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**PROPOSAL OF
SOVEREIGN
WEALTH FUND
MODEL
FOR
MOZAMBIQUE**

September 2020

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1. BACKGROUND

Mozambique has huge deposits of natural gas and other resources of high commercial value. With reserves estimated at around 277 trillion cubic feet, Mozambique could join the group of the world's top ten natural gas producers and become the second largest producer in Africa, after Nigeria. In addition to natural gas, the country's energy potential includes coal reserves, water resources, heavy sands, titanium and other high market value ores.

Starting to produce liquefied natural gas will bring challenges to the country from the point of view of macroeconomic and financial management. It is estimated that the country will raise about USD 96 billion over the lifetime of natural gas exploration projects. The main challenge is how to maximize the gains from natural gas revenues and other non-renewable natural resources¹ and develop functional and transparent institutions without stunting the economy.

International experience shows that creating a sovereign wealth fund (SWF) has been one of the alternatives found by some countries that are rich in non-renewable natural resources for the proper and transparent management of non-renewable natural revenues arising from their exploitation. In addition to helping to minimize the undesirable macroeconomic impacts of an excessive inflow of revenue into the economy, the creation of an SWF helps to discipline the use of revenue and create conditions for its sustainable management.²

In this context, the Banco de Moçambique (Bank of Mozambique, BM) organized, in March 2019, a high-level international seminar on sovereign wealth funds, in partnership with the International Monetary Fund (IMF). The objective of the event was to foster a broad forum for discussion and to obtain contributions that could serve as a basis for the process of creating a mechanism for the management of revenues from non-renewable natural resources in Mozambique.

Based on the results of the seminar, it is concluded that there is a national consensus on the importance of setting up a Sovereign Wealth Fund in Mozambique. The seminar was an important milestone for reaching political consensus on the need for the establishment of a Sovereign Wealth Fund (SWF) in Mozambique. One of the main lessons learned from the discussions was that creating a SWF is a government decision and the best time to do so is before the start of massive inflow of revenues from non-renewable natural resources.

¹ Non-Renewable Natural Resources refer to all existing mineral resources in the territory and sea of Mozambique, which are depleted in time.

² The Banco de Moçambique carried out working visits to the Sovereign Wealth Funds of Alaska in the United States of America, Trinidad and Tobago, East Timor, Botswana, Angola and Norges Bank. Annex 1 sets out the main findings of the visits.

There is a clear political orientation, and a commitment of His Excellency the President of the Republic, towards the creation of the Sovereign Wealth Fund in Mozambique. In his opening speech at the seminar of March 2019, His Excellency the President of the Republic of Mozambique, Filipe Nyusi, stressed that natural resources are the property of all Mozambicans, hence their rational use is fundamental so that they can benefit present and future generations, and provided a set of operational issues relevant to the implementation of a SWF in Mozambique, on which to reflect on. More recently, during his second term inauguration ceremony, His Excellency the President of the Republic stressed the need for the creation of a sovereign wealth fund and stressed that the model to be adopted should be based on principles of good governance, transparency, accountability and independence.

It is in this context that, as a contribution to this debate, the Banco de Moçambique prepared this document to present a proposal for the SWF model to be adopted, SWF law and roadmap for the operationalization of a SWF in Mozambique.

2. OBJECTIVES OF THE SOVEREIGN WEALTH FUND

It is proposed that the Sovereign Wealth Fund be set up with two objectives:

- **Accumulate savings** by maximizing the value of the fund in order to ensure that revenues from non-renewable natural resources are shared across generations. This objective responds to the sovereign concern of reconciling the needs of present and future generations.
- **Contribute to Fiscal Stabilization**, with a view to isolating the budget and the economy from the adverse impacts resulting from fluctuations in commodity prices in international markets.

In general, there are Funds experiences that set out the objective of infrastructure development or promotion. In this case, it is proposed that the infrastructure financing component be integrated into the State Budget, and it is up to the Ministry of Economy and Finance, in the normal process of budget execution, to decide on the allocation of resources, with no interference of the Fund in the decision-making process.

Thus, the financial resources transferred to the State, resulting from the exploitation of non-renewable natural resources, should be integrated into the State Budget, and the Assembly of the Republic is responsible for defining the use, including for priority investment expenses.

3. SOVEREIGN WEALTH FUND GOVERNANCE STRUCTURE

It is proposed that the SWF adopt a governmental structure with the following composition:

SWF Governing Bodies:

- a. **Assembly of the Republic (AR)** – highest authority has the responsibility to approve the Law establishing and regulating the functioning of the SWF. It is the highest level in the SWF government structure. The Sovereign Wealth Fund of Mozambique belongs to all Mozambicans and, in its governance, will be represented by the Assembly of the Republic.
- b. **Ministry of Economy and Finance** - acts on behalf of the Government. He is responsible for the overall management and establishment of the SWF Investment Policy. It delegates operational management to the Central Bank, within the legal framework approved by the Assembly of the Republic.

Note: *it is suggested that, within the Ministry of Economy and Finance, a Technical Unit of Strategic Asset Management be created, for advising the Minister of Finance in all technical matters, this advice that will constitute the main foundation of the decisions to be taken by the institution. This unit will be made up of senior managers with recognized experience in investment and asset management and may also include an independent resident international consultant.*

- c. **Banco de Moçambique** - is the SWF operational manager, responsible for implementing the investment policy. It may directly manage part of the Fund's assets, and allocate another part to internal and external managers to be hired by it. To reduce costs, the SWF operational management should rely on existing institutions, being the Banco de Moçambique, among the possible alternatives, the entity that has specialized human capital in the field of foreign reserves management.

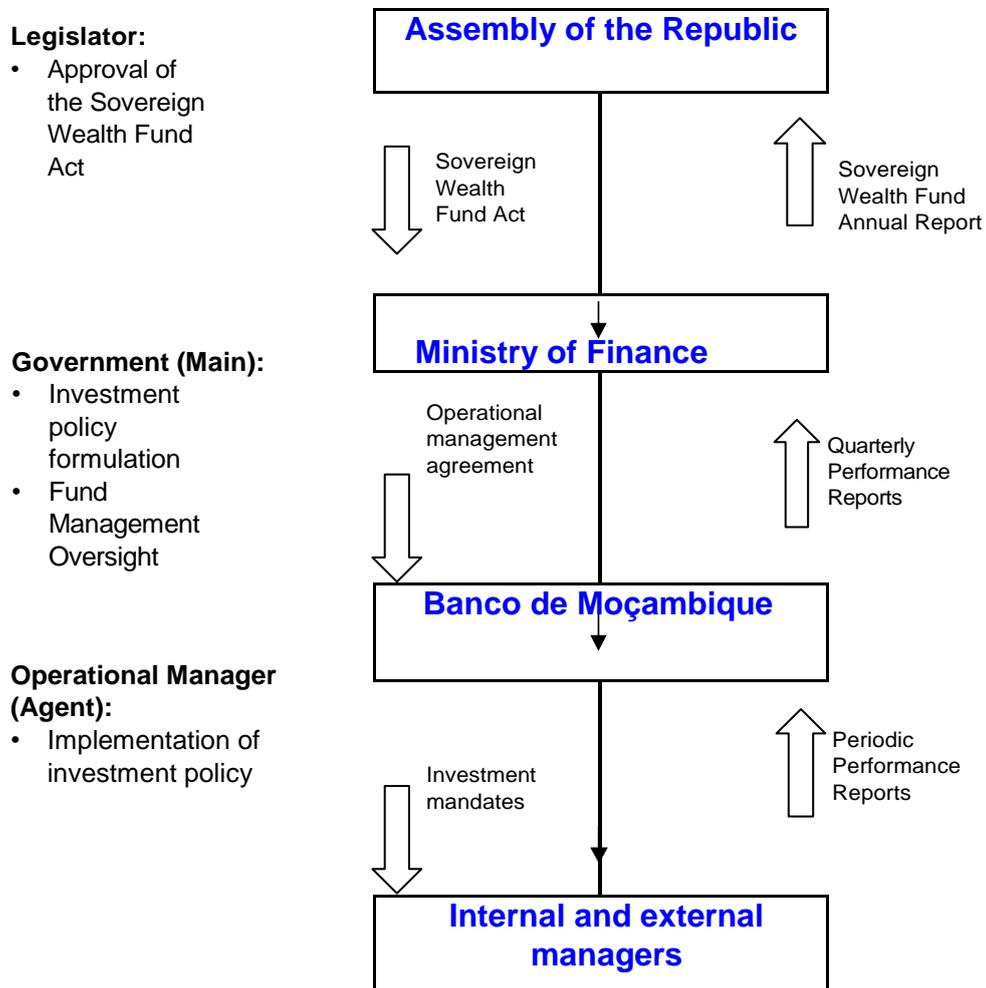
The accounts, records and other documents relating to the Fund should be audited every six months by the internal audit services for each of the entities concerned.

On the other hand:

- The audit of the accounts and operations of the Sovereign Wealth Fund should be carried out annually by an independent and certified external auditor, to be hired by the Ministry of Economy and Finance.
- The Assembly of the Republic shall delegate to the Administrative Court or other competent authority the responsibility to annually carry out an audit of the Ministry of Economy and Finance on all records of all operations and transactions related to the Fund.

Figure 1 shows the **organizational chart of the proposed governance** structure.

Figure 1: Mozambique's SWF governance structure



Generally, the decision-making hierarchy of an SWF involves four stages, namely, (i) determination of policy objectives and risk tolerance; (ii) determination of operational objectives; (iii) determination of strategic asset allocation, including limits of deviations from benchmarks (reflected in the investment guide); and (iv) operational implementation of investment decisions, according to the investment policy.

More specifically, in this case, the Assembly of the Republic will have the following responsibilities:

- Approve the Law that establishes the Sovereign Wealth Fund for Mozambique and all related regulations;
- If there is need for any specific clarification on certain specialized matters related to the management of the fund, the Assembly may request the Ministry of Finance and the Banco de Moçambique for the appropriate clarifications;

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- Approve amendments to the law as deemed necessary; and
 - Assess the report and financial statements of the Sovereign Wealth Fund, which shall be submitted annually by the Ministry of Economy and Finance.

The Ministry of Economy and Finance will be responsible for the following aspects:

- Developing the Investment Policy of the Sovereign Wealth Fund of Mozambique;
- Making medium and long-term projections of revenues from non-renewable mineral resources based on information collected from companies and trends in ore prices on international markets;
- Carrying out periodic monitoring of Fund performance;
- Drawing up the Fund's Annual Report;
- Appointing an independent auditor to audit the Fund's financial statements; and
- Regularly reporting to the Assembly of the Republic on the activities of the fund, or to provide ad hoc reports whenever the Assembly of the Republic so requests.

The main tasks of the Banco de Moçambique are as follows:

- Managing the Fund's assets and other resources, guided by the principles of accountability and transparency;
- Implementing the Investment Policy and technical guide;
- Selecting and hiring internal and external managers, and defining the share of the Fund's assets that will be allocated to these managers;
- Reporting to the Ministry of Economy and Finance;
- Preparing the Financial Statements of the Sovereign Wealth Fund.

The relationship between the Ministry of Economy and Finance and the Banco de Moçambique shall be governed by a Management Agreement to be signed by the two institutions, which shall contain all the terms and conditions of the delegation of operational management responsibility of the Banco de Moçambique.

For the operational management of the Sovereign Wealth Fund, the Ministry shall pay the Banco de Moçambique a fixed annual fee, which shall be specified in the agreement.

4. RULES FOR DEPOSIT AND WITHDRAWAL OF RESOURCES FROM THE FUND'S ACCOUNT

The Sovereign Wealth Fund shall have a single account to be opened at the Banco de Moçambique, the currency of which shall be the United States dollar, where all revenues from the Fund shall be deposited. This account shall have the designation "Single Account of Mozambique Sovereign Wealth Fund - CUF".

It is proposed that the Fund be governed by the following deposit and withdrawal rules:

Deposit Rules:

The total gross revenue from the exploitation of non-renewable natural resources shall be broken down as follows:

- Until the twentieth year:
 - ✓ 50% shall be channeled to the State Budget (OE); and
 - ✓ 50% shall be deposited into the Sovereign Wealth Fund account.
- From the twenty-first year:
 - ✓ 20% shall be channeled to the State Budget (OE); and
 - ✓ 80% must be deposited into the Sovereign Wealth Fund account.

In order to ensure prudent management of the resources to be channeled to the State Budget, the Ministry of Economy and Finance should devise a medium-term strategy for the use of funds channeled to the State Budget, where the creation of a provision to deal with the occurrence of extraordinary events³ will be safeguarded.

The Assembly of the Republic in the Ordinary or Amending Budget Proposal shall determine the use of the funds provisioned and other extraordinary revenues from the Fund.

Withdrawal Rules:

- a. For each fiscal year, a fee will be paid to the Banco de Moçambique for managing the Fund, as defined in the agreement between the Bank and the Ministry of Economy and Finance.

³ Extraordinary events include drought, floods, cyclones, tidal waves, tornadoes, pandemics, and other comparable calamities.

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- b. For the first twenty years, whenever there is an extreme unexpected shock in a fiscal year leading to a decrease in actual revenues from the exploitation of non-renewable natural resources by at least 10% compared to the projected revenues from these resources, financial resources from the Sovereign Wealth Fund shall be channeled into the State Budget.
 - c. The amount of the transfer referred to in the previous point should be equivalent to the difference between the projected revenue from non-renewable natural resources and the actual revenue from non-renewable natural resources for the same financial year. However, the resources to be channeled shall not exceed, in each fiscal year, four per cent of the revenue from the exploitation of non-renewable natural resources collected in the immediately preceding fiscal year.
 - d. Where transfers of funds from the fund to the State Budget occur as a result of extreme shocks, these resources shall be allocated for the following purposes:
 - i. Strengthening the budget allocation for Social Action;
 - ii. Strengthening the budget allocation for Public Health;
 - iii. Strengthening the budget allocation for Agriculture;
 - iv. Strengthening the budget allocation for Education.
 - e. It is estimated that the Fund will reach its maturity stage in the twentieth year of its existence, according to the projections of the expected revenue stream. Until then, the State Budget is expected to have greater financial autonomy and the economy's capacity to absorb financial resources from natural resources to be greatly reduced or limited.
 - f. Thus, from the twenty-first year of existence of the Fund, in each fiscal year, financial resources from the Fund will be channeled regularly to the State Budget, in the magnitude equivalent to four percent of the Fund's balance at the end of the immediately preceding financial year, to cover the deficit resulting from the fall in revenues.
 - g. During the existence of the Fund, whenever a public disaster occurs in a year leading the government to declare a State of Emergency, a State of War and/or a State of Siege, financial resources of the Sovereign Fund shall be channeled to support the State Budget, in the amount equivalent to two percent of the balance of the Fund established at the end of the immediately preceding financial year.

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- h. The two percent figure was set taking into account the need to not erode the Fund's value, and is equivalent to approximately half of the income obtained in the year concerned.
- i. In the years in which the rule of State Budget support is implemented due to the occurrence of a public disaster, the rule of State Budget support due to the occurrence of extreme shocks shall not be implemented. If both events occur in the same year, the rule of State Budget support due to the occurrence of a public disaster should prevail.

Revenues and Value of the Fund

The total gross revenue of the Fund shall consist of the following components:

- Mozambique's gross revenue, including Tax Revenue, derived from operations related to non-renewable natural resources exploration, including prospecting, research, development, exploration, transportation, sale and export, capital gains and other related activities;
- Any amount received by Mozambique as return on investment of fund revenue;
- Any amount received through direct or indirect participation of Mozambique in operations to exploit non-renewable natural resources;
- Any amount received by Mozambique directly related to non-renewable natural resources and not covered by the preceding paragraphs;
- In the case of Mozambique's indirect participation in operations to exploit non-renewable natural resources through a national company, the Fund's revenues shall also include (i) any amount payable by the National Company as tax, royalties or any other fee, pursuant to the Law of Mozambique; and (ii) the amount paid by the National Company as a dividend.

The total amount of the Fund shall at all times be the accounting balance of the Single Account of the Sovereign Wealth Fund of Mozambique.

Investments

All investments in the domestic market will be made exclusively through the State Budget, based on the aforementioned inflow and outflow rules.

In the composition of the asset portfolio, the Fund should focus on investments in financial instruments that do not originate or are not anchored to the sectors linked to the same types of resources that supply the Fund. The investment policy should clearly define the acceptable asset classes and the risk tolerance.

The use of the Fund's resources as guarantees for contracting loans by the State or by other entities, for paying debts and debt service contracted by the State or other entities is prohibited. Any contract, agreement or adjustment, to the extent that it is intended to encumber or impose a charge on the assets of the Fund, whether by way of guarantee, surety, mortgage or any other kind of burden, shall be void and shall have no effect.

Transparency and accountability

Quarterly and annual reports on the Fund's activities should be made available to the public and confidential information should be preserved.

The quarterly reports will be published on the BM's website, and the annual reports will be published on the MEF's website.

These institutions may also make other relevant documentation available to the public to inform about the fund's management process.

ANNEX 1: SUMMARY OF INTERNATIONAL EXPERIENCES

| Name and Country | Fund Objectives | Inflow and Outflow Rules |
|---|--|---|
| Alaska Fund (APFC) ⁴ <i>United States of America</i> | <ul style="list-style-type: none"> ✓ Stabilization ✓ Savings | <ul style="list-style-type: none"> ✓ At least 25% of royalty revenue is channeled to the fund annually. And all above 25%, is channeled to the General State Fund for expenditure support. |
| Heritage and Stabilization Fund (HSF) ⁵ <i>Trinidad and Tobago</i> | <ul style="list-style-type: none"> ✓ Savings ✓ Stabilization | <ul style="list-style-type: none"> ✓ All oil exploration revenue is channeled to the Budget; ✓ At the beginning of each quarter, where revenues collected exceed forecasts by 10%, the surplus is channeled to the HST; ✓ In each fiscal year, a minimum of 60% of the aggregate surplus must be channeled to the fund; ✓ The withdrawal rule provides that if the revenue collected falls below 10% of the estimated revenue for the year, withdrawals are used as follows: (i) 60% of the revenue deficit and (ii) 25% of the fund balance at the beginning of each year. |
| Petroleum Fund (FP) <i>East Timor</i> | <ul style="list-style-type: none"> ✓ Savings ✓ Stabilization | <ul style="list-style-type: none"> ✓ All oil exploration revenues are channeled to Petroleum Fund; ✓ Transfers of Petroleum Fund resources are allowed only for the Budget (3% of the Petroleum Fund value, including the present value of future oil revenues) and for the payment of management fees to the central bank. |
| Pula Fund - PF (Bank of Botswana) <i>Botswana</i> | <ul style="list-style-type: none"> ✓ Stabilization and ✓ Savings | <ul style="list-style-type: none"> ✓ There is no clear resource inflow and outflow rule on the Pula Fund (PF) management mechanism; |
| Angola's Sovereign Wealth Fund (FSDEA) <i>Angola</i> | <ul style="list-style-type: none"> ✓ Stabilization; ✓ Savings; ✓ Socio-economic development | <ul style="list-style-type: none"> ✓ All surplus of the difference between the value of oil revenues programmed in the budget and that observed will be channeled to the Fund. However, this rule has not been observed, as oil revenues exclusively finance the Fund, and a reflection is under way on the possibility of accommodating the revenues of other ores. |
| Norway's Sovereign Wealth Fund <i>Norway</i> | <ul style="list-style-type: none"> ✓ Intergenerational savings | <ul style="list-style-type: none"> ✓ It expects expenditure reduction over time; ✓ Rule of inflow: all revenues go directly to the Fund. ✓ Rule of outflow: 3% of the expected return from the Fund should be channeled to the Budget to fill the fiscal deficit of the non-oil sector. |

⁴APFC - Alaska Permanent Fund Corporation

⁵ HST-Heritage and Stabilization Fund

