a quarterly basis.

Mr. Williams: Let me not speak out of turn in the sense that whether there was—we certainly have advice to the extent that the legislation should be clarified, because it was accepted that there was possible inconsistency. So we certainly have a legal opinion that there is need to clarify the conflict.

Mr. Chairman: But do you have advice that what you are doing is correct? That is the point. What you are doing by using the annual figure rather than the quarterly figures? Do you have advice that what you are doing is correct?

Mr. Williams: I do not think we specifically asked for that Sir, but except one comment, Mr.

Chairman, as it has turned out, the transfers to the fund have been at least the 60 per cent which is the underlying rationale of the legislation in each year.

Mr. Chairman: No problem. This was just a specific technical point that Minister Bharath raised, and I think we need to get an answer to it, if this is what you are doing, do you have advice that what you are doing is right? And if you do not have advice, could you seek such advice and just let us know? It will all come out in the wash when the legislation is corrected, so we just wanted to know.

12.15 p.m.

Mr. Deyalsingh: Governor, you said that the underlying rationale, that is 60 per cent of the excess, was deposited in each of the years. Could you indicate to the Committee, as far as your memory could take you, how many years that has been done?

Mr. Ewart: The Fund was improved in March 2007 and for each fiscal year, 2008, 2009, 2010 and 2011.

Mr. Deyalsingh: So there have been consistent deposits over that period in accordance with the Act.

Mr. Ewart: There was one year in which there was a shortfall of actual compared with estimated and there was the opportunity to draw from the Fund and the Government elected not to.

Mr. Chairman: That would be 2009?

Mr. Ewart: Yes.

Mr. Bharath: Just one other, maybe of academic interest. Has anyone done an exercise as to the difference between the amounts that have been deposited based on a cumulative basis as opposed to had the fund been funded on a quarterly basis as some interpretation may have it? Has anyone done an analysis of the potential difference between what should have been deposited on a quarterly basis as opposed to what has been deposited on a cumulative annual basis and what the difference would be?

Mr. Ewart: To the best of my knowledge there has been no formal study. I have done a back-of-the-envelope calculation and it suggests that the transfers would have been slightly less if they were done on a quarterly basis.

Mr. Bharath: But Governor that is not possible.

Mr. Chairman: Could I put this matter to rest please? Could you do a—what is the opposite of

“back-of-the-envelope”—a detailed calculation for us and let us settle this? If it would be less than—

Mr. Bharath: That is not possible.

Mr. Chairman: Let us not argue about it. Could you do a detailed calculation for us, please, and let us see what it would have been if you had deposited 60 per cent of excess revenue every quarter as opposed to on an annual basis?

Mr. Ramlogan SC: Mr. Chairman, I am a bit taken aback that we have been operating without the basis of clear legal advice on the HSF and how to do the calculation, whether quarterly or annually. Where the law is unclear, it is not that you opt to pursue one or the other course without the benefit of some firm and clear legal advice. This is a matter with such great implications for the country that I strongly suggest, Governor, that we go to someone who is an expert in the area and get a legal opinion on the matter as to whether or not the practice that has developed is in accordance with the legislation, bearing in mind what the intention of Parliament may have been at the material time.

I know that you have hired many experts in this area in the commission of enquiry and in other matters, and it may be very well be that you may wish to consider one of the leading experts to provide advice so that we can know the legal justification one way or the other. You may be right, but I do not think it is right to arrogate onto yourself the right to make that decision without the benefit of proper legal advice.

Mr. Chairman: I endorse that, so I do not think we should argue about this. If you have no objection, could the HSF kindly obtain a legal opinion from an acknowledged international expert?

Mr. Bharath: Mr. Chairman, just to mitigate some of the effects of this, I think that what the Governor was suggesting was that on past occasions he may have made requests of the Ministry of Finance to try to obtain that sort of information.

Mr. Chairman: The Fund is an autonomous entity. Am I correct?

Mr. Ewart: Yes, the Fund is but, in the governance structure, the legislation has to be initiated by the Ministry of Finance.

Mr. Chairman: I do not want us to be at cross purposes here. Any amendment, clarification, correction to the legislation must be done by the Ministry of Finance, that is obvious, but in your implementation of the legislation, you should be guided by advice if there is any ambiguity, and

there is one. This is what the Attorney General is suggesting and I am endorsing that. I would not ask the Ministry of Finance to do that. Let the Fund get its own legal advice so that they are protected in terms of what they are doing. The Ministry of Finance could avail itself of that advice and use it to assist in doing the amendment.

Can we go quickly because we will not be going on much longer? We will call you back. Can we go quickly to the statement of comprehensive income for the year ended September 30, 2010? This would be page 2 of your financial statement for the year ended 2010. When you have it, just let me know. Ready? It is the page with income, expenditure, profit, et cetera.

Something came up this morning. I tried to explain it in my own way. We have to ask you now. Let us look first at the loss on the sale of investments in the year 2010. The loss was US \$66 million, whereas the gain was US \$101 million. If you look at the previous year 2009, the loss was about US \$4 million; the gain was about US \$9 million. What accounted for these huge changes in loss on investments and gain on investments between 2009 and 2010?

Mr. Noel: This is related to the composition of the Fund at the time. In 2008/2009, the Fund was primarily short, liquid, fixed deposits and in the year 2009/2010, we transitioned into our asset allocation that would have included more risky assets; that would have more volatility in them; that would include equities, long duration bonds and stuff like that; therefore the profile of active management would be quite different from the previous year.

Mr. Chairman: I understand that, but the numbers are very large and you are just lucky that you had a gain on investments of \$100 million to offset the loss of \$66 million. What would have happened, hypothetically, if you did not have that gain? What types of investment are you investing in that would give you a loss on investments of what is effectively TT \$400 million? I know you have had a gain of \$600 million, but what you are investing in?

Mr. Noel: You have to put it in context of the size of the portfolio and how the Funds are managed. They are actively managed and managed to a benchmark. From time to time, external managers would get in and out of position, buy or sell to get into a particular position. What, from a finance perspective, we looked at, is the return or that benchmark somebody is trying to beat, we would have been ahead of the game. We do not separate it out into losses and gains, but the net effect of that portfolio. So, from an investment manager perspective, one does not look at, "These are my trades that I lost on; or my trades that I gained on." It would have to be in total, how I managed the portfolio. I cannot stretch it out to say what are these losses because

they may have connected other trade that had a positive in it.

Mr. Ramlogan SC: The basket of financial investments that you make, I accept you would want to balance it off and look at the end result. I think what the Chairman is saying is that there must be some deeper analysis to see where there may be a performance deficiency in some aspect of it.

We just had, for example, the NIB and in respect of short term deposits, even if overall they were making a profit, there was an area there that should have been flagged for attention. I think that is where the Chairman is heading and I support him in going there. There must be some deeper analysis. If we take the panoramic approach to say that overall we did well, it is a bit like saying that the country is doing well when oil prices are high and we should not complain about the lack of diversification in the economy.

Agriculture may be doing bad; but oil price is high. To look into the basket to see which fruit is actually rotting and to take off the nice pile of grapes on top, is actually a good thing, not a bad thing.

Mr. Ewart: Just to butt in there, the whole nature of the investment and the reason we paid these external managers is that they are following the market on a daily basis. They are going in and out of the market depending on conditions. We have been going through, for the past four or five years, a market that is characterized by inordinate volatility and things have been going up and down on a daily basis.

Under these circumstances, what we look for, more than anything else, is the bottom line. There will be losses because of the volatility in the market and there will be gains. What has happened is that we have had more gains than losses. The very nature of the market is that no matter what one does now, there will be losses and gains. It has nothing to do with the strategic asset allocation. It has nothing to do with choosing the wrong securities. It is the market that determines the kind of volatility you face. The Central Bank, on an ongoing basis, is in contact with the external managers to understand what is happening in the market and how they are coming in and out.

Mr. Chairman: I think we will have to spend a lot of time on this. Before you go, let me pose some questions to you that the Auditor General raised for us. We will write you to this effect.

1. What criteria did the board use in the selection of the Investment Manager?
2. What are the financial benefits gained from the employment of the Investment

Managers and a global custodian to handle the assets and securities of the Fund?

This is very important.

3. How does the Central Bank ensure that the assets of the Fund are being properly managed by the managers and custodians?

There is a fourth question which you have more or less answered.

4. What are the main contributors to the increased loss on sale of investments?

You have said essentially that you operate on a net basis. We are going to write you on this. We are really concerned on why you moved from having a number of managers managing the portfolio to just one.

Mr. Ewart: Sorry.

Mr. Chairman: There is a comment from the Auditor General. I will read it for you.

With effect from August 2009, the Fund's investment portfolio was handled by a number of individual Investment Managers who are responsible for managing investments and reinvestments of cash security and other property in an account maintained by the custodian. The Central Bank, in 2008, entered into an agreement with a Massachusetts Trust Company to be the global custodian for all assets of the Fund.

It is in the context of that statement from the Auditor General that we are asking what criteria did you use, the selection of the investment managers and what are the benefits to be gained from the employment of investment managers?

We have to cut off soon. Mr. Bharath, you had a question?

Mr. Bharath: Two more questions. It relates to the gain and loss on investment. At the beginning of the year, or if you can give me some other indication as to when, when you are selecting your Investment Managers, do you give them a benchmark of what you are looking for in terms of returns?

The return you would have received for this last financial year would have been less than 1 per cent because you would have gained about TT \$200 million, which is about US \$35 million, approximately. You would have invested about TT \$20 billion, I assume, so your return on investment would have been 1 per cent or less than 1 per cent. Would that have been in line with what you would have been expecting from your Investment Managers for that period?

Mr. Ewart: What year are you talking about?

Mr. Chairman: Mr. Bharath, I think 2 per cent is what I worked it out as.

Mr. Bharath: I am looking at September 2010.

Mr. Ewart: In 2010, the return was 6 per cent.

Mr. Bharath: I am talking about the gain on investment, which is the difference between the gain and the loss, which is about US \$35 million.

Mr. Ewart: I am not sure how meaningful that is. In the final analysis what you look at is the return on investment for the year because you have a whole basket of investment that is moving in different ways.

Mr. Bharath: I agree. I am looking at the net.

Mr. Ewart: The return on investment in 2010 was 6 per cent.

Mr. Bharath: On your income statement, you state—

Members: That is on sale.

Mr. Bharath: Oh, I see. Fair enough.

Ms. Ferguson: That position as at 2010 would have outperformed the benchmark of 5.7 per cent. It was 6.07 per cent.

Mr. Bharath: Are they paid an additional bonus if they exceed your required returns?

Mr. Ewart: Their individual targets; but if they exceed the benchmark they are not. There is a benchmark for the entire portfolio and there are arrangements with the individual managers. The individual managers have some flexibility to go beyond their mandate within certain limits. If they are able to generate excess returns, they can make more money; but they do not make more money on the basis of exceeding the benchmark.

Mr. Chairman: In your statement for 2010, you have \$89 million in unrealized gains from fair value changes. Is there an agreed system where, if the value of your portfolio starts to go down rapidly, the Investment Managers will move in and cut your losses? You are counting on realized gains. These are equities and securities where the value has gone up on paper, but you have not sold it. You have not realized the profit. Do you have some agreement with your managers that, as the value of your portfolio decreases, they will move in at an appropriate time; or are you leaving it up to them?

12.35 p.m.

Mr. Noel: We do not have an agreement with the managers that—a stop loss or anything like that. We do not have that arrangement. The managers are managed on a relative basis not an absolute basis. We appreciate that they are managing in the market, so we are saying we are

going to give you a market benchmark. I mean, hindsight is 20/20, but it is a market driven benchmark. And as the Governor would have said, we experienced some volatility. And if one was to say well, on a couple basis points we sell off, in the long run I am not sure the fund would be better off for that.

Mr. Chairman: Let me ask the question a different way. If the managers do not achieve the targets, what do you do? You fire them, you fine them, you penalize them? What do you do with them?

Mr. Noel: We have investment management agreements with approximately six global managers, and the arrangement is such that we can fire, once we give them a month's notice and that month is really for administrative issues. But we have the opportunity if we find that they are not performing that we can fire—but having said that, this fund has a long-term objective. Therefore, it is with that kind of objective that we do not hire or fire somebody every 'Monday morning', but we look at some sort of history, you know, get some meaningful data before we assess people.

Mr. Chairman: That means that this question is very important. How do you ensure the assets of the fund are being properly managed? We will need an answer to that question.

Mr. Noel: Not now?

Mr. Chairman: No, no, no, not today. I would really like to close off now. It is getting a bit late. We will call you back, but we are going to write you with these specific questions. And it really revolves around what control systems you have in place to make sure the managers are doing a good job, basically.

Two weeks, if you could write the Parliament within two weeks.

Mr. Williams: Could I clarify. We should write—*[Interruption]*

Mr. Chairman: You will be written to by the Clerk of the Committee clarifying what the questions are and then we will ask for a response within two weeks of you receiving the letter from us.

Mr. Williams: Okay.

Mr. Chairman: There is a very important question which we neglected to ask you. Your 2011 accounts are late. We are told they are supposed to be in within four months of the end of the year.

Mr. Williams: Well, the Central Bank submits their accounts to the Ministry of Finance two

months after the end of the year. We have done that. It goes to the Ministry of Finance, there is a process whereby the Ministry of Finance sends it to Cabinet and then to Parliament. The Central Bank has met its deadline.

Mr. Chairman: We have not received it.

Mr. Williams: The Central Bank has met its deadline in that it has submitted the audited accounts as required by the law.

Mr. Chairman: Could somebody from official dom, tell us what is going on? Ministry of Finance, Auditor General, what is going on? If the Central Bank or the fund has submitted their accounts, why have we not received it for 2011? Auditor General, Finance, somebody?

Mrs. Zephryne: Actually, the accounts did come into the Ministry of Finance. The Note for Cabinet is prepared and it has to be deliberated by the Cabinet before it reaches the Parliament. So we are at the stage now where the Note is to go before the hon. Minister this week.

Mr. Chairman: Okay. When do you think it will reach us?

Mrs. Zephryne: Not to preempt the Cabinet, but I will say—it is difficult if I cannot preempt the Cabinet—

Mr. Chairman: Just give us an estimate.

Mrs. Zephryne:—but I would say by the end of March. We will try.

Mr. Chairman: Okay, that is fine. Thank you very much. We will write you, and we will expect your responses, and we will let you know when we wish to meet with you again. Thank you very much.

Meeting ended at 12.38 p.m.

**VERBATIM NOTES OF THE PUBLIC ACCOUNTS COMMITTEE HELD IN THE
ARNOLD THOMASOS ROOM (EAST), AND J. HAMILTON MAURICE ROOM, 2ND
LEVEL, MEZZANINE FLOOR, TOWER D, THE POS INTERNATIONAL
WATERFRONT CENTRE, 1A WRIGHTSON ROAD, PORT OF SPAIN, ON TUESDAY,
May 22, 2012, AT 10.45 A.M.**

PRESENT

| | | |
|---------------------------------|---|-------------------------|
| Mr. Colm Imbert | - | Chairman |
| Mr. Terrence Deyalsingh | - | Member |
| Mr. Anand Ramlogan, SC | - | Member |
| Mr. Danny Maharaj | - | Member |
| Ms. Ramona Ramdial | - | Member |
| Mrs. Corinne Baptiste-Mc Knight | - | Member |
| Miss Donna Cox | - | Member |
| Mr. Vasant Bharath | - | Member |
| | | |
| Mr. Ralph Deonarine | - | Secretary |
| Miss Keiba Jacob | - | Procedural Clerk |
| Miss Indira Binda | - | Graduate Research Asst. |

ABSENT

| | | |
|---------------------|---|------------------|
| Dr. Rupert Griffith | - | Member (Excused) |
| Mr. Anil Roberts | - | Member (Excused) |

OFFICIALS

Auditor General's Office

| | | |
|--------------------------------------|---|-----------------------|
| Mrs. Sharman Ottley | - | Auditor General |
| Miss Lorelly Pujadas | - | Asst. Auditor General |
| Miss Reahla Balroop | - | Audit Director |
| Consultants from Montano Ramcharitar | | |

Comptroller of Accounts

| | | |
|--------------------|---|---------------------|
| Miss. Brenda Jones | - | Treasury Accountant |
|--------------------|---|---------------------|

Miss. Ava Candida-Harris - Treasury Executive I

Also present were:

OFFICIALS OF THE TRINIDAD AND TOBAGO

HERITAGE & STABILIZATION FUND

| | | |
|------------------------|---|-------------------------------------------|
| Miss Avyann Ferguson | - | Chairman, HSF |
| Mrs. Anushka Alcazar | - | Governor, HSF |
| Mrs. Enid Zephryne | - | Governor, HSF (Ministry of Finance) |
| Mr. Ewart S. Williams | - | Governor, HSF (Central Bank) |
| Mr. Michael L. Raymond | - | Research Analyst, (Ministry of Finance) |
| Miss Marie Borely | - | Chief Financial Officer (Central Bank) |
| Mr. Alister Noel | - | Senior Manager, Operations (Central Bank) |

Mr. Chairman: I think we have the full committee here, with the exception of Minister Roberts and Minister Griffith. I think we are all fairly well-known. I do not think we need to introduce ourselves.

I now open the meeting to questions from Members. Who would like to go first? Mr. Deyalsingh, you went first upstairs.

Mr. Deyalsingh: Thank you, Mr. Chairman. Given that the West Indies does not have a very good opening player, I will go first and open the batting. I will pose the question to anyone who feels comfortable answering.

Given the losses incurred especially in one of the instruments, which is the non-US Core International Equity Fund, the advisors to this particular Fund, are they paid by commission, a flat fee or is it a combination? In other words, whether the Fund does good or bad, are they still paid?

Mr. Williams: I would ask Mr. Alister Noel, who is the Central Bank representative to follow

the Fund on a daily basis to take that one.

Mr. Noel: That particular mandate has two managers and they are both paid, on a commission basis, a percentage of the market value of the Fund; so the absolute figure would be lower if the Fund loses value or higher if the Fund gains.

Mr. Deyalsingh: If the Fund actually loses or makes a net loss, would they still get something?

Mr. Noel: Yes, they will get a commission.

Mr. Deyalsingh: How do you calculate a commission on a loss?

Mr. Noel: Their fees are calculated on the market value of the Fund. It is not on the gains or losses on the Fund.

Mr. Chairman: So, they are paid a percentage of the value at the end of a particular period; a quarter or a six-month period?

Mr. Noel: It varies from mandate to mandate but in this particular instance it is paid on a quarterly basis, so it is the average monthly market value.

Mr. Chairman: Would you be able to tell us now what they are paid—specifically the non-US Core International Equity?

Mr. Noel: We can always provide the figures at basis points.

Mr. Chairman: You cannot say offhand how much they are paid?

Mr. Noel: I would prefer to get the figures.

Mr. Chairman: Mr. Deyalsingh, you understand what is happening here.

Mr. Williams: Can I clarify so that we know what we are answering. We are talking about the operations of the Fund in the year ended September 2011. During that year, the Fund, as a whole, had a positive return of 0.79 per cent. That was perhaps the worst year for the Fund.

During that year, the fixed income mandate had a positive rate of return, but there were losses on the equity mandate, particularly the non-US equity mandates. The question is whether the managers of the particular mandates were paid or whether they got commissions on their mandate. Is that the issue?

Mr. Deyalsingh: That is correct.

Mr. Bharath: Mr. Noel, you mentioned that there were two mandates—

Mr. Noel:—two managers in this particular mandate.

Mr. Bharath: Did they perform similarly or not?

Mr. Noel: Yes, they performed in line with the market. Not to lump the year as a whole, up to

June 2011, the total return of the Fund would have been in excess of 5 per cent. You had certain material things occurring on the financial market; more uncertainly about the debt crisis in Europe and the possibility of a break-up—very similar to today where you have those same kinds of headline risks and stuff like that. You will see the Fund moving from a little over 5 per cent to just about 0.79 per cent. You would have seen that up to that point we would have had positive returns from both managers. The non-US is the one that would have the bigger exposure to Europe and such.

Mr. Bharath: I understand that. I just wanted to confirm for now that both managers performed similarly.

Mr. Ramlogan: Thank you, Mr. Chairman. The Auditor General flagged two issues: the increase in the loss on sale of investments and the increase in unrealized losses when you compare the 2011 figures to the 2010 figures.

I wanted to know whether we are looking at the individual bad apples in the basket to see whether or not specific trades that generated material losses within the basket are being properly monitored and tracked. Whereas one might look at the composite return and take a panoramic picture—within that basket there may have been specific trades that if monitored properly; if we detect them early rather than hold on to them and continue to see them give declining yield, we could arrest that decline by selling them off early or making some adjustments. Is that being done?

Mr. Williams: I would like to clarify that the process of identifying the fact that markets are moving in a particular direction in this particular case, the process of identifying that equity markets were facing difficult headwinds and that losses were being generated, that process itself is what creates the loss. What happens there is that the manager recognizes that equities are moving in a particular direction, he immediately moves to sell and that process of selling makes the loss. It ends up that by coming out of these equities, what the manager is trying to do is to stem the run. Because of the accounting conventions, you would see that there is a loss on the sale of those investments and that is why we tend to think that the way of looking at it is what happens in equities for the year as a whole or the quarter as a whole because the manager would sell loss-making equities and he would make profits on the new equities he buys.

Mr. Maharaj: In terms of the movement, let us say there is a decline in the equity market and there is a movement, you said that the loss would be realized by selling off the equity. My

question is about the point of selling off. How long do you wait—\$20 million, \$50 million, a \$100 million? Is there a cut-off point where the manager would say the movement has become too large to sell off? Do you have a cut-off point?

Mr. Williams: It is a judgment call for the manager. The manager is told there is a certain benchmark rate of return that you must make. In this case, given the fact that the market was facing difficulty in that last quarter, the manager would have had to face up to a situation where the benchmark was also facing difficulties. For the year as a whole, ending September 2011, the benchmark rate of return was 1.14 per cent. We ended up making lower than the benchmark, 79 basis points. I guess the issue is: how does one explain the underperformance in relation to the benchmark? I will like Mr. Noel to explain that difference between 0.79 per cent and 1.14 per cent.

12.10 a.m.

Mr. Ramlogan SC: Before he does, I would be interested in knowing because essentially, you are paying these people to beat the benchmark—that would be the ideal situation.

Mr. Williams: Yes.

Mr. Ramlogan SC: And if you are paying them to beat the benchmark, and they are not beating the benchmark, I will be interested in knowing well what is the structure of the remuneration? Is it that as they progressively go lower and lower from the benchmark that the commissions get less and less? Is it that we pay them a flat salary with a bonus that is linked or a commission that is linked to the performance and to the yield of the fund? How is it structured? Is it that the report should not give some specific details on these differences and the poor performance of relevant investment managers, perhaps, that would have contributed to the underperformance when compared to the benchmark index, so that we could identify them as it were?

Mr. Williams: Before Alister takes that up, I would like again to make the basic point, it is misleading to look at the performance of the fund over any particular year and call it poor performance. It is very misleading to do that, to the extent that the fund is going to move a large part in line with how the international economy moves, okay.

As Alister noted, for this year 2010-2011 up to September of that year the fund was showing positive rates of return of 5.7 per cent, or something like that. That year, the rate of return was 07.9 per cent. What happened was, in the last quarter of the fiscal year the European investment climate turned very bad. It had to do with the sovereign debt crisis and in particular

the difficulties in reaching agreement on Greece bailout.

What happened was, that investment, the equity markets, particularly in Europe, tanked, they went south, there was a shift to quality, investors pulled out their money out of European equities, and went to, in particular, US fixed income, and less so in US equity markets. I think we need to be careful about identifying a movement of one year and call that poor performance. Because the report notes that from inception even to the end of the fiscal year that is now being considered, 2011, the fund was showing positive rates of return of close to 4 per cent which was even larger than the benchmark for that period.

So, 2010-2011, was not a good year. But what happened thereafter? In the quarter immediately thereafter there was a rate of return of 2.74 per cent, and in the first quarter of this year there was a rate of return of 5.04 per cent. So, it is difficult to identify any particular period—you know, one particular year—and see that as a case of poor performance, and see that as a basis for punishing the investment managers.

I would want, Allister however—I think the question you raised about basis for the compensation is a good one. I would want Allister to—*[Interruption]*

Mr. Ramlogan SC: Governor, before he does, I just want to make the point, we get your point that it is a continuum and you cannot do it in a vacuum in isolation for one particular quarter or one particular year, and that point is well made. But bear in mind that what is before us as this Committee, is in fact, up to a point in time, and we cannot go beyond that as it were, to take into account matters which would have occurred subsequently.

I am interested in knowing, to the extent that the composite return for 2011 did not meet the composite benchmark, could you translate that loss into dollars and cents for me please, and tell us what did the fund actually lose because it is .79 per cent while the benchmark was 1.14 per cent? And that is what the fund's composite return for 2011, as I understand the accounts, was .79 per cent as compared to an expected benchmark of 1.14 per cent.

So, what does that translate—what does that loss mean in dollars and cents? How much money did we lose when we compared it?

Mr. Williams: Sorry, Mr. Chairman. There is no loss. The gain was not as large as—*[Interruption]*

Mr. Ramlogan SC: Sorry! When I say loss, I mean in terms—when you compare it with the benchmark. So when you compare it to what you—because your benchmark is “pretty high”.

Because the benchmark has not been reviewed or adjusted downwards for some time. Your benchmark has been in place for how long now?

Mr. Williams: The benchmark—well from the start, but the benchmark changes with particular circumstances. Therefore, what the benchmark says is that given what happened in international markets through, in 2010-2011, we would have expected—[*Crosstalk*]

Mr. Ramlogan SC: Sure! I understand that.

Mr. Williams:—a rate of return of 1.14. The rate of return turned out to be 0.79.

Mr. Ramlogan SC: Indeed.

Mr. Williams: One other point that is worth clarification is that your portfolio never perfectly replicates the benchmark. The benchmark is the closest approximation to the portfolio that you can get, and therefore, I think what Alister would explain is, why, given the benchmark which simply replicates the portfolio, how do you explain the difference between the rate of return from the benchmark and the actual rate of return?

Mr. Ramlogan SC: And all I am saying, Governor is, before he does that, I am interested in knowing the quantification in terms of the underperformance of the fund. The benchmark is something that I suppose, scientifically and mathematically, you all will calculate in light of the prevailing market conditions and climate. I understand perfectly your point, that this it is not—you know, it may very well be a moving target. And we understand the international crisis, especially in particular in light of what has happened in Europe. So that point is well made, and I am not going to make any bones about that. But I still want to know, to the extent that we had a benchmark which is used as the bar beneath which we want to limbo but not be burnt.

If we had achieved our benchmark what would have been the yield of the fund, or what would have been expected to get as opposed to what we actually got? What does that loss quantify? Just so we will have an idea in dollars and cents? What we expected to get if all things went well, all things being equal as opposed to what we ended up with? Because the accounts put that in—you are getting that in percentages, I could not pick up on it in terms of dollars and cents.

Mr. Chairman: All right, gentlemen. I have allowed you a little latitude. Governor what we are trying to get at here, we are trying to understand as a committee what happened with one particular component of the fund in 2011. And that is the non-US core international equity component. I think what Members are driving at is that, what are the protective systems in place

to minimize or mitigate any loss in any particular component on the fund, in particular this one. Generally, we would like to know what are the checks and balances that are in place to minimize any possible loss. And also, what actually happened during 2011 with respect to minimizing the loss in this particular component? I have a specific question of that. What percentage of the fund is held in non-US core international equities?

Mr. Williams: Mr. Chairman, I understand the question. The control or the mitigant to minimize any loss against an adverse movement in any of the particular categories is the diversification of the fund. The fund says—or the portfolio of the fund includes only 17.5 per cent in international equities, 17.5 per cent in US equities, 40 per cent in core fixed income and 25 per cent in short term fixed income.

The rationale is that all four markets cannot face difficulties at the same time. Therefore, the biggest control against weakening in any of these markets is the diversification. Okay. What happened in 2010-2011 was, that for the years as a whole equities performed badly. Therefore, both US equities and international equities performed badly, the latter performing worse than the former, simply because of the difficulties in Europe.

Because of the diversification of the fund there was a positive rate of return of around 1.66 per cent, I think, in the fixed income component of the fund; a rate of return of 1.6 per cent in the fixed income component. That was, however, offset by a loss in the equity portion of the fund. The specific answer to your question, therefore, what is in place to mitigate the loss in the non-US component? What is in place is the diversification whereby 40 per cent of the fund was held in fixed income longer term securities and 25 per cent of the fund held in fixed income, short term securities.

The built-in control of the fund is its strategic asset allocation that balances what happens with equities with what happens with fixed income securities.

Mr. Chairman: Governor, I do not know how to put this. We are not debating this issue right now. We understand, we think the fact that the fund has to be looked at on a continuous basis; we understand what happened in the market last year. We understand all of that. It is just from the perspective of the Committee; we are particularly interested in this component of the fund. Did you tell me what percentage of the fund is in a non-US core international equity?

Mr. Williams: Seventeen point five.

Mr. Chairman: Seventeen per cent?

Mr. Williams: Yes. At the end of that year it was approximately 15 per cent.

Mr. Chairman: And that would be about what; US \$6 hundred or US \$7 hundred million? Am I correct?

Mr. Williams: Fifteen per cent of—at that time the fund was just under US \$4 billion.

Mr. Chairman: So, say about US \$600 million.

Mr. Williams: Yes.

Mr. Chairman: So that these two—*[Interruption]*

Mr. Williams: Six twenty-one (US\$621 million).

Mr. Chairman: Yep—managers were managing approximately US \$600 million and experienced a loss of 1.66 per cent in the US \$600 million. So, what is that, about US \$10 million?

Mr. Williams: Yes.

Mr. Chairman: And all we are looking at, is what could have been done, what was done to mitigate that loss? That is all we want to know. We are not condemning anyone. We see the whole picture, but we are just zeroing on that particular component. What was done, and could have been done. Mr. Deyalsingh, could you chair the meeting for a second. I just need to deal with a matter.

[Mr. Deyalsingh in the Chair]

Mr. Ramlogan SC: Governor, do not forget my point. Maybe you would not have it at your fingertips, but I am still interested in knowing the dollar value of the underperformance. If you could extrapolate the figures or translate it into a dollar value, I am interested in knowing that.

Mr. Bharath: US \$28 million.

Mr. Ramlogan SC: Is that correct, US \$28 million?

Mr. Williams: Between the benchmark of 0.79 and 1.14. *[Inaudible]*

Mr. Deyalsingh: Governor? Could you put on your microphone, please?

Mr. Ramlogan SC: Governor, I appreciate that. I have agreed with you on that.

Mr. Williams: Okay.

Mr. Ramlogan SC: It is not loss, it is underperformance by comparison to the benchmark set. It is really an underperformance because overall, you know, given the climate, and so on, I take your point.

12.25p.m.

Mr. Noel: I will attempt to answer the question about what happened and what was put in place to mitigate some of the losses. I think I need to step back a little and talk about some of the things we have in place. One is that the Heritage and Stabilisation Fund is actively managed. We would have tried to explain what “active management” is. It means that we would have hired or engaged a number of asset managers with various expertise. They would have various views of the market. We would give them a market-base benchmark, so it is not a fixed benchmark. It is a benchmark with indices that are market driven—so it changes daily, monthly and quarterly—and their task is to outperform this benchmark.

We would have also given them—because of the board particular tolerance to risk—what we call a risk budget to tie them to that benchmark, so they cannot go and bet everything on one particular stock. You would have something called a “tracking error” which is the variance the managed portfolio’s performance could have away from that benchmark performance. So, given that context, you would have had managers in the non-US equity portion of the Fund, which accounted for a little over 15 per cent at the end of the year of the whole Heritage and Stabilisation Fund.

Up to the end of June we said they would have outperformed the benchmarks, and then the quarter ended September occurred, in fact, if I am not mistaken, August was particularly bad with equity markets really capitulating. At that point in time, we would have had some exposure to what some may consider “blue-chip companies”. The markets capitulated and we would have had managers trying to stay within the tracking error that we gave them, and managers would have different views and different opinions and, in some cases, tried to get closer to the benchmark.

In particular, one manager’s sector weights was a little outside of the benchmark, hoping or assuming that we would have had a market rally. It just worked out that the rally came later, because our financial year ended September 30, 2011. Having said that, in the quarter ending December, 2011, we would have had a great quarter, because in October and November when you would have had some sort of settlement—well now it may not be considered a settlement—but, at that time, it was felt that there was some settlement of the Greek debt crisis and how the European Union going to handle it, you had a rallying of the equity market, those same positions that were dogs in the quarter ending September rallied in that quarter. So, for the quarter in question—I am not going to look at the whole financial year, but look at that particular quarter—

if I look at it, I would tell you that the benchmark lost a little over 19 per cent in that quarter alone September, having that positive right through the previous quarters. So I just want to kind of fine tune it to just that quarter ending September where we had those losses.

[Mr. Chairman left the Meeting and Mr. Deyalsingh took the Chair]

We had two managers that at some point in time tried to get closer to the composition of the benchmarks or replicate the return of the benchmark, and maybe it was a little too late in some circumstances, but as time exposed, those same equity positions would have done well in the following quarter. Well, we are not dealing with this current fiscal year, but would have done very good in this fiscal year. So it is just trying to normalize and reduce their variation between the benchmark over that quarter that happened

Mr. Deyalsingh: Do we have any questions from Members of the Committee who have not yet asked.

Mr. Bharath: Thank you, Chairman. Am I to gather from the statements made with regard to performance in the last quarter of 2011 which is the period October—December—this is just for information—

Mr. Williams: The last quarter is July—September.

Mr. Bharath: No, I am just going a little before.

Mr. Deyalsingh: Members, when you are answering, please put on your mikes.

Mr. Bharath: Just for informational purposes, am I to gather that the unrealized loss of \$167 million has been increased based on performance, because we have an unrealized loss of \$167 million recorded to the period September, 2011? I am interesting to find out—I am just basing it and maybe I am wrong, on the statements that the Governor made with regard to what took place, although it is outside the ambit of what we are examining today for the last quarter of the calendar year, October—December, 2011—would that have increased the \$167 million unrealized loss?

Mr. Williams: No, sorry. There was a turnaround.

Mr. Bharath: Okay, fine. I just wanted to confirm that.

Mr. Williams: There was a turnaround. What happened was in the quarter October—December markets improved; market sentiment improved and there was a turnaround and what was a loss became a gain. One additional point, the 0.79 loss for the year as a whole—well the rate of return of 0.79 for the quarter ending December became a gain of 2.74.

Mr. Bharath: Okay, perfect. Having said that, and in light of the fact that the markets have been very turbulent, is there any gains to be had at relooking at your strategic asset allocation at this point? Secondly, is there any merit in also looking at your 2 per cent standard deviation? If it is that your returns are so low on your investments, giving a 2 per cent standard deviation seems to be giving your investment managers a very wide portfolio and a lot of room when your benchmark is 1.14, for example.

Mr. Williams: Let me clarify that the Heritage and Stabilisation Act provides for a review of all the main elements of the HSF after 5 years and the five years end around now. In fact, five years after March 2007 is March 2012 and, therefore, there would be a review. A review of the HSF has started. The review is now taking place at the level of the board and that would move to the level of the Ministry of Finance, because it is the Ministry of Finance that would make the proposal for changes in the strategic asset allocation. That review is taking place.

Your question is based on what we have seen, and what we have seen would be what we have seen over the last five years, not what we have seen only in this particular year. Is there a case for reviewing the strategic asset allocation? It would be a decision for the Minister of Finance and the Parliament. As far as we are concerned, we are still here ahead of the game.

If you look at the whole five-year period, it was envisaged that a rate of return of 3.5 per cent in real terms. The rate of return has exceeded 3.5 in real terms for the five-year ended March, 2012. The rate of return has been closer to 4.6 per cent in nominal terms, which in real terms is larger than the target of 3.5 per cent.

[Mr. Chairman rejoins the meeting]

Mr. Chairman: Gentlemen, allow me to rejoin this Meeting. I am sorry I was not here for the last couple of minutes. I am listening to what you are saying Governor, but you see we have all the figures. We have seen the performance of the fund since its inception. What we are doing this morning is just looking at the 2011 performance.

We looked at the 2010 performance, a couple months ago and it was quite good, 6 per cent or something like that, so we were happy with that. But now we have come to look at the 2011 performance and we are not happy with it. We are all aware of what is happening in Europe, and we all watch CCN and so on, so we do know what is going on. We just want to make sure that when you have a nonperforming element like this, which is US \$600 million, TT \$3.5 billion, that there are systems in place to prevent any significant loss and that is all we are

driving at.

I want to ask specify questions now and I know you would not be able to answer them right now, I suspect you would, but we would like to get them in writing, please. Do your managers use stock prices? In other words, do they set a price at which they would sell equity on the assumption that it is declining in value or do they use a percentage loss? Can you tell me that now or would you have to go away and come back and tell me what methodology your managers are using to minimize losses in a declining market?

Mr. Williams: I would certainly provide you with more information on this later on, but I still think it is important to clarify that any manager facing a judgment call in the course of any particular period, the manager needs to ask himself—

Mr. Chairman: Governor, please. We are not debating anything here. We are not in Parliament debating anything. Please do not take what I am saying the wrong way. We are just asking specific questions. We know the fund has performed well over the last several years. We know that; we got the documents. We know it did well last year and we spoke about that in this very room, we are not talking about that.

We, as a Committee, the entire Committee, zeroed in on the performance in the Non US Core International Equity which was not a good performance. There are other things we zeroed in on as well; the managers were paid \$18.5 million and yet the fund only realized a net gain of \$10 million. So is it good business to pay managers \$18 million to gain \$10 million? We are talking about US dollars here. They were paid in excess of TT \$100 million to give us a gain of \$60 million. All we as lay people are trying to find out is, firstly, are there sufficient systems in place to protect the integrity of the fund? In the same way that the fund made .79 per cent they could have loss 79 per cent. It could have, because the managers managing the Non US Core International Equity may not have stopped or sold at the appropriate time.

So, all we are trying to find out as lay people is, what are the systems in place to prevent a loss in the capital value of the fund in the context of what has happened with this Non US Core International Equity. That is all we want to know. What are the protective systems in place? Are you happy with the fact that we paid these people US \$18 million for them to earn us US \$10 million?

There was another question Members asked upstairs which I would put to you, because we are running out of time. How was the performance of these managers when compared to

other managers managing other sovereign funds around the world? Were they average, better or worse than other managers dealing with this same type of fund?

Mr. Ramlogan SC: While they are thinking about the answer to that, I just wanted to pose another question as well. I noted that there is an independent audit of the global custodian, and that was done by Ernst and Young, but I noticed that there is no similar independent audit of the investment managers. I wonder whether or not that is something we should not look at. The reason I say that is, this fund is being managed by eight international investment managers, but I do not see any provision made for us to obtain any niche specialist advice outside of those eight fund managers, for example, in accounting, tax law, asset counselling or anything else.

It may very well be, as opposed to just having simply eight managers, that the HSF itself might want to have regard to having specialist expertise in niche areas for its own self to help us to evaluate the performance of the fund and the investment managers themselves. So I do not know if E&Y is doing something that they should not do at the global custodian, anything on the performance of the managers who have been selected for a little while now.

12.40 p.m.

Mr. Chairman: As I said we are running out of time, the Secretary will write to you and record what our questions are.

There is a specific question which has been suggested that we ask you. What are the criteria that you use for assessing the performance of the fund managers and what measures have you implemented to treat with underperformance? Could you do that specifically in the context of non-US core international equities?

Another question, Minister Bharath had brought this up, but I think I should crystallize it. Has the Central Bank or the fund revisited its portfolio risk strategies with a view to minimizing future revenue losses? And, dealing with Mr. Deyalsingh's question, since you are paying the fund managers a flat fee, based on the value of the portfolio, have you considered moving to a reward payment by performance, so that if they perform, they get a bonus and if do not perform they get a penalty? Has the Fund considered this at all?

Mr. Noel: There are a number of questions, but I will try to respond to some of the things. When we select the managers, we would have looked at a number of fee proposals, and one of the fee proposals would be what you suggested: a bonus structure. If you outperform the benchmark, you would have gotten a particular fee. Most of those things, just like most services

out here, would have had first a flat fee higher than the variable fee that we have, because we have a percentage of market value. That percentage would have been much higher in that model, where you pay for outperformance. You get additional fees for outperformance, so your base fee would have been much higher.

At the time, with the assistance of the World Bank, our consultant, we felt that this model would have been sufficient. In this particular year one would say that maybe we did not benefit as we should have. In the previous year we did, because if you are looking at that figure it is \$15 million versus the 6 per cent that the Fund would have made. Having said that, that \$18 million also includes the custodian fees. The custodian is really the watchdog of the asset managers, so that is where we place the importance. If the custodian is looking after the interest of the HSF, they are looking at the compliance of the investment managers' compliance with our investment guidelines—the custodians are doing that—that is why we have the independent audit of that particular person. To have another audit of the investment manager, I mean, that is for the board to discuss. We felt that the main risk was, if we are going to have this third party looking at the activities of the Fund, then we should investigate, independently assess that third party. That is why in our response to the previous meeting's questions we would have spoken about that independent audit.

Mr. Chairman: So you are using someone else to look at the fund manager, and instead of looking at the fund manager, you are looking at the custodian? Is that what you are saying? Rather than examining the performance of the fund manager, you are examining the audit by the custodian of the fund manager you are examining the audit by the custodian of fund managers.

Mr. Noel: No, no, no. As we would have responded, on a daily basis we monitor the performance of the external managers. I am speaking only as to particular controls in assessing their compliance on an ongoing basis with our investment guidelines. That is why the custodian is a key—when we responded to all the controls last time—that is key. But we, from the Central Bank perspective, monitor our external managers on a daily, on a monthly, on a quarterly basis. In fact, we would have gone through pains to describe that we have quarterly conference calls with these custodians. They visit us on an annual basis for us to really ask the hard questions, to understand and appreciate their strategy going forward.

Mr. Chairman: The specific question I asked was what criteria you used to assess the performance of the fund managers and what measure have you implemented to deal with

underperformance by the fund managers. Those are the specific managers.

Mr. Noel: We can answer that in specific detail.

Mr. Chairman: We need to wrap up soon. So before we wrap up, could we just have final question from members please.

Mr. Vasant Bharath: Thank you, Chairman. I just wanted to come back to the question I raised about the standard deviation of 2 per cent. I just want to reinforce. Clearly if you have a bench mark of 1.14 per cent and you have a standard deviation of 2 per cent, then it is clear you are expecting a possible loss. I am just asking whether in light of the reduced investment returns, do you not believe that the standard deviation of 2 per cent may be giving your investment managers too wide a latitude from the bench mark.

Mr. Williams: Just to clarify, Mr. Bharath. In fiscal year 2011, the actual portfolio return was 0.79 per cent and the benchmark was 1.14 per cent and there was underperformance in that year. In the previous year, the portfolio return was 6.07.

Mr. Bharath: Governor, I understand all of that.

Mr. Chairman: Mr. Bharath—before I have a riot from the members on this side, because they are ready to protest, we are not interested in the previous year. I do not know how bluntly to put this, but that is the only way. We are not interested in the previous year.

You see, this committee deals with matters *ex post facto* in the year of review. We are only looking at the 2011 accounts. We are not looking at 2010; we are not looking at 2012. Unfortunately, we just do not operate that way. Could you please respond, dealing with the specific matter, without using 2010 as a comparison.

Mr. Bharath: Governor, before you respond. Chairman, just in defence of the Governor, that clearly what he is attempting to do is place everything in context. The question I am asking him is going forward, and of course he would have to make a determination based on—I think we are all clear that the previous five years returns were significantly higher than they are this year. The question is: based on your knowledge of the prevailing conditions today and what is likely to happen, which is your best guesstimate, as would be the case for your investment managers and so on, in Europe and elsewhere, in the next year or two, do you not believe that the margin of 2 per cent standard deviation may be high going forward?

Mr. Williams: Minister Bharath, I do not need to speculate because I actually have what has happened since then. I actual have what has happened in fiscal year 2012 in the first quarter. I

actually have that. In the first quarter so far in fiscal year 2012, on an ongoing basis, the cumulative portfolio return has been 5.27.

Mr. Bharath: So the answer is no?

Mr. Williams: The answer is no. The cumulative return has been higher than the benchmark.

Mr. Chairman: Any other questions?

Sen. Deyalsingh: Just a last observation. The package of documents signed off by Ms. Avyann Ferguson on April 12, 2012, if you turn to Appendix II, it engaged Mr. Bharath's thoughts upstairs where under the column "**weight**", they added up to 99 per cent. You have 17 per cent US equity, 17 per cent non-US equity. But during the Chairman's answer to one of the questions, he actually said it was 17.5, so that needs to be corrected, so we could then find that 1 per cent missing, because 1 per cent of billions of dollar is a lot of money. So just correct the columns under "**weight**", and increase US equities and non-US equities from 17 per cent to 17.5 per cent.

Mr. Williams: Okay.

Mr. Chairman: Any other question? Okay, gentlemen and ladies, the Secretary will write you and state concisely what our questions are, and we will expect the usual response from you.

Mr. Bharath: [*Inaudible*]

Mr. Chairman: Oh yes. Attorney General, I will hand this over to you.

Mr. Ramlogan SC: I think the committee noted the legal opinion that was provided by the HSF in response to a query that was raised on the last occasion. It is a bit dated, it is to November 2008 and also, Madam Chairperson, the author of the legal opinion does not appear on the legal opinion itself. In those circumstances, the committee felt, if you have no objection really—it was the feeling of the committee, Ms. Ferguson, that perhaps we could get the advice of a senior counsel on this matter, to be selected by the Attorney General, fees not to exceed a stipulated—an agreed figure, which we can share with her in private, as it were. But we feel that this is a sufficiently important matter on which we should get some clear guidance and an updated legal opinion.

Mr. Bharath: Chairman, just to add some weight to that, you would see that the Auditor General has again brought it up as an emphasis of matter, which really is bordering almost on—I will not suggest qualifying—but it is significant, because they have been bringing it up continuously over a number of years.

Mr. Chairman: When you reach the 2008 opinion it is a bit confusing. As the Attorney General has pointed out, that is not all that is wrong with it. There is no author and is virtually anonymous and out of date. We suggested this morning, and we will ask you to do, is to engage a competent attorney. I understand the concern about fees; lawyers do charge a lot of money for these things. So the Attorney General has undertaken to negotiate the fees and to bring them down to the lowest possible level, but we do need to clear this up, otherwise we would just been spinning around in circles with differences of opinion.

There is a clear divergence of opinion as to whether the money should be deposited quarterly, or the calculation to be done quarterly, or it should be done annually, it should be an aggregate or you should disaggregate or carry forward the figures from the previous quarter into the next quarter or use it from a year to year basis. There is a clear divergence of opinion. We would not want the Auditor General to continuously raise this as an issue, and we just deal with it in a nonspecific manner. So I would ask the Attorney General to liaise with the Fund and see if you can sort this out.

Ms. Ferguson: And the opportunity arises now for us to clarify the position in the terms of the review of the legislation, so we would have the opportunity to make it extremely clear so we will not have this divergence of opinion when the legislation is reviewed.

Mr. Chairman: That is fine. Anything else?

Thank you very much.

12.53 p.m.: *Meeting adjourned.*



MINISTRY OF THE ATTORNEY GENERAL

Cabildo Chambers
23-27 St. Vincent Street
Port of Spain

Phone: (868) 623-4282, 625-6531, 625-8901
Fax: (868) 625-6530, 625-0470, 624-1986
E-mail: ag@ag.gov.tt

M E M O R A N D U M

To: **Auditor General**

From: **Senior Legal Adviser
Process Review Team
Ministry of the Attorney General**

Date: **28th November 2008**

Sub: **Heritage and Stabilization Fund**

The subject above and my memo dated November 17, 2008 on the subject above refer.

The Attorney General has approved the following advice.

The content of the Heritage and Stabilization Fund Act 2007 (hereafter "the H&S Fund") has contributed to a situation where 2 reasonable interpretations can arise in respect of the method to be adopted when deposits are to be made to that Fund. However, only one of them is in accordance with the Act. In this regard, perhaps the Ministry of Finance in the approval of the draft legislation should have insisted on greater clarity in the expression of its intent.

Section 13 (1) and (2) of the H&S Fund Act 2007 states as follows:

“(1)Where petroleum revenues collected in each quarter of any financial year –

- (a) exceed the estimated petroleum revenues for that quarter of the financial year by more than ten per cent, the currency of the United States of America equivalent of the excess revenue shall be withdrawn from the Consolidated Fund and deposited to the Fund in accordance with section 14 (1); or*
- (b) exceed the estimated petroleum revenues for that quarter of a financial year but do not exceed such estimated revenues by at least ten per cent, the Minister may direct that the currency of the United States of America equivalent of all or part of the excess revenue shall be withdrawn from the Consolidated Fund and deposited to the Fund in accordance with section 14(1).*

(2) The deposits referred to in subsection (1) shall be made no later than the end of the month following the quarter in respect of which the deposit was calculated.”

Section 14(1) states:

“a minimum of sixty per cent of the aggregate of the excess revenue shall be deposited to the fund during a financial year.”

The original interpretation approached the sections 13 (1) (a) and 14 (1) in the following way:

- In the said section 13 (1) (a), the words appear to require that an individual quarterly approach be taken to the calculation of revenue collection and the determination of excess revenue over estimated revenue and that upon the collection of revenue and the ascertainment thereof for an excess over estimate in each quarter, the equivalent of that quarterly excess revenue is deposited in US dollars in the H&S Fund. In other words, it appears that 100% of the equivalent of the quarterly excess revenue should be deposited in the H&S Fund.
- The reference to section 14 (1) in section 13 (1) (a) meant that the words “aggregate of the excess revenue” had to be considered. The word “aggregate” means “collective”, “total” and leads one to believe that it is the totality of excess revenues – that is, **the four quarters worth of excess revenues taken together** – that should be addressed when applying the 60%. For example, it is difficult to see how the word “aggregate” would apply to any excess that might arise in the first quarter. As a result one is led to interpret

section 14(1) of the Act to mean that the calculation of the sixty per cent of the excess revenues should be done in respect of the totality of the four quarters which can only be at the end of the year.

Therefore the following conclusions were reached:

- *"Section 13 (1)(a) clearly states that the amount to be deposited into the H&S Fund is the US dollar equivalent of the excess revenue. Neither subsection (1) nor any other part of the Act authorizes any deduction from the excess revenue before such deposit is made under that subsection."* and
- *"all the excess must be deposited"* in response to the question *"Whether only 60% of excess petroleum revenues is payable for any quarter?"*

The other interpretation which, it is submitted, is in accordance with the Act takes the following approach:

- Section 13 (1) has 2 limbs: (1) an obligatory limb at (a) that requires the compulsory deposit into the Fund of a specified quantum of the excess revenue when that excess is greater than 10% of the estimated revenue and (2) a discretionary limb at (b) that permits the Minister to deposit any part or all of the excess when that excess is less than 10% of the estimated revenue.
- The specified quantum is determined by section 14 (1) which qualifies section 13 (1). Section 14 (1) requires that *"during the financial year"* that a minimum of 60% of the aggregate of excess revenues be deposited in the Fund. The word *"during"* means *"in the course of"* and therefore whenever excess revenues arise in any quarter or quarters of the financial year, 60% of the aggregate of those excess revenues must be deposited into the Fund.
- The word *"aggregate"* is not only determined by quantum but by time in this statutory context. The phrase *"during the financial year"* means that the *"aggregate"* must be the *"aggregate to date"*. It therefore means that calculations of the aggregate of the excess revenues must take into account shortfalls during previous quarters.

The following is therefore submitted as the correct approach to deposits of excess petroleum revenue into the H&S Fund:

Firstly, the Minister of Finance must consider deposits to the H&S Fund where petroleum revenues exceed estimates for that quarter.

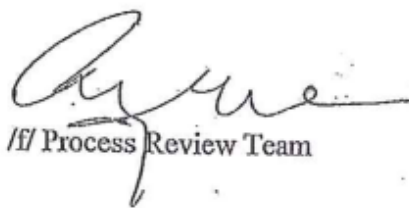
Secondly, where actual revenues exceed estimates by more than 10%, the amount that has to be deposited in the H&S Fund is a minimum of 60% of the aggregate of excess revenues. As a result, in any quarter, a minimum of 60% of the aggregate of excess revenues during the financial year up to and including that quarter is required to be deposited in the H&S Fund.

Thirdly, to calculate the aggregate of excess petroleum revenues, shortfalls in revenue in any quarter must be taken into account, in order to ensure that during the financial year up to and including that quarter a minimum of 60% has been deposited to the fund.

Fourthly, it is within the discretion of the Minister to deposit more than 60% of the aggregate of excess revenues but the Act does not require it. It is equally within the discretion of the Minister to deposit part or all of the actual excess revenue where such excess is not greater than 10% of the estimated petroleum revenue.

Regarding the query *"If 60% of the aggregate excess petroleum revenues is paid to the H&S Fund during the financial year, whether the remaining 40% is to be paid before the end of the month following the year end"*, the advice here is that there is no provision in the Act that requires the remaining 40% to be deposited before the end of the month following the year end.

The previous advice dated November 17, 2008 in response to the questions raised by the Auditor General on the H&S Fund is therefore withdrawn.


/s/ Process Review Team

Appendix IV

Asset Class Benchmarks and Tracking Error Used to December 2010

| Weight | Assets Class | Benchmark/Performance Index | Tracking Error Allowed | Actual Tracking Error to Dec. 2010 |
|--------|-----------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|------------------------------------|
| 25% | U.S. Government Treasury 1-5 years Securities | Merill Lynch U.S. Treasuries 1-5 years index | 0.50% | 0.26% |
| 40% | US Core Domestic Fixed Income | Barclays Capital US Aggregate Index | 1.00% | 0.57% |
| 17% | US Equities | Russell 3000 Ex-Energy comprised of the 3000 largest market capitalization stocks in the US and accounts for roughly 97 percent of the total market capitalization of that country | 4.00% | 2.33% |
| 17% | Non US Equities | MSCI EAFE EX Energy Index comprises the following countries: Australia, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switerland and UK. | 4.50% | 2.04% |