

# **TUVALU TRUST FUND**

## **Annual Report**

**2008**

# Tuvalu Trust Fund Annual Report

For the year ending 30 September 2008

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## **Abbreviations & Acronyms**

A\$	- Australian Dollar
CIF	- Consolidated Investment Fund
EDF	- European Development Fund
EU	- European Union
EU DSP	- European Union Development Support Programme
IC	- Investment Committee
NZ	- New Zealand
TTF	- Tuvalu Trust Fund
TTFAC	- Tuvalu Trust Fund Advisory Committee
UK	- United Kingdom
US\$	- United States Dollar

## Historical Note

The Tuvalu Trust Fund was established in 1987 to provide a source of recurrent revenue to the Government of Tuvalu which has extremely limited alternative sources of revenue at its disposal when it achieved independence in 1978. Tuvalu started developing a case for a Trust Fund with its donor partners in 1982. After undergoing a series of negotiations with donors and further refinements of the proposed Fund, an agreement (The International Trust Fund Agreement) was signed on 16 June 1987 by Tuvalu, New Zealand, Australia and the United Kingdom as the original parties. The Fund itself was invested on 21 August 1987, with an initial value of A\$27.1 million of which A\$1.6 million contributed by Tuvalu, A\$8 million by Australia, A\$8.3 million by New Zealand, \$8.5 million by United Kingdom, A\$0.7 million by Japan and A\$31,000 by South Korea. Since inception, the Fund has been receiving additional contributions from the parties to the Fund and South Korea. The table below summarizes contributions by each country up to 30 September 2008, including the initial contributions at the establishment of the Fund:

*Contributions into the Fund (A\$000's) up to 30 September 2008*

TUVALU	AUSTRALIA	NZ	UK	JAPAN*	S. KOREA*	TOTAL
30,843	18,319	12,579	8,450	695	69	70,954

### Purpose of the Fund

As set out in Part I, Article 2 of the agreement, the Fund has the following specific purpose:

- a) assist the Government to achieve greater financial autonomy in the management of its recurrent budget;
- b) enable the Government to maintain, and if possible, improve existing levels of social infrastructure and services;
- c) enhance the capacity of the Government to receive and effectively utilize external capital development and technical assistance;
- d) enable the Government to meet long-term maintenance and operating costs of social and economic infrastructure and services; and
- e) assist the Government to develop the economy of Tuvalu

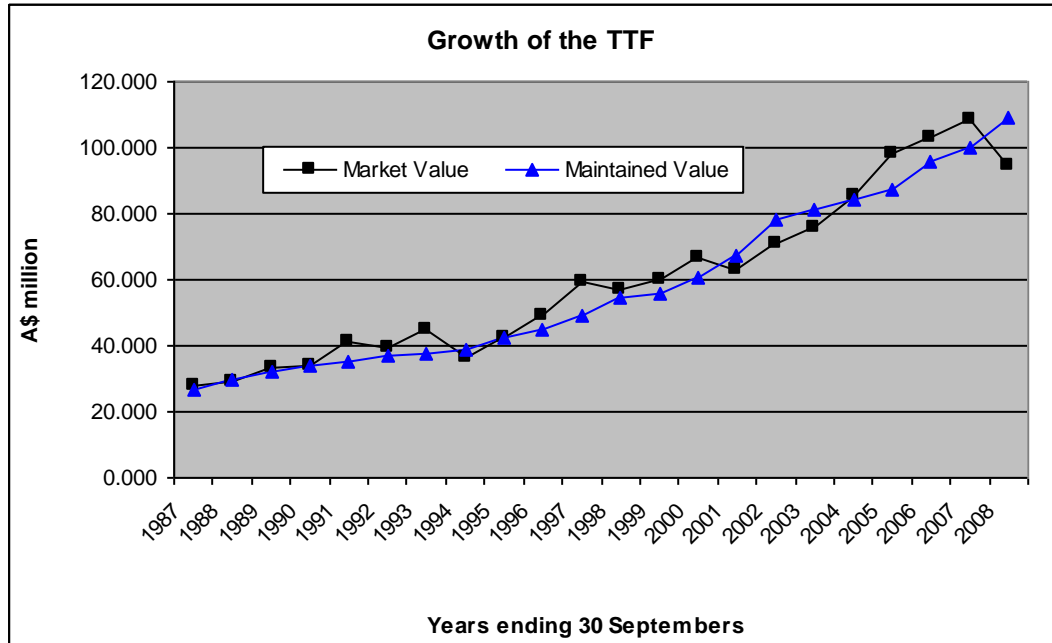
### The Growth of the Tuvalu Trust Fund

As at 30 September 2008, the Fund's value on the stock market stands at A\$94.550 million.

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\* not a party to the Agreement

The chart below shows the Funds Market value compared to its maintained value since inception to 30 September 2008.



### Creation of the Consolidated Investment Account – the Buffer Account

In November 1993, the TTF Board of Directors endorsed the initiative of the Tuvalu government to create a buffer account, the Consolidated Investment Fund (CIF). The CIF was created upon the need to provide a mechanism for holding distributions from the TTF (the A account) until such time as they were required. The CIF belongs entirely to the Government of Tuvalu as opposed to the TTF which is managed by the Board in trust for the people of Tuvalu and governed by the Agreement.

### Governance of the Fund

The Fund is governed by the provisions set out in the international Agreement. The Parties to the Agreement - the Government of Tuvalu, Australia, New Zealand and the United Kingdom – are the members of, and those responsible for, the Tuvalu Trust Fund. Following its regional programme review, the United Kingdom withdrew its membership of the Tuvalu Trust Fund Board and the Advisory Committee in 2004.

### Board of Directors

In accordance with Part II, Article 6 of the Agreement, the Fund has a Board of Directors, in which all powers of the Fund are vested in, and exercised by the Board. The Directors of the Fund are:

- a) a Director appointed by the Government of Tuvalu, who is Chairman of the Board;
- b) one Director appointed by each other original Party to the Agreement.

**Annual Reports**

In accordance with Part VIII, Article 23 of the Agreement, within six months of the end of each financial year, the Board shall publish and submit to each Party, an Annual Report on the activities and management of the Fund, including the annual accounts of the Fund Managers, and the reports of Fund Monitor, Auditor, and Advisory Committee.

## Board Directors



Hon. Lotoala Metia

*Chairman*

Minister of Finance, Economic Planning and Industries  
*for the* Government of Tuvalu  
(2006 to present)



Mr. James Sweeting

*Director*

Counselor, Development Cooperation, AusAID (Australia High Commission)  
*for the* Government of Australia  
(2007 to present)



Mr. Brian Bell

*Director*

Director, Nimmo-Bell & Co. Ltd  
*for the* Government of New Zealand  
(2002 to present)

## **Service Providers**

### **Board Secretariat**

Mr. Talavai Iona  
Tuvalu Trust Fund Board

### **Tuvalu Trust Fund Advisory Committee**

Mr. Michael Hyndman  
*Michael Hyndman Ltd*  
*for the Government of Australia*

David Abbott  
*Consultant*  
*for the Government of New Zealand*

Mr. Nicki Wrighton  
*Consultant*  
*for the Government of Tuvalu*

### **Tuvalu Trust Fund Investment Committee**

Mr. Brian Bell  
*Chairman*

Mr. Tim Hennaghan  
*Member*

### **Investment Consultant**

Mr. Dan Simpson  
*Senior Investment Consultant*  
Watson Wyatt

Ms. Amanda Clegg  
*Investment Analyst*  
Watson Wyatt



**Fund Auditor**

Mr. Sikeli Tuinanuma

*Partner*  
Ernst & Young

**Fund Managers**

Mr. Cameron Dowe  
*Client Services*  
Deutsche Asset Management (Australia) Ltd

Ms. Jenny Ju  
*Client Service Consultant*  
Credit Suisse Asset Management

Ms. Liz Chisholm  
*Relationship Manager*  
Wellington International Management Company Pte Ltd

Mr. Richard Keary  
BT Financial Group

Mr. Glen Giddings  
*Associate Director, Institutional Business*  
Barclays Global Investors

Michael Triguboff  
MIR Investment Management Ltd

Angela Coady  
*Client Services Manager*  
JF Capital Partners Ltd

Nick Hamilton  
*Client Services*  
Bell Asset Management

George Moromalos  
*Manager, Business Development*  
State Street Global Advisors, Australia Services Limited

## Chairman's Report

I am deeply honored to present the Annual Report of the Tuvalu Trust Fund for the financial year ending 30 September 2008. I am pleased to report that the affairs, activities and management of the Tuvalu Trust Fund during the 2008 financial year were in accordance with the International Agreement.

For the first time in 5 years, the Fund's market value fell below its maintained value by year end, meaning a distribution to the CIF was not possible. This was owed to the effects of the Global Financial Crisis, triggered by the US sub-prime crisis that started in 2007. Despite making a huge loss, the Fund's well diversified portfolio paid dividends by avoiding the full impact of the downturn in capital markets. The decision of the Board to decrease the Fund's growth allocation by a mere 5% at the beginning of the financial year was timely. These are difficult times and downturns in capital markets are expected. However, I have faith that there is light at the end of the tunnel. I strongly believe the Fund is well placed to meet its objective in the long run.

Despite the unfavorable prospects of a distribution for the next few years, the healthy balance in the CIF shall allow the government of Tuvalu to face this period with some degree of certainty, provided annual withdrawals from the CIF are maintained within sustainable levels. I must acknowledge with sincere appreciation the kind gesture of New Zealand's government, who made a one off payment to the CIF in December 2008 to assist Tuvalu weather the effects of the global financial crisis coupled with high fuel costs. On the same token, Australia's commitment to the same course is equally appreciated. These payments together will push the CIF's balance pass its Target Minimum Balance, a much welcomed development in these circumstances.

In closing, I wish to acknowledge the continued support and guidance of my fellow Board Directors, the commitment and professional services rendered by Fund Managers, Investment Consultant, Investment Committee, TTFAC and the Secretariat. I certainly expect your hard working ethics to continue in these testing times.

*Tuvalu mo te Atua.*

## Year in Review

For the first two quarters, the Australian market continued its solid performance from the previous financial year with GDP growth remaining around 4.0%. This growth was backed up by continued strength in consumer spending, manufacturing, retail trade and business confidence. This trend moderated in the June quarter and continued on to the last quarter with softer data being revealed by surveys. Sales figures in the housing market declined and employment growth registering decreases over the last two quarters.

Internationally, volatility continued to plague the global economy with the US housing sector further deteriorating. Slowed growth in the labour market in the first two quarters gave the first signs of a possible US recession. By September 2008, the global financial crisis intensified and there were significant events experienced by the US financial system with the collapse of major financial institutions. The US Government responded by providing unprecedented support to struggling major financial institutions. Growth in other major Asian economies slowed down in the last two quarters with inflation setting on. The collapse of the US sub-prime mortgage market and the reversal of the housing boom in other industrialized economies had a ripple effect around the world. The increasingly inter-connected world meant there were knock-on effects and as a result financial systems in major economies collapsed. A global economic recession was confirmed by the end of the financial year.

The global financial crisis meant the Fund posted a -8.8% annual loss.

### FUND PERFORMANCE

#### Tuvalu Trust Fund

##### *Market Value*

The closing market value of the TTF, as at 30 September 2007, was A\$108.246 million. The closing market value of the TTF, as at 30 September 2008, was A\$94.500 million, and was split between the new Fund Managers as follows (in A\$000's):

JFCP Australian Equities	6,007
MIR Australian Equities	6,222
SSGA Int'l Shares Index	12,650
Barclays Int'l Equities Index (hedged)	11,143
BT Global Return	4,861
Bridgewater Pure Alpha	5,100
Deutsche RREEF Global Properties Securities	5,325
BGI Enhanced Australian Bond	24,548
BGI Overseas Bond Index	9,345
Credit Suisse Inflation Linked Bonds	9,300

### *Maintained Value*

The maintained value as at 30 September 2008 is the sum of the maintained value as at 30 September 2007, plus additional contributions during the year, all adjusted for inflation for the financial year. Using this approach, the maintained value was calculated to be **A\$109.036 million**.<sup>1</sup>

### *Automatic Distribution in 2008*

On the basis of the above Maintained and Market Values as at 30 September 2008, the market value was below the maintained value by A\$14.5 million (13.3%), which meant a distribution from the TTF to the CIF was not possible.

### *TTF Performance*

For the first time in 5 years, the Fund posted a negative return of -8.8% and underperforming its overall benchmark by 1.2%. By way of broader comparison, the Dow Jones Industrial Index fell by 23% over the same period.

### **Consolidated Investment Fund**

The closing market value of the CIF, as at 30 September 2007, was A\$10.633 million. The closing market value of the CIF, as at 30 September 2008, was A\$12.265 million. During the financial year, A\$8.502 million was paid into the CIF from the TTF in respect of the 2006/2007 FY distribution. For the same financial year, the Fund also had a cash outflow of A\$7.842 million.

### **Changes to the TTF's Portfolio Structure**

The Board approved and implemented the recommendations of the IC and the Investment Consultant to replace the international equity active managers of the portfolio (Credit Suisse Asset Management and Wellington International Management) with index funds (passive managers) from State Street Global Advisors and BGI. The change took place in October 2007.

### **Board Meetings**

During the financial year ending 30 September 2008, the 45<sup>th</sup> and the 46<sup>th</sup> meetings of the Board of Directors were held, respectively, on 3 December 2007 in Funafuti, Tuvalu and 25 June 2008 in Suva, Fiji.

### *Board Attendance*

45<sup>th</sup> (December 2007) Board meeting:

Hon. Lotoala Metia (Chairman, *Tuvalu*)  
Mr. James Sweeting (Director, *Australia*)

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<sup>1</sup> TTFAC 2008 Annual Report, pg 6.

Mr. Brian Bell (Director, *New Zealand*)

46<sup>th</sup> (June 2008) Board meeting:

Hon. Lotoala Metia (Chairman, *Tuvalu*)

Mr. James Sweeting (Director, *Australia*)

Mr. Brian Bell (Director, *New Zealand*)

*Major Board decisions at the 45<sup>th</sup> Board Meeting*

1. TTFAC shall produce two separate reports in its Annual meeting. The 1<sup>st</sup> report is the full report of its findings during its visit. The second report is an amended version of the 1<sup>st</sup> report, taking out parts of the report that deals with government policies currently under consideration. The Second report shall be for public consumption once it has been tabled in Parliament.
2. A full analysis of the previous year's budget outturn will be carried out in the April visit of the TTFAC the following year. This analysis will be annexed to the Annual Report of the same year that goes to Parliament. The analysis of the current year's budget likely outturn done at the October visit will not be part of the Annual Report that goes to Parliament
3. The revised Statement of Investment Objectives and Policy (SIOP) was approved and signed by the Board. The major revisions to the SIOP included:
  - a. A move to a 60% growth assets strategy from 65%;
  - b. International equities sector be managed on a passive basis with 50% being invested in BGI's Cap-weighted index on a hedged basis and 50% in State Street's "wealth" weighted index on an unhedged basis.
  - c. Termination of the contracts with Credit Suisse and Wellington and the proceeds transferred to the aforementioned passive products.
  - d. 1.5% of the Fund's assets be transferred from the Australian equities sector to the Australian fixed interest sector in whatever way the Investment Consultant considers to be the most effective and efficient.
4. Budgetary performance benchmarks will be monitored by TTFAC in April each year based on the previous year's budget performance;

*Major Board decisions at the 46<sup>th</sup> Board Meeting*

1. Secretariat shall no longer use Watson Wyatt's long term asset assumptions for short term projections. Such projections shall be based on more suitable short term prediction reports by credible sources which the Investment Consultant shall recommend.

2. An Assistant Secretary position is to be created within the Secretariat and to be co-funded by the FTF and TTF Boards. This shall improve capacity in terms of providing continuity measures.
3. TTFAC reports which are getting cumbersome shall be re-formatted to ensure the key roles of the TTFAC which are to monitor the economy and provide independent advice on issues requested by the government are not compromised.

### **Fund Managers' Reports**

The TTF Managers provided monthly and quarterly Unit Holder and Transaction statements. The quarterly reports are provided in Annex 1.

BGI also produced Distribution/Tax Statements and Unit Holder Statements to the Fund Monitor on a quarterly basis in respect of the CIF. These reports are provided in Annex 2.

### **Investment Consultant's Reports**

The Investment Consultant, Watson Wyatt Australia Pty Ltd, produced four investment reports on the TTF for the quarters ending 31 December 2007, 31 March 2008, 30 June 2008 and 30 September 2008 (Annex 3).

Watson Wyatt also produced four investment reports on the CIF for quarters ending 1 December 2007, 31 March 2008, 30 June 2008 and 30 September 2008 (Annex 3).

### **Auditor's Report**

Ernst and Young completed the audit of the TTF and CIF 2008 Financial Accounts in June 2009 (see Annex 4).

### **Advisory Committee's Reports**

The TTFAC visited Tuvalu on 9 – 18 of April 2008 and produced its 2008 First Half-Yearly Report, which was presented at the 46<sup>th</sup> meeting of the Board. This is an interim report that is not for public distribution.

The Committee's 2008 Annual Report (Annex 5) was prepared during their visit of 9 – 31 October 2008. The attached report does not include policy issues under consideration covered by the Committee in its confidential report submitted to the government and the Board.

### **Investment Committee's Reports**

The IC produced two reports (Annex 6) to the Board during the financial year.

### **Contribution to the Fund**

The following additional contributions were credited into the Fund for the financial year:

Australia: A\$2,346,348 (June 2008)

New Zealand A\$851,700 (November 2007)

Tuvalu: A\$1,021,872 (January 2008)

The timing of Tuvalu's contribution coincided with the drawing down of the automatic distribution approved at the end of the 2007 financial year to support the government's 2008 Annual Budget. To save on bank fees, it was agreed that Tuvalu's contribution to the TTF shall be used to partly finance the total automatic distribution to the CIF.

### **EU DSP**

Tuvalu Government made a payment of \$1,021,872 in January 2008 to the TTF in respect of the 2006/2007 EU DSP. It is understood that this was the last of such payments by the government under previous EDF arrangements. The changes in the operational arrangements of the 10<sup>th</sup> EDF with a focus on water management meant direct budgetary support ceased hence no savings in the National budget were created to be transferred as additional Tuvalu contributions to the Fund.

### **Additional Contributions into the CIF**

In September 2008, the government of Tuvalu made a submission to New Zealand and Australia for emergency direct budgetary support to help counter the knock-on effects of the financial instability and uncertainty in industrialized nations and the rise in food prices which is having a compounding effect on the economy. High fuel costs, soaring commodity prices together with fears of global recession predicted to have enormous adverse effect on Tuvalu's vulnerable fiscal stance.

In response, New Zealand paid A\$3.7 million in December 2008 which brought the balance of the CIF to its Target Minimum Balance for 2008 of A\$16 million. Australia made a commitment to offer up to A\$1.25 million in its 2008-09 financial year to help Tuvalu manage its fiscal challenges, **subject to achieving commitments on the government's part.**

**TUVALU TRUST FUND**  
**Statement of the Directors**

**To the Government of Tuvalu**

In the opinion of the Directors, in accordance with Part VIII, Article of the Trust agreement, the Annual Report has been properly prepared from the financial statements set out in the report, the monitoring statements set out in the report, the advisory statements set out in the report , and is properly drawn up and based on the full and complete reports of the Fund managers, monitor, audit, advisory committee and other relevant source material so as to give a true and fair view of the affairs , activities and management of the Fund as at 30 September 2008, and of the transactions and results of the year ended on that date.

The FUND has been conducted in accordance with the constituent agreement of the parties to the Tuvalu Trust Fund.

SIGNED in accordance with resolution from and approval of the Board of Directors of the Tuvalu Trust Fund.

Hon. Lotoala Metia  
*Chairman*

Mr. Brian Bell  
*Director*

June, 2009.