



*Empowered lives.
Resilient nations.*

Case Study Report: Tuvalu Trust Fund

A case study providing inputs to discussions in Asia-Pacific region on the design and management of National Climate Funds, jointly prepared by UNDP and the TTF.

United Nations Development Programme

ENVIRONMENT AND ENERGY





Table of Contents

Introduction..... 3

The design of the TTF at a glance 3

 The legal status..... 3

 The fund’s model..... 3

 Governing body and beneficiaries 6

The establishment of the TTF 7

Lessons learned..... 8

Introduction

This paper aims to enrich knowledge sharing about the establishment and management of national climate funds (NCFs), which is organized by the Asia-Pacific Community of Practice on Climate Finance. To provide a technical input to the knowledge sharing, UNDP commissioned seven case studies on existing national funds in the fields of environment, conservation, energy, climate change and development. This paper reports the lessons learned extracted from the establishment and management of the Tuvalu Trust Fund (TTF), which is one of seven national funds across the Asia-Pacific region selected as a case study.¹

This report first summarizes the design of the TTF and provides a short description about the establishment and the management of the TTF. The lessons-learned from the establishment and management of the TTF are then presented. The case study analysis involved: literature review to set the scope of the study and in-depth interviews with relevant stakeholders, including the Fund Manager and Staff from the TTF. Prior to finalization, the report has been reviewed by the TTF team and the UNDP Pacific Centre.

The design of the TTF at a glance

The legal status

The establishment of the TTF was marked by the signing of an international agreement between The Tuvalu Government and potential donors. The donors involved at the establishment stage were UK, Australia and New Zealand only. Japan and Korea came in the following year but have since not really increased their contributions into the fund. in Suva on 16 June 1987. The purpose of the Fund (as stated in the International Agreement) is to contribute to the long-term financial viability of Tuvalu by providing an additional source of revenue for recurrent expenses of the Government of Tuvalu. The TTF therefore aims to:

- Assist the Government to achieve greater financial authority in the management of its recurrent budget;
- Enable the Government to maintain and if possible improve existing levels of social infrastructure and services;
- Enhance the capacity of the Government to receive and effectively utilize external capital development and technical assistance;
- Enable the Government to meet long-term maintenance and operating costs of social and economic infrastructure and services; and
- Assist the Government to develop the economy of Tuvalu.

The fund's model

The TTF has demonstrated that the Trust Fund concept for support to a national budget can have very positive benefits for a small state that lacks the resources and capacity to develop the economy by itself. The TTF contributes around 20 per cent budget revenues, particularly during the diminishing budgetary aid (absolute and percent revenue). The initial value of the Fund was A\$27.1 million contributed by:

¹ National funds selected for the case study analysis are: Bhutan Trust Fund for Environmental Conservation, China CMD Fund, Cambodia Climate Change Alliance Trust Fund, Thailand Energy Conservation Promotion Fund, Lao Environmental Protection Fund, Micronesia Conservation Trust and Tuvalu Trust Fund: <http://www.snap-undp.org/elibrary/default.aspx>

- Tuvalu A\$1.6 million
- Australia A\$8.0 million
- New Zealand A\$8.3 million
- United Kingdom A\$8.5 million
- Japan A\$0.7 million
- South Korea A\$31,000

Since establishment there have been additional contributions of A\$38.6 million:

- Tuvalu A\$28.2 million
- Australia A\$6.4 million
- New Zealand A\$3.2 million
- South Korea A\$37,821

In recent years the objectives set by the Board for the fund managers has been to provide a real annual return of 4.5 per cent on the capital. It has grown from its small A\$27.1 million (initial contributions from its establishment) in 1987 to a comfortable A\$127 million (Maintained Value as at March 2012).²

The TTF has an innovative “binary trust fund structure.” The binary structure consists of an endowment fund and a revolving fund. Like two management bodies, the two fund accounts work in conjunction to improve the overall efficiency of the fund (Figure 1).

A repository for the capital of the Trust Fund is known as the “A Account”. Most of the ‘A Account’ is invested in Australia with asset allocations reflecting the requirements to; (i) maintain the real purchasing power of the Fund; and (ii) provide a regular flow of income to the Government of Tuvalu. By agreement, the value of the ‘A Account’ must be maintained in real terms (including calculations for inflation and administrative expenses). Only during years when the ‘A Account’s’ Market Value exceeds the Maintained Value does the Government of Tuvalu receive Trust Fund incomes. When market value exceeds maintained value, the difference is referred to as the ‘automatic distribution’. This difference is paid into the Second Fund.

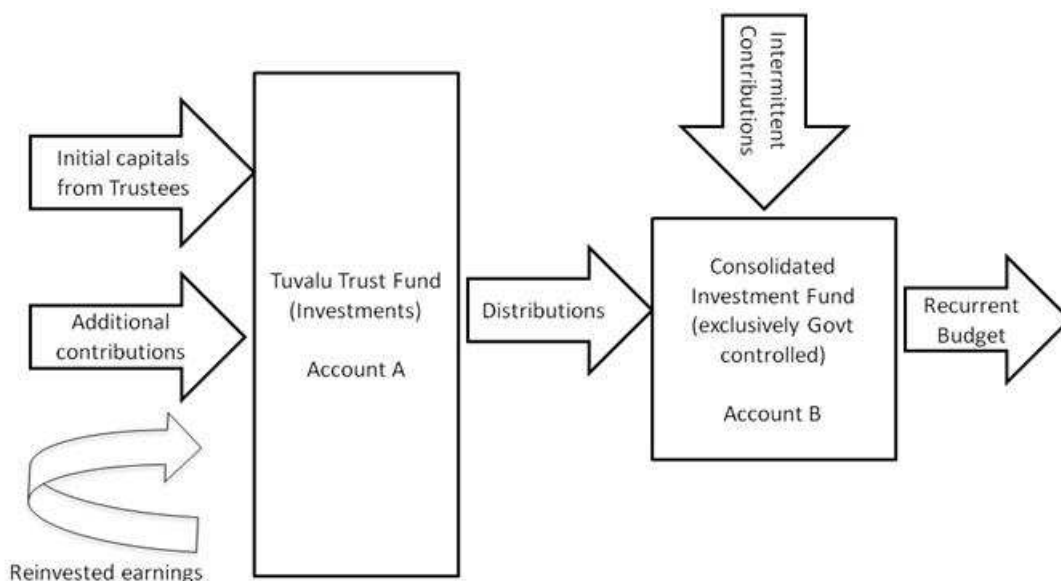
The Second Fund was established to smooth out trust fund contributions to the recurrent budget and to therefore improve the predictability and consistency of transfers. This revolving “buffer account”, known as account “B” and later “Consolidated Investment Fund” (CIF) receives funds from the returns or “disbursements” of ‘A Account’ and belongs exclusively to the Government of Tuvalu. The ‘B Account’ holds income distributions from the ‘A Account’ until funds are needed to be used for the national budget. It therefore serves as a buffer against the volatility of the ‘A Account’ returns, i.e., during years when there are no returns or low returns. The desired balance to be kept in the ‘B Account’ is four years projection of no income from the ‘A Account’. The B Account should keep around 16 per cent of the maintained value with recurrent budget allocations, or around 4 per cent of maintained value annually. This would then give four years of consistent or “smoothed out” contributions to Government revenues. This buffer is designed to provide insurance against revenue shocks inherent in economic cycles. The end of the fiscal year 2010/2011, marked the fourth consecutive year when no distribution could be made to the budget because the Market Value of the fund at AU\$115.1 million was less than the real market value of AU\$127.5 million; however, because of the CIF account, the government was able to draw almost AU\$16 million to support budget over the four year period.³

² This is calculated to be A\$122,946,337.00 Market Value as at 31 March 2012 based on the TTFAC Final Report of May 2012.

³ TTF (2011) Tuvalu Trust Fund and Falekaupule Trust Fund, Opportunities to Contribute to an Innovative Funding Modality for Tuvalu’s National and Community Development

The trust fund model has also provided a conduit through which development partners have been able to provide budget support by making contributions to the CIF which development partners are then drawn-down into the budget over a multi-year period. In a similar manner the main trust fund account has enabled development partners to make additional contributions to the capital of the fund.

Figure 1 The model of the Tuvalu Trust Fund



In 2007, expenditure including Secretariat charges, bank charges, audit fees and the Management fee amounted to 0.8 percent of the net assets of the Fund. In the period since the Fund began to 30 June 2007, \$65.7 million has been made available to the Government which allocated it as follows:⁴

- Recurrent Budget expenditure \$24.1 million
- Re-invested in the TTF \$29.2 million
- Held as a buffer in the B Account \$12.4 million

Central to the operation of the fund is the requirement that the capital of the fund be maintained in real terms for inflation. Only in very exceptional circumstances would the capital of the fund be considered to be drawn down by the Government of Tuvalu. In the 20 years that the Fund has been operating this has never happened. At the end of each financial year on 30 September, the Advisory Committee calculates the maintained value of the fund based on the Australian Consumer Price Index (CPI). If the market value of the fund is greater than the maintained value, then the difference is automatically distributed to the Tuvalu Government and placed in the CIF. This income is referred to as the automatic distribution from the Fund. If the value of the Fund falls below the Maintained Value then no distribution is made until the Fund once more exceeds its Maintained Value.⁵

⁴ TTF (2007) Tuvalu Trust Fund: 20th Anniversary Profile 1987-2007

⁵ TTF (2007) Tuvalu Trust Fund: 20th Anniversary Profile 1987-2007

Funds drawn down from the CIF into the Government budget are fungible as there is no specific allocation of this revenue to particular classes of expenditure. Unspent balances in the CIF represent Government savings, and may be re-invested in the Fund by returning them to the Fund, or carried forward to the next fiscal year.

Governing body and beneficiaries

The Board of Directors has all powers over the Fund (Figure 2). A Director appointed by the Government of Tuvalu is the Chairman of the Board and one Director appointed by each other original Party to the Agreement. Originally there were four directors with Tuvalu in the chair and the other original parties (Australia, New Zealand and UK) providing members. Following a review of its regional programme in the Pacific, the UK withdrew from the Board in 2004. There is provision for further directors to join the Board and represent any new contributing donors. Japan, Korea ADB and EU have observer status to date. The Board meets twice every year.

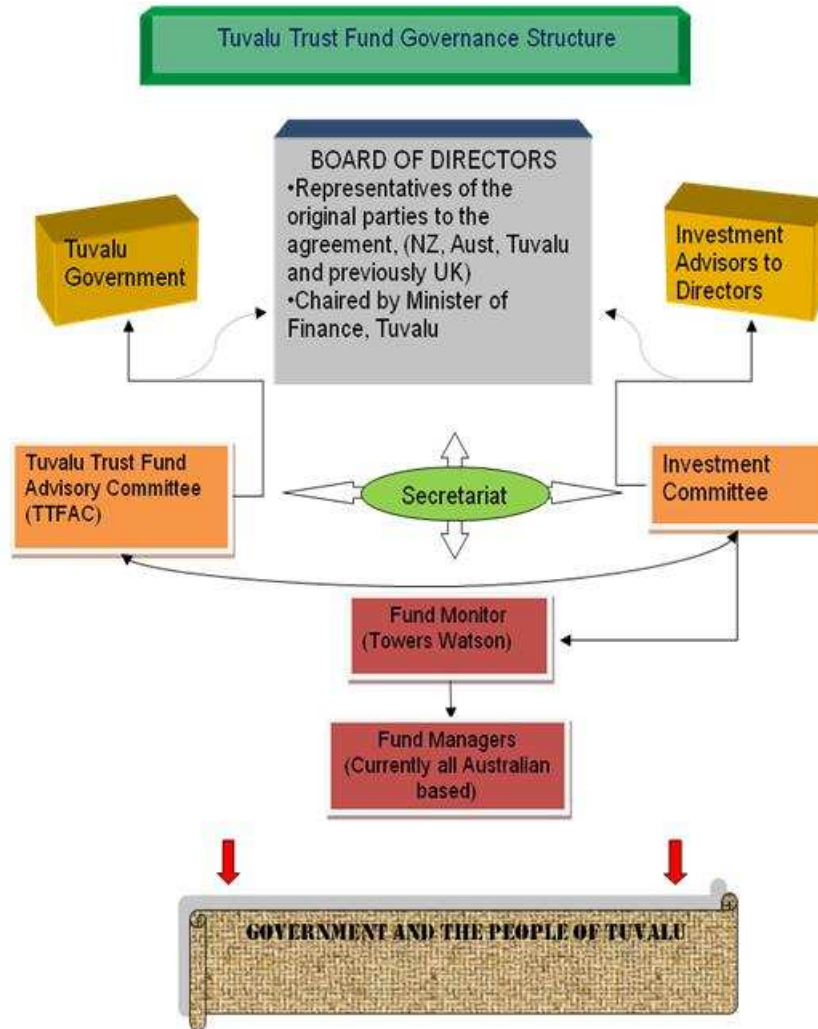
Professional Fund Managers, two Australian based firms, manage the fund on a day-to-day basis guided by a set of objectives and guidelines established by the Board in accordance with the Articles of the Agreement. At inception the Fund was invested wholly with one “balanced” Fund Manager. In 1993 the Fund was divided equally among two balanced Fund managers due to diversification considerations. In 2002, coinciding with the appointment of a new Fund Monitor, the Fund undertook a major restructuring by engaging with “specialist” Fund Managers. Performance of each firm is evaluated independently and comparatively.

Professional consultant actuaries evaluate the investment performance of the fund managers based on comparison with other fund managers and provide quarterly reports to the Board of Directors. Currently, monitoring of fund is carried out by Towers Watson (consultant actuaries) that regularly reviews the investment performance of the fund managers and report to the Board on a three monthly basis. In 2005, by a resolution of the Board, an Investment Committee was established to review in detail the reports of the Fund Monitor and make recommendations to the Board on practical steps to be taken. Furthermore, an annual audit is also performed by a professional firm, which is currently Ernst and Young.

An Advisory Committee regularly evaluates and monitors the impact of the Fund on Tuvalu and provides economic reports to the Government and the Board. The committee meets bi-annually in Tuvalu for about 10 days. It reviews the Government’s budget and provides advice on macro and micro economic issues. Members of the Advisory Committee consist of one member each representing Australia, New Zealand and the United Kingdom, and Tuvalu.

The Secretariat provides ongoing administrative support to the Board of Directors and is based in Funafuti. This role was played by the Secretary of Finance up until 2004 when a fulltime officer was recruited by the Board. Lee Faiva Moresi (TTF Secretary) and Salai Boreham (TTF Assistant Secretary) make up the Secretariat.

Figure 2 Tuvalu trust Fund Governance Structure



The establishment of the TTF

When Tuvalu achieved independence in 1978 the Government finances were difficult and continued to deteriorate. Unlike Kiribati, Tuvalu did not inherit any financial reserves from the Gilbert and Ellice Islands Colony. In 1982, a preliminary approach was made to the United Kingdom to provide a “once and for all” payment in lieu of continuing direct budget support. This was turned down. A similar approach was made to Australia and New Zealand for “one-off” assistance to reduce the overdraft (estimated at \$1.5 million in 1981). This request was also declined and the Government was faced with the prospect of managing the emerging economy on ever reducing finances.

By 1984, the Government of Tuvalu had developed the concept of a “Reserve Fund”, to which Australia, New Zealand and the United Kingdom might contribute and from which revenues would be used for recurrent expenditure. In January 1985, Tuvalu presented a preliminary paper seeking comments on the concept now described a “special budget fund”. This was followed by a further paper, which was discussed with potential donors in Suva in May 1985 that outlined a proposal for a “Special Budget” or “Trust Fund”.

In October 1985, Tuvalu provided a more comprehensive submission for the proposed “Tuvalu Trust Fund” and this was discussed with various possible donor Governments. Tuvalu’s then Deputy Prime Minister and Minister of Finance visited Australia, New Zealand and the United Kingdom to press the case for the establishment of the Fund. At the meeting with the Prime Minister of New Zealand it was announced that New Zealand had agreed in principle to support the Fund, and would set aside NZ\$500,000 in its 1986-87 development assistance budget to be held in reserve pending establishment of the Fund. New Zealand also indicated that it was to consider providing a further NZ\$7,500,000 towards the Fund should other donors (particularly Australia and the United Kingdom) be prepared also to contribute. This was a turning point in the consideration of the proposed Trust Fund.

During 1986, New Zealand and the United Kingdom with the support of the United Nations Development Program (UNDP) began to refine the proposal further – identifying with greater precision the necessary size of the Fund along with the potential legal and other requirements. Australia also undertook its own investigations of possible other alternatives for meeting Tuvalu’s budget difficulties. By mid-1986 regular meetings were being held between Tuvalu Government officials and potential donors with the need to develop a legally binding international agreement. As by now Australia had agreed to support the Fund, having set aside funding within its 1986-87 bilateral allocation to Tuvalu, it was important that the negotiations be concluded by June 1987. The agreement establishing the Fund was signed in Suva on 16 June 1987.

Lessons learned

The Tuvalu has managed to demonstrate comfortably that a Trust Fund set up can have significant positive impacts on national budget and the economy. The TTF has provided Tuvalu with a level of financial security by providing an additional source of government revenue that underpins the Budget and so the whole economy. Although the Fund is not specifically tied to line expenditure items, it is fair to say that real per capita income (on average) and physical infrastructure of Tuvalu have been substantially improved partly due to the Fund’s revenues.

Several important lessons from the case of the TTF are:

- **The model of the TTF** - Sequencing the two funds works because it draws on the comparative advantages of both types of funds. The endowment fund is useful for long-term planning and can earn investment income (capital appreciation and dividends); while the revolving fund provides more flexibility when a distribution from the main trust fund is paid. In this respect the two funds can both assist in stabilizing the long-term financial situation of the government as well as addressing short-term budget needs. The challenge of the short-term needs has created much discussion around the size of the CIF, as it balances the objectives of maximizing the drawdowns into the Budget while at the same time maintaining a smooth flow of revenue for the Budget over time. The comparative disadvantages such as more capital upfront and potential to incur investment losses for the trust fund and disruption of resource flows for the revolving fund, balance each other to realize a sustainable funding mechanism for Tuvalu.
- **Prudent financial management** - An important success factor with the TTF has been the prudent approach shown by the government in its financial affairs. This is demonstrated by a discipline to produce balanced or surplus budgets year on year. In its 2007 National Budget, the Government has introduced a TTF Budget Stabilization item in its Multi Year Budget Framework, which is pitched at 4 per cent of the TTF’s maintained value at 30th September of the previous year. This is a major development in the Government’s fiscal management strategies, which to some extent controls the level of drawdowns from the CIF in any given year to a much more sustainable level. The present government is also committed to building the CIF’s capital to reach its Target Minimum Balance (the equivalent of 16 per cent of the TTF’s maintained value) within the next four years. This will ensure the CIF has sufficient capital to provide the sustainable level of buffer to the annual Budget for a period of up to four years.
- **Strong ownership and relationship with partners** - Although there is strict oversight of the TTF, with multiple checks and balances, Tuvalu has a sense of ownership that makes them want to see the fund grow. (In fact, government was criticized by some

for putting off current consumption and reinvesting too much into the fund). Tuvalu is always chair of the board-- important symbolically. Secretariat based in Funafuti with a Tuvaluan in charge of Secretariat responsibilities. Furthermore, appointment of good professional people to the Board and the Advisory Committee who have multiple year terms with staggered completion dates. There is an informal consultative process before people are appointed.

Authors: *Kevin Petrini, Marilyn Simmons, Silvia Irawan, Alex Heikens*

Cover Photo: *Lien Heikens*

Acknowledgements: the authors would like to express their gratitude to representatives from the TTF and government, sharing their contributions, comments, views and experiences with the TTF.

Disclaimer: The views expressed in this publication are those of the authors and do not necessarily represent those of the United Nations, including UNDP, or its member states.

Citation: Petrini et al. (2012) Case Study Report: Tuvalu Trust Fund. A UNDP working paper.

<http://www.snap-undp.org/elibrary/default.aspx>