# ANNUAL REPORT SOVEREIGN WEALTH FUNDS

Ministry of Finance

2019

This publication constitutes the 2019 Annual Report on the Sovereign Wealth Funds maintained by the Ministry of Finance.

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https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/annual-report.

Santiago, Chile

# ANNUAL REPORT
# SOVEREIGN WEALTH FUNDS

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# 01 FOREWORD BY THE MINISTER

The year 2019 was marked by the trade war between the United States and China, which had negative effects on trade and world growth. In this scenario, the advanced economies grew just 1.7%, while the emerging and developing countries expanded 4.5%, both figures below the 2018 rates.

Locally, 18 October was a turning point in terms of both the social and economic agenda in the country. Prior to that date, the economy had been performing in line with projections, with annual GDP growth of 3.4% in the third quarter. However, the eruption and protraction of the crisis, characterized by social protests and recurring violence, affected the productive system, which had a strong impact on national output and fiscal income. This has been exacerbated by the new context of a global public health emergency. The COVID-19 pandemic is severely affecting our economy and the rest of the world, causing what is perhaps the worst economic crisis since the Great Depression.

In response to these new scenarios, the government of President Sebastián Piñera presented a significant social agenda in late 2019. This has been complemented by a series of initiatives to support Chilean families and businesses so that they can negotiate the economic effects deriving from the coronavirus.

In this context of a significant deterioration in economic activity, fiscal income has contracted, while fiscal spending has increased due to the initiatives being implemented by the government. To finance these measures, the government will use a combination of issuing debt and using some of the savings accumulated in the sovereign wealth funds, as well as advancing on measures to improve the efficiency of public expenditures.

Our two sovereign wealth funds are a fundamental component of the fiscal responsibility policy. During periods of economic booms and high copper prices, a large share of the fiscal surpluses are accumulated in the Economic and Social Stabilization Fund (ESSF), creating insurance for facing fiscal deficits during adverse economic times. The Pension Reserve Fund (PRF), in turn, receives an annual contribution to generate savings that will complement future pension payments to the most unfortunate sectors of our country. These two funds provide the resources to support the sustainable financing of social programs, independently of the economic cycle, and the implementation of countercyclical measures in times of crisis.

At year-end 2019, the sovereign wealth funds together had a market value of US$ 23,045 million, down from US$ 23,797 million at the close of the previous year. The market value of the ESSF at year-end 2019 was US$ 12,233 million. This reflects withdrawals of US$ 2,564 million, used to finance the annual contribution to the PRF and to support the funding needs of the Treasury deriving from the reduction in fiscal income in the last quarter of 2019; these withdrawals were partially offset by a net return on investment in the ESSF of US$ 663 million. With regard to the PRF, the market value at year-end was US$ 10,812 million, which reflects a net return on investment of US$ 1,161 million, partially offset by net withdrawals of US$ 13 million (due to a contribution of US$ 564 million and withdrawals of US$ 577 million).

In terms of performance, in 2019 the ESSF recorded net returns of 4.77% in dollars and 12.14% in pesos; the PRF, 12.04% in dollars and 19.92% in pesos. The return on the PRF tends to be more volatile than the ESSF in the short term, as a larger share is invested in riskier asset classes, but it has higher expected returns in the long run. Since the inception of the funds, the annualized net return of the PRF was 3.88% in dollars and 6.55% in pesos; for the ESSF, 2.59% in dollars and 5.22% in pesos.

In 2019, progress was made on the implementation of the new PRF investment policy, which was approved in November 2017. Early in the year, the fund began to invest in U.S. agency mortgage-backed securities (MBS) and high yield bonds; these two portfolios represented around 8% and 6% of the fund, respectively, at the time of implementation. Equities exposure continued to increase, to around 29% at year-end, with the goal of converging to 40% in early 2021.

In the case of the ESSF, following international good practices that require a periodic review of investment policies, we have commissioned a new study from an international consultant firm. The study will be completed in late 2020, and it will take into account the new fiscal situation and the expected disbursements from this fund.

The challenges that we are facing as a country are demanding. The economic crisis scenario will force us to maximize the use of resources, which are always scarce. It is important to emphasize that the sovereign wealth funds will play a crucial role in addressing this new global economic scenario. The world is facing a pandemic, which has generated a much greater economic impact than the global financial crisis of 2008. However, as a result of both the Fiscal Responsibility Law, passed in 2006, and a solid and efficient management of financial resources, Chile has room to respond to a crisis of this size.

Finally, Chile is better prepared to face the crisis than other countries in the region, thanks to having built a robust institutional structure over the past three decades. In this regard, the sovereign wealth funds and the fiscal rule have been fundamental.

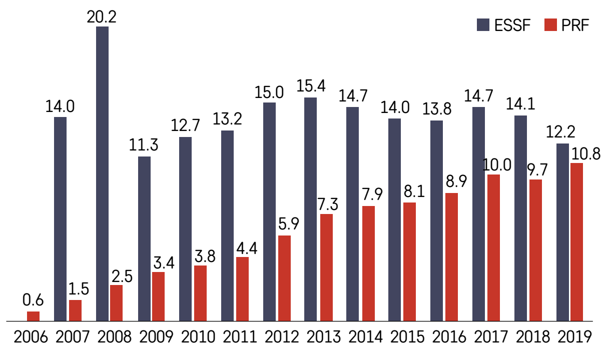
Ignacio Briones
Minister of Finance

# 02 SUMMARY

As of 31 December 2019, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US$ 23,045 million. The net returns in dollars were 4.77% and 12.04% for the ESSF and PRF, respectively, in 2019 and 2.59% and 3.88% annualized since their inception.[1]

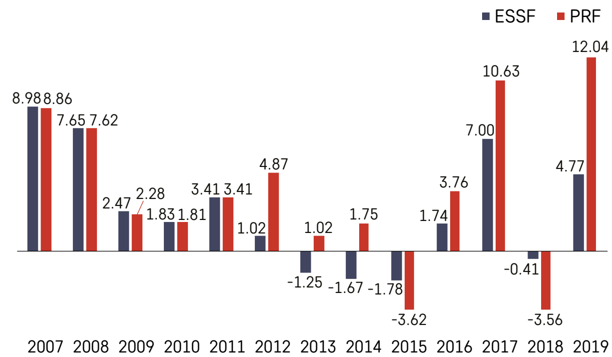
1 The returns published in this report are based on the time-weighted rate of return (TWR) methodology, unless the use of the internal rate of return (IRR) is explicitly identified. Returns for periods of over one year are compound annualized rates. For periods of less than one year, the return corresponds to the change in the given period. Net returns deduct the costs associated with managing the investment portfolios.

## F1 Market value (billions of dollars)



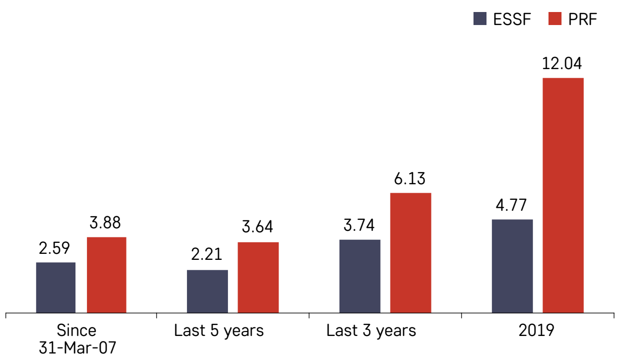

Source: Ministry of Finance

## F2 Annual net return in dollars[2] (percent)




Source: Ministry of Finance

## F3 Accumulated annual net return in dollars (percent)



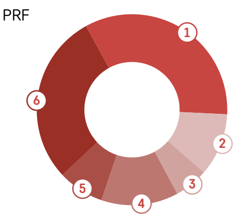

Source: Ministry of Finance

## F4 Asset class allocation as of 31 December 2019 (percent of portfolio)

ESSF


| | | |
|---|---|---|
| 1 | Sovereign bonds | **54.9** |
| 2 | Equities | **3.5** |
| 3 | Inflation - linked sovereign bonds | **7.7** |
| 4 | Banking and sovereign bills | **33.9** |

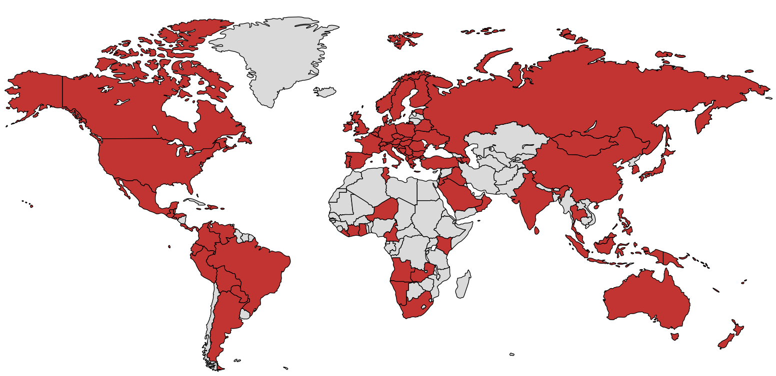
PRF




| | | |
|---|---|---|
| 1 | Sovereign and government related bonds | **33.8** |
| 2 | Inflation - linked sovereign bonds | **10.6** |
| 3 | U.S. agency MBS | **5.7** |
| 4 | Corporates bonds | **13.1** |
| 5 | High yield bonds | **7.8** |
| 6 | Equities | **28.9** |

Source: Ministry of Finance

## F5 Countries where the funds are invested as of 31 December 2019



Source: Ministry of Finance

2 The use of the TWR methodology to measure returns dates to 31 March 2007.

# 03 SOVEREIGN WEALTH FUNDS

Chile has two sovereign wealth funds, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). Both funds were created through the Fiscal Responsibility Law of 2006, which established the regulations and institutional framework for the accumulation, management and operation of the fiscal savings generated from the application of the structural balance rule (see Box 1). This law stipulated the creation of the PRF, which received its first contribution on 28 December 2006, and the ESSF, which received its first contribution on 6 March 2007. The ESSF was officially formed by combining into a single fund the resources saved in accordance with Decree Law Nº 3,653 of 1981 and the Copper Revenue Compensation Fund, as specified in Ministry of Finance Statutory Decree Nº1 (DFL Nº 1) of 2006.

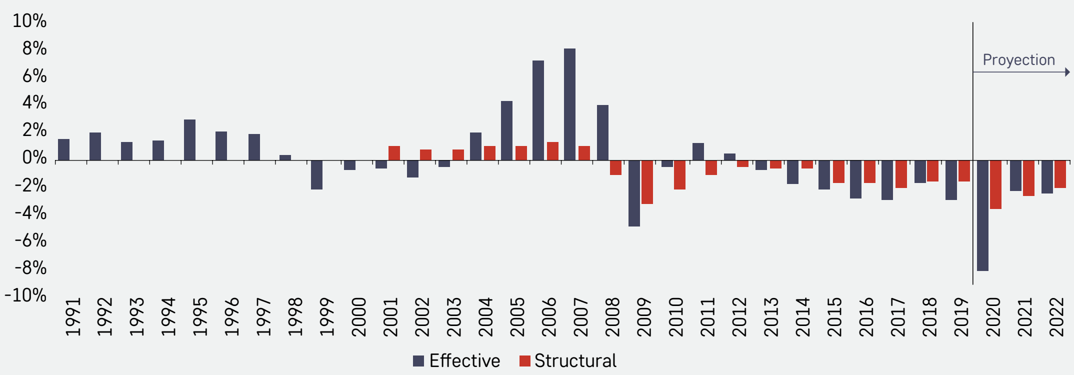
## BOX 1 The structural balance rule

Chile implemented a structural balance rule in 2001 with the objective of establishing an annual fiscal spending level consistent with the central government's structural income. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity and the price of copper. This is especially important for a country like Chile, where the volatility of fiscal revenue largely depends on the copper price. This allows the government to save in boom times, thereby avoiding drastic adjustments to fiscal expenditures during unfavorable economic periods. At the same time, when fiscal policy is credible and sustainable, monetary policy can be used as the main policy instrument for boosting or slowing down economic activity as needed. This policy has thus contributed to significantly reducing the volatility of fiscal spending and economic growth.

Initially, the structural balance rule was a commitment adopted by the Government which was reflected each year in the corresponding budget law, but after several years of application, it was formalized in the legislation. Thus, Law N°20,128 on Fiscal Responsibility was passed in the second half of 2006, requiring each Presidential Administration to announce its objective for the structural balance rule in its first year. The law further established the regulations and institutional framework for the accumulation, management and operation of fiscal savings. It created the PRF and authorized the President of the Republic to create the ESSF, which was officially founded in February 2007.

The structural balance target has changed over time. The target was initially set at 1% of structural surplus of GDP in 2001. The 2008 budget reduced it to 0.5% of GDP, because substantial resources were being accumulated in the sovereign wealth funds.[1] In 2009, the ex ante target was reduced to 0% to face the crisis that was then in full swing, nevertheless, the structural deficit for that year reached 3.1%. From 2010 to 2014, the government proposed reducing the structural deficit so as to converge to a 1% of GDP in 2014, reaching 0.5% at the end of 2014. The past government announced in 2015 that the structural deficit will gradually be adjusted around a quarter of a point of GDP each year through 2018, however, at the end of 2017 the structural deficit increased up to 2%. (see Figure B.1). In 2018, and 2019 the structural deficit was 1.5% of GDP.[2]

B.1 Effective and structural fiscal balance,[3] 1991-2022 (percent of GDP)




Source: Ministry of Finance

1 In 2008, the structural deficit ended at 1% of GDP.

2 The methodology for calculating the fiscal balance has changed over time. Information on past methodologies is available online, at www.dipres.cl/598/w3-propertyvalue-16156.html.

3 In 2020, the structural balance target was adjusted significantly due to the effects of the social crisis that started in October 2019.

## 3.1 Purpose of the Sovereign Wealth Funds

The ESSF was created to finance fiscal deficits that could arise in periods of low growth and/or a low copper price. Thus, using the resources in the ESSF is an alternative to issuing debt to finance public expenditures. The ESSF can also finance the payment of public debt and recognition bonds as well as regular contributions to the PRF, as established under Ministry of Finance Statutory Decree DFL N°1 of 2006.

The purpose of the PRF is to complement the financing of fiscal liabilities in the area of pensions and social welfare. Specifically, the fund backs the state guarantee for old-age and disability solidarity pension benefits, as well as solidarity pension contributions, as established under the pension reform of 2008.[3]

3 In 2008 the law 20,255 was enacted, it creates the solidarity pension system.

## 3.2 Rules on Contributions and Withdrawals

The Fiscal Responsibility Law of 2006 establishes the rules on fund contributions. The rules on withdrawals and the use of the funds are established in the same law, as well as in the Pension Law of 2008 for the PRF and DFL Nº 1 for the ESSF.

According to the Fiscal Responsibility Law, the PRF must receive a minimum annual contribution of 0.2% of the previous year's gross domestic product (GDP). If the effective fiscal surplus exceeds that amount, the contributions can be increased up to the amount of the surplus, with a maximum of 0.5% of the previous year's GDP. The transfer must occur in the first half of the year. This policy will be in place until the PRF reaches a balance equivalent to 900 million UFs (unidad de fomento).[4, 5]

In the case of the ESSF, the fund must receive any positive balance remaining after subtracting the PRF contributions from the effective surplus, less the amortization of public debt and estimated contributions that were made in advance the previous year[6] (see Figure 6).

Consistent with the objectives described above, and as it was mentioned before, the ESSF resources can be used at any time to complement fiscal revenue as needed in order to finance authorized public expenditures in the case of a fiscal deficit. They can also be used for the regular or extraordinary amortization of public debt (including recognition bonds) and for financing the annual contribution to the PRF when the Finance Minister so decides.

The PRF resources can only be used in accordance with the objectives cited earlier; that is, for the payment of pension and welfare system liabilities. Through 2015, annual withdrawals

4 As of 31 December 2019, the PRF reached a market value of UF 287 million.

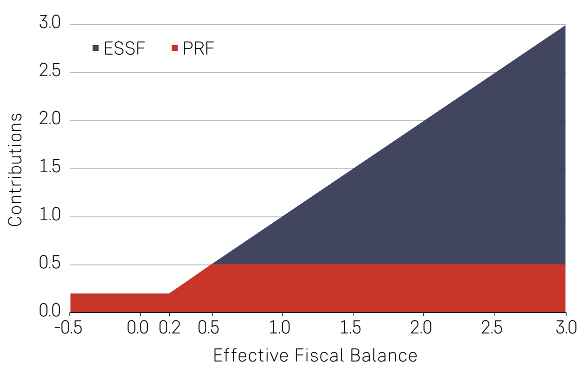
5 In the framework of the current health emergency, Law N° 21,225, which established measures to support families and micro, small and medium-sized companies due to the impact of the disease COVID-19, in its fourth article suspends contributions to the FRP in the years 2020 and 2021; subsequently, the current contribution rule remains in force.

6 The current legislation allows a fiscal surplus in the current year, which must be transferred to the ESSF in the following year, to be used for the amortization of public debt or for estimated (advance) contributions to the fund.

from the PRF must not exceed the fund's returns in the previous year. Starting in 2016, annual withdrawals will be capped at an amount equal to a third of the difference between the pension liabilities expense in the respective year and the inflation-adjusted pension liabilities expense in 2008.[7] After September 2021, the PRF will cease to exist if the withdrawals in a calendar year do not exceed 5% of the total expenditures associated with the state guarantee for old-age and disability basic solidarity pension benefits and old-age and disability solidarity pension contributions as established in the budget for that year.

Contributions to and withdrawals from the ESSF and PRF are formalized through Ministry of Finance decree.

F6 Fund contribution rules (percent of GDP)




Source: Ministry of Finance

7 In the framework of the COVID-19 pandemic, Law N° 21,227, which authorizes exceptional access to the unemployment insurance benefits stipulated in Law N° 19,728, establishes in Article 19 that, without detriment to the provisions of Article 8 of the Fiscal Responsibility Law, the amount of PRF resources that will be used in 2020 and 2021 will correspond to the full difference between total spending on social welfare and pension obligations in the respective year and total spending on social welfare and pension obligations in 2008, where the latter is adjusted annually to reflect the annual increase in the consumer price index.

# 04 INSTITUTIONAL FRAMEWORK

The institutional framework of the sovereign wealth funds is designed to facilitate decision making, performance execution, risk monitoring, and investment policy oversight. This provides an adequate separation of roles and responsibilities, which allows for accountability and operational independence in fund management. The entities that make up the institutional framework of the funds are the Ministry of Finance and its dependent bodies, the Financial Committee, the Central Bank of Chile, the external portfolio managers, the Treasury of Chile, and the custodian (see Figure 7).

## 4.1 Ministry of Finance and Dependent Bodies

The Fiscal Responsibility Law establishes that the sovereign wealth funds are the property of the Fisco of Chile and that the General Treasury of Chile (GTC) holds the legal title to the resources. The law authorizes the Finance Minister to make decisions on investing and managing the resources in the sovereign wealth funds, and it grants the Minister the authority to decide whether the operational management of the investment of the funds will be carried out directly through the GTC or delegated to the Central Bank of Chile or other external managers. Additionally, the Finance Minister created the Sovereign Wealth Funds Unit within the Ministry to support the activities associated with investing the funds. The Unit's functions include monitoring the performance of the fund managers, acting as Technical Secretariat for the Financial Committee, and preparing monthly, quarterly, and annual reports on the state of the sovereign wealth funds for submission to the National Congress and the general public.

The GTC is responsible for the fund accounting, for preparing the audited financial statements, and for monitoring compliance with investment limits. The Budget Office is responsible for budgetary issues related to the funds.

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## 4.2 Financial Committee

The Financial Committee is an external advisory board, whose members have a vast experience in economic and financial areas. The Financial Committee was officially created through Decree Nº 621, issued by the Ministry of Finance in 2007, to advise the Minister on the analysis and design of the sovereign wealth fund investment strategy, in compliance with Article 13 of the Fiscal Responsibility Law.

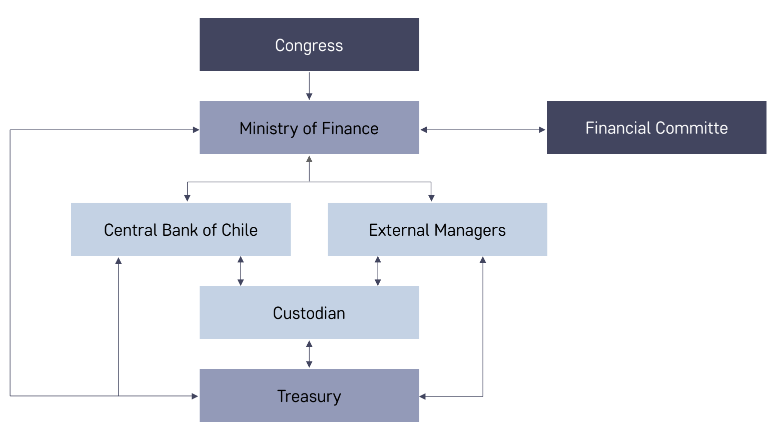
The main functions and powers of the Financial Committee are as follows:

> To advise the Finance Minister, when requested, on the long-term investment policy of the sovereign wealth funds, including the selection of asset classes, benchmarks, the acceptable range of deviation, eligible investments, and the inclusion new investment alternatives;

> To make recommendations to the Finance Minister regarding specific instructions on investment and custody, tender processes, the selection of fund managers, and the structure and content of reports;

> To provide an assessment, when requested by the Finance Minister, of the structure and content of the reports submit-

F7 Institutional framework of the sovereign wealth funds




Source: Ministry of Finance

ted to the Ministry of Finance by the agencies entrusted with the management and custody of the funds and to express an opinion on the quality of management and compliance with established investment policies;

> To provide an assessment of the structure and content of the quarterly reports prepared by the Ministry of Finance; and

> To advise the Finance Minister, when requested, on all matters relating to the investment of the funds.

In 2019, the Committee members were José De Gregorio Rebeco (Chairman), Cristián Eyzaguirre Johnston (Vice Chairman), Ricardo Budinich Diez, Jaime Casassus Vargas, Martín Costabal Llona, and Paulina Yazigi Salamanca.

For more information on the Finance Committee's activities in 2019, see their Annual Report, which is available online at https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/financial-committee/annual-report.

## 4.3 Central Bank of Chile

The functions of the Central Bank of Chile (CBC) in the management of the Chilean sovereign wealth funds were established by Executive Decree Nº 1,383, issued by the Finance Ministry in 2006, which was later modified by Decree N° 1,618 of 2012.[8] Pursuant to these decrees, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

> To manage portfolios that include instruments that are eligible for the international reserves or other fixed-income instruments acceptable for CBC investments.[9]

> To tender and delegate the management of all or part of the fiscal resources under its management to external managers in the name and on the account of the Fisco. As of 1 January 2014, the CBC can, at the request of the Ministry, carry out tenders for the selection of external managers of portfolios that are not under the management of the CBC.

> To open separate current accounts in the course of performing its role as fiscal agent.

> To maintain a register of transactions and other operations carried out in the management of the fiscal resources and, as of 1 January 2014, to reconcile the nominal daily positions of the portfolios that are not under its management.

> To contract the services of a custodian institution and to manage that contract.

> To supervise and evaluate the performance of appointed custodian institutions and external managers under the CBC's management.

> To report daily on investment positions, prepare monthly, quarterly and annual reports on the management of the portfolios, and to prepare an annual report on the services provided by the custodian.

> To make payments as needed in the performance of its role as fiscal agent.

The CBC, as fiscal agent, must comply with the investment guidelines established by the Ministry of Finance. These guidelines identify eligible assets, specify the strategic portfolio allocation, define the benchmarks for performance evaluation, and set investment limits and restrictions to control the sovereign wealth funds' risk exposure.

8 Finance Ministry Decree 1,618, of 2012, established that the CBC will only manage asset classes that are also eligible for investment under the CBC's international reserve management guidelines. Thus, the CBC is no longer responsible for supervising the external management of the corporate bond and equity portfolios, as it was in 2012 in representation of the Fisco.

9 According to this criteria, and as stipulated in Decree N° 1.618, the CBC does not longer manage the corporate bond and equity portfolios as of 1 January 2014.

On the instruction of the Finance Ministry, the CBC contracted J.P. Morgan Chase Bank N.A. (J.P. Morgan) to serve as international custodian of the sovereign wealth fund investments. J.P. Morgan is also responsible for calculating the funds' returns, reporting on the investment portfolios and portfolio risk, monitoring compliance with investment limits, and performing some other middle office functions, which are complemented by Finance Ministry and GTC personnel.

## 4.4 External Portfolio Managers

The external managers are specialized portfolio investment companies that have been contracted to invest some asset classes to which the sovereign wealth funds have exposure. Like the CBC, the external managers must comply with the investment guidelines defined by the Ministry.

Table 1 presents the list of external portfolio managers that are investing part of the sovereign wealth funds as of year-end 2019 (see Box 2).

The Ministry and the GTC[10] are responsible for supervising the managers of the equity portfolio, the investment grade corporate bond (corporate bond) portfolio, and the high yield bond portfolio.[11] As of January 2019, the CBC supervises the managers of the U.S. agency mortgage backed securities (U.S. agency MBS) portfolio.[12]

T1 List of External Managers by Fund

| External Manager | PRF | ESSF |
|---|---|---|
| BlackRock Institutional Trust Company, N.A. (BlackRock) | Equities | Equities |
| | Corporate bonds | |
| | High Yield bonds | |
| Mellon Investments Corporation (Mellon) | Equities | Equities |
| Allianz Global Investors (Allianz) | Corporate bonds | |
| Nomura Asset Management (Nomura) | High yield bonds | |
| BNP Paribas Asset Management (BNP Paribas) | U.S. agency MBS | |
| Western Asset Management Company (Western Asset) | U.S. agency MBS | |

Source: Ministry of Finance

10 In 2012, the CBC informed the Ministry that it wanted to reduce its duties with regard to the external portfolio managers of the sovereign wealth fund corporate bond and equity portfolios, such that, in the long run, the CBC would operate exclusively as a portfolio manager for the funds it was charged with investing, namely, the sovereign fixed-income and other government-related (semi-sovereign) bond portfolios. Thus, it asked the Ministry to write a new decree that would reduce its responsibility with regard to the external mandate. With the new decree, published in April 2013, the CBC ceased to perform, starting on 1 January 2014, a large share of its activities associated with tracking and monitoring the externally managed corporate bond and equity portfolios. For more information on the functions transferred from the CBC to the Ministry and the Treasury on 1 January 2014, see the 2013 Annual Report of the Sovereign Wealth Funds, available online at https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/annual-report.

11 It includes sovereign and corporate securities that are not investment grade.

12 The CBC supervises the managers of the U.S. agency MBS portfolio because these instruments are eligible for investment of the Bank's international reserves.

## BOX 2 External Managers Selection Processes

In 2011, following a detailed selection process, the CBC contracted BlackRock, Mellon, and Rogge Global Partners PLC (Rogge), which was later acquired by Allianz in 2016, to invest the corporate bond and equity portfolios of the PRF. These companies began managing the investment of 35% of the PRF portfolio in January 2012. Subsequently, in 2013, following changes to the ESSF investment policy and in accordance with instructions from the Finance Minister, the CBC contracted two of the same firms –BlackRock and Mellon– to invest the ESSF equity portfolio.[1]

In 2018, the CBC selected BlackRock and Nomura Asset Management Global (Nomura) for the external management of the high yield bond portfolios; and BNP Paribas Asset Management (BNP) and Western Asset Management Company (Western) for the U.S. agency MBS portfolios. Both asset classes are included in the new investment policy defined for the PRF, according to which the Ministry and the GTC will be responsible for the oversight and supervision of the high yield bond portfolio managers and the CBC will oversee the U.S. agency MBS portfolio managers. Both mandates were implemented in January 2019.

1 The Finance Ministry decided to contract the same firms used for the PRF because the equities mandate is identical for the ESSF and the PRF.

# 05 TRANSPARENCY

The government of Chile is committed to developing and improving all aspects of the management of the sovereign wealth funds, including areas related to the transparency of decisions and access to pertinent information on their administration. Therefore, systematic reports are regularly prepared and published on the funds' investments, contributions, withdrawals and market value. In addition, the web page and press releases are used to inform the public about the main issues covered in all Financial Committee meetings and the resulting recommendations, together with all important decisions made by the Finance Ministry on the management of the sovereign wealth funds.

Although by law the Finance Ministry is only required to prepare monthly and quarterly reports on the activity of the Chilean sovereign wealth funds, since 2008 the Ministry has also released an annual report containing detailed information on the funds' investment policy, performance and risks, as well as other activities associated with funds' management. Starting in 2011, the annual report includes the audited financial statements, prepared in accordance with international accounting standards.

The quality of the information included in the monthly and quarterly reports has also been improved. For example, since mid-2010 the data frequency on fund performance was increased from quarterly to monthly, and more information on the investment portfolios was made available.

To guarantee public access to all important information on the ESSF and the PRF, many of the reports are published in both Spanish and English and are available on the sovereign wealth funds' website.[13] Also, as of 2018, it is possible to subscribe to receive email notifications on the availability and updating of the monthly, quarterly, and annual reports that are published on the website.

Additionally, every two years the Ministry conducts a self-assessment of how well the Chilean sovereign wealth funds comply with each of the Santiago Principles.[14] The purpose of this exercise is to demonstrate to the public, both nationally and internationally, that the Chilean funds are managed in accordance with international best practices.[15] This time, the sixth self-evaluation of the Santiago Principles is included in Annex 1 of this report.

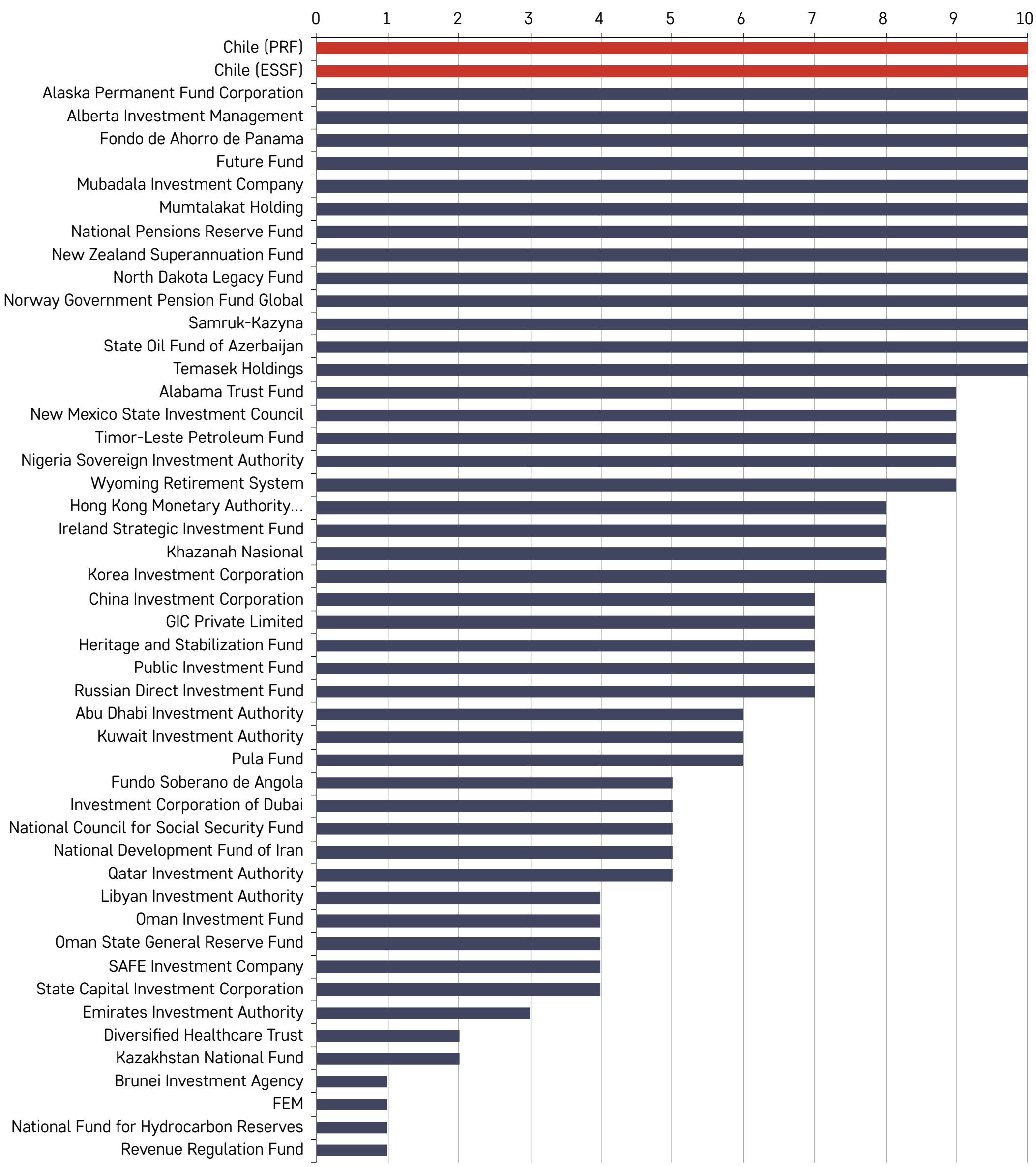
These efforts have been reflected in international recognition of the level of transparency of our funds. In particular, from the third quarter of 2009 to date, the Sovereign Wealth Fund Institute has awarded Chile the highest score on its Linaburg-Maduell Transparency Index, which measures the transparency of the main sovereign wealth funds (see Figure 8). In addition, the Chilean sovereign wealth funds are ranked among the most transparent funds in the world by the Peterson Institute for International Economics. The institute's report entitled "Uneven Progress on Sovereign Wealth Fund Transparency and Accountability" published in October 2016, included a new version of the SWF Scoreboard, which measures the transparency and accountability of the sovereign wealth funds analyzed. On this occasion, the ESSF and the FRP were placed in sixth and seventh place, with 91 and 88 points, respectively. The above represents a maintenance in the score obtained by the ESSF with respect to the previous version of Scoreboard, published in 2013, and an improvement in the case of the PRF. Moreover, according to the Santiago Compliance Index 2014, published by GeoEconomica to measure the degree of implementation of the Santiago Principles in the world's main sovereign wealth funds, both Chilean funds received the highest rating. According to GeoEconomica, this indicates that the governance, transparency, accountability and disclosure practices of our sovereign wealth funds comply with the substance and disclosure guidelines of the Santiago Principles and that the funds are subject to an appropriate self-assessment of compliance.

13 https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds.

14 The Santiago Principles are a series of principles and practices that have been accepted by the main countries with sovereign wealth funds. The purpose of the principles is to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as sound, prudent investment practices by the sovereign wealth funds (source: www.iwg-swf.org/pubs/esl/gapplists.pdf).

15 Prior self-assessments are available online at https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/good-governance-practices-santiago-principles.

F8 Linaburg-Maduell transparency index[16]




Source: Sovereign Wealth Fund Institute.

16 Information at fourth quarter of 2019.

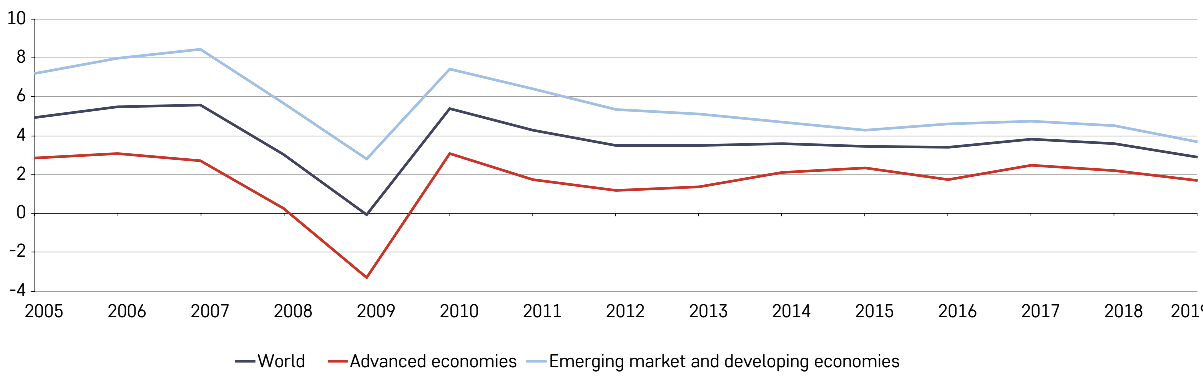
# 06 ANALYSIS OF THE INTERNATIONAL ECONOMY

For a better understanding of the recent performance of the sovereign wealth funds, this section summarizes the main developments in the international economy in 2019.

According to estimates by the International Monetary Fund (IMF),[17] the world economy grew 2.9% in 2019, which is somewhat lower than market expectations and reflects a sharper slowdown than expected in the largest economies toward the end of the year. The year was marked by the constant negotiations of the trade conflict between the United States and China, a slight weakening of the dollar, and more expansive international financial conditions.

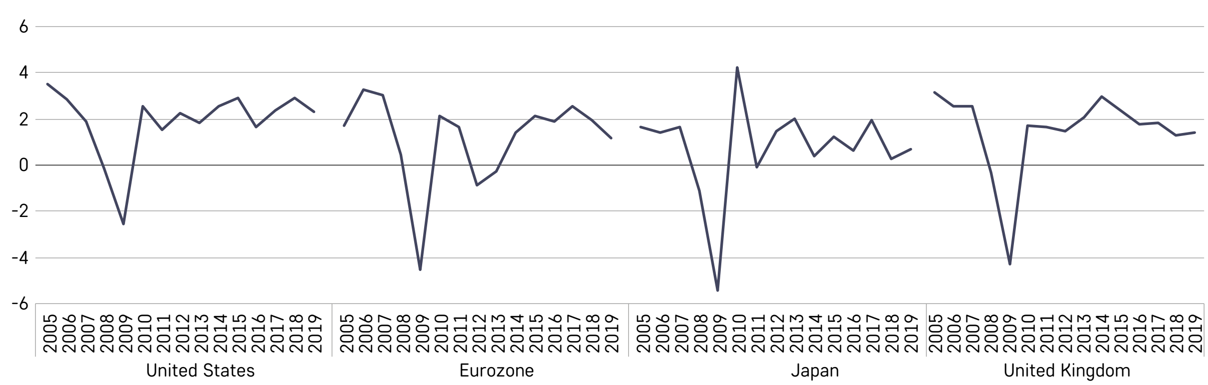
On aggregate, the advanced economies slowed from an annual growth rate of 2.2% in 2018 to 1.7% in 2019. The emerging and developing economies also recorded a slight downturn, from 4.5% in 2018 to 3.7% in 2019 (see Figure 9). In the advanced economies, it can be observed the slowdown in U.S and Euro Zone, and the stagnation of the United Kingdom in comparison to the previous year. Japan's economy, in contrast, experienced a moderate acceleration, accompanied by a significant fiscal impulse and business investment that improves domestic demand (see Figure 10). For the emerging and developing economies, notable trends included slowdowns in China and India and Brazil (see Figure 11).

F9 Real GDP growth, 2005 – 2019 (percent)




Source: International Monetary Fund

F10 Real GDP growth in specific developed economies, 2005–2019 (year-on-year change, percent)




Source: International Monetary Fund

17 The growth data presented in this section are extracted from the IMF World Economic Outlook database (October 2019), adding their corresponding updates for January and April 2020.

F11 Real GDP growth in specific emerging economies, 2005–2019 (year-on-year change, percent)


Source: International Monetary Fund

As mentioned, the U.S. economy had a slowdown in 2019, growing 2.3%, below the 2.9% of 2018. As of December 2019, the unemployment rate had fallen to 3.5%, suffering the downward trend that has been seen since 2010 (see Figure 12). The nominal hourly wage at year-end grew 2.9% relative to one year previous (see Figure 13), in line with a tightening labor market. Despite the increased pressure in the labor market, inflation remained low. The general price index ended the year up 2.3% relative to 2018, which is around the 2% annual inflation target set by the U.S. Federal Reserve (the Fed), while core inflation, which excludes food and energy prices, it also had a variation of 2.3% in the year (see Figure 14). In a context in which the U.S. economy has slowed, the Fed decreased the range of the monetary policy rate (the Federal Funds Rate) 25 basis points three times during 2019 to 1.50-1.75%.[18]

In the Eurozone, growth slowed from 1.9% in 2018 to 1.2% in 2019, reflecting a significant slowdown in the largest economies in the bloc, highlighting those of Germany and Switzerland (see Figure 15). Inflation in the Eurozone ended the year at 1.3% (see Figure 16). The unemployment rate declined over the course of the year, ending at 7.4%, maintaining the downward trend seen since 2013 (see Figure 17). In this scenario, the European Central Bank (ECB) announced in September 2019 a monetary stimulus package that included monthly bond purchases of 20 billion euros starting in November, together with a reduction in deposit interest rates from –0.4% to –0.5%.

Japan experienced a moderate acceleration in the year, from a growth rate of 0.3% in 2018 to 0.7% in 2019. The Central Bank of Japan kept its short-term interest rate target at –0.1% and maintained its ten-year bond purchase program, in order to keep those rates around 0%.

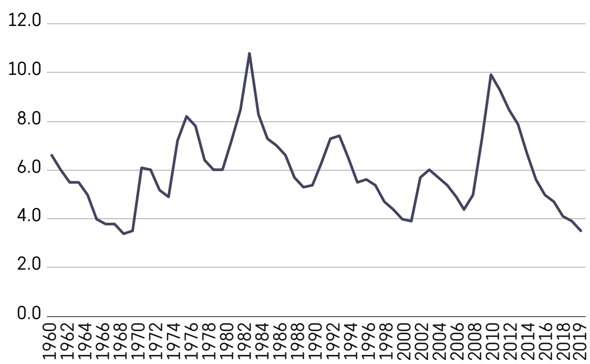
China grew 6.1% in 2019, down from 6.6% in 2018, but within the government's target range. This reflected lower domestic demand and exports due to the trade conflict with the United States. In response to the trade war, the authorities implemented a series of stimulus measures that included tax cuts, increased spending on infrastructure, and liquidity injections by the central bank to face the adverse economic scenario in the year.

In this global context, the U.S. dollar weakened with respect to the main world currencies by 0.9% (see Figure 18).[19] In terms of the currencies in which the sovereign wealth funds are invested, the Chinese renminbi and the euro depreciated the most (-1.3% and -2.2%, respectively), while the pound sterling, the Swiss franc, and the Japanese yen appreciated by 3.9%, 1.6%, and 1.0%, respectively.

18 At the July meeting the Fed decreased the range from 2.25% - 2.50% to 2.00% - 2.25%, in September to 1.75% - 2.00% and in October to 1.50 % - 1.75%.

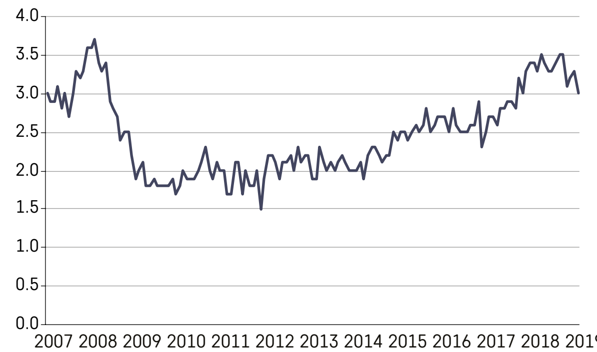
19 The Bloomberg Dollar Spot Index is a tradable index that shows the value of the dollar in relation to the ten main currencies of the world. Index returns greater than zero is indicative that the dollar appreciated in relation to the value of the basket of coins, while negative returns reflect that the dollar depreciated relative at the value of the basket of coins.

F12 U.S. unemployment rate, 1960 - 2019 (percent)



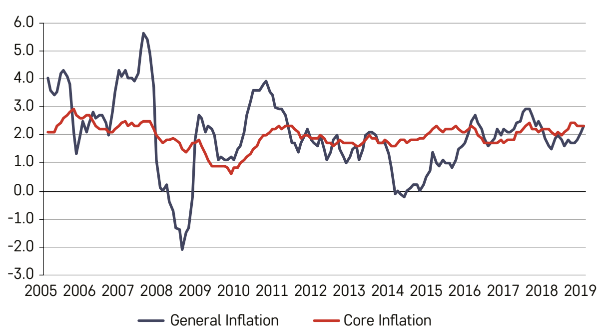

Source: *Bureau of Labor Statistics*

F13 U.S. wage growth, 2007 - 2019 (year-on-year change, percent)



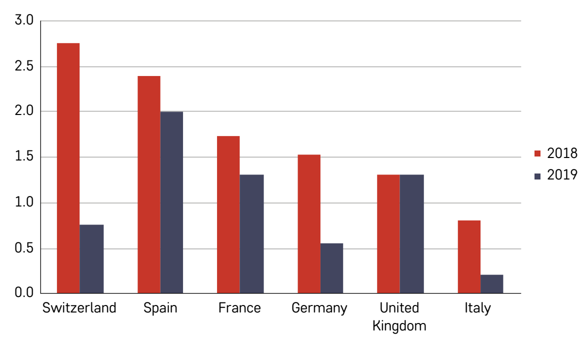

Source: *Bloomberg*

F14 U.S. consumer price index , 2005 - 2019 (year-on-year change, percent)




Source: *Bloomberg*

F15 Real GDP growth in selected Europe countries in 2019 (year-on-year change, percent)

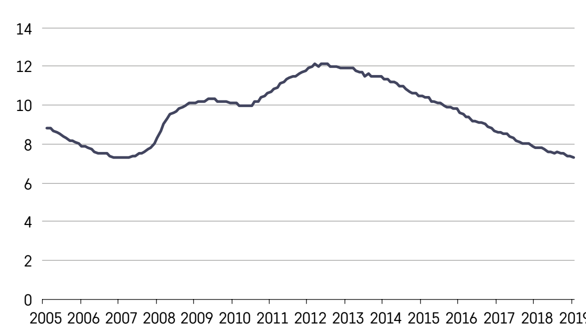



Source: International Monetary Fund. Estimates.

F16 Eurozone annual inflation, 2005 - 2019[20] (percent)


Source: *Bloomberg*

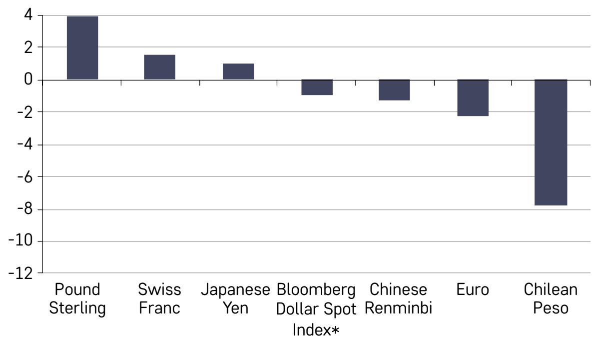
F17 Eurozone unemployment rate, 2005 - 2019 (percent)




Source: *Bloomberg*

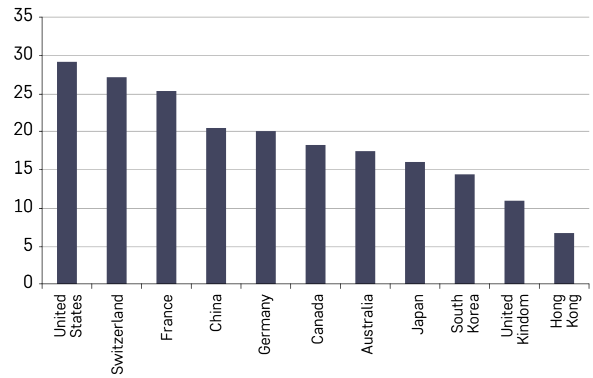
20 Harmonised Index of Consumer Prices.

F18 Selected currencies against the dollar in 2019[21] (year-on-year change, percent)



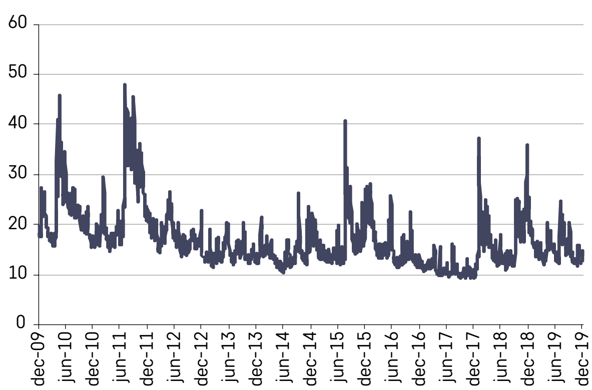

Source: *Bloomberg*

F19 MSCI equity indices returns in 2019 (year-on-year change, percent in local currency)



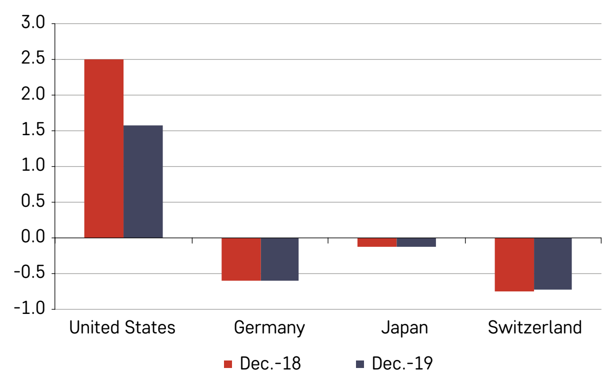

Source: *Bloomberg*

F20 Equity market volatility (VIX): S&P 500, 2009–2019 (in levels)




Source: *Bloomberg*

F21 Internal rate of return (IRR) on two-year bonds in selected countries, 2018–2019 (percent)




Source: *Bloomberg*

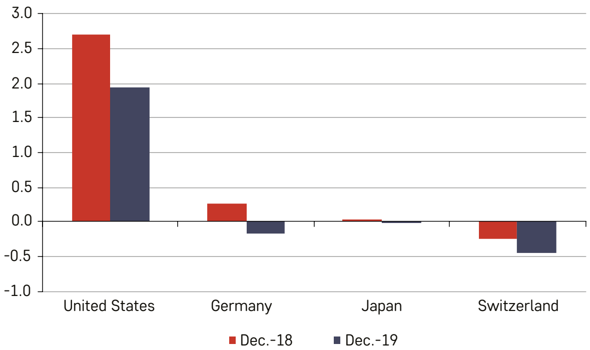
Throughout 2019, in most markets, there were significant increases in the price of equities. In a selected sample (see Figure 19), all the equities exchanges had positive returns. The equity markets with the best performance in 2019 were U.S., Switzerland and France, whose returns, measured in local currency, were 29.1%, 27.2% and 25.3%, respectively. The index with the worst performance in relative terms, in local currency, were those of South Korea, the United Kingdom and Hong Kong with 14.4%, 10.2% and 6.5%, respectively.[21]

The volatility of the stock market (S&P 500), measured through the Chicago Board Options Exchange (CBOE) equity volatility index (the VIX), presented in 2019 a lower average level than the previous year, experiencing its maximums in January and August with values of 25.5 and 24.6, respectively. The minimum was recorded in November (11.5), higher than the minimum registered in 2018 (9.2) (see Figure 20).

At the end of the year, in the US nominal two-year sovereign interest rates had decreased relative to the level observed in the same period of the previous year (see Figure 21), while in Germany, Japan and Switzerland they increased slightly. On the other hand, nominal 10-year interest rates decreased in the US, Germany, Switzerland, and Japan (see Figure 22).

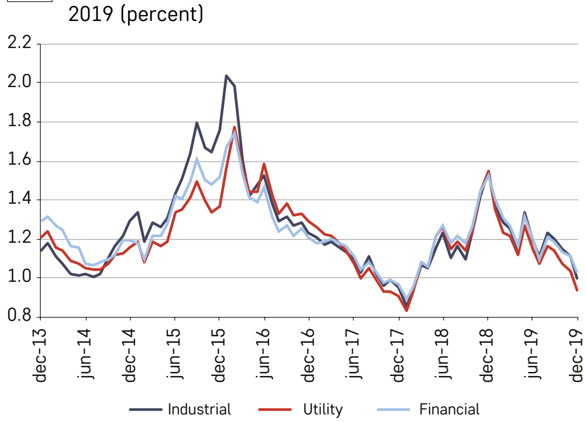
21 A negative return implies depreciation of the currency; a positive return, appreciation.

F22 Internal rate of return (IRR) on ten-year bonds in selected countries, 2018–2019 (percent)



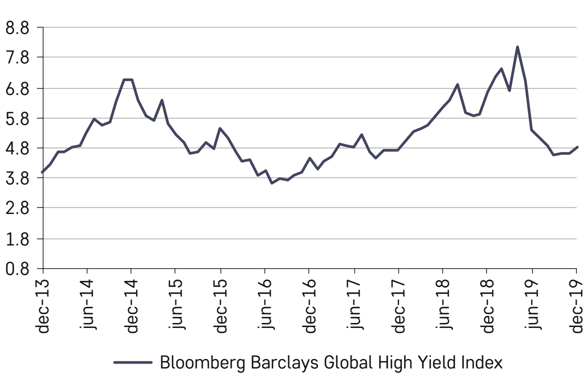

Source: *Bloomberg*

F23 Investment grade corporate spreads by industry, 2013-2019 (percent)




Source: *Bloomberg Barclays*

F24 High yield spreads, 2013 - 2019 (percent)




Source: *Bloomberg Barclays*

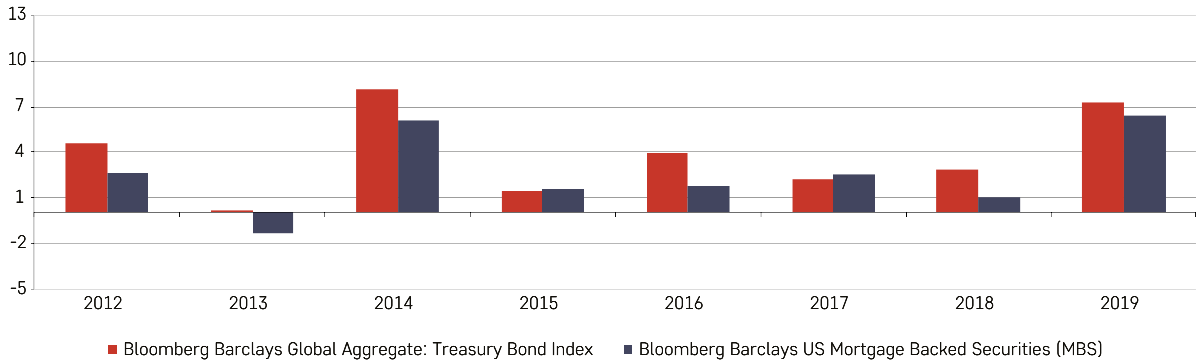
In the corporate market, spreads decreased in all sectors of the "Bloomberg Barclays Global Aggregate Corporate" index relative to 2018. In the industrial, financial, and utility sectors, spreads decreased 36%, 33%, and 40%, respectively (see Figure 23). At the same time, spreads narrowed for high yield bonds: the Bloomberg Barclays Global High-Yield index recorded a 27% reduction in spreads (see Figure 24).

In 2019, returns in local currency of investment grade sovereign bonds and the MBS of US agencies experienced positive returns. Thus the "Bloomberg Barclays Global Aggregate: Treasury Bond Index (hedged)" and the "Bloomberg Barclays US Mortgage Backed Securities (MBS)" closed the year with returns of 7.25% and 6.35%, respectively (see Figure 25). Investment grade corporate bonds, represented by the Bloomberg Barclays Global Aggregate: Corporates Index (hedged), and high yield bonds (sovereign and corporate), represented by the Bloomberg Barclays Global High Yield Index (hedged), closed the year with returns of 12.51% and 13.34%, respectively (see Figure 26).

When comparing the average prices of commodities in 2019 versus those of 2018, it is observed that most of the sectors experienced positive variations, except for the agriculture sector, which decreased 0.3%. Given its relevance for Chile, the variation in the nominal average price of copper stands out, which experienced a decrease of 8.0% compared to the previous year (see Figure 27).[22]

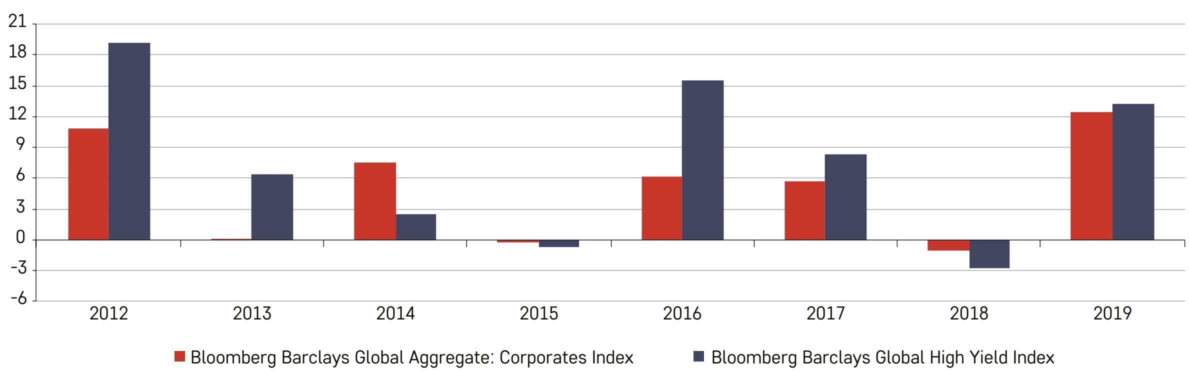
22 Price of Metals, Chilean Copper Commission.

F25 Bloomberg Barclays Global Aggregate: Treasury Bond Index and Corporate Bond Index (hedged), 2012–2019 (percent, measured in local currency)



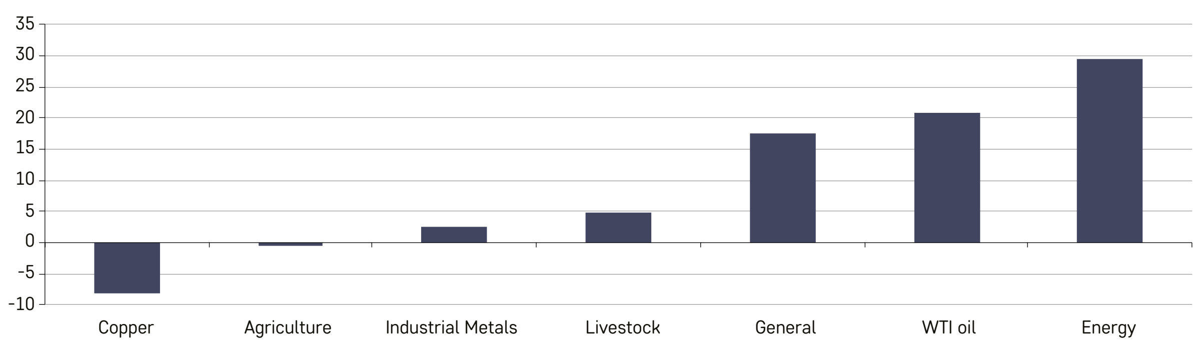

Source: *Bloomberg Barclays*

F26 Bloomberg Barclays Index Returns: Global Aggregate Corporates (hedged) and High Yield (hedged), 2012 - 2019 (in percentage, measured in local currency)




Source: *Bloomberg Barclays*

F27 Standard & Poor's commodity index in 2019 (year-on-year change, percent)

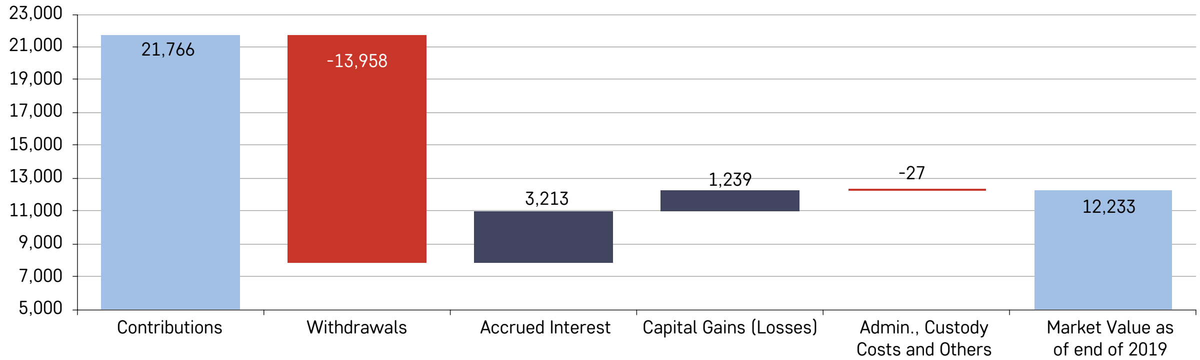



Source: *Bloomberg*

# 07 ECONOMIC AND SOCIAL STABILIZATION FUND

The market value of the ESSF at year-end 2019 was US$ 12,233 million. Since its inception on 6 March 2007, the fund has recorded total capital contributions of US$ 21,766 million, withdrawals of US$ 13,958 million, and net investment income of US$ 4,426 million. The latter breaks down into US$ 3,213 million in interest earned, US$ 1,239 million in capital gains, and US$ 27 million in management and custody costs (see Figure 28). In 2019, the fund's return in dollars (net of management costs) was 4.77%; the equivalent net return in pesos was 12.14%. Since the fund's inception, the annualized net return in dollars has been 2.59%; in pesos, 5.22%. The IRR in dollars was 4.87% in 2019 and 2.57% annualized since the creation of the fund.

F28 Change in market value, March 2007 – December 2019 (US$ million)




Source: Ministry of Finance

## 7.1 Investment Policy

In line with the objectives described in section 3.1, the main goal of the ESSF investment policy is to maximize the fund's accumulated value in order to partially cover cyclical reductions in fiscal revenue, while maintaining a low level of risk. This risk aversion is reflected in the choice of a highly liquid investment portfolio with low credit risk and low volatility, which ensures the timely availability of the resources to finance deficits and decreases the probability of being affected by significant losses in the fund's value.

The current ESSF investment policy, which was implemented in August 2013, is mainly centered on fixed-income investments in reserve currencies, which are typically favored in times of crisis. This maximizes not only the accumulated value of these resources measured in foreign currency, but also their conversion to pesos (the currency of most fiscal spending) when the resources are most needed. The investment policy also includes some equities exposure to improve the fund's expected long-term return. The strategic asset allocation is defined as 55% in sovereign bonds, 34% in money market instruments (15% in bank deposits and 19% in sovereign securities), 7.5% in equities and 3.5% in inflation-linked sovereign bonds.[23] The currency allocation of the fixed-income portfolio is specified as 40% in dollars, 25% in euros, 20% in yen and 7.5% in Swiss francs, expressed as a percentage of the total portfolio.

The asset classes defined for this policy are invested under a passive mandate based on fixed-income benchmarks in line with the low risk tolerance defined for the fund and a highly diversified equities benchmark (see Table 2). The instruments in the fixed-income benchmark are fairly liquid. The aggregate fixed-income portfolio has an ex ante tracking error of 50 basis points; the equity portfolio, 60 basis points.[24]

The fixed-income portfolio (92.33% of total assets at the end of 2019) is managed by the CBC, acting as fiscal agent, while the equity portfolio is handled by external portfolio managers (BlackRock and Mellon).

The instruments and issuers that are eligible for investment are determined by the corresponding benchmarks. The portfolio managers are also allowed to make limited use of ETFs, ADRs, GDRs, mutual funds and futures in order to facilitate tracking the equities benchmark. Leveraging is not allowed, and forwards or swaps can only be used, to a limited extent, for currency hedging.

23 The percentage of equities decreased to 5% as of April 1, 2020, which was offset by an increase in the fixed income portfolio.

24 The ex ante tracking error is used to measure how closely the portfolio tracks the benchmark. It is "ex ante" because it is a prediction of future performance. The smaller the tracking error, the more passive the management of the fund.

To keep the fund aligned with its strategic asset allocation, a portfolio rebalancing policy was defined, which consists in returning to the strategic allocation once a year and whenever the percentage of equities is outside the range of 5.5%–9.5% of the total portfolio. The annual rebalancing is coordinated with fund contributions, to the extent possible.

## 7.2 Market Value

The market value of the ESSF at year-end 2019 was US$ 12,233 million, versus US$ 14,134 million at year-end 2018. The decrease in value of the ESSF was mainly due to a withdrawal of US$ 2,564 million, of which $ 564 million was used to finance the annual contribution to the PRF, and US$ 2,000 million to finance the Fisco due to the reduction in fiscal income in the last quarter of 2019. This was partially offset by net investment gains of US$ 663 million. Since its inception on 6 March 2007, the ESSF has recorded capital contributions of US$ 21,766 million and withdrawals of US$ 13,958 million and has generated net financial gains of US$ 4,426 million (see Tables 3 and 4).[25]

T2 Strategic asset allocation and benchmarks (percent)

| Benchmark | USD | EUR | JPY | CHF | Equities | Total |
|---|---|---|---|---|---|---|
| **1. Bank deposits** | **5.0** | **6.0** | **4.0** | **0.0** | **0.0** | **15.0** |
| ICE BofaAML US Dollar 3 Month Deposit Bid Rate Average Index | 5.0 | — | — | — | — | 5.0 |
| ICE BofaAML Euro Currency 3 Month Deposit Bid Rate Average Index | — | 6.0 | — | — | — | 6.0 |
| ICE BofaAML Japanese Yen 3 Month Deposit Bid Rate Average Index | — | — | 4.0 | — | — | 4.0 |
| **2. Treasury bills and sovereign bonds** | **32.5** | **18.0** | **16.0** | **7.5** | **0.0** | **74.0** |
| **2.1 Treasury bills** | **6.0** | **7.0** | **6.0** | **0.0** | **0.0** | **19.0** |
| ICE BofA US Treasury Bills Index | 6.0 | — | — | — | — | 6.0 |
| ICE BofA Germany Treasury Bills Index | — | 7.0 | — | — | — | 7.0 |
| ICE BofA Japan Treasury Bills Index | — | — | 6.0 | — | — | 6.0 |
| **2.2 Sovereign bonds** | **26.5** | **11.0** | **10.0** | **7.5** | **0.0** | **55.0** |
| Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs | 26.5 | — | — | — | — | 26.5 |
| Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs | — | 11.0 | — | — | — | 11.0 |
| Bloomberg Barclays Global Aggregate - Treasury: Japan 7-10 Yrs | — | — | 10.0 | — | — | 10.0 |
| Bloomberg Barclays Global Aggregate - Treasury: Switzerland 5-10 Yrs | — | — | — | 7.5 | — | 7.5 |
| **3. Inflation-linked sovereign bonds** | **2.5** | **1.0** | **0.0** | **0.0** | **0.0** | **3.5** |
| Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs | 2.5 | — | — | — | — | 2.5 |
| Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs | — | 1.0 | — | — | — | 1.0 |
| **4. Equities** | **—** | **—** | **—** | **—** | **7.5** | **7.5** |
| MSCI All Country World Index (Ex Chile, Unhedged with reinvested dividends) | — | — | — | — | 7.5 | 7.5 |
| **5. Total** | **40.0** | **25.0** | **20.0** | **7.5** | **7.5** | **100.0** |

Source: Ministry of Finance

25 Most of the ESSF withdrawals were in 2009 (US$ 9,278 million) to finance the fiscal deficit and a fiscal stimulus plan implemented by the government in response to the economic crisis that year.

## T3 Contributions and withdrawals (millions of dollars)

| Period | Contributions | Withdrawals |
|---|---|---|
| 2007 | 13,100 | — |
| 2008 | 5,000 | — |
| 2009 | — | 9,278[a] |
| 2010 | 1,362 | 150[b] |
| 2011 | — | — |
| 2012 | 1,700 | — |
| 2013 | 603 | — |
| 2014 | — | 499[c] |
| 2015 | — | 464[c] |
| 2016 | — | 462[c] |
| 2017 | — | — |
| 2018 | — | 542[c] |
| 2019 | — | 2,564[d] |
| **Total** | **21,766** | **13,958** |

(a) US$ 837 million of the withdrawals were used to finance the full contribution to the PRF. US$ 441 million were used to pay public debt and the rest to finance a fiscal stimulus plan, and the fiscal deficit.

(b) The withdrawal was used to finance part of the contribution to the PRF.

(c) The withdrawal was used to finance the full contribution to the PRF.

(d) US$ 564 million was used to finance the contribution to the PRF, and the rest to finance the fiscal deficit.

Source: Ministry of Finance

## T4 Decomposition of market value (millions of dollars)

| Descomposition | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Since inception[a] |
|---|---|---|---|---|---|---|---|---|---|
| Starting market value | 13,157 | 14,998 | 15,419 | 14,689 | 13,966 | 13,772 | 14,739 | 14,134 | 0 |
| Contributions | 1,700 | 603 | 0 | 0 | 0 | 0 | 0 | 0 | 21,766 |
| Withdrawals | 0 | 0 | -499 | -464 | -462 | 0 | -542 | -2,564 | -13,958 |
| Accrued interest | 202 | 184 | 188 | 167 | 162 | 153 | 167 | 171 | 3,213 |
| Capital gains (losses) | -60 | -364 | -417 | -423 | 109 | 817 | -228 | 495 | 1,239 |
| Management, custody and other costs | -1.3 | -2.2 | -2.7 | -2.9 | -2.6 | -2.8 | -2.8 | -3.2 | -26.7 |
| Net financial gains | 141 | -182 | -231 | -259 | 268 | 967 | -63 | 663 | 4,426 |
| **Ending market value** | **14,998** | **15,419** | **14,689** | **13,966** | **13,772** | **14,739** | **14,134** | **12,233** | **12,233** |

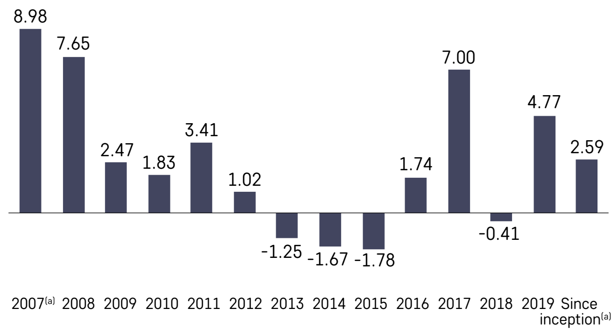
(a) The ESSF was created by combining into a single fund the additional fiscal revenue stabilization resources specified in Decree Law Nº 3,653 of 1981 and the Copper Revenue Compensation Fund; it received its first contribution on 6 March 2007.

Source: Ministry of Finance

# 7.3 Performance

In 2019, the return in dollars, net of management costs, was 4.77%. This was due to equities returns of 26.70% in the year and the positive effect of the 3.19% return on the fixed income portfolio, which represents 92.3% of the fund. In the latter portfolio, the return reflects a 3.33% return in local currency, which was partially offset by a –0.13% exchange rate effect.[26] The equivalent net return in pesos in the year was 12.14%, explained by the depreciation of the Chilean peso against the dollar in the year. Since 31 March 2007, the annualized net return was 2.59% in dollars and 5.22% pesos (see Table 5 and Figure 29). The IRR in dollars was 4.87% in 2019 and 2.57% annualized since the creation of the fund.

F29 Annual net return in dollars (percent)




(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Figure 30 shows the fund's quarterly net return in dollars in 2019, including the total return as well as the return on the fixed-income portfolio, disaggregated into the local currency return and the exchange rate effect,[27] and on the equity portfolio. In the first quarter, the ESSF earned a return of 1.49%, explained by the solid performance of the fixed-income portfolio in local currency and the equity portfolio, where the latter was 12.26%. In the second quarter, the fund recorded the highest return in dollars for the year, 2.87%, due mainly to the performance of the fixed-income portfolio in local currency and the exchange rate effect. The third quarter posted the lowest return of the year, –0.19%, explained by the negative exchange rate effect in the fixed-income portfolio. The fourth-quarter return, 0.55%, was mainly due to a positive exchange rate effect in the fixed-income portfolio (0.92%) and the return on the equity portfolio (8.77%).

T5 Net return (percent)

| Returns (a) | 2019 | Last 3 years | Since inception (b) |
|---|---|---|---|
| **Fixed-income** | **3.19** | **2.97** | **2.26** |
| Local currency | 3.33 | 1.73 | 2.48 |
| Exchange rate | -0.13 | 1.21 | -0.22 |
| **Equities** | **26.70** | **12.67** | **9.42** |
| **Returnin USD** | **4.77** | **3.74** | **2.59** |
| Exchange rate return, CLP | 7.03 | 3.72 | 2.56 |
| **Return in CLP (c)** | **12.14** | **7.60** | **5.22** |

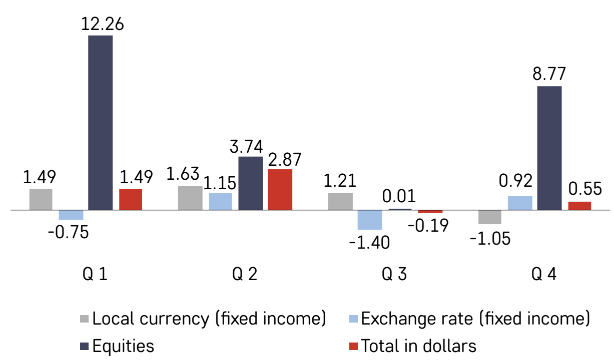
(a) Time-weighted return (return calculated as the growth rate of the funds that were invested throughout the period).

(b) The annualized return since the inception of the fund is calculated from 31 March 2007, the start date of the CBC's performance measure. The return since the inception of the equity portfolio is calculated from 31 July 2013.

(c) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate. .

Source: Ministry of Finance

F30 Net quarterly returns in 2019 (percent)




Source: Ministry of Finance

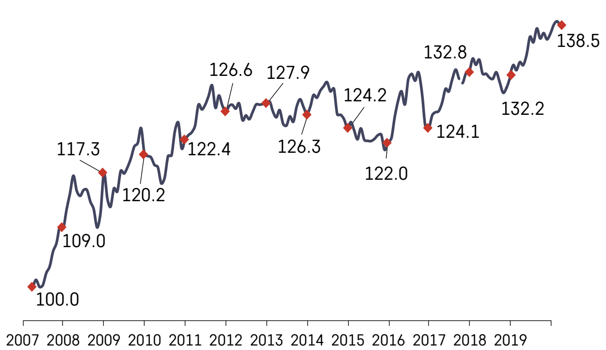
26 The performance of the FEES fixed income portfolio is mainly affected by the interest rates and exchange rates. The level and movements of interest rates largely determine the value of financial instruments in their currency of issue (local currency). However, since this portfolio is invested in dollars, euros, yen and Swiss francs, and that the return on the portfolio is measured in dollars, the parity of this currency with respect to the others impacts its result (exchange rate effect).

27 See footnote 26.

The fund's investment performance can be illustrated using an index of the portfolio's daily returns. Taking a starting value of 100 on 31 March 2007, the index reached 138.5 at year-end 2019 (see Figure 31).

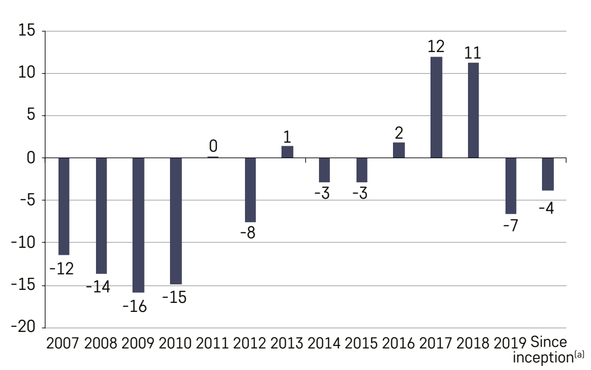
In 2019, the performance of the ESSF, measured as the difference between the portfolio return and the benchmark return, was negative and 7 basis points. Since 31 March 2007, the annualized return of the ESSF was 4 basis points below the benchmark (see Figure 32).

F31 Return index in dollars (31 March 2007 = 100)




Source: Ministry of Finance

F32 Net returns against the benchmark (basis points)




(a) Calculated from 31 March 2007.

Source: Ministry of Finance

By asset class, the return on the fixed-income portfolio in 2019 was 5 basis points above the benchmark, while that of the equity portfolio was 66 basis points below (see Table 6). The negative performance of the equity portfolio relative to the benchmark in 2019 was mainly due to the impact of withdrawals in the year. When the months in which withdrawals were made are excluded (June, November, and December), the excess return is –24 basis points, which is within the expected range given the impact of taxes on the excess return.[28] Finally, the excess return since the inception of the portfolio was –4 basis points. This performance has mainly been influenced by the fixed-income portfolio, an asset class that has been included in the investment portfolio since the creation of the ESSF, and only in part by the equity portfolio, where exposure began in August 2013.

T6 Net returns against the benchmark, by asset class[29] (basis points)

| Asset class | 2019 | Last 3 years | Since inception(a) (b) |
|---|---|---|---|
| Fixed-income | 5 | 6 | -4 |
| Equities | -66 | -39 | -11 |
| **Total portfolio** | **-7** | **6** | **-4** |

(a) The equity portfolio was implemented in August 2013.

(b) The return since inception is calculated is calculated from 31 March 2007, the start date of the CBC performance measure.

Source: Ministry of Finance

28 In general, the equity portfolio return is lower than the benchmark because the latter does not take into account the payment of taxes (for example, on dividends), whereas the portfolio return does. This effect is approximately 2 basis points each month.

29 The total excess return of the portfolio is calculated as the difference between the weighted sum of the returns of each asset class of the portfolio and the benchmark.

## 7.4 Portfolio Allocation

As of December 2019, the allocation of the ESSF by asset class comprised US$ 8,102 million in Treasury bills and sovereign bonds, US$ 430 million in inflation-linked sovereign bonds, US$ 2,762 million in bank time deposits and US$ 939 million in equities (see Table 7).

By country, the sovereign portfolio is invested in the United States, Japan, Germany, and Switzerland, where investments in the United States account for almost 41% of the portfolio and around a third of the total value of the ESSF. Bank deposits, as of year-end, are invested in banks from a number of countries, with exposures of over US$ 170 million in Japan, Spain, France, Germany, Australia, China and Denmark. These bank investments are time deposits in eligible banks selected by the CBC in accordance with the Finance Ministry's investment guidelines. Table 8 presents the breakdown of banks in which term deposits were held at the close of 2019. The equity portfolio at year-end was concentrated in the United States (around 57%) and, to a lesser extent, Japan, United Kingdom, China, Switzerland, Canada, France, Germany as well as 41 countries with investments of less than US$ 20 million each. The equities distribution by country tracks the country allocation in the benchmark.

Figure 33 shows the main corporate exposures in the ESSF equity portfolio at year-end 2019. The exposure to different issuers depends primarily on the share of each firm in the benchmark, due to the fund's passive investment strategy.

Relative to the benchmark, the asset allocation of the ESSF at year-end had an overweight in bank deposits by around 7.6%, at the expense of Treasury bills and sovereign bonds which was 66.2%. This is due to the fact that the CBC, which is responsible for the ESSF fixed-income portfolio, prioritized investments in time deposits over Treasury bills due to the low –or even negative– interest rates in some of the countries where the ESSF is invested. Exposure to inflation-linked sovereign bonds is in line

T7 Asset class allocation, 31 December 2019 (millions dollars and percent of the portfolio)

| Exposure | Country | US$ million | % of total |
|---|---|---|---|
| Sovereign | United States | 3,223 | 26.3 |
| | Japan | 2,451 | 20.0 |
| | Germany | 1,501 | 12.3 |
| | Switzerland | 927 | 7.6 |
| | **Total[a]** | **8,102** | **66.2** |
| Inflation-linked sovereign | United States | 307 | 2.5 |
| | Germany | 122 | 1.0 |
| | **Total** | **430** | **3.5** |
| Banking | Japan | 496 | 4.1 |
| | Spain | 383 | 3.1 |
| | France | 383 | 3.1 |
| | Germany | 382 | 3.1 |
| | Australia | 304 | 2.5 |
| | China | 258 | 2.1 |
| | Dernmark | 171 | 1.4 |
| | United Kingdom | 168 | 1.4 |
| | Sweden | 102 | 0.8 |
| | Israel | 59 | 0.5 |
| | Canada | 40 | 0.3 |
| | Holland | 8 | 0.1 |
| | Belgium | 7 | 0.1 |
| | Others[b] | 1 | 0.0 |
| | **Total** | **2,762** | **22.6** |
| Equities | United States | 535 | 4.4 |
| | Japan | 67 | 0.5 |
| | United Kingdom | 45 | 0.4 |
| | China | 35 | 0.3 |
| | Switzerland | 29 | 0.2 |
| | Canada | 29 | 0.2 |
| | France | 29 | 0.2 |
| | Germany | 24 | 0.2 |
| | Australia | 19 | 0.2 |
| | Holland | 17 | 0.1 |
| | Hong Kong | 14 | 0.1 |
| | South Korea | 13 | 0.1 |
| | Ireland | 13 | 0.1 |
| | Brazil | 9 | 0.1 |
| | Spain | 8 | 0.1 |
| | Sweden | 7 | 0.1 |
| | Italy | 6 | 0.0 |
| | South Africa | 5 | 0.0 |
| | Others[b] | 36 | 0.3 |
| | **Total** | **939** | **7.7** |
| | **Total Fund** | **12,233** | **100.0** |

(a) As of June 17, 2015, may include supranationals, agencies and state own companies with explicit guarantees.

(b) It includes cash, cash equivalents, and unsettled transactions.

Source: Ministry of Finance

T8 Banks with deposits, 31 December 2019

| Bank | Country |
|---|---|
| Commonwealth Bank of Australia | Australia |
| Banco Bilbao Vizcaya Argentaria SA | Spain |
| Sumitomo Mitsui Banking Corporation | Japan |
| DekaBank Deutsche Girozentrale | Germany |
| China Construction Bank Corporation | China |
| Banco Santander SA | Spain |
| Societe General | France |
| Mizuho Bank, Ltd. | Japan |
| Bred Banque Populaire | France |
| Standard Chartered Bank Korea Limited | Korea |
| Nykredit Bank A/S | Denmark |
| Landesbank Baden-Württemberg | Germany |
| Svenska Handelsbanken AB (publ) | Sweden |
| The Chiba Bank, Ltd. | Japan |
| DZ BANK AG Deutsche Zentral-Genossenschaftsbank | Germany |
| Bank of China (Hong Kong) Ltd. | China |
| Australia & New Zealand Banking Group Limited | Australia |
| Bank Hapoalim B.M. | Israel |
| Sumitomo Mitsui Trust Bank Ltd. | Japan |
| Danske Bank Aktieselskab | Denmark |
| The Bank of Nova Scotia | Canada |
| Credit Agricole Corporate and Investment Bank | France |
| HSBC France | France |
| Santander UK PLC | United Kingdom |
| ING Bank NV | Holland |
| BNP Paribas Fortis SA/NV | Belgium |
| The Shizuoka Bank Ltd | Japan |

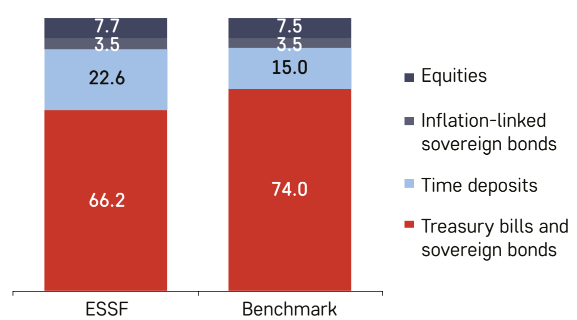
Source: Ministry of Finance

with the benchmark, with a share of 3.5% of the portfolio. Finally, there is an overexposure to equities of approximately 0.2%, mainly due to the positive return recorded by this asset class in the year (see Figures 34 and 35).

With regard to the currency allocation, at year-end the portfolio was aligned with the benchmark (see Figure 36).

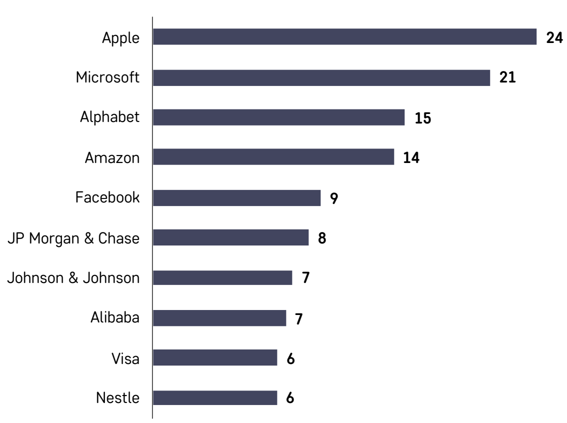
The credit quality of the sovereign investments included in the ESSF is directly related to the benchmark allocation. That is, the distribution by credit rating depends on the shares established in the benchmark for the United States, Germany, Japan, and Switzerland. Bank exposure depends on the CBC's assessment of the risk-return ratio of each bank at the time the deposit was made (see Table 9).

F34 Asset allocation, 31 December 2019 (percent of portfolio)



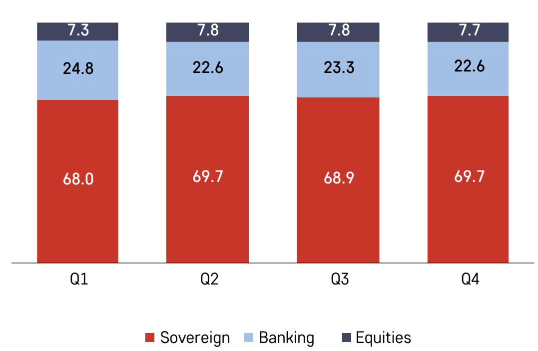

Source: Ministry of Finance

F33 Main exposures to companies (millions of dollars)



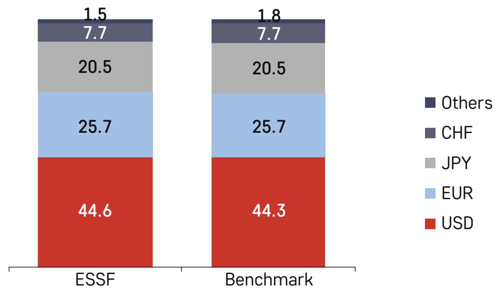

Source: Ministry of Finance

F35 Risk allocation in 2019 (percent of portfolio)




Source: Ministry of Finance

F36 Currency allocation on 31 December 2019 (percent of portfolio)




Source: Ministry of Finance

T9 Credit risk exposure, 31 December 2019 (percent of the fixed-income portfolio)

| Issuer | Credit rating | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | AAA | AA+ | AA | AA- | A+ | A | A- | Others(a) | Total |
| **Sovereign** | 53.8 | 0.0 | 0.0 | 0.0 | 21.7 | 0.0 | 0.0 | 0.0 | 75.5 |
| **Bank** | 0.0 | 0.0 | 0.9 | 4.2 | 4.0 | 12.5 | 2.9 | 0.0 | 24.5 |
| **Total** | **53.8** | **0.0** | **0.9** | **4.2** | **25.7** | **12.5** | **2.9** | **0.0** | **100.0** |

(a) It includes cash, cash equivalents, and unsettled transactions.

Source: Ministry of Finance

## 7.5 Management Costs and Income from the Securities Lending Program

The total cost of managing the ESSF in 2019 included US$ 1,284,856 for custody services, US$ 1,189,801 for CBC management services,[30] and US$ 625,927 for external management services. In the year, there were also payments associated with others services (auditing, external advising and accounting adjustments) for a total of US$ 66,286. Total management costs were equivalent to 2 basis points of the average size of the fund in 2019. Income from the securities lending program was US$ 1,597,618, which offset 50% of the total management costs of the ESSF (see Table 10).

## 7.6 Main Financial Risks

The ESSF is exposed to various types of risk as a result of the fund's investment in different financial instruments, including market risk, credit risk, liquidity risk and operational risk. Most of these risks are directly related to the asset and currency allocations and the choice of benchmarks, especially given the passive approach of the fund's investment policy. This section describes each risk in detail, together with the control mechanisms set up for controlling them.

T10 Management and custody costs and income from the securities lending program (dollars)

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|
| Custody (J.P. Morgan) | 530,901 | 1,379,420 | 1,302,645 | 1,295,073 | 1,113,997 | 1,186,530 | 1,144,991 | 1,284,856 |
| Management (CBC) | 768,014 | 789,277 | 802,573 | 957,404 | 935,495 | 932,360 | 1,153,147 | 1,189,801 |
| External Managers | - | - | 581,047 | 622,359 | 454,957 | 613,880 | 442,031 | 625,927 |
| Others (a) | - | - | - | - | 107,143 | 71,017 | 74,988 | 66,286 |
| **Total costs** | **1,298,915** | **2,168,697** | **2,686,265** | **2,874,836** | **2,611,593** | **2,803,787** | **2,815,156** | **3,166,870** |
| Total costs in basis points (b) | 1 | 1 | 2 | 2 | 2 | 2 | 2 | 2 |
| **Securities lending program** | **2,914,649** | **2,654,248** | **2,332,681** | **2,563,815** | **3,440,007** | **3,743,103** | **2,057,520** | **1,597,618** |

(a) It includes consulting, auditing, and tax consulting services.
(b) Calculated Based on the average fund's size for the year.
Source: Ministry of Finance

30 The increase in the CBC's management fees in 2018 and 2019 largely derives from expenses associated with upgrading a technology platform used for the management of the sovereign wealth funds.

## 7.6.1 Market Risk

The market value of the financial instruments in the ESSF investment portfolio can be exposed to possible losses as a result of changes in market conditions. In the case of the ESSF, the main variables affecting market value are interest rates, exchange rates, credit spread risk, and changes in stock values.

### Interest rate risk

Interest rate movements directly affect the price of fixed-income instruments. A rate increase causes a drop in market value, while a decrease produces a gain. The parameter that measures a portfolio's sensitivity to a parallel movement of the rate structure is duration: the longer the portfolio duration, the greater the risk of loss in response to an interest rate hike.

In the case of the ESSF, the interest rate risk that is tolerated in the benchmark is defined based on the duration of the individual indexes that make up the benchmark. This risk is monitored controlling that the portfolio duration stays near the benchmark duration. At year-end 2019, both the benchmark duration and the actual duration were approximately 4.8 years.

### Foreign exchange risk

Because the fund's performance is measured mainly in dollars, the value of investments in other currencies is affected by movements in the corresponding exchange rates. Most of the portfolio's fixed-income investments are denominated in dollars, euros, yen and Swiss francs, while the equity portfolio includes a small exposure to an additional 23 currencies. At the close of 2019, the foreign currency exposure, measured in dollars, deriving from investments in euros (25.7%), yen (20.5%), Swiss francs (7.7%), pounds sterling (0.4%) and other currencies with a minor share (1.2%).

### Credit spread risk

The market value of the instruments in the ESSF fixed-income portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is low in the ESSF, because the fixed-income portfolio includes mainly sovereign issues from the United States, Japan, Germany, and Switzerland, for which the lowest credit rating is A+ (Japan). Finally, the portfolio also includes bonds issued by institutions with an explicit government guarantee, agencies, and supranational entities with a high credit rating.

### Equity risk

The ESSF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2019, equities accounted for 7.7% of the ESSF.

### Volatility, VaR, and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility,[31] the minimum and maximum returns, and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 3.41% in 2019, versus 4.91% since 31 March 2007. Since the fund's inception, the highest monthly return was 5.44% (in December 2008), while the lowest was -3.87% in November 2016. The highest quarterly return was 7.31% in the first quarter of 2008; the lowest was -6.45% in the fourth quarter of 2016 (see Table 11). At year-end 2019, the VaR, which quantifies potential losses in a given period with a given probability, was 3.33% at a one-year horizon, with a 95% confidence level.[32]

31 Volatility is the standard deviation of the returns; it indicates the degree of dispersion of returns around the average. For this indicator a range of 3 years of data is taken.

32 This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 3.33% of its nominal value in dollars.

T11 Historical minimum and maximum returns (percent)

| Range | Month | Quarter |
|---|---|---|
| Highest return | 5.44 (Dec-08) | 7.31 (I 08) |
| Lowest return | -3.87 (Nov-16) | -6.45 (IV 16) |

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At the close of 2019, the ex ante tracking error of the ESSF was 3 basis points, while the ex post tracking error was 7 basis points,[33] consistent with a passive management strategy.

## 7.6.2. Credit Risk

The issuer of a fixed-rate instrument could enter into default if a liquidity or capital shortage makes it unable to meet its financial obligations. The funds' credit risk thus rises in response to an increase in the default probability of any of their host institutions or governments. The ESSF limits exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany, Japan and Switzerland, all of which have a sovereign rating of A+ or higher, and securities issued by eligible entities with an explicit government guarantee, supranational institutions and agencies with a high credit rating, which are selected based on the eligibility criteria used by the CBC for investing its international reserves. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see Table 12). The credit risk associated with forward and swap operations is contained through minimum credit ratings for counterparties and maximum exposure to each one: eligible counterparties must have a minimum rating of A from at least two of the international credit rating agencies (Fitch, Moody's and Standard & Poor's), and investment in any given counterparty is capped at 1% of the portfolio managed by the CBC and up to 3% in the case of an external manager. Furthermore, forward and swap operations cannot exceed a given percentage of the portfolio under management: for the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio; for the externally managed portfolios, forwards, swaps and futures cannot exceed 10% of each manager's portfolio.

The risk arising from the execution of a transaction –that is, the losses that could occur if the counterparty does not deliver the securities purchased or pay for the securities sold– is mitigated through the use of delivery versus payment (DVP) transactional or post-transactional systems, in which payment is conditional on simultaneous delivery. Finally, the risk of holding the funds' securities at a custodian institution is addressed by registering them in the name of the Republic of Chile and keeping them in separate accounts.

T12 Maximum credit exposure by bank issuer

| Rating | Maximum (US$ million) |
|---|---|
| AAA | 3.0% * IP at close of last quarter[a] |
| AA+<br>AA<br>AA- | 2.0% * IP at close of last quarter |
| A+<br>A<br>A- | 1.5% * IP at close of last quarter |

(a) IP means Investment Portfolio managed by the CBC.

Source: Ministry of Finance

33 The ex post tracking error is the standard deviation of the historical monthly excess returns recorded from 31 December 2016 through 31 December 2019.

## 7.6.3. Liquidity Risk

Liquidity risk arises from the losses that would occur from the early sale of securities in order to cover cash-flow needs. This risk is exacerbated during times of economic uncertainty, when some investments could be substantially discounted due to lack of demand or market depth.

In the ESSF, this risk is mitigated by maintaining a high percentage of liquid short-term assets. As of 31 December 2019, money market instruments accounted for 33.96%, which is in line with the 34% proposed under the current strategic allocation. Liquid assets include Treasury bills, certificates of deposit and time deposits, all of which are less sensitive to interest rate fluctuations. In addition, the market for Treasury bills and certificates of deposit allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

## 7.6.4. Operational Risk

Operational risk arises from the losses that would occur from mistakes in internal processes and systems, external events or human error. Examples of operational risk include transaction errors, fraud, failure to comply with legal obligations (contracts), etc.

This risk has been mitigated by delegating a large share of the operational management of the funds to the CBC, thereby taking advantage of the infrastructure that the CBC uses to manage its international reserves. The CBC has also set up a series of controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds and internal and external auditing processes to assess the effectiveness of the existing controls.

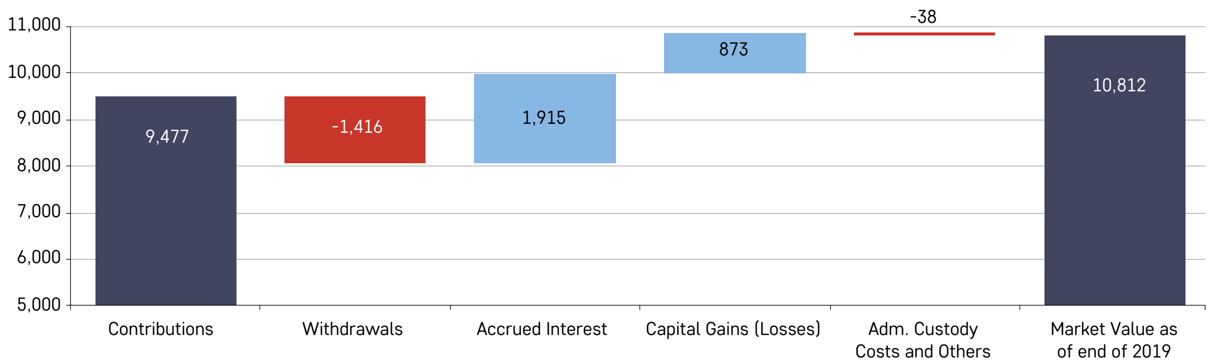
In the case of the external portfolio managers, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided. Starting in 2015, support for monitoring is provided by an international consulting firm.[34]

34 In 2015, the firm Verus was contracted to provide consulting services for the sovereign wealth funds through April 2018. Starting in May 2018, and following a selection process carried out by the CBC, RVK, Inc., was contracted to serve as the funds' international consultant.

# 08 PENSION RESERVE FUND

The market value of the PRF on 31 December 2019 was US$ 10,812 million. Since its inception on 28 December 2006, the fund has recorded total capital contributions of US$ 9,477 million, withdrawals of US$ 1,416 million, and net investment income of US$ 2,750 million, which breaks down into US$ 1,915 million in interest earned, US$ 873 million in capital gains, and US$ 38 million in management and custody costs (see Figure 37). In 2019, the return in dollars, net of management costs, was 12.04%; the equivalent net return in pesos in the same period was 19.92%. Since the fund's inception, the annualized net return in dollars was 3.88%; the equivalent in pesos, 6.55%. The IRR in dollars was 12.08% in 2019 and 3.46% annualized since the creation of the fund.

F37 Change in market value, March 2007 – December 2019 (US$ million)




Source: Ministry of Finance

## 8.1 Investment Policy

### 8.1.1 Convergence Process to the New Investment Policy.[35]

In November 2017, the Finance Minister accepted the Financial Committee's recommendations to modify the PRF investment policy. The new policy suggested by the Committee was defined based on the conclusions of a study undertaken by Mercer Investment Consulting (Mercer), which was completed in mid-2017.[36]

Considering that the fund's resources are intended to finance government pension liabilities, which are denominated in pesos, the new policy established a new investment objective and risk tolerance for the fund. Specifically, the investment objective was defined as obtaining an annualized expected return in pesos of at least 2% over Chilean inflation in a ten-year period, with a probability of at least 60%. At the same time, the risk tolerance was also redefined, so as to be consistent with the above investment objective and establishes that the probability that the fund's real return will be less than -12%, expressed in pesos, must not exceed 5% in any given year.

The new strategic asset allocation was defined so as to be consistent with the new investment objective and defined risk tolerance. Under the new policy, 40% of the fund will be invested in equities, 23% in sovereign and government-related bonds 5% in inflation-linked sovereign bonds, 13% in corporate bonds, 6% in mortgage-backed securities (MBS) issued by U.S. agencies (henceforth, U.S. agency MBSs), 8% in high yield bonds, and 5% in unlisted real estate assets (core). All the asset classes, with the exception of U.S. agency MBSs, will be invested globally. Additionally, the foreign currency exposure of the fixed-income portfolios will gradually be hedged to Chilean pesos. The benchmarks to be used for each asset class are listed in Table 13.

The Finance Committee recommended a gradual convergence to the new strategic asset allocation. The proposal was to gradually increase the share of equities over three years, with purchases approximately every six months, to be coordinated with

35 This section was prepared based on the Finance Committee's 2018 Annual Report.

36 The study is available at https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/relevant-studies.

T13 Strategic composition of assets and benchmarks

| Asset Class | Percent | Benchmarks |
|---|---|---|
| Equities | 40% | MSCI All Country World Index (USD unhedged with reinvested dividends) ex Chile |
| Sovereign and government-related bonds [(a)] | 23% | Bloomberg Barclays Global Aggregate: Treasuries Index (USD unhedged) |
| | | Blooomberg Barclays Global Aggregate: Government-Related Index (USD unhedged) [(b)] |
| Corporates bonds | 13% | Bloomberg Barclays Global Aggregate: Corporates Bond Index (USD unhedged) |
| High yield bonds | 8% | Bloomberg Barclays Global High Yield Index (USD unhedged) |
| U.S. Agency MBS | 6% | Bloomberg Barclays US Mortgage Backed Securities Index |
| Inflation-linked sovereign bonds | 5% | Bloomberg Barclays Global Inflation-Linked Index (USD unhedged) |
| Real estate | 5% | Benchmark to be defined |
| **Total** | **100%** | |

(a) Each sub-index of this asset class is added according to its relative capitalization.
(b) It includes other related sovereign issuers such as municipalities, state companies, agencies, etc.

Source: Ministry of Finance

contributions to and withdrawals from the PRF.[37] Thus, if market conditions allow, the asset class will be increased in January and June of each year, starting in 2018.

With regard to the new asset classes, the Committee recommended implementing the new policy in two phases, starting with the U.S. agency MBS and high yield bond asset classes. The real estate exposure and currency hedging strategy would then be implemented in a second phase.

The implementation of the real estate asset class was deferred to a second phase, because it requires an in-depth analysis of the operational, legal, and tax issues associated with this type of investment in the private market. The implementation of the currency hedging program was also left for a later phase, as it depends directly on the final currency composition of the fixed-income portfolio once the fund has fully converged to the strategic asset allocation.

37 Contributions to the PRF must be made in the first half of each year, usually in the month of June. The Ministry is working with the Budget Office (DIPRES) to coordinate the date of withdrawals and contributions to minimize transaction costs.

Taking into account the Committee's recommendations, the Finance Ministry defined transitional strategic asset allocations that reflect the way the fund will converge to the definitive allocation (see Table 14).[38, 39.]

During 2018, a consultant, RVK Inc. (RVK) was hired and, based on a selection process carried out by The CBC that same year, with the support of said consultant and Ministry staff, external MBS administrators were selected from U.S. agencies and high yield bonds. In January 2019 begin the investment in these asset classes.

In relation to the real estate sector, discussions with a number of real estate investment specialists in 2019 revealed that there

38 This table differs from the corresponding table presented in the 2018 Annual Report of the Sovereign Wealth Funds since the investment in the real estate sector has been postponed. The initial convergence plan was to start investing in this asset class in January 2020. However, the operational, tax, and legal complexities associated with this type of investment are still under analysis.

39 These transitional asset allocations could be modified as more information becomes available on the operational and legal complexities associated with the real estate sector.

T14 Transitory and final strategic asset allocation

| | Sovereign and government-related bonds | Inflation-linked sovereign bonds | Corporate bonds | Equities | U.S. agency MBS | High yield bonds | Real estate | Total |
|---|---|---|---|---|---|---|---|---|
| 31/12/2017 | 48 | 17 | 20 | 15 | 0 | 0 | 0 | 100 |
| 30/09/2018 [a] | 44 | 17 | 20 | 19 | 0 | 0 | 0 | 100 |
| 31/1/2019 | 39 | 11 | 13 | 23 | 6 | 8 | 0 | 100 |
| 30/6/2019 | 35 | 11 | 13 | 27 | 6 | 8 | 0 | 100 |
| 31/1/2020 | 34 | 8 | 13 | 31 | 6 | 8 | 0 | 100 |
| 30/6/2020 | 33 | 5 | 13 | 35 | 6 | 8 | 0 | 100 |
| 31/1/2021 | 23 | 5 | 13 | 40 | 6 | 8 | 5 | 100 |

(a) The first increase in equities was planned for June 2018, at which time the PRF would receive its annual contribution, but due to a delay in processing of the decree of contribution to the PRF, it was not until September that this increase could be made.

Source: Ministry of Finance

can be significant tax implications depending on the region, the chosen investment vehicle, and how the PRF is treated for tax purposes. Therefore, given that the United States is the largest market for this asset class, a legal and tax study was commissioned from Ernst and Young (EY) in order to understand the implications of investing in the core real estate segment in that country. The study is scheduled to be completed in 2020.

With regard to currency hedging, with support from RVK, meetings were held in 2019 with some institutional investors and firms specializing in hedge management in order to understand the operational complexities of this type of strategy. These discussions indicated that the main complexities are associated with the potential size of liquidations that would be necessary in the event of significant losses on currency forward transactions; the handling of the associated collateral; and a possible budget impact that could affect the fiscal balance. In 2019, the Budget Office (Dipres) was asked to analyze the latter issue, and the conclusions will be presented to the Financial Committee in the first half of 2020.

## 8.2 Market Value

The market value of the PRF on 31 December 2019 was US$ 10.812 billion, which represents an increase of US$ 1,149 million relative to year-end 2018. The increase is mainly due to a net financial gains of US$ 1,161 million. In June 2019 was made a contribution of US $ 564 million, equivalent to 0.2% of GDP in 2018 (see Table 15) and a withdrawal of US $ 577 million, resulting in a net withdrawal of US $ 13 millions.

Since its inception on 28 December 2006, the fund has recorded contributions totaling US$ 9,477 billion, withdrawals of US$ 1,416 million, and net investment gains of US$ 2,750 billion (see Table 16).

T15 Annual contributions and withdrawals (millions of dollars)

| Period | Contribution | % GDP of prev. year | Withdrawal [a] |
|---|---|---|---|
| 2006 | 605 | 0.5 | |
| 2007 | 736 | 0.5 | |
| 2008 | 909 | 0.5 | |
| 2009 | 837 | 0.5 | |
| 2010 | 337 | 0.2 | |
| 2011 | 443 | 0.2 | |
| 2012 | 1,197 | 0.5 | |
| 2013 | 1,377 | 0.5 | |
| 2014 | 499 | 0.2 | |
| 2015 | 464 | 0.2 | |
| 2016 | 462 | 0.2 | |
| 2017 | 505 | 0.2 | 314 |
| 2018 | 542 | 0.2 | 525 |
| 2019 | 564 | 0.2 | 577 |
| **Total** | **9,477** | | **1,416** |

(a) For more information about the withdrawal rules of PRF see section 3.2 of this report.

Source: Ministry of Finance

T16 Decomposition of market value (millions of dollars)

| Descomposición | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Since inception[a] |
|---|---|---|---|---|---|---|---|---|---|
| Starting market value | 4,406 | 5,883 | 7,335 | 7,944 | 8,112 | 8,862 | 10,011 | 9,663 | 0 |
| Contributions | 1,197 | 1,377 | 499 | 464 | 462 | 505 | 542 | 564 | 9,477 |
| Withdrawals | 0 | 0 | 0 | 0 | 0 | -314 | -525 | -577 | -1,416 |
| Accrued interest | 131 | 174 | 190 | 194 | 197 | 208 | 222 | 265 | 1,915 |
| Captil gains (losses) | 151 | -95 | -76 | -485 | 94 | 755 | -581 | 904 | 873 |
| Management, custody and other costs | -1.2 | -4.4 | -4.6 | -4.5 | -4.2 | -4.9 | -4.7 | -7.5 | -37.5 |
| Net financial gains | 280 | 75 | 110 | -295 | 288 | 958 | -364 | 1,161 | 2,750 |
| Ending market value | 5,883 | 7,335 | 7,944 | 8,112 | 8,862 | 10,011 | 9,663 | 10,812 | 10,812 |

(a) The PRF was created on 28 December 2006, with an initial contribution of US$ 604.5 million.

Source: Ministry of Finance

## 8.3 Performance

In 2019, the fund's return in dollars, net of management costs, was 12.04%, which breaks down as follows: sovereign and government-related bonds, 5.95%; inflation-linked sovereign bonds, 8.12%; U.S. agency MBS, 6.16%; corporate bonds, 11,65%; high yield bonds, 8,70%; and equities, 26.79%. The equivalent net return in pesos in 2019 was 19.92%. The annualized net return in dollars over the last three years was 6.13%; in pesos, 10.08%. Since 31 March 2007, the annualized net return in dollars was 3.88%; in pesos, 6.55% (see Table 17 and Figure 38). The IRR in dollars was 12.08% in 2019 and 3.46% annualized since the creation of the fund.

An analysis of quarterly returns in dollars (see Table 18) shows that the fund recorded a positive return in the first quarter, driven by the solid performance of the sovereign fixed-income portfolio with a 12.04% return in that quarter. The second quarter was in line with the first, with a strong positive return on the corporate fixed-income portfolio. The third quarter had lowest return of the year, primarily explained by the poor performance of high yield bonds and the almost null return on equities, partially offset by the positive returns on the remaining asset classes. Finally, the last quarter recorded positive returns, driven mainly by the strong performance of the equity portfolio.

T17 Net return (percent)

| Returns [a] | 2019 [b] | Last 3 years | Since inception [c] |
|---|---|---|---|
| Sovereign and government-related bonds | 5.95 | 4.27 | 0.92 |
| Inflation-linked sovereign bonds | 8.12 | 4.03 | 2.56 |
| U.S. agency MBS | 6.16 | - | 6.16 |
| Corporate bonds | 11.65 | 5.39 | 3.60 |
| High yield bonds | 8.70 | - | 8.70 |
| Equities | 26.79 | 12.73 | 10.50 |
| **Return in USD** | **12.04** | **6.13** | **3.88** |
| Exchange rate effect, CLP | 7.03 | 3.72 | 2.56 |
| **Return in CLP [c]** | **19.92** | **10.08** | **6.55** |

(a) Time-weighted rate of return (calculated as the growth rate of the funds that were invested throughout the entire period).

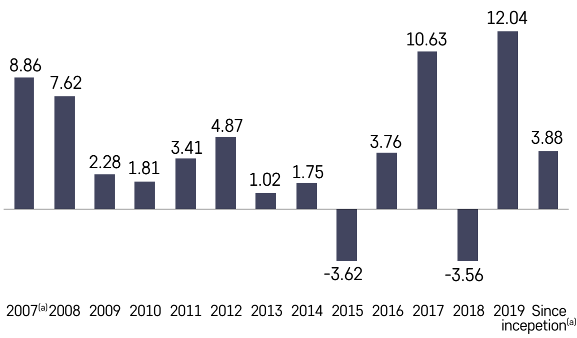
(b) Calculated as of January 22, 2019 for U.S. agency MBS and High Yield bonds.

(c) The returns on sovereign and government-related bonds, inflation-indexed sovereign bonds, corporates bonds and equities are calculated from 31 December 2011.The returns on U.S. agency MBS and high yield bonds from inception are calculated from 22 January 2019. The fund since inception return is calculated from 31 March 2007.

(d) The return in CLP is the sum of the percent change in the peso-dollar exchange rate and the return in dollars.

Source: Ministry of Finance

F38 Annual net return in dollars (percent)




(a) Calculated from 31 March 2007.

Source: Ministry of Finance

F39 Return index in dollars (31 March 2007 = 100)


Source: Ministry of Finance

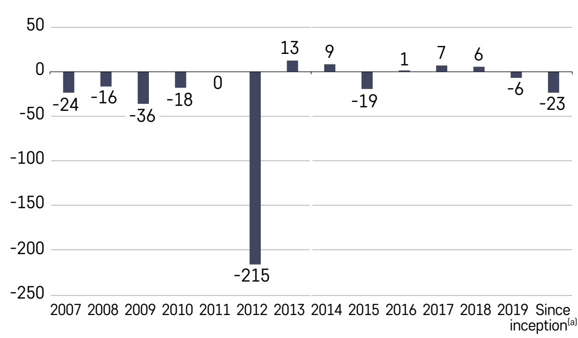
T18 Net quarterly return in dollars in 2019, by asset class (percent)

| Returns | Q1 (a) | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Sovereign and government-related bonds | 1,79 | 3,57 | 0,62 | -0,12 |
| Inflation-linked sovereign bonds | 4,19 | 1,89 | 1,69 | 0,15 |
| U.S. agency MBS | 2,06 | 1,96 | 1,39 | 0,62 |
| Corporate bonds | 4,20 | 4,05 | 1,12 | 1,83 |
| High yield bonds | 2,26 | 3,15 | -0,47 | 3,53 |
| Equities | 12,04 | 3,75 | 0,04 | 9,03 |
| **Total portfolio** | **4,59** | **3,39** | **0,60** | **3,00** |

(a) Investments in U.S. agency MBS and high yield bonds started on January 22, 2019.

Source: Ministry of Finance

F40 Returns against the benchmark (basis points)




(a) Calculated from 31 March 2017.

Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the portfolio's daily returns (see Figure 39). Taking a starting value of 100 on March 31, 2007, the index reached 162.6 at year-end 2019.

The performance of the PRF, measured as the difference between the portfolio return and the benchmark return, was 6 basis points in 2019, while the annualized performance since 31 March 2007 was -23 basis points (see Figure 40). The negative performance of -215 basis points in 2012 was largely due to the implementation of the new investment policy. If the months of January and February 2012 are excluded to remove the implementation period, when the portfolio allocation had not yet been aligned with the new strategic asset allocation and the fund managers were granted a waiver from the asset allocation requirement, then the performance in 2012 was -3 basis points.[40]

By asset class, in 2019 the sovereign bond portfolio (that is, the aggregate portfolio of sovereign, government-related, and inflation-linked sovereign bonds), U.S. agency MBS, corporate bonds and high yield bonds portfolio recorded an excess returns

40 The transfer of funds to the external managers of the corporate bond and equity portfolios, which was a necessary step for convergence to the strategic asset allocation of the new investment policy implemented in 2012, occurred on 17 January and 1 March 2012. Consequently, the external managers did not have the necessary resources to invest the PRF in accordance with the new strategic asset allocation until 1 March 2012. However, the PRF performance shown in Figure 40 for 2012 represents the excess return that would have been recorded had the portfolio immediately converged to the new strategic asset allocation on 17 January 2012. If the months of January and February are excluded, since they represent a transition period during which the portfolio managers were granted waivers following the fund transfers, then the performance in 2012 was -3 basis points.

of 8 basis points, -23 basis points, 13 basis points and -42 basis points respectively (see Table 19). In the case of the equity portfolio, the excess return was -57 basis points, which is strongly affected by a contribution made in the month of January in order to increse equities exposure to 23%. When that month is excluded, the excess return on the equity portfolio was -31 basis points, which is consistent with the negative impact of taxes on the fund's return.[41] In the last three years, the annualized excess return was 7 basis points for the sovereign portfolio, –8 basis points for corporate bonds, -34 basis points for equities, and 3 basis points for the total portfolio. Note that the returns on the U.S. agency MBS portfolio and the high yield bond portfolio are calculated from 22 January 2019.

T19 Net returns against the benchmark , by asset class[42] (basis points)

| Asset class | 2019 | Last 3 years [(a)] | Since inception [(a), (b)] |
|---|---|---|---|
| Sovereign portafolio [(c)] | 8 | 7 | -13 |
| U.S. agency MBS | -23 | - | -23 |
| Corporate bonds | 13 | -8 | -28 |
| High yield bonds | -42 | - | -42 |
| Equities | -57 | -34 | -43 |
| **Total portfolio** | **-6** | **3** | **-23** |

(a) Performance since inception for corporate bonds, and equities is calculated since 31 December 2011. Performance since inception for US agencies MBS and high yield bonds is calculated since 22 January 2019.

(b) The return since inception of the sovereign portfolio and the total portfolio is calculated from 31 March 2007, the start date of the CBC performance measure.

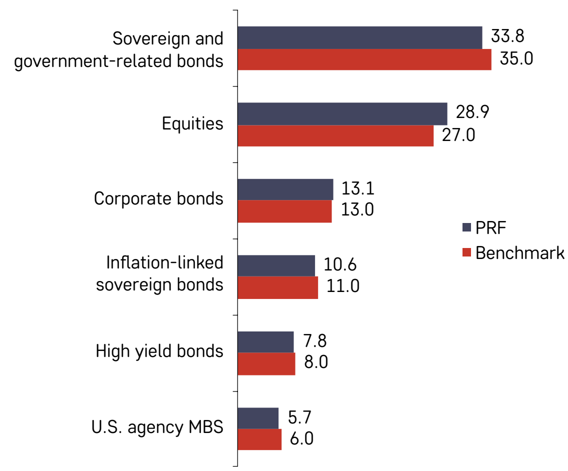
(c) The sovereign portfolio represents the aggregate performance of sovereign bonds, government-related bonds and inflation-indexed bonds.

Source: Ministry of Finance

## 8.4. Portfolio Allocation

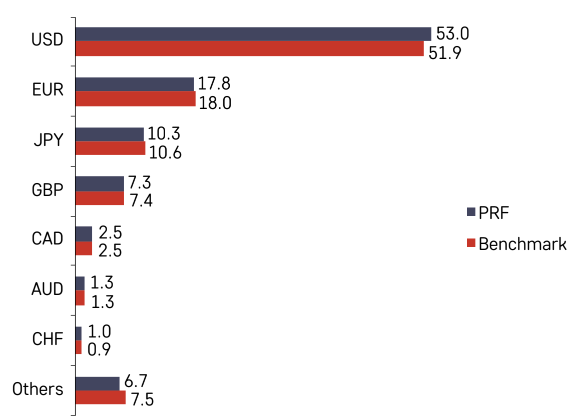
As of December 2019, the allocation of the PRF by asset class comprised US$ 3,653 million in sovereign and government-related bonds, US$ 1,149 million in inflation-linked sovereign bonds, US$ 620 million in U.S. agency MBS, US$ 1,415 million in corporate bonds, US$846 in high yield bonds and US$ 3,129 million in equities. In terms of portfolio equities, the percent allocation by asset class to the benchmark was slightly underexposed in sovereign and government related bonds, and overexposed in equities (see Figure 41). Regarding the currency allocation, at year-end 2019 the fund was in line with the benchmark, with around 90% of the fund invested in U.S. dollars, euros, Japanese yen, and pounds sterling (see Figure 42).

F41 Asset class allocation, 31 December 2019 (percent of portfolio)




Source: Ministry of Finance

F42 Currency allocation, 31 December 2019 (percent of portfolio)




Source: Ministry of Finance

41 As with the ESSF, the negative performance of the equity portfolio was mainly due to the payment of taxes on that portfolio, a cost that is not taken into account in the benchmark return.

42 The excess return of the total portfolio is calculated as the difference between the weighted sum of the returns of each asset class of the portfolio and the benchmark.

In terms of credit risk allocation, at year-end, 33.2% of the PRF fixed-income portfolio was invested in instruments rated AAA, 38.1% in AA+ y A-, and the remaining 28.7% between BBB+, CCC- and others (see Table 20).

Relative to the benchmark, at year-end 2019 the fund was overweighted in North America, 2.7%; underweighted in Europe and Asia, 0.9% and 1.6%, respectively; and in line with the benchmark in Latin America and Africa (see Figure 43). These deviations principally derive from overexposure to the United States in corporate and high yield bonds. Another factor is that the CBC favors the sovereign bond segment to the detriment of other government-related securities,[43] looking for higher credit quality and liquidity for the fund while replicating the benchmark duration.

Relative to the benchmark, at year-end 2019 the fund was slightly overweighted in the government, information technology, consumer staples, health care, and consumer discretionary sectors; underweighted in the financial sector; and in line with the benchmark in the industrial, communication services, and real estate sectors (see Figure 44).

By country, the fund's exposure is concentrated in the United States, with 47.3% of the total portfolio at year-end 2019, followed by Japan, with 10.7%. Exposure to the first five countries account for almost 70% of the total fund (see Table 21).

PRF investment is very diversified, and the exposure to each issuer depends primarily on its share in the benchmark for the corresponding asset class. Figures 45, 46, 47, 48, and 49 present the main exposures by issuer in each asset class.

T20 Credit risk exposure, 31 December 2019 (percent of fixed-income portfolio)

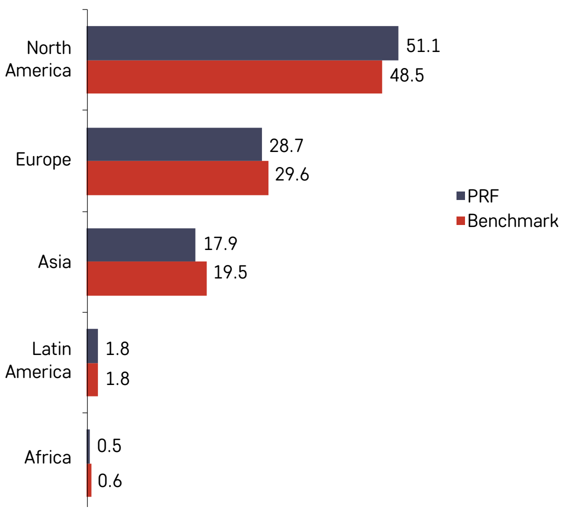
| | Sovereign and government-related bonds | Inflation-linked sovereign bonds | U.S. agency MBS | Corporate bonds | High yield bonds | Total fixed-income |
|---|---|---|---|---|---|---|
| AAA | 17.8% | 7.3% | 8.1% | 0.0% | 0.0% | 33.2% |
| AA+ / AA- | 7.8% | 5.9% | 0.0% | 1.2% | 0.0% | 14.9% |
| A+ / A- | 15.2% | 0.5% | 0.0% | 7.5% | 0.0% | 23.1% |
| BBB+ / BBB- | 5.3% | 1.2% | 0.0% | 9.1% | 0.0% | 15.6% |
| BB+ / BB- | 0.0% | 0.0% | 0.0% | 0.4% | 5.1% | 5.5% |
| B+ / B- | 0.0% | 0.0% | 0.0% | 0.0% | 4.5% | 4.5% |
| CCC+ or lower | 0.0% | 0.0% | 0.0% | 0.0% | 1.1% | 1.1% |
| Others[a] | 1.5% | 0.0% | 0.0% | 0.2% | 0.3% | 2.0% |
| **Total** | **47.6%** | **14.9%** | **8.1%** | **18.4%** | **11.0%** | **100.0%** |

(a) It includes cash and cash equivalents.

Source: Ministry of Finance

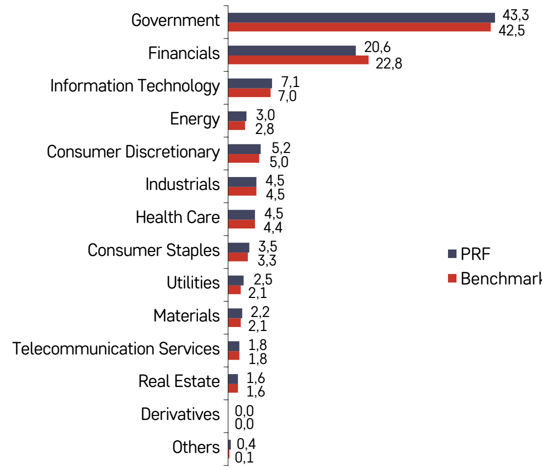
43 State-owned companies, multilateral organizations, etc.

F43 Regional allocation, 31 December 2019 (percent of portfolio)




Source: Ministry of Finance

F44 Sector allocation, 31 December 2019 (percent of portfolio)




Source: Ministry of Finance

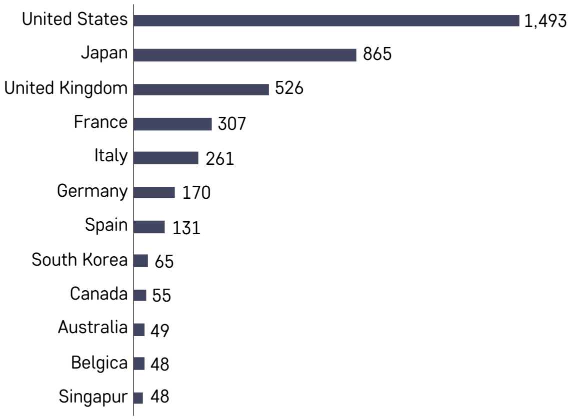
T21 Allocation by country, 31 December 2019 (percent of portfolio)

| Country allocation | Sovereign and government-related bonds | Inflation-linked sovereign bonds | U.S. agency MBS | Corporate bonds | High yield bonds | Equities | Total |
|---|---|---|---|---|---|---|---|
| United States | 9.5 | 4.5 | 5.7 | 7.4 | 3.7 | 16.5 | 47.3 |
| Japan | 8.0 | 0.3 | 0.0 | 0.2 | 0.0 | 2.1 | 10.7 |
| United Kingdom | 1.7 | 3.2 | 0.0 | 1.1 | 0.3 | 1.4 | 7.6 |
| France | 2.1 | 0.9 | 0.0 | 0.7 | 0.2 | 0.9 | 4.8 |
| Canada | 1.2 | 0.2 | 0.0 | 0.7 | 0.3 | 0.9 | 3.3 |
| Italy | 1.8 | 0.7 | 0.0 | 0.1 | 0.2 | 0.2 | 2.9 |
| Germany | 1.3 | 0.3 | 0.0 | 0.3 | 0.1 | 0.7 | 2.7 |
| Holland | 0.6 | 0.0 | 0.0 | 0.8 | 0.5 | 0.5 | 2.4 |
| Spain | 1.2 | 0.2 | 0.0 | 0.2 | 0.0 | 0.2 | 1.9 |
| Australia | 0.5 | 0.1 | 0.0 | 0.2 | 0.0 | 0.6 | 1.4 |
| South Korea | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 | 1.2 |
| Switzerland | 0.1 | 0.0 | 0.0 | 0.1 | 0.0 | 0.9 | 1.1 |
| Ireland | 0.2 | 0.0 | 0.0 | 0.1 | 0.1 | 0.4 | 0.8 |
| Others [(a)] | 5.0 | 0.2 | 0.0 | 1.0 | 2.5 | 3.2 | 11.9 |
| **Total** | **33.8** | **10.6** | **5.7** | **13.1** | **7.8** | **28.9** | **100.0** |

(a) It includes cash and cash equivalents.

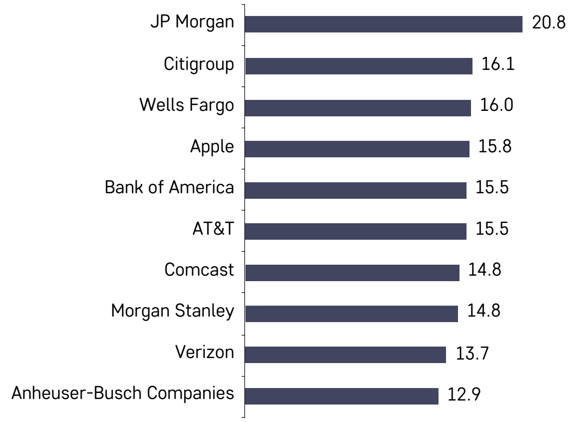
Source: Ministry of Finance

F45 Main exposures to nominal and inflation-linked sovereign bonds, and government-related bonds[44] (million of dollars).




Source: Ministry of Finance

F46 Main exposures to corporate bonds (millions of dollars)

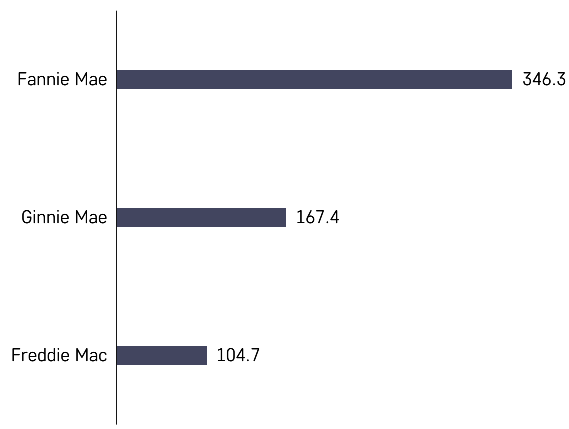



Source: Ministry of Finance

F47 Main exposures to high yield bonds (millions of dollars)

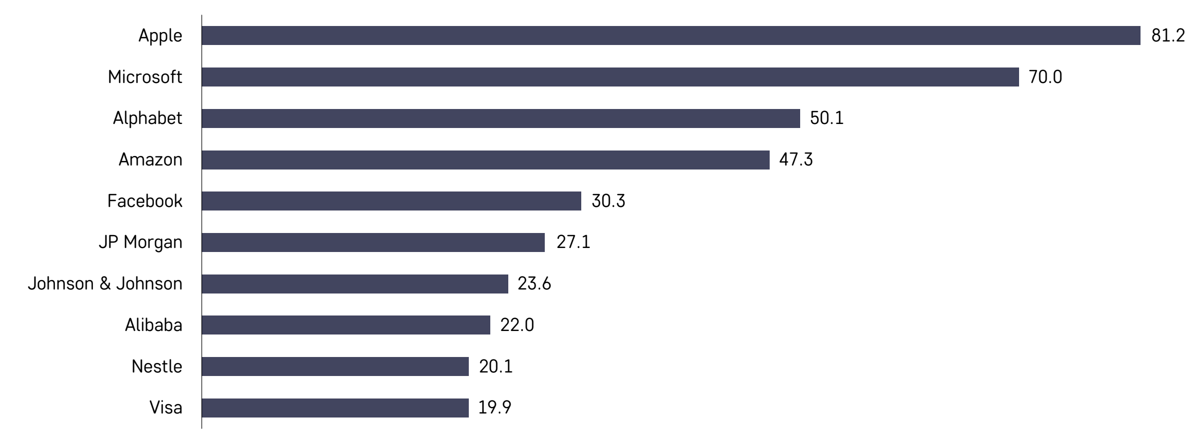

Source: Ministry of Finance

F48 Main Exposures to U.S. agency MBS (millions of dollars)




Source: Ministry of Finance

F49 Main equities exposures to companies (millions of dollars)




Source: Ministry of Finance

44 It includes inflation-linked bonds.

## 8.5 Management Costs and Income from the Securities Lending Program

The total cost of managing the PRF included US$ 2,322,776 for custody services, US$ 1,085,958 for the CBC's management services, and US$ 3,948,867 for external portfolio managers.[45,46] In the year, there were also payments associated with others external services (auditing and advising services) for a total of US$ 104,645. Together, the total management and custody costs represented 7 basis points of the total PRF portfolio in 2019. The income from the securities lending program totaled US$ 833,796, which partly offset the management and custody costs (see Table 22).

## 8.6 Main Financial Risks

The PRF portfolio is largely exposed to the same risks as the ESSF. However, idiosyncratic credit risk is higher in the PRF due to its exposure to a larger number of countries. Moreover, because the fund invests in invesment grade and high yield corporate bonds, it is exposed to the credit risk of the issuing companies. It also has a larger share of equities investments than the ESSF, which increases its exposure to the higher volatility of this asset class. As in the case of the ESSF, most of these risks depend directly on the asset class allocation and the chosen benchmarks, given the passive management stipulated in the fund's investment policy.

### 8.6.1. Market Risk

The market value of the financial instruments in the PRF portfolio can be exposed to losses as a result of changes in market conditions. As with the ESSF, the fixed-income portfolio is exposed to interest rate risk, foreign exchange risk and credit spread risk. In addition, the PRF is exposed to equity risk. This section describes these risk in detail, together with the control mechanisms set up for monitoring them.

#### Interest rate risk

In the PRF, interest rate risk is mainly a function of the benchmark portfolio duration, which is calculated from the duration of the indexes that make up the benchmark. In contrast to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk from a larger number of countries, and it is more sensitive due to its longer duration. This risk is monitored and controlled by keeping the portfolio duration close to the benchmark. The benchmark duration at the close of 2019 was 7.48 years, while the actual duration of the PRF was 7.51 years.

T22 Management and custody costs and income from the securities lending program (dollars)

| Items | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|
| Custody (J.P. Morgan) [a] | 91,572 | 1,971,424 | 2,296,139 | 1,639,504 | 1,449,173 | 1,595,229 | 1,540,339 | 2,322,776 |
| Management (CBC) | 520,186 | 1,032,599 | 724,115 | 947,984 | 1,003,643 | 995,777 | 1,115,871 | 1,085,958 |
| Management (external) | 548,098 | 1,347,401 | 1,608,982 | 1,884,965 | 1,550,659 | 2,147,271 | 1,545,941 | 3,948,867 |
| Other costs [b] | 70,588 | — | — | — | 241,507 | 111,763 | 537,400 | 104,645 |
| **Total costs** | **1,230,443** | **4,351,424** | **4,629,236** | **4,472,453** | **4,244,983** | **4,850,040** | **4,739,550** | **7,462,246** |
| Total cost in basis points [c] | 2 | 6 | 6 | 6 | 5 | 5 | 5 | 7 |
| **Securities lending program** | **219,422** | **235,855** | **567,458** | **278,184** | **307,653** | **338,324** | **394,528** | **833,796** |

(a) Custody costs in 2014 include payments for services rendered from May to December 2013.
(b) It includes consulting, auditing, and tax consulting services.
(c) It includes custody and administration expenses.
Source: Ministry of Finance

45 The increase in 2018's and 2019's CBC remuneration corresponds mainly to the expenses associated with the renovation of a technological platform used in the administration of sovereign wealth funds.

46 The increase in costs associated with external managers in 2019 is due to the higher percentage associated with equities and the incorporation of high yield bonds and U.S. agency MBS in the transitional strategic composition of 2019.

## Prepayment risk

Prepayment risk is associated with securities that allow the premature return of principal by the issuer. The U.S. agency MBS portfolio is exposed to this risk because the underlying assets are mortgage loans, which could be refinanced when mortgage interest rates are low. When a loan is prepaid, the individual borrower who is refinancing the mortgage loan returns the value of the principal owed to the MBS investor, and the investor loses the present value of future interest payments that would otherwise have been received, which are higher than the current rates for reinvestment. This risk is monitored by controlling that the prepayment speed in the portfolio of each U.S. agency MBS portfolio manager is similar to the benchmark.

## Foreign exchange risk

Because the fund's performance is measured in dollars, the value of investments in other currencies is affected by the corresponding exchange rate movements. Given the passive management strategy, the tolerance for foreign exchange risk is defined by the currency allocation of the benchmark. As of year-end 2019, approximately 98% of the portfolio was invested in 10 different currencies, including the dollar, while the remaining 3% was exposed to 19 currencies. Specifically, the fund's exposure to currency risk is mainly through investments denominated in euros (17.8%), yen (10.3%), pounds sterling (7.3%), Canadian dollars (2.5%), and Australian dollars (1.3%).

## Credit spread risk

The market value of the instruments in the PRF fixed-income portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. The PRF is subject to higher credit spread risk than the ESSF because its fixed-income portfolio includes instruments from many issuers around the world, such as governments of developed and developing countries with and without investment grade, and other issuers such as public and semi-public agencies, multilateral financial institutions, corporations and so on. In the case of investment grade corporations and sovereigns, credit spread risk is mitigated by having a well-diversified portfolio and investing only in instruments with a rating of BBB– or higher. In the case of high yield bonds, the investment involves instruments that, by definition, have a higher credit risk. To mitigate this risk, the fund has contracted portfolio managers that incorporate credit analysis in their investment process, so as to exclude corporate issuers which could experience a significant worsening of their credit rating, and that construct well-diversified portfolios to eliminate the idiosyncratic risk of a particular issuer.

## Equity risk

The PRF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2019, equities accounted for 28.94% of the fund, which is higher than the strategic asset allocation (27%).

## Volatility, VaR, and tracking error

The annual volatility of the PRF was 4.07% in 2019, versus 5.24% for the period from 31 March 2007 onward. Since the fund's inception, the highest monthly return was 5.47% (in December 2008), while the lowest was de -3.33% (in January 2009). The highest quarterly return was 7.36% in the first quarter of 2008; the lowest was -5.75% in the fourth quarter of 2016 (see Table 23). At year-end 2019, the VaR was 3.46% in a one-year horizon, with a 95% confidence level.[47]

47 This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 5.63% of its nominal value in dollars.

T23 Historical minimum and maximum returns (percent)

| Range | Month | Quarter |
|---|---|---|
| Highest return | 5,47 (Dic-08) | 7,36 (I 08) |
| Lowest return | -3,33 (Ene-09) | -5,75 (IV 16) |

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At year-end 2019, the ex ante tracking error of the PRF was 15 basis points, while the ex post tracking error was 15 basis points.

## 8.6.2 Credit Risk

In the PRF bond portfolio, exposure to this type of risk is mitigated by having a well-diversified portfolio and investing only in instruments from issuers included in the benchmark. For bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly associated with investing the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards and swaps is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see Table 24). In addition, forwards and swaps cannot exceed a stipulated percentage of each manager's portfolio. For the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio. In the case of the external managers, forwards, swaps and futures cannot exceed 10% of each manager's portfolio.

In the case of high yield bonds, the very nature of the asset class implies that there is a higher probability of default due to the fact that the fund is investing in issuers that do not have an investment grade rating, that is, that have a rating of BB+/Ba1 or less (see Table 20). Of these, around 10% are in the CCC+/C range, which corresponds to higher risk and a higher default probability. As indicated above, to mitigate this risk, the external managers responsible for this asset class construct well-diversified portfolios and carry out a credit analysis to exclude firms that, in their opinion, are more likely to enter default.

The risk arising from the execution of a transaction –that is, the losses that could occur if the counterparty does not deliver the securities purchased or pay for the securities sold– is mitigated through the use of delivery versus payment (DVP) transactional or post-transactional systems, in which payment is conditional on simultaneous delivery. Finally, the risk of holding the funds' securities at a custodian institution is addressed by registering them in the name of the Republic of Chile and keeping them in separate accounts.

## 8.6.3 Liquidity Risk

The PRF is exposed to fairly low liquidity risk because the fund has historically had little need for cash. Disbursements from the

T24 Credit limits on bank deposits and forwards

| Limits | | Time deposits | Forwards |
|---|---|---|---|
| Minimum rating | | A- | A- |
| Maximum per issuer[a] | CBC portfolio | 1% (sobre AA-)<br>0,5% (entre A- y A+) | 1% (sobre AA-)<br>0,5% (entre A- y A+) |
| | Externally managed portfolios | 5% | 3% |

(a) Percent of each manager's portfolio (CBC or a given external manager).

Source: Ministry of Finance

fund started in 2017 with a withdrawal of US$ 314 million in September of that year, followed by two withdrawals of US$ 295 million and US$ 230 million in September and December 2018, respectively, and a final withdrawal of US $ 576 million in June 2019. To minimize transaction costs and the risk of having to generate liquidity at inopportune times, a attempt has been made to coordinate withdrawals with the annual contributions so as to offset the movements. Furthermore, the sale of instruments in the PRF portfolio is mainly associated with changes in the benchmark, which can require the portfolio managers to make an adjustment (that is, to sell an instrument that left the benchmark in order to purchase one that was incorporated). In the event of changes in the benchmark, the investment guidelines allow some flexibility for managers to make the necessary adjustments, in order to reduce the impact of having to sell at an unfavorable time. Additionally, over the coming years it will be necessary to sell instruments in the sovereign fixed-income portfolio in order to converge to the new strategic asset allocation. The liquidity risk associated with this transition is fairly low, given that the dates and amounts of the cash movements are generally known in advance.

## 8.6.4 Operational Risk

Operational risk arises from the losses that would occur from mistakes in internal processes and systems, external events or human error. Examples of operational risk include transaction errors, fraud, failure to comply with legal obligations (contracts), etc.

For the portfolio managed by the CBC, this risk has been mitigated because the operational management of the funds is carried out using the same infrastructure that the CBC uses to manage its international reserves. The CBC has also set up a series of controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds and internal and external auditing processes to assess the effectiveness of the existing controls.

In the case of the external portfolio managers, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided. Starting in the second half of 2015, support for monitoring is provided by an international consulting firm.[48]

48 See footnote 34.

# 09 FINANCIAL STATEMENTS: ECONOMIC AND SOCIAL STABILIZATION FUND

Financial statements for the years ended on 31 December 2018 and 2019 and the independent auditors' report[49]

49 The numbering on the pages of this chapter corresponds to the original numbering of the audited financial statements that is independent of the rest of the report.

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INDEPENDENT AUDITOR’S REPORT

Santiago, March 25, 2020

General Treasury of the Republic
Economic and Social Stabilization Fund

*Financial statements report*

We have audited the accompanying financial statements of Economic and Social Stabilization Fund (hereinafter the “Fund”), which comprise the statements of financial position for the years ended December 31, 2019 and 2018, and the related statements of income and comprehensive income, changes in equity and cash flows for the years then ended and the related notes to the financial statements.

*Management's responsibility for the financial statements*

General Treasury of the Republic is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility involves the design, implementation and maintenance of an internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Auditing Standards generally accepted in Chile. Those standards require that we plan and perform the audit order to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund’s preparation and fair presentation of the consolidated financial statements in order to design auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Economic and Social Stabilization Fund for the years ended December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

*Other matters*

As indicated in Note 1, the use of resources from Economic and Social Stabilization Fund is intended to consolidate into a fund the additional stabilization resources from tax revenue referred to in Decree Law N° 3.653 from 1981 and the Compensation Fund copper revenues constituted according to the loan agreement BIRF N°2.625 CH, as indicated in Decree with Force of the Law N° 1 dated December 11, 2006.

The above translation of the auditor's report is provided as a free translation from the original Spanish language, which is the official and binding version. Such translation has been made solely for the convenience of non-Spanish readers.

Sergio Bascuñán Rivera

ECONOMIC AND SOCIAL STABILIZATION FUND

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ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENTS OF FINANCIAL POSITION FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

| ASSETS | Notes | 31-12-2019 | 31-12-2018 |
|---|---|---|---|
| | | US$ | US$ |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | 1 | 4,715,538 | 5,018,748 |
| Total current assets | | 4,715,538 | 5,018,748 |
| FINANCIAL ASSETS THROUGH PROFIT OR LOSS | | | |
| Stocks | 6 | 913,294,367 | 905,269,174 |
| Other capitalization instruments | 6 | 21,767,232 | 20,181,112 |
| Time deposits | 6 | 2,761,773,234 | 3,181,369,668 |
| Government bonds | 6 | 6,716,234,500 | 7,938,699,602 |
| Indexed bonds | 6 | 429,606,972 | 488,297,373 |
| Treasury bills | 6 | 1,386,145,221 | 1,598,802,754 |
| Derivatives | | 122,418 | 150,941 |
| Total investments | | 12,228,943,944 | 14,132,770,624 |
| Total assets | | 12,233,659,482 | 14,137,789,372 |

| LIABILITIES AND NET EQUITY | Notes | 31-12-2019 | 31-12-2018 |
|---|---|---|---|
| | | US$ | US$ |
| LIABILITIES | | | |
| Derivative financial instruments | 7 | 252,995 | 3,942,084 |
| Total liabilities | | 252,995 | 3,942,084 |
| NET EQUITY | | | |
| Fiscal resources | | 10,371,326,865 | 10,912,903,120 |
| Fiscal withdrawals | 8 | (2,563,889,347) | (541,576,255) |
| Retained earnings | | 3,762,520,423 | 3,825,920,225 |
| Profit (loss) for the year | | 663,448,546 | (63,399,802) |
| Total net equity | | 12,233,406,487 | 14,133,847,288 |
| TOTAL LIABILITIES AND NET EQUITY | | 12,233,659,482 | 14,137,789,372 |

The accompanying notes N° 1 to 17 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENTS OF INCOME

| | Notes | For the period between January 1 and 31-12-2019 | 31-12-2018 |
|---|---|---|---|
| | | US$ | US$ |
| OPERATING INCOME | | | |
| Interests earned | 9 | 144,543,358 | 140,869,343 |
| Dividend income | 10 | 26,738,171 | 26,053,549 |
| Net realized gain | | 245,961,292 | - |
| Net unrealized gain | | 249,372,595 | - |
| Total operating income | | 666,615,416 | 166,922,892 |
| OPERATING LOSSES | | | |
| Net realized loss from sale of financial instruments | | - | (14,545,312) |
| Net unrealized loss from price changes of financial instruments | | - | (212,962,225) |
| Total operating losses | | - | (227,507,537) |
| Total operating income | | 666,615,416 | (60,584,645) |
| ADMINISTRATIVE EXPENSES | | | |
| Fiscal Agency Expense (Central Bank of Chile) | 8 | (1,815,729) | (1,595,178) |
| Custodian and External Managers expenses | 8 | (1,284,856) | (1,144,991) |
| Other Custodian Expenses and External Managers | 8 | (62,146) | (74,988) |
| J,P, Morgan adjustment | | (4,140) | - |
| PROFIT (LOSS) FOR THE YEAR | | 663,448,546 | (63,399,802) |
| | | ========== | ========== |

The accompanying notes N° 1 to 17 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENTS OF COMPREHENSIVE INCOME

| | For the period between January 1 and | |
|---|---|---|
| | 31-12-2019 | 31-12-2018 |
| | US$ | US$ |
| Profit (loss) for the year | 663.448.546 | (63.399.802) |
| Other comprehensive income reclassified to profit and loss | - | - |
| Other comprehensive income not reclassified to profit and loss | - | - |
| Total comprehensive income | - | - |
| Comprehensive income for the year | 663.448.546 | (63.399.802) |
| | ========== | ========== |

The accompanying notes N° 1 to 17 are an integral part of these financial statements

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENTS OF CHANGES IN NET EQUITY

FOR THE YEARS ENDED

DECEMBER 31, 2019 AND 2018

| | Notes | Fiscal Resources | Retained earning | Comprehensive income for the year | Total |
|---|---|---|---|---|---|
| | | US$ | US$ | US$ | US$ |
| Beginning balance as of January 1, 2019 | | 10,371,326,865 | 3,825,920,225 | (63,399,802) | 14,133,847,288 |
| Final dividend distribution | | - | (63,399,802) | 63,399,802 | - |
| Fiscal withdrawal | 8 | (2,563,889,347) | - | - | (2,563,889,347) |
| Profit for the year | | - | - | 663,448,546 | 663,448,546 |
| Ending balance as of December 31, 2019 | | 7,807,437,513 | 3,762,520,423 | 663,448,546 | 12,233,406,487 |
| | | ============ | =========== | ========== | ============ |
| Beginning balance as of January 1, 2018 | | 10,912,903,120 | 2,859,155,143 | 966,765,082 | 14,738,823,345 |
| Final dividend distribution | | - | 966,765,082 | (966,765,082) | - |
| Fiscal withdrawal | 8 | (541,576,255) | - | - | (541,576,255) |
| Loss for the year | | - | - | (63,399,802) | (63,399,802) |
| Ending balance as of December 31, 2018 | | 10,371,326,865 | 3,825,920,225 | 63,399,802 | 14,133,847,288 |
| | | ============ | =========== | ========== | ============ |

The accompanying notes N° 1 to 17 are an integral part of these financial statements

ECONOMIC AND SOCIAL STABILIZATION FUND

CASH FLOWS STATEMENTS

(Indirect method)

| | Notes | For the years ended 31-12-2019 | 31-12-2018 |
|---|---|---|---|
| | | US$ | US$ |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| (Loss) profit for the year | | 663,448,546 | (63,399,802) |
| Net unrealized loss (profit) | | (249,372,595) | 212,962,225 |
| Changes in Administration and Custody Funds | | 2,149,510,186 | 337,459,080 |
| Cash flows from operating activities | | 2,563,586,137 | 487,021,503 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Decrease from capital withdrawal | 8 | (2,563,889,347) | (541,576,255) |
| Cash flows from financing activities | | (2,563,889,347) | (541,576,255) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | (303,210) | (54,554,752) |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | | 5,018,748 | 59,573,500 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | 11 | 4,715,538 | 5,018,748 |

The accompanying notes N° 1 to 17 are an integral part of these financial statements

ECONOMIC AND SOCIAL STABILIZATION

NOTES TO FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2019 AND 2018

## NOTE 1 – GENERAL INFORMATION

The Economic and Social Stabilization Fund (hereinafter the "Fund" or ESSF) was set up under the Law 20.128 on September 30, 2006 of the Chilean Ministry of Finance for the purpose of consolidating into a fund the additional stabilization resources of tax revenue referred to in Decree Law N° 3.653 from 1981 and the Compensation Fund for income from copper constituted according to the loan agreement BIRF N°2.625 CH, as indicated in Decree Law N° 1 dated December 11, 2006.

The adoption of this Fund has been regulated by the following instructions, provided by the Ministry of Finance:

a) Decree N° 1.618 from April 18, 2013, which authorizes the Central Bank of Chile, as Fiscal Agent, to administrate the Economic and Social Stabilization Fund and instructs that it reports about Investments to the Ministry of Finance and the General Treasury of the Republic.

b) Ministry of Finance's Official Letter N° 68 of January 11, 2019, in which the new Execution Guidelines related to the management of resources of the Economic and Social Stabilization Fund are communicated to the Fiscal Agent.

c) Comptroller General of the Republic's Official Letter N° 71.390 of 2009, which instructs on the valuation criteria of the Fund.

d) Decree N° 1.492 of 2015, which regulates the coordination and operation of advisory activities, supports the management and inspection of financial assets and liabilities of the Public Treasurer, especially, of the Social Stabilization Fund and of the Pension Reserve Fund (renders invalid Decree N° 1.636 of 2009).

   In article 4 of the mentioned Decree it is possible to highlight the following activities related to the General Treasury of the Republic:

   - Register the investments of the Treasure Resources, as well as the lending operations, in accordance with the accounting and budgetary standards established by the Comptroller General of the Republic and/or the Budget Office, as appropriate.

   - Carry out the accounting of Sovereign Wealth Fund in accordance with international accounting standards or their local equivalent, prepare quarterly and annual financial statements of the Sovereign Wealth Fund in accordance with those standards, and order, charged to the Sovereign Wealth Fund's resources, independent audits of the annual financial statements, all subject to the limit established in Article 7 of this Decree. For that purpose, it will select and hire audit firm or firms among those that are authorized to provide their professional services to entities supervised by the Commission of Banks and Financial Institutions.

   - Support the Ministry of Finance in the preparation of Sovereign Wealth Fund's reports and the Report on Public Debts Statistics.

   - Verify that nominal and valued records of the investments of the Sovereign Wealth Fund are consistent with the Custodians' records. This activity has been carried out since January 1, 2014 for the portfolios managed by External Managers, and since July 1, 2014 for the portfolios managed by Central Bank of Chile.

- Issue the transfer instructions related to contributions and withdrawals from and to the Sovereign Wealth Funds, pursuant to the instructions given by the Ministry of Finance, validate the payments related to the administration and custody of the Sovereign Wealth Funds, as appropriate, and instruct the Central Bank of Chile the payment of the different services provided by the External Managers.

- Supervise compliance with standards and limits established by the Ministry of Finance for investments in the capital markets of the Public Treasury resources other than the Sovereign Wealth Fund, and periodically send a report on that matter to the Budget Office and to the Ministry of Finance.

- Keep an updated manual of procedures for the execution of all the functions and attributions that are detailed in this article.

- Carry out any other advisory, coordination or management support work necessary for the performance of its duties.

The information provided by the accounting of the Sovereign Wealth Funds, derives from an entity such as the General Treasury of the Republic, whose temporary existence has full force and future projection, so the figures resulting from the accounting process are not referred to estimated realization values.

e) The Ministry of Finance's Record N° 2.463 of December 13, 2018, communicates the new Guidelines on Custody and other fund's matters.

f) Ordinary Official Letter N° 69 of January 14, 2019, modifies the ordinary official letter N° 2.463 of 2018 that informs the new Custody Guidelines to the fiscal agent.

g) Ordinary Official Letter N° 45 of October 11, 2017, of the Ministry of Finance that authorizes retribution payments of 2018, for the Portfolio management services and others.

h) Ministry of Finance's Decree N° 1.618 of 2013 that redefines the activities of the Central Bank of Chile as Fiscal Agent.

In Article 15, letter a) of Decree N° 1.618 of 2013, the Fiscal Agent is authorized to carry out, under request of the Ministry of Finance, one or more tenders for the portfolio management, and to hire its External Managers, on behalf of the Treasury. Consequently, in 2019, the custody services of the following External Managers were hired:

- BNY Mellon Equities.
- Blackrock Equities.
- Allianz Global Investors
- Nomura Corporate Research and Asset Management

i) Official Letter N°1.073 of the Ministry of Finance of June 3, 2019 for contracting an agent and custodian in China for local investment management.

j) Decree N° 892 of the Ministry of Finance of 2014 establishing the fiscal policy, in accordance with the provisions of Article 1 of Law N° 20.128.

*Qualitative characteristics of the Fund's financial statements*

i) The Relevance Principle, as a category of the Fund's Financial Statements, from which the Materiality and Relative Importance Principle is inferred implies that in accounting, in order to weight the correct implementation of the principles and rules, it is necessary to always act with practical sense as long as the overall picture of information is not distorted.

ii) Reliability of Information Principle, as a gender category from which the following principles of information are inferred as species: Faithful Representation Principle, Substance over Form Principle, Neutrality Principle, Prudence Principle, and Integrity Principle, within an internal control system mainly based on the Chilean Central Bank verification role of the information prepared by the Custodian Agent, in its capacity as Fiscal Agent.

iii) Comparability principle that constitutes one of the purposes of the Sovereign Wealth Funds' accounting of adhering to the international financial standards, in order to be consistent with global accounting practices.

iv) Understandability Principle to create financial statements of the Sovereign Wealth Funds prepared for general information purposes.

On January 11, 2019, the Ministry of Finance reported, in the Official Letter N° 68, the new Investment Guidelines related to the Economic and Social Stabilization Fund's resources, which is effective since August 5, 2015, replacing and invalidating, as appropriate, the Investment guidelines included in the Official Letter N° 1.567, of 2015, from the Ministry of Finance.

NOTE 2 - SIGNIFICANT ACOUNTING POLICIES

The significant accounting policies applied in the preparation of these financial statements are presented below. These policies have been systematically applied to all the activities presented, unless otherwise indicated.

2.1 Basis of preparation

The Fund's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issues by the International Accounting Standard Board (IASB).

Since January 1, 2018, the Fund has applied the IFRS 9, which establish that the debt instruments are measured at amortized cost if and only if: i) The asset is held within the business model whose objective is to hold assets in order to collect contractual cash flows, and ii) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. If one of these criteria is not met, the debt instruments are classified at fair value through profit or loss. However, the Fund may choose to designate at the initial recognition of a debt instrument that meets the criteria of amortized cost to measure it at fair value through profit or loss if at doing it significantly eliminates or reduces an accounting mismatch. In the current period, the Fund has not decided to measure at fair value through profit or loss any debt instruments meeting the amortized cost criteria.

Investments in equity instruments (stocks) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for negotiations and is designated by the Fund to be measured at fair value through other comprehensive income. If the equity instrument is designated at fair value through other comprehensive income, all the losses and profits of its valuation, except for the dividend income, which is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and will not be subsequently reclassified to profit or loss.

Financial statements are presented in USA dollars and have been prepared from the Sovereign Wealth Fund information that the Central Bank of Chile, as Fiscal Agent, receives from its Custodian Agent J.P. Morgan Chase & Co.

The financial statements presented by the General Treasury of the Republic for the Fund are:

- Classified Statements of Financial Position.
- Statements of Comprehensive Income.
- Statements of Changes in Equity.
- Statements of Cash Flows.
- Notes to Financial Statements.

## 2.2 Accounting period

The Financial statements comprise the years between January 1 and December 31, 2019 and 2018.

## 2.3 Presentation and functional currency

Items included in the Financial Statement of the Fund are recorded using the currency of the primary economic environment in which the Fund operates. Thus, the Fund's values are presented in US dollars, defined as the presentation and functional currency.

Transactions in foreign currencies, other than US dollar, are translated to the functional currency at the rate current at the time of the transaction. Exchange differences arising when monetary items are settled or when monetary items are translated at closing rates are recognized in the statement of comprehensive income.

## 2.4 Classification and valuation of investments

Investments of the Sovereign Wealth Funds are liquid assets in foreign currency made by the Central Bank of Chile, as Fiscal Agent, JP Morgan, as Custodian Bank, and External Managers in order to capitalize fiscal resources, which are immediately available to finance the activities of the Sovereign Wealth Funds.

*Financial Assets and liabilities, Classification and measurement*

As of January 1, 2018, the Fund has applied the provisions in IFRS 9, which establishes that for the purposes of classification and measurement of its financial assets, the Fund must consider its business model to manage its financial instruments and the characteristics of the contractual flows of those instruments. The fund has classified its financial assets in the following categories:

*Financial assets at amortized cost*

This category classifies those financial instruments that are held within a business model whose objective is to hold them in order to collect contractual cash flows. Likewise, the contractual terms of the financial asset give rise, on specified dates to cash flows that correspond to payments of principal and interests.

*Financial assets at fair value through other comprehensive income*

This category classifies those financial instruments that are held in a business model whose objective is achieved by both collecting contractual cash flows and selling those financial assets. Likewise, the contractual conditions of the financial asset give rise on specified dates to cash flows that correspond to payments of principal and interests. Additionally, the Fund may choose to designate investments in equity instruments, as financial assets at fair value through other comprehensive income. In any other case, they are recorded at fair value through profit or loss.

*Financial assets at fair value through profit or loss*

Financial assets are measured at fair value through profit or loss, unless they are classified at amortized cost or at fair value through other comprehensive income. Additionally, the Fund can make an irrevocable designation at the moment of initial recognition, as financial asset at fair value through profit or loss, if this eliminates accounting mismatch. The Fund adopted the policy of not using hedge accounting.

The purpose of the Fund is to obtain monthly returns similar to those of benchmark comparator, according to a passive management style, for which investment strategies that allow the achievement of this purpose are selected.

The Fund classifies in this category the following instruments: Government Bonds, Inflation-indexed Bonds, Corporate Bonds, Time Deposits, common and preferred stocks, ADR, GDR, REIT, Treasury Bills, Commercial Papers and Derivative Instruments.  The basis of classification within this investment category are that the instruments have a reasonably active secondary market, under normal conditions, and that are consistent with the provisions of ORD 68 of January 11, 2019, in which the Execution Guidelines related to the Fund's resources are established. These investments are recorded at their fair value through profit or loss.

The determination of fair values is made by the Custodian, using the last transaction price of the closing day in the market where they are traded.

*Financial liabilities*

The Fund classifies its liabilities at amortized cost, except:

- Financial liabilities at fair value through profit or loss, including derivatives which are measured after the fair value.
- Financial liabilities that arise when an asset transfer does not qualify for derecognition or are recorded under the continuing involvement approach.
- Financial liabilities that arise from financial guarantee contracts.
- Financial liabilities that arise from commitments to provide loans at a below-market interest rate.
- Financial liabilities from a business combination.

The Fund may, at initial recognition, designate a financial liability at fair value through profit or loss, if that eliminates an accounting mismatch or a group of financial instruments is managed and measured at fair value as part of its business model.

*Recognition, derecognition and measurement*

Investment purchases and sales in regular bases are recognized on the transaction date, when the Fund agrees to buy or sell the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are expensed as incurred in the income statement, in the case of assets and liabilities at fair value through profit or loss, and they are registered as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are those incurred to acquire financial assets or liabilities. They include fees, commissions and other concepts related to the operation paid to agents, advisors, brokers and operators.

Financial assets are derecognized when the right to receive cash flows from the investments has expired or the Fund has significantly transferred all the risks and benefits related to its ownership.

Following the initial recognition, all the financial assets and financial liabilities at fair value through profit or loss are measured at fair value. Profits and losses arising on changes in the fair value of the category “Financial assets or financial liabilities at fair value through profit or loss” are presented in the Statements of Comprehensive Income within “Net changes in fair value of financial assets and liabilities at fair value through profit or loss” in the period in which they arise.

Dividend income from financial assets at fair value through profit or loss are recognized in results within “Dividend income” when the right of the Fund to receive its payment is established. Interest over debt security at fair value through profit or loss is recognized in results within “Interests and Adjustments” according to the effective interest rate.

Financial assets at amortized cost and other liabilities are valued after their initial recognition, based on the effective interest method. Accrued interests and adjustments are recorded in “Interests and adjustments” of the Statement of Comprehensive Income.

The effective interest method is used to calculate the amortized cost of a financial asset or liability and to assign financial income or expenses in the corresponding period. The effective interest is the rate that discounts the expected future cash inflows or outflows expected over the life of the financial instrument, or when appropriate, a shorter period in respect to the book value of the financial asset or liability. On calculating the type of effective interest, the Fund estimates cash flows considering all the contractual terms of the financial instrument, but it does not consider future credit losses.

The calculation includes all the fees and percent points paid or received among the contracting parties that are a comprehensive part of the type of effective interest, transaction costs and all the other premiums or discounts.

*Fair value estimate*

The fair value of financial assets and liabilities traded in active markets (such as derivatives and investments to negotiate) is based on quoted markets prices on the date of the statement of financial position; quoted market prices used for financial assets maintained by the Fund is the purchase price; the quoted market price appropriate for financial liabilities is the asking price (in case purchase and asking prices are different). When the Fund maintains derivative financial instruments paid through compensation, it uses intermediate market prices as a basis to establish fair values in order to compensate the risk positions, and applies this purchase or asking price to the net open position, as appropriate.

The fair value hierarchy will have the following levels:

a) Quoted prices (without adjustment) in active markets for identical assets and liabilities (Level 1).

b) Variables other than the quoted prices within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (Level 2); and

c) Variables used for asset or liability that are not based on observable market data (unobservable variables) (Level 3).

2.5 Cash

In preparing the Financial Statements of the Fund, a distinction is made between the cash in current account of the General Treasury of the Republic held for the Funds, and the cash held by the Custodian from operations of the Fund's administration.

2.6 Administration Funds

They represent securities delivered to the Central Bank of Chile, in its capacity as Fiscal Agent, to J.P. Morgan, as Custodian Bank, and to External Managers for the management of the Fund's resources, securities that can be partially or totally disposed for the entrusted work.

2.7 Fund in custody

They represent securities delivered by the Central Bank of Chile, in its capacity as Fiscal Agent, to J.P. Morgan Chase & Co., and to External Managers providing global custody services of the securities and instruments of the Fund.

2.8 Net equity

The net equity of the Fund is composed by the initial balance of Total Assets at par value plus Fiscal contributions minus Fiscal Withdrawals, including the profit or loss for the year.

According to the dispositions in articles N° 1, 2, 3 and 4 of the Statutory Decree N° 1 of September 1, 2006, the Fund will be constituted and increased with the following contributions:

The additional stabilization resources of fiscal income referred to in Decree Law N° 3.653 of 1981 and the Compensation Fund for Copper Income established in accordance with the Loan Agreement BIRF N° 2.625 CH are merged in a single Fund . The new Fund will be called "Economic and Social Stabilization Fund", hereinafter "the Fund".

Additionally, it states that:

a) With those that since the adoption of Decree Law are deposited in the accounts corresponding to the Funds mentioned in Article 1, be hereby refunded.

b) With the resources derived from the application of the transitory second article of the Law N° 19.030.

c) With an annual contribution equivalent to the balance resulting from subtracting the actual surplus, the contribution referred to in letter a) of article 6 and contributions made in use of the power indicated in article 11, both from Law N° 20.128, as long as the balance is positive; and

d) With other extraordinary contributions arranged for the Fund, by a decree from the Ministry of Finance, from the sale of assets or debt issues, as well as the other resources authorized by other laws.

The resources mentioned in the previous letter will be paid through one or more installments until completing the total payment.

The resources of the Fund will be held in one or more special accounts of the Treasury Service.

In spite of the dispositions of article N° 2 of the Decree Law N° 1, during the budgetary execution it will be possible to make contributions to the Fund, as advance payments and charged to the determination that will be done in the same budgetary year, or in future budgetary years, in accordance with Article N° 20 from the Law N° 20.128.

The product of the profitability generated by the investment of Fund's resources, that is, the returns obtained from the financial investment of resources, discounted the costs of that management, will be held as advanced payments made to such Fund.

Nonetheless, if the advances made exceed the amounts to be contributed according to the determination made in the respective budgetary year, the excess will constitute and advance with charge to the determination that must be made in the subsequent budgetary year.

The resources of the Fund can be used for:

a) The financing of the Budget Law, up to the amount established by that law, and included in the Calculation of General Income of the respective Nation.

b) The substitution of income and/or financing higher expense derived from the budgetary execution, in accordance with the authorizations and limitations established in the current legislation.

c) Amortizations, interests or other expenses for Public Debt, including those originated from interest and/or exchange rate swap contracts.

d) The amortization, interests or other expenses due to the payment of Recognition Bonds referred to in provisional article 11 of Decree Law N° 3.500 on interest and/or exchange rates.

e) The financing of the contribution referred to in letter a) of Article 6 from the Law 20.128, when stipulated by the Ministry of Finance, and

f) The financing of extraordinary contributions to the Fund referred to in Article 5 from the Law 20.128, when stipulated by the Ministry of Finance.

In spite of the foregoing, the Ministry of Finance may issue a decree to refund to General Income the resources of the Fund, those amounts from fiscal contribution for payments under the concepts indicated in the preceding letter in the previous year, and that were included in the calculation of the contributions referred to in the final paragraph of Article 20 of Law 20.128.

2.9 Statements of Cash Flows

To prepare the Statements of Cash Flows, the Sovereign Wealth Fund has defined the following considerations:

– Cash and cash equivalents include cash on hand, time deposits in credit institutions and other highly-liquid short term investments.

– Cash flow from operating activities includes administrative expenses of the operation of Sovereign Wealth Funds.

– Cash flow from financing activities includes activities producing changes in the size and composition of net equity, such as income from fiscal contributions and expenses due to fiscal withdrawal.

The Fund uses the indirect method to prepare the Statements of Cash Flows, for which purpose the operational net result, formed by costs incurred in the year due to administration expenses, commissions and insurance, and the financing net result due to the difference in fiscal contributions of the year are considered as components of the annual fund variation.

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are compensated and the net amount is reported in the statement of financial position when there is a legal right to offset recognized amounts and there is an intention to settle on a net basis or to realize the asset make and settle the liability simultaneously.

2.11 New accounting pronouncements

2.11. 1 New pronouncements that are not yet effective

At the issuance date of these Consolidated Financial Statements, new standards, amendments and interpretations have been issued to the current standards that are not yet effective and the Company has not early adopted any standard or that has been applied when appropriate.

The following standards, amendments and interpretations are effective for annual periods beginning on the dates included below:

| | **New Standard, Amendments and Interpretations** | **Effective for annual periods beginning on:** |
|---|---|---|
| Amendments to IAS 1 and IAS 8 | Presentation of Financial Statements and accounting policies, changes in estimates and accounting errors. | January 1, 2020 |
| Amendments to IAS 39, IFRS 7 and IFRS 9 | Reform to the reference interest rate. | January 1, 2020 |
| Amendments to IFRS 3 | Definition of a business | January 1, 2020 |
| IFRS 17 | Insurance contract | January 1, 2021 |

The management of the Fund estimates that the adoption of these new Standards, Amendments and Interpretations will not have a significant impact on financial statements.

2.11.2 Standards that have been used in the preparation of these financial statements.

IAS 12 Income tax

In January 2016, the IASB issued amendments to the IAS 12, which clarify the requirements for the recognition of assets for deferred taxes that correspond to debt instruments measured at fair value. Their recognition should be assessed as long as it is probable that the entity has future fiscal income to use the deductible temporary difference.

This amendment did not affect the financial statements of the Fund.

IFRS 9 Financial instruments

On July 24, 2014, the IFRS finished its project to improve the financial instruments accounting by publishing the IFRS 9 Financial instruments. This standard includes new requirements based on principles for classification and measurement, introduces a “prospective” model of expected credit losses for accounting the impairment and changes in hedge accounting.

The classification designation determines how the financial assets and liabilities are accounted in the financial statements and, in particular, how they are measured. The IFRS 9 introduces a new approach to classify financial assets, based on the business model of the entity for the financial assets management and the characteristics of their contractual flows.

About impairment, the standards establish a unique model that will be applied to all the financial instruments, eliminating the complexities associated to prior accounting requirements, which will require timely recognition of expected credit losses.

IFRS 9 introduces adjustments to regulatory requirements for hedge accounting, as well as new strategy alternatives, the new dispositions represent an important revision of hedge accounting, to align the accounting treatment with the risk management activities, allowing the entities to better reflect these activities in their financial statements. Moreover, as a result of these changes, the financial statements users will receive better information about the risk management and the effect of hedge accounting on financial statements.

This standard also establishes that the change in the fair value that corresponds to the own credit risk will be registered in other comprehensive income, allowing to decrease any eventual volatility that could rise in the results of the entity due to its recognition. The anticipated application of this improvement is allowed before any other requirement of the IFRS 9.

The mandatory application date was January 1, 2018, allowing its early application.

IFRS 15 Revenue from contracts with customers

In May 2014, IFRS 15 was issued, which purpose is to establish the principles an entity should apply to present useful information to financial statements users about the nature, amount, opportunity and uncertainty of income from ordinary activities and cash flows rising from a contract with customers. This new standard replaced the following current standards and interpretation: IAS 8 Revenue, IAS 11 Construction contracts, IFRIC 13 Costumer loyalty programs, IFRIC 15 Agreements for the construction of real estate, IFRIC 18 Transfers of assets from costumers, and SIC 31 Revenue – Barter transactions involving advertising services. The new model applies to all the contracts with clients except for those within the scope of other IFRS, such as leases, insurance contracts and financial instruments.

On April 12, 2016, IASB published amendments to IFRS 15, clarifying requirements for the implementation of the new standards. These amendments clarify how:

- To identify a performance obligation (the promise to transfer a good or service to a customer) in a contract;
- To determine whether a company is the principal (the provider of a good or service) or an agent (responsible for organizing the good or service provided); and
- To determine whether the product of granting a license must be recognized at a point in time or over time.

The application date of this new standard was as of January 1, 2018, allowing its early application. The adoption of IFRS 15 does not have significant impacts on the financial position or results of the operations of the Fund.

NOTE 3 - INVESTMENT GUIDELINES OF THE ECONOMIC AND SOCIAL STABILIZATION FUND (FEES)

**I.- Functions entrusted to the Fiscal Agent**

In accordance with the provisions of articles 4 and 15 of the Agency Decree, the Fiscal Agent is entrusted with the functions indicated below. For these purposes, two portfolios are distinguished: on the one hand, the portfolio of article 4 of the Agency Decree (hereinafter, the "Portfolio Managed by the Fiscal Agent"), and, on the other hand, the portfolio corresponding to article 15 of the Agency Decree, whose Resources are managed by external managers of the Treasury (hereinafter, the "Portfolio Managed by External Managers").

**I.1. Functions related to checking accounts at the Central Bank of Chile**

I.1.1. Portfolio Managed by the Fiscal Agent:

a. Open and maintain a checking account at the Central Bank of Chile on behalf of the General Treasury of the Republic (hereinafter, the "Treasury") for the Resources (hereinafter, the "Checking Account Portfolio Managed by the Fiscal Agent of the FEES" ).

b. Receive, register and deposit in the Checking Account Portfolio Managed by the Fiscal Agent of the FEES, the sums of money transferred to it by the Treasury, in order to apply them to the administrative order conferred on the Fiscal Agent.

c. Receive, register and deposit in the Checking Account Portfolio Managed by the Fiscal Agent of the FEES, the sums of money that come from the investment or liquidation of the Resources and that are going to be transferred to the Treasury, to other portfolios, to the Checking Account Portfolio Managed by External Managers of the FEES for purposes of payments to third parties corresponding to said portfolio or to whom the Minister of Finance indicates, either during the term of the Fiscal Agency or at its end.

d. For the account and on behalf of the Treasury, make the corresponding payments in relation to the administration or custody of the Resources, in the terms provided in subparagraph f) of article 4 of the Agency Decree.

e. Report daily account activity through electronic communication to the Minister of Finance and the General Treasurer of the Republic (hereinafter, the "Treasurer"), or whoever they designate.

I.1.2. Portfolio Managed by External Managers:

a. Open and maintain a checking account at the Central Bank of Chile on behalf of the Treasury for Resources (hereinafter, the "Checking Account Portfolio Managed by External Directors of the FEES").

b. Receive, register and deposit in the Checking Account Portfolio Managed by External Managers of the FEES, the sums of money transferred to it by the Treasury, in order to apply them to the administration order conferred on the External Managers.

c. Receive, register and deposit in the Checking Account Portfolio Managed by External Managers of the FEES, the sums of money coming from the investment or liquidation of the Resources and that will be transferred to the Treasury, other portfolios or to whom the Minister of Finance indicates, either during the term of the Fiscal Agency or at its end.

d. Make the payments that correspond to the custody of the Resources for and on behalf of the Treasury, in the terms provided in subparagraph e) of article 15 of the Agency Decree

e. Make payments for and on behalf of the Treasury to the External Directors or other third parties prior instruction from the Treasury.

f. Report daily account activity through electronic communication to the Minister of Finance and the Treasurer, or whoever they designate.

**I.2. Custody-related functions**

I.2.1. Portfolio Managed by the Fiscal Agent:

On behalf of the Treasury, hire one or more foreign financial institutions or security depositories, to provide the Treasury with custody services for the instruments acquired by the Resources (hereinafter, the "Custodians"), in accordance with subparagraph (d) of article 4 of the Agency Decree and with the Custody Guidelines that are in force. Likewise, hire, on behalf of the Treasury, related complementary services, such as tax counselling or international consulting.

I.2.2. Portfolio Managed by External Managers:

On behalf of the Treasury, hire one or more foreign financial institutions or security depositories, that provide the Treasury with custody services for the securities and instruments acquired by the Resources, in accordance with subparagraph (c) of article 15 of the Agency Decree and with the Custody Guidelines that are in force. Likewise, hire, on behalf of the Treasury, related complementary services, such as tax counseling or international consulting.

**I.3. Administration related functions**

I.3.1. Portfolio Managed by the Fiscal Agent:

a. The Fiscal Agent will administer, in representation and on behalf of the Treasury, all or part of the Portfolio Resources Managed by the Fiscal Agent

   In the same capacity, the Fiscal Agent will be authorized to delegate to one or more legal persons, national or foreign (hereinafter, the "Delegated Managers"), the portfolio administration of a part or of the total of the Resources administered by the Agent. Fiscal.

The Delegated Managers must be selected, in accordance with the Ministry of Finance's requirements, and hired by the Fiscal Agent on behalf of and representing the Treasury, using its internal procedures and standards, having previously received the approval of the Ministry of Finance, in order to comply with these guidelines.

The net effective returns obtained from the Resources investments will be considered additional amounts and will be managed by the Fiscal Agent.

The Minister of Finance may modify at any time the amount of the Resources corresponding to the Portfolio Managed by the Fiscal Agent. If it increases, the additional resources must be delivered by the Treasury to the Fiscal Agent by means of a cash transfer to the Checking Account of the Portfolio Managed by the Fiscal Agent of the FEES. Nevertheless, resources may only be transferred to the Fiscal Agent on business days in the United States of America.

However, the Treasury must instruct contributions and withdrawals at least 3 business days prior according to the calendar of bank holidays in the United States of America and Chile.

b. To accomplish this (and subject to the objectives, guidelines and restrictions established in this document), the Fiscal Agent will have full authority on behalf of the Treasury to make decisions on its investments, sales and other activities that may apply. The Fiscal Agent will be able to select, buy, sell, maintain , tender, redeem or exchange investment instruments of any nature; subscribe instrument issues; make foreign exchange contracts both spot and forward; instruct the custodian to make the payments associated with the completion of the transactions; collect mortgages, interests, repayments and other benefits, and carry out the other operations, acts and contracts that the Fiscal Agent deems appropriate in relation to the administration of the Resources and for the fulfillment of the functions entrusted in this office.

   Likewise, the Fiscal Agent will have the power to execute the acts and contracts referred to in the preceding paragraph through banks, brokers or any other financial intermediaries.

c. The Fiscal Agent may add Resources administration transactions to those that are carried out for the own portfolio, corresponding to the international reserves of the Central Bank of Chile, as well as other fiscal resources administered by the Fiscal Agent. The Fiscal Agent is not entitled to directly acquire for themselves the isolated instruments of the Portfolio Managed by the Fiscal Agent of the FEES on behalf of the Treasury, nor can they directly acquire for the Portfolio Managed by the Fiscal Agent of the FEES the isolated instruments owned by the Central Bank of Chile from their own portfolio.

d. For all legal purposes, the fiscal agent will hold the funds and investments managed in separate accounts, indicating that they are property of the treasury of Chile.

I.3.2. Portfolio Managed by External Managers:

a. Carry out, at the request of the Minister of Finance, one or more tenders for the complete or partial administration of the Portfolio Managed by External Managers Resources and hire them for and on behalf of the Treasury, in accordance with subparagraph a) of Article 15 of the Agency Decree.

b. The net effective profitability obtained from the investments in this portfolio will be considered additional amounts to be managed by the External Managers..

c. The Minister of Finance may modify at any time the amount of the Resources corresponding to the Portfolio Managed by External Managers. If the Minister increases them, the additional resources must be delivered by the Treasury to the External Managers, through the Fiscal Agent, by means of cash transfer to the Checking Account Portfolio Managed by External Managers of the FEES. Despite the previous points, the resources may only be transferred to the External Managers, through the Fiscal Agent, on business days in the United States of America. All in all, the Treasury must instruct contributions and withdrawals at least 3 business days prior according to the calendar of bank holidays in the United States of America and in Chile.

d. The Custodian(s), for all legal purposes, will hold the funds in custody and in separate accounts, indicating that they are the property of the Chilean Treasury.

I.3.3 Rebalancing

The Ministry of Finance and/or the Treasury will instruct the Fiscal Agent the contributions, withdrawals and transfer of resources from the Portfolio Managed by the Fiscal Agent to the Portfolio Managed by External Managers, or vice versa, that are required to achieve compliance with the deviation ranges that are established in the respective investment guidelines, with at least 3 business days in advance, according to the calendar of bank holidays in the United States of America and Chile.

**I.4. Functions related to monitoring and reporting**

I.4.1. Portfolio Managed by the Fiscal Agent:

a. To oversee the Portfolio Resources Managed by the Fiscal Agent, maintain complete and detailed information on all transactions and other operations carried out, in accordance with subsection g) of Article 4 of the Agency Decree.

b. Carry out the supervision, monitoring and evaluation of the Delegated Manager(s) of the Fiscal Agent's performance and the Custodian(s)'s service; establish and clarify, where appropriate, on a daily basis the differences that may arise between the records of the Fiscal Agent, the Delegated Managers and the Custodians, as well as the other discrepancies detected corresponding to the hired services; inform the Minister of Finance, or whoever they designate, to determine the exercise of legal or administrative actions that are appropriate for the defense or protection of the Resources and to enforce the corresponding civil, criminal and administrative responsibilities, by the damages, crimes or infractions committed by the Delegated Managers or the Custodians.

c. Inform the Minister of Finance and the Treasurer, or whoever they designate, through electronic means, the daily position of the investments made with the Resources, with a delay of no more than three business days from the reported date. The obligation of information provided in this letter shall be deemed fulfilled by sending the respective electronic communication in the formats instructed by the Minister of Finance or whoever they designate, under the sole responsibility of the person in charge. In any case, if there are discrepancies between the information sent by the Fiscal Agent and that received by the Ministry of Finance and the Treasury, the information entered in the Fiscal Agent's records will remain.

d. Inform the Minister of Finance and the Treasurer, or whoever they designate, through electronic means, any change or correction regarding the information in subsection c) above, concerning the daily position of the investments made with the Resources.

e. Deliver to the Minister of Finance and the Treasurer, or whoever they designate, monthly, quarterly and annual reports concerning the management of the Portfolio Managed by the Fiscal Agent and an evaluation regarding the Delegated Managers' performance.

f. In addition, a report containing the procedure used by the Custodian (s) and the Fiscal Agent (serving as the basis for preparing management reports) will be delivered annually to the same representatives. Likewise, with the same frequency, both representatives will be provided with a report concerning the Custodian (s)' service. These reports will be prepared by comparing the background and information supplied by the Custodian (s), with the records and background maintained by the Fiscal Agent regarding the Portfolio Managed by the Fiscal Agent. The monthly reports will include a copy of the payment orders associated with the Portfolio Managed by the Fiscal Agent of the FEES and the corresponding invoices, as well as information about any methodological changes in the preparation of the reports.

g. The Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will decide on the quarterly and annual reports referred to in the preceding paragraph, either to approve them or comment on them (by email). Any sort of approval or comment will be sent to the Manager of International Markets and to the Manager of the Financial Markets Division of the Central Bank of Chile within a period of 30 calendar days from the date the report was submitted. In case observations are presented in the terms set forth, which will have to be well-founded and specific, the Fiscal Agent will have a period of 15 calendar days to answer them with the purpose of clarifying or resolving them, as needed. For their part, the Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will decide on the response received, by email, and must approve or reject it with the same requirements previously indicated within 15 calendar days.

h. Write out, maintain and send to the Ministry of Finance (on a monthly basis, at the least) the list of eligible banks and places, according to the criteria indicated in the respective investment regulations included in these guidelines.

i. Meet monthly with staff from the Ministry of Finance to discuss aspects related to the administration of the Portfolio Managed by the Fiscal Agent of the FEES. These meetings will be held within five business days following the delivery of the respective monthly management report prepared by the Fiscal Agent, mentioned in subsection e) above. Despite the abovementioned points, the Ministry of Finance may request additional meetings when deemed appropriate. In coordination with the Fiscal Agent, the Ministry of Finance may participate in organizational instances (telephone calls and meetings) with the Delegated Managers of the Fiscal Agent.

j. As established in Article 7 of the Agency Decree, the Treasury is responsible for the accounting of fiscal resources and the preparation of audited financial statements. However, the administration of the Resources of the Portfolio Managed by the Fiscal Agent will be supervised when determined by the Fiscal Agent in the terms established in its Organic Constitutional Law. Despite the abovementioned points, the Fiscal Agent will require from the Custodians the reports issued by the corresponding supervisory bodies and/or by their external auditors regarding operations with the Portfolio Resources Managed by the Agent at least once a year. However, the Minister of Finance, or whoever they designate, may request from the Fiscal Agent the background on the operations carried out, as well as the processes carried out in the administration of the Portfolio Managed by the Fiscal Agent. In addition, the Fiscal Agent, upon acceptance by the Ministry of Finance, may consider hiring an external expert advisor to evaluate and monitor the management and processes used in the performance of their duties.

I.4.2. Portfolio Managed by External Managers:

a. Verify, in accordance with the standards that the industry normally applies concerning investments in the same type of assets in question, that the Registers of transactions and other operations issued by the External Manager (s) of fiscal resources are consistent in each daily closing as to its nature, that is, regarding its notional amount, term and date, with those reported at said closing by the Custodian (s). For the purposes of subsection a), "daily closing" shall mean the closing of the business day of the Fiscal Agent.

The Fiscal Agent shall subsequently verify closings recorded on non-working days of the Fiscal Agent that are business days of the Custodian or External Managers The Fiscal Agent shall report monthly to the Minister of Finance and the Treasurer, or whoever they designate, the result of said verification. Taking into consideration the previous mentioned points, the Fiscal Agent shall make reconciliations of notional transactions and positions daily and inform the differences that may arise between their Registers and/or the Registers informed by the External Managers with which the Custodians maintain, as well as the other discrepancies corresponding to the hired services, which will be informed to the Minister of Finance, or whoever he designates, to determine the exercise of the legal or administrative actions that proceed for the defense or protection of the Resources and to make effective the civil, penal and administrative responsibilities that correspond for the damages, crimes or infractions committed by the External Managers or the Custodians.

b. For the purposes of this section I.4.2., and in all that concerns the Portfolio Managed by External Managers, "Records" shall be understood as the information received from the External Managers and/or the Custodians, to verify that the Custodians have the same notional positions as reported by the External Manager (s).

c. An annual report will be delivered to the Minister of Finance and the Treasurer, or whoever they designate, containing the methodology used by the Custodian (s) and the Fiscal Agent. This will serve as the basis for preparing management reports. Likewise, with the same frequency, both representatives will be provided with a report on the service provided by the Custodian (s). These reports will be prepared by comparing the background and the information provided by the Custodian (s), with the information submitted by the External Managers in reference to the Portfolio Managed by External Managers. The monthly reports referred to in paragraph a) above will include a copy of the payment orders associated with the Portfolio Managed by External Managers of the FEES and the corresponding invoices, as well as information about any methodological change in the preparation of the reports.

d. The Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will approve or make observations regarding any matter contained in the reports referred to in paragraphs a) and c) above, by email, which will be sent to the Manager of International Markets of the Central Bank of Chile once they decide on the reports of the Portfolio Managed by the Fiscal Agent in accordance with the deadlines and procedures indicated in section I.4.1.g.

e. The Fiscal Agent will require, at least once during the year, from the Custodians, the reports referring to their operations with the Fiscal Resources issued by the corresponding supervisory bodies and/or by their external auditors. Likewise, the Fiscal Agent may consider hiring an external expert advisor to evaluate and follow up on the management and processes used in the performance of their duties by the Custodian (s).

The Fiscal Agent will only perform the functions described in paragraphs a), c) and e) above in relation to the Custodian (s).

## II.- Resource Investment Guidelines

### II.1 Management objective

The objective of Resource management is to obtain exposure to the asset classes detailed in section II.3 in accordance with the specific objectives defined in the investment guidelines established for each of them and indicated in section II.4.

### II.2 Investment portfolio

For the investment of the Resources, an investment portfolio (hereinafter "IP") will be established, made up of the sum of the Portfolio Managed by the Fiscal Agent and the Portfolio Managed by External Managers, whose guidelines, parameters and particular rules are contained in the following sections and in the respective investment guidelines.

### II.3 Asset Classes and Benchmarks

The IP's fiscal resources will be invested in four asset classes: 1) Banking; 2) Treasury Bills and Sovereign Bonds; 3) Inflation-Indexed Sovereign Bonds (all of the above corresponding to the Portfolio Managed by the Fiscal Agent); and 4) Stocks (corresponding to the Portfolio Managed by External Managers).

The comparator benchmark or Benchmarks (hereinafter, the "Benchmarks") associated with each asset class are those identified in Table 1, together with the composition (%) of the total Resources that each asset class must have (hereinafter, the "Referential Composition").

**Table 1: Benchmark Composition and Benchmarks**

| Benchmark Composition | | |
|---|---|---|
| **Asset class** | **Benchmark** | **IP Percentage** |
| Banking | ICE BofaAML US Dollar 3 Month Deposit Bid Rale Average Index | 5.0% |
| | ICE BofaAML Euro Currency 3 Month Deposit Bid Rate Average Index | 6.0% |
| | ICE BofaAML Japanese Yen 3 Month Deposit Bid Rale Average Index | 4.0% |
| | **BANKING TOTAL** | **15.0%** |
| Treasury Bills and Sovereign Bonds | ICE BofaAML US Treasury Bills Index | 6.0% |
| | ICE BofaAML Euro Treasury Bills Index | 7.0% |
| | ICE BofaAML Japan Treasury Bills Index | 6.0% |
| | **Treasury bills** | **19.0%** |
| | Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs. | 26.5% |
| | Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs. | 11.0% |
| | Bloomberg Barclays Global Aggregate - Treasury: Japan 7·10 Yrs. | 10.0% |
| | Bloomberg Barclays Global Aggregate - Treasury: Switzerland 5-10 Yrs. | 7.5% |
| | **Sovereign Bonds** | **55.0%** |
| | **Total Treasury bills and sovereign bonds** | **74.0%** |
| Inflation-Indexed Sovereign Bonds | Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs. | 2.5% |
| | Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs. | 1.0% |
| | **Total Inflation-Indexed Sovereign Bonds** | **3.5%** |
| Stocks | **MSCI All Country World Index· (unhedged with reinvested dividends)** | **7.5%** |
| **TOTAL FEES** | | **100%** |

### II.4 Investment Guidelines

The specific investment guidelines for each asset class are contained in the attached documents indicated below:

Appendix A: Investment Guidelines for Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation.

Appendix B: Stock Investment Guideline.

### II.5 Rebalancing policy.

The rebalancing policy for the FEES requires converging the Referential Composition established in Table 1 in the following situations: i) in the event of a contribution to the FEES and ii) in the event that the deviation ranges indicated are exceeded for three consecutive days in Table 2. Despite the before mentioned points, the Ministry of Finance will determine the specific date of the rebalancing associated with i) and ii) of this paragraph. If situations i) and ii) do not occur, the Ministry of Finance will instruct a rebalancing in the FEES at least once a year and will also monitor compliance with the deviation ranges indicated in Table 2.

**Table 2: Deviation ranges for rebalancing**

| Portfolio | IP Percentage | Deviation range (IP Percentage) |
|---|---|---|
| Portfolio Managed by the Fiscal Agent | 92.5% | 90.5% - 94.5% |
| Portfolio Managed by External Managers | 7.5% | 5.5% - 9.5% |

Nevertheless, when a rebalancing is carried out, the Manager of the Financial Markets Division of the Central Bank of Chile may request, by email, that the Coordinator of International Finance of the Ministry of Finance maintain the relative positions of the Portfolio Managed by the Fiscal Agent in relation to the Benchmark and not having to converge to the Referential Composition established in Table 1. The Coordinator of International Finance of the Ministry must authorize to maintain said positions through email sent to the Manager of the Bank's Financial Markets Division Central of Chile.

**APPENDIX A**
**INVESTMENT GUIDELINE FOR BANKING ASSETS, TREASURY BILLS AND SOVEREIGN BONDS AND SOVEREIGN BONDS INDEXED TO INFLATION**

## 1. Management Objective

The objective of managing the resources of Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation from the Economic and Social Stabilization Fund (FEES) is to obtain total monthly return, before fees, similar to that of benchmark comparators according to a passive management style. The Fiscal Agent will select the necessary investment strategy, within the risk standards established in the guidelines and parameters in section 2 below.

## 2. Guidelines and Parameters

### 2.1. Comparator Benchmark

The Comparator Benchmark associated with the Portfolio of Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation are those presented in Table 1.

**Table 1: Comparator Benchmark**

| Asset class | | Comparator Benchmark(Benchmarks) |
|---|---|---|
| Banking | Time deposits in dollars | ICE BofaAML US Dollar 3 Month Deposit Bid Rate Average Index |
| | Time deposits in euros | ICE BofaAML Euro Currency 3 Month Deposit Bid Rate Average Index |
| | Time deposits in yen | ICE BofaAML Japanese Yen 3 Month Deposit Bid Rate Average Index |
| Treasury Bills and Sovereign Bonds | US Treasury Bills | ICE BofaAML US Treasury Bills Index |
| | German Treasury Bills | ICE BofaAML Euro Treasury Bills Index |
| | Japanese Treasury Bills | ICE BofaAML Japan Treasury Bills Index |
| | US sovereign bonds | Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs |
| | German sovereign bonds | Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs. |
| | Japanese sovereign bonds | Bloomberg Barclays Global Aggregate - Treasury: Japan 7-10 Yrs |
| | Swiss sovereign bonds | Bloomberg Barclays Global Aggregate - Treasury: Switzerland S-ID Yrs. |
| Inflation-Indexed Sovereign Bonds | US Inflation-Indexed Sovereign Bonds) | Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs |
| | German Inflation-Indexed Sovereign Bonds | Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs |

### 2.2. Risk budget

The deviation margins for the Portfolio of Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Inflation-Indexed Bonds under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark. The risk budget is defined in terms of the *ex ante* tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services. For the Portfolio Managed by the Fiscal Agent, a risk budget of 50 basis points of annual tracking error (ex ante) is assigned.

## 2.3. Eligible issuers

### 2.3.1. Bank issuers

Banks with long-term instrument classifications equal to or greater than A- are eligible in at least two of the international risk classifiers Fitch, Moody's and Standard & Poor's. The investment limits per issuer for the eligible risk classifications (between categories AAA and A-) will be those specified in Table 2. It will be calculated each quarter and considering each contribution, based on the final value of the FEES in the previous quarter or the value of the fund the day prior to the contribution adding the amount of said contribution.

**Table 2: Limits by issuer of bank exposure**

| Risk classification | Maximum limit |
|---|---|
| AAA | 3.0% *FEES previous quarter close |
| AA+<br>AA<br>AA- | 2.0% * FEES previous quarter close |
| A+<br>A<br>A- | 1.5% *FEES previous quarter close |

It should be noted that there is a difference between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

### 2.3.2. Treasury Bills and Sovereign Bonds

Sovereign issuers that are part of the corresponding Benchmark will be eligible.

In addition, the Supranational Entities, Agencies and Entities with Explicit State Guarantee that are eligible for investment in the portfolio of the International Reserves invested by the Central Bank of Chile will be considered as eligible issuers.

For the purposes of monitoring the positioning, performance and risk indicators, the instruments issued by Supranational Entities, Agencies and Entities with Explicit State Guarantee with a remaining maturity less than one year will be considered as part of the Treasury Bill portfolio in Table 1. On the other hand, the instruments issued by Supranational Entities, Agencies and Entities with Explicit State Guarantee with a remaining maturity over or equal to one year will be considered as part of the Sovereign Bond portfolio of Table 1.

## 2.4. Eligible currencies

Only the currencies that are part of the corresponding Benchmark will be eligible.

## 2.5. Eligible instruments

The instruments eligible for the Portfolio of Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation will be the following:

a. Banking: only checking account balances in banks, night and weekend deposits, time deposits with a maximum limit of 365 calendar days and certificates of deposit, and checking account balances, time and overnight deposits in central banks will be eligible from authorized countries.

b. Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation: only the instruments that are part of the Benchmark Comparator and those that meet the eligibility criteria of the Benchmark Comparator are eligible. They should therefore be incorporated into the latter at the end of the respective month. If an instrument is not definitely incorporated into the Benchmark as expected for any reason, the Fiscal Agent will have a period of 7 business days to sell said instrument. In addition, instruments that are no longer eligible and that are eliminated from the Reference Comparator will be eligible as a result of their lifetime being less than the minimum required, as long as the issuer remains part of the index.

c. Supranational Entities, Agencies and Entities with Explicit State Guarantee: only discounted letters and notes (including Euro Commercial Papers) will be eligible; "Bullet" bonuses both "Callables" and not "Callables"; whose remaining lifetime, in all cases, is less than or equal to 10 years.

To estimate the maximum investment amount, the maximum limit must be rounded to the ten million.

**2.6. Limits on forward or currency swap operations**

For the Portfolio Managed by the Fiscal Agent, the following regulations are established for the use of exchange hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with bank counterparties that have a risk rating equivalent to at least A- or higher, in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or compensation.

d. The term of these contracts may not exceed 95 calendar days.

e. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in equivalent US$. Because of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

f. Notwithstanding the foregoing, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when hiring a forward or swap that aims to completely or partially close a position associated with another forward or swap, and provided that these contracts include clauses of close-out netting, have the same lifetime and the same currency pair, the counterparty risk will be measured taking into account the total net position of 105 different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ for the entire duration of the contract. For the purposes of section 2.6, letter h., said renewal will also not be considered within the exposure to derivatives.

g. The counterparty risk corresponding to each forward or swap contract will be considered for the purposes of complying with the limits established in Table 2 above.

h. The notional amount of the forward or swap contracts in force may not exceed 4% of the Portfolio Managed by the Fiscal Agent.

i. The notional value of the forwards or swaps that the Fiscal Agent hires with an eligible counterparty may not exceed 1% of the market value of the portfolio. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, these limits per issuer will double for said counterparty, for two business days, counting from the day the forward is renewed. Likewise, for the purposes of calculating the counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in Table 2 above for two business days from the day the forward is renewed.

**2.7. Limits to spot currency operations**

The Fiscal Agent may carry out spot currency transactions with counterparties that have long-term instrument risk ratings in a category equal to or greater than A- in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

**2.8. Limits to investment in Supranational Entities, Agencies and Entities with Explicit State Guarantee.**

The limit that may be invested in instruments issued by Supranational Entities, Agencies and Entities with Explicit State Guarantee with a remaining maturity of less than one year will correspond to a maximum of 3.0% for instruments expressed in US$ and 3.5% for instruments expressed in EUR, both stated as a percentage of the FEES. Investments in JPY will not be allowed for these instruments.

The maximum limit that may be invested in instruments issued by Supranational Entities, Agencies and Entities with Explicit State Guarantee with a remaining maturity greater than or equal to one year will correspond to 2.65% for instruments in US$, 1.10% for EUR, 1.00% for JPY and 0.75% for CHF, all expressed as a percentage of the FEES.

**2.9. Special restrictions**

No part of the portfolio may be invested in any type of instrument of Chilean issuers or in instruments expressed in Chilean pesos. The Fiscal Agent may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed. Debt is not allowed for investment purposes except to cover any failure in the settlement of an Instrument.

**2.10. External cash movements**

External cash movements in the Portfolio of Bank Assets, Treasury Bills and Sovereign Bonds and Sovereign Bonds Indexed to Inflation will result from applying the rebalancing policy to converge the Strategic Composition of Assets of the FEES or withdrawals from the fund.

The rebalancing policy for the FEES requires converging of the Reference Composition in the following situations: i) in the event of a contribution to the FEES and ii) in the event of exceeding the deviation range allowed for said asset class for three consecutive days. Notwithstanding the foregoing, the Ministry of Finance will determine the specific date of rebalancing associated with i) and ii) of this paragraph. If situations i) and ii) do not occur, the Ministry of Finance will instruct a rebalancing in the FEES at least once a year.

Every time a rebalance or withdrawal is materialized from the FEES, the Ministry of Finance will instruct the amounts to be transferred between the External Managers and the Portfolio Managed by the Fiscal Agent. When an external cash contribution is made for the Portfolio Managed by the Fiscal Agent, the Fiscal Agent will be granted a special permit (waiver) of 10 bank business days, from the day of the contribution, regarding the fulfillment of the requirements of the sections 1, 2.2 and the limits of Table 2. When an external cash withdrawal is made for the Portfolio Managed by the Fiscal Agent, the Fiscal Agent will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2 and the limits of Table 2. The special permit may be extended upon request to the Ministry of Finance, justifying the reasons for said extension. If between the date of the cash withdrawal instruction and the withdrawal itself there is a period of less than 10 business days, it will be understood that the special permit will correspond to that term.

Notwithstanding the foregoing, when a rebalance is carried out, the Manager of the Financial Markets Division of the Central Bank of Chile may request, by email, the Coordinator of International Finance of the Ministry of Finance to maintain the relative positions of the Portfolio Managed by the Fiscal Agent in relation to the Benchmark Comparator and not having to converge to the respective Reference Composition. The coordinator of International Finance of the Ministry of Finance must authorize maintaining these positions through email addressed to the Manager of the Financial Markets Division of the Central Bank of Chile.

### 3. Valuation criteria

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of the Custodian Bank. Nevertheless, it is worth stating that the Central Bank of Chile, for internal purposes related to the Portfolio Managed by the Fiscal Agent, may use the same procedure for its own operations corresponding to international reserves, in order to provide compliance with subsection g) of article 4 of the Agency Decree.

### 4. Securities loan program

The Fiscal Agent for the Portfolio Managed by the Internal Fiscal Agent may agree with the Custodian (s) of the FEES securities lending programs (hereinafter, "Programs" or "Securities Lending") provided that the Custodians with whom the Administration of said Programs are obliged to meet the operating criteria established in the Custody Guidelines, especially including the obligation to make the restitution of the respective titles or their market value.

### 5. Others

Foreign exchange operations will be considered spot operations according to the convention used in each market. However, exchange operations that are related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the instrument's settlement period that is being bought or sold.

The base currency of the portfolio for the purpose of the Fiscal Agent’s performance is the United States dollar.

In the event that at any time any of the Instructions described in these guidelines is breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the Fiscal Agent, they will not be considered a breach of the guidelines as long as it takes the necessary measures to ensure compliance within 7 business days after the situation has been detected. The term applicable to the Portfolio Managed by the Fiscal Agent may be extended upon request made by the Fiscal Agent to the Minister of Finance, or whoever they designate, and the reasons for the extension must be justified.

**APPENDIX B**
**STOCKS INVESTMENT GUIDELINE**

**1. Management objective**

The objective of the Economic and Social Stabilization Fund Stocks Portfolio (FEES) resource administration is to obtain total monthly return, before fees, similar to that of the Benchmark Comparator according to a passive administration style, within the standards of risk established in the relevant guidelines and parameters of section 2 below.

**2. Guidelines and parameters**

**2.1. Benchmark Comparator**

The Benchmark Comparator associated with the Stock Portfolio is MSCI ALL Country World/Index Ex-Chile (unhedged with the dividends re-invested) index.

For the purposes of calculating performance and tracking error, the Benchmark will be used before taxes.

**2.2. Risk budget**

The deviation margins for the Portfolio of Stocks under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark Comparator. The risk budget is defined in terms of the ex-ante tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services.

For the Portfolio of Stocks, a risk budget of 60 basis points of annual tracking error (ex-ante) is assigned.

**2.3. Eligible issuers and currencies**

Only the issuers and currencies that are part of the corresponding Benchmark Comparator are eligible.

**2.4 Instruments eligible for Stocks**

The instruments eligible for the Portfolio of Stocks are the following:

a. Instruments that are part of the Benchmark Comparator and those that will be incorporated into the Benchmark Comparator from the moment their inclusion is formally communicated by the supplier of the Benchmark Comparator. If for any reason the instruments are not added to the Benchmark as expected, the External Manager will have 7 business days in the local market to sell said instruments from the date their incorporation was expected.

b. The Ministry of Finance will generate, maintain and communicate to the Fiscal Agent a list of eligible Mutual Funds and Exchange Traded Funds (ETFs), which may also include ETFs advised, under-advised or managed by a subsidiary of the External Manager. The Ministry of Finance may modify the mentioned list from time to time through written means to the External Manager. The External Manager will continue depending on these instructions until notified otherwise by the Ministry of Finance.

c. American Depositary Receipts (ADRs), Global Depository Receipts (GDRs) and other Depositary Receipts traded on the stock exchange, of the stocks that constitute the Benchmark, provided they do not require the use of tax agents in the country of the issuer of the underlying instrument.

d. Futures traded on stock exchange indexes used for hedging reasons that allow minimizing differences with respect to the Benchmark or that allow gaining exposure to part of it. No leverage will be allowed. In other words, the exposure to these derivatives may not exceed the market value of the portion of the underlying assets. If the underlying asset is effective, it must be held in the instruments allowed in section 2.5 below.

### 2.5. Cash eligible instruments

The cash exposure may not exceed 5% of the value of the portfolio under management. The return obtained in cash must be incorporated into the return calculation of the portfolio under management.

Checking account balances, overnight deposits and/or weekend deposits in banks with classifications of long-term instruments in a category equal to or greater than A- will be eligible as cash in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's. The markets eligible for the investment of cash will be those of countries or jurisdictions where the eligible instruments of the respective mandates are listed.

The maximum exposure to an eligible bank issuer is equivalent to 5% of the market value of the portfolio based on its market value at the end of the previous quarter. Nevertheless, each time the External Manager receives a contribution in cash, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for a maximum of 10 business days from the day of the contribution. Furthermore, when the External Manager receives the instruction to produce liquidity for a cash withdrawal, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

### 2.6 Limits on currency forward or swap operations

The External Manager may enter into forward or swap contracts to minimize the differences with respect to the currency composition of the Benchmark Comparator.

The following regulations are established for the use of currency hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with counterparties that have long-term instruments with a risk rating equivalent to at least A- or higher in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or for compensation.

d. The term of these contracts may not exceed 95 calendar days.

e. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in its equivalent in US$. For the purpose of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

f. However, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when entering a forward or swap contract whose objective is to completely or partially close a position associated with another forward or swap, and provided that these contracts include close-out netting clauses, whether they are with the same counterparty, they have the same expiration date and the same currency pair, the counterparty risk will be measured considering the total net position of the different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract for the purpose of measuring counterparty risk.

g. The counterparty risk corresponding to each forward and swap contract will be considered for the purposes of complying with the limits established in section 2.5.

h. The notional value of the forwards or swaps that the External Manager contracts with an eligible counterparty may not exceed 3% of the market value of the portfolio managed by him. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, this limit per issuer will increase to 6% for said counterparty, for two business days, from the day the forward is renewed. Likewise, for the purposes of calculating counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in section 2.5 for two business days, counting from the day the forward is renewed. For the purposes of the third paragraph of section 2.8, said renewal shall also not be considered within the exposure to derivatives.

### 2.7. Limits to spot currency operations

The External Manager may execute spot currency transactions with counterparties that have long-term instrument risk classifications equal to or greater than A- in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor’s.

### 2.8. Special restrictions

It is not allowed to invest in any type of instruments of Chilean issuers or in instruments expressed in Chilean pesos.

The External Manager may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed.

The External Manager may contract futures, forwards or currency swaps whose notional amounts valued at market price and in absolute value, may not in aggregate exceed 10% of the portfolio managed.

Mutual funds and Exchange Traded Funds (ETFs), taken together, may not represent, from the External Manager's portfolio, more than the aggregated shares of Egypt, the Philippines, India, Pakistan, Poland, Russia, Thailand, Taiwan and Turkey in the Benchmark comparator applicable to Stocks plus 2%.

The External Manager may not invest in the local markets of Chile, Egypt, the Philippines, India, Peru, Pakistan, Poland, Russia, Thailand, Taiwan and Turkey. Investments in China may only be made through the Hong Kong exchange or any other exchange in which the stocks of the Benchmark are traded, excluding the local markets of China, provided that the External Manager is authorized to invest in the respective local markets.

The External Stocks Manager may not invest in its own stocks or its affiliates.

Borrowing is not allowed for investment purposes except to cover any failure of an instrument in settlement.

### 2.9. External cash movements

External cash movements in the Portfolio of Stocks will result from the application of the rebalancing policy to converge the Strategic Composition of Assets of the FEES or withdrawals from the fund.

The rebalancing policy for the FEES requires convergence of the Benchmark Composition in the following situations: i) in the event of a contribution to the FEES and ii) in the event that the deviation range allowed for said asset clause has been exceeded for three consecutive days. However, the Ministry of Finance will determine the specific date of the rebalancing associated with i) and ii) of this paragraph. If situations i) and ii) do not occur, the Ministry of Finance will instruct a rebalancing in the FEES at least once a year.

Every time a rebalance or withdrawal occurs from the FEES, the Ministry of Finance will instruct the amounts to transfer to/from and/or between the External Managers, if applicable. When an external cash contribution is made, the External Manager will be granted a special waiver of 10 bank business days, from the day of the contribution, regarding compliance with the requirements of sections 1,2.2, and the first and last paragraph of section 2.5. When an external cash withdrawal is made, the External Manager will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2, and the first and last paragraph of section 2.5. The special permit may be extended at the request of any of them to the Ministry of Finance, justifying the reasons for said extension. If there is a term of less than 10 business days between the date of the cash withdrawal instruction and the withdrawal itself, it will be understood that the special permit will be of that term.

## 3. Valuation criteria

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of Custodian Bank.

## 4. Securities loan program

The External Manager may not carry out or agree on securities lending programs. Nonetheless, the Ministry of Finance understands and accepts that the FEES portfolio may be exposed to a securities lending program through the investment of the ETFs authorized in these guidelines. In addition, the Central Bank of Chile, in its role as Fiscal Agent, may agree with the Custodian (s) of the FEES securities lending programs for the Portfolio of Stocks (hereinafter, "Programs" or "Securities Lending") provided that the Custodians with whom the administration of said Programs are obliged to comply with the operating criteria established in the Custody Guidelines, especially including the obligation to make the restitution of the respective titles or of the market value of themselves.

## 5. Others

Foreign exchange operations will be considered spot operations according to the convention used in each market. However, exchange operations related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purposes of the performance of the External Manager is the US$.

In the event that at any time any of the instructions described in these guidelines are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the External Manager, the latter will not be considered in default of the guidelines if it takes the necessary measures to ensure compliance within seven business days after the situation has been detected. This period may be extended from a request made by the External Manager to the Ministry of Finance, justifying the reason for the extension.

However, the External Manager may temporarily hold received ineligible instruments due to corporate events. The External Manager will have 30 calendar days from the corporate event to sell said instruments. If the above is not possible, the External Manager must notify the Treasury and communicate an action plan for the liquidation of those instruments. In the particular case of entitlements, preferred stocks, rights, warrants or other equivalent instruments received as a result of corporate events that grant the right to buy, exchange for eligible stocks or receive cash, these may be held in the portfolio until their expiration.

The External Manager is expressly authorized to carry out internal cross operations.

Note 4 – SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

4.1. Significant accounting estimates.

Management makes estimates and formulates assumptions about the future. The resulting accounting estimates rarely tend, by definition, to be equivalent to the actual related results. The estimates and assumptions having a significant risk of causing important adjustments to the accounting values of assets and liabilities within the next financial year are described below:

Fair value of instruments are not quoted in an active market, or traded in the stock market.

The fair value of such values not quoted in an active market cannot be determined using sources of price such as pricing agencies or indicative prices of “Market Markers” for bonds and debts, so they are obtained from the Custodian's information.

The models use observable data, as applicable. However, factors such as credit risk (both own and counterparty), volatilities and correlations require the management to make estimates. Changes in the assumptions about these factors may affect the reported fair value of the financial instruments.

Determining what “observable” means requires a significant criteria of the Fund’s management. Thus, observable data are considered to be those market data that can be readily available, regularly distributed or updated, reliable and verifiable, not private (for exclusive use), and provided by independent sources that participate actively in the relevant market.

4.2 Significant judgments when applying accounting policies

*Functional currency*

The Administration considers the US dollar as the currency that most faithfully represents the economic effect of transactions, facts and underlying conditions. The US dollar is the currency in which the contributions from the Chilean State are received.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The ESSF is exposed to different kind of risks due to its investments in different financial instruments. These risks can be categorized as market, counterparty, liquidity and operational risk. Most of these risks depend directly on the compositions by asset class and currency, and the selected benchmarks, especially given the passive emphasis of the Fund's investment policy. Each of these risks and the mechanisms created for each one of them are described in detail below.

5.1 Market Risk

*Market risk* refers to possible losses that may occur in the ESSF as a consequence of changes in the market conditions that affect the value of instruments of its investment portfolio. In the case of this Fund, the main variables that affect its market value are the interest rates, the rate of exchange, credit risk premium (credit spread risk), and the change in the stocks' value.

*Interest rate risk:* The interest rate movements affect directly the price of fixed income instruments. An increase in rates produces a fall in its market value, while the fall of these rates causes a profit. The parameter that measures the sensitivity of a portfolio to a parallel movement of the structure of interest rates is the duration. The longer the duration, the higher the loss risk to which the portfolio is exposed to an increase of interest rates. The ESSF is prepared to tolerate the interest rate risk of the benchmark, which depends on the individual durations of the indexes that comprise it.

*Exchange rate risk:* Since the ESSF return is measured in dollars, the value of investments is also affected by the variations in exchange rates. The portfolio includes, mostly, fixed income that is denominated in dollars, euros, yens and Swiss francs. Moreover, there is a small exposure to other 27 currencies in the equity portfolio.

*Credit risk premium:* The market value of the fixed income instruments of the ESSF are exposed to changes in the market perception about the solvency of the issuers of these instruments. In general, a worsening in the issuer's solvency is related to a credit risk premium in the instruments issued, which originates the fall of its market value. This risk is limited in the ESSF since its fixed income portfolio only includes the USA, Germany, Japan and Switzerland as sovereign issuers. Moreover, since 2015 it is possible to invest in supranational entities, agencies and entities with explicit state guarantees that are eligible to invest in the portfolio of international reserves where the Central Bank of Chile invests, which have a high credit quality.

*Equity risk:* This risk refers to losses the ESSF may suffer as a result of falls in stock prices included in its portfolio. The intrinsic risk of an individual stock is eliminated at investing in a highly diversified portfolio and willing to tolerate the systematic risk related to the used equity index (MSCI ACWI ex Chile). The strategic composition of assets considers between 5 to 10% of the total portfolio of stocks.

## 5.2 Counterparty Risk

The issuer of a fixed income instrument may come into a situation of default if, due to a lack of liquidity or capital, cannot meet its financial obligations. In this way, the resources are exposed to a higher counterparty risk as the probabilities of default of an institution or government that is the payee of the funds' investments increase. In the case of the ESSF, the exposure to this kind of risk is controlled in different ways, depending whether the exposure is sovereign or bank. In the first case, the investment is only allowed in USA, Germany, Japan and Switzerland, countries whose sovereign risk classification is higher than AA-

Moreover, since 2015 it is possible to invest in supranational entities, agencies and entities with explicit state guarantees that are eligible to invest in the portfolio of internationals reserves where the Central Bank of Chile invests, which have a high credit quality. For banks, minimum credit classification and limits to the maximum per counterparty have been defined (see Table 6).

**Table 6:**

| **Risk Class** | **Maximum limit (US$ millions)** |
|---|---|
| AAA | 3.0% *ESSF, previous quarter-end closing (a) |
| AA+<br>AA<br>AA- | 2.0% * ESSF, previous quarter-end closing |
| A+<br>A<br>A- | 1.5% * ESSF, previous quarter-end closing |

(a) IP means investment portfolio.
Source: Ministry of Finance.

On the other hand, the risk rising from executing transactions, that is, the losses that may occur in case that the counterparty does not deliver the instruments when they are purchased or the payment when they are sold, is mitigated through the use of transactional or post-transactional structure that allow the delivery of instruments against payment. Finally, the risk of maintaining the investments under a custodian institution is controlled registering the property of the funds in Treasury's name and in segregated accounts.

## 5.3 Liquidity Risk

The liquidity risk comes from losses that can be generated if it is necessary to sell an instrument in advance to satisfy cash needs. The risk is higher in uncertain situations, since some investment may be exposed to significant discounts in theirs prices as a result of the lack of demand or market depth.

In the ESSF, this risk is mitigated maintaining a high percentage in short-term liquid assets. Treasury Bills, Certificates of Deposit and Time deposits, among others, are considered as liquid assets. All of them are characterized by a lower sensitivity to rate variations. Treasury bills and certificate of deposits can be traded in a market that allows selling them quickly without significant penalties. Time deposits provide liquidity as they reach their maturity date.

## 5.4 Operational Risk

The operational risk refers to losses that may occur as a result of errors in internal processes, systems, external events or human failures. Examples of operational risks are transaction errors, frauds, failures in the execution of legal responsibilities (contracts), etc.

In the case of the portfolio managed by the Central Bank of Chile, the operational administration of the Funds will be made using the same infrastructure of the issuer available for the management of international reserves.

The operational management of the Fund lies in the International Investment Management. The Central Bank of Chile ("BCCh") also has control processes that consider an appropriate separation of responsibilities and duties, computer applications according to market quality standards and backup systems to guarantee the operational continuity of the Fund investment. This is in addition to internal and external audit processes performed at the BCCh in order to assess the efficacy of current controls.

On the other hand, in the case of the portfolio managed by External Managers, this risk is reduced hiring Managers who have wide experience in the area, a high reputation in the market and strong management systems. Likewise, the Managers' performance is overseen and if their job is unsatisfactory, the contract will be terminated.

## NOTE 6 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

a) As of December 31 2019 and 2018, the investments at fair value amount US$ 12,228,943,944 and US$ 14,132,770,624 respectively.

| **Custodian Investment J.P. Morgan** | **Fair Value Hierarchy level** | **2019 US$** | **2018 US$** |
|---|---|---|---|
| Stocks | 1 | 913,294,367 | 905,269,174 |
| Other capitalization instruments | 1 | 21,767,232 | 20,181,112 |
| Government bonds | 1 | 6,716,234,500 | 7,938,699,602 |
| Indexed bonds | 1 | 429,606,972 | 488,297,373 |
| Treasury bills | 1 | 1,386,145,221 | 1,598,802,754 |
| Derivatives | 1 | 122,418 | 150,941 |
| **Subtotal** | | **9,467,170,710** | **10,951,400,956** |

| **Custodian Investment Central Bank of Chile** | **Fair value Hierarchy level** | **2019 US$** | **2018 US$** |
|---|---|---|---|
| Time deposits | 1 | 2,761,773,234 | 3,181,369,668 |
| **Subtotal** | | **2,761,773,234** | **3,181,369,668** |
| **Total** | | **12,228,943,944** | **14,132,770,624** |

b) As of December 31, 2019 and 2018, the detail of investments, in accordance with investment currency, is the following:

| Original currency | Fair value instruments, JP Morgan | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % of IP | US$ | % of IP |
| US dollar | 4,096,180,935 | 43.27 | 4,704,607,339 | 42.96 |
| Euro | 1,712,782,392 | 18.09 | 1,816,765,039 | 16.59 |
| Yen | 2,518,864,270 | 26.61 | 3,132,295,791 | 28.60 |
| Other | 1,139,343,113 | 12.03 | 1,297,732,787 | 11.85 |
| **Subtotal** | **9,467,170,710** | **100.00** | **10,951,400,956** | **100.00** |

| Original currency | Fair value instruments, Central Bank of Chile | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % of IP | US$ | % of IP |
| US dollar | 1,320,029,735 | 47.80 | 1,383,227,847 | 43.48 |
| Euro | 1,441,743,499 | 52.20 | 1,798,141,821 | 56.52 |
| Yen | - | - | - | - |
| Other | - | - | - | - |
| **Subtotal** | **2,761,773,234** | **100.00** | **3,181,369,668** | **100.00** |
| **Total** | **12,228,943,944** | **100.00** | **14,132,770,624** | **100.00** |

c) As of December 31, 2019 and 2018, the total value of assets per risk sector is detailed below:

| Risk sector | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Capitalization instruments | 935,061,599 | 7.65 | 925,450,286 | 6.55 |
| Bank (*) | 2,766,611,190 | 22.61 | 3,186,539,357 | 22.54 |
| Bonds | 8,531,986,693 | 69.74 | 10,025,799,729 | 70.91 |
| **Total** | **12,233,659,482** | **100.00** | **14,137,789,372** | **100.00** |

| Asset class | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Capitalization instruments | 935,061,599 | 7.64 | 925,450,286 | 6.55 |
| Money market (*) | 4,152,756,411 | 33.95 | 4,785,342,111 | 33.85 |
| Sovereign bonds | 6,716,234,500 | 54.90 | 7,938,699,602 | 56.15 |
| Inflation-indexed bonds | 429,606,972 | 3.51 | 488,297,373 | 3.45 |
| **Total** | **12,233,659,482** | **100.00** | **14,137,789,372** | **100.00** |

(*) Including cash and cash equivalents

NOTE 7 – DERIVATIVE FINANCIAL INSTRUMENTS

As of December 31, 2019 and 2018, the derivative financial liabilities at fair value through profit or loss amount US$ 252,995 and US$ 3,942,084 respectively.

a) The detail of derivative (liabilities) is as follows:

| Investment, Custodian J.P. Morgan | Fair value hierarchy level | 2019 US$ | 2018 US$ |
|---|---|---|---|
| Derivatives | 2 | 252,995 | 3,942,084 |
| **Subtotal** | | **252,995** | **3,942,084** |

b) The details of liabilities for derivatives, in accordance with the investment currency is as follows:

| Original currency | Instruments at Fair value, JP Morgan | | | |
|---|---|---|---|---|
| | 2019 | | 2017 | |
| | US$ | % of IP | US$ | % of IP |
| US dollar | 90,355 | 35.71 | 1,516,186 | 38.46 |
| Euro | 54,213 | 21.43 | 758,093 | 19.23 |
| Yen | 72,284 | 28.57 | 1,667,805 | 42.31 |
| Others | 36,143 | 14.29 | - | - |
| **Total** | **252,995** | **100.00** | **3,942,084** | **100.00** |

c) The detail of liabilities for derivatives, classified by risk sector, is as follows:

| Risk sector | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Banking | 252,995 | 100.00 | 3,942,084 | 100.00 |
| **Total** | **252,995** | **100.00** | **3,942,084** | **100.00** |

| Liability class | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Money market | 252,995 | 100.00 | 3,942,084 | 100.00 |
| **Total** | **252,995** | **100.00** | **3,942,084** | **100.00** |

## NOTE 8 – FOUNDATION OF THE FUND

The Fund was founded on September 30, 2006, designating the Central Bank of Chile to manage it as Fiscal Agent, J.P. Morgan as Custodian Bank, and also designating the External Managers. The movements recorded for these entities for the year ended December 31, 2019 and 2018, are as follows:

| | 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Contributions US$ | Withdrawals US$ | Retribution to BCCh as Fiscal Agent (1) US$ | Custody Of the Portfolio Administrated by BCCh US$ | Custody of the portfolios External Managers US$ | BlackRock US$ | Mellon US$ | Rogge US$ | Other US$ |
| January | - | - | - | (129,112) | (67,231) | (129,950) | - | - | - |
| February | - | - | - | - | - | - | (63,649) | - | - |
| March | - | - | (297,450) | (66,941) | (33,092) | - | - | - | - |
| April | - | - | - | - | - | (53,263) | - | - | (40,765) |
| May | - | - | - | (132,164) | (62,075) | - | (65,758) | - | (21,381) |
| June | - | (563,889,347) | (297,450) | (64,014) | (30,006) | - | - | - | - |
| July | - | - | - | - | - | (55,011) | - | - | - |
| August | - | - | - | - | - | - | (69,962) | - | - |
| September | - | - | (297,450) | (65,316) | (30,656) | (57,601) | - | - | - |
| October | - | - | - | (133,447) | (72,235) | - | - | - | - |
| November | - | (1,000,000,000) | - | (132,696) | (71,701) | (59,919) | (71,714) | - | - |
| December | - | (1,000,000,000) | (297,450) | (131,890) | (62,279) | - | - | - | - |
| **Total** | **-** | **(2,563,889,347)** | **(1,189,800)** | **(855,580)** | **(429,275)** | **(355,744)** | **(270,183)** | **-** | **(62,146)** |

(1) Ordinary Official Letter N° 2242 of 20-08-2018 of the Ministry of Finance authorizes retribution payments of 2019, for the services of Portfolio management and others.

| | 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Contributions US$ | Withdrawals US$ | Retribution to BCCh as Fiscal Agent (1) US$ | Custody Of the Portfolio Administrated by BCCh US$ | Custody of the portfolios External Managers US$ | BlackRock US$ | Mellon US$ | Rogge US$ | Others US$ |
| January | - | - | - | - | - | - | - | - | (34,941) |
| February | - | - | - | (134,672) | (66,951) | - | - | - | - |
| March | - | - | (288,287) | - | - | (64,696) | (77,524) | - | - |
| April | - | - | - | (136,041) | (62,094) | - | - | - | (24,518) |
| May | - | - | - | - | - | - | (78,667) | - | - |
| June | - | - | (288,287) | (68,306) | (30,672) | - | - | - | - |
| July | - | - | - | (135,784) | (70,194) | - | - | - | - |
| August | - | - | - | - | - | (65,644) | - | - | - |
| September | - | (541,576,255) | (288,287) | (133,756) | - | - | (78,003) | - | (15,529) |
| October | - | - | - | (66,443) | (64,550) | - | - | - | - |
| November | - | - | - | - | (36,091) | - | - | - | - |
| December | - | - | (288,287) | (63,985) | (75,451) | - | (77,497) | - | - |
| **Total** | **-** | **(541,576,255)** | **(1,153,148)** | **(738,987)** | **(406,003)** | **(130,340)** | **(311,691)** | **-** | **(74,988)** |

(1) Ordinary Official Letter N° 2242 of 20-08-2018 of the Ministry of Finance authorizes retribution payments of 2018, for the services of portfolio management and others.

## NOTE 9 – INTEREST EARNED

As of December 31, 2019 and 2018, the detail of income for interest earned short-term debt at fair value through profit or loss is as follows:

| | **2019 US$** | **2018 US$** |
|---|---|---|
| Interest earned, Portfolio Art. 4 | 144,544,260 | 140,078,412 |
| Interest earned, Externally managed portfolio | (902) | 790,931 |
| **Total** | **144,543,358** | **140,869,343** |

## NOTE 10 – DIVIDEND INCOME

As of December 31 2019 and 2018, the detail of “Dividend income” is as follows:

| Dividend due to investment administrated by | 31/12/2019 US$ | 31/12/2018 US$ |
|---|---|---|
| Fiscal Agent | 1,572,248 | - |
| Mellon Capital Management Corporation | 12,590,719 | 12,990,257 |
| BlackRock Institutional Trust Company, N.A. | 12,575,204 | 13,063,292 |
| **Total** | **26,738,171** | **26,053,549** |

## NOTE 11 – CASH AND CASH EQUIVALENTS

As of December 31, 2019 and 2018, the detail of cash and cash equivalents is as follows:

| Cash in Custodian's and External Manager's accounts | 31/12/2019 US$ | 31/12/2018 US$ |
|---|---|---|
| J.P. Morgan | 933,000 | 927,573 |
| Mellon Capital Management Corporation | 1,209,895 | 1,984,936 |
| BlackRock Institutional Trust Company, N.A. | 2,572,643 | 2,106,239 |
| **Total** | **4,715,538** | **5,018,748** |

## NOTE 12 – PROFITABILITY OF THE FUND

In the years ended December 31, 2019 and 2018, the profitability of the Fund has been as follows:

| Type of Profitability | Accumulated profitability | | |
|---|---|---|---|
| | Current period | Last 12 months | Last 24 months |
| Nominal | 0.65% | 4.77% | 3.74% |

NOTE 13 – FAIR VALUE

The Fund has applied IFRS 13 to determine the fair value of its financial assets and liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB).

The definition of fair value corresponds to the price that would be received for selling an asset or paid for transferring a liability in a transaction between market participants on the date of measure (that is, an input price) The transaction is made in the main or most advantageous market and it is not forced, that is, it does not consider Fund's specific factors that may be included in the real transaction.

| FINANCIAL ASSETS | 31/12/2019 | | | 31/12/2018 | | |
|---|---|---|---|---|---|---|
| | Level | Net Book Value US$ | Fair Value US$ | Level | Net Book Value US$ | Fair Value US$ |
| Cash and cash equivalent. | 1 | 4,715,538 | 4,715,538 | 1 | 5,018,748 | 5,018,748 |
| Stocks | 1 | 913,294,367 | 913,294,367 | 1 | 905,269,174 | 905,269,174 |
| Other capitalization instruments | 1 | 21,767,232 | 21,767,232 | 1 | 20,181,112 | 20,181,112 |
| Time deposits | 1 | 2,761,773,234 | 2,761,773,234 | 2 | 3,181,369,668 | 3,181,369,668 |
| Government bonds | 1 | 6,716,234,500 | 6,716,234,500 | 1 | 7,938,699,602 | 7,938,669,602 |
| Indexed bonds | 1 | 429,606,972 | 429,606,972 | 1 | 488,297,373 | 488,297,373 |
| Treasury bills | 1 | 1,386,145,221 | 1,386,145,221 | 1 | 1,598,802,754 | 1,598,802,754 |
| Commercial papers | 1 | - | - | 1 | - | - |
| Derivatives | 1 | 122,418 | 122,418 | 1 | 150,941 | 150,941 |
| **FINANCIAL LIABILITIES 3,942,084** | | | | | | |
| Derivative financial instruments | 1 | 252,995 | 252,995 | 1 | 3,942,084 | 3,942,084 |

During the years 2019 and 2018, all the assets and liabilities of the Fund have been valued at fair value through profit or loss, using for that purpose, the prices quoted in the stock market (level 1). As of December 31, 2019 and 2018, the Fund has not made transfers of fair value hierarchy.

NOTE 14 – LIENS AND PROHIBITIONS

In accordance with the Official Letter N° 1.267 of June 4, 2013, Title II N° 5 of the Ministry of Finance of Chile, the Fiscal Agent for the Portfolio, Article 4, may arrange with the Fund Custodian(s), securities lending programs, in accordance with the operational criteria established in the Guidelines on Custody of the Fund, including the obligation to return the respective titles or, otherwise, their market value. The resources obtained or disbursed will be registered on the financial statements of the Sovereign Wealth Fund as results of the year.

As of December 31, 2019 and 2018, the Fund has the following instruments as "Securities Lending":

| Year 2019 | | |
|---|---|---|
| **Location** | **Nominal Amounts** | **Market value US$** |
| Europe | 921,809,585 | 1,092,316,016 |
| United States of America | 722,240,381 | 774,177,851 |
| **Total** | **1,644,049,966** | **1,866,493,867** |

| Year 2018 | | |
|---|---|---|
| Location | Nominal Amounts | Market value US$ |
| Europe | 1,408,422,000 | 1,636,796,409 |
| United States of America | 201,046,000 | 208,518,321 |
| **Total** | **1,609,468,000** | **1,845,314,730** |

NOTA 15 – CUSTODY OF SECURITIES

As of December 31, 2019 and 2018, the detail of the custody of securities is as follows:

December 31, 2019:

| | Custody of Securities | | | | | |
|---|---|---|---|---|---|---|
| Entities | Amount in Custody (US$) | National Custody % of total investments in instruments issued by National Issuers | % of total Asset of the Fund | Amount in Custody (US$) | Foreign Custody % of total investments in instruments issued by Foreign Issuers | % of total Asset of the Fund |
| Security Deposit Companies | - | - | - | - | - | - |
| Other entities (*) | - | - | - | 12,228,690,948 | 100.00 | 99,96 |
| **Total portfolio of investments in custody** | **-** | **-** | **-** | **12,228,690,948** | **100.00** | **99,96** |

(*) These amounts are compensated between financial instruments of asset and liability.

December 31, 2018:

| | Custody of Securities | | | | | |
|---|---|---|---|---|---|---|
| Entities | Amount in Custody (US$) | National Custody % of total investments in instruments issued by National Issuers | % of total Asset of the Fund | Amount in Custody (US$) | Foreign Custody % of total investments in instruments issued by Foreign Issuers | % of total Asset of the Fund |
| Security Deposit Companies | - | - | - | - | - | - |
| Other entities (*) | - | - | - | 14,128,878,540 | 100 | 99,96 |
| **Total portfolio of investments in custody** | **-** | **-** | **-** | **14,128,878,540** | **100** | **99,96** |

(*) These amounts are offset between financial instruments of asset and liability.

NOTE 16 – RELEVANT EVENTS

At the closing date of these financial statements, no relevant events that could significantly affect the balance or interpretations of these financial statements have been presented.

NOTE 17 – SUBSEQUENT EVENTS

Between January 1, 2020 and the issuance date of these financial statements (March 25, 2020) there are not significant events that might affect their presentation.

# 10 FINANCIAL STATEMENTS: PENSION RESERVE FUND

Financial statements for the years ended on 31 December 2019 and 2020 and the independent auditors' report [50]

50 The numbering on the pages of this chapter corresponds to the original numbering of the audited financial statements that is independent of the rest of the report.

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INDEPENDENT AUDITOR'S REPORT

Santiago, March 25, 2020

General Treasury of the Republic
Pension Reserve Fund

*Financial statements report*

We have audited the accompanying financial statements of Pension Reserve Fund (hereinafter the "Fund"), which comprise the statements of financial position for the years ended December 31, 2019 and 2018, and the related statements of income and comprehensive income, changes in equity and cash flows for the years then ended and the related notes to the financial statements.

*Management's responsibility for the financial statements*

General Treasury of the Republic is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility involves the design, implementation and maintenance of an internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Auditing Standards generally accepted in Chile. Those standards require that we plan and perform the audit order to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund's preparation and fair presentation of the consolidated financial statements in order to design auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

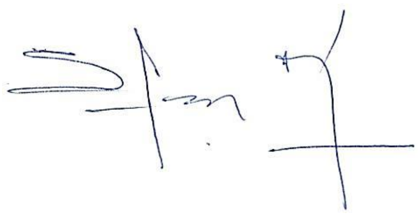
*Opinion*

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Economic and Social Stabilization Fund for the years ended December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

*Other matters*

As indicated in Note 1, the Pension Reserve Fund was set up in order to complement the financing of fiscal obligations derived from the state guarantee for minimum old-age, disability and survivor's pensions, regulated by Decree Law N°3.500 of 1980, and the welfare pensions stipulated in Decree Law N°869 of 1975.

The above translation of the auditor's report is provided as a free translation from the original Spanish language, which is the official and binding version. Such translation has been made solely for the convenience of non-Spanish readers.



Sergio Bascuñán Rivera

PENSION RESERVE FUND

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PENSION RESERVE FUND

STATEMENTS OF FINANCIAL POSITION FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

| ASSETS | Notes | 31/12/2019 | 31/12/2018 |
|---|---|---|---|
| | | US$ | US$ |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | 11 | 44,427,161 | 40,339,768 |
| Total current assets | | 44,427,161 | 40,339,768 |
| FINANCIAL ASSETS THROUGH PROFIT OR LOSS | | | |
| Stocks | 6 | 3,044,464,557 | 1,646,913,209 |
| Other capitalization instruments | 6 | 72,406,412 | 36,863,216 |
| Corporate bonds | 6 | 2,040,701,638 | 1,986,132,197 |
| Time deposits | 6 | - | 288,213 |
| Government bonds | 6 | 4,077,862,200 | 4,732,741,209 |
| Mortgage backed securities (MBS) | 6 | 554,187,511 | - |
| Indexed bonds | 6 | 917,760,925 | 1,219,529,867 |
| Treasury bills | 6 | 58,987,701 | - |
| Derivatives | 6 | 1,426,289 | 699,422 |
| Total investments | | 10,767,797,233 | 9,623,167,333 |
| Total assets | | 10,812,224,394 | 9,663,507,101 |
| | | ============ | =========== |

| LIABILITIES AND NET EQUITY | Notes | 31/12/2019 | 31/12/2018 |
|---|---|---|---|
| | | US$ | US$ |
| LIABILITIES | | | |
| Derivative financial instruments | 7 | 140,315 | 257,583 |
| Total liabilities | | 140,315 | 257,583 |
| NET EQUITY | | | |
| Fiscal resources | | 8,082,197,471 | 8,065,673,883 |
| Fiscal contributions | 8 | 563,889,347 | 541,576,255 |
| Retained earnings | | 1,581,052,047 | 1,945,277,883 |
| (Loss) profit for the year | 8 | 1,161,454,825 | (364,225,836) |
| Fiscal Withdrawals | | (576,509,611) | (525,052,667) |
| Total net equity | | 10,812,084,079 | 9,663,249,518 |
| TOTAL LIABILITIES AND NET EQUITY | | 10,812,224,394 | 9,663,507,101 |
| | | ============ | ============ |

The accompanying notes N° 1 to 17 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENTS OF INCOME

| | Notes | For the years ended 31/12/2019 | 31/12/2018 |
|---|---|---|---|
| | | US$ | US$ |
| OPERATING INCOME | | | |
| Interests earned | 9 | 200,844,318 | 184,883,144 |
| Dividend income | 10 | 64,283,603 | 36,820,694 |
| Net realized gain | | 26,921,015 | - |
| Net unrealized gain | | 876,866,754 | - |
| Total operating income, net | | 1,168,915,690 | 221,703,838 |
| OPERATING LOSSES | | | |
| Net realized loss from sale of financial instruments | | - | (10,860,284) |
| Net unrealized loss from price changes of financial instruments | | - | (570,329,888) |
| Total operating losses, net | | - | (581,190,172) |
| Total operating income, net | | 1,168,915,690 | (359,486,334) |
| ADMINISTRATIVE EXPENSES | | | |
| Fiscal agency expense (Central Bank of Chile) | 8 | (5,034,825) | (2,661,812) |
| Custodian and external managers expenses | 8 | (2,322,776) | (1,540,339) |
| Other expenses | | (102,671) | (537,400) |
| J,P, Morgan adjustment | | (593) | 49 |
| PROFIT (LOSS) FOR THE YEAR | | 1,161,454,825 | (364,225,836) |

The accompanying notes N° 1 to 17 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENTS OF COMPREHENSIVE INCOME

| | For the years ended 31/12/2019 | 31/12/2018 |
|---|---|---|
| | US$ | US$ |
| Profit (Loss) for the year | 1,161,454,825 | (364,225,836) |
| Other comprehensive income reclassified to profit and loss | - | - |
| Other comprehensive income not reclassified to profit and loss | - | - |
| Total comprehensive income | - | - |
| Comprehensive income for the year | 1,161,454,825 | (364,225,836) |
| | ========== | ========== |

The accompanying notes N° 1 to 17 are an integral part of these financial statements

PENSION RESERVE FUND

STATEMENTS OF CHANGES IN NET EQUITY

FOR THE YEARS ENDED

DECEMBER 31, 2019 AND 2018

| | Notes | Fiscal Resources | Retained earnings | Comprehensive income for the year | Total |
|---|---|---|---|---|---|
| | | US$ | US$ | US$ | US$ |
| Beginning balance as of January 1, 2019 | | 8,082,197,471 | 1,945,277,883 | (364,225,836) | 9,663,249,518 |
| Final dividend distribution | | - | (364,225,836) | 364,225,836 | - |
| Fiscal contribution | 9 | 563,889,347 | - | - | 563,889,347 |
| Fiscal withdrawal | 9 | (576,509,611) | - | - | (576,509,611) |
| Loss for the year | | - | - | 1,161,454,825 | 1,161,454,825 |
| Ending balance as of December 31, 2019 | | 8,069,577,207 | 1,581,052,047 | 1,161,454,825 | 10,812,084,079 |
| | | =========== | ========== | ========== | ============ |
| Beginning balance as of January 1, 2018 | | 8,065,673,883 | 987,604,530 | 957,673,353 | 10,010,951,766 |
| Final dividend distribution | | 957,673,353 | (957,673,353) | - | - |
| Fiscal contribution | 9 | 541,576,255 | | - | 541,576,255 |
| Fiscal withdrawal | 9 | (525,052,667) | - | - | (525,052,667) |
| Loss for the year | | - | - | (364,225,836) | (364,225,836) |
| Ending balance as of December 31, 2018 | | 8,082,197,471 | 1,945,277,883 | (364,225,836) | 9,663,249,518 |
| | | =========== | ========== | ========== | ============ |

The accompanying notes N° 1 to 17 are an integral part of these financial statements.

PENSION RESERVE FUND
CASH FLOWS STATEMENTS

(Indirect method)

| | Notes | For the years ended 31/12/2019 | 31/12/2018 |
|---|---|---|---|
| | | US$ | US$ |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit (loss) for the year | | 1,161,454,825 | (364,225,836) |
| Net unrealized loss (profit) | | (876,866,754) | 570,329,888 |
| Changes in Administration and Custody Funds | | (267,880,413) | (208,982,813) |
| Cash flows from operating activities | | 16,707,658 | (2,878,761) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Increase in capital contributions | 8 | (12,6120,265) | 16,523,588 |
| Cash flows from financing activities | | (12,620,265) | 16,523,588 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 4,087,393 | 13,644,827 |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | | 40,339,768 | 26,694,941 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | 11 | 44,427,161 | 40,339,768 |

The accompanying notes N° 1 to 17 are an integral part of these financial statements
.

PENSION RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2019 AND 2018

NOTE 1 – GENERAL INFORMATION

The Pension Reserve Fund (hereinafter the "Fund" or "FRP") was set up under the Law Nº 20.128 on September 30, 2006 of the Chilean Ministry of Finance, for the purpose of complementing the financing of fiscal obligations derived from the state guarantee for minimum old-age, disability and survivor's pensions, regulated by Decree Law N°3.500 of 1980, and the welfare pensions stipulated in Decree Law N°869 of 1975.

The adoption of this Fund has been regulated by the following instructions, provided by the Ministry of Finance:

a) Decree N° 1.618 from April 18, 2013, which authorizes the Central Bank of Chile, as Fiscal Agent, to administrate the Pension Reserve Fund and instructs that it reports about Investments to the Ministry of Finance and the General Treasury of the Republic

b) Decree N° 1.247 from August 31, 2007, which sets the standards, limits, procedures and controls for investments of the Fund's resources.

c) Decree N°1.247 from 2007, which modifies the limits for the Fund's investments.

d) Comptroller General of the Republic's Official Letter N° 71.390 of 2009, which instructs on the valuation criteria of the Fund.

e) Decree N° 1.492 of 2015, which regulates the coordination and operation of advisory activities, supports the management and inspection of financial assets and liabilities of the Public Treasurer, especially, of the Pension Reserve Fund (renders invalid Decree N° 1.636 of 2009).

In article 4 of the mentioned Decree it is possible to highlight the following activities related to the General Treasury of the Republic:

– Account for the investments of the Treasure Resources, as well as the lending operations, in accordance with the accounting and budgetary standards established by the Comptroller General of the Republic and/or the Budget Office, as appropriate.

– Account for the Sovereign Wealth Fund in accordance with international accounting standards or their local equivalent, prepare quarterly and annual financial statements of the Sovereign Wealth Fund in accordance with those standards, and order, charged to the Sovereign Wealth Fund's resources, independent audits of the annual financial statements, all subject to the limit established in Article 7 of this Decree. For that purpose, it will select and hire audit firm or firms among those that are authorized to provide their professional services to entities supervised by the Commission of Banks and Financial Institutions.

– Support the Ministry of Finance in the preparation of Sovereign Wealth Fund's reports and the Report on Public Debts Statistics.

– Verify that nominal and valued records of the investments of the Sovereign Wealth Fund are consistent with the Custodians' records. This activity has been carried out since January 1, 2014 for the portfolios managed by External Managers, and since July 1, 2014 for the portfolios managed by Central Bank of Chile.

– Issue the transfer instructions related to contributions and withdrawals from and to the Sovereign Wealth Funds, pursuant to the instructions given by the Ministry of Finance, validate the payments related to the administration and custody of the Sovereign Wealth Funds, as appropriate, and instruct the Central Bank of Chile the payment of the different services provided by the External Managers.

– Supervise managers' compliance with the investment policy limits of the Sovereign Wealth Funds, in accordance with the controls defined by the Ministry of Public Treasury through resolutions. This activity has been carried out since April 1, 2014 for the portfolios managed by External Managers and since July 1, in the same year for the portfolios managed by the Central Bank of Chile.

– Supervise compliance with standards and limits established by the Ministry of Finance for investments in the capital markets of the Public Treasury resources other than the Sovereign Wealth Fund, and periodically send a report on that matter to the Budget Office and to the Ministry of Finance.

– Keep an updated manual of procedures for the management of all the functions and attributions that are detailed in this article.

– Carry out any other advisory, coordination or management support work necessary for the performance of its duties.

The information provided by the accounting of the Fund, derives from an entity such as the General Treasury of the Republic, whose temporary existence has full force and future projection, so the figures resulting from the accounting process are not referred to estimated realization values.

f) Ordinary Official Letter N° 2.424 of December 6, 2018 that states the new Guidelines on investments for the Pension Reserve Fund. It repeals Ordinary Official Letter N°1925 of 2013.

g) Ordinary Official Letter N° 2.463 of December 13, 2018 stating the new Custodian Guidelines.

h) Ordinary Official Letter N° 69 of January 14, 2019, modifies the ordinary official letter N° 2.463 of 2018 that informs the new Custody Guidelines to the fiscal agent.

i) Decree N° 1.378 of the Ministry of Finance of October 5, 2015 establishing the fiscal policy, in accordance with the provisions of Article 1 of Law N° 20.128

j) Decree N°1.890 of 2018, that reports redistribution of the Fiscal Agent in relation to the Sovereign Wealth Funds.

*Qualitative characteristics of the Fund's financial statements*

i) The Relevance Principle, as a category of the Fund's Financial Statements, from which the Materiality and Relative Importance Principle is inferred implies that in accounting, in order to weight the correct implementation of the principles and rules, it is necessary to always act with practical sense as long as the overall picture of information is not distorted.

ii) Reliability of Information Principle, as a gender category from which the following principles of information are inferred as species: Faithful Representation Principle, Substance over Form Principle, Neutrality Principle, Prudence Principle, and Integrity Principle, within an internal control system mainly based on the Chilean Central Bank verification role of the information prepared by the Custodian Agent, in its capacity as Fiscal Agent.

iii) Comparability principle that constitutes one of the purposes of the Sovereign Wealth Funds' accounting of adhering to the international financial standards, in order to be consistent with global accounting practices.

iv) Understandability Principle to create financial statements of the Sovereign Wealth Funds prepared for general information purposes.

In accordance with Article N°7, of Law N° 20.128, the Ministry of Finance shall commission an actuarial study every three years in order to assess the sustainability of the Pension Fund Reserve.

Likewise, this study shall be developed each time a modification to the minimum or welfare pension is proposed. Except for the automatic readjustment of Article 14, of Decree Law N°2.448 of 1979, and Article 10 of Law N°18.611. The result of these studies shall be included in the records referred to in Article 14 of Constitutional Law N°18.918 of the National Congress.

On December 6, 2018, the Ministry of Finance reported in the Official Letter N°2424 the new Investment Guidelines related to the Pension Reserve Fund resources, which replace and invalidate as appropriate the investment guidelines included in the Official Letter N°1.566 of 2015 of the Ministry of Finance.

In Article 1, number 4 of Decree N°1.618 of 2013 the Fiscal Agent is authorized by the Ministry of Finance to make one or several tenders for the administration of the Externally Managed Portfolio and hire External Managers, on behalf and in representation of the Treasury. Consequently, in 2013 the custodian services of the following External Managers were hired:

- Blackrock Corps
- Blackrock High Yield Bonds
- BNY Mellon Equities.
- Western Assets
- BNP Paribas
- Blackrock Equities.
- Allianz Global Investors
- Nomura Corporate Research and Asset Management

In July, 2016 the Microdata Center of the Department of Economics of the University of Chile issued a report of the Actuarial Study on the Sustainability of the Pension Reserve Fund; the development of the expected projection for the Fund was assessed in different scenarios and for the next 20 years. Accordingly, the Pension Reserve Fund showed a sustainable performance in each one of the scenarios.

NOTE 2 - SIGNIFICANT ACOUNTING POLICIES

The significant accounting policies applied in the preparation of these financial statements are presented below. These policies have been systematically applied to all the activities presented, unless otherwise indicated.

2.1 Basis of preparation

The Fund's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issues by the International Accounting Standard Board (IASB).

Since January 1, 2018, the Fund has applied the IFRS 9, which establish that the debt instruments are measured at amortized cost if and only if: i) The asset is held within the business model whose objective is to hold assets in order to collect contractual cash flows, and ii) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. If one of these criteria is not met, the debt instruments are classified at fair value through profit or loss. However, the Fund may choose to designate at the initial recognition of a debt instrument that meets the criteria of amortized cost to measure it at fair value through profit or loss if at doing it significantly eliminates or reduces an accounting mismatch. In the current period, the Fund has not decided to measure at fair value through profit or loss any debt instruments meeting the amortized cost criteria.

The debt instruments that are subsequently measured at amortized cost are subject to impairment.

Investments in equity instruments (stocks) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for negotiations and is designated by the Fund to be measured at fair value through other comprehensive income. If the equity instrument is designated at fair value through other comprehensive income, all the losses and profits of its valuation, except for the dividend income, which is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and will not be subsequently reclassified to profit or loss.

Financial statements are presented in USA dollars and have been prepared from the Sovereign Wealth Fund information that the Central Bank of Chile, as Fiscal Agent, receives from its Custodian Agent J.P. Morgan Chase & Co.

The financial statements presented by the General Treasury of the Republic for the Fund are:

- Classified Statements of Financial Position.
- Statements of Comprehensive Income.
- Statements of Changes in Equity.
- Statements of Cash Flows.
- Notes to Financial Statements.

2.2 Accounting period

The Financial statements comprise the years between January 1 and December 31, 2019 and 2018.

2.3 Presentation and functional currency

Items included in the Financial Statement of the Fund are recorded using the currency of the primary economic environment in which the Fund operates. Thus, the Fund's values are presented in US dollars, defined as the presentation and functional currency.

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Transactions in foreign currencies, other than US dollar, are translated to the functional currency at the rate current at the time of the transaction. Exchange differences arising when monetary items are settled or when monetary items are translated at closing rates are recognized in the statement of comprehensive income.

## 2.4 Classification and valuation of investments

Investments of the Sovereign Wealth Funds are liquid assets in foreign currency made by the Central Bank of Chile, as Fiscal Agent, through eligible intermediaries, such as Banks and Financial Institutions, in order to capitalize fiscal resources, which are immediately available to finance the activities of the Sovereign Wealth Funds.

*Financial Assets and liabilities, Classification and measurement*

As of January 1, 2018, the Fund has applied the provisions in IFRS 9, which establishes that for the purposes of classification and measurement of its financial assets, the Fund must consider its business model to manage its financial instruments and the characteristics of the contractual flows of those instruments. The fund has classified its financial assets in the following categories:

*Financial assets at amortized cost*

This category classifies those financial instruments that are held within a business model whose objective is to hold them in order to collect contractual cash flows. Likewise, the contractual terms of the financial asset give rise, on specified dates to cash flows that correspond to payments of principal and interests.

*Financial assets at fair value through other comprehensive income*

This category classifies those financial instruments that are held in a business model whose objective is achieved by both collecting contractual cash flows and selling those financial assets. Likewise, the contractual conditions of the financial asset give rise on specified dates to cash flows that correspond to payments of principal and interests. Additionally, the Fund may choose to designate investments in equity instruments, as financial assets at fair value through other comprehensive income. In any other case, they are recorded at fair value through profit or loss.

*Financial assets at fair value through profit or loss*

Financial assets are measured at fair value through profit or loss, unless they are classified at amortized cost or at fair value through other comprehensive income. Additionally, the Fund can make an irrevocable designation at the moment of initial recognition, as financial asset at fair value through profit or loss, if this eliminates accounting mismatch. The Fund adopted the policy of not using hedge accounting.

The purpose of the Fund is to obtain monthly returns similar to those of benchmark comparator, according to a passive management style, for which investment strategies that allow the achievement of this purpose are selected.

The Fund classifies in this category the following instruments: Government Bonds, Mortgage Backed Securities (MBS), High- Performance Bonds, Inflation-indexed Bonds, Time deposits, Common and Preferred stocks, ADR, GDR, REIT, ETF, RIGHT, Treasury bills, Commercial Papers and Derivative Instruments. The basis of classification within this investment category are that the instruments have a reasonably active secondary market, under normal conditions, and that are consistent with the provisions of ORD 68 of January 11, 2019, in which the Execution Guidelines related to the Fund's resources are established. These investments are recorded at their fair value through profit or loss.

The determination of fair values is made by the Custodian, using the last transaction price of the closing day in the market where they are traded.

*Financial liabilities*

The Fund classifies its liabilities at amortized cost, except:

- Financial liabilities at fair value through profit or loss, including derivatives which are measured after the fair value.
- Financial liabilities that arise when an asset transfer does not qualify for derecognition or are recorded under the continuing involvement approach.
- Financial liabilities that arise from financial guarantee contracts.
- Financial liabilities that arise from commitments to provide loans at a below-market interest rate.
- Financial liabilities from a business combination.

The Fund may, at initial recognition, designate a financial liability at fair value through profit or loss, if that eliminates an accounting mismatch or a group of financial instruments is managed and measured at fair value as part of its business model.

*Recognition, derecognition and measurement*

Investment purchases and sales in regular bases are recognized on the transaction date, when the Fund agrees to buy or sell the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are expensed as incurred in the income statement, in the case of assets and liabilities at fair value through profit or loss, and they are registered as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are those incurred to acquire financial assets or liabilities. They include fees, commissions and other concepts related to the operation paid to agents, advisors, brokers and operators.

Financial assets are derecognized when the right to receive cash flows from the investments has expired or the Fund has significantly transferred all the risks and benefits related to its ownership.

Following the initial recognition, all the financial assets and financial liabilities at fair value through profit or loss are measured at fair value. Profits and losses arising on changes in the fair value of the category "Financial assets or financial liabilities at fair value through profit or loss" are presented in the Statements of Income.

Dividend income from financial assets at fair value through profit or loss are recognized in results within "Dividend income" when the right of the Fund to receive its payment is established. Interests over debt security at fair value through profit or loss is recognized in results within "Interests and Adjustments" according to the effective interest rate.

Financial assets at amortized cost and other liabilities are valued after their initial recognition, based on the effective interest method. Accrued interests and adjustments are recorded in "Interests earned" of the Statement of Comprehensive Income.

The effective interest method is used to calculate the amortized cost of a financial asset or liability and to assign financial income or expenses in the corresponding period. The effective interest is the rate that discounts the expected future cash inflows or outflows expected over the life of the financial instrument, or when appropriate, a shorter period in respect to the book value of the financial asset or liability. On calculating the type of effective interest, the Fund estimates cash flows considering all the contractual terms of the financial instrument, but it does not consider future credit losses.

The calculation includes all the fees and percent points paid or received among the contracting parties that are a comprehensive part of the type of effective interest, transaction costs and all the other premiums or discounts.

*Fair value estimate*

The fair value of financial assets and liabilities traded in active markets (such as derivatives and investments to negotiate) is based on quoted markets prices on the date of the statement of financial position; quoted market prices used for financial assets maintained by the Fund is the purchase price; the quoted market price appropriate for financial liabilities is the asking price (in case purchase and asking prices are different). When the Fund maintains derivative financial instruments paid through compensation, it uses intermediate market prices as a basis to establish fair values in order to compensate the risk positions, and applies this purchase or asking price to the net open position, as appropriate.

The fair value hierarchy will have the following levels:

a) Quoted prices (without adjustment) in active markets for identical assets and liabilities (Level 1).

b) Variables other than the quoted prices within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (Level 2); and

Variables used for asset or liability that are not based on observable market data (unobservable variables) (Level 3).

2.5 Cash

In preparing the Financial Statements of the Fund, a distinction is made between the cash in current account of the General Treasury of the Republic held for the Funds, and the cash held by the Custodian from operations of the Fund's administration.

2.6 Administration Funds

They represent securities delivered to the Central Bank of Chile, in its capacity as Fiscal Agent, to J.P. Morgan, as Custodian Bank, and to External Managers for the management of the Fund's resources, securities that can be partially or totally disposed for the entrusted work.

2.7 Fund in custody

They represent securities delivered by the Central Bank of Chile, in its capacity as Fiscal Agent, to J.P. Morgan Chase & Co., and to External Managers providing global custody services of the securities and instruments of the Fund.

2.8 Net equity

The net equity of the Fund is composed by the initial balance of Total Assets at par value plus Fiscal contributions minus Fiscal Withdrawals, including the profit or loss for the year.

According to the dispositions in articles N° 6 and 7 of Law N°20.128, the Reserve Fund will be constituted and increased with the following contributions:

a) A contribution equivalent to the effective surplus and up to 0,5% of the Gross Domestic Product (GDP) of the previous year. If the resulting amount of the annual contribution mentioned in the previous paragraph was less than 0.2% of the GDP of the previous year, an annual contribution would be paid in order to reach the 0,2% annual contribution of the GDP of the previous year.

The amount referred to in this letter shall be paid to the Reserve Fund within the first semester of each year, through one or more deposits until the total is reached.

b) Through the product of the investment profitability of the resources of the Reserve Fund, and
c) Through the other contribution stated by Law.

The contribution referred to in letter a) shall be made only until the accumulated resources in the Reserve Fund reach an amount equivalent to UF900.000.000. Once that amount is reached, the obligation will be met, consequently no other contribution shall be made under this concept.

The resources of the Fund will have as a single objective to complement the payment of obligations referred to in the objective of the Fund. And they shall be used exclusively for this purpose after ten years Law 20.128 came into effect.

The Reserve Fund will be extinguished in its full right, if after fifteen years Law N°20.128 came into effect, the drafts to be made in a calendar year are below a 5% of the amount of expense in state guarantee for minimum pensions and in welfare pensions as considered in the Budget Law of that year.

2.9 Statements of Cash Flows

To prepare the Statements of Cash Flows, the Sovereign Wealth Fund has defined the following considerations:

– Cash and cash equivalents include cash on hand, time deposits in credit institutions and other highly-liquid short term investments.

– Cash flow from operating activities includes administrative expenses of the operation of Sovereign Wealth Funds.

– Cash flow from financing activities includes activities producing changes in the size and composition of net equity, such as income from fiscal contributions and expenses due to fiscal withdrawal.

The Fund uses the indirect method to prepare the Statements of Cash Flows, for which purpose the operational net result, formed by costs incurred in the year due to administration expenses, commissions and insurance, and the financing net result due to the difference in fiscal contributions of the year are considered as components of the annual fund variation.

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are compensated and the net amount is reported in the statement of financial position when there is a legal right to offset recognized amounts and there is an intention to settle on a net basis or to realize the asset make and settle the liability simultaneously.

2.11 New accounting pronouncements

2.11. 1 New pronouncements that are not yet effective

At the issuance date of these Consolidated Financial Statements, new standards, amendments and interpretations have been issued to the current standards that are not yet effective and the Company has not early adopted any standard or that has been applied when appropriate.

The following standards, amendments and interpretations are effective for annual periods beginning on the dates included below:

| | **New Standard, Amendments and Interpretations** | **Effective for annual periods beginning on:** |
|---|---|---|
| Amendments to IAS 1 and IAS 8 | Presentation of Financial Statements and accounting policies, changes in estimates and accounting errors. | January 1, 2020 |
| Amendments to IAS 39, IFRS 7 and IFRS 9 | Reform to the reference interest rate. | January 1, 2020 |
| Amendments to IFRS 3 | Definition of a business | January 1, 2020 |
| IFRS 17 | Insurance contract | January 1, 2021 |

The management of the Fund estimates that the adoption of these new Standards, Amendments and Interpretations will not have a significant impact on financial statements.

2.11.2 Standards that have been used in the preparation of these financial statements.

IAS 12 Income tax

In January 2016, the IASB issued amendments to the IAS 12, which clarify the requirements for the recognition of assets for deferred taxes that correspond to debt instruments measured at fair value. Their recognition should be assessed as long as it is probable that the entity has future fiscal income to use the deductible temporary difference.

This amendment did not affect the financial statements of the Fund.

IFRS 9 Financial instruments

On July 24, 2014, the IFRS finished its project to improve the financial instruments accounting by publishing the IFRS 9 Financial instruments. This standard includes new requirements based on principles for classification and measurement, introduces a “prospective” model of expected credit losses for accounting the impairment and changes in hedge accounting..

The classification designation determines how the financial assets and liabilities are accounted in the financial statements and, in particular, how they are measured. The IFRS 9 introduces a new approach to classify financial assets, based on the business model of the entity for the financial assets management and the characteristics of their contractual flows.

About impairment, the standards establish a unique model that will be applied to all the financial instruments, eliminating the complexities associated to prior accounting requirements, which will require timely recognition of expected credit losses.

IFRS 9 introduces adjustments to regulatory requirements for hedge accounting, as well as new strategy alternatives, the new dispositions represent an important revision of hedge accounting, to align the accounting treatment with the risk management activities, allowing the entities to better reflect these activities in their financial statements. Moreover, as a result of these changes, the financial statements users will receive better information about the risk management and the effect of hedge accounting on financial statements.

This standard also establishes that the change in the fair value that corresponds to the own credit risk will be registered in other comprehensive income, allowing to decrease any eventual volatility that could rise in the results of the entity due to its recognition. The anticipated application of this improvement is allowed before any other requirement of the IFRS 9.

The mandatory application date was January 1, 2018, allowing its early application.

IFRS 15 Revenue from contracts with customers

In May 2014, IFRS 15 was issued, which purpose is to establish the principles an entity should apply to present useful information to financial statements users about the nature, amount, opportunity and uncertainty of income from ordinary activities and cash flows rising from a contract with customers. This new standard replaced the following current standards and interpretation: IAS 8 Revenue, IAS 11 Construction contracts, IFRIC 13 Costumer loyalty programs, IFRIC 15 Agreements for the construction of real estate, IFRIC 18 Transfers of assets from costumers, and SIC 31 Revenue – Barter transactions involving advertising services. The new model applies to all the contracts with clients except for those within the scope of other IFRS, such as leases, insurance contracts and financial instruments.

On April 12, 2016, IASB published amendments to IFRS 15, clarifying requirements for the implementation of the new standards. These amendments clarify how:

- To identify a performance obligation (the promise to transfer a good or service to a customer) in a contract;
- To determine whether a company is the principal (the provider of a good or service) or an agent (responsible for organizing the good or service provided); and
- To determine whether the product of granting a license must be recognized at a point in time or over time.

The application date of this new standard was as of January 1, 2018, allowing its early application. The adoption of IFRS 15 does not have significant impacts on the financial position or results of the operations of the Fund

NOTE 3 - INVESTMENT GUIDELINES OF THE PENSION RESERVE FUND

**I.- Functions entrusted to the Fiscal Agent**

In accordance with the provisions of articles 4 and 15 of the Agency Decree, the Fiscal Agent is entrusted with the functions indicated below. For these purposes, two portfolios are distinguished: on the one hand, the portfolio of article 4 of the Agency Decree (hereinafter, the "Portfolio Managed by the Fiscal Agent"), which is in turn divided into the portfolio where Resources are directly managed by the Fiscal Agent ( hereinafter, the “Portfolio Managed by the Internal Fiscal Agent”) and the Portfolio where the resources are managed by delegation of the Fiscal Agent to external delegated managers (hereinafter, the “Portfolio Managed by the Delegated Fiscal Agent”), and, on the other hand, the portfolio corresponding to article 15 of the Agency Decree, whose Resources are managed by external managers of the Treasury (hereinafter, the "Portfolio Managed by External Managers").

**I.1. Functions related to checking accounts at the Central Bank of Chile**

I.1.1. Portfolio Managed by the Fiscal Agent:

a. Open and maintain a checking account at the Central Bank of Chile on behalf of the General Treasury of the Republic (hereinafter, the "Treasury") for the Resources (hereinafter, the "Checking Account Portfolio Managed by the Fiscal Agent of the FRP").

b. Receive, register and deposit in the Checking Account Portfolio Managed by the Fiscal Agent of the FRP, the sums of money transferred to it by the Treasury, in order to apply them to the administrative order conferred on the Fiscal Agent.

c. Receive, register and deposit in the Checking Account Portfolio Managed by the Fiscal Agent of the FRP, the sums of money that come from the investment or liquidation of the Resources and that are going to be transferred to the Treasury, to other portfolios, to the Checking Account Portfolio Managed by External Managers of the FRP for purposes of payments to third parties corresponding to said portfolio or to whom the Minister of Finance indicates, either during the term of the Fiscal Agency or at its end.

d. For the account and on behalf of the Treasury, make the corresponding payments in relation to the administration or custody of the Resources, in the terms provided in subparagraph f) of article 4 of the Agency Decree.

e. Report daily account activity through electronic communication to the Minister of Finance and the General Treasurer of the Republic (hereinafter, the "Treasurer"), or whoever they designate.

I.1.2. Portfolio Managed by External Managers:

a. Open and maintain a checking account at the Central Bank of Chile on behalf of the Treasury for Resources (hereinafter, the "Checking Account Portfolio Managed by External Directors of the FRP").

b. Receive, register and deposit in the Checking Account Portfolio Managed by External Managers of the FRP, the sums of money transferred to it by the Treasury, in order to apply them to the administration order conferred on the External Managers.

c. Receive, register and deposit in the Checking Account Portfolio Managed by External Managers of the FRP, the sums of money coming from the investment or liquidation of the Resources and that will be transferred to the Treasury, other portfolios or to whom the Minister of Finance indicates, either during the term of the Fiscal Agency or at its end.

d. Make the payments that correspond to the custody of the Resources for and on behalf of the Treasury, in the terms provided in subparagraph e) of article 15 of the Agency Decree

e. Make payments for and on behalf of the Treasury to the External Directors or other third parties prior instruction from the Treasury.

f. Report daily account activity through electronic communication to the Minister of Finance and the Treasurer, or whoever they designate.

**I.2. Custody-related functions**

I.2.1. Portfolio Managed by the Fiscal Agent:

On behalf of the Treasury, hire one or more foreign financial institutions or security depositories, to provide the Treasury with custody services for the instruments acquired by the Resources (hereinafter, the "Custodians"), in accordance with subparagraph (d) of article 4 of the Agency Decree and with the Custody Guidelines that are in force. Likewise, hire, on behalf of the Treasury, related complementary services, such as tax counselling or international consulting.

I.2.2. Portfolio Managed by External Managers:

On behalf of the Treasury, hire one or more foreign financial institutions or security depositories, that provide the Treasury with custody services for the securities and instruments acquired by the Resources, in accordance with subparagraph (c) of article 15 of the Agency Decree and with the Custody Guidelines that are in force. Likewise, hire, on behalf of the Treasury, related complementary services, such as tax counseling or international consulting.

**I.3. Administration related functions**

**I.3.1. Portfolio Managed by the Fiscal Agent**:

a. The Fiscal Agent will administer, in representation and on behalf of the Treasury, all or part of the Portfolio Resources Managed by the Fiscal Agent

   In the same capacity, the Fiscal Agent will be authorized to delegate to one or more legal persons, national or foreign (hereinafter, the "Delegated Managers"), the portfolio administration of a part or of the total of the Resources administered by the Agent. Fiscal.

   The Delegated Managers must be selected, in accordance with the Ministry of Finance’s requirements, and hired by the Fiscal Agent on behalf of and representing the Treasury, using its internal procedures and standards, having previously received the approval of the Ministry of Finance, in order to comply with these guidelines.

   The net effective returns obtained from the Resources investments will be considered additional amounts and will be managed by the Fiscal Agent.

   The Minister of Finance may modify at any time the amount of the Resources corresponding to the Portfolio Managed by the Fiscal Agent. If it increases, the additional resources must be delivered by the Treasury to the Fiscal Agent by means of a cash transfer to the Checking Account of the Portfolio Managed by the Fiscal Agent of the FRP. Nevertheless, resources may only be transferred to the Fiscal Agent on business days in the United States of America.

Likewise, subject to the previous authorization of the Minister of Finance, and based on the provisions of Article 4, letter ( f ), of Decree Law N°1 of 2005, of the Ministry of Finance, all or part of the contributions to the FRP may come from the Economic and Social Stabilization Fund (hereinafter, “FEES”). In such case, the Fiscal Agent will be authorized to determine if the contributions from the FEES, shall be made through direct transfer of financial instruments from the Portfolio Managed by the Fiscal Agent of the FEES to the Portfolio Managed by the Fiscal Agent of the FRP, as well as through the transfer of the cash resulting from the settlement of those instruments. In order to value the instruments contributed from the FEES to the FRP the price of the business day previous to such transfer in accordance with the criteria stated in the corresponding investment guidelines. However, the Treasury shall instruct the contributions and withdrawals at least three business days prior to the date they are disbursed in accordance with the calendar of bank holidays in the United States of America and Chile.

b. To accomplish this (and subject to the objectives, guidelines and restrictions established in this document), the Fiscal Agent will have full authority on behalf of the Treasury to make decisions on its investments, sales and other activities that may apply. The Fiscal Agent will be able to select, buy, sell, maintain , tender, redeem or exchange investment instruments of any nature; subscribe instrument issues; make foreign currency contracts both spot and forward; instruct the custodian to make the payments associated with the completion of the transactions; collect mortgages, interests, repayments and other benefits, and carry out the other operations, acts and contracts that the Fiscal Agent deems appropriate in relation to the administration of the Resources and for the fulfillment of the functions entrusted in this office.

   Likewise, the Fiscal Agent will have the power to execute the acts and contracts referred to in the preceding paragraph through banks, brokers or any other financial intermediaries.

c. The Fiscal Agent may add Resources administration transactions to those that are carried out for the own portfolio, corresponding to the international reserves of the Central Bank of Chile, as well as other fiscal resources administered by the Fiscal Agent. The Fiscal Agent is not entitled to directly acquire for themselves the isolated instruments of the Portfolio Managed by the Fiscal Agent of the FEES on behalf of the Treasury, nor can they directly acquire for the Portfolio Managed by the Fiscal Agent of the FEES the isolated instruments owned by the Central Bank of Chile from their own portfolio.

d. For all legal purposes, the fiscal agent will hold the funds and investments managed in separate accounts, indicating that they are property of the treasury of Chile..

**I.3.2. Portfolio Managed by External Managers:**

a. Carry out, at the request of the Minister of Finance, one or more tenders for the complete or partial administration of the Portfolio Managed by External Managers Resources and hire them for and on behalf of the Treasury, in accordance with subparagraph a) of Article 15 of the Agency Decree.

b. The net effective profitability obtained from the investments in this portfolio will be considered additional amounts to be managed by the External Managers..

c. The Minister of Finance may modify at any time the amount of the Resources corresponding to the Portfolio Managed by External Managers. If the Minister increases them, the additional resources must be delivered by the Treasury to the External Managers, through the Fiscal Agent, by means of cash transfer to the Checking Account Portfolio Managed by External Managers of the FRP. Despite the previous points, the resources may only be transferred to the External Managers, through the Fiscal Agent, on business days in the United States of America. All in all, the Treasury must instruct contributions and withdrawals at least 3 business days prior according to the calendar of bank holidays in the United States of America and in Chile.

d. The Custodian(s), for all legal purposes, will hold the funds in custody and in separate accounts, indicating that they are the property of the Chilean Treasury.

### I.3.3 Rebalancing

The Ministry of Finance and/or the Treasury will instruct the Fiscal Agent the contributions, withdrawals and transfer of resources from the Portfolio Managed by the Fiscal Agent to the Portfolio Managed by External Managers, or vice versa, that are required to achieve compliance with the deviation ranges that are established in the respective investment guidelines, with at least 3 business days in advance, according to the calendar of bank holidays in the United States of America and Chile.

### I.4. Functions related to monitoring and reporting

I.4.1. Portfolio Managed by the Fiscal Agent:

a. To oversee the Portfolio Resources Managed by the Fiscal Agent, maintain complete and detailed information on all transactions and other operations carried out, in accordance with subsection g) of Article 4 of the Agency Decree.

b. Carry out the supervision, monitoring and evaluation of the Delegated Manager(s) of the Fiscal Agent's performance and the Custodian(s)'s service; establish and clarify, where appropriate, on a daily basis the differences that may arise between the records of the Fiscal Agent, the Delegated Managers and the Custodians, as well as the other discrepancies detected corresponding to the hired services; inform the Minister of Finance, or whoever they designate, to determine the exercise of legal or administrative actions that are appropriate for the defense or protection of the Resources and to enforce the corresponding civil, criminal and administrative responsibilities, by the damages, crimes or infractions committed by the Delegated Managers or the Custodians.

c. Inform the Minister of Finance and the Treasurer, or whoever they designate, through electronic means, the daily position of the investments made with the Resources, with a delay of no more than three business days from the reported date. The obligation of information provided in this letter shall be deemed fulfilled by sending the respective electronic communication in the formats instructed by the Minister of Finance or whoever they designate, under the sole responsibility of the person in charge. In any case, if there are discrepancies between the information sent by the Fiscal Agent and that received by the Ministry of Finance and the Treasury, the information entered in the Fiscal Agent's records will remain.

d. Inform the Minister of Finance and the Treasurer, or whoever they designate, through electronic means, any change or correction regarding the information in subsection c) above, concerning the daily position of the investments made with the Resources.

e. Deliver to the Minister of Finance and the Treasurer, or whoever they designate, monthly, quarterly and annual reports concerning the management of the Portfolio Managed by the Fiscal Agent and an evaluation regarding the Delegated Managers' performance.

f. In addition, a report containing the procedure used by the Custodian (s) and the Fiscal Agent (serving as the basis for preparing management reports) will be delivered annually to the same representatives. Likewise, with the same frequency, both representatives will be provided with a report concerning the Custodian (s)' service. These reports will be prepared by comparing the background and information supplied by the Custodian (s), with the records and background maintained by the Fiscal Agent regarding the Portfolio Managed by the Fiscal Agent. The monthly reports will include a copy of the payment orders associated with the Portfolio Managed by the Fiscal Agent of the FEES and the corresponding invoices, as well as information about any methodological changes in the preparation of the reports.

g. The Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will decide on the quarterly and annual reports referred to in the preceding paragraph, either to approve them or comment on them (by email). Any sort of approval or comment will be sent to the

Manager of International Markets and to the Manager of the Financial Markets Division of the Central Bank of Chile within a period of 30 calendar days from the date the report was submitted. In case observations are presented in the terms set forth, which will have to be well-founded and specific, the Fiscal Agent will have a period of 15 calendar days to answer them with the purpose of clarifying or resolving them, as needed. For their part, the Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will decide on the response received, by email, and must approve or reject it with the same requirements previously indicated within 15 calendar days.

h. Write out, maintain and send to the Ministry of Finance (on a monthly basis, at the least) the list of eligible banks and places, according to the criteria indicated in the respective investment regulations included in these guidelines.

i. Meet monthly with staff from the Ministry of Finance to discuss aspects related to the administration of the Portfolio Managed by the Fiscal Agent of the FEES. These meetings will be held within five business days following the delivery of the respective monthly management report prepared by the Fiscal Agent, mentioned in subsection e) above. Despite the abovementioned points, the Ministry of Finance may request additional meetings when deemed appropriate. In coordination with the Fiscal Agent, the Ministry of Finance may participate in organizational instances (telephone calls and meetings) with the Delegated Managers of the Fiscal Agent.

j. As established in Article 7 of the Agency Decree, the Treasury is responsible for the accounting of fiscal resources and the preparation of audited financial statements. However, the administration of the Resources of the Portfolio Managed by the Fiscal Agent will be supervised when determined by the Fiscal Agent in the terms established in its Organic Constitutional Law. Despite the abovementioned points, the Fiscal Agent will require from the Custodians the reports issued by the corresponding supervisory bodies and/or by their external auditors regarding operations with the Portfolio Resources Managed by the Agent at least once a year. However, the Minister of Finance, or whoever they designate, may request from the Fiscal Agent the background on the operations carried out, as well as the processes carried out in the administration of the Portfolio Managed by the Fiscal Agent. In addition, the Fiscal Agent, upon acceptance by the Ministry of Finance, may consider hiring an external expert advisor to evaluate and monitor the management and processes used in the performance of their duties.

I.4.2. Portfolio Managed by External Managers:

a. Verify, in accordance with the standards that the industry normally applies concerning investments in the same type of assets in question, that the Registers of transactions and other operations issued by the External Manager (s) of fiscal resources are consistent in each daily closing as to its nature, that is, regarding its notional amount, term and date, with those reported at said closing by the Custodian (s). For the purposes of subsection a), "daily closing" shall mean the closing of the business day of the Fiscal Agent.

   The Fiscal Agent shall subsequently verify closings recorded on non-working days of the Fiscal Agent that are business days of the Custodian or External Managers The Fiscal Agent shall report monthly to the Minister of Finance and the Treasurer, or whoever they designate, the result of said verification. Taking into consideration the previous mentioned points, the Fiscal Agent shall make reconciliations of notional transactions and positions daily and inform the differences that may arise between their Registers and/or the Registers informed by the External Managers with which the Custodians maintain, as well as the other discrepancies corresponding to the hired services, which will be informed to the Minister of Finance, or whoever he designates, to determine the exercise of the legal or administrative actions that proceed for the defense or protection of the Resources and to make effective the civil, penal and administrative responsibilities that correspond for the damages, crimes or infractions committed by the External Managers or the Custodians.

b. For the purposes of this section I.4.2., and in all that concerns the Portfolio Managed by External Managers, "Records" shall be understood as the information received from the External Managers and/or the Custodians, to verify that the Custodians have the same notional positions as reported by the External Manager (s).

c. An annual report will be delivered to the Minister of Finance and the Treasurer, or whoever they designate, containing the methodology used by the Custodian (s) and the Fiscal Agent. This will serve as the basis for preparing management reports. Likewise, with the same frequency, both representatives will be provided with a report on the service provided by the Custodian (s). These reports will be prepared by comparing the background and the information provided by the Custodian (s), with the information submitted by the External Managers in reference to the Portfolio Managed by External Managers. The monthly reports referred to in paragraph a) above will include a copy of the payment orders associated with the Portfolio Managed by External Managers of the FEES and the corresponding invoices, as well as information about any methodological change in the preparation of the reports.

d. The Minister of Finance, the Coordinator of International Finance or the Head of the Sovereign Funds Unit will approve or make observations regarding any matter contained in the reports referred to in paragraphs a) and c) above, by email, which will be sent to the Manager of International Markets of the Central Bank of Chile once they decide on the reports of the Portfolio Managed by the Fiscal Agent in accordance with the deadlines and procedures indicated in section I.4.1.g.

e. The Fiscal Agent will require, at least once during the year, from the Custodians, the reports referring to their operations with the Fiscal Resources issued by the corresponding supervisory bodies and/or by their external auditors. Likewise, the Fiscal Agent may consider hiring an external expert advisor to evaluate and follow up on the management and processes used in the performance of their duties by the Custodian (s).

The Fiscal Agent will only perform the functions described in paragraphs a), c) and e) above in relation to the Custodian (s).

## II.- Resource Investment Guidelines

### II.1 Management objective

The objective of Resource management is to obtain exposure to the asset classes detailed in section II.3 in accordance with the specific objectives defined in the investment guidelines established for each of them and indicated in section II.4.

### II.2 Investment portfolio

For the investment of the Resources, an investment portfolio (hereinafter "IP") will be established, made up of the sum of the Portfolio Managed by the Fiscal Agent and the Portfolio Managed by External Managers, whose guidelines, parameters and particular rules are contained in the following sections and in the respective investment guidelines.

### II.3 Asset Classes and Benchmarks

In accordance with Resolution N° 207 of 2018 of the Ministry of Finance, the Resources of IP will be invested in seven asset classes: 1) Sovereign Bonds and other related Assets; 2) Inflation-Indexed Sovereign Bonds; 3) Mortgage Backed Securities from USA Agencies (MBS); 4) Corporate Bonds; 5) High-Yield Bonds: 6) Stocks and 7) Real estate assets. Additionally, the total currency exposure generated by the fixed-income assets of the new benchmark composition (55%) will be covered at Chilean pesos, in accordance with the guidelines stated in Appendix G of Section II.4 thereof.

The comparator benchmark or Benchmarks (hereinafter, the "Benchmarks") associated with each asset class are those identified in Table 1, together with the composition (%) of the total Resources that each asset class must have (hereinafter, the "Referential Composition").

In accordance with this new Benchmark Composition, the assets for Sovereign Bonds and Other Related Assets and Sovereign Bonds Indexed to Inflation will be included in the Portfolio Managed by the Internal-Fiscal Agent. Likewise, the Mortgage Backed Securities from USA Agencies (MBS) will be included in the Portfolio Managed by the Delegate Fiscal Agent. Finally, the assets for Corporate Bonds, High-Yield Bonds, Stocks and Real Estate Assets will be incorporated to the Portfolio Managed by External Managers.

**Table 1: Benchmark Composition and Benchmarks**

| Benchmark Composition | | Benchmarks |
|---|---|---|
| **Asset Class** | **IP Percentage** | |
| Sovereign Bonds and Other related assets [1] | 23% | Bloomberg Barclays Global Aggregate: Treasuries Index (USD unhedged) |
| | | Bloomberg Barclays Global Aggregate: Government Related Index (USD unhedged) |
| Sovereign Bonds Indexed to Real Inflation | 5% | Bloomberg Barclays Global inflation-linked Index (USD unhedged) |
| Mortgage Backed Securities from USA Agencies. (MBS) | 6% | Bloomberg Barclays US Mortgage Backed Securities Index |
| Corporate Bonds | 13% | Bloomberg Barclays Global Aggregate: Corporates Index (USD unhedged) |
| High-Yield Bonds | 8% | Bloomberg Barclays Global High Yield Index (USD unhedged) |
| Stocks | 40% | MSCI All Country World Index[2] (USD unhedged. With reinvested dividends) |
| Real-estate assets | 5% | To be defined |

1 Each sub index of this class of asset is added in accordance with its relative capitalization
2 Chile excluded.

Notwithstanding the foregoing, the Transition Guidelines informed to the Fiscal Agent through resolution N°1-032 of 2018, of the Ministry of Finance, set the general guidelines that must be applied to converge to Benchmark Composition, presented in Table 1.

## II.4 Investment Guidelines

The specific investment guidelines for each asset class are contained in the attached documents indicated below:

- Appendix A: Investment Guideline for Sovereign Bonds and Other Related Assets, and Sovereign Bonds indexed to Inflation.
- Appendix B: Investment Guideline for Mortgage Backed Securities from USA Agencies (MBS)
- Appendix C: Investment Guideline for Stocks
- Appendix D: Investment Guideline for Corporate Bonds
- Appendix E: Investment Guideline for High-Yield Bonds
- Appendix F: Investment Guideline for Real Estate bonds
- Appendix G: Investment Guideline for Currency Hedging Strategy

In accordance with the provisions of the Transition Guidelines, Appendix F “Investment Guideline for Real Estate Assets” and Appendix G “Investment Guideline for Currency Hedging Strategy” shall be incorporated and informed formally to the Fiscal Agent for acceptance, at least two months prior to its implementation date.

## II.5 Transition Period and Rebalancing Policy

In relation with the transition period and the rebalancing policy, in accordance with the provisions of Resolution 1.032 of 2018, the Ministry of Finance will reduce the global exposure of the FRP beginning in 2018 to the following class of assets: Sovereign Wealth Bonds and Other Related bonds, Sovereign Bonds Indexed to Inflation and Corporate bonds. The counterpart of these movements will be an increase in the share of Stocks.

The changes associated to Mortgage Backed Securities from USA Agencies (MBS), High-Yield Bonds, and Real Estate Assets, and the implementation of a Currency Hedging Strategy, will be made starting the year 2019.

Consequently, during this transition period no rebalancing policy will be applied which will be defined before reaching the Strategic Composition of Assets stated in Table 1. The Ministry of Finance shall communicate the Temporary Benchmark Composition valid with each rebalancing instruction until the final convergence is reached.

**APPENDIX A**
**INVESTMENT GUIDELINE FOR SOVEREIGN BONDS AND OTHER RELATED ASSETS, AND SOVEREIGN BONDS INDEXED TO INFLATION.**

## 1. Management Objective

The objective of managing the resources of the Portfolio of Sovereign Bonds and Other Related Assets, and Sovereign Bonds Indexed to Inflation of the Pension Reserve Fund (FP) is to obtain total monthly return, before fees, similar to that of benchmark comparators according to a passive management style. The Fiscal Agent will select the necessary investment strategy, within the risk standards established in the guidelines and parameters in section 2 below.

## 2. Guidelines and parameters

### 2.1. Comparator Benchmark

The Comparator Benchmark associated with the asset class Sovereign Bonds and Other Related Assets are *Bloomberg Barclays Global Aggregate: Treasuries Index (USD unhedged), ticker: LGTRTRUU, y Bloomberg Barclays Global Aggregate: Government-Related Index (USD unhedged), ticker: BGAGTRUU*. Each sub index of this asset class is added in accordance with their new relative capitalization.

The Comparator Benchmark associated with the asset class Sovereign Bonds Indexed to Inflation is *Bloomberg Barclays Global inflation-Linked Index (USD unhedged), ticker: LF94TRUU.*

The portfolio of Sovereign Bonds and Other Related Assets, and Sovereign Bonds indexed to inflation correspond to the Portfolio Managed by the Internal Fiscal Agent.

### 2.2. Risk budget

The deviation margins for the Portfolio of Sovereign Bonds and other Related Assets, and Sovereign Bonds Indexed to Inflation under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark. The risk budget is defined in terms of the *ex ante* tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services. For the Portfolio Managed by the Fiscal Agent, a risk budget of 50 basis points of annual tracking error (ex ante) is assigned.

### 2.3. Eligible issuers and currencies

The issuers and currencies that are part of the corresponding Benchmark will be eligible.

### 2.4. Eligible instruments

The instruments eligible for Sovereign bonds and Other Related Assets will be the following:

a. Instruments that form part of the Benchmark Comparator and those instruments estimated to be incorporated to the Benchmark Comparator in the next or the following month. If for any reason the instrument estimated to be incorporated to the Benchmark comparator is not included as expected, the Fiscal Agent will have 7 business days to sell such instrument.

b. Reopening of instruments, provided that in the prospect of each reopening, is stated in its ISIN will be homologated to an instrument already included in the Benchmark Comparator. It will be allowed to invest in this instrument during the time necessary for its homologation. If the instrument is not homologated as expected, the Fiscal Agent will have 7 additional business days to sell such instrument.

c. Reg S Instruments, 144a or SEC registered, provided that there is one identical in the Benchmark Comparator that is equivalent with the following characteristics: the issuer, coupon, type of coupon (fixed, variable, etc.), maturity, risk rating agencies Fitch, Moody's Standard & Poor's, currency, payment priority (subordinated, unsecured, etc.) and type of maturity (callable, puttable, etc.)

d. Instruments that are no longer eligible for the Benchmark Comparator and that are eliminated from that product, their maturity is lower than the minimum requested, provided that the issuer is still part of the index. Likewise, the instruments that were acquired in letter c) above will also continue to be eligible if their equivalent within the Benchmark Comparator is eliminated because their maturity is lower than the minimum requested, and the issuer is still part of the index.

The eligible instruments for Inflation Indexed Bonds are as follows:

a. Instruments that are part of the Benchmark Comparator and those instruments that are estimated to be incorporated to the Benchmark Comparator the next or the following month. If for any reason the instrument estimated to be incorporated to the Benchmark comparator is not included as expected, the Fiscal Agent will have 7 business days to sell such instrument. Besides, instruments are eligible, if they were no longer eligible and were eliminated from the Benchmark Comparator because their maturity is lower than the minimum requested, provided that the issuer is still part of the index.

**2.5. Instruments eligible for cash**

The cash exposure cannot exceed 5% of the value of the portfolio under management. The income obtained in the cash must be incorporated to the calculation of income of the Portfolio Managed by the Internal Fiscal Agent.

The instruments eligible for cash are balances in checking accounts account, overnight deposits, weekend and time deposits with a maximum term of 15 calendar days in banks with classifications of long-term instruments with risk rating agencies such as Fitch , Moody's and Standard & Poor's. The eligible markets for cash investments will be those countries or jurisdictions where the eligible instruments are quoted from the respective mandates.

For the Portfolio Managed by the Internal Fiscal Agent, it is allowed to have investments in the same issuing bank as follows:

a. A maximum of 1% of the Portfolio Managed by the Internal Fiscal Agent, for issuers with an average rating of at least AA-.

b. A maximum of 0,5% of the Portfolio Managed by Internal Fiscal Agent, for issuers with an average rating between A- and A+.

However, each time a contribution is made to the Portfolio Managed by the Internal Fiscal Agent, it is allowed to invest in the same banking issuer for a maximum of 10 business days from the contribution date for a maximum amount up to US$80 million. Besides, when the Fiscal Agent receives the instruction to produce liquidity for a cash withdrawal, the Fiscal Agent will be able to invest up to US$ 80 million in the same banking issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

### 2.6. Limits on forward or currency swap operations

For the Portfolio Managed by the Fiscal Agent, the following regulations are established for the use of exchange hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with bank counterparties that have a risk rating equivalent to at least A- or higher, in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or compensation.

d. The term of these contracts may not exceed 95 calendar days.

e. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in equivalent US$. Because of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

f. Notwithstanding the foregoing, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when hiring a forward or swap that aims to completely or partially close a position associated with another forward or swap, and provided that these contracts include clauses of close-out netting, have the same lifetime and the same currency pair, the counterparty risk will be measured taking into account the total net position of different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ for the entire duration of the contract. For the purposes of section 2.6, letter h., said renewal will also not be considered within the exposure to derivatives.

g. The counterparty risk corresponding to each forward or swap contract will be considered for the purposes of complying with the limits established in Section 2.5 above.

h. The notional amount of the forward or swap contracts in force may not exceed 4% of the Portfolio Managed by the Fiscal Agent.

i. The notional value of the forwards or swaps that the Fiscal Agent hires with an eligible counterparty may not exceed the limits per issuer stated in letters a) and b) of section 2.5 above.. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, these limits per issuer will double for said counterparty, for two business days, counting from the day the forward is renewed. Likewise, for the purposes of calculating the counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in letters a) and b) of section 2.5 above for two business days from the day the forward is renewed.

**2.7. Limits of Sovereign Bonds Assets and Other Related Assets, and Sovereign Bonds Indexed to Inflation.**

The investment limits by risk classification of Sovereign bonds and Other Related Assets, and Sovereign Bonds Indexed to Inflation as a percentage (%) of the Portfolio Managed by the Internal Fiscal Agent is detailed in Table 1.

**Table 1: Limits by risk classification of Sovereign Bonds and Other Related Assets and Sovereign Bonds Indexed to Inflation.**

| Risk Classification | Maximum Percentage of the portfolio managed by the Internal Fiscal Agent |
|---|---|
| AAA | 100% |
| AA+ | |
| AA | |
| AA- | |
| A+ | 60% |
| A | |
| A- | |
| BBB+ | 40% |
| BBB | |
| BBB- | |

In order to monitor the above mentioned limits, the median credit risk classification given to the long-term instruments by the international rating agencies Standard & Poor's, Moody's or Fitch. If there are only two risk classifications, the lowest will prevail. If there is only one risk classification, that one will be selected.

**2.8. Limits to spot currency operations**

The Fiscal Agent may carry out spot currency transactions with counterparties that have long-term instrument risk ratings in a category equal to or greater than A- in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

### 2.9. Special restrictions

No part of the portfolio may be invested in any type of instrument of Chilean issuers or in instruments expressed in Chilean pesos. The Fiscal Agent may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed. Debt is not allowed for investment purposes except to cover any failure in the settlement of an Instrument.

### 2.10. External Cash Movements

External cash movements in the Portfolio of Sovereign Bonds and Other Related Assets, and Sovereign Bonds Indexed to Inflation will result from applying the rebalancing policy to converge the Strategic Composition of Assets of the FRP or withdrawals from the fund. The rebalancing policy of the FRP will take place in the following situations:

a. In the event of exceeding the deviation ranges allowed once converged to the strategic composition of assets for the FRP, or

b. In the event of a contribution to the FRP.

Every time a rebalance or withdrawal is materialized from the FRP, the Ministry of Finance will instruct the amounts to be transferred between the External Managers and the Portfolio Managed by the Fiscal Agent. When an external cash contribution is made for the Portfolio Managed by the Fiscal Agent, the Fiscal Agent will be granted a special permit (waiver) of 10 bank business days, from the day of the contribution, regarding the fulfillment of the requirements of the sections 1, 2.2 and the first and last paragraph of 2.5. When an external cash withdrawal is made for the Portfolio Managed by the Fiscal Agent, the Fiscal Agent will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2 and the first and last paragraph of 2.5. The special permit may be extended upon request to the Ministry of Finance, justifying the reasons for said extension. If between the date of the cash withdrawal instruction and the withdrawal itself there is a period of less than 10 business days, it will be understood that the special permit will correspond to that term.

Notwithstanding the foregoing, when a rebalance is carried out, the Manager of the Financial Markets Division of the Central Bank of Chile may request, by email, the Coordinator of International Finance of the Ministry of Finance to maintain the relative positions of the Portfolio Managed by the Fiscal Agent in relation to the Benchmark Comparator and not having to converge to the respective Reference Composition. The coordinator of International Finance of the Ministry of Finance must authorize maintaining these positions through email addressed to the Manager of the Financial Markets Division of the Central Bank of Chile.

## 3. Valuation criteria

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of the Custodian Bank. Nevertheless, it is worth stating that the Central Bank of Chile, for internal purposes related to the Portfolio Managed by the Fiscal Agent, may use the same procedure for its own operations corresponding to international reserves, in order to provide compliance with subsection g) of article 4 of the Agency Decree.

## 4. Securities loan program

The Fiscal Agent for the Portfolio Managed by the Internal Fiscal Agent may agree with the Custodian (s) of the FRP securities lending programs (hereinafter, "Programs" or "Securities Lending") provided that the Custodians with whom the Administration of said Programs are obligate to meet the operating criteria established in the Custody Guidelines, especially including the obligation to make the restitution of the respective titles or their market value.

## 5. Others

Foreign currency operations will be considered spot operations according to the convention used in each market. However, exchange operations that are related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the instrument's settlement period that is being bought or sold.

The base currency of the portfolio for the purpose of the Fiscal Agent's performance is the United States dollar.

In the event that at any time any of the Instructions described in these guidelines is breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the Fiscal Agent, they will not be considered a breach of the guidelines as long as it takes the necessary measures to ensure compliance within 7 business days after the situation has been detected. The term applicable to the Portfolio Managed by the Fiscal Agent may be extended upon request made by the Fiscal Agent to the Minister of Finance, or whoever they designate, and the reasons for the extension must be justified.

# ANEXO B
# INVESTMENT GUIDELINE FOR MORTGAGE BACKED SECURITIES FROM USA AGENCIES (MBS)

## 1. Management objective

The objective of the resource administration for the Mortgage Backed Securities from USA Agencies (MBS) of the Pension Reserve Fund (FRP) is to obtain total monthly return, before fees, similar to that of the Benchmark Comparator according to a passive administration style, within the standards of risk established in the relevant guidelines and parameters of section 2 below.

## 2. Guidelines and parameters

### 2.1. Benchmark Comparator

The Benchmark Comparator associated with the Portfolio of Mortgage Backed Securities from USA Agencies (MBS) is *Bloomberg Barclays US Mortgage Backed Securities (MBS) Index, ticker: LUMSTRUU.*

### 2.2. Risk Budget

a. The deviation margins for the Mortgage Backed Securities from USA Agencies (MBS) under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark. The risk budget is defined in terms of the *ex ante* tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services.
b. For the Portfolio of Mortgage Backed Securities from USA Agencies (MBS) the risk budget is defined as a monthly average of 20 basis points of annual tracking error (ex ante) annualized as long as the maximum value does not exceed 30 basis points.

c. The deviation of the effective duration of the total portfolio in relation to the Benchmark may not exceed +/-0,5 years.

### 2.3. Eligible issuers and currencies

The issuers and currencies that are part of the corresponding Benchmark Comparator are eligible.

### 2.4. Eligible Instruments

The eligible instruments for the Portfolio of Mortgaged Backed Securities from USA Agencies (MBS) are the following:

a. Pass-Through Mortgage Backed Securities with fixed rate secured by GNMA, FNMA and FHLMC that are part of the programs included in the Benchmark Comparator.

b. Debt instruments nominated in dollars that are issued or secured by the USA Government or by the Agencies (FNMA, FHLMC, FHLB y GNMA).

c. *To Be Announced* (TBAs): The underlying pools for the TBA transactions must derive from eligible MBS. Leverage is not allowed. This means that the Delegated Manager must hold, at all times, at least an amount of cash equal to the exposure of the TBA's. The instruments eligible as cash are detailed in section 2.5 below.

d. Futures of sovereign instruments of USA traded in the *Chicago Mercantile Exchange* (CME) or Eurodollar futures traded in the *Chicago Board of Trade* (CBOT), only used for hedging purposes, that allow to minimize the differences with respect to the Benchmark Comparator, or that allow to improve exposure to part of it. Leverage is not allowed. In other words, the exposure to these futures may not exceed the market value of the portion of the underlying assets. If the underlying asset is effective, it must be held in the instruments allowed in section 2.5 below.

### 2.5. Cash eligible instruments

The cash held in excess to TBA requirements cannot exceed 5% of the portfolio value under management. The return obtained in cash must be incorporated into the return calculation of the portfolio under management.

Checking account balances, overnight deposits and/or weekend deposits and time deposits with a maximum limit of 15 calendar days in banks with classifications of long-term instruments in a category equal to or greater than A- will be eligible as cash in at least two of the international risk classifiers Fitch, Moody's and Standard & Poor's. USA Treasury Bills are considered as cash and cash equivalents.

The maximum exposure to an eligible bank issuer is equivalent to 5% of the market value of the portfolio based on its market value at the end of the previous quarter. Nevertheless, each time the Delegated Manager receives a contribution in cash, he may invest up to 10% of the market value of the portfolio in the same bank issuer for a maximum of 10 business days from the date of the contribution. Furthermore, when the Delegated Manager receives the instruction to produce liquidity for a cash withdrawal, he may invest up to 10% of the market value of the portfolio in the same bank issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as financial intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. USA Treasury Bills are not considered as part of this limit. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

### 2.6. Limits on TBAs

The restrictions for TBAs are the following:

a. The exposure to TBA’s cannot exceed 30% of the portfolio..

b. The maturity date of any TBA must be less than 90 days.

c. TBA short positions are not allowed. Nonetheless, it is allowed the sell TBA current positions.

d. TBA underlying securities are not allowed.

TBA must be traded only with US *Primary Dealers* or eligible banks with classification of long term instruments in categories equal or higher than A- in at least, two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

e. All TBA transactions must be conducted through clearing agencies registered in the USA Securities Exchange Commission (SEC) or must be traded under a *Master Securities Forwards Transaction Agreement* (MSFTA) that complies with FINRA Rule 4210.

**2.7. Special Restrictions**

a. The External Manager may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed.

b. Future notional amounts with USA interest rates in USA at market value and expressed in absolute value, cannot exceed 10% of the market value of the portfolio.

c. The maturity date of a future of interest rate or Eurodollar future must be less than 90 days.

d. It is not allowed to submit or receive the underlying securities in futures of USA sovereign instruments.

e. It is not allowed to invest more than 20% of the market value of the portfolio in the instruments allowed in letter b) of Section 2.4 above.

f. Borrowing is not allowed for investment purposes except to cover any failure of an instrument in settlement.

**2.8. External cash movements**

External cash movements in the Portfolio of Mortgage Backed Securities from USA Agencies (MBS) will result from the application of the rebalancing policy to converge the Strategic Composition of Assets of the FRP or withdrawals from the fund.

The rebalancing policy for the FRP will take place in the following situations:

a. When an asset class exceeds the deviation range allowed for such asset class, or

b. In case of a contribution to the FRP.

Every time a rebalance or withdrawal occurs from the FRP, the Ministry of Finance through the Fiscal Agent will instruct the amounts to transfer from/to and/or between the managers, if applicable. When an external cash contribution is made, the External Manager will be granted a special waiver of 10 bank business days, from the day of the contribution, regarding compliance with the requirements of sections 1, 2.2, 2.5 a) y 2.5 d). When an external cash withdrawal is made, the Delegated Manager will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2, 2.5 a) y 2.5 d). The special permit may be extended at the request of any of them to the Fiscal Agent, justifying the reasons for said extension. If there is a term of less than 10 business days between the date of the cash withdrawal instruction and the withdrawal itself, it will be understood that the special permit will be of that term.

**3. Valuation criteria**

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of Custodian Bank.

### 4. Securities loan program

The Delegated Manager cannot make or agree on securities loan programs.

### 5. Others

The base currency of the portfolio for the purposes of the performance of the External Manager is the US$.

In the event that at any time any of the instructions described in these guidelines are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the Delegated Manager, the latter will not be considered in default of the guidelines if it takes the necessary measures to ensure compliance within seven business days after the situation has been detected. This period may be extended from a request made by the External Manager to the Ministry of Finance, justifying the reason for the extension.

## APPENDIX C

## STOCKS INVESTMENT GUIDELINE

### 1. Management objective

The objective of the Reserve Pension Fund Stocks Portfolio (FRP) resource administration is to obtain total monthly result, before fees, similar to that of the Benchmark Comparator according to a passive administration style, within the standards of risk established in the relevant guidelines and parameters of section 2 below.

### 2. Guidelines and parameters

#### 2.1. Benchmark Comparator

The Benchmark Comparator associated with the Stock Portfolio is MSCI ALL Country World/Index Ex-Chile (unhedged with the dividends re-invested) index.

For the purposes of calculating performance and tracking error, the Benchmark will be used before taxes.

#### 2.2. Risk budget

The deviation margins for the Portfolio of Stocks under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark Comparator. The risk budget is defined in terms of the ex-ante tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services.

For the Portfolio of Shares, a risk budget of 60 basis points of annual tracking error (ex-ante) is assigned.

#### 2.3. Eligible issuers and currencies

Only the issuers and currencies that are part of the corresponding Benchmark Comparator are eligible.

#### 2.4. Instruments eligible for Stocks

The instruments eligible for the Portfolio of Stocks are the following:

a. Instruments that are part of the Benchmark Comparator and those that will be incorporated into the Benchmark Comparator from the moment their inclusion is formally communicated by the supplier of the Benchmark Comparator. If for any reason the instruments are not added to the Benchmark as expected, the External Manager will have 7 business days in the local market to sell said instruments from the date their incorporation was expected.

b. The Ministry of Finance will generate, maintain and communicate to the Fiscal Agent a list of eligible Mutual Funds and Exchange Traded Funds (ETFs), which may also include ETFs advised, under-advised or managed by a subsidiary of the External Manager. The Ministry of Finance may modify the mentioned list from time to time through written means to the External Manager. The External Manager will continue depending on these instructions until notified otherwise by the Ministry of Finance.

c. American Depositary Receipts (ADRs), Global Depository Receipts (GDRs) and other Depositary Receipts traded on the stock exchange, of the stocks that constitute the Benchmark, provided they do not require the use of tax agents in the country of the issuer of the underlying instrument .

d. Futures traded on stock exchange indexes used for hedging reasons that allow minimizing differences with respect to the Benchmark or that allow gaining exposure to part of it. No leverage will be allowed. In other words, the exposure to these derivatives may not exceed the market value of the portion of the underlying assets. If the underlying asset is effective, it must be held in the instruments allowed in section 2.5 below.

**2.5. Cash eligible instruments**

The cash exposure may not exceed 5% of the value of the portfolio under management. The return obtained in cash must be incorporated into the return calculation of the portfolio under management.

Checking account balances, overnight deposits and/or weekend deposits in banks with classifications of long-term instruments in a category equal to or greater than A- will be eligible as cash in at least two of the international risk classifiers Fitch, Moody's and Standard & Poor's. The markets eligible for the investment of cash will be those of countries or jurisdictions where the eligible instruments of the respective mandates are listed.

The maximum exposure to an eligible bank issuer is equivalent to 5% of the market value of the portfolio based on its market value at the end of the previous quarter. Nevertheless, each time the External Manager receives a contribution in cash, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for a maximum of 10 business days from the day of the contribution. Furthermore, when the External Manager receives the instruction to produce liquidity for a cash withdrawal, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

**2.6. Limits on currency forward or swap operations**

The External Manager may hire forwards or swaps to minimize the differences with respect to the currency composition of the Benchmark Comparator.

The following regulations are established for the use of currency hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with counterparties that have long-term instruments with a risk rating equivalent to at least A- or higher in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or for compensation.

d. The term of these contracts may not exceed 95 calendar days.

e. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in its equivalent in US$. For the purpose of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

f. However, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when hiring a forward or swap whose objective is to completely or partially close a position associated with another forward or swap, and provided that these contracts include close-out netting clauses, whether they are with the same counterparty, they have the same expiration date and the same currency pair, the counterparty risk will be measured considering the total net position of the different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract for the purpose of measuring counterparty risk.

g. The counterparty risk corresponding to each forward and swap contract will be considered for the purposes of complying with the limits established in section 2.5.

h. The notional value of the forwards or swaps that the External Manager contracts with an eligible counterparty may not exceed 3% of the market value of the portfolio managed by him. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, this limit per issuer will increase to 6% for said counterparty, for two business days, from the day the forward is renewed. Likewise, for the purposes of calculating counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in section 2.5 for two business days, counting from the day the forward is renewed. For the purposes of the third paragraph of section 2.8, said renewal shall also not be considered within the exposure to derivatives.

**2.7. Límits to spot currency operations**

The External Manager may execute spot currency transactions with counterparties that have long-term instrument risk classifications equal to or greater than A- in at least two of the international risk classifiers Fitch, Moody's and Standard & Poor's.

**2.8. Special restrictions**

It is not permitted to invest in any type of instruments of Chilean issuers or in instruments expressed in Chilean pesos.

The External Manager may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed.

The External Manager may contract futures, forwards or currency swaps whose notional amounts valued at market price and in absolute value, may not in aggregate exceed 10% of the portfolio managed.

Mutual funds and Exchange Traded Funds (ETFs), taken together, may not represent, from the External Manager's portfolio, more than the aggregated shares of Egypt, the Philippines, India, Pakistan, Poland, Russia, Thailand, Taiwan and Turkey in the Benchmark comparator applicable to Stocks plus 2%.

The External Manager may not invest in the local markets of Chile, Egypt, the Philippines, India, Peru, Pakistan, Poland, Russia, Thailand, Taiwan and Turkey. Investments in China may only be made through the Hong Kong exchange or any other exchange in which the stocks of the Benchmark are traded, excluding the local markets of China, provided that the External Manager is authorized to invest in the respective local markets.

The External Stocks Manager may not invest in its own stocks or its affiliates.

Borrowing is not allowed for investment purposes except to cover any failure of an instrument in settlement.

**2.9. External cash movements**

External cash movements in the Portfolio of Stocks will result from the application of the rebalancing policy to converge the Strategic Composition of Assets of the FRP or withdrawals from the fund.

The rebalancing policy for the FRP will take place in the following situations:

a. When an asset class exceeds the deviation range allowed for such asset class, or

b. In case of a contribution to the FRP.

Every time a rebalance or withdrawal occurs from the FRP, the Ministry of Finance will instruct the amounts to transfer to/from and/or between the External Managers, if applicable. When an external cash contribution is made, the External Manager will be granted a special waiver of 10 bank business days, from the day of the contribution, regarding compliance with the requirements of sections 1,2.2, and the first and last paragraph of section 2.5. When an external cash withdrawal is made, the External Manager will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2, and the first and last paragraph of section 2.5. The special permit may be extended at the request of any of them to the Ministry of Finance, justifying the reasons for said extension. If there is a term of less than 10 business days between the date of the cash withdrawal instruction and the withdrawal itself, it will be understood that the special permit will be of that term.

**3. Valuation criteria**

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of Custodian Bank.

**4. Securities loan program**

The External Manager may not carry out or agree on securities lending programs. Nonetheless, the Ministry of Finance understands and accepts that the FRP portfolio may be exposed to a securities lending program through the investment of the ETFs authorized in these guidelines. In addition, the Central Bank of Chile, in its role as Fiscal Agent, may agree with the Custodian (s) of the FRP securities lending programs for the Portfolio of Stocks (hereinafter, "Programs" or "Securities Lending") provided that the Custodians with whom the administration of said Programs are obliged to comply with the operating criteria established in the Custody Guidelines, especially including the obligation to make the restitution of the respective titles or of the market value of themselves.

**5. Others**

Foreign exchange operations will be considered spot operations according to the convention used in each market. However, exchange operations related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purposes of the performance of the External Manager is the US$.

In the event that at any time any of the instructions described in these guidelines are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the External Manager, the latter will not be considered in default of the guidelines if it takes the necessary measures to ensure compliance within seven business days after the situation has been detected. This period may be extended from a request made by the External Manager to the Ministry of Finance, justifying the reason for the extension.

However, the External Manager may temporarily hold received ineligible instruments due to corporate events. The External Manager will have 30 calendar days from the corporate event to sell said instruments. If the above is not possible, the External Manager must notify the Treasury and communicate an action plan for the liquidation of those instruments. In the particular case of entitlements, preferred stocks, rights, warrants or other equivalent instruments received as a result of corporate events that grant the right to buy, exchange for eligible stocks or receive cash, these may be held in the portfolio until their expiration.

The External Manager is expressly authorized to carry out internal cross operations.

## APPENDIX D

## INVESTMENT GUIDELINE FOR CORPORATE BONDS

### 1. Management Objective

The objective of managing the resources of the Portfolio of the Corporate bonds of the Pension Reserve Fund (FRP) is to obtain total monthly return, before fees, similar to that of Benchmark Comparators according to a passive management style, within the risk standards established in the guidelines and parameters in section 2 below.

### 2. Guidelines and Parameters

### 2.1. Comparator Benchmark

The Comparator Benchmark associated with the Portfolio of Corporate Bonds is *Bloomberg's Barclays Global Aggregate: Corporates Index (unhedged), ticker: LGCPTRUU.*

### 2.2. Risk budget

The deviation margins for the Portfolio of Corporate Bonds under management are subject to a risk budget. This allows deviations to be limited with respect to the Comparator Benchmark. The risk budget is defined in terms of the *ex ante* tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services.

For the Portfolio of Corporate Bonds, a risk budget of 50 basis points of annual tracking error (ex ante) is assigned.

### 2.3. Issuers and eligible currencies

Only the currencies that are part of the corresponding Benchmark will be eligible.

### 2.4. Eligible instruments

The instruments eligible for the Portfolio of Corporate bonds are the following:

a. Instruments that are part of the Benchmark Comparator and those instruments that are estimated to be incorporated to the Benchmark Comparator the next or the following month. If for any reason the instrument estimated to be incorporated to the Benchmark comparator is not included as expected, the Fiscal Agent will have 7 business days to sell such instrument.

b. Futures traded in the stock exchange about instruments or fixed income index, only used for hedging purposes, that allow to minimize the differences with respect to the Benchmark Comparator, or that allow to improve exposure to part of it. Leverage is not allowed. In other words, the exposure to these derivatives may not exceed the market value of the portion of the underlying assets. If the underlying asset is effective, it must be held in the instruments allowed in section 2.5 below.

c. Instruments that are no longer eligible for the Benchmark Comparator and that are eliminated from that product, their maturity is lower than the minimum requested, provided that the issuer is still part of the index. Likewise, the instruments that were acquired in letter e) of this section will also continue to be eligible if their equivalent within the Benchmark Comparator is eliminated because their maturity is lower than the minimum requested, and the issuer is still part of the Benchmark Comparator.

d. Reopening of instruments, provided that in the prospect of each reopening, is stated in its ISIN will be homologated to an instrument already included in the Benchmark Comparator. It will be allowed to invest in this instrument during the time necessary for its homologation. If the instrument is not homologated as expected, the External Manager will have a month to sell such instrument.
e. Reg S Instruments, 144a or SEC registered, provided that there is one identical in the Benchmark Comparator that is equivalent with the following characteristics: the issuer, coupon, type of coupon (fixed, variable, etc.), maturity, risk rating agencies Fitch, Moody's Standard & Poor's, currency, payment priority (subordinated, unsecured, etc.) and type of maturity (callable, puttable, etc.)

**2.5. Cash eligible instruments**

The cash exposure may not exceed 5% of the value of the portfolio under management. The return obtained in cash must be incorporated into the return calculation of the portfolio under management.

Checking account balances, overnight deposits and/or weekend deposits in banks with classifications of long-term instruments in a category equal to or greater than A- will be eligible as cash in at least two of the international risk classifiers Fitch, Moody's and Standard & Poor's. The markets eligible for the investment of cash will be those of countries or jurisdictions where the eligible instruments of the respective mandates are listed.

The maximum exposure to an eligible bank issuer is equivalent to 5% of the market value of the portfolio based on its market value at the end of the previous quarter. Nevertheless, each time the External Manager receives a contribution in cash, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for a maximum of 10 business days from the day of the contribution. Furthermore, when the External Manager receives the instruction to produce liquidity for a cash withdrawal, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

**2.6. Límits on currency forward or swap operations**

The External Manager may enter into forward or swap contracts to minimize the differences with respect to the currency composition of the Benchmark Comparator.

The following regulations are established for the use of currency hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with counterparties that have long-term instruments with a risk rating equivalent to at least A- or higher in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or for compensation.

d. The term of these contracts may not exceed 95 calendar days. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in its equivalent in US$. For the purpose of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

e. However, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when hiring a forward or swap whose objective is to completely or partially close a position associated with another forward or swap, and provided that these contracts include close-out netting clauses, whether they are with the same counterparty, they have the same expiration date and the same currency pair, the counterparty risk will be measured considering the total net position of the different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract for the purpose of measuring counterparty risk.

f. The counterparty risk corresponding to each forward and swap contract will be considered for the purposes of complying with the limits established in section 2.5.

g. The notional value of the forwards or swaps that the External Manager contracts with an eligible counterparty may not exceed 3% of the market value of the portfolio managed by him. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, this limit per issuer will increase to 6% for said counterparty, for two business days, from the day the forward is renewed. Likewise, for the purposes of calculating counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in section 2.5 for two business days, counting from the day the forward is renewed. For the purposes of the third paragraph of section 2.10, said renewal shall also not be considered within the exposure to derivatives.

**2.7. Limits by issuer of the Portfolio of Corporate Bonds**

The limit by issuer of the Portfolio of Corporate Bonds as percentage (%) of the portfolio managed by each External Manager will be set in Table 1 below, in accordance with its risk classification:

Table 1: Limits for risk rating by corporate bonds issuer.

| Risk Classification | Issuer limit |
|---|---|
| AAA | 15% |
| AA+ | 10% |
| AA | 10% |
| AA- | 10% |
| A+ | 5% |
| A | 5% |
| A- | 5% |
| BBB+ | 5% |
| BBB | 5% |
| BBB- | 5% |

### 2.8. Limits by risk classification of the Portfolio of Corporate Bonds

The investment limit by risk classification in Corporate Bonds, as percentage (%) of the portfolio managed by each External Manager, will be set in Table 2.

**Table 1: Limits by risk classification of Sovereign Bonds and Other Related Assets and Sovereign Bonds Indexed to Inflation.**

**Table 2: Limits by risk classification of Corporate Bonds**

| Risk Classification | Maximum percentage of the Portfolio externally managed |
|---|---|
| AAA | 100% |
| AA+ | |
| AA | |
| AA- | |
| A+ | 60% |
| A | |
| A- | |
| BBB+ | 40% |
| BBB | |
| BBB- | |

In order to monitor the limits set by the Ministry of Finance, mentioned in sections 2.7 and 2.8, the median credit risk classification given to the long-term instruments by the international rating agencies Standard & Poor's, Moody's or Fitch. If there are only two risk classifications, the lowest will prevail. If there is only one risk classification, that one will be selected.

### 2.9. Límits to spot currency operations

The Fiscal Agent may carry out spot currency transactions with counterparties that have long-term instrument risk ratings in a category equal to or greater than A- in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

### 2.10. Special restrictions

No part of the portfolio may be invested in any type of instrument of Chilean issuers or in instruments expressed in Chilean pesos.

The External Manager may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed.

The External Manager may enter into future contract, forwards or currency swap whose notional values at market value and absolute values may not in the aggregate be above the 10% of the portfolio under management.

Debt is not allowed for investment purposes except to cover any failure in the settlement of an Instrument.

The External Manager may contract futures, forwards or currency swaps whose notional amounts valued at market price and in absolute value, may not in aggregate exceed 10% of the portfolio managed.

The External Manager may not invest in its own stocks or its affiliates.

Borrowing is not allowed for investment purposes except to cover any failure of an instrument in settlement.

**2.11. External cash movements**

External cash movements in the Portfolio of Corporate Bonds will result from the application of the rebalancing policy to converge the Strategic Composition of Assets of the FRP or withdrawals from the fund.

The rebalancing policy of the FRP will take place in the following situations:

a. In the event of exceeding the deviation ranges allowed for such asset class, or

b. In the event of a contribution to the FRP.

Every time a rebalance or withdrawal occurs from the FRP, the Ministry of Finance will instruct the amounts to transfer to/from and/or between the External Managers, if applicable. When an external cash contribution is made, the External Manager will be granted a special waiver of 10 bank business days, from the day of the contribution, regarding compliance with the requirements of sections 1,2.2, and the first and last paragraph of section 2.5. When an external cash withdrawal is made, the External Manager will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2, and the first and last paragraph of section 2.5. The special permit may be extended at the request of any of them to the Ministry of Finance, justifying the reasons for said extension. If there is a term of less than 10 business days between the date of the cash withdrawal instruction and the withdrawal itself, it will be understood that the special permit will be of that term.

**3. Valuation criteria**

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of Custodian Bank.

**4. Securities loan program**

The External Manager may not carry out or agree on securities lending programs.

**5. Others**

Foreign exchange operations will be considered spot operations according to the convention used in each market. However, exchange operations related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purposes of the performance of the External Manager is the US$.

In the event that at any time any of the instructions described in these guidelines are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the External Manager, the latter will not be considered in default of the guidelines if it takes the necessary measures to ensure compliance within seven business days after the situation has been detected. This period may be extended from a request made by the External Manager to the Ministry of Finance, justifying the reason for the extension.

**APPENDIX E**
**INVESTMENT GUIDELINE FOR HIGH-YIELD BONDS**

**1. Management Objective**

The objective of the Fund of Pension Reserve (FRP) resource administration is to obtain total monthly return, net from fees, , similar to that of the Benchmark Comparator according to an enhanced passive administration style, within the standards of risk established in the relevant guidelines and parameters of section 2 below.

**2. Guidelines and parameters**

**2.1. Benchmark Comparator**

The Benchmark Comparator associated with the Global High-Yield Bonds Portfolio is *Bloomberg Barclays Global High Yield Index (unhedged) in USD, ticker: LG30TRUU*.

**2.2. Risk budget**

The deviation margins for the Portfolio of Global High-Yield Bonds under management are subject to a risk budget. This allows deviations to be limited with respect to the Benchmark Comparator. The risk budget is defined in terms of the ex-ante tracking error that is measured in base points and that will be calculated daily by the Custodian Bank or the institution that performs the middle office services.

For the Portfolio of Global High-Yield Bonds, a risk budget of 150 basis points of annual tracking error (ex-ante) is assigned

**2.3. Eligible issuers and currencies**

Only the issuers and currencies that are part of the corresponding Benchmark Comparator are eligible.

**2.4. Eligible instruments**

The instruments eligible for the Portfolio of Global High-Yield Bonds are the following:

a. Instruments that are part of the Benchmark Comparator and those instruments that are estimated to be incorporated to the Benchmark Comparator the next or the following month. If for any reason the instrument estimated to be incorporated to the Benchmark comparator is not included as expected, the External Manager will have two months to sell such instrument.

b. Instruments that are eliminated from the Benchmark Comparator, because their maturity is lower than the minimum requested, provided that the issuer is still part of the Benchmark Comparator.

c. Futures traded on stock exchange for instruments or fixed income indexes used only for hedging reasons that allow minimizing differences with respect to the Benchmark or that allow gaining exposure to part of it. No leverage will be allowed. In other words, the exposure to these derivatives may not exceed the market value of the portion of the underlying assets. If the underlying asset is effective, it must be held in the instruments allowed in section 2.5 below.

d. Reopening of instruments, provided that in the prospect of each reopening, is stated in its ISIN that will be homologated to an instrument already included in the Benchmark Comparator. It will be allowed to invest in this instrument during the time necessary for its homologation. If the instrument is not homologated as expected, the Fiscal Agent will have 7 additional business days to sell such instrument.

e. Reg S Instruments, 144a or SEC registered, provided that there is one identical in the Benchmark Comparator that is equivalent with the following characteristics: the issuer, coupon, type of coupon (fixed, variable, etc.), maturity, risk rating agencies Fitch, Moody's Standard & Poor's, currency, payment priority (subordinated, unsecured, etc.) and type of maturity (callable, puttable, etc.)

f. Sovereign instruments, denominated in eligible currency, included in the *Bloomberg Barclays Global Aggregate Treasury Index Unhedged, ticker: LGTRTRUU,* and shall be used to manage cash and duration.

g. Instruments that are in default and that will be out of the Benchmark Comparator, if the External Manager thinks it is adequate, provided the External Manager tries to sells those instruments in commercially reasonable terms, considering liquidity and reasonability of the sales prices. The External Manager will have a three-month period to sell those instruments, after the instrument is out of the Benchmark Comparator. The External Manager will be able to request an extension such term in writing.

h. Instruments that are out of the Benchmark Comparator due to an improvement in risk classification can be held, subject the instrument is included in the Bloomberg Barclays Global Aggregate Credit Index Unhedged, ticker: LGDRTRUU.

i. The Ministry of Finance will generate, hold and communicate to the External Manager, a list with the eligible Exchange Traded Funds (ETFs), that can also include ETF's advised, sub advised, or managed by a subsidiary of the External Manager. The ministry of Finance may modify such list on a regular basis in writing with the External Manager. The External Manager will still be subject to instructions until he is notified otherwise by the Ministry of Finance.

**2.5. Cash eligible instruments**

The cash exposure may not exceed 5% of the value of the portfolio under management. The return obtained in cash must be incorporated into the return calculation of the portfolio under management.

Checking account balances, overnight deposits and/or weekend deposits in banks with classifications of long-term instruments in a category equal to or greater than A- will be eligible as cash in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's. The markets eligible for the investment of cash will be those of countries or jurisdictions where the eligible instruments of the respective mandates are listed. Treasury bills denominated in eligible currencies are considered as cash and cash equivalents.

The maximum exposure to an eligible bank issuer is equivalent to 5% of the market value of the portfolio based on its market value at the end of the previous quarter. Nevertheless, each time the External Manager receives a contribution in cash, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for a maximum of 10 business days from the day of the contribution. Furthermore, when the External Manager receives the instruction to produce liquidity for a cash withdrawal, the External Manager may invest up to 10% of the market value of the portfolio in the same bank issuer for 10 business days before and until the date of the cash withdrawal.

It should be noted that a distinction is made between exposure to the Custodian Bank, in its role as custodian, and exposure to said bank in its role as intermediary. The end of day cash balances may be held with the

Custodian Bank, in the custody account, up to an aggregate amount equivalent to 5% of the market value of the portfolio. If the Custodian Bank loses eligibility as a financial intermediary, the investment limit in its custodian role will be maintained.

**2.6. Limits on currency forward or swap operations**

The External Manager may enter into forward or swap contracts to minimize the differences with respect to the currency composition of the Benchmark Comparator.

The following regulations are established for the use of currency hedging mechanisms using forwards or currency swaps:

a. Forwards or swaps may only be carried out between the eligible currencies.

b. Forward contracts or currency swaps can only be made with counterparties that have long-term instruments with a risk rating equivalent to at least A- or higher in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

c. Forward contracts or currency swaps may be in the form of "cash delivery" or for compensation.

d. The term of these contracts may not exceed 95 calendar days.

e. The counterparty risk associated with each forward and swap contract will correspond to 100% of its notional value, in its equivalent in US$. For the purpose of these guidelines, the notional value of the forward or swap shall be understood as the amount associated with the purchase currency in the forward or swap contract. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract.

f. However, the counterparty risk associated with each contract that includes a close-out netting clause in the event of insolvency or bankruptcy of the counterparty, will correspond to 15% of the notional value of the forward and 30% of the notional value of the swap, in its equivalent in US$. Likewise, when entering a forward or swap contract whose objective is to completely or partially close a position associated with another forward or swap, and provided that these contracts include close-out netting clauses, whether they are with the same counterparty, they have the same expiration date and the same currency pair, the counterparty risk will be measured considering the total net position of the different forwards and swaps involved. For the purpose of measuring counterparty risk, forwards and swaps will be valued daily in US$ throughout the term of the contract for the purpose of measuring counterparty risk.

g. The counterparty risk corresponding to each forward and swap contract will be considered for the purposes of complying with the limits established in section 2.5.

h. The notional value of the forwards or swaps that the External Manager contracts with an eligible counterparty may not exceed 3% of the market value of the portfolio managed by him. However, when there is a renewal of a forward (rolling) contract with the same counterparty and in the same currency pair, although for an amount that may differ from the original, this limit per issuer will increase to 6% for said counterparty, for two business days, from the day the forward is renewed. Likewise, for the purposes of calculating counterparty risk, this renewal will not be considered for the calculation of the risk limits per issuer established in section 2.5 for two business days, counting from the day the forward is renewed. For the purposes of the third paragraph of section 2.8, said renewal shall also not be considered within the exposure to derivatives.

**2.7. Límits to spot currency operations**

The External Manager may execute spot currency transactions with counterparties that have long-term instrument risk classifications equal to or greater than A- in at least two of the international risk rating agencies Fitch, Moody's and Standard & Poor's.

**2.8. Special restrictions**

a. It is not allowed to invest in any type of instruments of Chilean issuers or in instruments expressed in Chilean pesos.

b. The External Manager may not use derivatives to increase the exposure to financial instruments beyond the market value of the resources managed.

c. The External Manager may contract futures, forwards or currency swaps whose notional amounts valued at market price and in absolute value, may not in aggregate exceed 10% of the portfolio managed..

d. The External Manager may not invest in its own stocks or its affiliates.

e. The External Manager may contract futures, forwards or currency swaps whose notional amounts valued at market price and in absolute value, may not in aggregate exceed 10% of the portfolio managed.

f. Borrowing is not allowed for investment purposes except to cover any failure of an instrument in settlement.

g. ETFs cannot represent more than 10% of the portfolio.

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**2.9. External cash movements**

External cash movements in the Portfolio of High-Yield Bonds will result from the application of the rebalancing policy to converge the Strategic Composition of Assets of the FRP or withdrawals from the fund.

The rebalancing policy of the FRP will take place in the following situations:

a. When an asset class exceeds the deviation range for that asset class, or

b. In case of a contribution to the FRP.

Every time a rebalance or withdrawal occurs from the FRP, the Ministry of Finance will instruct the amounts to transfer to/from and/or between the External Managers, if applicable. When an external cash contribution is made, the External Manager will be granted a special waiver of 10 bank business days, from the day of the contribution, regarding compliance with the requirements of sections 1,2.2, and the first and last paragraph of section 2.5. When an external cash withdrawal is made, the External Manager will be granted a special permit of 10 bank business days, before and until the day of the withdrawal, regarding compliance with the requirements of sections 1, 2.2, and the first and last paragraph of section 2.5. The special permit may be extended at the request of any of them to the Ministry of Finance, justifying the reasons for said extension. If there is a term of less than 10 business days between the date of the cash withdrawal instruction and the withdrawal itself, it will be understood that the special permit will be of that term.

**3. Valuation Criteria**

The valuation of the portfolio will be according to the "marked to market" criterion, using the valuation sources of Custodian Bank.

**4. Securities loan program**

The External Manager may not carry out or agree on securities lending programs. Nonetheless, the Ministry of Finance understands and accepts that the FEES portfolio may be exposed to a securities lending program through the investment of the ETFs authorized in these guidelines.

**5. Others**

Foreign exchange operations will be considered spot operations according to the convention used in each market. However, exchange operations related to the purchase or sale of an instrument will be considered a spot when the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purposes of the performance of the External Manager is the US$.

In the event that at any time any of the instructions described in these guidelines are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the External Manager, the latter will not be considered in default of the guidelines if it takes the necessary measures to ensure compliance within seven business days after the situation has been detected. This period may be extended from a request made by the External Manager to the Ministry of Finance, justifying the reason for the extension.

## Note 4 – SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

### 4.1. Significant accounting estimates.

Management makes estimates and formulates assumptions about the future. The resulting accounting estimates rarely tend, by definition, to be equivalent to the actual related results. The estimates and assumptions having a significant risk of causing important adjustments to the accounting values of assets and liabilities within the next financial year are described below:

Fair value of instruments are not quoted in an active market, or traded in the stock market.

The fair value of such values not quoted in an active market cannot be determined using sources of price such as pricing agencies or indicative prices of “Market Markers” for bonds and debts, so they are obtained from the Custodian's information.

The models use observable data, as applicable. However, factors such as credit risk (both own and counterparty), volatilities and correlations require the management to make estimates. Changes in the assumptions about these factors may affect the reported fair value of the financial instruments.

Determining what “observable” means requires a significant criteria of the Fund’s management. Thus, observable data are considered to be those market data that can be readily available, regularly distributed or updated, reliable and verifiable, not private (for exclusive use), and provided by independent sources that participate actively in the relevant market.

### 4.2 Significant judgments when applying accounting policies

*Functional currency*

The Administration considers the US dollar as the currency that most faithfully represents the economic effect of transactions, facts and underlying conditions. The US dollar is the currency in which the contributions from the Chilean State are received.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The portfolio of the FRP is mostly exposed to the same risks of the FEES. However, the FRP has a higher financial risk as it is exposed to a larger number of countries and their investment in corporate bonds. As in the case of the FEES, most of the risks directly depend on the composition by asset class and the selected benchmarks given the passive investment strategy in the policy of the fund investment.

5.1. Market risk:

Market risk in the FRP derives on the one hand from potential losses due to decrease in the market value of the financial instruments of the portfolio. As in the FEES, the fixed income portfolio is exposed to the risks of interest rate and exchange rate, and the credit risk premium. On the other hand, this fund is also exposed to equity risk. These risks and their control are described below:

*Interest rate risk*: In the FRP this risk depends on the duration of the benchmark. This is calculated from the duration of the indexes that compose the benchmark. Unlike the FEES, the fixed income portfolio of the FRP is exposed to interest rate risk of a larger number of countries and is more sensitive as it has a longer duration. This risk is monitored controlling that the duration of the portfolio was closer to that of the benchmark.

*Exchange rate risk:* Since the FRP return is measured in dollars, the value of investments is also affected by the variations in exchange rates. Due to the passive investment strategy, the exchange exposure comes from investment denominated in Euros (18%, yens (11%) and sterling pounds (7%), Canadian dollars (3%), Australian dollars (1%) and others with lower participation.

*Credit risk premium:* The market value of the fixed income instruments of the FRP are exposed to changes in the market perception about the solvency of the issuers of these instruments. In general, a worsening in the issuer's solvency is related to a credit risk premium in the instruments issued, which originates the fall of its market value. This risk is higher in the FRP (compared to the FEES) because its fixed income portfolio includes many issuers around the world. For instance, the fund invests in instruments issued by several sovereign issuers, in developed or developing countries, and by issuers as public or semipublic agencies, multilateral financial institutions and companies among others. This risk is mitigated having a diversified portfolio and investing in instruments that only have investment degree (with a BBB- rating) or higher.

Moreover, since 2015 it is possible to invest in supranational entities, agencies and entities with explicit state guarantees that are eligible to invest in the portfolio of international reserves where the Central Bank of Chile invests.

*Equity risk:* This risk refers to losses the FRP may suffer as a result of falls in stock prices included in its portfolio. The intrinsic risk of an individual stock is eliminated at investing in a highly diversified portfolio and willing to tolerate the systematic risk related to the used equity index (MSCI ACWI ex Chile). The strategic composition of assets considers 40% of the total portfolio of stocks.

*Volatility VaR and tracking error: Volatility can also be measured in terms of the Benchmark. It is possible to evaluate how closely a portfolio follows the index to which it is benchmarked. In the case of the FRP, the ex-ante tracking error is used, to predict with a certain degree of confidence, the deviation degree of the portfolio from the benchmark.*

5.2. Credit Risk Management:

In the portfolio of bonds of the FRP, the exposure to this risk is controlled mainly through a diversified portfolio and allowing investments only in the benchmark issuers. In the case of banking deposits, this risk is low because the terms of bank deposits are very short and also associated primarily to cash investment that is necessary for the portfolio management. There is also a minimum credit rating and limits on the amount that can be deposited in a bank. In the case of credit rating associated to forward operations, it is limited through requirements for the minimum credit quality the counterparties must have and defining a maximum exposure in each one of them (please see Table 6). It has also been determined that forward operations do not exceed a certain percentage of the portfolios that each Manager controls. In the case of the portfolio managed by the Central Bank of Chile, forwards and swaps cannot represent more than 4% of the portfolio. For External Managers this limit also includes futures operations in order to limit the total use of derivative instruments. Therefore, forwards, swaps and futures cannot represent more than 10% of the portfolio of each external manager. From 2015, it is allowed to invest in supranational entities, agencies and entities with an explicit state guarantee eligible for investment by the Central Bank of Chile in the management of its International Reserve portfolio. These entities have a high credit rating.

Moreover, since 2015 it is possible to invest in supranational entities, agencies and entities with explicit state guarantees that are eligible to invest in the portfolio of internationals reserves where the Central Bank of Chile invests, which have a high credit quality.

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**Table 6. Credit limits, bank deposits and forwards**
**(in millions of Dollars unless otherwise stated)**

| Limits | | Time Deposits | Forwards |
|---|---|---|---|
| Minimum risk Classification | | A- | AA- |
| Counterparty maximum | Portfolio BCCh | 20 | 1% (a) |
| | External managers | 20 | 1% (a) |

(a) Percentage of the portfolio of each manager
Source: Ministry of Finance

On the other hand, the risk rising from executing transactions, that is, the losses that may occur in case that the counterparty does not deliver the instruments when they are purchased or the payment when they are sold, is mitigated through the use of transactional or post-transactional structure that allow the delivery of instruments against payment. Finally, the risk of maintaining the investments under a custodian institution is controlled registering the property of the funds in Treasury’s name and in segregated accounts.

5.3. Liquidity Risk:

The FRP is exposed to a low liquidly risk because the fund has little need for cash, because the disbursements from the fund started in 2016. The sale of instruments of the portfolio is mainly associated with changes in the benchmarks, which can require the portfolio managers to make an adjustment (that is to sell an instrument that is out of the benchmark in order to purchase one that was incorporated), and with the possible rebalancing which is triggered when an asset class exceeds the permissible deviation range or when the fund receives contributions. In the case of changes in the benchmark, the investment guidelines allow some flexibility for managers to make the necessary adjustments, to reduce the impact of selling at an unfavorable time. For rebalancing, there are clear standards on planning its implementation.

5.4. Operational Risk:

The operational risk refers to losses that may occur as a result of errors in internal processes, systems, external events or human failures. Examples of operational risks are transaction errors, frauds, failures in the execution of legal responsibilities (contracts), etc.

In the case of the portfolio managed by the Central Bank of Chile, the operational administration of the funds is made using the same infrastructure of the issuer available for the management of the international reserves. The Central Bank of Chile (“BCCh”) also has control processes that consider an appropriate separation of responsibilities and duties, computer applications according to market quality standards and backup systems to guarantee the operational continuity of the funds. This is in addition to internal and external audit processes performed at the BCCh in order to assess the efficacy of current controls

On the other hand, in the case of the portfolio managed by External Managers, this risk is reduced hiring Managers who have wide experience in the area, a high reputation in the market and strong management systems. Likewise, the Managers’ performance is overseen and if their job is unsatisfactory, the contract will be terminated.

NOTE 6 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

As of December 31 2019 and 2018, the investments at fair value amount US$ 10.767.797.233 and US$9,623,167,333 respectively.

a) As of December 31, 2019 and 2018, the detail of investments at fair value through profit or loss is as follows:

| **Custodian Investment, J.P. Morgan** | **Fair Value Hierarchy Level** | **2019 US$** | **2018 US$** |
|---|---|---|---|
| Stocks | 1 | 3,044,464,557 | 1,646,913,209 |
| Other capitalization instruments | 1 | 72,406,412 | 36,863,216 |
| Corporate bonds | 1 | 2,040,701,638 | 1,986,132,197 |
| Government bonds | 1 | 4,077,862,200 | 4,732,741,209 |
| Mortgage backed securities | 1 | 554,187,511 | - |
| Indexed bonds | 1 | 917,760,925 | 1,219,529,867 |
| Treasury bills | 1 | 58,987,701 | - |
| Derivatives | 1 | 1,426,289 | 699,422 |
| **Subtotal** | | **10.767.797.233** | **9,622,879,120** |

| **Custodian Investment Central Bank of Chile** | **Fair value Hierarchy level** | **2019 US$** | **2018 US$** |
|---|---|---|---|
| Time deposits | 2 | - | 288,213 |
| **Subtotal** | | **-** | **288,213** |
| **Total** | | **10,767,797,233** | **9,623,167,333** |

b) As of December 31, 2019 and 2018, the detail of investments, in accordance with investment currency, is the following :

| Original currency | Fair value instruments, JP Morgan | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % of IP | US$ | % of IP |
| US dollar | 5,862,802,027 | 54.45 | 4,255,585,035 | 44.22 |
| Euro | 1,928,010,605 | 17.91 | 2,172,973,012 | 22.58 |
| Yen | 1,125,980,972 | 10.46 | 1,314,469,355 | 13.66 |
| Others | 1,851,003,629 | 17.19 | 1,879,851,718 | 19.54 |
| **Subtotal** | **10,767,797,233** | **100.00** | **9,622,879,120** | **100.00** |

| Original currency | Fair value instruments, Central Bank of Chile | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % of IP | US$ | % of IP |
| US dollar | - | - | - | - |
| Others | - | - | 288,213 | 100.00 |
| **Subtotal** | **-** | **-** | **288,213** | **100.00** |
| **Total** | **10,767,797,233** | **-** | **9,623,167,333** | **-** |

c) As of December 31, 2019 and 2018, the total value of assets per risk sector is detailed below:

| Risk sector | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Capitalization instruments | 3,116,870,969 | 28.83 | 1,683,776,425 | 17.42 |
| Bank (*) | 45,853,450 | 0.42 | 41,327,403 | 0.43 |
| Bonds | 7,590,512,274 | 70.20 | 7,938,403,273 | 82.15 |
| Treasury bills | 58,987,701 | 0.55 | - | - |
| **Total** | **10,812,224,394** | **100.00** | **9,663,507,101** | **100.00** |

| Asset class | Market value | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | US$ | % | US$ | % |
| Capitalization instruments | 3,116,870,969 | 28.83 | 1,683,776,425 | 17.42 |
| Money market | 45,853,450 | 0.42 | 41,327,403 | 0.43 |
| Corporate bonds | 2,040,701,638 | 18.86 | 1,986,132,196 | 20.55 |
| Sovereign bonds | 4,077,862,200 | 37.72 | 4,732,741,209 | 48.98 |
| Inflation-indexed bonds | 917,760,925 | 8.49 | 1,219,529,867 | 12.62 |
| Mortgage backed securities | 554,187,511 | 5.13 | - | - |
| Treasury bills | 58,987,701 | 0.55 | - | - |
| **Total** | **10,812,224,394** | **100.00** | **9,663,507,101** | **100.00** |

(*) Including cash and cash equivalents.

NOTE 7 – DERIVATIVE FINANCIAL INSTRUMENTS

As of December 31, 2019, and 2018, the financial liabilities at fair value through profit or loss amount US$140.315 and US$257.583 respectively.

a) The detail of derivatives valued at fair value is as follows:

| **Investment, Custodian J.P. Morgan** | **Fair value hierarchy level** | **2019 US$** | **2018 US$** |
|---|---|---|---|
| Derivatives | 1 | 140,315 | 257,583 |
| **Subtotals** | | **140,315** | **257,583** |

b) The detail of derivatives, in accordance with investment currency is as follows:

| **Original currency** | **Instruments at Fair Value JP Morgan** | | | |
|---|---|---|---|---|
| | **2019** | | **2018** | |
| | **US$** | **% del PI** | **US$** | **% del PI** |
| USD | 70,158 | 50.00 | 128,791 | 50.00 |
| EUR | 17,539 | 12.50 | 64,396 | 25.00 |
| JPY | - | - | - | - |
| Others | 52,618 | 37.50 | 64,396 | 25.00 |
| **Total** | **140,315** | **100.00** | **257,583** | **100.00** |

c) The detail of liabilities classified by risk sector is as follows:

| **Risk sector** | **Market value** | | | |
|---|---|---|---|---|
| | **2019** | | **2018** | |
| | **US$** | **%** | **US$** | **%** |
| Banking | 140,315 | 100.00 | 257,583 | 100.00 |
| **Total** | **140,315** | **100.00** | **257,583** | **100.00** |

| **Liability class** | **Market value** | | | |
|---|---|---|---|---|
| | **2019** | | **2018** | |
| | **US$** | **%** | **US$** | **%** |
| Money market | 140,315 | 100.00 | 257,583 | 100.00 |
| **Total** | **140,315** | **100.00** | **257,583** | **100.00** |

## NOTE 8 – FOUNDATION OF THE FUND

The Fund was founded on September 30, 2006, designating the Central Bank of Chile to manage it as Fiscal Agent, J.P. Morgan as Custodian Bank, and also designating the External Managers. The movements recorded for these entities for the year ended December 31, 2019 and 2018, are as follows:

| | 2019 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Contributions US$ | Withdrawals US$ | Retribution to BCCh as Fiscal Agent (1) US$ | Custody Of the Portfolio Administrated by BCCh | Custody of the portfolios External Managers US$ | BlackRock US$ | Mellon US$ | Allianz US$ | BNP Paribas US$ | Nomura HY US$ | Western Asset US$ | Others US$ |
| January | - | - | - | (151,369) | (143,609) | (488,630) | - | - | - | - | - | - |
| February | - | - | - | - | - | - | (115,730) | (155,218) | - | - | - | - |
| March | - | - | (271,489) | (74,804) | (66,232) | - | - | - | - | - | - | - |
| April | - | - | - | - | - | (248,424) | - | - | - | - | - | (82,765) |
| May | - | - | - | (133,027) | (196,671) | - | (155,058) | (110,491) | - | - | - | (14,618) |
| June | 563,889,347 | (576,509,611) | (271,489) | (82,625) | (93,554) | - | - | - | (30,679) | (211,505) | (38,520) | - |
| July | - | - | - | (25,989) | (46,084) | (327,898) | - | - | - | - | - | (788) |
| August | - | - | - | - | - | (105,579) | (168,802) | (113,590) | - | - | - | - |
| September | | - | (271,489) | (86,659) | (89,985) | (271,562) | - | - | - | - | - | - |
| October | - | - | - | (173,293) | (217,751) | (110,104) | - | - | - | (281,276) | - | - |
| November | - | - | - | (177,560) | (202,505) | (290,784) | (187,018) | (116,872) | (83,799) | - | (52,505) | (4,500) |
| December | - | - | (271,489) | (171,380) | (189,678) | - | - | - | - | (284,820) | - | - |
| **Total** | **563,889,347** | **(576,509,611)** | **(1,085,956)** | **(1,076,706)** | **(1,246,069)** | **(1,842,981)** | **(626,608)** | **(496,171)** | **(114,478)** | **(777,601)** | **(91,025)** | **(102,671)** |

(1) Ordinary Official Letter N° 1.890 of 08/10/2018 of the Ministry of Finance authorizes retribution payments of 2019, for the services of Portfolio management and others.

| | 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Contributions US$ | Withdrawals US$ | Retribution to BCCh as Fiscal Agent (1) US$ | Custody Of the Portfolio Administrated by BCCh US$ | Custody of the portfolios External Managers US$ | BlackRock US$ | Mellon US$ | Allianz US$ | Others US$ |
| January | - | - | - | - | - | - | - | - | (70,941) |
| February | - | - | - | (148,942) | (126,293) | - | - | (160,894) | - |
| March | - | - | (278,968) | - | - | (243,091) | (102,644) | - | - |
| April | - | - | - | (149,762) | (120,622) | - | - | - | (363,711) |
| May | - | - | - | - | - | - | (104,171) | (161,122) | - |
| June | - | - | (278,968) | (75,909) | (61,469) | - | - | - | - |
| July | - | - | - | (148,585) | (128,195) | - | - | - | - |
| August | - | - | - | - | - | (241,157) | - | (157,706) | (630) |
| September | 541,576,255 | (295,225,185) | (278,968) | (149,965) | - | - | (103,285) | - | (31,529) |
| October | - | - | - | (77,102) | - | - | - | - | - |
| November | - | - | - | - | (187,886) | - | - | (157,782) | - |
| December | - | (229,827,482) | (278,968) | (76,303) | (89,308) | - | (114,089) | - | (70,588) |
| **Total** | **541,576,255** | **(525,052,667)** | **(1,115,872)** | **(826,568)** | **(713,773)** | **(484,248)** | **(424,189)** | **(637,504)** | **(537,399)** |

(1) Ordinary Official Letter N°45 of 11-10-2017 of the Ministry of Finance authorizes retribution payments of 2018, for the services of portfolio management and others.

## NOTE 9 – INTEREST EARNED

As of December 31, 2019 and 2018, the detail of income for interest earned short-term debt at fair value through profit or loss is as follows:

| | 2019 US$ | 2018 US$ |
|---|---|---|
| Interest earned, Portfolio Art. 4 | 102,484,472 | 117,601,642 |
| Interest earned, Externally managed portfolio | 98,359,846 | 67,281,502 |
| **Total** | **200,844,318** | **184,883,144** |

NOTE 10 – DIVIDEND INCOME

As of December 31 2019 and 2018, the detail of “Dividend income” is as follows:

| Dividend due to investment administrated by | 31/12/2019 US$ | 31/12/2018 US$ |
|---|---|---|
| Fiscal Agent | 826,596 | - |
| Mellon Capital Management Corporation. | 31,802,188 | 18,336,914 |
| BlackRock Institutional Trust Company, N.A. | 31,668,357 | 18,483,780 |
| Allianz Global Investors Corps | (1,045) | - |
| Nomura Corporate Research and Asset Management Inc. | (12,493) | - |
| BNP Paribas Asset Management USA Inc. | - | - |
| **Total** | **64,283,603** | **36,820,694** |

NOTE 11 – CASH AND CASH EQUIVALENTS

As of December 31, 2019 and 2018, the detail of cash and cash equivalents is as follows:

| Cash in Custodian’s and External Manager’s accounts | 31/12/2019 US$ | 31/12/2018 US$ |
|---|---|---|
| J.P. Morgan | 8,915,505 | 18,858,887 |
| Mellon Capital Management Corporation | 3,933,674 | 3,221,275 |
| Allianz Global Investors Corps | 4,930,023 | 4,790,323 |
| BlackRock Institutional Trust Company, N.A. | 16,472,572 | 13,469,283 |
| Nomura Corporate Research and Asset Management Inc. | 9,164,290 | - |
| BNP Paribas Asset Management USA Inc | 1,011,097 | - |
| **Total** | **44,427,161** | **40,339,768** |

NOTE 12 – PROFITABILITY OF THE FUND

In the years ended December 31, 2019 and 2018, the profitability of the Fund has been as follows:

| Type of Profitability | Accumulated Profitability | | |
|---|---|---|---|
| | 2019 | Last 12 months | Last 24 months |
| Nominal | 1.56% | 12.04% | 6.13% |

NOTE 13 – FAIR VALUE

The Fund has applied IFRS 13 to determine the fair value of its financial assets and liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB).

The definition of fair value corresponds to the price that would be received for selling an asset or paid for transferring a liability in a transaction between market participants on the date of measure (that is, an input price) The transaction is made in the main or most advantageous market and it is not forced, that is, it does not consider Fund's specific factors that may be included in the real transaction.

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| | 31/12/2019 | | | 31/12/2018 | | |
|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | **Level** | **Net Book Value US$** | **Fair Value US$** | **Level** | **Net Book Value US$** | **Fair Value US$** |
| Cash and cash equivalent. | 1 | 44,427,161 | 44,427,161 | 1 | 40,339,768 | 40,339,768 |
| Stocks | 1 | 3,044,464,557 | 3,044,464,557 | 1 | 1,646,913,209 | 1,646,913,209 |
| Other capitalization instruments | 1 | 72,406,412 | 72,406,412 | 1 | 36,863,216 | 36,863,216 |
| Corporate bonds | 1 | 2,040,701,638 | 2,040,701,638 | 1 | 1,986,132,197 | 1,986,132,197 |
| Time deposits | 1 | - | - | 2 | 288,213 | 288,213 |
| Government bonds | 1 | 4,077,862,200 | 4,077,862,200 | 1 | 4,732,741,209 | 4,732,741,209 |
| Mortgage Backed Securities (MBS) | 1 | 554,187,511 | 554,187,511 | 1 | - | - |
| Indexed bonds | 1 | 917,760,925 | 917,760,925 | 1 | 1,219,529,867 | 1,219,529,867 |
| Treasury bills | 1 | 58,987,701 | 58,987,701 | 1 | - | - |
| Derivatives | 1 | 1,426,289 | 1,426,289 | 1 | 699,422 | 699,422 |
| **FINANCIAL LIABILITIES** | | | | | | |
| Derivative Financial Instruments | 1 | 140,315 | 140,315 | | 257,583 | 257,583 |

During the years 2019 and 2018, all the assets and liabilities of the Fund have been valued at fair value through profit or loss, using for that purpose, the prices quoted in the stock market (level 1). As of December 31, 2019 and 2018, the Fund has not made transfers of fair value hierarchy.

NOTE 14 – LIENS AND PROHIBITIONS

In accordance with the Official Letter N° 1.267 of June 4, 2013, Title II N° 5 of the Ministry of Finance of Chile, the Fiscal Agent for the Portfolio, Article 4, may arrange with the Fund Custodian(s), securities lending programs, in accordance with the operational criteria established in the Guidelines on Custody of the Fund, including the obligation to return the respective titles or, otherwise, their market value. The resources obtained or disbursed will be registered on the financial statements of the Sovereign Wealth Fund as results of the year.

As of December 31, 2019 and 2018, the Fund has the following instruments as “Securities Lending”:

| Year 2019 | | |
|---|---|---|
| **Location** | **Nominal Value** | **Market Value US$** |
| Europe | 241,707,914 | 302,056,613 |
| United States of America | 172,554,845 | 301,720,728 |
| **Total** | **414,262,759** | **603,777,341** |

| Year 2018 | | |
|---|---|---|
| Location | Nominal Value | Market value US$ |
| Europe | 147,449,000 | 217,579,417 |
| United States of America | 94,935,000 | 108,967,850 |
| **Total** | **242,384,000** | **326,547,267** |

NOTA 15 – CUSTODY OF SECURITIES

As of December 31, 2019 and 2018, the detail of the custody of securities is as follows:

December 31, 2019:

| Entities | Custody of Securities | | | | | |
|---|---|---|---|---|---|---|
| | Amount in Custody amount (US$) | National Custody % of total investments in instruments issued by National Issuers | % of total Asset of the Fund | Amount in Custody (US$) | Foreign Custody % of total investments in instruments issued by Foreign Issuers | % of total Asset of the Fund |
| Security Deposit Companies | - | - | - | - | - | - |
| Other entities (*) | - | - | - | 10,154,481,706 | 100.00 | 98.99 |
| **Total portfolio of investments in custody** | **-** | **-** | **-** | **10,154,481,706** | **100.00** | **98.99** |

(*) These amounts are compensated between financial instruments of asset and liability,

December 31, 2018:

| Entities | Custody of Securities | | | | | |
|---|---|---|---|---|---|---|
| | Amount in Custody (US$) | National Custody % of total investments in instruments issued by National Issuers | % of total Asset of the Fund | Amount in Custody (US$) | Foreign Custody % of total investments in instruments issued by Foreign Issuers | % of total Asset of the Fund |
| Security Deposit Companies | - | - | - | - | - | - |
| Other entities (*) | - | - | - | 9,622,909,750 | 100.00 | 99.58 |
| **Total portfolio of investments in custody** | **-** | **-** | **-** | **9,622,909,750** | **100.00** | **99.58** |

(*) These amounts are offset between financial instruments of asset and liability,

NOTE 16 – RELEVANT EVENTS

At the closing date of these financial statements, no relevant events that could significantly affect the balance or interpretations of these financial statements have been presented,

NOTE 17 – SUBSEQUENT EVENTS

Between January 1, 2020 and the issuance date of these financial statements (March 25, 2020), no subsequent events have occurred, which could significantly affect the balances or interpretation of these financial statements.

# APPENDIXES

# Appendix 1: Self-assessment of compliance with Santiago Principles: 2020

In line with Chile's commitment to international best practices, the Government of Chile has participated actively in international initiatives aimed at establishing an operational framework for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance played an active role in the International Working Group of Sovereign Wealth Funds (IWG-SWF), which was established in May 2008 to formulate and promote a common set of voluntary principles for sovereign wealth funds.

In 2008, the IWG-SWF held a series of meetings in which members shared opinions on the development and definition of these voluntary principles. The key meeting in this process took place in Santiago, Chile, in September 2008, when an agreement was reached on a series of Generally Accepted Principles and Practices backed by the main countries with sovereign wealth funds. This agreement is known internationally as the Santiago Principles. These principles are based on existing practices and are intended to facilitate the free circulation of cross-boarder investments and promote the openness and stability of financial systems.

Therefore, the Finance Ministry has decided to include in its annual report the sixth self-assessment of the sovereign wealth funds' compliance with each of the Santiago Principles. This is part of this Administration's efforts to improve the publicly available information on the funds and to demonstrate that they are managed in accordance with international best practices. The rest of this appendix describes the principles and assesses the Chilean funds' compliance with each one as of May 2020.

**GAPP 1[1]. Principle:**

The legal framework for the sovereign wealth fund (SWF) should be sound and support its effective operation and the achievement of its stated objective(s).

**GAPP 1.1 Sub-principle:**

The legal framework for the SWF should ensure the legal soundness of the SWF and its transactions.

**GAPP 1.2 Sub-principle:**

The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

**Assessment:**

The institutional framework of the Chilean sovereign wealth funds (SWFs) is established by different laws and decrees that define their operating rules. The main legal text is Law N° 20,128 on Fiscal Responsibility, which establishes the regulations and institutional framework for the accumulation and management of fiscal resources. Specifically, the Fiscal Responsibility Law (FRL) created Pension Reserve Fund (PRF) and authorized the creation of the Economic and Social Stabilization Fund (ESSF), which was officially established via Statutory Decree N° 1 of 2006, issued by the Ministry of Finance (DFL1). The FRL further stipulates that the Finance Ministry is responsible for defining the investment policy, with advice from the Financial Committee, and that it can delegate the management of the SWFs to the Central Bank of Chile (CBC), the Treasury, or external managers.

The use of the two SWFs is defined in the FRL, DFL1, and Law N° 20.255 (the Pension Reform Law). Fund withdrawals must be authorized through Finance Ministry Decree and are executed by the CBC and the Treasury. The SWFs are subject to audit by the Office of the Comptroller General.

Executive Decree N° 1,383 of 2006, from the Ministry of Finance, delegates the management of both SWFs to the CBC, in the

1 Generally accepted principles and practices.

role of fiscal agent, and establishes the general regulatory framework for their management. This decree was modified in 2013 to reduce the CBC's responsibilities for supervising and monitoring those asset classes that are not eligible for its international reserves and that are managed by external portfolio managers. Since 2014, the relationship with external managers managing asset classes not elegible for the CBC's international reserves corresponds to the Ministry of Finance, which is also responsible for their supervision.

Executive Decree N° 621 of 2007, from the Ministry of Finance, created the Financial Committee, with the purpose of advising the Finance Minister on the diverse issues that need to be taken into account in the definition of the SWF investment policy.

Thus, the regulatory framework governing the Chilean SWFs has solid, transparent foundations, supports efficient operations, and facilitates the achievement of the objectives for which they were created. The regulatory framework has been published in the Official Gazette and is also available online the SWF website (www.hacienda.cl/areas-de-trabajo/finanzas-internacionales/fondos-soberanos/normativa).

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**GAPP 2. Principle:**

The policy purpose of the SWF should be clearly defined and publicly disclosed.

**Assessment:**

The objective of the PRF is established in the FRL and the Pension Reform Law; that of the ESSF, in the FRL and DFL1. All the legislations related to this principle available online at https://www.hacienda.cl/areas-de-trabajo/finanzas-internacionales/fondos-soberanos/normativa. In addition, the policy objectives of the SWFs are clearly described in the annual report prepared by the Finance Ministry, which is publicly available on its website: https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds.

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**GAPP 3. Principle:**

Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

**Assessment:**

The resources held in the two SWFs are invested entirely in foreign currency and entirely overseas; the domestic macroeconomic impact is therefore minimal. However, the ESSF has direct consequences on the domestic macroeconomy, deriving from its objective of financing fiscal deficits that could arise in periods of low growth and/or low copper prices. The decision and timing of withdrawals from this fund are determined by the Finance Ministry, since they could affect the value of the peso-dollar exchange rate. To minimize this impact, withdrawals from the ESSF and their conversion to pesos, when necessary in the past, have been coordinated with the country's other fiscal and monetary authorities. In the case of the PRF, part of its capital can be use to finance fiscal pension liabilities as of 2016. However, the annual withdrawals from this fund are limited to a maximum amount equivalent to one-third of the difference between the pension expense in the year and the inflation-adjusted pension expense in 2008, which is a relatively small amount that does not have implications for the exchange rate.

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**GAPP 4. Principle:**

There should be clear and publicly disclosed policies, rules, procedures or arrangements in relation to the SWF's general approach to funding, withdrawal and spending operations.

**GAPP 4.1 Sub-principle:**

The source of SWF funding should be publicly disclosed.

**GAPP 4.2 Sub-principle:**

The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

**Assessment:**

The rules on fund contributions are established in the FRL and DFL1; while the uses of the resources are defined in the FRL, the DFL1, and the Pension Reform Law, as part of their legal framework. The law authorizes the Ministry of Finance to determine the timing and amount of withdrawals, which is then publicly reported. Fiscal expenditures, in turn, must be approved by the Chilean National Congress each year in the budget process.

As indicated above, the legislation applicable to the SWFs is available on their website. Contributions and withdrawals, as well as the expenses associated with operating the funds, are periodically reported to the public. Contributions and withdrawals are published in monthly, quarterly, and annual reports. Expenses are divulged in quarterly and annual reports.

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**GAPP 5. Principle:**

The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

**Assessment:**

The CBC and the external managers prepare daily and monthly reports on the state of the SWFs and their investment performance. These reports are submitted to the Finance Ministry and the Treasury. Additionally, the CBC prepares quarterly and annual reports that are also sent to the Finance Ministry and the Treasury.

Based on information provided by the CBC and the custodian bank, the Finance Ministry publishes monthly reports that include information on the funds' investment returns, size, contributions, withdrawals, and portfolio allocation. The Finance Ministry also prepares quarterly reports that complement the publicly available information, as well as an annual report on the state of the SWFs. The Financial Committee prepares its own annual report on its activities and recommendations, which is submitted to the Finance Minister, the Finance Committees of the Senate and the House of Representatives, and the Special Budget Committee. All these reports are available on the SWF website.

**GAPP 6. Principle:**

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

**Assessment:**

The legal framework establishes a clear division of roles and responsibilities that facilitates accountability and the operational independence of fund management. The FRL establishes that the SWFs are the property of the Treasury of Chile and that the Treasury holds the title to the resources. In accordance with the provisions of the FRL, the Finance Minister is responsible for making decisions on the management of the SWFs and their investment policies.

For the definition of the SWF investment policy, the Finance Minister receives support from the Financial Committee, which assists with the analysis of various aspects that should be taken into account in the decision. The Ministry then prepares investment guidelines specifying the instruments and issuers eligible for investment, as well as other issues such as investment limits or the use of derivatives.

The external portfolio managers are responsible for investing the equity, investment-grade corporate bond, high-yield bond, and U.S. agency mortgage-backed security (MBS) portfolios, in accordance with their individual contracts. The CBC is responsible for investing the sovereign fixed-income portfolios (including bank deposits in the case of the ESSF) and of supervising the MBS external managers. Both the CBC and the external managers are fully independent to invest the SWFs, subject to the instructions and restrictions defined by the Ministry of Finance in the investment guidelines.

The custodian bank, contracted by the CBC in representation of the Treasury, is responsible for securities custody and also performs middle-office tasks, such as reporting on compliance with investment limits, calculating the performance of each manager, and preparing financial and accounting reports on the SWFs.

The Sovereign Wealth Fund Unit within the finance Ministry's International Finance Area supervises the investment by the CBC and the external managers of equities, investment grade, corporate bonds and high yield bonds, based on information provided by the custodian bank, the CBC, and the external managers. The unit also prepares monthly, quarterly, and annual reports based on information provided by the custodian bank; acts as administrative secretary for the Financial Committee; and provides support in all areas related to the SWF investment policy.

The Treasury is responsible for the SWF accounting, including the preparation of the audited financial statements and incorporation in the national accounts. As of April 2014, the Treasury is also responsible for monitoring compliance with investment limits, verifying the external managers' fees, and other administrative duties.

Finally, the Budget Office is responsible for all budgetary aspects related to the funds, such as contributions and withdrawals.

**GAPP 7. Principle:**

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

The FRL establishes the objectives of the SWFs and identifies the Finance Minister as the chief officer in charge of the funds, responsible for making decisions on their management and investment policy. The FRL names the Treasury as owner of the resources. The Finance Minister is appointed by the President of the Republic. The members of the Finance Committee are appointed by the Finance Minister, according to criteria established in Executive Decree N° 621 of 2007, from the Ministry of Finance.

With regard to oversight, the Ministry of Finance is responsible for monitoring the investment performance and strategy of the CBC and the external managers. As mentioned, as of April 2014 the Treasury monitors compliance with the investment guidelines, by reviewing the custodian bank's reports on compliance with investment limits and also undertaking an independent review of compliance with these limits.

Finally, the Office of the Comptroller General, an autonomous agency, is responsible for auditing the Chilean public sector finances and hence the SWFs.

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**GAPP 8. Principle:**

The governing body(ies) should act in the best interests of the SWF and have a clear mandate and adequate authority and competency to carry out its functions.

**Assessment:**

The institutional framework is defined in the legislation cited above. The FRL establishes that the Finance Minister is the chief officer in charge of the SWFs, with the responsibility to make decisions on their management and investment policy. To ensure an adequate performance of this task, the FRL mandated the creation of a Financial Committee, which advises the Minister on the analysis and design of the investment policies. While the Minister is not obligated to follow the Committee's recommendations, they are public and thus carry a reputational risk. Finally, the Finance Minister also created the Sovereign Wealth Fund Unit within the International Finance Area. The unit carries out any tasks required in relation to the investment of the SWFs and provides support to the Financial Committee.

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**GAPP 9. Principle:**

The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

**Assessment:**

The Finance Minister has defined the SWF investment policy and delegated the operational management of the funds to the CBC, which manages the sovereign fixed-income mandate for both funds (including bank deposits in the case of the ESSF), and the external managers, who manage the equity mandate for the ESSF and PRF as well as mandates for investment grade corporate bonds, high yield bonds and US Agency Mortgage Backed Bonds

(MBS) in the case of the PRF. All the fund managers follow the investment guidelines issued by the Ministry of Finance. These guidelines are reviewed and accepted by the CBC, which is a technical and autonomous agency and as such is independent of –and not subject to supervision by– the Government. The CBC and the external managers are fully independent to buy and sell instruments and decide on other operational aspects of fund management within the parameters established by the Finance Ministry in the investment guidelines. The CBC and the external managers submit periodic reports to the Finance Ministry (daily, monthly, quarterly, and annual reports in the case of the CBC; and daily and monthly reports in the case of the external managers) on the performance of their duties, including details on the SWF investments.

---

**GAPP 10. Principle:**

The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents or management agreement.

**Assessment:**

The accountability framework is established in the laws and decrees cited in the assessment of Principle 1. These were duly published in the Official Gazette and are available on the SWF website (https://www.hacienda.cl/areas-de-trabajo/finanzas-internacionales/fondos-soberanos/normativa) from the Chilean Library of Congress (www.bcn.cl).

To ensure an adequate and effective accountability framework, several reports are prepared by the different entities involved in managing the SWFs.

Article 12 of the FRL and Article 7 of the DFL1, which regulate the PRF and the ESSF, respectively, establish that the Finance Ministry must submit quarterly reports on the state of the SWFs to the House and Senate Finance Committees and the Special Budget Committee. Additionally, although not required by law, the Finance Ministry publishes an annual report on the SWFs. All these reports are available to the public on the SWF website mentioned above.

The CBC must report to the Finance Minister on the operational management of the SWFs, as established in Executive Decree N° 1,383. The CBC submits to the Finance Ministry daily, monthly, quarterly, and annual reports on its management performance and on the service provided by the external managers and the custodian bank.

The Financial Committee is an advisory body whose reporting obligations are established in Executive Decree N° 621, cited above. Pursuant to Article 7 of that decree, the Committee must present an annual report on its work to the Finance Minister and submit a copy of the report to the House and Senate Finance

Committees and the Special Budget Committee. This report is also available to the public on the SWF website.

Finally, the Office of the Comptroller General, an autonomous agency, is responsible for auditing the Chilean public sector finances and hence the SWFs.

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**GAPP 11. Principle:**

An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

**Assessment:**

The Ministry of Finance prepares an annual report on the SWFs based on information provided by the CBC, the external managers, and the custodian bank. This report includes financial information and is available to the public.

Since 2011, the Treasury prepares the financial statements, in accordance with IFRS, which are audited by an independent firm. The audited financial statements are published in the SWF annual report prepared by the Ministry of Finance.

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**GAPP 12. Principle:**

The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

**Assessment:**

SWF operations are audited by the Central Bank's internal auditors.

As indicated above, since 2011 the Treasury prepares the financial statements, in accordance with IFRS, which are audited by an independent firm following the auditing principles used in Chile.

---

**GAPP 13. Principle:**

Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management and staff.

**Assessment:**

The authorities and staff who perform tasks related to the Chilean SWFs are subject to professional and ethical standards by law, such as the principle of probity, which requires irreproachable professional conduct and the efficient and good-faith exercise of duties, in accordance with the general interest.

Additionally, all Finance Ministry staff and consultants are subject to a Code of Ethics, approved via Exempt Resolution N° 204, issued by the Undersecretary of Finance on 22 July 2016, which establishes legally applicable professional and ethical standards and is available on the SWF website (www.hacienda.cl/ministerio/codigo-de-etica-y-sistema-de-integridad).

Finally, the members of the Financial Committee are subject to ethical standards specified in the decree establishing the Committee, as well as additional standards defined internally.

**GAPP 14. Principle:**

Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

**Assessment:**

All transactions with third parties are based on economic and financial considerations. In the case of the Finance Ministry, there are rules and procedures in place that establish the steps that must be followed by employees for contracting third-party goods and/or services. The CBC and the Treasury must also comply with a series of clearly defined rules and procedures for this type of activity.

---

**GAPP 15. Principle:**

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

**Assessment:**

The procedures established by the CBC and the external managers are intended to guarantee that the operations and activities of the Chilean SWFs are executed in compliance with the applicable regulatory and reporting requirements in the countries in which they operate.

---

**GAPP 16. Principle:**

The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

**Assessment:**

The objective and the institutional framework of the SWFs are defined in the legal framework described above under Principle

The operational management is carried out by the CBC and external managers, which are independent from and are not supervised by the government. The operational framework for CBC management is defined in Executive Decree N° 1,383, 2006, from the Ministry of Finance, which was published in the Official Gazette. This information is also available on the SWF website (https://www.hacienda.cl/areas-de-trabajo/finanzas-internacionales/fondos-soberanos/normativa) and from the Chilean Library of Congress (www.bcn.cl). The external managers invest according to investment guidelines established by the Finance Ministry for the ESSF and PRF, which are available on the following websites: www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/economic-and-social-stabilization-fund/investment-policy/investment-guidelines and www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/pension-reserve-fund/investment-policy/investment-guidelines.

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**GAPP 17. Principle:**

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

**Assessment:**

Information on the size, absolute returns, and investment countries of the SWFs is published in monthly and quarterly reports prepared by the Finance Ministry. The annual report, also prepared by the Ministry, contains additional information. All these reports are available on the SWF website.

**GAPP 18. Principle:**

The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance and investment strategy, as set by the owner or the governing bodies, and be based on sound portfolio management principles.

**GAPP 18.1 Sub-principle:**

The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

**GAPP 18.2 Sub-principle:**

The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

**GAPP 18.3 Sub-principle:**

A description of the investment policy of the SWF should be publicly disclosed.

**Assessment:**

The current investment policy for the ESSF and PRF is consistent with their objectives and risk tolerance. A description of the SWF objectives and investment policies is included in the annual report prepared by the Finance Ministry. The investment guidelines are also available on the SWF website in Spanish and English.

The investment policy for each fund determines the financial risks to which they are exposed. Given the passive management approach, these risks mainly depend on the funds' strategic asset allocations and benchmarks. To date, the use of debt has not been allowed, while the use of derivatives is allowed solely for hedging or for gaining exposure to part of the benchmark. Currently, the SWFs are operationally managed by the CBC and external managers. The Central Bank of Chile and the external portfolio managers are supervised by the Finance Ministry and the Treasury, with the exception of the external U.S. agency MBS portfolio managers, which are supervised by the Central Bank because this asset class is eligible for investment of CBC international reserves. In general, the external managers must be contracted through a selection process carried out by the CBC, in accordance with its internal policies and procedures. The scope of the external managers' responsibilities and activities, as well as their supervision, are established in the corresponding investment guidelines.

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**GAPP 19. Principle:**

The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

**GAPP 19.1 Sub-principle:**

If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

**GAPP 19.2 Sub-principle:**

The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

**Assessment:**

The operational management of the SWFs has been delegated to the CBC and external managers, which make investment decisions autonomously, based solely on economic and financial grounds, and in accordance with the mandated passive management approach. The CBC uses the same operational standards as for its international reserves, which are audited and reviewed by international consultants. In the case of the external managers, the controls associated with the investment processes are audited independently, and the results of the audit are submitted annually to the Finance Ministry by the external managers. The Finance Ministry is responsible for defining the investment policy and guidelines, taking into account the opinion of the Financial Committee.

**GAPP 20. Principle:**

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

**Assessment:**

Investment decisions are executed independently by the CBC and the external managers, which, in their management, use operating procedures and parameters that incorporate the highest standards of integrity. Furthermore, the regulatory framework requires that the members of the Financial Committee base their recommendations exclusively on public information.

---

**GAPP 21. Principle:**

SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

**Assessment:**

The PRF began investing in equity in 2012; the ESSF, in 2013. However, given the passive investment approach –subject to a previously established benchmark– and the small volume relative to the size of each instrument in the benchmark, the Finance Ministry has chosen to follow a neutral strategy with regard to the voting rights associated with these investments.

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**GAPP 22. Principle:**

The SWF should have a framework that identifies, assesses and manages the risks of its operations.

**GAPP 22.1 Sub-principle:**

The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning and an independent audit function.

**GAPP 22.2 Sub-principle:**

The general approach to the SWF's risk management framework should be publicly disclosed.

**Assessment:**

The different entities that make up the organizational structure of the SWFs have in place procedures and controls, which together provide an adequate framework for managing the risks to which the SWFs are exposed. A detailed analysis of these risks is included in the SWF annual report published by the Finance Ministry.

The Finance Ministry defines the investment guidelines, which stipulate the maximum exposure to the main risks deriving from the SWF investments. The CBC and the external managers, who are responsible for determining and executing financial operations, monitor their investments to ensure that the limits established in the guidelines are not exceeded. Moreover, in its SWF management, the CBC uses the same operational framework applied to the investment of its international reserves, including a series of procedures and controls that allow mitigating not only operational risk, but also reputational and market risk. The external managers also implement a range of procedures, which are audited by external firms and reported annually to the Finance Ministry.

The custodian bank reports to the Finance Ministry's SWF Unit on the Central Bank's and external managers' compliance with the investment limits and on the portfolio risk level. As of April 2014, the Treasury supervises compliance with the investment guidelines on the part of the CBC and the external managers.

The reports submitted by the custodian bank, the CBC, and the external managers contain important information on the managed portfolios, ensuring the proper management of the SWFs. Finally, as indicated earlier, the main risks to which the SWFs are exposed are reported to the public in the annual report prepared by the Finance Ministry.

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**GAPP 23. Principle:**

The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

**Assessment:**

SWF returns are measured both in absolute terms and relative to the corresponding benchmark. The CBC, the external managers, and the custodian bank report the returns to the Finance Ministry, which, in turn, reports to the Financial Committee and also publishes the information. The methodology used to calculate returns and performance is based on Global Investment Performance Standards (GIPS®).

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**GAPP 24. Principle:**

A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

**Assessment:**

This is the sixth self-assessment of the Santiago Principles. As indicated in the first assessment in 2010, the exercise is carried out every two years. This self-assessment is also available on the SWF website.

# Appendix 2: Index of Tables, Figures and Boxes

| N° | Boxes | Pag |
|---|---|---|

# Appendix 3: Glossary

**Active management** — An investment strategy aimed at earning higher returns than a benchmark index.

**American Depositary Receipt (ADR)** — a financial security issued by a U.S. bank and negotiable in the United States, where the physical certificate represents a specific number of shares in a company that was incorporated outside that country.

**Alternative investments** — Investments in instruments other than traditional securities (such as equities and fixed-income instruments), in particular private equity, hedge funds, commodities and real estate.

**Asset class** — A specific investment category, such as equities, corporate bonds, sovereign bonds and money market instruments. The assets in a given class generally have similar risk characteristics, react similarly in the market and are subject to the same regulations.

**Basis point** — One one-hundredth of a percentage point: 1 basis point = (1/100) of 1%, or 0.01.

**Bond** — A financial liability of an organization (for example, a company or a government) to investors under which the issuer undertakes not only to return the capital, but also to pay an agreed interest rate at a specific date(as).

**Cash** — Cash on hand and bank demand deposits.

**Corporate bond** — A bond issued by a corporation or company.

**Credit default swaps (CDS)** — Financial instruments used by investors to protect against default on bond payments. They can also be used to take speculative positions on the bond covered by the CDS.

**Credit rating** — The degree of solvency of the issuer of a financial instrument (a company or country), as defined by a credit rating institution.

**Duration** — A parameter that measures a bond's sensitivity to interest rate movements. The longer the bond's duration, the greater its exposure to loss in response to an interest rate hike.

**Equity (Stock)** — An instrument that represents ownership in a corporation or company. Buyers of these securities become owners or shareholders and thus share in the firm's earnings and losses.

**Exchange rate return** — The share of the return deriving from fluctuations in the exchange rate between the dollar and the other currencies in which investments are made.

**Exchange traded funds (ETFs)** — Financial instruments traded on the stock exchange, which typically replicate a market index. They have traditionally been used to obtain passive exposure to equity indexes, but their use has been expanding into fixed-income instruments, commodities and even active strategies.

**Fiscal Responsibility Law** — Chilean Law N° 20,128, published in the Official Gazette on 30 September 2006.

**Fixed-income instruments** — Investment instruments that pay a fixed return at a specified time, which is known when the investment is made. Examples of fixed-income instruments include sovereign bonds, corporate bonds and bank deposits.

**Global Depositary Receipt (GDR)** — a financial security issued by a bank and negotiable in more than one country, where the physical certificate represents a specific number of shares in a company that was incorporated outside the countries in which the certificate is traded.

**Inflation-linked sovereign bond** — A bond that is adjusted based on a specified inflation index. In the case of the United States, these bonds are called Treasury Inflation-Protected Securities (TIPS).

**Internal rate of return (IRR)** — The effective rate of return on investments, calculated by setting the present value of all net cash flows to zero.

**Investment policy** — A set of criteria, principles and guidelines that regulate the amount, structure and dynamics of a portfolio's investments.

**LIBID** — The London interbank bid rate is the rate paid on interbank deposits; defined as the LIBOR less 0.125%.

**LIBOR** — The London interbank offered rate is the rate charged on interbank loans.

**Liquidity** — The facility with which an investment or instrument can be sold without significant loss of value.

**Money market instruments** — Short-term instruments with a maturity of less than one year, which are easily converted into cash and are less volatile than other asset classes.

**Mutual funds (MFs)** — An investment vehicle managed by an entity that pools capital from different investors in order to achieve exposure in different asset classes. Unlike ETFs, MFs are not traded on an exchange.

**Passive management** — An investment strategy aimed at replicating the returns of a representative index or indexes of a given asset class.

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**Portfolio** — A collection of investment instruments held by an individual or an institutional investor.

**Quantitative easing** — an unconventional monetary policy tool used by some central banks to increase the supply of money, usually through the purchase of bonds issued by its own government.

**Recognition bond (bonos de reconocimiento)** — A bond issued by the Chilean Institute for Pension Normalization on account of contributions made by workers to the former pay-as-you-go pension system prior to joining the current AFP system.

**Return in local currency** — A financial instrument's return in the denomination currency. Corresponds to the share of the return deriving from the interest rate level, interest rate movements, changes in credit quality and other factors.

**Risk** — The possibility of suffering financial losses; the variability of an investment's return.

**Securities risk (reputational risk or headline risk)** —The risk that the public's perception of an entity will worsen.

**Sovereign bond** — A bond issued by a government.

**Special Drawing Rights (SDR)** — International reserve assets created by the IMF to supplement its member countries' official reserves. SDRs can be exchanged for freely usable currencies.

**Spread** — The difference between the yield rates at maturity of two fixed-income instruments, which is used to measure their relative risk.

**Standard & Poor's Depositary Receipts (SPDR)** — The first ETF, created in 1993 with the goal of replicating the performance of the U.S. S&P500 stock index.

**TED spread** — The difference between the bank lending rate (LIBOR) and the risk-free rate (U.S. Treasury bills). A larger TED spread is typically associated with less liquidity in the market.

**Time-weighted rate of return (TWR)** — A measure of returns calculated by compounding or multiplying the daily returns without taking into account any contributions or withdrawals. In contrast to the IRR, the TWR eliminates the contribution of net cash flows.

**Total return** — The sum of the return in the local currency and the return from exchange rate movements.

**Tracking error (ex post or ex ante)** — An indicator used to measure how closely a portfolio tracks its benchmark. The ex post tracking error is calculated with historical data; the ex ante tracking error is a prediction of future performance.

**Value-at-Risk (VaR)** — A measure of the potential loss in a portfolio over a given period of time and with a given probability.

**Variable-income instruments** — Equities.

**Volatility** — A measure of a financial asset's risk, based on the variability or dispersion of the asset's price over a period of time.

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# Appendix 4: Abbreviations

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| ADR | American Depositary Receipt |
| AUD | Australian dollar |
| bp | Basis points |
| CAD | Canadian dollar |
| CBC | Central Bank of Chile |
| CBJ | Central Bank of Japan |
| CDS | Credit Default Swaps |
| CHF | Swiss franc |
| ECB | European Central Bank |
| ETF | Exchange-Traded Fund |
| EUR | Euro |
| FC | Financial Committee |
| FED | U.S. Federal Reserve |
| ESSF | Economic and Social Stabilization Fund |
| GAAP | Generally accepted accounting principles |
| GBP | Pound sterling |
| GDP | Gross domestic product |
| GDR | Global Depositary Receipt |
| IFRS | International Financial Reporting Standards |
| IMF | International Monetary Fund |
| IIR | Internal rate of return |
| JPM | J.P. Morgan |
| JPY | Japanese yen |
| LIBID | London interbank bid rate |
| LIBOR | London interbank offered rate |
| M US$ | Thousands of U.S. dollars |
| MM US$ | Millions of U.S. dollars |
| MBS | Mortgage-backed securities |
| PRF | Pension Reserve Fund |
| TE | Tracking error |
| TWR | Time-weighted rate of return |
| UF | Unidad de Fomento (an inflation-linked unit of account) |
| USA | United States of America |
| USD | U.S. dollar |
| US$ | U.S. dollar |
| VaR | Value at risk |

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