ANNUAL REPORT

Sovereign Wealth Funds
Ministry of Finance

2016

This publication constitutes the 2016 Annual Report on the Sovereign Wealth Funds maintained by the Ministry of Finance.

The electronic version of this report is available on the
Ministry of Finance's web site:
http://www.hacienda.cl/english/sovereign-wealth-funds/annual-report.html

INTELLECTUAL PROPERTY REGISTRATION Nº 278316
ISSN: 0718-7424

Santiago, Chile

ANNUAL REPORT

Sovereign Wealth Funds
Ministry of Finance

2016

CONTENTS

01 FOREWORD BY THE MINISTER

In the past few years, the drop in the copper price and the slow growth rate of the economy have caused a reduction in government revenues. At the same time, the structural parameters of our fiscal policy have been systematically revised. This has been an important challenge for the Fisco, since the significant downturn in revenues has translated into very limited space to increase public spending. Nevertheless, our strengths have allowed us to be flexible in order to gradually accommodate these difficult times.

In 2016, we adjusted public spending, reducing it from the level initially approved by the National Congress. This measure was part of our commitment, established in 2015, to gradually reduce the structural deficit by approximately one-quarter of a point of GDP per year, thereby guaranteeing a gradual convergence to balanced public accounts. Thus, in 2017, we intend to reach a structural deficit equivalent to 1.3% of GDP, versus 1.6% in 2016.

With this in mind, the 2017 budget considers a prudent expansion in spending that supports the government's commitment to fiscal responsibility. Our goal is to address our citizens' main priorities, concentrating our efforts on education and health, while also leaving room for investment and a contribution to economic dynamism. Thus, starting in 2017 there will be a pension adjustment, approved by law in 2016, to benefit the most vulnerable people in our country. All beneficiaries of the Solidarity Pillar will receive a 10% increase in the state contribution through the old-age and disability basic solidarity pension.

Although our gross debt level has increased, primarily due to the effective fiscal deficits recorded starting in 2013, our fiscal position remains healthy, with a net debt level equivalent to 1% of GDP at year-end 2016. This contributes to market confidence in our solvency, which in early 2017 was reflected in the high share of foreign investors in the local bond issue of US$1.5 billion.

The Fisco maintains a significant balance of financial assets, which mainly reflects the decision to finance deficits with debt and maintain a healthy cushion for facing contingencies. Thus, a large share of this fiscal position is made up of our sovereign wealth funds—namely, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). At year-end 2016, the two funds together held assets totaling US$22,634 million, representing nearly 80% of total Fisco financial assets. In the year, the ESSF earned net investment returns of US$268 million; the PRF, US$288 million. This translates into an annual net return in dollars of 1.74% for the ESSF and 3.76% for the PRF.

In 2016 we continued refining our sovereign wealth fund management. To this end, we contracted an international consultant—Mercer Investment Consulting—to review the current PRF investment policy. Based on the results, we will decide whether it is necessary to modify the current investment policy to ensure its consistency with the fund's objectives. Also, in 2017, the first withdrawals will be made from the PRF to finance part of the benefits that make up the Solidarity Pillar.

Additionally, as part of our effort to always incorporate best practices in sovereign wealth fund management, in 2016 we started a program for sending some of our technical staff to visit the offices of all our external portfolio managers. This will create better team relationships and a fuller understanding of the processes used for investing our resources, thereby increasing and improving our monitoring abilities.

Our funds have again been recognized as among the most transparent in the world. In October 2016, the Peterson Institute for International Economics published its assessment of seventy sovereign wealth funds in terms of their accountability and transparency. The ESSF and PRF were ranked fifth and sixth worldwide, respectively. Also in 2016, our participation in the International Forum of Sovereign Wealth Funds was approved by law, demonstrating our commitment to complying with the Santiago Principles and promoting international collaboration on issues associated with sovereign wealth funds.

As a country, we are still facing the challenge of recovering our economic growth level, and we must ensure that the process engenders greater degrees of cooperation, integration, and participation. As part of this process, we are committed to the solid, efficient management of our assets, which is essential for our fiscal solvency and sustainability. We will maintain our efforts to ensure that our sovereign wealth funds continue to be recognized for excellence in management, transparency, and accountability, as benefits these resources belonging to all Chileans.

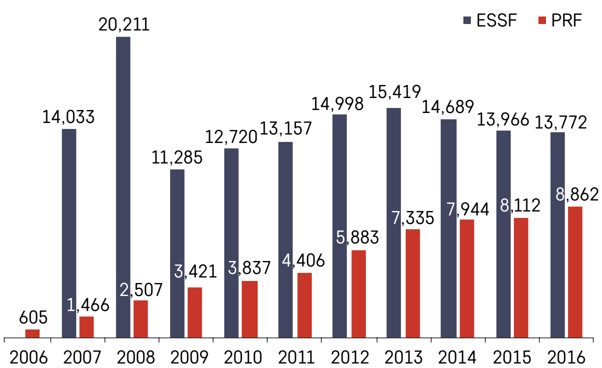
Rodrigo Valdés Pulido
Minister of Finance

02 SUMMARY

As of 31 December 2016, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US$ 22,634 million. The net returns in dollars were 1.74% and 3.76% for the ESSF and PRF, respectively, in 2016 and 2.24% and 3.20% annual since their inception.[1]

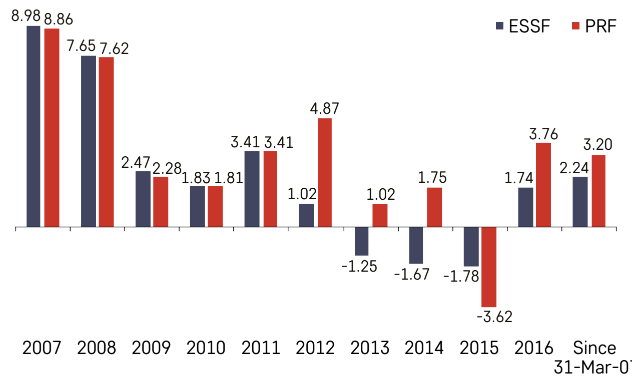
1 The returns published in this report are based on the time-weighted rate of return (TWR) methodology, unless the use of the internal rate of return (IRR) is explicitly identified. Returns for periods of over one year are compound annualized rates. For periods of less than one year, the return corresponds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

F1 Market value (millions of dollars)



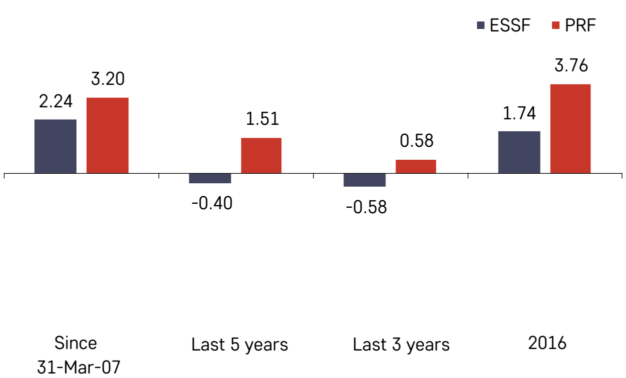
Source: Ministry of Finance

F2 Annual net return in dollars[2, 3] (percent)



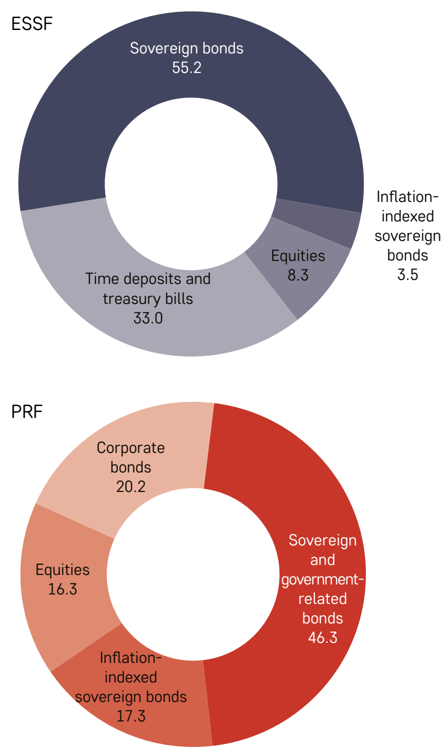
Source: Ministry of Finance

F3 Accumulated annual net return in dollars (percent)



Source: Ministry of Finance

F4 Asset class allocation as of 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

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

3 Starting in 2016, the Ministry of Finance reports historical returns calculated by the custodian bank, J.P. Morgan, which may differ slightly from past reports, which were calculated by the Ministry. This change mainly affects returns in 2007, 2008, and 2009, and the impact does not exceed 3 basis points (annualized) since the inception of each fund.

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.

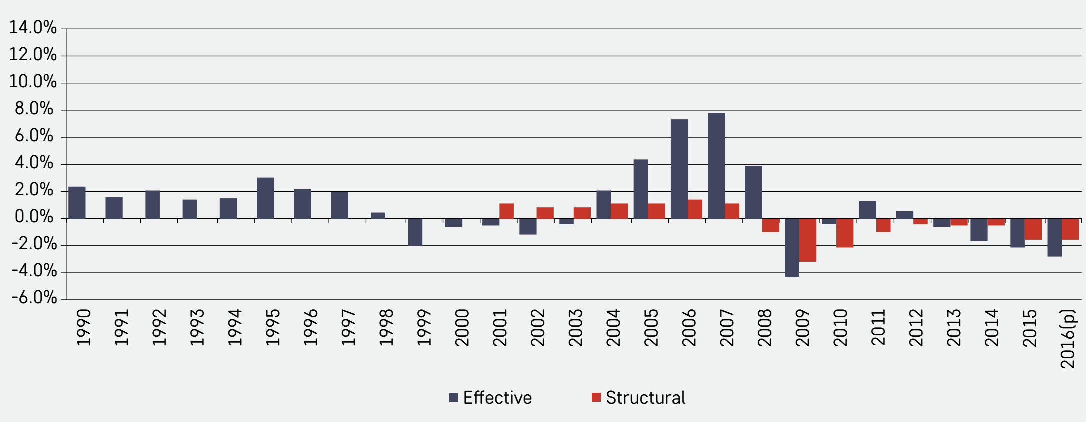
BOX 1 The structural balance rule

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 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. From 2010 to 2014, the government proposed reducing the structural deficit so as to converge to –1% of GDP in 2014. The current government announced in 2015 that the structural deficit will gradually be adjusted around a quarter of a point of GDP each year through 2018 (see Figure B1).

B1 Evolution of the effective and structural fiscal balance (percent of GDP)



Source: Ministry of Finance

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

3.1 Purpose of the Sovereign Wealth Funds

The ESSF was created to finance fiscal deficits that can occur in periods of low growth and/or low copper prices. This helps to reduce fluctuations in fiscal spending across the economic cycle. 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.

3.2 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)*.

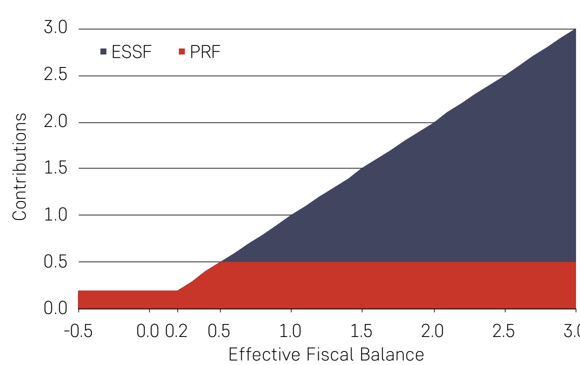
In the case of the ESSF, the fund must receive any positive balance remaining after subtracting the PRF contributions from the effective surplus, less the amortization of public debt and estimated contributions that were made in advance the previous year[4] (see Figure 5).

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 from the PRF must not exceed the fund's returns in the previous year[5]. 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. 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.

F5 Fund contribution rules (percent of GDP)



Source: Ministry of Finance

4 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.

5 As of the date of publication of this report, no withdrawals have been made from the fund.

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 General Treasury of Chile, and the custodian (see Diagram 1).

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 (CBC) 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 (the 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.

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.

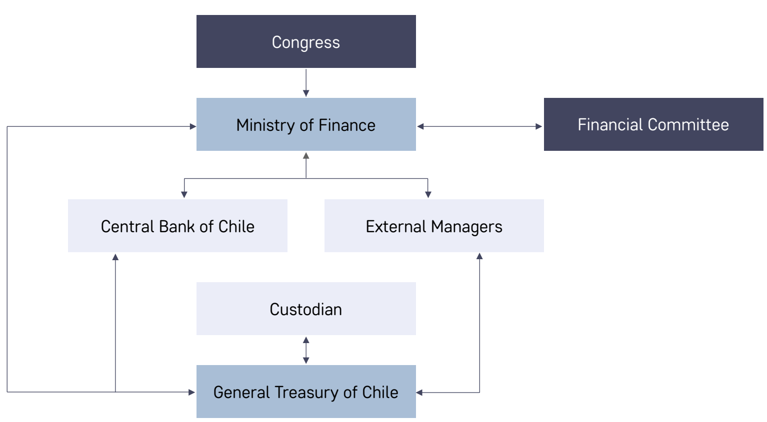
The main functions and powers of the Financial Committee are as follows:

> 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 submitted to the Ministry of Finance by the entities entrusted with

D1 Institutional framework of the sovereign wealth funds



Source: Ministry of Finance

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 opinion 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 2016, the Committee members were José De Gregorio Rebeco (Chairman), Cristián Eyzaguirre Johnston (Vice Chairman), Ricardo Budinich Diez, Jaime Casassus Vargas, Martín Costabal Llona, and Igal Magendzo Weinberger. In September 2016, Ricardo Budinich Diez joined the Committee, replacing Eduardo Walker Hitschfeld, who had been a member since the Committee was formed in 2007. Mr. Walker stepped down for personal reasons.

For more information on the Finance Committee's activities in 2016, see their Annual Report, which is available online at www.hacienda.cl/english/sovereign-wealth-funds/financial-committee/annual-report.html

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.[6] 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[7].

> 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 (currently corporate bonds and stocks).

> 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. As of 1 January 2014, the CBC processes the payments to external corporate bond and equities managers, with prior authorization by the Ministry and the GTC.

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.

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,

6 Finance Ministry Decree 1,618 of 2012 removed the CBC from the management of the corporate bond and equities portfolios that were under its management at that time and that had been appointed, in the name of the Fisco, to external portfolio managers.

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

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 portfolio managers are entities specialized in portfolio investment that have been contracted to invest the ESSF and PRF equities portfolios and the PRF corporate fixed-income portfolio. In 2011, following a careful selection process, the CBC contracted BlackRock Institutional Trust Company, N.A. (BlackRock), Mellon Capital Management Corporation (Mellon), and Rogge Global Partners PLC (Rogge) for the investment of the PRF corporate fixed-income and equities portfolios. These companies took over the management of 35% of the PRF portfolio in January 2012. In 2013, after changes were introduced to the ESSF investment policy, the CBC contracted two of the same firms—BlackRock y Mellon—to manage the ESSF equities portfolio, in accordance with instructions from the Finance Ministry[8]. Starting on 1 January 2014, monitoring the performance of the external managers is the responsibility of the Ministry and the Treasury[9].

Like the CBC, the external managers must comply with the investment guidelines defined by the Ministry of Finance.

8 The Finance Minister decided to contract the same firms as for the PRF, given that the equities mandates for the ESSF and the PRF are identical.

9 For more information on the functions transferred from the CBC to the Ministry and the Treasury on 1 January 2014, see the 2013 Sovereign Wealth Funds Annual Report, available online at www.hacienda.cl/fondos-soberanos/informe-anual.html.

05 MAIN ACTIVITIES IN 2016

In 2016 the Ministry undertook a number of activities associated with managing the sovereign wealth funds. The main initiatives were as follows: (i) a review of the PRF investment policy; (ii) the expansion of the securities lending program; (iii) the PRF sustainability study; (iv) monitoring the fund managers; and (v) adjusting the fund rebalancing policy. These activities reflect the Ministry's efforts to manage the funds' resources efficiently and flexibly, incorporating suggestions from the portfolio managers, and to supervise the managers in accordance with market best practices.

5.1 Review of the PRF Investment Policy

Given that the current PRF investment policy was defined in late 2007, the Ministry contracted an international consultant to undertake a review. The consultant was selected following a request for proposals, approved by the Committee, which was sent out to a number of financial consulting firms. The responses were evaluated by the Ministry based on factors such as experience, methodological approach, willingness to provide a financial model, quality of the proposal, and fees. The process was completed in July, with the project being awarded to Mercer Investment Consulting (Mercer).

Before the PRF investment policy review was launched, an important preliminary step was to analyze the main characteristics of the asset classes that are typically used by long-term investors, in order to delimit the universe of assets that would be considered in the course of the review. The Ministry thus prepared an analysis of the main characteristics of traditional asset classes and alternative investments, which was presented to the Committee.[10] Based on this information, the Committee made recommendations on the asset classes that should be included in the PRF investment policy review.

In late 2016, Mercer submitted its first report, which included a general description of the main characteristics of the investment policies of other institutional investors, to provide a frame of reference for the PRF; a recommendation on how to define the fund's investment objective, including risk tolerance and the reference currency for measuring performance; and a description of the theoretical framework that would be used in the review.

Two more phases of the review will be completed in the first half of 2017, including the specification of the strategic asset allocation recommended for the PRF, stress tests and stress scenarios for the recommended portfolio, and a proposal on the investment policy statement. Additionally, Mercer will provide the Ministry with a model for reviewing the recommended asset allocation and will train the staff of the Sovereign Wealth Funds Unit on its use.

5.2 Expansion of the Securities Lending Program

In 2016, a decision was made to modify the securities lending program of the sovereign wealth funds (see Box 2). The current program, which is managed by the custodian bank, involves lending sovereign fixed-income securities in dollars and euros, while receiving high-credit-quality instruments in the same currencies as collateral (U.S. government or government-backed agency securities for dollar loans; European government securities with a rating of AA– or higher for euro loans). Based on the custodian bank's suggestion and the Committee's recommendation, it was decided to include the equities portfolios in the securities lending program for both funds, accepting the same type of collateral as for sovereign fixed-income instruments in dollars. The inclusion of this asset class in the lending program should make it possible to earn a similar level of income as under the current fixed-income program while lending out a smaller share of the portfolio, thereby reducing credit exposure. To avoid lending out significant shares, a lending cap was established at 50% of the market value of the lendable portfolio for the fixed-income and equities.

As of the date of publication of this Annual Report, this recommendation has not yet been implemented, as the definition of the monitoring and control mechanisms is still in progress.

10 Inversiones alternativas se refiere a la inversión en infraestructura, inmobiliaria, capital privado, *hedge funds*, materias primas, entre otros.

BOX 2 Securities custody and the securities lending program

The securities custodian is the institution responsible for safekeeping an investor's financial assets. The custodian's main role is to hold and protect the securities that have been entrusted to the institution, and to return the assets when the owner so requires. The custodian is also charged with facilitating securities transfers related to sale and purchase instructions issued by the investor and enforcing all rights associated with the securities, such as collecting interest or dividend payments. The custodian may also represent the investor at shareholder or bondholder meetings.

To maximize the return on their resources, many investors use securities lending programs, a service typically offered by custodians. In a securities lending program, the custodian, acting in the name of the owner of the securities in question, loans the instruments held in custody to a third party (the counterparty). These loans are usually guaranteed by the counterparty through the delivery of cash or other financial instruments that are held as collateral. The custodian often provides a second guarantee, as well. When financial instruments are used as collateral, the counterparty is obligated to pay a fee to the owner of the loaned securities, through the custodian, and to return the borrowed securities when requested or at the end of the established loan period. When the collateral is cash, the securities owner invests the money to generate income, through the custodian, and must pay interest to the counterparty on the cash received as collateral. In both cases, the custodian receives part of the earnings as compensation for managing the program.

In the case of the Chilean funds, the custodian is J.P. Morgan Chase Bank N.A., and the securities lending program only accepts fixed-income financial instruments as collateral.

5.3 PRF Sustainability Study

In 2016, the PRF sustainability study, which must be conducted every three years in accordance with the Fiscal Responsibility Law, was carried out to evaluate the fund's capacity for effectively complementing the financing requirements for fiscal pension expenditures. The study is the responsibility of the Budget Office (Dipres), which, following a tender process, awarded the project to a consultant team comprising Pablo Castañeda, Rubén Castro, Eduardo Fajnzylber, Juan Pablo Medina, and Félix Villatoro.

In the first half of the year, the consultant team gave presentations to the Committee, the Ministry, and the Budget Office, during which the methodology and the preliminary results were reviewed and recommendations were made, which were incorporated into the final version of the study.[11]

The main conclusions of the study are as follows:

> The PRF will follow a growth trend over the next 20 years, as the minimum contributions (0.2% of GDP, as stipulated in the Fiscal Responsibility Law) are greater than the maximum withdrawals allowed for the PRF.

> With regard to the sustainability of the PRF, the study concluded that once the limit of UF 900 million has been reached,[12] that size would be sufficient to cover all associated obligations in a period of 20 years, but it would not be enough if the goal is to maintain its real value in perpetuity.

After the study was completed, the government announced a 10% increase in the basic solidarity pension, starting in 2017. Consequently, the Budget Office updated the main projections of the PRF sustainability study, concluding that the PRF is sustainable even under adverse scenarios in the medium term. Only in the event that the assumptions of an adverse scenario materialized every year in the future could there be a risk for the PRF in the long term (in a forecast horizon of over 50 years).[13]

11 Castañeda P., R. Castro, E. Fajnzylber, J. Medina, and F. Villatoro (2016). "Estudio sobre la sustentabilidad del Fondo de Reserva de Pensiones." The study is available online at www.hacienda.cl/fondos-soberanos/estudios-relevantes.html.

12 The Fiscal Responsibility Law establishes that once that amount is reached, the PRF cannot receive any additional contributions.

13 See the technical appendix to the 2016 PRF sustainability study, available online at www.hacienda.cl/fondos-soberanos/estudios-relevantes.html.

5.4 Monitoring the ESSF and PRF Portfolio Managers

In early 2016, delegations were received from the CBC and Mellon, which are required to report annually to the Committee and the Ministry on their portfolio management. Both managers gave presentations on the main market developments, their 2015 performance results, their investment strategies, and some additional issues relevant to managing the funds. These visits are part of the regularly scheduled activities through which the portfolio managers report on their management and performance.

Also in 2016, the process of monitoring the external portfolio managers was expanded to include visits by Finance Ministry staff to the offices of BlackRock, Mellon, and Rogge. The visits are intended to help create better team relationships and provide a fuller understanding of the processes used for investing the resources, thereby increasing and improving improving the staff's monitoring abilities monitoring abilities.

5.5 Adjustment to the Rebalancing Policy

To keep the funds aligned with their strategic asset allocation, the investment guidelines define a rebalancing policy for both the ESSF and the PRF.

The ESSF rebalancing policy requires converging to the benchmark allocation (see Section 8.1) under two specific circumstances: (i) in the event that the fund receives a contribution; and (ii) in the event that the equities portfolio exceeds the range of 5.5–9.5% as a share of the total fund. In addition, if neither situation arises, the Ministry will issue instructions for rebalancing the fund at least once a year.

The PRF policy is similar, requiring convergence to the benchmark allocation (see Section 9.1) under the following circumstances: (i) in the event that the fund receives a contribution; and (ii) in the event that one of the portfolios exceeds the permissible deviation, as a share of the total fund: 45–51% for the sovereign bond and government-related securities portfolio, 14–20% for the inflation-indexed sovereign bond portfolio, 17–23% for the corporate bond portfolio, and 12–18% for the equities portfolio.

Given that the rules do not specify whether the rebalancing should be triggered immediately if a limit is exceeded, the Committee recommended, and the Ministry established, that the rebalancing take place when a portfolio exceeds the permissible deviation for three business days. Once the rebalancing order is triggered, it must be implemented as quickly as possible, subject to any operational restrictions that need to be taken into account.

.

06 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.[14]

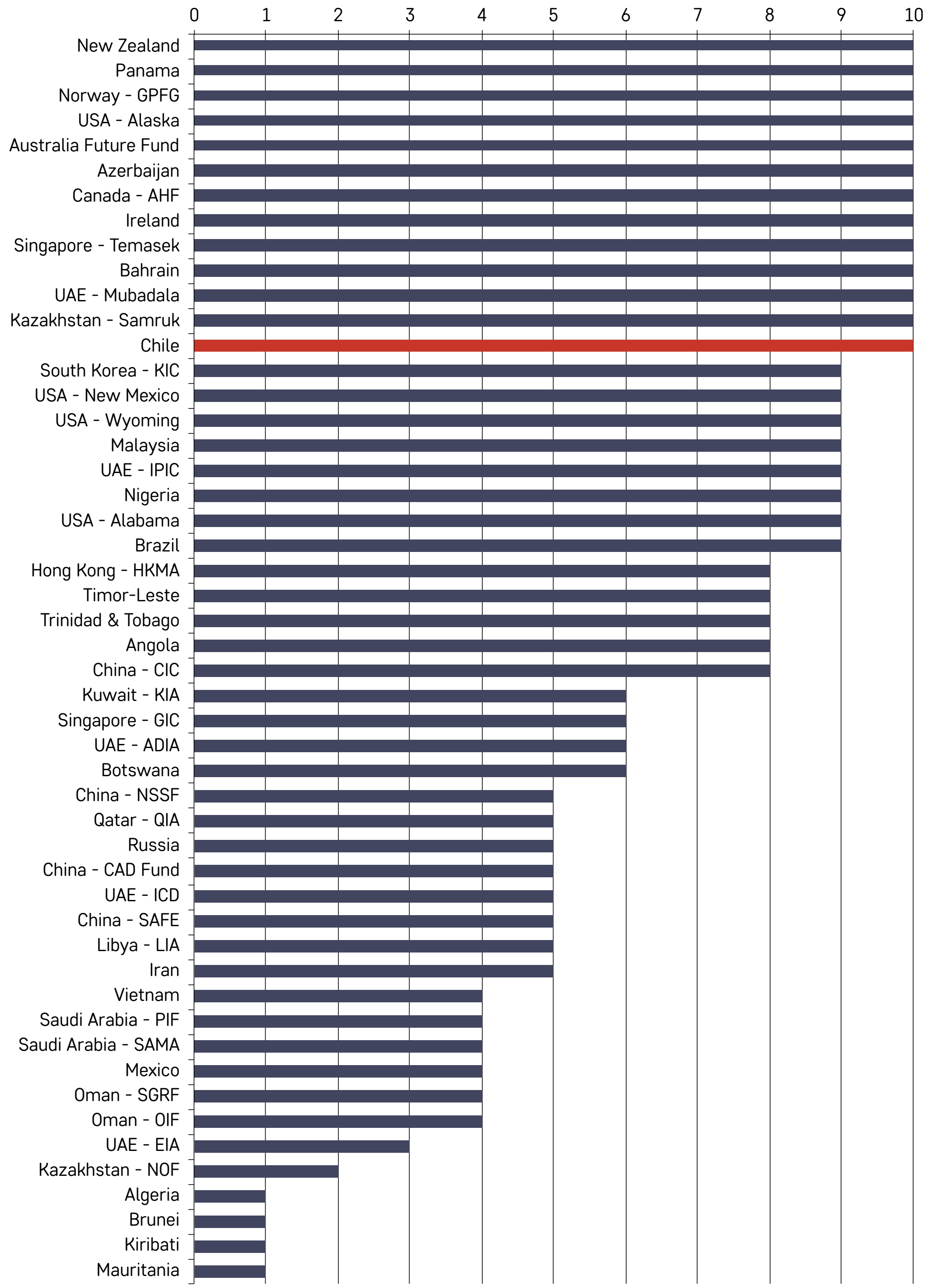
Chile also remains committed to international initiatives aimed at establishing a framework of generally accepted principles and practices for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance is an active participant in the International Forum of Sovereign Wealth Funds (IFSWF), which hosts an annual meeting of the world's main sovereign wealth funds to share ideas and exchange opinions on key issues and to facilitate understanding of their activities and of the Santiago Principles.[15]

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 6). 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.

14 www.hacienda.cl/fondos-soberanos.html and www.hacienda.cl/english/sovereign-wealth-funds.html.

15 The Santiago Principles are a series of principles and practices accepted by the main countries that have created sovereign wealth funds. These principles aim to identify a framework of generally accepted principles and practices that properly reflect sound governance and accountability structures, as well as prudent and well-founded investment practices for sovereign wealth funds (source: www.iwg-swf.org/pubs/esl/gapplists.pdf).

F6 Linaburg-Maduell transparency index, fourth quarter of 2016.



Source: Sovereign Wealth Fund Institute

07 ANALYSIS OF THE INTERNATIONAL ECONOMY

In 2016, political uncertainty was high due to events such as the British referendum on whether to leave the European Union, the U.S. presidential elections, efforts by some developed economies to stimulate growth, and the slowdown in China. All these events affected economic variables that influence the performance of the sovereign wealth funds.

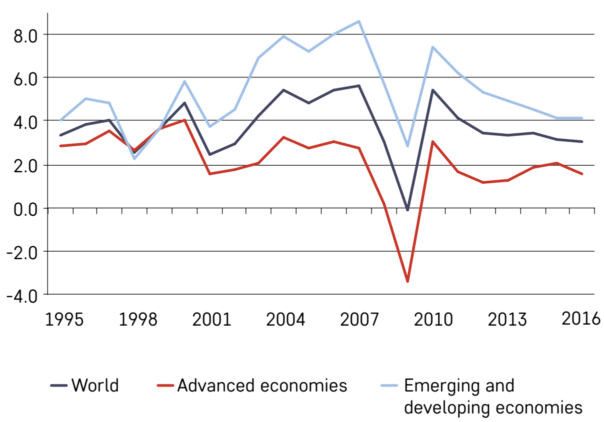
To facilitate understanding of the behavior of the global economy in 2016, this section presents an analysis of the main economic variables that are relevant for the sovereign wealth fund investments.[16]

16 This section is extracted from Chapter 2, "Market Analysis" from the Financial Committee Annual report 2016.

According to estimates by the International Monetary Fund (IMF),[17] the gross domestic product (GDP) of the global economy grew at a rate of 3.1% in 2016, which is slightly lower than in 2015. Emerging and developing economies recorded a growth rate of around 4.1% in 2016, maintaining their 2015 rate. For the advanced economies, however, the expected growth rate decreased to approximately 1.6% (see Figure 7). Within this latter group, the United States, the Eurozone, and Japan are expected to grow below their 2015 rates (see Figure 8).

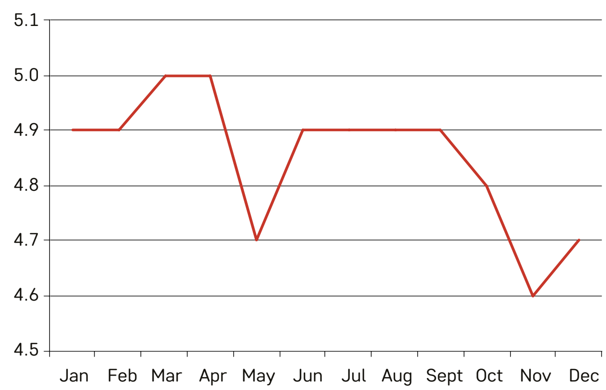
The U.S. economy grew 1.6% in 2016, although the third quarter was more dynamic, at 3.5%. Unemployment fell to 4.7%, approaching the levels recorded before the subprime crisis (see Figure 9). Hourly wages grew 2.9% relative to a year ago, the highest rate of the last seven years (see Figure 10). The general price index increased significantly in the second half of the year, settling around the annual target of 2% defined by the U.S. Federal Reserve (Fed), while core inflation, which excludes energy and food products, was relatively stable at around 2% annual throughout the period (see Figure 11). In this scenario, the Fed decided to increase the monetary policy rate (the Federal funds

F7 GDP growth, 1995–2016 (percent)



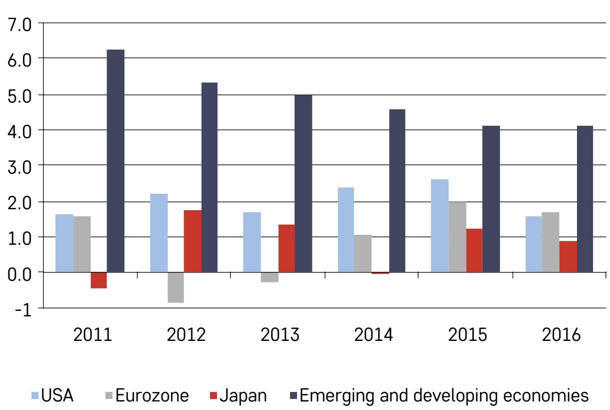
Source: International Monetary Fund

F9 U.S. unemployment rate in 2016 (percent)



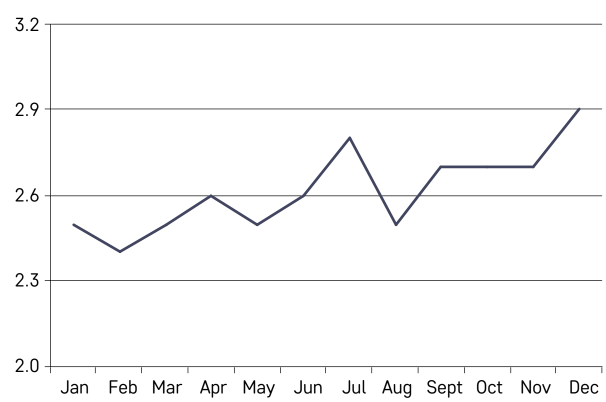
Source: Bureau of Labor Statistics

F8 GDP growth in selected economies, 2011–2016 (percent)



Source: International Monetary Fund

F10 U.S. wage growth in 2016 (percent)



Source: Bloomberg

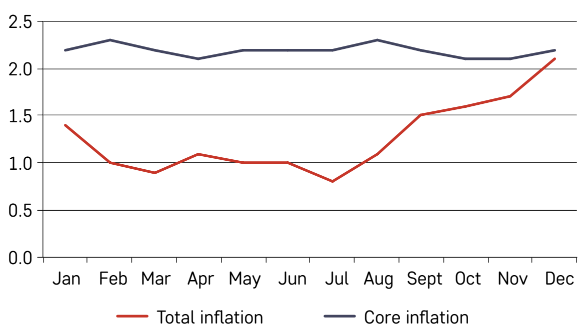
17 Growth numbers presented in this section are extracted from World Economic Outlook database (January updated version) from the IMF.

rate) by 25 basis points at its December meeting, to a range of 0.50–0.75%. This is the second increase since December 2015, when the Fed began normalizing U.S. monetary policy after maintaining an expansionary stance since 2006.

Growth in the Eurozone was 1.7% in the year. Germany and France, the two largest economies in the European Union, recorded GDP growth of 1.7% and 1.3%, respectively, versus 0.9% in Italy, 3.2% in Spain, and 5.2% in Ireland (see Figure 12). Inflation in 2016 was below the 2% target set by the European Central Bank (ECB), although it rose in the second half (see Figure 13), while employment declined over the course of the period (see Figure 14). In this context, the ECB maintained its quantitative easing program and in April announced an increase in the size of its asset purchase program of up to 80 billion of euros a month. This was reduced in December to 60 billion a month starting in April 2017, with an extension through December 2017 or until the price level aligns with the inflation target.

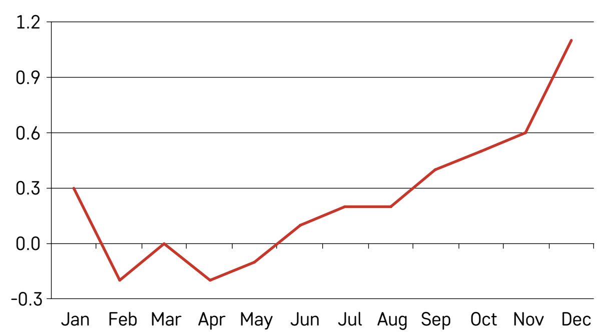
Japan grew 0.9% in 2016. In September, in order to bring inflation into the target range of around 2%, the Central Bank of Japan added yield curve control to its monetary stimulus plan. Specifically, the Bank committed to expanding the monetary base until annual CPI inflation exceeds the inflation target and to apply mechanisms that help control the interest rate level at both short and long terms. This includes the implementation of a

F11 U.S. consumer price index in 2016 (year-on-year change, in percent)



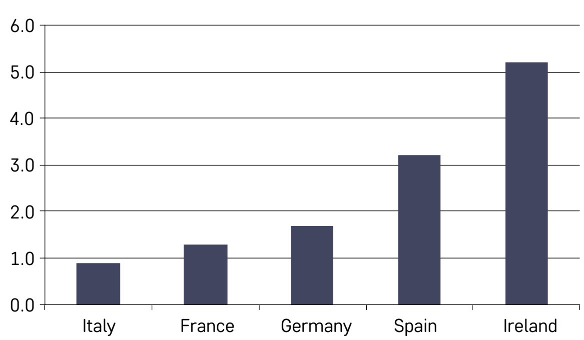
Source: Bloomberg

F13 Annual inflation in the Eurozone in 2016 (percent)



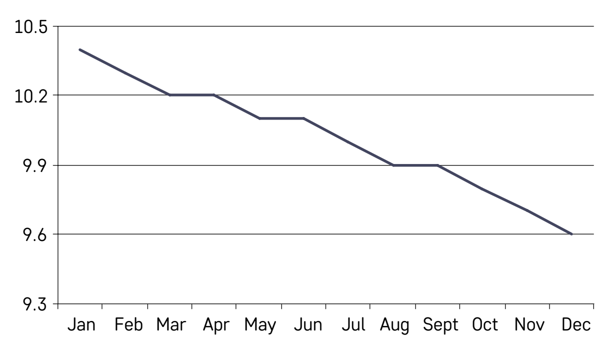
Source: Bloomberg

F12 GDP growth in selected European economies in 2016 (percent)



Source: International Monetary Fund

F14 Unemployment rate in the Eurozone in 2016 (percent)



Source: Bloomberg

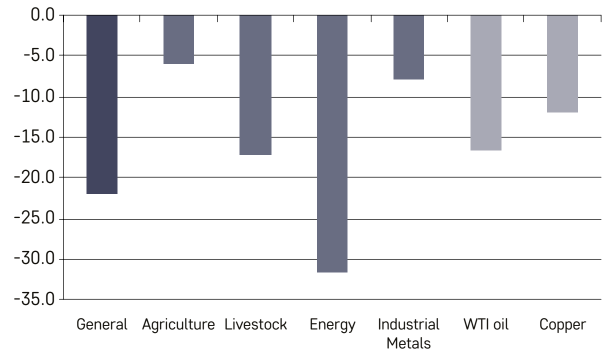
Japanese ten-year sovereign bond purchase program, aimed at keeping the ten-year interest rate at 0%.

In China the economy continues to slow, recording growth of 6.7% at year-end 2016 versus 6.9% in 2015. Consequently, the government has maintained an expansionary fiscal policy aimed at stimulating the domestic economy. The People's Bank of China used the equivalent of US$320 billion of international reserves (around 10% of total reserves) to put a brake on the depreciation of its currency, the renminbi, which has been affected by the slow economy. Nevertheless, in October the IMF added the renminbi to the basket that makes up the Special Drawing Rights,[18] in acknowledgement of its importance in the global economy.

Average commodity prices fell in all sectors in 2016 versus 2015. The energy sector recorded the largest drop, -32%. The average copper price decreased around 12% relative to a year ago, which is highly relevant for the Chilean economy. Oil prices declined around 17%, on average, in 2016 (see Figure 15).

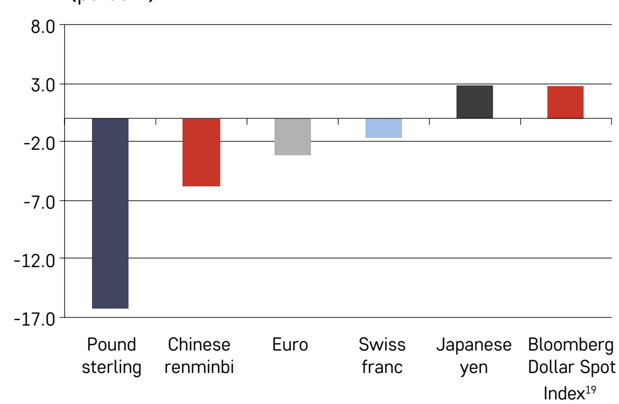
In this global context, the U.S. dollar strengthened against the main world currencies. Of the currencies in the sovereign wealth funds' investment portfolios, the pound sterling depreciated the most in the year (16.2%), mainly after the referendum on the United kingdom's exit from the European Union (see Figure 16).

F15 Standard & Poor's commodity indexes, WTI oil, and copper year-on-year change in 2016 (percent)



Source: Bloomberg

F16 Selected currency movements against the dollar in 2016 (percent)



Source: Bloomberg

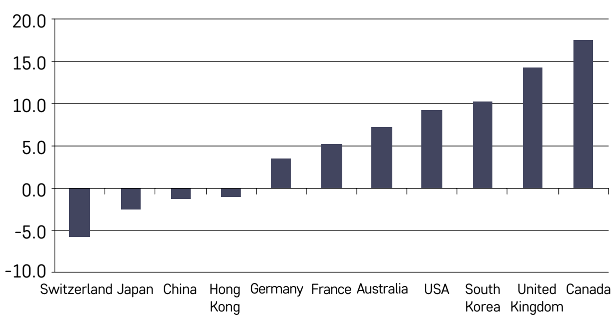
18 The value of one Special Drawing Right is based on a basket of five currencies: U.S. dollar, 41.73%; euro, 30.93%; Japanese yen, 8.33%; pound sterling, 8.09%; and Chinese renminbi, 10.92%.

With regard to the financial markets, several stock exchanges increased significantly in 2016. For a selected sample (see Figure 17), the stock markets with the worst performance in the period were Switzerland and Japan, whose returns in local currency were -5.9% and -2.6% respectively. In contrast, Canada and the United Kingdom posted the highest yields, at 17.6% and 14.3%, respectively.

Stock market volatility (S&P 500), measured through the VIX Index, was slightly lower on average in 2016 than in 2015. The index peaked in February, when uncertainty about China's growth capacity coincided with the lowest oil price of the period (see Figure 18).

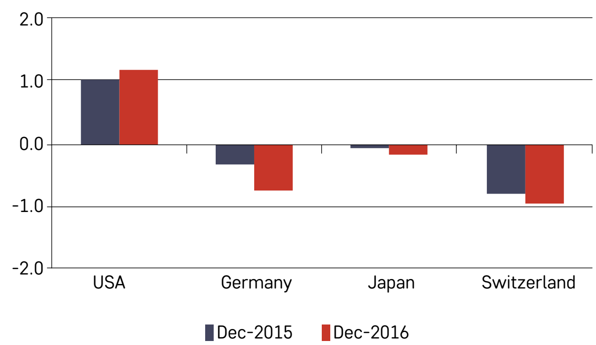
Both two- and ten-year sovereign interest rates fell relative to 2015 in Germany, Japan, and Switzerland, but increased in the United States (see Figures 19 and 20). The first three countries continued to record negative annual two-year rates in the period under analysis.

F17 Returns on MSCI equity indexes in 2016, selected countries (percent, measured in local currency)



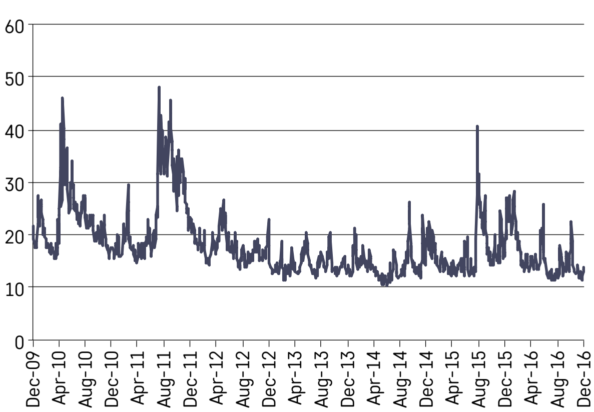
Source: Bloomberg

F19 Internal rate of return (IRR) on two-year sovereign bonds in 2016, selected countries (percent)



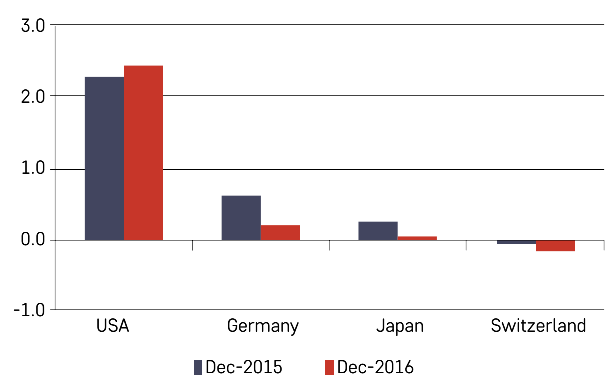
Source: Bloomberg

F18 Volatility in the S&P 500 (VIX), 2009-2016 (level)



Source: Bloomberg

F20 IRR on ten-year sovereign bonds in 2016, selected countries (percent)

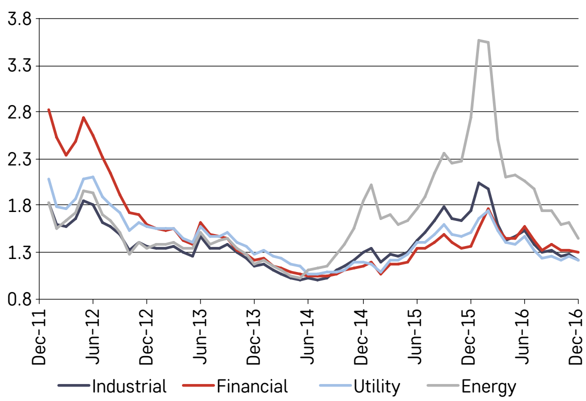


Source: Bloomberg

In the corporate market, spreads narrowed in all sectors of the Bloomberg Barclays Global Aggregate Corporate Index in 2016, vis-à-vis year-end 2015[19] Thus, industrial, financial, and utility sector spreads decreased 30%, 5%, and 20%, respectively. In the industrial sector, the energy subsector fell 48% relative to year-end 2015 (see Figure 21)[20].

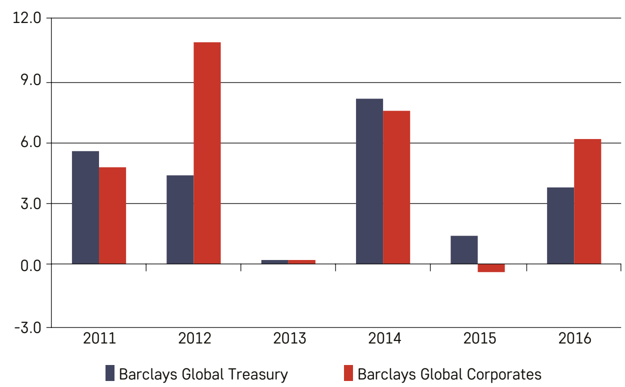
In 2016, corporate and sovereign bond yields in local currency were positive in almost all the countries in which the sovereign wealth funds are invested. The Barclays Capital Global Aggregate: Treasury Bond Index (hedged) and the Barclays Capital Global Aggregate: Corporate Bond Index (hedged) closed the year with yields of 3.86% and 6.22%, respectively (see Figure 22).

F21 Corporate spreads by industry, 2011–2016 (percent)



Source: Barclays

F22 Return on Barclays Global Treasury and Global Corporate indexes (hedged), 2010 – 2016 (percent, measured in local currency)



Source: Barclays

19 The Bloomberg Barclays Global Aggregate Corporate Index is constructed on the basis of global investment-grade fixed-income corporate bonds. It comprises a set of 54 countries, including both developed and developing economies. The index can be subdivided into three sectors: industrial, financial, and utility sectors. At year-end 2016 the index had 10,076 instruments, distributed as follows: 54% industrial, 35% financial, and 11% utility sectors.

20 The Industrial sector includes raw materials, capital goods, communications, cyclical consumer goods, noncyclical consumer goods, energy, technology, transport, and others.

08 THE ECONOMIC AND SOCIAL STABILIZATION FUND

The market value of the ESSF at year-end 2016 was US$ 13,772 million. Since its inception on 6 March 2007, the fund has received capital contributions totaling US$ 21,766 million, with total withdrawals of US$ 10,853 million and net investment income of US$ 2,859 million. In 2016, the fund's return in dollars (net of management costs) was 1.74%; the equivalent net return in pesos was -3.92%, mainly due to the depreciation of the dollar against the peso in the period. Since the fund's inception, the annualized net return in dollars has been 2.24%; in pesos, 4.45%. The IRR in dollars was 1.96% in 2016 and 2.23% annualized since the creation of the fund.

8.1 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 avoids 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-indexed sovereign bonds. 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 1). 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 equities portfolio, 60 basis points.[21]

T1 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**
Merrill Lynch Libid 3 Month Average USD	5.0	—	—	—	—	5.0
Merrill Lynch Libid 3 Month Average EUR	—	6.0	—	—	—	6.0
Merrill Lynch Libid 3 Month Average JPY	—	—	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**
Merrill Lynch Treasury Bills Index USD	6.0	—	—	—	—	6.0
Merrill Lynch Treasury Bills Index EUR	—	7.0	—	—	—	7.0
Merrill Lynch Treasury Bills Index JPY	—	—	6.0	—	—	6.0
2.2 Sovereign bonds	**26.5**	**11.0**	**10.0**	**7.5**	**0.0**	**55.0**
Barclays Capital Global Treasury: U.S. 7-10 Yrs	26.5	—	—	—	—	26.5
Barclays Capital Global Treasury: Germany 7-10 Yrs	—	11.0	—	—	—	11.0
Barclays Capital Global Treasury: Japan 7-10 Yrs	—	—	10.0	—	—	10.0
Barclays Capital Global Treasury: Switzerland 5-10 Yrs	—	—	—	7.5	—	7.5
3. Inflation-indexed sovereign bonds	**2.5**	**1.0**	**0.0**	**0.0**	**0.0**	**3.5**
Barclays Capital Global Inflation-Linked: U.S. TIPS 1-10 Yrs	2.5	—	—	—	—	2.5
Barclays Capital Global Inflation-Linked: Germany 1-10 Yrs	—	1.0	—	—	—	1.0
4. Equities	**—**	**—**	**—**	**—**	**7.5**	**7.5**
MSCI All Country World Index (unhedged with reinvested dividends) ex Chile	—	—	—	—	7.5	7.5
5. Total	**40.0**	**25.0**	**20.0**	**7.5**	**7.5**	**100.0**

Source: Ministry of Finance

21 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.

The fixed-income portfolio (92.5% of total assets) is managed by the CBC, acting as fiscal agent, while the equities 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.

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.

8.2 Market Value

The market value of the ESSF at year-end 2016 was US$ 13,772 million, versus US$ 13,966 million at year-end 2015. The decrease was mainly due to a withdrawal of US$ 462 million to finance the legally required contribution to the PRF, which was partially offset by net investment income of US$ 268 million. Since its inception on 6 March 2007, the ESSF has recorded capital contributions of US$ 21,766 million and withdrawals of US$ 10,853 million[22] and has generated net financial gains of US$ 2,859 million (see Tables 2 and 3).

T2 Contributions and withdrawals (millions of dollars)

Period	Contributions	Withdrawals
2007	13,100	—
2008	5,000	—
2009	—	9,278
2010	1,362	150[a]
2011	—	—
2012	1,700	—
2013	603	—
2014	—	499[b]
2015	—	464[b]
2016	—	462[b]
Total	21,766	10,853

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

Source: Ministry of Finance

T3 Evolution and decomposition of market value (millions of dollars)

Descomposition	2012	2013	2014	2015	2016	Since inception[a]
Starting market value	13,157	14,998	15,419	14,689	13,966	0
Contributions	1.700	603	0	0	0	21,766
Withdrawals	0	0	-499	-464	-462	-10,853
Accrued interest	202	184	188	167	162	2,722
Capital gains (losses)	-60	-364	-417	-423	109	155
Management, custody and other costs	-1.3	-2.2	-2.7	-2.9	-2.6	-17.9
Net financial gains	141	-182	-231	-259	268	2,859
Ending market value	14,998	15,419	14,689	13,966	13,772	13,772

(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

22 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.

8.3 Performance

In 2016, the fund's return in dollars, net of management costs, was 1.74%. This primarily reflects the return on the fixed-income portfolio, 1.15%, which represents 92% of the fund, and, to a lesser extent, the equities portfolio return, 8.27%, which represents just 8% of the fund. The fixed-income return breaks down into 1.38% in local currency and -0.23% from exchange rate effects.[23] The equivalent net return in pesos in the year was -3.92%, which is mainly explained by the depreciation of the dollar against the peso during the period. Since 31 March 2007, the annualized net return in dollars and pesos was 2.24% and 4.45%, respectively (see Table 4). An analysis of the fund's historical evolution (see Figure 23) shows that from 2013 to 2015, the ESSF recorded negative returns in dollars, largely due to the exchange rate effect in the period. The IRR in dollars was 1.96% in 2016 and 2.23% annualized since the fund's inception.

Figure 24 shows the quarterly breakdown of the net return in dollars in 2016, decomposed into the return in local currency and the exchange rate effect for the fixed-income portfolio, plus the equities portfolio. [24] In the first quarter, the fund recorded a total return in dollars of 5.23%, mainly due to the positive effect of the appreciation (against the dollar) of the main currencies in which the ESSF fixed-income portfolio is invested (3.21%) and the positive returns of that portfolio in local currency (2.39%). The fund's return was also positive in the second quarter (2.52%), due to the fixed-income portfolio's performance in local currency (1.37%), exchange rate appreciations in the fixed-income portfo-

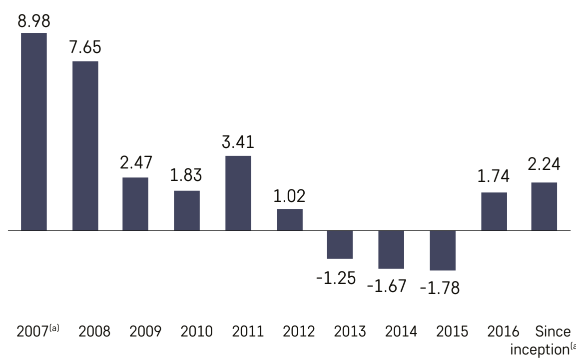
T4 Net returns (percent)

Returns[a]	2016	Last 3 years	Since inception[b]
Local currency	1.38	2.43	2.65
Exchange rate	-0.23	-3.39	-0.61
Fixed-income	**1.15**	**-0.96**	**2.04**
Equities [c]	8.27	3.58	-
Returnin USD	**1.74**	**-0.58**	**2.24**
Exchange rate return, CLP	-5.66	8.41	2.21
Return in CLP [d]	**-3.92**	**7.82**	**4.45**

(a) Time-weighted return (return calculated as the growth rate of the funds that were invested throughout the period).
(b) The return since inception calculated from 31 March 2007, when the performance of the CBC began to be measured.
(c) The equities portfolio was implemented in August 2013, so only the returns for 2016 and the last three years are shown.
(d) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate.

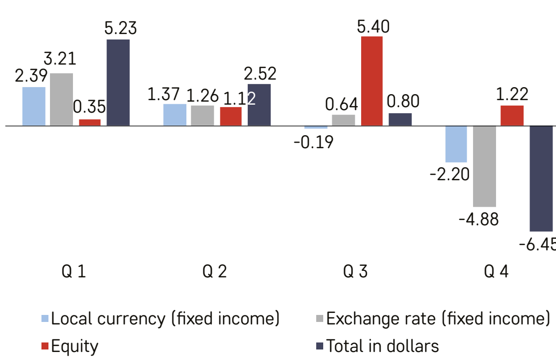
Source: Ministry of Finance

F23 Annual net TWR in dollars (percent)



(a) Calculated from 31 March 2007.
Source: Ministry of Finance

F24 Net quarterly returns in 2016 (percent)



Source: Ministry of Finance

23 The performance of the ESSF fixed-income portfolio primarily reflects interest rates and exchange rates. The level and changes in interest rates largely determine the value of the financial instruments in their currency of issue (local currency). However, given that the funds are invested in dollars, euros, yen, and Swiss francs, while the portfolio performance is measured in dollars, the exchange rate of the dollar against these currencies also affects the fund's return.

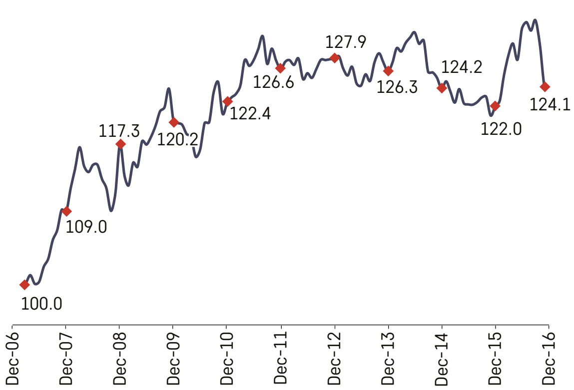
24 See footnote 24.

lio (1.26%), and the equities portfolio (1.12%). In the third quarter, the fund's return in dollars was again positive, at 0.80%, thanks to a solid performance by the equities portfolio (5.40%) and currency appreciation in the fixed-income portfolio (0.64%), which was partially offset by the return in local currency in the fixed-income portfolio (-0.19%). Finally, the fourth-quarter return was -6.45%, mainly due to the depreciation of the currencies in the fixed-income portfolio against the dollar (-4.88%) and the performance in local currency (-2.20%). The equities portfolio partially offset these effects (1.22%).

The fund's investment performance can be illustrated using an index of the portfolio's monthly returns. Taking a starting value of 100 on 31 March 2007, the index reached 124.1 at year-end 2016 (see Figure 25).

In 2016, the performance of the ESSF, measured as the difference between the portfolio return and the benchmark return, was 3 basis points, which is consistent with the greater emphasis on a passive investment strategy since 1 May 2011. Since 31 March 2007, the annualized return of the ESSF was 7 basis points below the benchmark (see Figure 26).

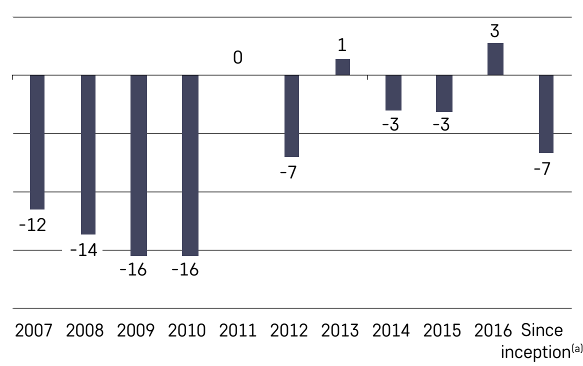
F25 ESSF return index in dollars (31 March 2007 = 100)



Source: Ministry of Finance

By asset class, the fixed-income portfolio recorded an excess return of 5 basis points over the benchmark in 2016, while the equities portfolio was 15 basis points below the benchmark (see Table 5).[25] Since inception, the total excess return of the ESSF was -7 basis points; this primarily stems from the fixed-income portfolio, given that the investment in equities only date to August 2013.

F26 Excess returns over the benchmark (basis points)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

T5 Excess returns over the benchmark, by asset class[27] (basis points)

Asset class	2016	Last 3 years (a)	Since inception (b)
Fixed-income	5	2	-7
Equities	-15	-9	-
Total portfolio	**3**	**-1**	**-7**

(a) The equities 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

25 The return on the equities portfolio is lower than the benchmark primarily because the benchmark does not include tax payments (for example, on dividends), whereas the ESSF portfolio return does take them into account, which reduces the return.

26 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.

8.4 Portfolio Allocation

As of December 2016, the allocation of the ESSF by asset class comprised US$ 9,014 million in Treasury bills and sovereign bonds, US$ 3,140 million in bank time deposits, US$ 1,139 million in equities, and US$ 478 million in inflation-indexed sovereign bonds (see Table 6).

By country, the sovereign portfolio is invested in the United States, Germany, Japan, and Switzerland, where investments in the United States account for almost 40% 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$ 420 million in France, China, Japan, Spain, 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 7 presents the breakdown of bank deposits at the close of 2016. The equities portfolio at year-end was concentrated in the United States (around 50%) and, to a lesser extent, Japan and the United Kingdom, as well as 46 countries with investments of less than US$ 40 million each. The equities distribution by country tracks the country allocation in the benchmark.

Relative to the benchmark, the asset allocation of the ESSF at year-end had an overweight in bank deposits by around 8%, at the expense of Treasury bills and sovereign bonds (see Figures 27 and 28). 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. With regard to the currency allocation, at year-end the portfolio was aligned with the benchmark (see Figure 29).

T6 Allocation by type of risk, 31 December 2016 (millions of dollars and percent of portfolio)

Exposure	Country	US$ million	% of total
Sovereign	USA	3,616	26.3
	Japan	2,849	20.7
	Germany	1,513	11.0
	Switzerland	1,035	7.5
	Total [(a)]	9,014	65.4
Inflation-indexed sovereign	USA	341	2.5
	Germany	138	1.0
	Total	**478**	**3.5**
Banking	France	748	5.4
	China	430	3.1
	Japan	427	3.1
	Spain	427	3.1
	Denmark	426	3.1
	Germany	294	2.1
	United Kingdom	216	1.6
	Belgium	60	0.4
	Singapore	40	0.3
	Others[(b)]	72	0.5
	Total	**3,140**	**22.8**
Equities	USA	633	4.6
	Japan	89	0.6
	United Kingdom	61	0.4
	Switzerland	37	0.3
	Canada	37	0.3
	France	36	0.3
	Germany	34	0.2
	Australia	28	0.2
	South Korea	17	0.1
	The Netherlands	16	0.1
	Hong Kong	16	0.1
	Spain	12	0.1
	Sweden	11	0.1
	Others[(b)]	111	0.8
	Total	**1,139**	**8.3**
	Total Fund	13,772	100.0

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

(b) Includes cash, cash equivalents, and unsettled transactions.

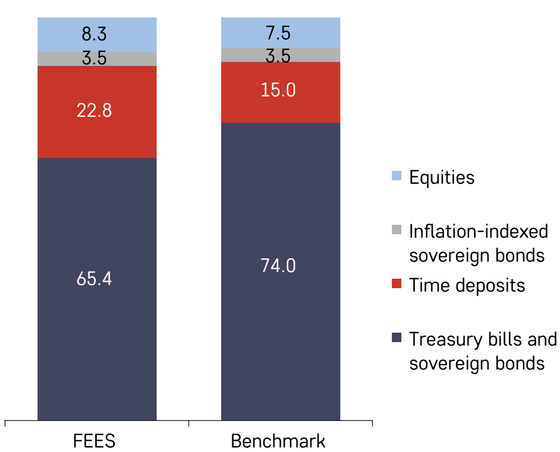
Source: Ministry of Finance

T7 Banks with deposits, 31 December 2016

Banks	Country
Bred Banque Populaire	France
Credit Agricole Corporate and Investment Bank	France
Natixis	France
Societe Generale	France
Bank of China (Hong Kong) Ltd	China
China Construction Bank Corporation	China
Sumitomo Mitsui Trust Bank Ltd	Japan
The Chiba Bank Ltd	Japan
Banco Bilbao Vizcaya Argentaria SA	Spain
Banco Santander SA	Spain
Danske Bank Aktieselskab	Denmark
Nykredit Bank A/S	Denmark
Bayerische Landesbank	Germany
Dekabank Deutsche Girozentrale	Germany
Norddeutsche Landesbank Girozentrale	Germany
Lloyds TSB Bank PLC	United Kingdom
Standard Chartered Bank	United Kingdom
KBC Bank NV	Belgium
DBS Bank Ltd	Singapore

Source: Ministry of Finance

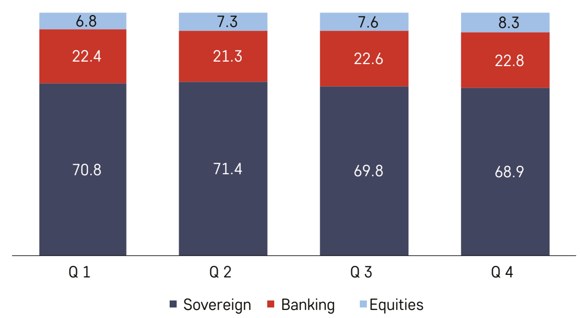
F27 Asset allocation, 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

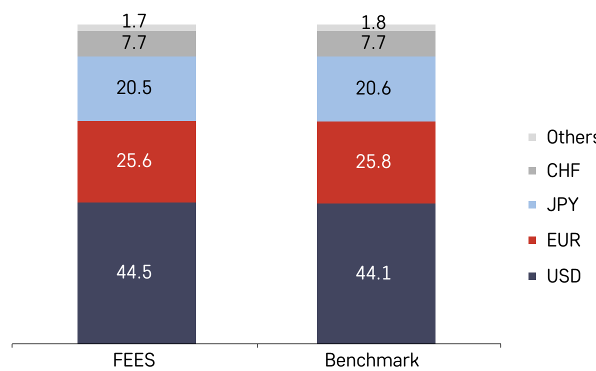
The credit quality of the sovereign investments included in the ESSF is directly related to the benchmark allocation. That is, the distribution by credit rating depends on the shares established in the benchmark for the United States, Germany, Japan, and Switzerland. Bank exposure depends on the CBC's assessment of the risk-return ratio of each bank at the time the deposit was made (see Table 8).

F28 Risk allocation in 2016 (percent of portfolio)



Source: Ministry of Finance

F29 Currency allocation, 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

T8 Credit risk exposure, 31 December 2016 (percent of the fixed-income portfolio)

Issuer	Credit rating								
	AAA	AA+	AA	AA-	A+	A	A-	Others[a]	Total
Sovereign	52.6	0.0	0.0	0.0	22.6	0.0	0.0	0.0	75.1
Bank	0.0	0.0	0.0	0.3	3.4	15.1	5.4	0.6	24.9
Total	52.6	0.0	0.0	0.3	26.0	15.1	5.4	0.6	100.0

a) Includes cash, cash equivalents, and unsettled transactions.

Source: Ministry of Finance

8.5 Management Costs and Income from the Securities Lending Program

The total cost of managing the ESSF in 2016 included US$ 1,113,997 for custody services, US$ 935,495 for CBC management services, and US$ 454,957 for external management services. In the year, there were also payments associated with consulting services provided by Verus Advisory Inc. (Verus),[27] auditing services for the 2015 financial statements, and tax consulting services, for a total of US$ 107,143. Total management costs were equivalent to 2 basis points of the average size of the fund in 2016. Income from the securities lending program was US$ 3,440,007, which largely offset the total management costs of the ESSF (see Table 9).

8.6 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.

8.6.1 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 equity 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 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 2016, both the benchmark duration and the actual duration were approximately 4.8 years.

T9 Management and custody costs and income from the securities lending program (dollars)

	2012	2013	2014	2015	2016
Custody (J.P. Morgan)	530,901	1,379,420	1,302,645	1,295,073	1,113,997
CBC Management	768,014	789,277	802,573	957,404	935,495
External Managers	-	-	581,047	622,359	454,957
Others[a]	-	-	-	-	107,143
Total costs	**1,298,915**	**2,168,697**	**2,686,265**	**2,874,836**	**2,611,593**
Securities lending program	**2,914,649**	**2,654,248**	**2,332,681**	**2,563,815**	**3,440,007**

(a) Includes tax advisory, audit and consulting services payments.

Source: Ministry of Finance

27 Previously the consultant was Strategic Investment Solutions Inc. which then merged with Versus in late 2015. This consultant was hired by the Ministry in 2015 for support in the monitoring of the managers of the sovereign wealth funds.

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 equities portfolio includes a small exposure to an additional 21 currencies. At the close of 2016, the foreign currency exposure, measured in dollars, deriving from investments in euros (25.6%), yen (20.5%), Swiss francs (7.7%), pounds sterling (0.5%) and other currencies with a minor share (1.3%).

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 minimal in the ESSF, because the fixed-income portfolio includes mainly sovereign issues from the United States, Germany, Japan and Switzerland, among which the lowest rating is A+ (Japan), and securities issued by eligible entities with an explicit government guarantee, supranational institutions and agencies 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 stock 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 stock index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2016, equities accounted for 8.3% of the ESSF.

Volatility, VaR, and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility[28], the minimum and maximum returns, and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 7.1% in 2016, versus 5.3% 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 10). At year-end 2016, the VaR, which quantifies potential losses in a given period with a given probability, was 10.71% at a one-year horizon, with a 95% confidence level.[29]

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 2016, the ex ante tracking error of the ESSF was 10 basis points, while the ex post tracking error[30] was 8 basis points, consistent with a passive management strategy.

T10 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

28 Volatility is the standard deviation of the returns; it indicates the degree of dispersion of returns around the average.

29 This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 10.71% of its nominal value in dollars.

30 El *tracking error ex post* corresponde a la desviación estándar anualizada de los excesos de retorno mensuales históricos comprendidos entre el 31 de diciembre de 2013 y el 31 de diciembre de 2016.

8.6.2 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 11). 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 or the 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.

8.6.3 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 2016, money market instruments accounted for 33.6%, 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.

T11 Maximum credit exposure by bank issuer

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

(a) IP: Investment portfolio.

Source: Ministry of Finance

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.

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 the second half of 2015, support for monitoring is provided by Verus, an international consulting firm.

09 PENSION RESERVE FUND

As of 31 December 2016, the PRF had a market value of US$ 8,862 million. Since its inception on 28 December 2006, the fund has received contributions totaling US$ 7,867 million and recorded net investment income of US$ 996 million. In 2016, the fund's return in dollars, net of management costs, was 3.76%, with an equivalent net return in pesos of -1.90%. Since the fund's inception, the annualized net return in dollars was 3.20%; the equivalent in pesos, 5.41%. The IRR in dollars was 3.47% in 2016 and 2.10% annualized since the creation of the fund.

9.1 Investment Policy

The main objective of PRF investment is to generate resources for financing a share of the government's pension liabilities. To achieve this, the investment policy incorporates the specific objective of maximizing expected returns while keeping risk within a 95% probability that the fund will not lose more than 10% of its value in dollars in a given year. The investment horizon is medium to long term, given the size and timeline of the liabilities that the fund has to finance.

The current PRF investment policy, implemented in January 2012, stipulates a portfolio allocation of 48% in sovereign and government-related bonds, 17% in inflation-indexed sovereign bonds, 15% in equities and 20% in corporate bonds. The CBC manages asset classes with sovereign risk exposure, while the equities and corporate bond portfolios are managed externally (BlackRock and Mellon for equities; and BlackRock and Rogge for corporate bonds).

The asset classes defined under this policy are invested according to highly diversified benchmarks (see table 12) and using a largely passive approach. The ex ante tracking error is capped at 50 basis points for the aggregate portfolio of sovereign bonds, government-related bonds and inflation-indexed bonds, 60 basis points for the equities portfolio and 50 basis points for the corporate bond portfolio.

The eligible instruments and issuers are determined by the benchmarks used. A limited use of ETFs, ADRs, GDRs, mutual funds and futures in also allowed in order to facilitate tracking the equities benchmark. Leveraging is not permitted, and the authorized use of forwards or swaps is confined exclusively to exchange rate hedging.

A portfolio rebalancing policy has been established to allow convergence to the strategic asset allocation described above. The policy is triggered whenever the PRF receives additional contributions and when any of the asset classes exceed the following target ranges: 45–51% for sovereign and government-related bonds, 14–20% for inflation-indexed sovereign bonds, 17–23% for corporate bonds and 12–18% for equities.

9.2 Market Value

As of 31 December 2016, the PRF had a market value of US$ 8,862 million, an increase of US$ 750 million over year-end 2015. This growth is mainly due to a contribution of US$ 462 million, equivalent to 0.2% of 2015 GDP (see Table 13), and net investment income of US$ 288 million.

Since its inception on 28 December 2006, the fund has received contributions totaling US$ 7,867 million and earned net investment income of US$ 996 million (see Table 14).

T12 Strategic asset allocation and benchmarks (percent of portfolio)

Strategic asset allocation		Benchmark
Asset class	Percent of total	
Sovereign and government-related bonds[a]	48	Barclays Capital Global Aggregate: Treasury Bond Index (unhedged) Barclays Capital Global Aggregate: Government-Related (unhedged)[b]
Inflation-indexed sovereign bonds (real)	17	Barclays Capital Global Inflation-Linked Index (unhedged)
Corporate bonds	20	Barclays Capital Global Aggregate: Corporates Bond Index (unhedged)
Equities	15	MSCI All Country World Index (unhedged with reinvested dividends) ex Chile

(a) Each sub index of this asset class is added according to its relative capitalization.
(b) Includes other government-related issuers, such as municipalities, state-owned companies, agencies, etc.
Source: Ministry of Finance

T13 Annual contributions (millions of dollars)

Period	Contribution	% GDP of prev. year
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
Total	7,866	

Source: Ministry of Finance

T14 Evolution and decomposition of market value (millions of dollars)

Decomposition	2012	2013	2014	2015	2016	Since inception[a]
Starting market value	4,406	5,883	7,335	7,944	8,112	0
Contributions	1,197	1,377	499	464	462	7,867
Withdrawals	0	0	0	0	0	0
Accrued interest	131	174	190	194	197	1.221
Captil gains (losses)	151	-95	-76	-485	94	-205
Management, custody and other costs	-1.2	-4.4	-4.6	-4.5	-4.2	-20.5
Net financial gains	280	75	110	-295	288	996
Ending market value	5,883	7,335	7,944	8,112	8,862	8,862

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

9.3 Performance

The fund's return in dollars, net of management costs, was 3.76% in 2016, which breaks down into sovereign and government-related bonds (1.64%), the inflation-indexed sovereign bonds (4.16%), corporate bonds (4.31%), and equities (8.29%). The equivalent net return in pesos for the year was -1.90%. The annualized return in dollars over the last three years was 0.58%, where the sovereign and government-related bonds portfolio was the only portfolio with a negative return in the period, of -0.78%. The annualized net return in pesos in the last three years was 8.99%. Since 31 March 2007, the annualized net return was 3.20% in dollars and 5.41% in pesos (see Table 15 and Figure 30). The IRR in dollars was 3.47% in 2016, while the annualized IRR since the fund's inception was 2.10%.

T15 Net returns (percent)

Returns[a]	2016	Last 3 years	Since inception[b],[c]
Sovereign and government-related bonds	1.64	-0.78	-
Inflation-indexed sovereign bonds	4.16	0.62	-
Corporate bonds	4.31	1.21	-
Equities	8.29	3.48	-
Return in USD	**3.76**	**0.58**	**3.20**
Exchange rate effect, CLP	-5.66	8.41	2.21
Return in CLP[d]	**-1.90**	**8.99**	**5.41**

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

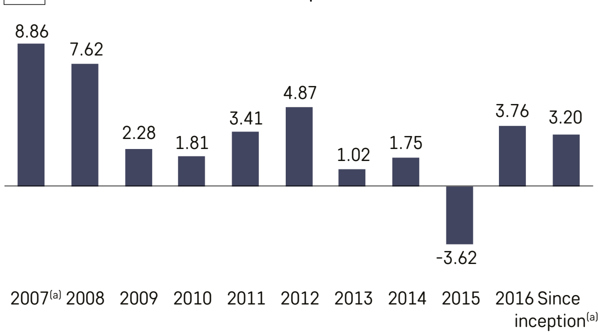
(b) The return on corporate bonds and equities is not presented for the full period since inception, because the fund has only been investing in these asset classes since 17 January 2012.

(c) The return since inception is calculated from 31 March 2007, when the performance of the CBC began to be measured.

(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

F30 Annual net TWR in dollars (percent)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Broken down by quarter, the fund recorded positive returns in dollars in all quarters except the last (-5.75%) (see Table 16). The fourth-quarter performance is mainly due to the impact of the depreciation against the dollar of the main currencies in which each asset class in the fixed-income portfolio is invested (sovereign and government-related bonds, inflation-indexed bonds, and corporate bonds) and, to a lesser extent, to interest rate hikes in some of countries in which the fund is invested. These effects were partially offset by the return on the equities portfolio (1.22%).

The fund's investment performance can be illustrated using an index of the portfolio's daily returns (see Figure 31). Taking a starting value of 100 on 31 March 2007, the index reached 136.0 at year-end 2016.

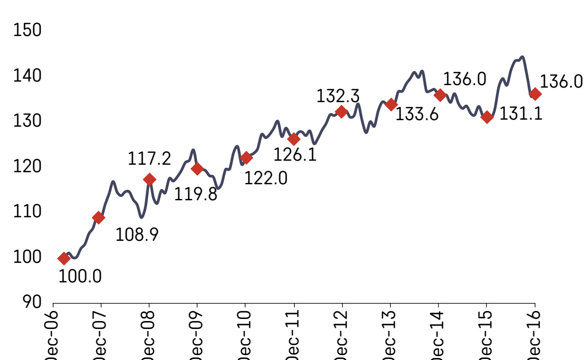
The performance of the PRF, measured as the difference between the portfolio return and the benchmark return, was 3 basis points in 2016, while the annualized return since 31 March 2007 was -30

T16 Net quarterly return in dollars in 2016, by asset class (percent)

Returns	Q 1	Q 2	Q 3	Q 4
Sovereign and government-related bonds	6.86	3.58	0.68	-8.79
Inflation-indexed bonds	4.71	1.59	3.28	-5.20
Corporate bonds	4.75	2.03	1.93	-4.25
Equities	0.37	1.14	5.39	1.22
Total portfolio	**5.15**	**2.59**	**2.06**	**-5.75**

Source: Ministry of Finance

F31 PRF return index in dollars (31 de March 2007 = 100)

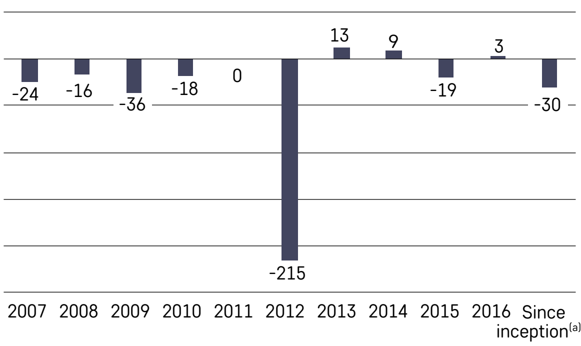


Source: Ministry of Finance

basis points (see Figure 32). 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.[31]

By asset class, the sovereign portfolio (the aggregate portfolio of sovereign bonds, government-related securities, and inflation-indexed bonds) recorded a positive excess return of 6 basis points over the benchmark in 2016, while the corporate bond portfolio had an excess return of 4 basis points (see Table 17). The equities portfolio had a negative excess return of -13 basis points vis-à-vis the benchmark in 2016. In the last three years, the annualized excess return was 8 basis points for the sovereign portfolio, -2 basis points for corporate bonds, -19 basis points for equities, and -3 basis points for the total portfolio.[33]

F32 Excess returns over the benchmark[33] (basis points)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

T17 Excess returns over the benchmark, by asset class[35] (basis points)

Asset class	2016	Last 3 years	Since inception (a)
Sovereign portfolio (b)	6	8	-
Corporate bonds	4	-2	-
Equities	-13	-19	-
Total portfolio	**3**	**-3**	**-30**

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

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

Source: Ministry of Finance

31 The transfer of funds to the external managers of the corporate bond and equities 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 32 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.

32 The 2012 Annual Report published the figure taking into account the waiver granted to the portfolio managers, but starting with the 2013 Annual Report, the figure is not adjusted for the waiver, following the recommendation of the Financial Committee.

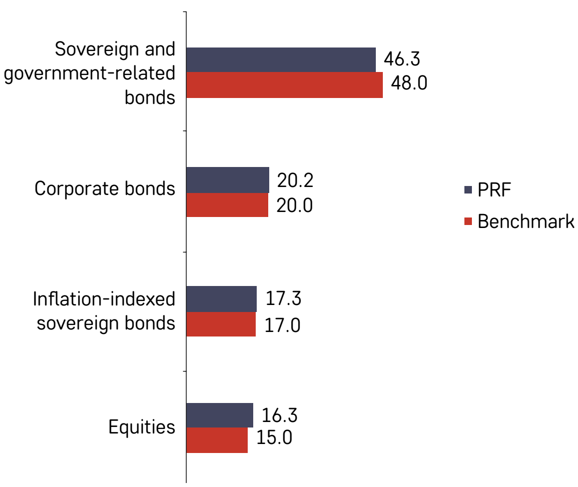
33 As with the ESSF, the negative performance of the equities portfolio mainly reflects tax payments on portfolio gains, which are not considered in the benchmark.

34 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.

9.4 Portfolio Allocation

As of December 2016, the allocation of the PRF by asset class comprised US$ 4,100 million in sovereign and government-related bonds, US$ 1,529 million in inflation-indexed sovereign bonds, US$ 1,789 million in corporate bonds, and US$ 1,444 million in equities. In terms of portfolio shares, the percent allocation by asset class and currency was relatively similar to the benchmark, although the shares of the sovereign and government-related bonds portfolio and the equities portfolio were both higher (see Figure 33). With regard to the currency allocation, at year-end 2016 the U.S. dollar was over-weighted relative to the benchmark, and currencies with smaller portfolio shares were underweighted (see Figure 34).

F33 Asset class allocation, 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

In terms of credit risk allocation, at year-end, 27% of the PRF fixed-income portfolio was invested in instruments rated AAA, 50% in AA+ y A–, and the remaining 23% between BBB+ and BBB- (see Table 18).

With regard to geographical distribution, investments are mainly concentrated in North America, Europe, and Asia. Relative to the benchmark, the fund was under-weighted in Europe by 2.5%, slightly over-weighted in North America and Latin America, and fairly aligned in other regions at year-end 2016 (see Figure 35).

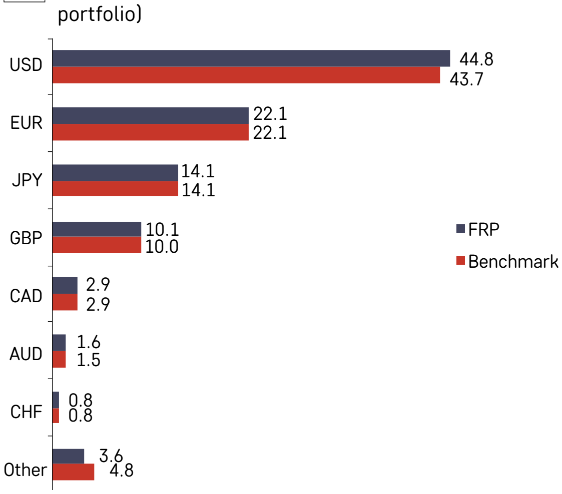
T18 Credit risk exposure, 31 December 2016 (percent of fixed-income portfolio)

	Sovereign and government-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Total fixed-income
AAA	16.2	10.5	0.2	26.9
AA+	2.4	5.5	0.4	8.2
AA	5.4	3.0	0.3	8.7
AA-	2.6	0.0	1.4	4.0
A+	13.0	0.0	2.1	15.1
A	4.2	0.1	3.6	7.9
A-	1.6	0.0	4.8	6.4
BBB+	4.2	0.2	5.1	9.5
BBB	4.1	1.4	3.1	8.5
BBB-	1.5	0.0	3.0	4.6
Others[a]	0.1	0.0	0.2	0.2
Total	55.3	20.6	24.1	100.0

(a) Includes cash and cash equivalents.

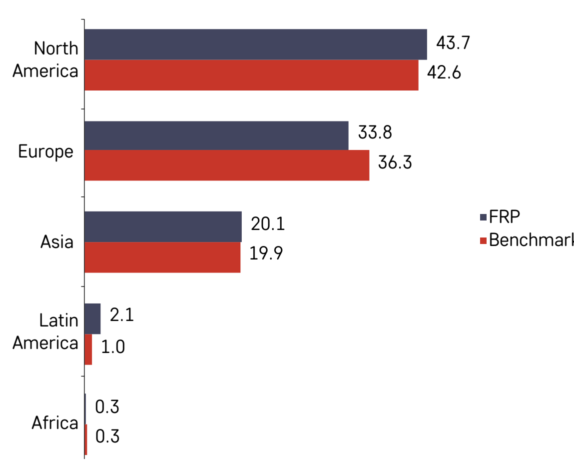
Source: Ministry of Finance

F34 Currency allocation, 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

F35 Regional allocation, 31 December 2016 (percent of portfolio)

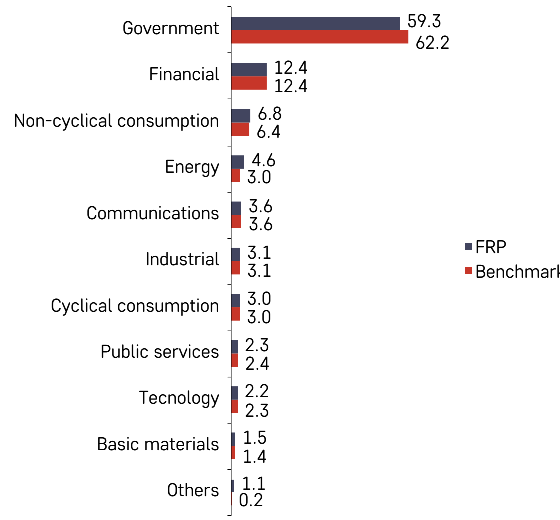


Source: Ministry of Finance

By economic sector, over half the fund is invested in the government sector, followed by the financial and noncyclical consumer goods sectors. Relative to the benchmark, at year-end 2016 the fund was slightly under-weighted in the government sector, over-weighted in energy, and aligned in the other sectors (see Figure 36).

By country, the fund's exposure is concentrated in the United States, with 38% of the total portfolio at year-end 2016, followed by Japan, with 14%. Exposure to the first five countries account for over 70% of the total fund (see Table 19).

F36 Sectoral allocation, 31 December 2016 (percent of portfolio)



Source: Ministry of Finance

T19 Allocation by country, 31 December 2016 (percent of portfolio)

Country allocation	Sovereign and government-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Equities	Total
USA	9.8	7.4	11.8	9.1	38.1
Japan	12.2	0.1	0.4	1.3	13.9
United Kingdom	1.9	5.2	1.6	0.9	9.6
France	2.9	1.8	1.3	0.5	6.6
Italy	3.0	1.1	0.3	0.1	4.5
Canada	2.1	0.4	0.9	0.5	3.9
Germany	1.9	0.6	0.3	0.5	3.2
Spain	2.1	0.2	0.1	0.2	2.5
The Netherlands	0.6	0.0	1.2	0.2	2.1
Mexico	1.4	0.0	0.2	0.1	1.7
South Korea	1.3	0.0	0.0	0.2	1.6
Australia	0.5	0.2	0.4	0.4	1.5
Belgium	0.8	0.0	0.0	0.1	0.9
Others[a]	5.7	0.3	1.7	2.3	9.9
Total	**46.3**	**17.3**	**20.2**	**16.3**	**100.0**

(a) Includes cash and cash equivalents.

Source: Ministry of Finance

T20 Management and custody costs and income from the securities lending program (dollars)

Ítems	2012	2013	2014	2015	2016
Custody (J.P. Morgan)[a]	91,572	1,971,424	2,296,139	1,639,504	1,449,173
CBC management	520,186	1,032,599	724,115	947,984	1,003,643
External management	548,098	1,347,401	1,608,982	1,884,965	1,550,659
Other costs[b]	70,588	—	—	—	241,507
Total costs	**1,230,443**	**4,351,424**	**4,629,236**	**4,472,453**	**4,244,983**
Securities lending program	**219,422**	**235,855**	**567,458**	**278,184**	**307,653**

(a) Custody costs in 2014 include payments for services rendered from May to December 2013.

(b) Includes consulting, auditing, and tax consulting services.

Source: Ministry of Finance

9.5 Management Costs and Income from the Securities Lending Program

The total cost of managing the PRF included US$ 1,449,173 for custody services, US$ 1,003,643 for the CBC's management services, and US$ 1,550,659 for external portfolio managers. In the year, there were also payments associated with consulting services provided by Verus, tax consulting services, and auditing services for the PRF financial statements, for a total of US$ 241,507. Together, the total management and custody costs represented 5 basis points of the total PRF portfolio in 2016. The income from the securities lending program totaled US$ 307,653, which partly offset the management and custody costs (see Table 20).

9.6 Main Financial Risks

The PRF portfolio is exposed to many of the same risks as the ESSF. However, credit risk is higher in the PRF due to investment in a larger number of countries and in corporate bonds. As with the ESSF, most of these risks are directly related to the asset class allocation and the choice of benchmarks, given the passive approach of the fund's investment policy.

9.6.1 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 2016 was 8.05 years, while the actual duration of the PRF was 7.99 years.

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 2016, 98% of the portfolio was invested in 10 different currencies, including the dollar, while the remaining 2% was exposed to 16 currencies. Specifically, the fund's exposure to currency risk is mainly through investments denominated in euros (22%), yen (14%), pounds sterling (10%), Canadian dollars (3%), and Australian dollars (2%).

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, public and semi-public agencies, multilateral financial institutions, corporations and so on. Credit spread risk is mitigated by having a well-diversified portfolio and investing only in investment-grade instruments (with a rating of BBB– or higher).

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 stock is eliminated by investing in a highly diversified portfolio. The fund's tolerance for stock 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 2016, equities accounted for 16.3% of the fund, which is very close to the strategic asset allocation (15%).

Volatility, VaR, and tracking error

The annual volatility of the PRF was 7.0% in 2016, versus 5.6% 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 21). At year-end 2016, the VaR was 10.50% in a one-year horizon, with a 95% confidence level.[35]

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 2016, the ex ante tracking error of the PRF was 24 basis points, while the ex post tracking error was 15 basis points. If January and February 2012 are excluded to remove the implementation period of the new investment policy, then the ex post tracking error is reduced from 43 to 19 basis points. Thus, both indicators are consistent with a passive management strategy.

T21 Historical minimum and maximum returns (percent)

Range	Month	Quarter
Highest return	5.47 (Dec-08)	7.36 (I 08)
Lowest return	-3.33 (Jan-09)	-5.75 (IV 16)

Source: Ministry of Finance

35 This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 10.50% of its nominal value in dollars.

9.6.2 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 investment-grade 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 22). 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, the use of futures is also allowed so as to limit the total use of derivatives. Thus, forwards, swaps and futures cannot exceed 10% of each external 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 Fisco and keeping them in separate accounts.

9.6.3 Liquidity Risk

The PRF is exposed to minimal liquidity risk because the fund has little need for cash, given that disbursements from the fund will start in 2017. The sale of instruments in the 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), and with the possible need for 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, in order to reduce the impact of having to sell at an unfavorable time. For rebalancing, there are clear rules on planning its implementation.

9.6.4 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 Verus, an international consulting firm.

.

T22 Credit limits on bank deposits and forwards

Limits		Time deposits	Forwards
Minimum rating		A-	A-
Maximum per issuer[a]	CBC portfolio	1% (above AA-) 0,5% (A- and A+)	1%
	Externally managed portfolios	20 MM US$	

(a) Percent of each manager's portfolio (for the CBC or each external manager).
Source: Ministry of Finance

10 FINANCIAL STATEMENTS: ECONOMIC AND SOCIAL STABILIZATION FUND

Financial statements for the years ended on 31 December 2016 and 2015 and the independent auditors' report[37]

37 The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2016 and 2015 were prepared by the General Treasury and audited by Crowe Horwarth. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

ECONOMIC AND SOCIAL STABILIZATION FUND

Financial Statements
31 December 2016 and 2015

US$ — U.S. dollar

Horwath HB Auditores Consultores
Member Crowe Horwath International
Avda. Apoquindo 3669, oficina 902
Las Condes – Santiago – Chile
(562) 2607 67 00
www.crowehorwath.cl

INDEPENDENT AUDITORS' REPORT

Santiago, 24 March 2017

To the Office of the Treasury of Chile
Economic and Social Stabilization Fund

Report on the financial statements

We have conducted an audit of the attached financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2016 and 2015, with the corresponding income, comprehensive income, changes in net equity, and cash flow statements for these years, together with the corresponding notes.

Management's responsibility for the financial statements

The Treasury of Chile is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes the design, implementation, and maintenance of appropriate internal control procedures that ensure the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on the 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 an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves carrying out procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks associated with material misstatements on the financial statements, whether due to fraud or error. On making these risk assessments, the auditor considers the internal control procedures that are relevant to the preparation and fair presentation of the Fund's 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 entity's internal control. We therefore do not express such an opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the significant accounting estimates made by the Fund's management, as well as assessing the general presentation of the financial statements.

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

Opinion

In our opinion, these financial statements fairly present, in all material aspects, the financial position of the Economic and Social Stabilization Fund as of 31 December 2016 and 2015 and its operating performance and cash flows for the years ended on those dates, in accordance with International Financial Reporting Standards.

Other matters

As indicated in Note 1, the Economic and Social Stabilization Fund's resources are intended to be used to provide additional resources for the stabilization of fiscal income, replacing the fund established for that purpose under Decree Law Nº 3,653 of 1981 and the Copper Compensation Fund established under IBRD loan agreement Nº 2,625 CH, as specified in Statutory Decree No. 1 issued on 11 December 2006.

Sergio Bascuñán Rivera

ECONOMIC AND SOCIAL STABILIZATION FUND

CONTENTS

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF FINANCIAL POSITION

ASSETS	Notes	31 Dec 2016 US$	31 Dec 2015 US$
CURRENT ASSETS			
Cash and cash equivalents	12	60,482,821	355,669,386
Total current assets		60,482,821	355,669,386
FINANCIAL ASSETS AFFECTING INCOME			
Equities	7	1,108,802,965	963,130,549
Other capitalization instruments	7	25,707,200	21,989,549
Time deposits	7	3,068,045,957	2,847,401,814
Government bonds	7	7,531,684,173	7,720,564,327
Indexed bonds	7	478,495,845	489,361,336
Treasury bills	7	1,482,089,786	1,230,307,859
Commercial papers	7	-	340,155,210
Derivatives		16,801,162	-
Total investments		13,711,627,088	13,612,910,644
Total assets		13,772,109,909	13,968,580,030

LIABILITIES AND NET EQUITY	Notes	31 Dec 2016 US$	31 Dec 2015 US$
LIABILITIES			
Derivative financial instruments	8	51,646	2,304,310
Total liabilities		51,646	2,304,310
NET EQUITY			
Fisco resources		11,375,188,745	11,839,070,131
Contributions by the Fisco in the year	9	-	-
Withdrawals by the Fisco in the year	9	(462,285,625)	(463,881,386)
Retained earnings		2,591,086,975	2,849,750,837
Loss in the year		268,068,168	(258,663,862)
Total net equity		13,772,058,263	13,966,275,720
TOTAL LIABILITIES AND NET EQUITY		13,772,109,909	13,968,580,030

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF INCOME

	Notes	31 Dec 2016 US$	31 Dec 2015 US$
OPERATING INCOME			
Interest earned	10	136,965,528	142,386,955
Income from dividends	11	24,605,788	24,689,604
Net realized gains		226,754,919	-
Net unrealized gains		-	56,028,249
Total operating income		388,326,235	223,104,808
OPERATING LOSSES			
Net losses from sale of financial instruments		-	(478,893,834)
Net unrealized losses from price changes on financial instruments		(117,713,258)	-
Total operating losses		(117,713,258)	(478,893,834)
Total operating income		270,612,977	(255,789,026)
MANAGEMENT EXPENSES			
Fiscal agent's fee (Central Bank of Chile)	9	(1,390,452)	(1,579,763)
Custodian's fees and external managers' fees	9	(1,113,997)	(1,295,073)
Other custody and external management expenses	9	(107,143)	-
Adjustment, J.P. Morgan		66,783	-
INCOME (LOSS) IN THE YEAR		268,068,168	(258,663,862)

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF COMPREHENSIVE INCOME

	31 Dec 2016	31 Dec 2015
	US$	US$
Income (loss) in the year	268,068,168	(258,663,862)
Other comprehensive income reclassified to income in subsequent years	-	-
Other comprehensive income not reclassified to income in subsequent years	-	-
Total other comprehensive income	-	-
Comprehensive income in the year	268,068,168	(258,663,862)

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CHANGES IN NET EQUITY

	Notes	Fiscal resources	Accumulated resources	Comprehensive income in the year	Total
		US$	US$	US$	US$
Opening balance, 1 January 2016		11,375,188,745	2,849,750,837	(258,663,862)	13,966,275,720
Distribution of income from previous year		-	(258,663,862)	258,663,862	-
Withdrawals by the Fisco	9	(462,285,625)	-	-	(462,285,624)
Comprehensive income for the year		-	-	268,068,168	268,068,168
Closing balance, 31 December 2016		10,912,903,120	2,591,086,975	268,068,168	13,772,058,263
Opening balance, 1 January 2015		11,839,070,131	3,081,120,886	(231,370,049)	14,688,820,968
Distribution of income from previous year		-	(231,370,049)	231,370,049	-
Withdrawals by the Fisco	9	(463,881,386)	-	-	(463,881,386)
Comprehensive income for the year		-	-	(258,663,862)	(258,663,862)
Closing balance, 31 December 2015		11,375,188,745	2,849,750,837	(258,663,862)	13,966,275,720

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CASH FLOW

(Indirect method)

	Notes	31 Dec 2016 US$	31 Dec 2015 US$
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		268,068,168	(258,663,862)
Net unrealized gains (losses)		117,713,258	(56,028,249)
Changes in fund management and custody		(218,682,366)	713,989,642
Net cash flows from operating activities		167,099,060	399,297,531
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	-	-
Decrease from capital withdrawals		(462,285,625)	(463,881,386)
Net cash flows from financing activities		(462,285,625)	(463,881,386)
NET INCREASE IN CASH AND CASH EQUIVALENTS		(295,186,565)	(64,583,855)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		355,669,386	420,253,241
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	60,482,821	355,669,386

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 –GENERAL INFORMATION

The Economic and Social Stabilization Fund (ESSF) was created through Law Nº 20,128, issued by the Ministry of Finance of Chile on 30 September 2006, which combined into a single fund the additional fiscal income stabilization resources stipulated in Decree Law Nº 3,653 of 1981 and the Copper Revenue Compensation Fund established under loan agreement IBRD Nº 2625 CH, as specified in Statutory Decree Nº 1 of 11 December 2006.

The operation of this Fund is regulated by the following instructions issued by the Ministry of Finance:

a) Decree Nº 1,383 of 2006, which authorizes the Central Bank of Chile (CBC) to act as fiscal agent in managing the Economic and Social Stabilization Fund and establishes guidelines for reporting on the investments to the Finance Minister and the Treasury.

b) Ministry of Finance Official Letter Nº 433 of 2012, which informs the fiscal agent of the new performance guidelines for managing the Economic and Social Stabilization Fund.

c) Comptroller General Official Letter Nº 71,390 of 2009, which provides instructions on the fund's valuation criteria.

d) Decree Nº 1,492 of 2015, which regulates the coordination and functioning of advisory activities, management support, and auditing of the Public Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund (and which abolishes Decree Nº 1,636 of 2009).

   Article 4 of this Decree includes the following activities in association with the Treasury:

   - Record all investments of Treasury resources, as well as debt operations, in accordance with the accounting and budgetary standards established by the Comptroller General and/or the Budget Office, as applicable.

   - Perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms, and commission independent auditors for the annual financial statements, subject to the stipulations of Article 7 of this Decree. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.

   - Support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.

– Verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records. This provision was applied to the portfolios under the management of external fund managers on 1 January 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.

– Issue transaction instructions associated with contributions to and withdrawals from the sovereign wealth funds in accordance with instructions from the Finance Minister, validate payments associated with the management and custody of the sovereign wealth funds, as required, and issue instructions to the Central Bank of Chile on the payment of the different services provided by the external managers.

– Supervise compliance with the norms and limits established by the Ministry of Finance with regard to the capital market investment of Treasury resources that are held outside the sovereign wealth funds and to send periodic reports on the matter to the Budget Office and the Ministry of Finance.

– Maintain a current manual of procedures for the handling of all functions and duties described in this Article.

– Provide any additional management support, coordination or consulting as needed for the performance of these functions.

The information for the accounting of the sovereign wealth funds is provided by the Treasury, which is and will continue to be an institution in good standing, such that the data resulting from the accounting process are not estimated values.

e) Ministry of Finance Decree Nº 1,567 of 2015, which establishes the new investment guidelines for the Economic and Social Stabilization Fund and which abolishes Official Letter Nº 1,267 of 2013.

f) Ministry of Finance Official Letter Nº 1,926 of 2013, which establishes the new custody guidelines.

g) Ministry of Finance Decree Nº 1,618 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.

Article 15, paragraph (a), of Decree Nº 1,618 of 2013 authorizes the fiscal agent to conduct, at the request of the Finance Minister, one or more tenders for the management of the externally managed portfolio and to contract the external managers thereof, in the name and on the account of the Fisco. Under this provision, the following external managers were contracted to perform custody services starting in 2013:

– BNY Mellon Equities;
– Blackrock Equities.

h) Ministry of Finance Decree Nº 892 of 2014, which establishes fiscal policy in accordance with the provisions of Article 1 of Law Nº 20,128.

Qualitative characteristics of the ESSF financial statements

i) The Principle of Relevance, as a category of the ESSF financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.

ii) The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence, and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.

iii) The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.

iv) The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

On 17 June 2015 the Ministry of Finance issued Official Letter N° 1,567, which contains the new investment guidelines for the Economic and Social Stabilization Fund. These guidelines, which entered into force on 5 August 2015, replace and rescind the investment guidelines contained in Official Letter N° 1,267, issued by the Ministry of Finance in 2013.

NOTE 2 – MAIN ACCOUNTING CRITERIA USED

The main accounting criteria used in the preparation of these financial statements are described below. These criteria have been applied systematically to all the statements presented, unless otherwise indicated.

2.1 Basis of preparation and presentation of the financial statements

The ESSF financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

As required by IFRS 9, debt instruments are measured at amortized cost if and only if (i) the asset is held within a 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, at the initial recognition of a debt instrument that meets the amortized cost criteria, the fund may choose to designate that instrument as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. In the current period, the fund has not decided to designate any debt instruments that meet the amortized cost criteria as measured at fair value through profit or loss.

Debt instruments that are subsequently carried at amortized cost are subject to depreciation.

Investments in equity instruments (equities) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for trade and is designated by the fund as measured at fair value through profit or loss in other comprehensive income. If the equity instrument is designated as measured at fair value through profit or loss in other comprehensive income, all gains and losses from revaluation, except dividend income that is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and cannot later be reclassified to profit or loss.

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds provided by the custodian, J.P. Morgan Chase & Co., to the Central Bank of Chile, which acts as fiscal agent.

The financial statements presented by the Treasury for the ESSF are as follows:

– Statement of Financial Position.
– Statement of Comprehensive Income.
– Statement of Changes in Net Equity.
– Statement of Cash Flows.
– Notes to the Financial Statements.

2.2 Accounting period

The financial statements cover the years between 1 January and 31 December 2016 and 2015, respectively.

2.3 Functional and presentation currency

The entries included in the ESSF financial statements are recorded using the currency of the primary economic environment in which the fund operates. Thus, the fund's securities are presented in U.S. dollars, as the functional and presentation currency.

Foreign currency transactions in currencies other than the U.S. dollar are converted to the functional currency using the exchange rate prevailing on the date of the transaction. Foreign currency gains and losses stemming from the settlement of these transactions or the conversion of monetary assets denominated in a foreign currency to the closing exchange rate are recognized on the Statement of Comprehensive Income.

2.4 Investment classification and valuation

The fund's investments comprise liquid foreign currency assets that are made by the Central Bank of Chile, as fiscal agent, using eligible intermediaries, basically banks and financial institutions. The investment objective is to maximize fiscal resources, which can be accessed immediately if needed to finance the activities of the sovereign wealth funds.

Financial assets and liabilities

Classification

The fund classifies investments in debt instruments, capitalization instruments, and financial derivative instruments as financial assets at fair value through profit or loss.

Financial assets at net fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is acquired principally for trading (short-term sale or repurchase) or is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Derivatives are also classified at fair value through profit or loss. The fund has adopted the policy of not using hedge accounting.

These overseas financial investments are recognized, valued, and classified in accordance with international financial reporting standards, as follows:

Financial instruments at fair value through profit or loss: Government bonds, inflation-indexed bonds, corporate bonds, common and preferred stocks, ADRs, GDRs, REITs, Treasury bills, commercial papers, and derivative instruments. The basis for classifying the securities in this investment category is that they have a reasonably active secondary market, under normal conditions. They are recorded at fair value, and any changes in value are recognized directly through profit or loss.

Equities and other capitalization instruments are recorded at fair value, and any changes in value are recognized directly on the Statement of Comprehensive Income.

The custodian determines fair value using the last transaction price of the day at the close of the market in which they are traded.

Financial assets at amortized costs

Financial assets at amortized cost are nonderivative financial assets with fixed or determinable payments and fixed maturities, which the fund manager intends to hold to maturity so as to receive interest, adjustment, and exchange rate income in accordance with the contractual terms of the instrument.

On the closing date of each statement of financial position, the fund assesses whether there is objective evidence of impairment of a financial asset or a group of financial assets in this category, comparing the book value of the asset with any loss events that could have an impact on the expected future cash flows of the financial asset or group of assets, which can be reliably estimated.

Financial liabilities

Financial liabilities at amortized cost will be classified as other liabilities.

Recognition, reduction, and measurement

The regular purchase and sale of investments is recognized on the date of the transaction, or the date the fund commits to buying or selling the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are charged to expenses on the income statement when they are incurred in the case of financial assets and liabilities at fair value through profit or loss, and they are recorded as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are costs that are incurred in the process of acquiring financial assets or liabilities. They include all fees, commissions, and other items paid to agents, consultants, brokers, and operators in association with the operation.

Financial assets are reduced for accounting purposes when the rights to receive cash flows from the investment have expired or the fund has essentially transferred all the risks and benefits associated with ownership.

After the initial recognition, all financial assets and financial liabilities carried at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in fair value in the category “Financial assets or financial liabilities carried at fair value through profit or loss” are presented on the Statement of Comprehensive Income under the item “Net changes in fair value of financial assets and financial liabilities carried at fair value through profit or loss” in the period in which the change occurs.

Dividend income from financial assets at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Dividend income” when the fund’s right to receive the payment has been established. Interest on debt securities at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Interest and adjustments” based on the effective interest rate.

Financial assets at amortized cost and other liabilities are valued, after initial recognition, using the effective interest rate method. Accrued interest and adjustments are recorded in the “Interest and adjustments” account of the Statement of Comprehensive Income.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating the financial income or financial expense over the period in question. The effective interest rate is the rate that exactly discounts effective future payments or receipts estimated over the life of the financial instrument, or, if appropriate, over a shorter period, relative to the accounting value of the financial asset or financial liability. To calculate the effective interest rate, the fund estimates cash flows taking into account all the contractual terms of the financial instrument, but not future credit losses.

The calculation includes all fees and points paid or received between the counterparties that are integral to the effective interest rate, transaction costs, and all other premiums or discounts.

Estimation of fair value

The fair value of financial assets and liabilities traded in active markets (such as derivatives and available-for-sale securities) is based on quoted market prices on the date of the Statement of Financial Position. The quoted market price used for financial assets held by the fund is the purchase price; the quoted market price taken for financial liabilities is the sale price (if the sale and purchase prices differ). When the fund holds derivative instruments that are netted, intermediate market prices are used as the basis for establishing the fair value for netting positions, and this purchase or sale price is applied to the net open position, as appropriate.

The hierarchy of fair value is as follows:

a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

b) Variables other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, price derivatives) (Level 2); and

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

2.5 Cash

In the preparation of the ESSF financial statements, a distinction is made between cash held in the current account maintained for the fund by the Treasury and cash held by the custodian as a result of operations undertaken in the course of the custodial management of the fund.

2.6 Funds under management

These are securities delivered, under the mandate of managing ESSF resources, to the Central Bank of Chile, as fiscal agent; to J.P. Morgan, as custodian bank; and to the external portfolio managers. The securities can be totally or partially employed in the performance of the assigned duties

2.7 Funds in custody

These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co. and to the external portfolio managers, which provide general custody services for ESSF securities and instruments.

2.8 Net equity

The net equity of the sovereign wealth funds is derived from the opening balance of total assets at nominal value, plus fiscal contributions, minus fiscal withdrawals, plus income for the year.

In accordance with the stipulations of Articles N° 1, 2, 3, and 4 of Statutory Decree N° 1 of 11 September 2006, the ESSF will be established and increased with the following resources:

The additional fiscal income stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under IBRD Loan Agreement N° 2,625 CH are to be combined into a single fund, called the Economic Social Stabilization Fund (ESSF).

The following resources are also to be combined into the fund:

a) All deposits in accounts held by the funds identified in Article 1, as of the date that the Statutory Decree enters into force;

b) All resources deriving from the application of Transitory Article 2 of Law N° 19,030;

c) An annual contribution equal to the balance remaining after subtracting from the effective surplus, the contributions stipulated in paragraph (a) of Article 6 and in Article 11, both of Law N° 20,128, provided the balance is positive; and

d) Other extraordinary contributions designated for the fund via Finance Ministry decree, from the sale of assets or the issue of debt instruments; as well as other resources stipulated in other laws.

The resources identified in the above points will be delivered to the fund in one or more installments until the total contribution has been made.

The resources pertaining to the fund will be held in one or more special accounts held by the Treasury.

Apart from the stipulations of Article N° 2 of Statutory Decree N° 1, during budget execution, contributions can be made to the fund in the form of early (advance) payments of contributions to be determined in the budgetary process underway or in future budget executions, in conformance with Article N° 20 of Law N° 20,128.

Any proceeds from the return on the fund's investments, that is, the return on the financial investment of the existing resources minus the costs of managing those resources, will be held as advance payments to the fund.

If the advance payments exceed the amount of the contribution as determined in the respective budget execution, the surplus will constitute an advance payment to be credited to the next budget execution.

The ESSF resources can be used as follows:

a) To finance the budget, up to the amount established in the Budget Law and included in the corresponding General Revenues Calculation.

b) To provide income replacement and/or to finance a fiscal deficit produced during budget execution, subject to the authorizations and limits established in the current legislation;

c) To pay amortization, interest or other costs related to the Public Debt, including interest and/or exchange rate swap contracts;

d) To pay amortization, interest or other costs related to recognition bonds (*bonos de reconocimiento*), as specified in Transitory Article 11 of Decree Law N° 3,500 on interest and/or exchange rates;

e) To finance the contributions stipulated in Article 6, paragraph (a), of Law N° 20,128, when so determined by the Finance Minister; and

f) To finance extraordinary contributions to the fund as described in Article 5 of Law N° 20,128, when so determined by the Finance Minister.

However, the Ministry of Finance can issue a decree stipulating that the resources which were allocated to pay for the items indicated in the above points in the last budget exercise, and which were included in the calculation of the contributions mandated in the last paragraph of Article 20 of Law N° 20,128, be reincorporated to the Nation's General Revenues, with a charge to the fund's resources.

2.9 Statement of Cash Flows

For the purpose of preparing the Statement of Cash Flows, the sovereign wealth funds use the following definitions:

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

– Net operating income: Includes management costs for operating the sovereign wealth funds.

– Net financing income: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

The fund uses the indirect method for preparing the Statement of Cash Flows, which defines the change in funds over the year as comprising net operating income, including costs incurred in the year due to management expenses, commissions, and insurance, and net financing income, resulting from the difference between fiscal contributions and withdrawals in the period.

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are offset, and the net amount is reported on the Statement of Financial Position, when there is a legal right to offset the recognized amounts and there is a positive intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

2.11 New accounting rules

On the date of publication of these financial statements, a number of new rules and amendments, as well as improvements and new interpretations of existing rules, have been issued, but have not yet entered into force. The ESSF management has not adopted the new provisions in advance of the mandatory application date, which is indicated in the following table:

	New rules, improvements, and amendments	**Mandatory application date:**
Amendment to IAS 7	Disclosure initiative: additional disclosure that allows users of financial statements to evaluate changes in liabilities from financing activities.	1 January 2017
Amendment to IAS 12	Recognition of deferred tax assets for unrealized losses.	1 January 2017
IFRS 9	Replacement of IAS 39.	1 January 2018
IFRS 15	Revenue from ordinary activities deriving from contracts with customers.	1 January 2018
IFRS 16	Operating leases: new accounting standard for recognizing leases.	1 January 2019
Amendment to IFRS 2	Classification and measurement of share-based payments.	1 January 2018

The ESSF management deems that the adoption of the new rules, amendments, and interpretations described above will not have a significant impact on the fund's financial statements in the initial application period.

NOTE 3 – ESSF INVESTMENT GUIDELINES

I. Duties assigned to the fiscal agent

The following duties and function are assigned to the fiscal agent, in accordance with Articles N° 4 and 15 of Decree N° 1,383, of 2006, modified by Decree N° 1.,618, of 2012, both issued by the Ministry of Finance (henceforth, the Agency Decree):

I.1. Duties related to Central Bank transaction accounts

I.1.1. Portfolio governed under Article 4 of the Agency Decree (henceforth, the Article 4 portfolio):

a. Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the ESSF Article 4 portfolio transaction account).

b. Receive, record, and deposit in the ESSF Article 4 portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the fiscal agent.

c. Receive, record, and deposit in the ESSF Article 4 portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, to the ESSF externally managed portfolio transaction account for the purpose of making third-party payments corresponding that portfolio, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.

d. Make payments, in the name and on the account of the Fisco, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (f) of Article 4 of the Agency Decree.

e. Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.1.2. Portfolio governed under Article 15 of the Agency Decree (henceforth, the externally managed portfolio):

a. Open and maintain a transaction account in the Central Bank of Chile in the name of the Treasury (henceforth, the ESSF externally managed portfolio transaction account).

b. Receive, record, and deposit in the ESSF externally managed portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the external managers.

c. Receive, record, and deposit in the ESSF externally managed portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination

d. Make payments, in the name and on the account of the Fisco, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (e) of Article 15 of the Agency Decree.

e. Make payments, in the name and on the account of the Fisco, to the external manager(s) or other third parties when so instructed by the Treasury.

f. Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.2. Duties related to custody

I.2.1. Article 4 portfolio:

Contract, in the name of the Fisco, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (d) of Article 4 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.2.2. Externally managed portfolio:

Contract, in the name of the Fisco, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (c) of Article 15 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.3. Duties related to management

I.3.1. Article 4 portfolio:

a. The fiscal agent will manage the fund's resources on the account and at the risk of the Fisco.

The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the fiscal agent.

The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the fiscal agent via a cash transfer to the ESSF Article 4 portfolio transaction account. Nevertheless, the resources can only be transferred to the fiscal agent on business days in the United States of America. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

b. To fulfill this duty, and subject to the objectives, guidelines, and restrictions established in this document, the fiscal agent will have the full authority, in representation of the Fisco, to make decisions on investment, disposal, and related activities, including the ability to choose, buy, sell, hold, auction, recover, or exchange investment instruments of any type; underwrite the issue of instruments; enter into spot or forward foreign exchange contracts; instruct the custodian to make payments associated with the execution of transactions; earn dividends, interest, amortization, and other benefits; and engage in other operations, acts, and contracts that the fiscal agent deems appropriate with regard to the management of the portfolio and the fulfillment of the duties outlined in this document.

The fiscal agent will also have the authority to implement the acts and contracts described in the previous paragraph through banks, brokers or any other financial intermediaries.

c. The fiscal agent will be able to aggregate transactions executed for the management of the portfolio with transactions executed for the Central Bank of Chile's international reserve portfolio, as well as for other fiscal resources managed by the fiscal agent.

The fiscal agent cannot directly acquire any instruments that are being removed the ESSF Article 4 portfolio in representation of the Fisco or directly acquire for the ESSF Article 4 portfolio any instruments owned by the Central Bank of Chile that are being removed from the Bank's own portfolio.

d. The fiscal agent will hold the funds and investments under its management in separate accounts, clearly indicating that they are the property of the Fisco of Chile for all legal purposes.

I.3.2. Externally managed portfolio:

a. The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the external managers.

b. The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the external managers, via the fiscal agent, in the form of a cash transfer to the ESSF externally managed portfolio transaction account. Nevertheless, the resources can only be transferred to the external managers on business days in the United States of America.

The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

c. The custodian(s) will hold the funds in its custody in separate accounts, clearly indicating that they are the property of the Fisco of Chile for all legal purposes.

I.3.3. Rebalancing

The Ministry of Finance or the Treasury will instruct the fiscal agent on the contributions to and/or withdrawals and transfers from the Article 4 portfolio to the externally managed portfolio, or vice versa, as necessary to achieve compliance with the target ranges established in section II.3.8. The instructions must be issued at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

I.4. Duties related to monitoring and reports

I.4.1. Article 4 portfolio:

a. Maintain full and detailed information on all transactions and other operations carried out in association with the management of the Article 4 portfolio, in accordance with the stipulations of paragraph (g) of Article 4 of the Agency Decree.

b. Supervise, monitor, and evaluate the services provided by the custodian(s); establish daily and, if necessary, clarify any differences that might arise between the records maintained by the fiscal agent and the custodians, as well as any other discrepancies detected in relation to the contracted services; and report to the Finance Minister, or an authorized delegate, for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund’s resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the custodians.

c. Report to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, the daily investment position of the portfolio, with a lag of not more than three (3) business days from the date of the report. The reporting requirement outlined in this paragraph will be understood as fulfilled when the respective electronic communication has been sent, using the means and formats stipulated by the Finance Minister or an authorized delegate, under the exclusive responsibility of the sender. In the event of discrepancies between the information sent by the fiscal agent and the information received by the Ministry of Finance and the Treasury, the version contained in the fiscal agent’s records will prevail.

d. Report, under the terms described above, to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, any change or correction to the information described in the preceding paragraph (c), on the daily investment position of the portfolio.

e. Submit to the Finance Ministry and the Treasurer, or their authorized delegates, monthly, quarterly, and annual reports on the management of the Article 4 portfolio.

f. Submit to the same authorities an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records maintained by the fiscal agent on the Article 4 portfolio. The monthly reports will include a copy of the payment orders associated with the ESSF Article 4 portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.

g. The Ministry will issue an opinion on the quarterly and annual reports described above, either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager and the General Manager of the Central Bank within a period of 30 consecutive days from the date the report was submitted. In the event that there are such observations, which must be well-founded and specific, the fiscal agent will have a period of 15 consecutive days to respond, with the specific objective of clarifying and resolving the issues raised, as appropriate. Subsequently, the Finance Minister or the International Finance Coordinator or the Head of the Sovereign Wealth Funds Unit will issue an opinion on the response received, via electronic mail, stating either approval or rejection, under the same requirements outlined above, within a period of 15 consecutive days from the date of reception.

h. Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible banks and localities, in accordance with the criteria stipulated in points II.3.3.2 and II.3.4.5 of these guidelines. Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible supranational entities, agencies, and entities with an explicit government guarantee, in accordance with the criteria stipulated in point II.3.3.5.

i. Meet monthly with Finance Ministry staff to discuss any aspect of the management of the ESSF Article 4 portfolio. These meetings will be held within five (5) business days of the submission of the monthly management report prepared by the fiscal agent. The Ministry of Finance can also request additional meetings as deemed appropriate.

j. As established in Article 7 of the Agency Decree, the accounting of the fiscal resources and the preparation of the audited financial statements are the responsibility of the Treasury. At the same time, the management of the Article 4 portfolio will be subject to internal supervision and control by the fiscal agent in accordance with the terms established in the Central Bank of Chile’s Basic Constitutional Act. In addition, at least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on Article 4 portfolio operations. Moreover, the Finance Minister, or an authorized delegate, can request that the fiscal agent submit reports on operations and processes carried out in the management of Article 4 portfolio. Finally, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of its duties and functions.

I.4.2. Externally managed portfolio:

a. Verify, in accordance with industry standards normally applied to investments in a given type of asset, that the records of transactions and other operations reported by the external manager(s) and by the custodian(s) of the fiscal resources are consistent at the close of each day, in terms of their notional amount, duration, and date, with the transactions reported at closure by the custodian(s). For the purposes of this paragraph (a), the daily closure is defined as the close of the fiscal agent's business day. In addition, the fiscal agent must subsequently verify the closures reported on non-business days for the fiscal agent that are business days for the custodian or external managers. The fiscal agent must report monthly to the Finance Minister and the Treasurer, or their authorized delegates, the results of the daily verification process. Furthermore, the fiscal agent must conduct a daily reconciliation of transactions and notional positions and report any differences that might arise between the records maintained by the fiscal agent and/or the external managers and the records maintained by the custodians, as well as any other discrepancies detected in relation to the contracted services; any such differences must be reported to the Finance Minister or authorized delegate for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal or administrative liability for any damages, crime or infringement committed by the external managers or the custodians.

b. For the purposes of this section I.4.2., and in all matters concerning the externally managed portfolio, "records" are defined as the information received from the external manager(s) or the custodian(s), in order to verify that the custodian(s) have the same notional positions as reported by the external manager(s).

c. Submit to the Finance Minister and the Treasurer, or their authorized delegates, an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records for the externally managed portfolio submitted by the external managers. The monthly reports described in the preceding paragraph will include a copy of the payment orders associated with the ESSF externally managed portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.

d. The Ministry will issue an opinion on the reports described in the preceding paragraphs (a) and (c), either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager of the Central Bank when the opinion encompasses Article 4 portfolio reports, in accordance with the timeline and procedures outlined in paragraph I.4.1.g.

e. At least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on all operations involving fiscal resources. Moreover, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of the custodian's duties and functions

The fiscal agent will only perform the duties described in paragraphs (a), (c), and (e) with regard to the custodian(s).

II. Portfolio investment guidelines

II.1. Management objective

II.1.1. Article 4 portfolio.

The management objective of the ESSF Article 4 portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy. The fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

II.1.2. Externally managed portfolio.

The management objective of the ESSF externally managed portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below.

II.2. Investment portfolio.

For the investment of the fiscal resources, an investment portfolio (IP) will be established comprising the sum of the Article 4 portfolio and the externally managed portfolio. The specific guidelines, parameters, and rules are contained in the following sections.

II.3. Guidelines and parameters

II.3.1 Asset classes

The fiscal resources in the investment portfolio (IP) will be invested in four asset classes: (1) Bank instruments; (2) Treasury bills and sovereign bonds; (3) Inflation-indexed sovereign bonds; and (4) Equities. The first three classes are allocated to the Article 4 portfolio; the fourth class (equities) is allocated to the externally managed portfolio. The benchmark allocation of the investment portfolio by asset class (henceforth, the benchmark allocation) is shown in Table 1.

Table 1: Benchmark allocation of the investment portfolio (IP).

Asset class	Percent of IP
Bank instruments	15.0%
Treasury bills and sovereign bonds	74.0%
Inflation-indexed sovereign bonds	3.5%
Equities	7.5%
Total	**100%**

The first three asset classes (bank assets; treasury bills and sovereign bonds; and inflation-indexed sovereign bonds) make up the Article 4 portfolio; they will be purchased directly by the Central Bank of Chile and managed directly by the Central Bank as the fiscal agent. The fourth asset class (equities and other assets) comprises the externally managed portfolio; these assets will be acquired by the external portfolio managers and managed directly by these external managers.

II.3.2. Benchmarks.

The benchmarks associated with each asset class are listed in Table 2, together with the required allocation (% of total resources).

Table 2: Benchmarks

Benchmark	Percent of IP
Merrill Lynch LIBID 3-Month Average USD	5.0%
Merrill Lynch LIBID 3-Month Average EUR	6.0%
Merrill Lynch LIBID 3-Month Average JPY	4.0%
Bank instruments	**15.0%**
Merrill Lynch Treasury Bills Index USD	6.0%
Merrill Lynch Treasury Bills Index EUR	7.0%
Merrill Lynch Treasury Bills Index JPY	6.0%
Treasury bills	**19.0%**
Barclays Capital Global Treasury: U.S. 7–10 yrs.	26.5
Barclays Capital Global Treasury: Germany 7–10 yrs.	11.0
Barclays Capital Global Treasury: Japan 7–10 yrs.	10.0
Barclays Capital Global Treasury: Switzerland 7–10 yrs.	7.5
Sovereign bonds	**55.0%**
Treasury bills and sovereign bonds	**74.0%**
Barclays Capital Global Inflation – Linked: U.S. Tips 1–10 yrs.	2.5%
Barclays Capital Global Inflation – Linked: Germany 1–10 yrs.	1.0%
Inflation-indexed sovereign bonds	**3.5%**
Equities: MSCI All Country World Index * (unhedged, with reinvested dividends)	7.5%
Total	**100.0%**

* Excluding Chile.

Performance and the tracking error are calculated based on pre-tax benchmarks.

II.3.3. Article 4 portfolio.

II.3.3.1 Risk budget

The Article 4 portfolio has an ex ante tracking error of 50 basis points.

II.3.3.2. Eligible banks

The methodology for selecting institutions and allocating investment limits is based on international credit ratings.

a) Selection criteria: The institution's long-term rating must be A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

b) Issuer limits: The investment limits for each eligible rating category (AAA to A–) are listed in Table 3. They are calculated every quarter and in the event of contributions, based on the closing value of the investment portfolio in the previous quarter or the value on the day prior to the contribution plus the amount of the contribution.

Table 3: Bank exposure limits

Credit rating	Maximum permitted (1)
AAA	3.0% * IP at close of last quarter
AA+ AA AA-	2.0% * IP at close of last quarter
A+ A A–	1.5% * IP at close of last quarter

(1) To estimate the maximum amount that can be invested, the investment limit is rounded to a tenth of a million.

II.3.3.3. Eligible sovereign issuers

Issuers that are included in the benchmark are eligible for investment.

Also eligible are supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in its international reserve portfolio.

For the purpose of monitoring positions, performance, and risk indicators, any instruments issued by supranational entities, agencies, and entities with an explicit government guarantee that have a residual maturity of less than one year are included in the Treasury bills portfolio in Table 2. Instruments issued by supranational entities, agencies, and entities with an explicit government guarantee that have a residual maturity of one year or longer are included in the sovereign bonds portfolio in Table 2.

II.3.3.4. Eligible currencies

Only currencies that are included in the benchmark are eligible for investment.

II.3.3.5. Eligible Instruments

a) Bank: The only eligible bank instruments are bank transactional account balances, overnight and weekend deposits, time deposits, and certificates of deposit, as well as transactional account balances, overnight deposits, and time deposits held in central banks in eligible countries.

b) Sovereign: Only instruments included in the benchmark are eligible for investment. However, instruments that meet the benchmark eligibility criteria and that therefore should be incorporated into the benchmark at the close of the respective month are also considered eligible for investment. In the event that an instrument is not actually incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of seven (7) business days to sell the instrument in question. In addition, portfolio managers are also allowed to maintain investments in instruments that are no longer eligible because their maturity has dropped below the minimum and that have therefore been eliminated from the benchmark, provided that the issuer remains in the index.

c) Supranational entities, agencies, and entities with an explicit government guarantee: Eligibility is restricted to discount bills and notes (including Euro Commercial Papers); callable and noncallable bullet bonds; with a residual maturity, in all cases, of less than or equal to 10 years

II.3.3.6. Currency forwards

The following rules apply to the use of currency hedging mechanisms involving forwards or swaps:

a) Forwards or swaps can only be arranged between eligible currencies, and the contract duration cannot exceed 95 consecutive days.

b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

c) Currency forward or swap contracts can specify either cash delivery or net settlement.

d) The counterparty risk associated with each forward or swap contract will equal 100% of the notional value, in its U.S. dollar (USD) equivalent. For the purposes of these guidelines, the notional value of the forward or swap is defined as the amount associated with the purchase currency in the contract. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.3.2).

e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their USD equivalent. If a forward or swap is contracted in order to fully or partially close a position associated with another forward or swap—and provided that both contracts include close-out netting clauses, are with the same counterparty, have the same maturity date and are in the same currencies—then the counterparty risk will be measured taking into account the net position of the different forwards and swaps involved. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.3.2).

f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.

g) The notional value of the forwards or swaps contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio. However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increases to 2% for that counterparty, for a period of two (2) business days starting on the date of the roll. For the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (as established in Note II.3.3.2) for two (2) business days, starting on the date of the roll.

II.3.4. Externally managed portfolio.

II.3.4.1. Risk budget

The externally managed portfolio has an ex ante tracking error of 60 basis points for equities.

II.3.4.2. Eligible issuers and currencies

Only issuers and currencies that are included in the benchmark are eligible for investment.

II.3.4.3. Eligible instruments

Only the types of instruments included in the benchmark are eligible for investment. However, the following instruments are also eligible:

a) The Ministry of Finance will generate, maintain, and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds, which must be reported by the custodian.

b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary receipts (GDRs) of stocks included in the equity benchmark, provided that they do not necessitate the use of tax agents in the issuing country of the underlying asset.

c) Exchange-traded stock index futures, used for hedging purposes to minimize differences vis-à-vis the equity benchmark (see Table 2) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivatives transaction. That is, the notional amount involved in each derivatives transaction cannot exceed the market value of the share of the underlying assets. If the underlying asset is cash, it must be held in eligible instruments allowed (Note II.3.4.5).

II.3.4.4. Instruments that are to be incorporated into the equity benchmark

External portfolio managers can invest in these instruments as soon as their inclusion is formally communicated by the benchmark supplier. If for any reason the instruments are not actually added to the benchmark as expected, the external manager will have a period of seven (7) business days in the local market to sell the instruments in question, starting on the date on which their inclusion was expected.

II.3.4.5. Eligible instruments for cash in foreign currency

The external portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the last 20 business days (based on the U.S. bank holiday calendar) of the portfolio of each external manager. The return on cash in foreign currency earned by each external manager will be incorporated in the calculation of that manager's total portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances and overnight and/or weekend deposits in banks with a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For the externally managed portfolio, each portfolio manager can invest up to US$ 20 million in a given bank. However, in the event of a portfolio contribution, the external portfolio manager can invest a maximum equivalent to US$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, when the external manager receives the instruction to generate liquidity for a cash withdrawal, that manager can invest up to US$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.4.6. Limits on forwards and swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark currency allocation and solely with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section II.3.3.6, paragraphs (a) to (e). However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increased to 2% for that counterparty, for a period of two (2) business days starting on the date of the roll. The counterparty risk associated with the forward or swap must be taken into account for complying with the issuer risk limits (as established in Note II.3.4.5). However, for the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (Note II.3.4.5) for two (2) business days, starting on the date of the roll.

II.3.5. Limits on spot currency transactions

The external portfolio managers, or the fiscal agent, can carry out foreign currency spot transactions with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

II.3.6. Limits on investment with supranational entities, agencies, and entities with an explicit government guarantee

The limit on investment in instruments issued by supranational entities, agencies, and entities with an explicit government guarantee with a residual maturity of less than one year is 3.0% for USD-denominated instruments and 3.5% for EUR-denominated instruments, both expressed as a percentage of the investment portfolio. For these instruments, investment in JPY are not allowed.

The limit on investment in instruments issued by supranational entities, agencies, and entities with an explicit government guarantee with a residual maturity of one year or longer is 2.65% for USD-denominated instruments, 1.10% for EUR-denominated instruments, 1.00% for JPY-denominated instruments, and 0.75% for CHF-denominated instruments, all expressed as a percentage of the investment portfolio.

II.3.7. Special restrictions

No part of the investment portfolio can be invested in any type of instrument from Chilean issuers or in instruments denominated in Chilean pesos.

The fiscal agent and the external portfolio managers cannot use derivatives to increase their exposure to financial instruments beyond the market value of the resources under their individual management.

The following restrictions apply specifically to the externally managed portfolio: (i) external managers can contract currency futures, forwards, or swaps, where the aggregate notional amounts cannot exceed 10% of the portfolio under management; (ii) mutual funds and exchange-traded funds (ETFs) together cannot represent, as a share of a given external manager's portfolio, more than the aggregate share of Egypt, India, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey in the equity benchmark indicated in Table 2, plus 2%; (iii) external managers cannot invest in the local markets of Chile, Egypt, India, Peru, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey; (iv) investments in China can only be made through the stock market in Hong Kong; and (v) external managers cannot invest in their own shares.

II.3.8. Rebalancing policy

The ESSF rebalancing policy requires that the portfolio converge to the benchmark established in Table 2 under the following situations: (i) in the event of a contribution to the ESSF; and (ii) in the event that the target ranges specified in Table 4 are exceeded. The Ministry of Finance will determine the specific date on which rebalancing associated with points (i) and (ii) of this paragraph will be implemented. In the event that situations (i) and (ii) do not occur, the Ministry of Finance will issue instructions for a rebalancing of the ESSF at least once a year and will also monitor compliance with the target ranges identified in Table 4.

The rebalancing could result either in cash contributions to the Article 4 portfolio and/or the externally managed portfolios or in withdrawals from the Article 4 portfolio and/or the externally managed portfolios. In the event of a contribution, the Ministry of Finance will issue instructions on the amounts to be transferred between the external managers and the Article 4 portfolio in order to achieve convergence to the benchmark established in Table 2. When the rebalancing results in a cash contribution to the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent or the external manager will have ten (10) bank business days to achieve this convergence, during which the fiscal agent and the external manager, if applicable, will be granted a waiver of compliance with the requirements of sections II.1.1., II.1.2., II.3.3.1., II.3.4.1, and the first paragraph of II.3.4.5. When the rebalancing results in a cash withdrawal from the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent and the external manager, if applicable, will be granted a waiver from compliance with the requirements of sections II.1.1., II.1.2., II.3.3.1., II.3.4.1, and the first paragraph of II.3.4.5, for a period of ten (10) bank business days before and including the date of the withdrawal. The waiver can be extended if either party submits a request for extension to the Ministry of Finance, with an explanation of the reasons for the request. In the event that the period between the date on which the cash withdrawal instructions are issued and the date on which the actual withdrawal is implemented is less than ten (10) bank business days, the waiver will cover only that period.

Table 4: Target range for rebalancing

Portfolio	Percent of IP	Target range (percent of IP)
Article 4 portfolio	92.5%	90.5% – 94.5%
Externally managed portfolio	7.5%	5.5% – 9.5%

In addition, in the event of rebalancing, the Director of the Financial Operations Division of the Central Bank of Chile can send a request, via electronic mail, to the Finance Ministry's Capital Markets and International Finance Coordinator for permission to maintain the relative positions of the Article 4 portfolio vis-à-vis the benchmark and thus not to have to converge to the benchmark established in Table 2. The Capital Markets and International Finance Coordinator must authorize the holding of said positions by sending an electronic mail to the Central Bank's Director of the Financial Operations Division.

II.4. Valuation criteria

The investment portfolio valuation that must be reported to the Finance Ministry is to be prepared by the custodian(s) using marked-to-market accounting, based on their own valuation sources. However, for the internal accounting of the Article 4 portfolio, the Central Bank of Chile can use the same methodology that it uses for operations involving its international reserves, as stipulated in paragraph (g) of Article 4 of the Agency Decree.

II.5. Securities lending program

II.5.1. Article 4 portfolio

The fiscal agent for the Article 4 portfolio can participate in securities lending programs with the ESSF custodian(s), provided that the custodians contracted to manage the securities lending programs (henceforth, the program managers) are obligated to comply with the operating criteria established in the custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

II.5.2 Externally managed portfolio

The external portfolio managers cannot carry out or contract securities lending programs.

II.6 Other

Foreign exchange operations will be considered spot transactions, provided that the period between the trade date and the settlement date does not exceed two days. Foreign exchange operations that are related to the purchase or sale of an instrument will be considered spot operations when the period between the trade date and the settlement date follows the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purpose of measuring the performance of the fiscal agent and the external portfolio managers is the U.S. dollar.

In the event of noncompliance with any of the instructions described in this report, at any time, due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the fiscal agent or the external portfolio managers, in their respective mandates, the situation will not be considered noncompliance with the guidelines, provided that the necessary measures are taken to ensure compliance within seven (7) days of detecting the situation. This period can be extended by the Finance Ministry at the request of the fiscal agent or the external managers, as appropriate, when justified.

However, the external managers can temporarily hold any ineligible instruments that they receive due to corporate events or that have become ineligible due to corporate events. In that case, the external managers will have a period of 30 consecutive days to sell the instruments in question, starting on the date of the corporate event. If they are unable to do so, the external managers must notify the Treasury and communicate a plan of action to liquidate the instruments. In the particular case of entitlements, preferred stock, rights, warrants or other equivalent instruments received due to corporate events that grant the right to purchase stocks, exchange for eligible stocks or receive cash, these instruments can be kept in the portfolio until expiration.

NOTE 4 –CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1. Critical accounting estimates.

In preparing the financial statements, management must make estimates and formulate assumptions about the future. The resulting accounting estimates, by definition, are rarely going to correspond precisely to actual results. The estimates and assumptions that carry a strong risk of causing significant adjustments to the accounting value of assets and liabilities within the next accounting period are described below:

Fair value of instruments that are not quoted on an active market or traded on the equity market.

The fair value of instruments that are not quoted on an active market cannot be determined by the fund based on pricing sources (such as price-setting agencies, as applicable to each fund) or indicative prices from market makers for bonds or debt, which are obtained through the custodian.

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

The determination of what constitutes “observable” represents a critical judgment by the fund’s manager. Therefore, observable data are defined as market data that can be easily obtained, are regularly distributed or updated, are trustworthy and verifiable, are not private (for exclusive use), and are provided by independent sources that are active participants in the relevant market.

4.2 Critical judgments for applying accounting policies

Functional currency

Management considers the U.S. dollar to be the currency that most faithfully represents the economic effect of transactions, events, and underlying conditions. The U.S. dollar is the currency in which the fund receives contributions from the Chilean government.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The ESSF is exposed to various types of risk as a result of its investment in different financial instruments, including market risk, credit risk, liquidity risk, and operational risk. Most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the ESSF investment policy. This section describes the risks in greater detail, together with the mechanisms established to mitigate them.

5.1 Market risk

Market risk: The market value of financial instruments can be exposed to losses as a result of changes in market conditions that affect the value of the instruments in the fund's investment portfolio. In the case of the ESSF, the variables with the biggest impact on market value are interest rates, exchange rates, credit spread risk, and changes in equities values.

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

Exchange rate risk: Because the fund's return is measured in dollars, the value of investments is also affected by exchange rate fluctuations. The portfolio is mostly made up of fixed-income investments denominated in dollars, euros, yen, and Swiss francs. There is also small exposure to an additional 28 currencies in the equity portfolio.

Credit spread risk: The market value of the fixed-income instruments in the ESSF 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 minimal in the ESSF, because the fixed-income portfolio includes only sovereign issues from the United States, Germany, Japan, and Switzerland, among which the lowest rating is A–. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have 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 stock 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). The strategic asset allocation only allows 7.5% of the total portfolio to be invested in equities.

5.2 Credit risk

The issuer of a fixed-income instrument could enter into a default situation if it becomes unable to meet its financial obligations due to a lack of liquidity or capital. Thus, the fund's credit risk exposure increases to the extent that the default probability of a destination institution or government rises. 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 over AA–. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio; these entities all have a high credit rating. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by counterparty (see Table 6).

Table 6

Risk class	Maximum allowed (US$ million)
AAA	3.0% * IP at close of last quarter (a)
AA+ AA AA–	2.0% * IP at close of last quarter
A+ A A–	1.5% * IP at close of last quarter

(a) IP: Investment portfolio.
Source: Ministry of Finance.

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 separately in the name of the Fisco and holding them in separate accounts.

5.3 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. 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.

5.4 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.

In the case of the portfolio managed by the Central Bank of Chile, the operational management of the funds utilizes the same infrastructure that the Central Bank uses to manage its international reserves.

The International Investments Area is in charge of managing the funds. The Central Bank 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 externally managed portfolio, 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.

NOTE 6 – ACCOUNTING CHANGES

As of 31 December 2016, there were no accounting changes relative to the previous year.

NOTE 7 –FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

a) Investments carried at fair value were US$ 13,711,627,088 on 31 December 2016 and US$ 13,612,910,644 on 31 December 2015.

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Equities	1	1,108,802,965	963,130,549
Other capitalization instruments	1	25,707,200	21,989,549
Government bonds	1	7,531,684,173	7,720,564,327
Indexed bonds	1	478,495,845	489,361,336
Treasury bonds	1	1,482,089,786	1,230,307,859
Commercial papers	1	-	340,155,210
Derivatives	1	16,801,162	-
Subtotal		**10,643,581,131**	**10,765,508,830**

Custodian investments, Central Bank of Chile	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Time deposits	1	3,068,045,957	2,847,401,814
Subtotal		**3,068,045,957**	**2,847,401,814**
Total		**13,711,627,088**	**13,612,910,644**

b) The breakdown of investments by investment currency on 31 December 2016 and 2015 is as follows:

Currency of origin	Fair value instruments, J.P. Morgan			
	2016		2015	
	US$	% del IP	US$	% del IP
U.S. dollar	4,633,315,591	43.53	4,966,018,877	46.13
Euro	1,764,585,059	16.58	1,781,357,917	16.55
Yen	2,937,988,926	27.60	2,731,763,299	25.38
Other	1,307,691,555	12.29	1,286,368,737	11.95
Subtotal	**10,643,581,131**	**100.00**	**10,765,508,830**	**100.00**

Currency of origin	Fair value instruments, Central Bank of Chile			
	2016		2015	
	US$	% del IP	US$	% del IP
U.S. dollar	1,295,538,712	42.23	1,036,584,137	36.40
Euro	1,772,507,245	57.77	1,810,817,677	63.60
Yen	-	-	-	-
Subtotal	**3,068,045,957**	**100.00**	**2,847,401,814**	**100.00**
Total	**13,711,627,088**		**13,612,910,644**	

c) The total value of assets by risk segment on 31 December 2016 and 2015 is as follows:

Risk segment	Market value			
	2016		2015	
	US$	%	US$	%
Capitalization instruments	1,134,510,165	8.24	985,120,097	7.05
Bank (*)	3,145,329,941	22.84	3,543,226,410	25.37
Bonds	9,492,269,803	68.92	9,440,233,522	67.58
Total	**13,772,109,909**	**100.00**	**13,968,580,030**	**100.00**

Asset class	Market value			
	2016		2015	
	US$	%	US$	%
Capitalization instruments	1,134,510,165	8.24	985,120,097	7.05
Money market (*)	4,627,419,727	33.60	4,773,534,270	34.17
Sovereign bonds	7,531,684,173	54.69	7,720,564,327	55.27
Inflation-indexed bonds	478,495,844	3.47	489,361,336	3.50
Total	**13,772,109,909**	**100.00**	**13,968,580,030**	**100.00**

(*) Includes cash and cash equivalents.

NOTE 8 –FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US$ 51,646 on 31 December 2016 and US$ 2,304,310 on 31 December 2015.

a) The breakdown of derivatives carried at fair value is as follows:

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Derivatives	1	51,646	2,304,310
Subtotal		**51,646**	**2,304,310**

b) The breakdown of derivatives by investment currency is as follows:

Currency of origin	**Fair value instruments, J.P. Morgan**			
	2016		**2015**	
	US$	**% del IP**	**US$**	**% del IP**
U.S. dollar	19,367	37.50	691,293	30.00
Euro	12,911	25.00	276,517	12.00
Yen	6,456	12.50	829,552	36.00
Other	12,912	25.00	506,948	22.00
Total	**51,646**	**100.00**	**2,304,310**	**100.00**

c) The total value of liabilities by risk segment is as follows:

Risk segment	**Market value**			
	2016		**2015**	
	US$	**%**	**US$**	**%**
Bank	51,646	100.00	2,304,310	100.00
Total	**51,646**	**100.00**	**2,304,310**	**100.00**

Liability class	**Market value**			
	2016		**2015**	
	US$	**%**	**US$**	**%**
Money market	51,646	100.00	2,304,310	100.00
Total	**51,646**	**100.00**	**2,304,310**	**100.00**

NOTE 9 – CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, to J.P. Morgan, in the role of custodian bank, and to the external managers was created in March 2007. The following movements were recorded in 2016 and 2015:

	2016								
	Contributions US$	Withdrawals US$	Compensation to the CBC as fiscal agent (1) US$	Custody of the portfolio managed by the CBC US$	Custody of the externally managed portfolios US$	BlackRock US$	Mellon US$	Rogge US$	Other US$
January	-	-	-	(63,443)	-	-	(72,136)	-	-
February	-	-	-	(65,536)	(61,342)	-	-	-	-
March	-	-	(233,874)	-	-	(55,293)	-	-	-
April	-	-	-	(67,989)	(30,311)	-	(67,240)	-	-
May	-	-	-	(68,898)	(30,557)	-	-	-	-
June	-	(462,285,625)	(233,874)	(70,520)	(29,178)	-	-	-	-
July	-	-	-	(68,838)	(34,650)	-	-	-	(59,754)
August	-	-	-	(140,300)	(85,408)	(51,497)	-	-	(24,095)
September	-	-	(233,874)	-	(29,906)	(55,777)	(72,849)	-	(23,294)
October	-	-	-	(68,382)	-	-	-	-	-
November	-	-	-	(69,177)	(31,731)	-	(80,165)	-	-
December	-	-	(233,874)	(67,630)	(30,201)	-	-	-	-
Total	**-**	**(462,285,625)**	**(935,495)**	**(750,713)**	**(363,284)**	**(162,567)**	**(292,390)**	**-**	**(107,143)**

(1) Ministry of Finance Res. N°3050 of 11/Oct/2014 authorizes payment of compensation for 2015, for portfolio management and other services.

	2015								
	Contributions US$	Withdrawals US$	Compensation to the CBC as fiscal agent (1) US$	Custody of the portfolio managed by the CBC US$	Custody of the externally managed portfolios US$	BlackRock US$	Mellon US$	Rogge US$	Other US$
January	-	-	-	(61,564)	(34,470)	(63,280)	(82,655)	-	-
February	-	-	-	(58,152)	(30,938)	-	-	-	-
March	-	-	(239,351)	(65,401)	(29,518)	-	-	-	-
April	-	-	-	(65,764)	(32,067)	-	(81,566)	-	-
May	-	-	-	(66,759)	(32,935)	(63,192)	-	-	-
June	-	(463,881,386)	(239,351)	(67,194)	(32,402)	-	-	-	-
July	-	-	-	(69,042)	(33,994)	(62,372)	(81,582)	-	-
August	-	-	-	(66,026)	(73,168)	-	-	-	-
September	-	-	(239,351)	(64,904)	(31,520)	(62,345)	-	-	-
October	-	-	-	(64,305)	(59,504)	-	-	-	-
November	-	-	-	(63,621)	(29,090)	-	(71,023)	-	-
December	-	-	(239,351)	(130,486)	(32,238)	(54,344)	-	-	-
Total	**-**	**(463,881,386)**	**(957,404)**	**(843,223)**	**(451,850)**	**(305,533)**	**(316,826)**	**-**	**-**

(1) Ministry of Finance Res. N°3050 of 11/Oct/2014 authorizes payment of compensation for 2015, for portfolio management and other services.

NOTE 10 – INTEREST EARNED

The breakdown of interest income earned on investments in debt securities carried at fair value through profit or loss as of 31 December 2016 and 2015 is as follows:

	2016 US$	**2015 US$**
Interest earned, Central Bank of Chile	136,255,881	141,644,205
Interest earned, J.P. Morgan	709,647	742,750
Total	**136,965,528**	**142,386,955**

NOTE 11 – DIVIDEND INCOME

The breakdown of dividends received from equity investments as of 31 December 2016 and 2015 is as follows:

Dividends from investments managed by	**31 Dec 2016 US$**	**31 Dec 2015 US$**
Mellon Capital Management Corporation	12,282,032	12,384,991
BlackRock Institutional Trust Company, N.A.	12,323,756	12,304,613
Total	**24,605,788**	**24,689,604**

NOTE 12 – CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2016 and 2015 breaks down as follows:

Cash in custodian and externally managed accounts	**31 Dec 2016 US$**	**31 Dec 2015 US$**
J.P. Morgan	55,594,093	351,117,619
Mellon Capital Management Corporation	1,541,948	1,265,102
BlackRock Institutional Trust Company, N.A.	3,346,780	3,286,665
Total	**60,482,821**	**355,669,386**

NOTE 13 – ESSF RETURNS

The breakdown of the fund’s returns as of 31 December 2016 and 2015 is as follows:

Type of return	**Accumulated return**		
	Current period		**Current period**
Nominal	(0.36)%	1.74%	(0.58)%

NOTE 14 – FAIR VALUE

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

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The transaction is carried out in the principal or most advantageous market and is not forced. That is, it does not take into account specific characteristics of the ESSF that could have an impact on the real transaction.

	31 Dec 2016			31 Dec 2015		
FINANCIAL ASSETS	**Level**	**Net book value US$**	**Fair value US$**	**Level**	**Net book value US$**	**Fair value US$**
Cash and cash equivalents	1	60,482,821	60,482,821	1	355,669,386	355,669,386
Equities	1	1,108,802,965	1,108,802,965	1	963,130,549	963,130,549
Other capitalization instruments	1	25,707,200	25,707,200	1	21,989,549	21,989,549
Time deposits	1	3,068,045,957	3,068,045,957	1	2,847,401,814	2,847,401,814
Government bonds	1	7,531,684,173	7,531,684,173	1	7,720,564,327	7,720,564,327
Indexed bonds	1	478,495,845	478,495,845	1	489,361,336	489,361,336
Treasury bills	1	1,482,089,786	1,482,089,786	1	1,230,307,859	1,230,307,859
Commercial papers	1	-	-	1	340,155,210	340,155,210
Derivatives	1	16,801,162	16,801,162	1	-	-
FINANCIAL LIABILITIES						
Derivative financial instruments		51,646	51,646	1	2,304,310	2,304,310

In 2016 and 2015, all the assets and liabilities in the ESSF were measured according to the prices quoted in the equity market. That is, the valuation technique is based on Level 1 inputs, such that the fund has not made any changes in fair value hierarchies to date.

NOTE 15 – LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N° 1,267 of 4 June 2013, Section II N°5, the fiscal agent for the Article 4 portfolio can enter into agreements with the fund's custodian(s) to participate in securities lending, provided that the custodians comply with the operating criteria established in the ESSF custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay the corresponding market value. The resources earned or disbursed are to be recorded on the ESSF financial statements as income in the year.

On 31 December 2016 and 2015, the ESSF owned the following instruments under the item Securities lending:

2016		
Location	**Notional value**	**Market value US$**
Europe	-	-
United States of America	-	-
Total	**-**	**-**

2015		
Location	**Notional value**	**Market value US$**
Europe	846,035,000	980,812,551
United States of America	2,565,426,000	2,605,752,860
Total	**3,411,461,000**	**3,586,565,411**

NOTE 16 – SECURITIES CUSTODY

As of 31 December 2016, securities custody is as follows:

	Securities custody					
	National custody			Foreign custody		
Entity	**Amount in custody (US$)**	**% of total investments in instruments issued by national issuers**	**% of total ESSF assets**	**Amount in custody (US$)**	**% of total investments in instruments issued by foreign issuers**	**% of total ESSF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	13,711,575,441	100	99.56
Total investment portfolio in custody	**-**	**-**	**-**	**13,711,575,441**	**100**	**99.56**

(*) These amounts are offset between financial assets and liabilities.

As of 31 December 2015, securities custody is as follows:

	Securities custody					
	National custody			Foreign custody		
Entity	**Amount in custody (US$)**	**% of total investments in instruments issued by national issuers**	**% of total ESSF assets**	**Amount in custody (US$)**	**% of total investments in instruments issued by foreign issuers**	**% of total ESSF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	13,270,451,123	100	95.018
Total investment portfolio in custody	**-**	**-**	**-**	**13,270,451,123**	**100**	**95.018**

(*) These amounts are offset between financial assets and liabilities.

NOTE 17 –RELEVANT EVENTS

As of the closing date of these financial statements, there were no relevant events that could materially affect the balances or interpretation of these financial statements.

NOTE 18 – SUBSEQUENT EVENTS

Between 1 January 2017 and the date of issue of these financial statements (24 March 2017), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

11 FINANCIAL STATEMENTS: PENSION RESERVE FUND

Financial statements for the years ended on 31 December 2016 and 2015 and the independent auditors' report[38]

38 The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2016 and 2015 were prepared by the General Treasury and audited by Crowe Horwarth. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

PENSION RESERVE FUND

Financial Statements
31 December 2016 and 2015

US$ — U.S. dollar

Horwath HB Auditores Consultores
Member Crowe Horwath International
Avda. Apoquindo 3669, oficina 902
Las Condes – Santiago – Chile
(562) 2607 67 00
www.crowehorwath.cl

INDEPENDENT AUDITORS' REPORT

Santiago, 24 March 2017

To the Office of the Treasury of Chile
Pension Reserve Fund

Report on the financial statements

We have conducted an audit of the attached financial statements of the Pension Reserve Fund for the years ended on 31 December 2016 and 2015, with the corresponding income, comprehensive income, changes in net equity, and cash flow statements for these years, together with the corresponding notes.

Management's responsibility for the financial statements

The Treasury of Chile is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes the design, implementation, and maintenance of appropriate internal control procedures that ensure the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on the 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 an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves carrying out procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks associated with material misstatements on the financial statements, whether due to fraud or error. On making these risk assessments, the auditor considers the internal control procedures that are relevant to the preparation and fair presentation of the Fund's 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 entity's internal control. We therefore do not express such an opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the significant accounting estimates made by the Fund's management, as well as assessing the general presentation of the financial statements.

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

In our opinion, these financial statements fairly present, in all material aspects, the financial position of the Pension Reserve Fund as of 31 December 2016 and 2015 and its operating performance and cash flows for the years ended on those dates, in accordance with International Financial Reporting Standards.

Other matters

As indicated in Note 1, the Pension Reserve Fund's resources are intended to be used to complement the financing of fiscal obligations stemming from the state guarantee of minimum old-age, disability, and survival pensions prescribed by Decree Law Nº 3,500 of 1980 and the welfare pensions prescribed by Decree law Nº 869 of 1975.

Sergio Bascuñán Rivera

PENSION RESERVE FUND

CONTENTS

PENSION RESERVE FUND

STATEMENT OF FINANCIAL POSITION

ASSETS	Notes	31 Dec 2016	31 Dec 2015
		US$	US$
CURRENT ASSETS			
Cash and cash equivalents	12	24,197,760	22,163,013
Total current assets		24,197,760	22,163,013
FINANCIAL ASSETS AFFECTING INCOME			
Equities	7	1,405,244,962	1,134,593,055
Other capitalization instruments	7	32,715,042	25,884,946
Corporate bonds	7	1,952,755,987	1,778,515,089
Time deposits	7	300,184	25,612,106
Government bonds	7	4,326,772,740	4,083,895,380
Indexed bonds	7	1,120,283,465	1,041,207,664
Derivatives		28,772	441,435
Total investments		8,838,101,152	8,090,149,675
Total assets		8,862,298,912	8,112,312,688

LIABILITIES AND NET EQUITY	Notes	31 Dec 2016	31 Dec 2015
		US$	US$
LIABILITIES			
Derivative financial instruments	8	224,100	107,228
Total liabilities		224,100	107,228
NET EQUITY			
Fisco resources		7,412,184,657	6,948,303,270
Contributions by the Fisco in the year	9	462,285,625	463,881,387
Retained earnings		700,020,803	995,396,134
Income in the year		287,583,727	(295,375,331)
Total net equity		8,862,074,812	8,112,205,460
TOTAL LIABILITIES AND NET EQUITY		8,862,298,912	8,112,312,688

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENT OF INCOME

	Notes	31 Dec 2016	31 Dec 2016
		US$	US$
OPERATING INCOME			
Interest earned	10	167,433,707	166,908,726
Dividend income	11	29,959,134	27,376,865
Net unrealized gains from price changes on financial instruments		96,087,823	-
Total net operating income		293,480,664	194,285,591
OPERATING LOSSES			
Net realized losses from sale of financial instruments		(1,853,223)	(279,054,740)
Net unrealized losses from price changes on financial instruments		-	(206,133,728)
Total net operating losses		(1,853,223)	(485,188,468)
Net operating income (loss)		291,627,441	(290,902,877)
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(2,554,302)	(2,832,950)
Custodian's fees and external portfolio managers' fees	9	(1,449,173)	(1,639,504)
Other expenses		(241,507)	-
Adjustment, J.P. Morgan		201,268	-
INCOME (LOSS) IN THE YEAR		287,583,727	(295,375,331)

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENT OF COMPREHENSIVE INCOME

	31 Dec 2016	31 Dec 2015
	US$	US$
Income (loss) in the year	287,583,727	(295,375,331)
Other comprehensive income reclassified to income in subsequent years	-	-
Other comprehensive income not reclassified to income in subsequent years	-	-
Total other comprehensive income	-	-
Comprehensive income in the year	287,582,727	(295,375,331)

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENT OF CHANGES IN NET EQUITY

	Notes	Fisco Resources	Accumulated income	Comprehensive income in the year	Total
		US$	US$	US$	US$
Opening balance, 1 January 2016		7,412,184,657	995,396,134	(295,375,331)	8,112,205,460
Distribution of income from the previous year		-	(295,375,331)	295,375,331	-
Contributions by the Fisco	9	462,285,625	-	-	462,285,625
Comprehensive income for the year		-	-	287,583,727	287,583,727
Closing balance, 31 December 2016		7,874,470,282	700,020,803	287,583,727	8,862,074,812
Opening balance, 1 January 2015		6,948,303,270	885,746,051	109,650,083	7,943,699,404
Distribution of income from the previous year		-	109,650,083	(109,650,083)	-
Contributions by the Fisco	9	463,881,387	-	-	463,881,387
Comprehensive income for the year		-	-	(295,375,331)	(295,375,331)
Closing balance, 31 December 2015		7,412,184,657	995,396,134	(295,375,331)	8,112,205,460

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENT OF CASH FLOWS

(Indirect method)

	Notes	31 Dec 2016	31 Dec 2015
		US$	US$
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		287,583,727	(295,375,331)
Unrealized (losses) gains		(96,087,823)	206,133,728
Changes in fund management and custody		(651,746,782)	(372,488,356)
Cash flows from operating activities		(460,250,878)	(461,729,959)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	462,285,625	463,881,387
Cash flows from financing activities		462,285,625	463,881,387
NET INCREASE IN CASH AND CASH EQUIVALENTS		2,034,747	2,151,428
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		22,163,013	20,011,585
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	24,197,760	22,163,013

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 –GENERAL INFORMATION

The Pension Reserve Fund (PRF) was created through Law Nº 20,128, issued by the Ministry of Finance of Chile on 30 September 2006, to complement the financing of fiscal obligations stemming from the state guarantee of minimum old-age, disability, and survival pensions prescribed by Decree Law Nº 3,500 of 1980 and the welfare pensions prescribed by Decree Law Nº 869 of 1975.

The operation of this fund is regulated by the following instructions issued by the Ministry of Finance:

a) Decree Nº 1,383 of 2006, which authorizes the Central Bank of Chile (CBC) to act as fiscal agent in managing the Pension Reserve Fund and establishes guidelines for reporting on the investments to the Finance Minister and the Treasury.

b) Decree Nº 1,382 de 2007, which establishes standards, limits, procedures, and controls for investing PRF resources.

c) Decree Nº 1,649 de 2007, which modifies the fund's investment limits.

d) Ministry of Finance Official Letter Nº 1,673 of 2011, which informs the fiscal agent of the new performance guidelines for managing the Pension Reserve Fund.

e) Comptroller General Official Letter Nº 71,390 of 2009, which provides instructions on the fund’s valuation criteria.

f) Decree Nº 1,492 of 2015, which regulates the coordination and functioning of advisory activities, management support, and auditing of the Public Treasury’s financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund (and which abolishes Decree Nº 1,636 of 2009).

   Article 4 of this Decree includes the following activities in association with the Treasury:

   - Record all investments of Treasury resources, as well as debt operations, in accordance with the accounting and budgetary standards established by the Comptroller General and/or the Budget Office, as applicable.

   - Perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms, and commission independent auditors for the annual financial statements, subject to the stipulations of Article 7 of this Decree. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.

   - Support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.

– Verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records. This provision was applied to the portfolios under the management of external fund managers on 1 January 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.

– Issue transaction instructions associated with contributions to and withdrawals from the sovereign wealth funds in accordance with instructions from the Finance Ministry, validate payments associated with the management and custody of the sovereign wealth funds, as required, and issue instructions to the Central Bank of Chile on the payment of the different services provided by the external managers.

– Supervise compliance, on the part of each portfolio manager, with the limits stipulated in the sovereign wealth fund investment policy, in accordance with the controls established by the Ministry of Finance by resolution. This provision was applied to the portfolios under the management of external fund managers on 1 April 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.

– Supervise compliance with the norms and limits established by the Ministry of Finance with regard to the capital market investment of Treasury resources that are held outside the sovereign wealth funds and to send periodic reports on the matter to the Budget Office and the Ministry of Finance.

– Maintain a current manual of procedures for the handling of all functions and duties described in this Article.

– Provide any additional management support, coordination, or consulting as needed for the performance of these functions.

The information for the accounting of the sovereign wealth funds is provided by the Treasury, which is and will continue to be an institution in good standing, such that the data resulting from the accounting process are not estimated values.

g) Ministry of Finance Official Letter Nº 1,566 of 2015, which establishes the new investment guidelines for the Pension Reserve Fund (which abolishes Official Letter Nº 1,925 of 2013).

h) Ministry of Finance Official Letter Nº 1,926 of 2013, which establishes the new custody guidelines.

i) Ministry of Finance Decree Nº 1,618 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.

j) Ministry of Finance Decree Nº 892 of 2014, which establishes fiscal policy in accordance with the provisions of Article 1 of Law Nº 20,128.

Qualitative characteristics of the PRF financial statements

i) The Principle of Relevance, as a category of the PRF financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.

ii) The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence, and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.

iii) The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.

iv) The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

Pursuant to Article N° 7 of Law N° 20,128, the Ministry of Finance must commission an actuarial study every three years to assess the sustainability of the Pension Reserve Fund.

An actuarial study must also be carried out whenever there is a proposal to change the amount of the minimum or welfare pensions, with the exception of the automatic adjustment stipulated in Article 14 of Decree Law N° 2,448 of 1979 and Article 10 of Law N° 18,611. The results of these studies must be incorporated into the records considered in Article 14 of Law N° 18,918, the Basic Constitutional Act of the National Congress.

On 17 June 2015 the Ministry of Finance issued the new investment guidelines for the Pension Reserve Fund, which replace and rescind the investment guidelines contained in Official Letter Nº 1,925, issued by the Ministry of Finance in 2013.

Article 15, paragraph (a), of Decree Nº 1,618 of 2013 authorizes the fiscal agent to conduct, at the request of the Finance Minister, one or more tenders for the management of the externally managed portfolio and to contract the external managers thereof, in the name and on the account of the Fisco. Under this provision, the following external managers were contracted to perform custody services starting in 2013:

- Rogge Corps.
- Blackrock Corps.
- BNY Mellon Equities.
- Blackrock Equities.

In July 2016, the Microdata Center of the Economics Department of the University of Chile issued a report on the Actuarial Study of the Sustainability of the Pension Reserve Fund. The study measured the expected evolution of the Pension Reserve Fund under different scenarios, to provide the basis for a sustainability analysis of the PRF over the next 20 years. The report finds that the PRF demonstrates sustainability in every one of the scenarios tested.

NOTE 2 – MAIN ACCOUNTING CRITERIA USED

The main accounting criteria used in the preparation of these financial statements are described below. These criteria have been applied systematically to all the statements presented, unless otherwise indicated.

2.1 Basis of preparation and presentation of the financial statements

The PRF financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

As required by IFRS 9, debt instruments are measured at amortized cost if and only if (i) the asset is held within a 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, at the initial recognition of a debt instrument that meets the amortized cost criteria, the fund may choose to designate that instrument as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. In the current period, the fund has not decided to designate any debt instruments that meet the amortized cost criteria as measured at fair value through profit or loss.

Debt instruments that are subsequently carried at amortized cost are subject to depreciation.

Investments in equity instruments (equities) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for trade and is designated by the fund as measured at fair value through profit or loss in other comprehensive income. If the equity instrument is designated as measured at fair value through profit or loss in other comprehensive income, all gains and losses from revaluation, except dividend income that is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and cannot later be reclassified to profit or loss.

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds provided by the custodian, J.P. Morgan Chase & Co.

The financial statements presented by the Treasury for the PRF are as follows:

- Statement of Financial Position.
- Statement of Comprehensive Income.
- Statement of Changes in Net Equity.
- Statement of Cash Flows.
- Notes to the Financial Statements.

2.2 Accounting period

The financial statements cover the years between 1 January and 31 December 2016 and 2015, respectively.

2.3 Functional and presentation currency

The entries included in the PRF financial statements are recorded using the currency of the primary economic environment in which the fund operates. Thus, the fund’s securities are presented in U.S. dollars, as the functional and presentation currency.

Foreign currency transactions in currencies other than the U.S. dollar are converted to the functional currency using the exchange rate prevailing on the date of the transaction. Foreign currency gains and losses stemming from the settlement of these transactions or the conversion of monetary assets denominated in a foreign currency to the closing exchange rate are recognized on the Statement of Comprehensive Income.

2.4 Investment classification and valuation

The fund's investments comprise liquid foreign currency assets that are made by the Central Bank of Chile, as fiscal agent, using eligible intermediaries, basically banks and financial institutions. The investment objective is to maximize fiscal resources, which can be accessed immediately if needed to finance the activities of the sovereign wealth funds.

Financial assets and liabilities

Classification

The fund classifies investments in debt instruments and financial derivative instruments as financial assets at fair value through profit or loss.

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is acquired principally for trading (short-term sale or repurchase) or is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Derivatives are also classified at fair value through profit or loss. The fund has adopted the policy of not using hedge accounting.

These overseas financial investments are recognized, valued, and classified in accordance with international financial reporting standards, as follows:

Financial instruments at fair value through profit or loss: Government bonds, inflation-indexed bonds, corporate bonds, common and preferred stocks, ADR, GDR, REIT, Treasury bills, commercial papers, and derivative instruments. The basis for classifying the securities in this investment category is that they have a reasonably active secondary market, under normal conditions. They are recorded at fair value, and any changes in value are recognized directly through profit or loss.

Equities and other capitalization instruments are recorded at fair value, and any changes in value are recognized directly through profit or loss.

The custodian determines fair value using the last transaction price of the day at the close of the market in which they are traded.

Financial assets at amortized costs

Financial assets at amortized cost are nonderivative financial assets with fixed or determinable payments and fixed maturities, which the fund manager intends to hold to maturity so as to receive interest, adjustment, and exchange rate income in accordance with the contractual terms of the instrument.

On the closing date of each statement of financial position, the fund assesses whether there is objective evidence of impairment of a financial asset or a group of financial assets in this category, comparing the book value of the asset with any loss events that could have an impact on the expected future cash flows of the financial asset or group of assets, which can be reliably estimated.

Financial liabilities

Financial liabilities at amortized cost will be classified as other liabilities.

Recognition, reduction, and measurement

The regular purchase and sale of investments is recognized on the date of the transaction, or the date the fund commits to buying or selling the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are charged to expenses on the income statement when they are incurred in the case of financial assets and liabilities at fair value through profit or loss, and they are recorded as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are costs that are incurred in the process of acquiring financial assets or liabilities. They include all fees, commissions, and other items paid to agents, consultants, brokers, and operators in association with the operation.

Financial assets are reduced for accounting purposes when the rights to receive cash flows from the investment have expired or the fund has essentially transferred all the risks and benefits associated with ownership.

After the initial recognition, all financial assets and financial liabilities carried at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in fair value in the category “Financial assets or financial liabilities carried at fair value through profit or loss” are presented on the Statement of Comprehensive Income under the item “Net changes in fair value of financial assets and financial liabilities carried at fair value through profit or loss” in the period in which the change occurs.

Dividend income from financial assets at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Dividend income” when the fund’s right to receive the payment has been established. Interest on debt securities at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Interest and adjustments” based on the effective interest rate.

Financial assets at amortized cost and other liabilities are valued, after initial recognition, using the effective interest rate method. Accrued interest and adjustments are recorded in the “Interest and adjustments” account of the Statement of Comprehensive Income.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating the financial income or financial expense over the period in question. The effective interest rate is the rate that exactly discounts effective future payments or receipts estimated over the life of the financial instrument, or, if appropriate, over a shorter period, relative to the accounting value of the financial asset or financial liability. To calculate the effective interest rate, the fund estimates cash flows taking into account all the contractual terms of the financial instrument, but not future credit losses.

The calculation includes all fees and points paid or received between the counterparties that are integral to the effective interest rate, transaction costs, and all other premiums or discounts.

Estimation of fair value

The fair value of financial assets and liabilities traded in active markets (such as derivatives and available-for-sale securities) is based on quoted market prices on the date of the Statement of Financial Position. The quoted market price used for financial assets held by the fund is the purchase price; the quoted market price taken for financial liabilities is the sale price (if the sale and purchase prices differ). When the fund holds derivative instruments that are netted, intermediate market prices are used as the basis for establishing the fair value for netting positions, and this purchase or sale price is applied to the net open position, as appropriate.

The hierarchy of fair value is as follows:

a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

b) Variables other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, price derivatives) (Level 2); and

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

2.5 Cash

In the preparation of the PRF financial statements, a distinction is made between cash held in the current account maintained for the fund by the Treasury and cash held by the custodian as a result of operations undertaken in the course of the custodial management of the fund.

2.6 Funds under management

These are securities delivered, under the mandate of managing PRF resources, to the Central Bank of Chile, as fiscal agent; to J.P. Morgan, as custodian bank; and to the external portfolio managers. The securities can be totally or partially employed in the performance of the assigned duties.

2.7 Funds in custody

These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co. and to the external managers, which provide general custody services for PRF securities and instruments.

2.8 Net equity

The net equity of the sovereign wealth funds is derived from the opening balance of total assets at nominal value, plus fiscal contributions, minus fiscal withdrawals, plus income for the year.

In accordance with the stipulations of Articles Nº 6 and 7 of Law Nº 20,128, the Pension Reserve Fund will be established and increased with the following resources:

a) A contribution equal to the effective fiscal surplus, with a cap of 0.5% of the previous year's gross domestic product. If the amount of the annual contribution indicated above is less than 0.2% of the previous year's gross domestic product, then an additional contribution should be paid so as to reach a total annual contribution of 0.2% of the previous year's gross domestic product.

   The contribution described herein must be delivered to the Pension Reserve Fund within the first half of the year, in one or more installments until the total contribution has been made.

b) The proceeds from the return on the PRF investments; and

c) Other contributions established by law.

The contribution described in point (a) above will only be made until the year in which the PRF accumulates a balance equal to UF900 million. Once this amount has been reached, the obligation will be considered fulfilled, and no further contributions will be made under this item.

The exclusive objective of PRF assets is to complement the payment of the liabilities laid out in the PRF objective, and they can only be used for this purpose starting ten years from the effective date of Law Nº 20,128.

The Pension Reserve Fund will cease to exist if, after fifteen years from the effective date of Law Nº 20,128, the withdrawals to be made in a calendar year do not exceed 5% of the sum of expenditure on the state guarantee of minimum pensions and welfare pensions established in that year's budget.

2.9 Statement of cash flows

For the purpose of preparing the Statement of Cash Flows, the sovereign wealth funds use the following definitions:

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

– Net operating income: Includes management costs for operating the sovereign wealth funds.

– Net financing income: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

The fund uses the indirect method for preparing the Statement of Cash Flows, which defines the change in funds over the year as comprising net operating income, including costs incurred in the year due to management expenses, commissions and insurance, and net financing income, resulting from the difference between fiscal contributions and withdrawals in the period.

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are offset, and the net amount is reported on the Statement of Financial Position, when there is a legal right to offset the recognized amounts and there is a positive intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

2.11 New accounting rules

On the date of publication of these financial statements, a number of new rules and amendments, as well as improvements and new interpretations of existing rules, have been issued, but have not yet entered into force. The PRF management has not adopted the new provisions in advance of the mandatory application date, which is indicated in the following table:

	New rules, improvements, and amendments	**Mandatory application date:**
Amendment to IAS 7	Disclosure initiative: additional disclosure that allows users of financial statements to evaluate changes in liabilities from financing activities.	1 January 2017
Amendment to IAS 12	Recognition of deferred tax assets for unrealized losses.	1 January 2017
IFRS 9	Replacement of IAS 39.	1 January 2018
IFRS 15	Revenue from ordinary activities deriving from contracts with customers.	1 January 2018
IFRS 16	Operating leases: new accounting standard for recognizing leases.	1 January 2019
Amendment to IFRS 2	Classification and measurement of share-based payments.	1 January 2018

The PRF management deems that the adoption of the new rules, amendments, and interpretations described above will not have a significant impact on the fund's financial statements in the initial application period.

NOTE 3 – PRF INVESTMENT GUIDELINES

I. Duties assigned to the fiscal agent

The following duties and functions are assigned to the fiscal agent, in accordance with Articles N° 4 and 15 of Decree N° 1,383, of 2006, modified by Decree N° 1,618, of 2012, both issued by the Ministry of Finance (henceforth, the Agency Decree):

I.1. Duties related to Central Bank transaction accounts

I.1.1. Portfolio governed under Article 4 of the Agency Decree (henceforth, the Article 4 portfolio):

a) Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the PRF Article 4 portfolio transaction account).

b) Receive, record, and deposit in the PRF Article 4 portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the fiscal agent.

c) Receive, record, and deposit in the PRF Article 4 portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, to the PRF externally managed portfolio transaction account for the purpose of making third-party payments corresponding that portfolio, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.

d) Make payments, in the name and on the account of the Fisco, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (f) of Article 4 of the Agency Decree.

e) Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.1.2. Portfolio governed under Article 15 of the Agency Decree (henceforth, the externally managed portfolio):

a) Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the PRF externally managed portfolio transaction account).

b) Receive, record, and deposit in the PRF externally managed portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the external portfolio managers.

c) Receive, record, and deposit in the PRF externally managed portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.

d) Make payments, in the name and on the account of the Fisco, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (e) of Article 15 of the Agency Decree.

e) Make payments, in the name and on the account of the Fisco, to the external manager(s) or other third parties when so instructed by the Treasury.

f) Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.2. Duties related to custody

I.2.1. Article 4 portfolio:

Contract, in the name of the Fisco, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (d) of Article 4 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.2.2. Externally managed portfolio

Contract, in the name of the Fisco, one or more foreign financial institutions or securities depositories to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (c) of Article 15 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.3. Duties related to management

I.3.1. Article 4 portfolio

a) The fiscal agent will manage the fund's resources on the account and at the risk of the Fisco. The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the fiscal agent. The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the fiscal agent via a cash transfer to the PRF Article 4 portfolio transaction account. The resources can only be transferred to the fiscal agent on business days in the United States of America. Moreover, subject to the prior authorization of the Finance Minister, pursuant to the stipulations of Article 4, paragraph (f) of Statutory Decree D.F.L. N° 1, issued by the Ministry of Finance in 2006, all or part of the PRF contributions can come from the Economic and Social Stabilization Fund (ESSF). In that case, the fiscal agent will have the authority to determine whether the contributions from the ESSF will be effectuated through a direct transfer of financial instruments from the ESSF Article 4 portfolio to the PRF Article 4 portfolio, or through a cash transfer following the liquidation of such instruments. For this purpose, financial instruments will be valued on the date of the transfer, according to the criteria outlined in section II. 4 below. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

b) To fulfill this duty, and subject to the objectives, guidelines, and restrictions established in this document, the fiscal agent will have the full authority, in representation of the Fisco, to make decisions on investment, disposal, and related activities, including the ability to choose, buy, sell, hold, auction, recover, or exchange investment instruments of any type; underwrite the issue of instruments; enter into spot or forward foreign exchange contracts; instruct the custodian to make payments associated with the execution of transactions; earn dividends, interest, amortization, and other benefits; and engage in other operations, acts, and contracts that the fiscal agent deems appropriate with regard to the management of the portfolio and the fulfillment of the duties outlined in this document.

   The fiscal agent will also have the authority to implement the acts and contracts described in the previous paragraph through banks, brokers or any other financial intermediaries.

c) The fiscal agent will be able to aggregate transactions executed for the management of the portfolio with transactions executed for the Central Bank of Chile's international reserve portfolio, as well as for other fiscal resources managed by the fiscal agent.

The fiscal agent cannot directly acquire any instruments that are being removed the PRF Article 4 portfolio in representation of the Fisco or directly acquire for the PRF Article 4 portfolio any instruments owned by the Central Bank of Chile that are being removed from the Bank's own portfolio.

d) The fiscal agent will hold the funds and investments under its management in separate accounts, clearly indicating that they are the property of the Fisco of Chile for all legal purposes.

I.3.2. Externally managed portfolio

a) The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the external managers.

b) The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the external managers, via the fiscal agent, in the form of a cash transfer to the PRF externally managed portfolio transaction account. Nevertheless, the resources can only be transferred to the external managers, through the fiscal agent, on business days in the United States of America. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

c) The custodian(s) will hold the funds in its custody in separate accounts, clearly indicating that they are the property of the Fisco of Chile for all legal purposes.

I.3.3. Rebalancing

The Ministry of Finance or the Treasury will instruct the fiscal agent on the contributions, withdrawals, and transfers from the Article 4 portfolio to the externally managed portfolio, or vice versa, as necessary to achieve compliance with the target ranges established in section II.3.6. The instructions must be issued at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

I.4. Duties related to monitoring and reports

I.4.1. Article 4 portfolio

a) Maintain full and detailed information on all transactions and other operations carried out in association with the management of the Article 4 portfolio, in accordance with the stipulations of paragraph (g) of Article 4 of the Agency Decree.

b) Supervise, monitor, and evaluate the services provided by the custodian(s); establish daily and, if necessary, clarify any differences that might arise between the records maintained by the fiscal agent and the custodians, as well as any other discrepancies detected in relation to the contracted services; and report to the Finance Minister, or an authorized delegate, for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the custodians.

c) Report to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, the daily investment position of the portfolio, with a lag of not more than three (3) business days from the date of the report. The reporting requirement outlined in this paragraph will be understood as fulfilled when the respective electronic communication has been sent, using the means and formats stipulated by the Finance Minister or an authorized delegate, under the exclusive responsibility of the sender. In the event of discrepancies between the information sent by the fiscal agent and the information received by the Ministry of Finance and the Treasury, the version contained in the fiscal agent's records will prevail.

d) Report, under the terms described above, to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, any change or correction to the information described in the preceding paragraph (c), on the daily investment position of the portfolio.

e) Submit to the Finance Ministry and the Treasurer, or their authorized delegates, monthly, quarterly, and annual reports on the management of the Article 4 portfolio.

f) Submit to the same authorities an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records maintained by the fiscal agent on the Article 4 portfolio. The monthly reports will include a copy of the payment orders associated with the PRF Article 4 portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.

g) The Ministry will issue an opinion on the quarterly and annual reports described above, either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager and the General Manager of the Central Bank within a period of 30 consecutive days from the date the report was submitted. In the event that there are such observations, which must be well-founded and specific, the fiscal agent will have a period of 15 consecutive days to respond, with the specific objective of clarifying and resolving the issues raised, as appropriate. Subsequently, the Finance Minister or the International Finance Coordinator or the Head of the Sovereign Wealth Funds Unit will issue an opinion on the response received, via electronic mail, stating either approval or rejection, under the same requirements outlined above, within a period of 15 consecutive days from the date of reception.

h) Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible banks and localities, in accordance with the criteria stipulated in points II.3.2.4 and II.3.3.4 of these guidelines.

i) Meet monthly with Finance Ministry staff to discuss any aspect of the management of the PRF Article 4 portfolio. These meetings will be held within five (5) business days of the submission of the monthly management report prepared by the fiscal agent. The Ministry of Finance can also request additional meetings as deemed appropriate.

j) As established in Article 7 of the Agency Decree, the accounting of the fiscal resources and the preparation of the audited financial statements is the responsibility of the Treasury. At the same time, the management of the Article 4 portfolio will be subject to internal supervision and control by the fiscal agent in accordance with the terms established in the Central Bank of Chile's Basic Constitutional Act. In addition, at least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on Article 4 portfolio operations. Moreover, the Finance Minister, or an authorized delegate, can request that the fiscal agent submit reports on operations and processes carried out in the management of Article 4 portfolio. Finally, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of its duties and functions.

I.4.2. Externally managed portfolio

a) Verify, in accordance with industry standards normally applied to investments in a given type of asset, that the records of transactions and other operations reported by the external manager(s) and by the custodian(s) of the fiscal resources are consistent at the close of each day in terms of their notional amount, duration, and date, with the transactions reported at closure by the custodian(s). For the purposes of this paragraph (a), the daily closure is defined as the close of the fiscal agent's business day. In addition, the fiscal agent must subsequently verify the closures reported on non-business days for the fiscal agent that are business days for the custodian or external managers. The fiscal agent must report monthly to the Finance Minister and the Treasurer, or their authorized delegates, the results of the daily verification process. Furthermore, the fiscal agent must conduct a daily reconciliation of transactions and notional positions and report any differences that might arise between the records maintained by the fiscal agent and/or the external managers and the records maintained by the custodians, as well as any other discrepancies detected in relation to the contracted services; any such differences must be reported to the Finance Minister or authorized delegate for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the external managers or the custodians.

b) For the purposes of this section I.4.2., and in all matters concerning the externally managed portfolio, "records" are defined as the information received from the external manager(s) or the custodian(s), in order to verify that the custodian(s) have the same notional positions as reported by the external manager(s).

c) Submit to the Finance Minister and the Treasurer, or their authorized delegates, an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records for the externally managed portfolio submitted by the external managers. The monthly reports described in the preceding paragraph (a) will include a copy of the payment orders associated with the PRF externally managed portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.

d) The Ministry will issue an opinion on the reports described in the preceding paragraphs (a) and (c), either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance, or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager of the Central Bank when the opinion encompasses Article 4 portfolio reports, in accordance with the timeline and procedures outlined in paragraph I.4.1.g.

e) At least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on all operations involving fiscal resources. Moreover, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of the custodian's duties and functions. The fiscal agent will only perform the duties described in paragraphs (a), (c), and (e) with regard to the custodian(s).

II. Portfolio investment guidelines

II.1. Management objective

II.1.1. Article 4 portfolio: The management objective of the PRF Article 4 portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy. The fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

II.1.2. The management objective of the PRF externally managed portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below.

II.2. Investment portfolio

For the investment of the fiscal resources, an investment portfolio (IP) will be established comprising the sum of the Article 4 portfolio and the externally managed portfolio. The specific guidelines, parameters, and rules are contained in the following sections.

II.3. Guidelines and parameters

II.3.1. Asset classes and benchmarks

The fiscal resources in the investment portfolio (IP) will be invested in four asset classes: (1) Sovereign and government-related bonds; (2) Inflation-indexed sovereign bonds; (3) Corporate bonds; and (4) Equities. The first two classes are allocated to the Article 4 portfolio; the last two classes (corporate bonds and equities) are allocated to the externally managed portfolio. The benchmarks for each asset class are shown in Table 1, together with the benchmark allocation of the IP by asset class (henceforth the benchmark allocation).

Table 1: Benchmark allocation of the investment portfolio (IP)

Benchmark		Benchmarks
Asset class	**Percent of IP**	
Sovereign and government-related bonds [1]	48%	Barclays Capital Global Aggregate: Treasury Bond Index (unhedged)
		Barclays Capital Global Aggregate: Government-Related (unhedged)
Inflation-indexed sovereign bonds (real)	17%	Barclays Capital Global Inflation Linked Index (unhedged)
Corporate bonds	20%	Barclays Capital Global Aggregate: Corporate Bond Index (unhedged)
Equities	15%	MSCI All Country World Index (ACWI) [2] (unhedged, with reinvested dividends)

1. Each subindex of this asset class is added according to its relative capitalization.

2. Excluding Chile.

Performance and the tracking error are calculated based on pre-tax benchmarks.

The first two asset classes (sovereign and government-related bonds; and inflation-indexed sovereign bonds) make up the Article 4 portfolio; they will be purchased directly by the Central Bank of Chile and managed directly by the CBC as the fiscal agent. The third and fourth asset classes (corporate bonds; and equities and other assets) make up the externally managed portfolio; they will be acquired and managed directly by the external managers.

II.3.2. Article 4 portfolio

II.3.2.1. Risk budget

The Article 4 portfolio has an ex ante tracking error of 50 basis points.

II.3.2.2. Eligible issuers and currencies

Only issuers and currencies that are included in the benchmark are eligible for investment.

II.3.2.3. Eligible instruments

II.3.2.3.1 Eligible instruments for sovereign and government-related bonds:

a) Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, the fiscal agent will have a period of seven (7) business days to sell the instrument.

b) Reopened securities are also eligible for investment, provided that the prospectus indicates that the ISIN will be harmonized to a security that is already included in the benchmark. Investment in this instrument will be allowed during the time necessary for harmonization. If the instrument is not harmonized as expected, the fiscal agent will have seven (7) business days to sell the instrument.

c) Investment is allowed in instruments that are not included in the benchmark but that differ from other securities which are currently included in the benchmark or which will be included at the end of the month solely by having been issued under different regulatory rules. To be eligible, the instrument must, at the very least, conform in terms of the issuer, coupon, type of coupon (fixed, variable, etc.), maturity, credit rating from Fitch, Moody's, and Standard & Poor's, currency, payment priority (subordinated, unsecured, etc.), and embedded options (callable, putable, etc.).

d) Instruments that have ceased to be eligible and have thus been removed from the benchmark because their residual maturity is below the required minimum are still eligible for investment, provided that the issuer remains in the index. Similarly, instruments that were acquired under paragraph (c) above will also continue to be eligible if their equivalent in the benchmark is eliminated due to their maturity dropping below the required minimum, again provided that issuer remains in the index.

II.3.2.3.2. Eligible instruments for inflation-indexed sovereign bonds:

Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, the fiscal agent will have a period of seven (7) business days to sell the instrument. Instruments that have ceased to be eligible and have thus been removed from the benchmark solely because their residual maturity is below the required minimum are still eligible for investment, provided that the issuer remains in the index.

II.3.2.4. Eligible instruments for cash in foreign currency in the Article 4 portfolio.

The fiscal agent can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the Article 4 portfolio in the last 20 business days, based on the calendar of bank holidays in the United States.

The return on cash in foreign currency will be incorporated in the calculation of the Article 4 portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances, overnight and/or weekend deposits, and time deposits up to 15 calendar days in banks with a long-term credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For Article 4 portfolio, limits for any single bank issuer are as follows:

(a) A maximum of 1.0% of the Article 4 portfolio for issuers with an average rating of AA– or higher.

(b) A maximum of 0.5% of the Article 4 portfolio for issuers with an average rating of A– to A+.

However, in the event of a contribution to the Article 4 portfolio, the fiscal agent can invest a maximum equivalent to US$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, on receiving the instruction to generate liquidity for a cash withdrawal, the fiscal agent can invest up to US$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.2.5. Currency forwards or swaps

The following rules apply to the use of currency hedging mechanisms involving currency forwards or swaps:

a) Forwards or swaps can only be arranged between eligible currencies, and the contract duration cannot exceed 95 consecutive days.

b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

c) Currency forward or swap contracts can specify either cash delivery or net settlement.

d) The counterparty risk associated with each forward or swap contract will equal 100% of the notional value, in its U.S. dollar (USD) equivalent. For the purposes of these guidelines, the notional value of the forward or swap is defined as the amount associated with the purchase currency in the contract. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.2.4).

e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their USD equivalent. If a forward or swap is contracted in order to fully or partially close a position associated with another forward or swap—and provided that both contracts include close-out netting clauses, are with the same counterparty, have the same maturity date, and are in the same currencies—then the counterparty risk will be measured taking into account the net position of the different forwards and swaps involved. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the established credit risk limits (Note II.3.2.4).

f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.

g) The notional value of the forwards or swaps contracted by the fiscal agent with an eligible counterparty cannot exceed the issuer limits established in paragraphs (a) and (b) of Note II.3.2.4. However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, these limits are doubled for that counterparty, for a period of two (2) business days starting on the date of the roll. For the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit—as established in paragraphs (a) and (b) of Note II.3.2.4—for two (2) business days, starting on the date of the roll.

II.3.2.6 Limits on sovereign and government-related bonds

The credit rating limits for investment in the sovereign and government-related bond asset class, as a share of the Article 4 portfolio (% of resources), are listed in Table 2.

Table 2: Credit rating limits for sovereign and government–related bonds

Credit rating	Maximum % of the portfolio
AAA	100%
AA+	
AA	
AA–	
A+	60%
A	
A–	
BBB+	40%
BBB	
BBB–	

For the purpose of monitoring the investment limits by asset class, the median credit rating on long-term instruments from the three international rating agencies (Standard & Poor's, Moody's, and Fitch) is used. If only two ratings are available, the lower of the two is taken. If there is only one, that rating is taken.

II.3.3. Externally managed portfolio

II.3.3.1. Risk budget

The externally managed portfolio is subject to the following risk budgets:

1. Corporate bonds: annual ex ante tracking error of 50 basis points.

2. Equities: annual ex ante tracking error of 60 basis points.

II.3.3.2. Eligible issuers and currencies

Only issuers and currencies that are included in the corresponding benchmark are eligible for investment.

II.3.3.3. Eligible instruments

II.3.3.3.1 Eligible instruments for corporate bonds

Instruments included in the benchmark are eligible for investment, as are the following instruments:

a) Exchange-traded futures on fixed-income instruments or indexes, used solely for hedging purposes to minimize differences relative to the applicable corporate bond benchmark (see Table 1) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in the instruments eligible for cash in foreign currency (Note II.3.3.4).

b) Instruments that have ceased to be eligible and have been removed from the benchmark because their residual maturity or size is below the required minimum, provided that the issuer remains in the benchmark.

c) Instruments that meet the benchmark's eligibility criteria and will thus be incorporated at the close of the month. In the event that an instrument is not incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of one month to sell the instrument.

II.3.3.3.2. Eligible instruments for equities

Instruments included in the benchmark are eligible for investment, as are the following instruments:

a) The Finance Ministry will generate, maintain, and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds (ETFs), which the fiscal agent must, in turn, report to the custodian.

b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of stocks included in the equity benchmark, provided that they do not require the use of tax agents in the issuing country of the underlying asset.

c) Exchange-traded futures on stock indexes, used for hedging purposes to minimize differences relative to the applicable equity benchmark (see Table 1) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in eligible instruments, as established in Note II.3.3.4.

II.3.3.3.3. Eligible instruments that are to be incorporated into the equity benchmark

External portfolio managers can invest in these instruments as soon as their inclusion is formally communicated by the benchmark supplier. If for any reason the instruments are not actually added to the benchmark as expected, the external manager will have a period of seven (7) business days in the local market to sell the instruments in question, starting on the date on which their inclusion was expected.

II.3.3.4. Eligible instruments for cash in foreign currency in the externally managed portfolio

External portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the externally managed portfolio in the last 20 business days, based on the calendar of bank holidays in the United States. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of that manager's total portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances and overnight and/or weekend deposits in banks with a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For the externally managed portfolio, each portfolio manager can invest up to US$ 20 million in a given bank. However, in the event of a portfolio contribution, the external portfolio manager can invest a maximum equivalent to US$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, when the external manager receives the instruction to generate liquidity for a cash withdrawal, that manager can invest up to US$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.3.5 Limits on forwards and swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark currency allocation and solely with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section II.3.3.6, paragraphs (a) to (e). However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increases to 2% for that counterparty, for a period of two (2) business days starting on the date of the roll. The counterparty risk associated with the forward or swap must be taken into account for complying with the issuer risk limits (as established in Note II.3.4.5). However, for the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (Note II.3.4.5) for two (2) business days, starting on the date of the roll.

II.3.3.6. Issuer limits for corporate bonds

The limit by issuer for the corporate bond asset class as a share of the externally managed portfolio (% of resources) managed by each external portfolio manager is listed in Table 3, based on the issuer's credit rating.

Table 3: Issuer limits for corporate bonds, by credit quality

Credit rating	Issuer limit
AAA	15%
AA+	10%
AA	10%
AA–	10%
A+	5%
A	5%
A–	5%
BBB+	5%
BBB	5%
BBB–	5%

II.3.3.7 Credit rating limits for corporate bonds

The credit rating limits for investments in the corporate bond asset class, as a share of the externally managed portfolio (% of resources) managed by each external portfolio manager are listed in Table 4.

Table 4: Credit rating limits for corporate bonds

Credit rating	Maximum % of the externally managed portfolio
AAA	100%
AA+	
AA	
AA–	
A+	60%
A	
A–	
BBB+	50%
BBB	
BBB–	

For the purpose of monitoring the investment limits established by the Finance Ministry (sections II.3.3.6 and II.3.3.7), the median credit rating on long-term instruments from the three international rating agencies (Standard & Poor's, Moody's, and Fitch) is used. If only two ratings are available, the lower of the two is taken. If there is only one, that rating is taken.

II.3.4. Limits on spot currency transactions

The external portfolio managers, or the fiscal agent, can carry out foreign currency spot transactions with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

II.3.5. Special restrictions

No part of the investment portfolio can be invested in any type of instrument from Chilean issuers or in instruments denominated in Chilean pesos.

The fiscal agent and the external portfolio managers cannot use derivatives to increase their exposure to financial instruments beyond the market value of the resources under their individual management.

External portfolio managers can contract currency futures, forwards, or swaps. However, the aggregate notional amounts cannot exceed 10% of the portfolio under management.

The following restrictions also apply specifically to the externally managed portfolio: (i) mutual funds and exchange-traded funds (ETFs) together cannot represent, as a share of a given external manager's portfolio, more than the aggregate share of Egypt, India, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey in the equity benchmark indicated in Table 2, plus 2%; (ii) external managers cannot invest in the local markets of Chile, Egypt, India, Peru, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey; and (iii) investments in China can only be made through the stock market in Hong Kong.

External equity managers cannot invest in their own shares; and external corporate bond managers cannot invest in their own bonds.

II.3.6. Rebalancing policy

The PRF rebalancing policy requires that the portfolio converge to the benchmark established in Table 1 under the following situations: (i) in the event of a contribution to the PRF; and (ii) in the event that the target ranges specified in Table 5 are exceeded. The Ministry of Finance will determine the specific date on which rebalancing associated with points (i) and (ii) of this paragraph will be implemented and will also monitor compliance with the target ranges identified in Table 5.

The rebalancing could result either in cash contributions to the Article 4 portfolio and/or the externally managed portfolios or in withdrawals from the Article 4 portfolio and/or the externally managed portfolios. In the event of a contribution, the Ministry of Finance will issue instructions on the amounts to be transferred between the external managers and the Article 4 portfolio in order to achieve convergence to the benchmark established in Table 1. When the rebalancing results in a cash contribution to the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent or the external manager will have ten (10) bank business days to achieve this convergence, during which the fiscal agent and the external manager, if applicable, will be granted a waiver of compliance with the requirements of sections II.1.1, II.1.2, II.3.2.1, the first paragraph of II.3.2.4, II.3.3.1, and the first paragraph of II.3.3.4. When the rebalancing results in a cash withdrawal from the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent and the external manager, if applicable, will be granted a waiver from compliance with the requirements of sections II.1.1, II.1.2, II.3.2.1, the first paragraph of II.3.2.4, II.3.3.1, and the first paragraph of II.3.3.4, for a period of ten (10) bank business days before and including the date of the withdrawal. The waiver can be extended if either party submits a request for extension to the Ministry of Finance, with an explanation of the reasons for the request. In the event that the period between the date on which the cash withdrawal instructions are issued and the date on which the actual withdrawal is implemented is less than ten (10) bank business days, the waiver will cover only that period.

Table 5: Target ranges

Benchmark		Target range (percent of IP)
Asset class	**Percent of IP**	
Sovereign and government-related bonds	48%	45%–51%
Inflation-indexed bonds (Real)	17%	14%–20%
Corporate bonds	20%	17%–23%
Equities	15%	12%–18%

In addition, in the event of rebalancing, the Director of the Financial Operations Division of the Central Bank of Chile can send a request, via electronic mail, to the Finance Ministry's Capital Markets and International Finance Coordinator for permission to maintain the relative positions of the Article 4 portfolio vis-à-vis the benchmark and thus not to have to converge to the benchmark established in Table 1. The Capital Markets and International Finance Coordinator must authorize the holding of said positions by sending an electronic mail to the Central Bank's Director of the Financial Operations Division.

II.4. Valuation criteria

The investment portfolio valuation that must be reported to the Finance Ministry is to be prepared by the custodian(s) using marked-to-market accounting, based on their own valuation sources. However, for the internal accounting of the Article 4 portfolio, the Central Bank of Chile can use the same methodology that it uses for operations involving its international reserves, as stipulated in paragraph (g) of Article 4 of the Agency Decree.

II.5. Securities lending program

II.5.1. Article 4 portfolio

The fiscal agent for the Article 4 portfolio can participate in securities lending programs with the PRF custodian(s), provided that the custodians contracted to manage the securities lending programs (henceforth, the program managers) are obligated to comply with the operating criteria established in the custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

II.5.2. Externally managed portfolio

The external portfolio managers cannot carry out or contract securities lending programs.

II.6. Other

Foreign exchange operations will be considered spot transactions, provided that the period between the trade date and the settlement date does not exceed two (2) days. Foreign exchange operations that are related to the purchase or sale of an instrument will be considered spot operations when the period between the trade date and the settlement date follows the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purpose of measuring the performance of the fiscal agent and the external portfolio managers is the U.S. dollar.

In the event of noncompliance with any of the instructions described in this report, at any time, due to fluctuations in market prices, abnormal market conditions, or any other reason beyond the control of the fiscal agent or the external portfolio managers, in their respective mandates, the situation will not be considered noncompliance with the guidelines, provided that the necessary measures are taken to ensure compliance within seven (7) days of detecting the situation. For the externally managed corporate bond portfolio, the period for ensuring compliance is extended to one calendar month from the date the situation is detected.

The Finance Minister, or an authorized delegate, can extend the period applicable to the Article 4 portfolio at the request of the fiscal agent, when justified, and can similarly extend the periods applicable to the externally managed portfolios at the request of the corresponding external manager, also when justified.

However, the external managers can temporarily hold any ineligible instruments that they receive due to corporate events or that have become ineligible due to corporate events. In that case, the external managers will have a period of 30 consecutive days to sell the instruments in question, starting on the date of the corporate event. If they are unable to do so, the external managers must notify the Treasury and communicate a plan of action to liquidate the instruments. In the particular case of entitlements, preferred stock, rights, warrants, or other equivalent instruments received due to corporate events that grant the right to purchase equities, exchange for eligible stocks, or receive cash, these instruments can be kept in the portfolio until expiration.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1 Critical accounting estimates:

In preparing the financial statements, management must make estimates and formulate assumptions about the future. The resulting accounting estimates, by definition, are rarely going to correspond precisely to actual results. The estimates and assumptions that carry a strong risk of causing significant adjustments to the accounting value of assets and liabilities within the next accounting period are described below:

Fair value of instruments that are not quoted on an active market or traded on the stock market.

The fair value of instruments that are not quoted on an active market cannot be determined by the fund based on pricing sources (such as price-setting agencies, as applicable to each fund) or indicative prices from market makers for bonds or debt, which are obtained through the custodian.

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

The determination of what constitutes “observable” represents a critical judgment by the fund’s manager. Therefore, observable data are defined as market data that can be easily obtained, are regularly distributed or updated, are trustworthy and verifiable, are not private (for exclusive use), and are provided by independent sources that are active participants in the relevant market.

4.2. Critical judgments for applying accounting policies:

Functional currency:

Management considers the U.S. dollar to be the currency that most faithfully represents the economic effect of transactions, events, and underlying conditions. The U.S. dollar is the currency in which the fund receives contributions from the Chilean government.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The PRF portfolio is exposed to many of the same risks as the ESSF. However, credit risk is higher in the PRF due to the fund's investments in a larger number of countries and in corporate bonds. As in the case of the ESSF, most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the PRF investment policy.

5.1. Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions that affect the value of the instruments in the fund's investment portfolio. Like the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk, exchange rate risk, and credit spread risk. In addition, the PRF is also exposed to equity risk. This section describes the risks in greater detail, together with the mechanisms established to mitigate them.

Interest rate risk: In the PRF, interest rate risk is mainly a function of the benchmark duration. This is calculated based on the duration of the indexes that make up the benchmark. Compared to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk in a larger number of countries, and it is more sensitive since it has a longer duration. This risk is controlled by keeping the duration close to the benchmark.

Exchange rate risk: Because the fund's return is measured in dollars, the value of investments is also affected by exchange rate fluctuations. Given the passive management mandate, the exchange rate exposure that the PRF is willing to accept depends on the benchmark currency allocation. Thus, the fund's exchange rate exposure mainly derives from investment denominated in euros (25%), yen (13%), pounds sterling (11%), Canadian dollars (3%), Australian dollars (2%) and other currencies with a smaller share.

Credit spread risk: The market value of the fixed-income instruments in the PRF 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 higher in the PRF than in the ESSF because the fixed-income portfolio includes investments in a large number of issuers from around the world. For example, the fund invests in instruments issued by the governments of developed and developing countries, public and semi-public agencies, multi-lateral financial institutions, corporations, and so on. This risk is mitigated by having a well-diversified portfolio and investing only in investment-grade instruments (with a rating of BBB– or higher). Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have a high credit rating.

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 stock 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). The strategic asset allocation only allows 15% of the total portfolio to be invested in equities.

Volatility, VaR and tracking error: Volatility is also measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. The PRF uses ex ante tracking error to predict, with some degree of confidence, the portfolio's deviation from the benchmark.

5.2. Credit risk:

In the PRF bond portfolio, credit risk exposure is controlled primarily by having a well-diversified portfolio and investing only in issuers included in the benchmark. In the case of bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly used to invest 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 is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see Table 6). In addition, forwards 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, the use of futures is also allowed so as to limit the total use of derivatives. Thus, forwards, swaps, and futures cannot exceed 10% of each external manager's portfolio. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have a high credit rating.

Table 7. Credit limits on bank deposits and forwards
(millions of U.S. dollars, unless otherwise indicated)

Limit		Time deposits	Forwards
Minimum credit rating		A–	AA–
Maximum per counterparty	CBC portfolio	20	1% (a)
	Externally managed portfolios	20	1% (a)

(a) Percent of each manager's portfolio
Source: Ministry of Finance.

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 separately in the name of the Fisco of Chile.

5.3. Liquidity risk:

The PRF is exposed to minimal liquidity risk because the fund has little need for cash, given that disbursements from the fund could not start before 2016. The sale of instruments in the 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), and with the possible need for 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, in order to reduce the impact of having to sell at an unfavorable time. For rebalancing, there are clear rules on planning its implementation.

5.4. 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.

In the case of the portfolio managed by the Central Bank of Chile, the operational management of the funds utilizes the same infrastructure that the Central Bank uses to manage its international reserves. The Central Bank 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 externally managed portfolio, 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.

NOTE 6 – ACCOUNTING CHANGES

As of 31 December 2016, there were no accounting changes relative to the previous.

NOTE 7 –FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US$ 8,838,101,152 on 31 December 2016 and US$ 8,090,149,675 on 31 December 2015.

a) The breakdown of investments carried at fair value on 31 December 2016 and 2015 is as follows:

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Equities	1	1,405,244,962	1,134,593,055
Other capitalization instruments	1	32,715,042	25,884,946
Corporate bonds	1	1,952,755,987	1,778,515,089
Government bonds	1	4,326,772,740	4,083,895,380
Indexed bonds	1	1,120,283,465	1,041,207,664
Derivatives	1	28,772	441,435
Subtotal		**8,837,800,968**	**8,064,537,569**

Custodian investments, Central Bank of Chile	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Time deposits	1	300,184	25,612,106
Subtotal		**300,184**	**25,612,106**
Total		**8,838,101,152**	**8,090,149,675**

b) The breakdown of investments by investment currency on 31 December 2016 and 20154 is as follows:

Currency of origin	Fair value instruments, J.P. Morgan			
	2016		2015	
	US$	% del PI	US$	% del PI
U.S. dollar	4,001,302,055	45.27	3,510,427,181	43.53
Euro	1,972,217,083	22.32	1,867,255,062	23.15
Yen	1,231,494,661	13.93	1,093,487,450	13.56
Other	1,632,787,169	18.48	1,593,367,876	19.76
Subtotal	**8,837,800,968**	**100.00**	**8,064,537,569**	**100.00**

Currency of origin	Fair value instruments, Central de Chile			
	2016		2015	
	US$	% del PI	US$	% del PI
U.S. dollar	-	-	20,104,152	78.49
Other	300,184	100.00	5,507,954	21.51
Subtotal	**300,184**	**100.00**	**25,612,106**	**100.00**
Total	**8,838,101,152**	**-**	**8,090,149,675**	**-**

c) The total value of assets by risk segment on 31 December 31 December 2016 and 2015 is as follows:

Risk segment	Market value			
	2016		2015	
	US$	%	US$	%
Equities	1,437,960,003	16.22	1,160,478,001	14.31
Bank (*)	24,526,717	0.28	48,216,555	0.59
Bonds	7,399,812,192	83.50	6,903,618,132	85.10
Total	**8,862,298,912**	**100.00**	**8,112,312,688**	**100.00**

Asset class	Market value			
	2016		2015	
	US$	%	US$	%
Equities	1,437,960,003	16.23	1,160,478,001	14.31
Bank (*)	24,526,717	0.28	48,216,555	0.59
Corporate bonds	1,952,755,987	22.03	1,778,515,089	21.92
Sovereign bonds	4,326,772,740	48.82	4,083,895,380	50.34
Inflation-indexed bonds	1,120,283,465	12.64	1,041,207,663	12.84
Total	**8,862,298,912**	**100.00**	**8,112,312,688**	**100.00**

(*) Includes cash and cash equivalents.

NOTE 8 –FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US$ 224,100 on 31 December 2016 and US$ 107,228 on 31 December 2015.

a) The breakdown of derivatives by investment currency is as follows:

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2016 US$**	**2015 US$**
Derivatives	1	224,100	107,228
Subtotal		**224,100**	**107,228**

b) The breakdown of derivatives, by investment currency, is as follows:

Currency of origin	**Fair value instruments, J.P. Morgan**			
	2016		**2015**	
	US$	**% of IP**	**US$**	**% of IP**
AUD	-	-	-	-
CAD	-	-	-	-
CHF	80,036	35.72	13,404	12.50
EUR	16,007	7.14	26,807	25.00
GBP	-	-	13,404	12.50
JPY	16,007	7.14	-	-
MXN	-	-	-	-
SGD	-	-	-	-
USD	112,050	50.0	53,613	50.00
Total	**224,100**	**100.00**	**107,228**	**100.00**

c) The total value of liabilities by risk segment is as follows:

Risk segment	**Market value**			
	2016		**2015**	
	US$	**%**	**US$**	**%**
Bank	224,100	100.00	107,228	100.00
Total	**224,100**	**100.00**	**107,228**	**100.00**

Liability class	**Market value**			
	2016		**2015**	
	US$	**%**	**US$**	**%**
Money market	224,100	100.00	107,228	100.00
Total	**224,100**	**100.00**	**107,228**	**100.00**

NOTE 9 – CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, to J.P. Morgan, in the role of custodian bank, and to the external managers was created in March 2007. The following movements were recorded in 2016 and 2015:

	2016								
	Contributions US$	Withdrawals US$	Compensation to the CBC as fiscal agent (1) US$	Custody of the portfolio managed by the CBC US$	Custody of the externally managed portfolios US$	BlackRock US$	Mellon US$	Rogge US$	Other US$
January	-	-	-	(67,342)	-	-	(84,857)	-	-
February	-	-	-	(66,935)	(116,694	-	-	(143,605)	(58,899)
March	-	-	(250,911)	-	-	(195,030)	-	-	-
April	-	-	-	(66,912)	(58,074)	-	(79,092)	-	-
May	-	-	-	(67,891)	(59,768)	-	-	(145,361)	-
June	462,285,625	-	(250,911	(67,058)	(58,105)	-	-	-	-
July	-	-	-	(66,798)	(60,524)	-	-	-	(121,319)
August	-	-	-	(141,620)	(162,048)	(190,283)	-	(154,222)	(13,995)
September	-	-	(250,911)	-	(54,080)	(205,046)	(88,034)	-	-
October	-	-	-	(70,775)	-	-	-	-	-
November	-	-	-	(70,962)	(60,687)	-	(101,741)	(163,388)	(47,294)
December	-	-	(250,910)	(68,659)	(59,241)	-	-	-	-
Total	**462,285,625**		**(1,003,643)**	**(754,952)**	**(694,221)**	**(590,359)**	**(353,724)**	**(606,576)**	**241,507**

(1) Ministry of Finance Res. N°3050 of 11/Oct/2014 authorizes payment of compensation for 2015, for portfolio management and other services.

	2015								
	Contributions US$	Withdrawals US$	Compensation to the CBC as fiscal agent (1) US$	Custody of the portfolio managed by the CBC US$	Custody of the externally managed portfolios US$	BlackRock US$	Mellon US$	Rogge US$	Other US$
January	-	-	-	(65,171)	(60,974)	(196,420)	(87,638)	-	-
February	-	-	-	(64,589)	(59,118)	-	-	(141,206)	-
March	-	-	(236,996)	(65,917)	(56,062)	-	-	-	-
April	-	-	-	(65,936)	(58,726)	-	(86,476)	-	-
May	-	-	-	(64,060)	(59,807)	(195,168)	-	(140,621)	-
June	463,881,387	-	(236,996)	(65,549)	(59,889)	-	-	-	-
July	-	-	-	(64,255)	(62,198)	(190,696)	(89,361)	-	-
August	-	-	-	(65,628)	(71,764)	-	-	(140,912)	-
September	-	-	(236,996)	(69,293)	(58,792)	(194,619)	-	-	-
October	-	-	-	(67,722)	(113,421)	-	-	-	-
November	-	-	-	(67,602)	(56,574)	-	(83,560)	(143,904)	-
December	-	-	(236,996)	(136,257)	(60,200)	(194,385)	-	-	-
Total	**463,881,387**	**-**	**(947,984)**	**(861,979)**	**(777,525)**	**(971,288)**	**(347,035)**	**(566,643)**	**-**

(1) Ministry of Finance Res. N°3050 of 11/Oct/2014 authorizes payment of compensation for 2015, for portfolio management and other services.

NOTE 10 – INTEREST EARNED

The breakdown of interest income earned on investments in debt securities carried at fair value through profit or loss as of 31 December 2016 and 2015 is as follows:

	2016 US$	2015 US$
Interest earned, Central de Chile	102,534,440	103,597,196
Interest earned, J.P. Morgan	64,899,267	63,311,530
Total	**167,433,707**	**166,908,726**

NOTE 11 –DIVIDEND INCOME

The breakdown of dividends received from equity investments as of 31 December 2016 and 2015 is as follows:

Dividends from investments managed by	**31 Dec 2016 US$**	**31 Dec 2015 US$**
Mellon Capital Management Corporation	14,963,716	13,706,907
BlackRock Institutional Trust Company, N.A.	14,995,418	13,669,958
Total	**29,959,134**	**27,376,865**

NOTE 12 – CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2016 and 2015 breaks down as follows:

Cash in custody and externally managed accounts	**31 Dec 2016 US$**	**31 Dec 2015 US$**
J.P. Morgan	6,631,690	351,001
Mellon Capital Management Corporation	1,877,637	1,491,695
Rogge Global Partners	6,974,944	5,965,424
BlackRock Institutional Trust Company, N.A.	8,713,489	14,354,893
Total	**24,197,760**	**22,163,013**

NOTE 13 – PRF RETURNS

The breakdown of the fund's returns as of 31 December 2016 and 2015 is as follows:

	Accumulated return		
Type of return	**2016**	**Last 12 months**	**Last 24 months**
Nominal	0.21%	3.76%	0.58%

NOTE 14 – FAIR VALUE

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

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The transaction is carried out in the principal or most advantageous market and is not forced. That is, it does not take into account specific characteristics of the PRF that could have an impact on the real transaction.

	31 Dec 2016			31 Dec 2015		
FINANCIAL ASSETS	**Level**	**Net book value US$**	**Fair value US$**	**Level**	**Net book value US$**	**Fair value US$**
Cash and cash equivalents	1	24,197,760	24,197,760	1	22,163,013	22,163,013
Equities	1	1,405,244,962	1,405,244,962	1	1,134,593,055	1,134,593,055
Other capitalization instruments	1	32,715,042	32,715,042	1	25,884,946	25,884,946
Corporate bonds	1	1,952,755,987	1,952,755,987	1	1,778,515,089	1,778,515,089
Time deposits	1	300,184	300,184	1	25,612,106	25,612,106
Government bonds	1	4,326,772,740	4,326,772,740	1	4,083,895,380	4,083,895,380
Indexed bonds	1	1,120,283,465	1,120,283,465	1	1,041,207,664	1,041,207,664
Derivatives	1	28,772	28,772	1	441,435	441,435
FINANCIAL LIABILITIES						
Derivative financial instruments		224,100	224,100		107,228	107,228

In 2016 and 2015, all the assets and liabilities in the PRF were measured according to the prices quoted in the equity market. That is, the valuation technique is based on Level 1 inputs, such that the fund has not made any changes in fair value hierarchies to date.

NOTE 15 – LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter Nº 1,267 of 4 June 2013, Section II Nº 5, the fiscal agent for the Article 4 portfolio can enter into agreements with the fund's custodian(s) to participate in securities lending, provided that the custodians comply with the operating criteria established in the PRF custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay the corresponding market value. The resources earned or disbursed are to be recorded on the PRF financial statements as income in the year.

On 31 December 2016 and 2015, the PRF owned the following instruments under the item Securities lending:

2016		
Location	**Notional value**	**Market value US$**
Europe	—	—
United States of America	—	—
Total	**—**	**—**

2015		
Location	**Notional value**	**Market value US$**
Europe	66,329,000	75,160,841
United States of America	166,155,000	166,195,948
Total	**232,484,000**	**241,356,789**

NOTE 16 – SECURITIES CUSTODY

As of 31 December 2016 and 2015, securities custody is as follows:

	Securities custody in 2016					
Entity	**Amount in custody (US$)**	**National custody % of total investments in instruments issued by national issuers**	**% of total PRF assets**	**Amount in custody (US$)**	**Foreign custody % of total investments in instruments issued by foreign issuers**	**% of total PRF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	8,837,877,052	100	99.73
Total investment portfolio in custody	**-**	**-**	**-**	**8,837,877,052**	**100**	**99.73**

(*) These amounts are offset between financial assets and liabilities.

	Securities custody in 2015					
Entity	**Amount in custody (US$)**	**National custody % of total investments in instruments issued by national issuers**	**% of total PRF assets**	**Amount in custody (US$)**	**Foreign custody % of total investments in instruments issued by foreign issuers**	**% of total PRF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	8,090,042,446	100	99.73
Total investment portfolio in custody	**-**	**-**	**-**	**8,090,042,446**	**100**	**99.73**

(*) These amounts are offset between financial assets and liabilities.

NOTE 17 – RELEVANT EVENTS

As of the closing date of these financial statements, there were no relevant events that could materially affect the balances or interpretation of these financial statements.

NOTE 18 – SUBSEQUENT EVENTS

Between 1 January 2017 and the date of issue of these financial statements (24 March 2017), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

APPENDIXES

Appendix 1: Index of tables, figures, boxes and diagrams

N° Figures		Page

N° Boxes		Page

N° Diagrams		Page

Appendix 2: Glossary of Terms

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%.

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 — An instrument that represents ownership or equity 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-indexed 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.

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.

Reputational risk (or headline risk) —The risk that the public's perception of an entity will worsen.

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.

Sovereign bond — A bond issued by a government.

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 equity 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 — 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.

Appendix 3: Abbreviations

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
IRR	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-indexed unit of account)
USA	United States of America
USD	U.S. dollar
US$	U.S. dollar
VaR	Value at Risk

Ministerio de Hacienda

Gobierno de Chile