

Natural Resource Funds



Botswana

Pula Fund



Market Value

Pula Fund
\$6.9 billion

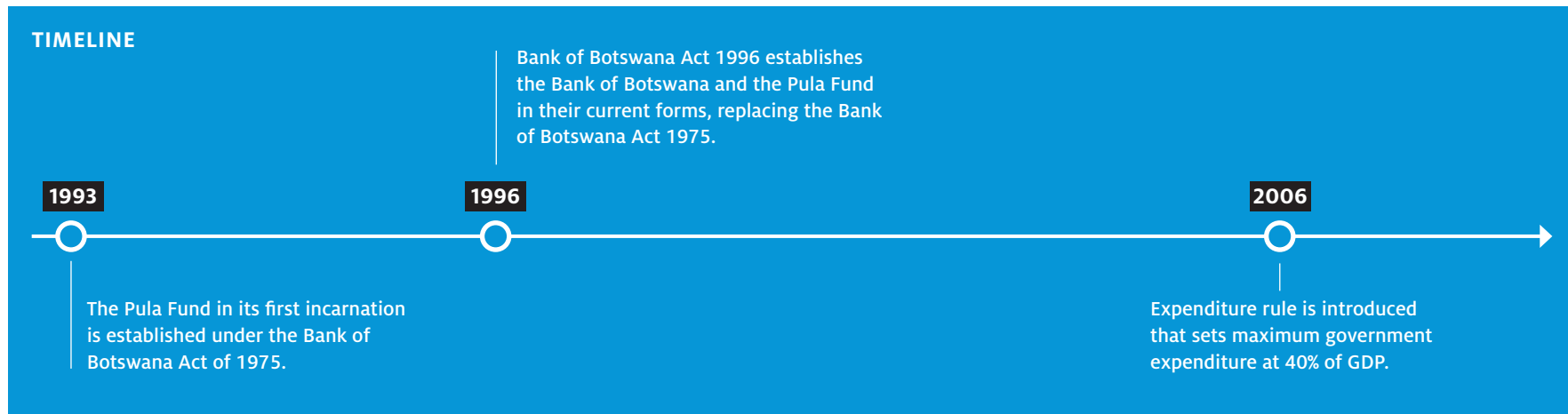


| Good Governance Fundamentals | |
|------------------------------|-----|
| Clear Deposit Rules | no |
| Clear Withdrawal Rules | no |
| Clear Investment Rules | yes |
| Transparent | no |
| Publicly Available Audits | yes |
| Effective Oversight | no |

Fund Highlights

- The Pula Fund was established under the Bank of Botswana Act of 1975 and reestablished under the Bank of Botswana Act of 1996.
- The fund consists of two accounts, the Government Investment Account that belongs to the Government of Botswana and a foreign exchange reserve account that belongs to the Bank of Botswana.
- The Pula Fund’s policy objective is unclear, however it has been used to stabilize revenues and serves as a future generations savings fund.

- Botswana seeks to ensure that current spending is only financed with non-resource revenues. Resource revenues are then either used to finance investment (including human capital) or saved in the Pula Fund.
- While general budget principles guide flows into and out of the fund, no explicit operational rules for deposits and withdrawals exist.
- There is limited public information on fund assets and weak oversight of fund activities.



Fund Inception

- The Pula Fund was originally established in 1993 under the **Bank of Botswana Act in 1975**.
- The Pula Fund was reestablished under the Bank of Botswana Act 1996.¹

Fund Objectives

- Although the Pula Fund has been described as a future generations savings fund, its objective according to the original Bank of Botswana Act 1975 and the subsequent Bank of Botswana Act 1996 remains unclear. On occasion, the fund has been used for revenue stabilization.²
- The Pula Fund preserves a portion of the country's foreign reserves from diamond and mineral exports as a long-term investment.


Good Governance Standards and Gaps in Regulation


Each box represents a regulatory standard essential for promoting consistent use of and safeguarding resource revenues. White boxes highlight regulatory gaps in fund governance.

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Good Governance Standards Met

| OPERATIONS | INVESTMENT | MANAGEMENT | TRANSPARENCY AND OVERSIGHT |
|--|--|--|--|
| Objectives are Clear | Use of Resource Revenues as Collateral | Penalties for Misconduct by Fund Managers & Staff | Public Disclosure of Independent External Audits* |
| Rule for How Much Can be Withdrawn in Any Given Year | Domestic Investment is Explicitly Prohibited | Ethical & Conflict of Interests Standards for Managers & Staff | Public Disclosure of Internal Audit Results |
| Rule for Which Revenues Must be Deposited and When | Investment Risk Limitations | The Detailed Responsibilities of Fund Managers & Staff | Formalized Oversight Mechanism |
| Exceptions to Rules are Clarified | Publication of Specific Investments | The Role of Government Agencies in Fund Management | Public Disclosure of Regularly Compiled Fund Reports** |

 Presence of Regulation

 Absence of Regulation

* Audit results are published in the annual Bank of Botswana reports despite the absence of regulations.

** There are no regularly compiled reports beyond the information included in the overall Bank of Botswana annual reports.

Operational Laws, Rules and Policies

The Pula Fund is not governed by strict deposit or withdrawal rules. Instead, deposits are determined by the size of foreign exchange inflows and the size of fiscal surplus. Withdrawals cover fiscal deficits.

Fund Structure

The Pula Fund consists of two parts:

1. The Government Investment Account, which belongs to the government of Botswana.
2. The Pula Fund's foreign reserves, which belong to the Bank of Botswana.

Fund Deposit Rules³

Government of Botswana Deposits

- In determining how much mineral revenue to save and spend, Botswana sets a Sustainable Budget Index, the ratio of non-investment spending to non-mineral revenues. For example, in 2012 the government set the Sustainable Budget Index at 0.8, which means that no more than 80 percent of non-mineral revenues can be spent on recurrent government expenditures outside the health and education sectors.⁴
- Once the government determines the maximum amount it can spend on non-investment expenditures, it must split remaining revenues (all mineral revenues and remaining non-mineral revenues) between spending on health, education and public investments (e.g. roads; electricity) and saving in the Pula Fund.

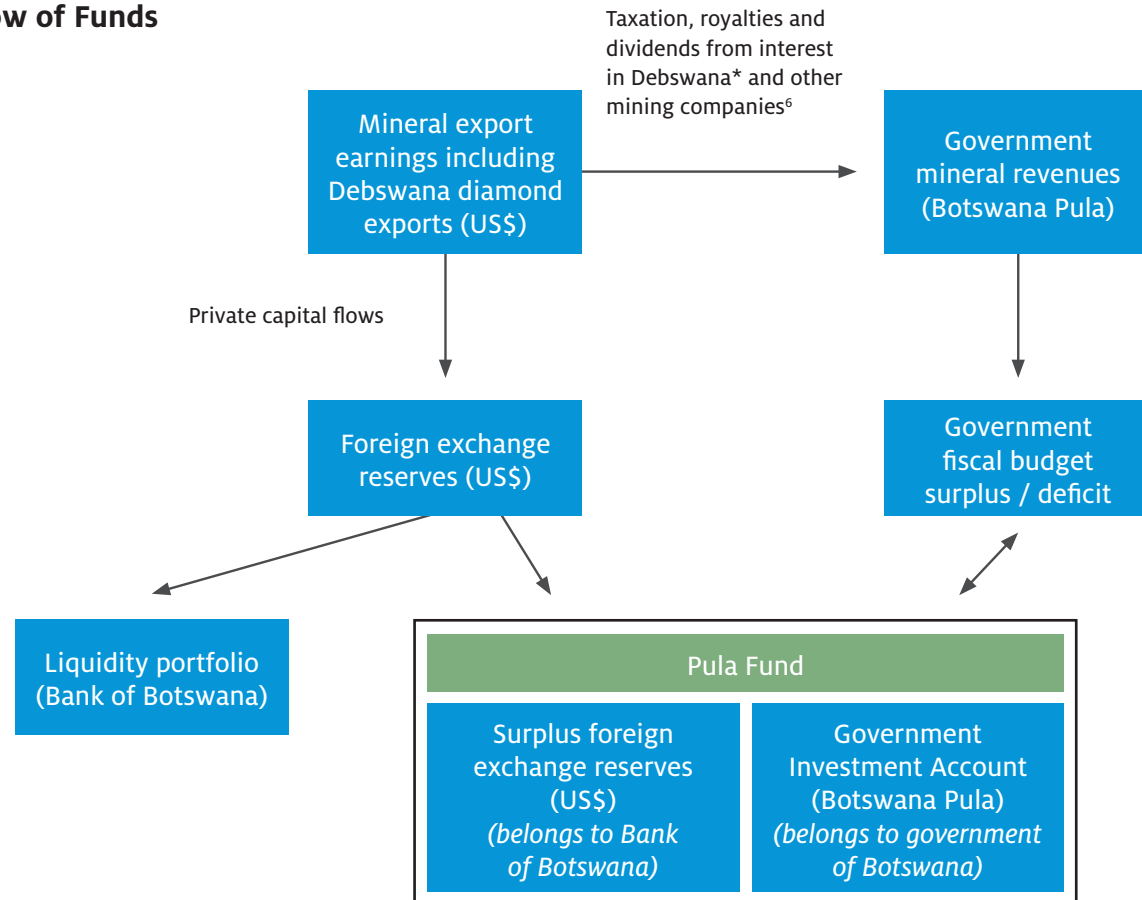
- The total amount of spending is constrained by an expenditure rule that prohibits the government from spending more than 40 percent of GDP in any given year.⁵
- Any fiscal savings, either intended or required by the expenditure rule, are transferred to the government's portion of the Pula Fund known as the Government Investment Account.

Bank of Botswana Deposits

- Foreign exchange reserves that are in excess of the amount required for daily foreign transactions (kept in the Liquidity Portfolio and currently set at six months of cover) are transferred to the Bank of Botswana's portion of the Pula Fund.

Operational Laws, Rules and Policies

Flow of Funds



*Debswana is a 50/50 joint venture mining company between the government of Botswana and De Beers.

Investment Laws, Rules and Policies

Investment Authority

The Pula Fund is managed by the Bank of Botswana and is jointly owned by the Bank and the government of Botswana.⁷

Investment Objectives⁸

- Ensure the safety of the foreign exchange reserve and preserve its value.
- Maintain liquidity so that funds can be made available in a timely manner and at reasonable prices.
- Optimize returns through prudent investment and acceptable levels of risk.

Investment Strategy⁹

The Fund mitigates risk with the following strategies:

- Reserves are only invested in currencies that are freely convertible. If investing in sovereign debt, it must be rated at least Aa2/AA by Moody's and Standard and Poor's (Baa3/BBB- in the case of G7 member countries).
- The Bank invests mainly in U.S. dollar, euro, pound sterling and yen assets. The currency allocations for fixed income assets follows the allocations the IMF uses for their Special Drawing Rights currency basket, set at 41.9% U.S. dollars, 37.4% euro, 11.3% pound sterling and 9.4% yen since 2011.¹⁰
- Allocation of equity investments in various countries is determined by each country's weight in the MSCI Index, a stock market index comprised of a collection of stocks from all developed markets.

- The Fund uses external fund managers to manage a portion of the foreign reserves as a means of benchmarking performance against assets that are managed internally by the Bank of Botswana.

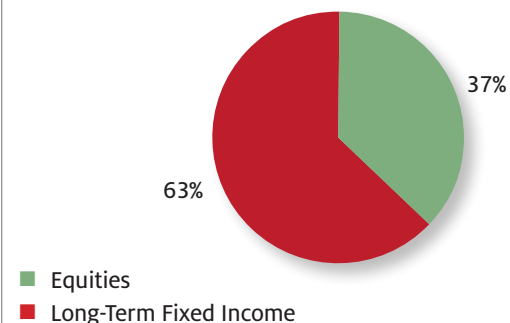
Investment Allocation¹¹

The Bank of Botswana reviews the Pula Fund's asset mix every three to four years. The current guideline for allocation of assets as of 2012 is as follows:

- 40% Equities
- 60% Long-Term Fixed Income Assets

Allocation by Asset Class¹²

As of December 2012



Policy on in-State investments:

The Pula Fund may not invest directly in Botswana.¹³

Management and Accountability

Management and internal accountability

The National Assembly passed legislation creating the Pula Fund and the national development plans that help guide its operation.

The Minister of Finance and Development Planning is consulted on strategic asset allocation and receives audited reports from the Bank of Botswana for presentation to the National Assembly.

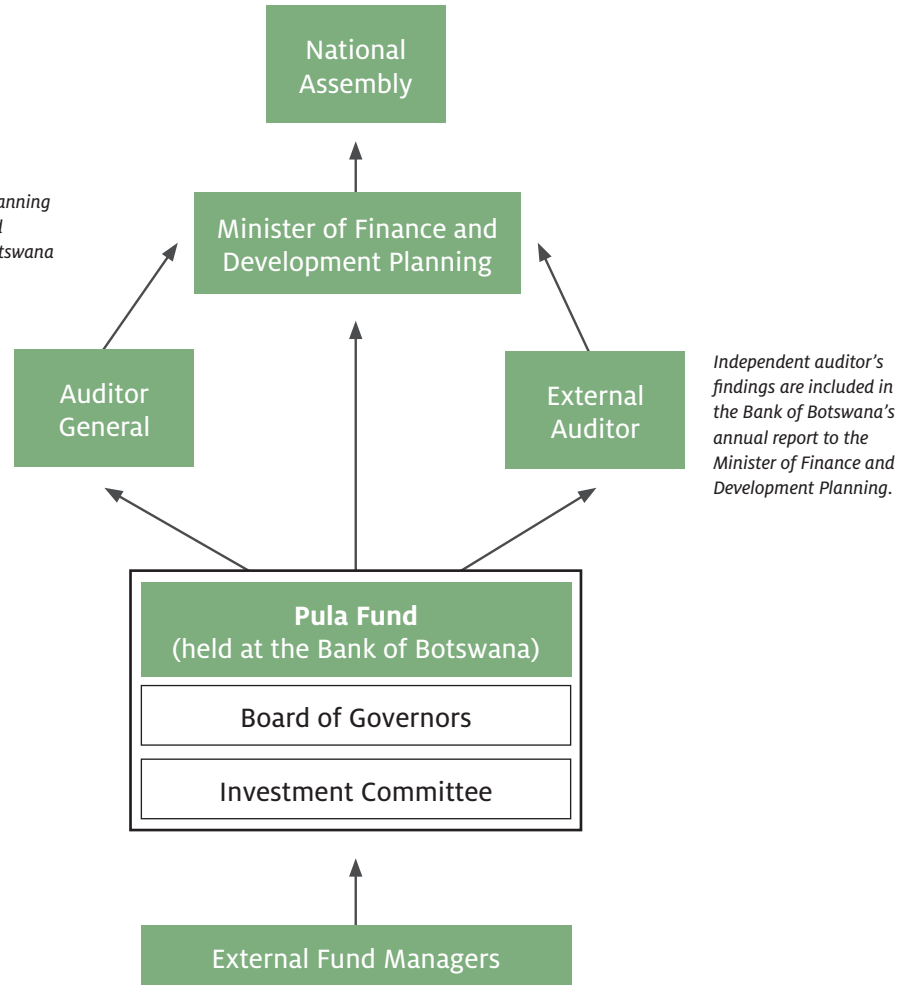
The Auditor General, as requested by the Minister of Finance and Development Planning, reports on the accounts and operations of the Bank of Botswana.

The Board of Governors is responsible for approving investment policies and guidelines.

The Investment Committee makes decisions regarding portfolio rebalancing that are then approved by the Board of Governors. It also monitors the performance of external fund managers.

A portion of funds are managed by external fund managers with the rest managed by the Bank of Botswana itself.

External accountability



Oversight and Safeguards

Pula Fund financial information can be found in the Bank of Botswana's audited annual report.

Oversight Mechanisms

- The Investment Committee performs a **periodic review of investment methodology**.
- Fund finances are subject to a **regular and comprehensive internal audit**.
- Fund finances to be subject to a **regular and independent external audit** that meets international standards.

Common Oversight Mechanisms or Safeguards Not Present in Botswana

- Lack of a **domestic oversight committee** to “police” Fund activity and ensure adherence to the regulations that govern the Fund’s activity.
- Lack of **formal government approval** of Fund deposits and withdrawals.
- Funds are not managed **separately from** the country’s **international reserves**.
- An **international oversight institution**, such as the World Bank or the IMF, does not routinely monitor Fund management.

Transparency Laws, Rules and Policies

There is public disclosure of the following:

| | | |
|--|-----|----|
| When or how often Fund reports are published and made publicly available | yes | |
| Which individuals or organizations are responsible for publishing Fund reports | yes | |
| Size of the Fund(s) | yes | |
| Deposit and withdrawal amounts | | no |
| Returns on investments | yes | |
| Detailed asset allocation – geographic location | | no |
| Detailed asset allocation – asset class | yes | |
| Detailed asset allocation – specific assets | | no |
| Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules | | no |

Annex: List of Applicable Laws

Bank of Botswana

Act 1975

[http://www.elaws.gov.bw/docs/statutes/
Botswana%20Statute%20Law%201975.pdf](http://www.elaws.gov.bw/docs/statutes/Botswana%20Statute%20Law%201975.pdf)

Bank of Botswana

Act 1996

[http://www.bankofbotswana.bw/assets/uploaded/
Bank%20of%20Botswana%20Act.pdf](http://www.bankofbotswana.bw/assets/uploaded/Bank%20of%20Botswana%20Act.pdf)

National Development Plan 2007

[http://www.finance.gov.bw/index.php?
option=com_content1&parent_id=334&id=338](http://www.finance.gov.bw/index.php?option=com_content1&parent_id=334&id=338)

1. <http://www.imf.org/external/np/pp/eng/2012/082412a.pdf> p. 35.
2. <http://www.imf.org/external/np/pp/eng/2012/082412a.pdf> p. 35.
3. <http://www.imf.org/external/np/pp/eng/2012/082412a.pdf> p. 35.
4. Bank of Botswana Annual Report 2012 p. 100. Available at: <http://www.bankofbotswana.bw/assets/uploaded/bob-ar-2012-main.pdf>
5. http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2010/11/16/000158349_20101116090208/Rendered/PDF/WPS5480.pdf p. 8.
6. Building the Domestic Revenue Base: Natural Resource Taxation and Tax Morale in Mozambique, Tanzania and Zambia. NORAD Workshop Report April 2012. Beat Gisler p. 15. Available at: <http://www.norad.no/en/thematic-areas/macro-economics-and-public-administration/tax-for-development/currents-issues/presentations-tax-seminar-in-lusaka-april-2012>
7. <http://www.imf.org/external/np/pp/eng/2012/082412a.pdf> p. 35.
8. <http://www.bankofbotswana.bw/index.php/content/2009103012004-reserve-management-guidelines>
9. IMF Guidelines for Foreign Exchange Reserve Management: Country Case Studies p. 47-48. Available at: <http://www.imf.org/external/pubs/ft/ferm/guidelines/2005/part2.pdf>
10. <http://www.imf.org/external/np/tre/sdr/sdrbasket.htm>
11. IMF Guidelines for Foreign Exchange Reserve Management: Country Case Studies p. 47. Available at: <http://www.imf.org/external/pubs/ft/ferm/guidelines/2005/part2.pdf>
12. Bank of Botswana Annual Report 2012 p. 44. Available at: <http://www.bankofbotswana.bw/assets/uploaded/bob-ar-2012-main.pdf>
13. <http://www.imf.org/external/pubs/ft/gfsr/2007/02/pdf/annex12.pdf> p. 49.