ANNUAL REPORT
SOVEREIGN WEALTH FUNDS

· MINISTRY OF FINANCE ·

2013

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1. 1. FOREWORD BY THE MINISTER

This year, 2013, was the final year of the administration led by President Sebastián Piñera. In this time, we have achieved many of the different goals we set ourselves in early 2010, thereby improving the quality of life of millions of Chileans. From the perspective of fiscal policy, we have strengthened the fiscal position; improved transparency and the fiscal institutional framework; refined the methodology used in the cyclically adjusted fiscal balance rule; and contributed to the accumulation of resources and the management of our sovereign wealth funds.

One of the priorities of this Administration was to improve the fiscal position, which had deteriorated substantially in 2008 and 2009. Despite the earthquake in 2010 and the needs deriving from the different government programs and social demands, the real deficit was reduced from 4.4% of GDP in 2009 to 0.6% in 2013. This was possible due to our commitment to limiting the growth of public spending (4.6% in real terms in 2010–2013) and reducing the structural deficit from 3.1% in 2010 to 0.7% in 2013, a target that was achieved in 2012.

During our administration, we also improved the methodology and institutional framework of the cyclically adjusted fiscal balance rule, in order to minimize discretion in its application. We commissioned a study of the methodology by the Structural Balance Advisory Committee. The majority of the Committee's recommendations were incorporated into the calculation of structural revenue in the annual budget starting in 2011. The institutional structure for fiscal policy was strengthened through the formal establishment of the Fiscal Advisory Council in 2013, as recommended by the Committee, in order to guarantee the independence of the estimations used in calculating of the balance.

Fiscal consolidation has gone hand in hand with the recovery of the sovereign wealth funds, which have surpassed their pre-crisis levels and reached a historical peak. Three factors contributed to this trend. First, during this administration, there were no withdrawals from the funds. Large financing needs, such as those associated with the 2010 earthquake, were financed from alternative sources, such as economic growth, the reduction of tax evasion and tax adjustments. Second, we have contributed nearly US$ 7,000 million to the funds, of which approximately US$ 3,200 million were over and above the contributions required under the Fiscal Responsibility Law. Third, the funds have recorded positive returns since 28 February 2010, at an annualized rate of 3% in dollars for the Pension Reserve Fund (PRF) and 1.4% for the Economic and Social Stabilization Fund (ESSF), earning US$ 1,239 million in the period.

This administration has also continued to make progress on improving the funds' investment policies, in order to ensure that they meet the objectives for which they were created. Thus, important changes were introduced to the PRF investment policy in early 2012. Since then, and for the first time in the history of both sovereign wealth funds, 20%

of the portfolio is invested in a highly diversified portfolio of bonds issued by foreign corporations and 15% in international stocks. For the rest of the portfolio, which is mainly invested in fixed-income sovereign bonds, the number of eligible countries was expended considerably. Thus, starting in 2012, the PRF risk profile is more in line with the state's pension obligations, which the fund is intended to finance. The policy change has been positive: from early 2012 to December 2013, the PRF earned an additional return of 2.62% relative to what it would have earned under the previous policy (equivalent to US$ 320 million).

The implementation of a new ESSF investment policy began in August 2013, with the goal of improving the fund's ability to cover a potential drop in future fiscal income. The new policy reduced the share invested in fixed-income dollar instruments from 50% to 40%, expressed as a percentage of the total portfolio, and in euros from 40% to 25%. This allowed an increase in the share of fixed-income yen instruments from 10% to 20% and the incorporation of sovereign bonds denominated in Swiss francs (7.5%). To guarantee liquidity and protect the funds resources, 84% of the fixed-income portfolio is invested in sovereign instruments, with the balance in short-term time deposits. Finally, the new policy added a small share of 7.5% in international stocks, in order to increase returns.

The careful management of the sovereign wealth funds, the clarity of management practices and the timely delivery of key information have contributed to positioning our funds at the top of the Linaburg-Maduell transparency index of the Sovereign Wealth Fund Institute since the third quarter of 2009. The position of the Chilean funds also improved in the 2013 transparency and accountability ranking by the Petersen Institute for International Economics, in its report on "Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard." Specifically, the ESSF was ranked in third place, up from thirteenth in 2011, and the PRF in tenth place, up from fifteenth.

This effort has paid off in important ways. During this administration, the four main international rating agencies improved Chile's sovereign rating, based on the low debt level and net credit position of the public sector, as evidenced in the savings accumulated in the sovereign wealth funds. This has had beneficial consequences for our economy, with lower financing costs not only for the government, but for all Chilean issuers. It is not a coincidence, then, that the last Chilean sovereign debt issue obtained the lowest interest rate and the narrowest spread that an emerging country has ever achieved (2.38% and 55 basis points, respectively).

The soundness of Chile's institutional framework, together with the resources saved in the sovereign wealth funds, belong to all Chileans. Safeguarding this heritage allows a careful, stable management of the Chilean economy, thereby ensuring the sustainability of the country's social programs and the continuous improvement of the quality of life of all Chileans, with more and better opportunities. Many challenges remain, in a task that is never finished, but with hard work and an eye on the future, we can continue to move forward.

—

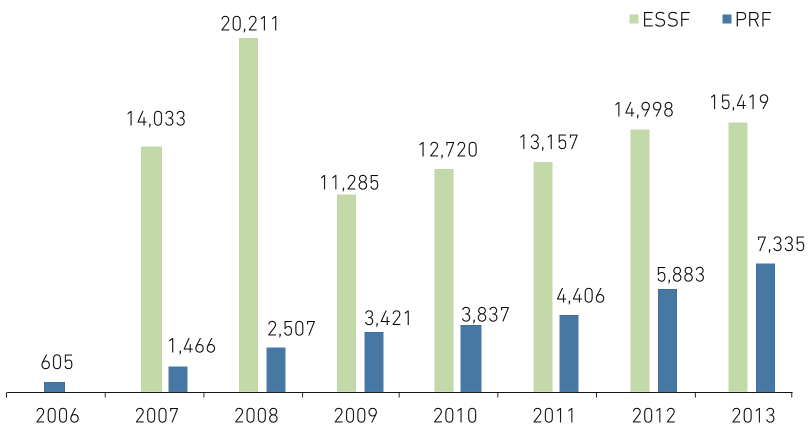
Felipe Larraín
Finance Minister

2. SUMMARY

As of 31 December 2013, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US$ 22,754 million and net returns in dollars of 3.50% and 4.38%, respectively, since their inception.[1]

Figure 1: Market Value

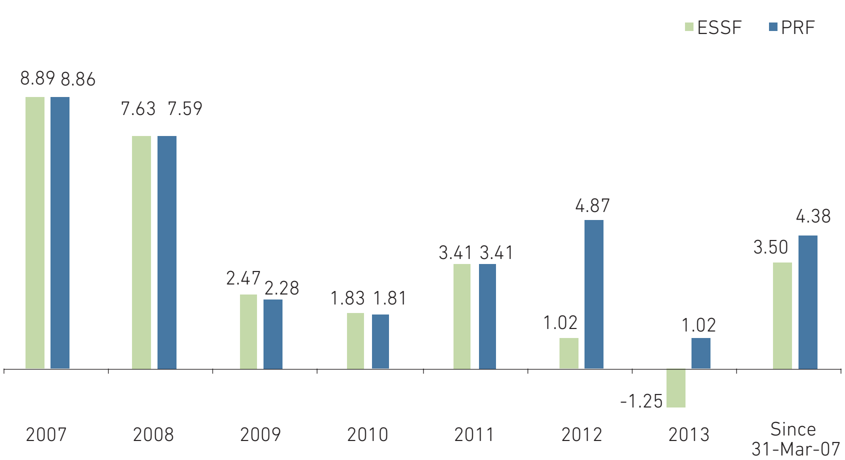
(millions of dollars)



Source: Ministry of Finance

Figure 2: Net return in dollars[2]

(percent)



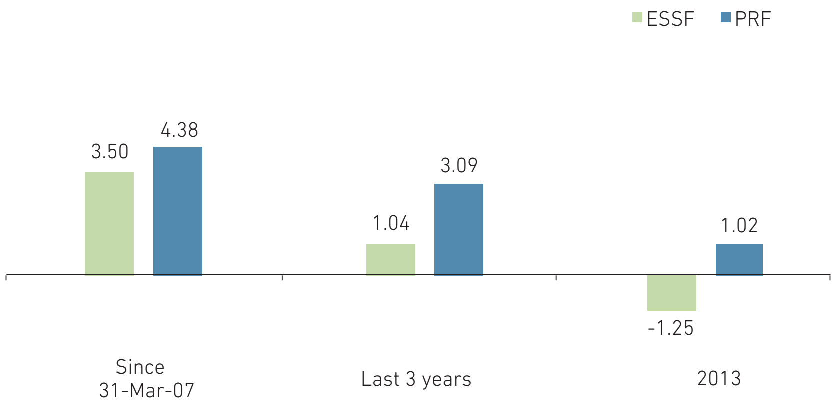
Source: Ministry of Finance

1 The returns published in this report are based on the time-weighted rate of return (TWR) methodolgy, 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.

2 The use of the TWR methodology to measure returns dates to 31 March 2007, when the performance measure of the Central Bank of Chile was introduced.

Figure 3: Accumulated net annual return in dollars

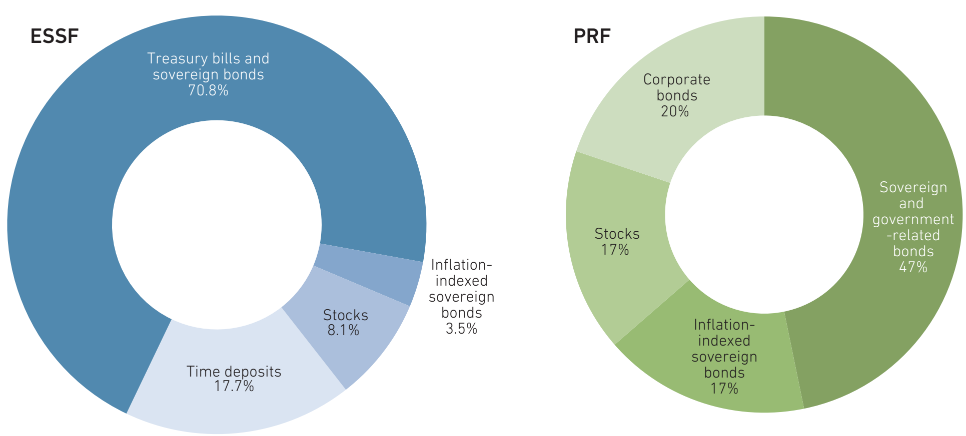
(percent)



Source: Ministry of Finance

Figure 4: Asset class allocation as of 31 December 2013

(percent of portfolio)



Source: Ministry of Finance

CHAPTER 3

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: A structural balance rule that has improved over time

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 revenue. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity, the copper price and other factors that determine effective fiscal revenue. This is especially important in the case of 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. It also naturally supports monetary policy, since it saves excess fiscal revenue when monetary policy is tight and uses it when monetary policy is loose. This policy has thus contributed to significantly reducing the volatility of fiscal spending and economic growth. Initially, the structural balance rule depended on the political will of the government in power. However, once this was consolidated among the different sectors of the country, it became possible to formalize the savings accumulation rules. Thus, Law N°20,128 on Fiscal Responsibility was passed in the second half of 2006, establishing the regulations and institutional framework for the accumulation, management and operation of fiscal savings. The law created the PRF and authorized the President of the Republic to create the ESSF, which was officially founded in February 2007. The law further requires each Presidential Administration to announce its objective for the structural balance rule in its first year. In 2013 the Finance Minister established the Fiscal Advisory Council by decree, whose main role is to guarantee independence in the estimation of the structural variables and to verify the structural balance estimates.

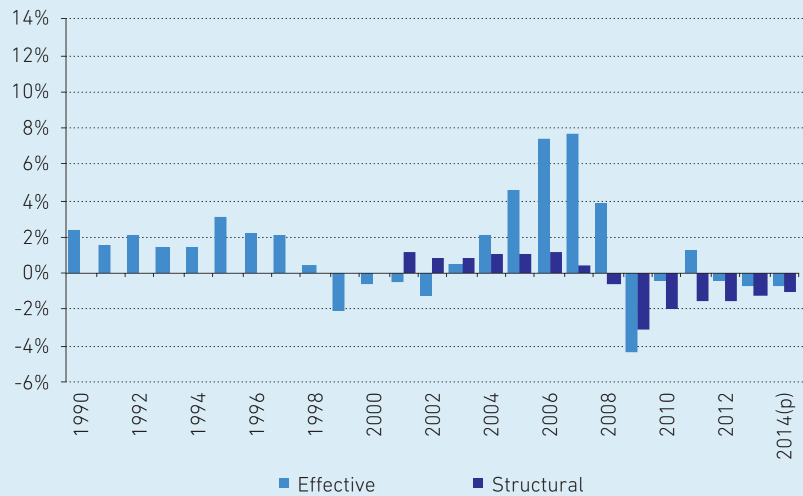
Before 2010, the methodology used to calculate the structural balance had undergone various changes that had reduced transparency. The Finance Ministry therefore commissioned an Advisory Committee to carry out a study of the design of a second-generation structural balance fiscal policy for Chile. The members of the committee were Vittorio Corbo, Ricardo Caballero, Mario Marcel, Francisco Rosende, Klaus Schmidt-Hebbel, Rodrigo Vergara and Joaquín Vial, all economists outside the Ministry of Finance. In addition to expressing their opinion on key issues related to economic policy, the committee members submitted a series of recommendations for increasing the transparency of decisions made in Chile on implementing changes in fiscal policy and improving the rule. The vast majority of the committee's recommendations were incorporated starting with the 2011 budget.[1]

The structural balance target has also 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.[2] In 2009, the ex ante target was reduced to 0% to face the crisis that was then in full swing, although the structural deficit in 2009 was ultimately 3.1%. Since then, it has been adjusted each year so as to converge to a structural deficit of 1% in 2014 (see figure B1).

The success of fiscal policy has led to broad support across all sectors of the country. At the international level, Chile has become a benchmark for many countries at different levels of development. In particular, the creation of the Fiscal Advisory Council has been very well received by various international organizations, including the Organization for Economic Cooperation and Development (OECD), in its report "OECD Economic Surveys – CHILE" published in January 2012, and the International Monetary Fund (IMF), in its "2012 Article IV Consultation".

Figure B1: Effective and structural fiscal balance

(percent of GDP)



Source: Ministry of Finance.

1 The 2011 budget incorporates the recommendations contained in the preliminary report of the Fiscal Advisory Committee for designing of a second-generation structural balance fiscal policy for Chile. Both the final report, "Proposals for Improving the Fiscal Rule: Final Report," and the preliminary version, "First Report," are available on the Budget Office's website (www.dipres.cl) in the section on Structural Balance Policy.

2 In 2008, the structural balance 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 a low copper price. 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.

3.2 RULES ON CONTRIBUTIONS AND WITHDRAWALS

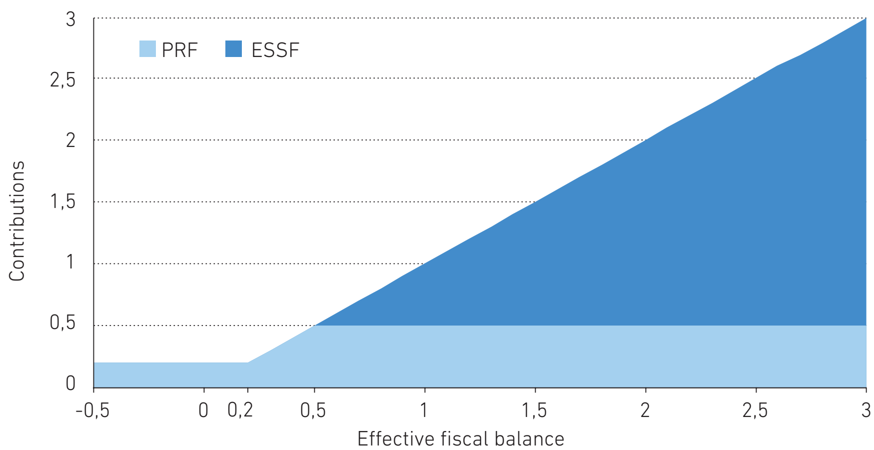
The Fiscal Responsibility Law of 2006 establishes the rules on fund contributions. The rules on withdrawals and the use of the funds are established in the same law, as well as in the Pension Law of 2008 for the PRF and DFL Nº 1 for the ESSF.

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 made in advance the previous year[3] (see figure 5).

Figure 5: Fund contribution rules

(percent of GDP)



Source: Ministry of Finance

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 2016, annual withdrawals from the PRF must not exceed the fund's returns in the previous year[4]. 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 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.

3 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 advance contributions to the fund.

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

CHAPTER 4

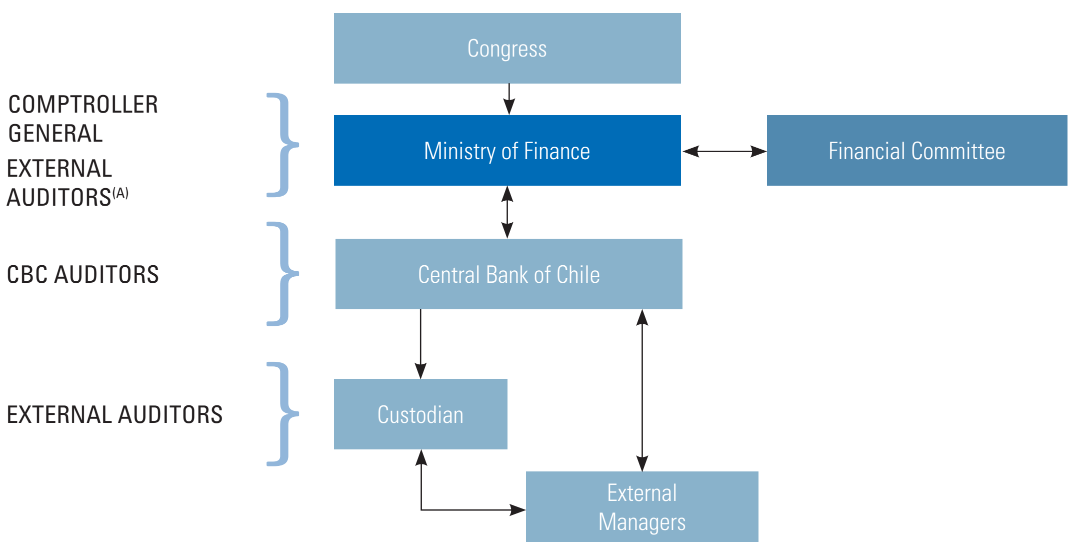
Institutional Framework

The institutional framework of the sovereign wealth funds is designed to facilitate decisionmaking, 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 institutional basis of the funds is established in the Fiscal Responsibility Law (see diagram 1). Article 12 of that law establishes the institutional framework for managing the investment of fiscal resources, authorizing the Finance Minister to define whether this is done directly through the General Treasury (the Treasury), through the Central Bank of Chile (CBC) or through contracted external managers. Decree Nº 1,383, issued by the Ministry of Finance in 2006, appoints the CBC to oversee the management of the resources in both funds and to act as fiscal agent, following approval by the CBC Board; and also establishes the general framework for managing the resources in question[5]. At the request of the CBC, Decree N° 1,618 of 2012 modified the general framework so that, as of 1 January 2014, the management of the corporate fixed-income and stock portfolios of the ESSF and PRF was separated from the bank. Before 2014, the CBC had delegated their management to external managers.

In addition, Decree Nº 621, issued by the Finance Ministry in 2007, created the Financial Committee, which advises the Finance Minister on the matters related to the investment of the ESSF and PRF resources, in compliance with Article 13 of the Fiscal Responsibility Law[6].

Diagram 1: Institutional framework of the sovereign wealth funds, 2007–2013[7]



External auditors are responsible for analyzing and verifying the accuracy and consistency of the financial statements prepared by the Treasury.

Source: Ministry of Finance

4.1 MINISTRY OF FINANCE AND DEPENDENT BODIES

The Fiscal Responsibility Law establishes that the funds are the property of the Fisco of Chile and that General Treasury 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 expressly grants the Minister the authority to decide whether the operational management of

5 Decree 1,383 of 2006 was published in the Official Gazette on 17 February 2007. Decreee N° 1,618 of 2012 was published on 18 April 2013.

6 Published in the Official Gazette on 11 August 2007.

7 This diagram is valid through 31 December 2013. As of 1 January 2014, the external managers report directly to the Ministry, with no interaction with the CBC.

the investment of the funds will be carried out directly through the Treasury or delegated to the CBC or other external managers. This law also expressly authorizes the Finance Minister to determine the investment policy of the resources in the two funds.

In March 2007, the Finance Minister appointed the CBC to oversee the tasks of managing the ESSF and the PRF, in the role of fiscal agent, based on its reputation and experience in handling international reserves. At the same time, the Minister issued guidelines governing the Bank's management of the investment of the funds.

The Ministry of Finance reports the state of the sovereign wealth funds to the National Congress and the general public through the publication of monthly, quarterly and annual reports.

The General Treasury is responsible for the fund accounting and for preparing the audited financial statements. The Budget Office is responsible for budgetary issues related to the funds.

As of 1 January 2014, the Ministry and the Treasury will be responsible for the contractual relationship with the external managers and for monitoring their performance, as well as other tasks associated with the external corporate fixed-income and stock portfolios (see chapter 5.2). These external managers were previously contracted by the CBC, which supervised their performance through year-end 2013.

4.2 CENTRAL BANK OF CHILE

The functions of the CBC in the management of the Chilean sovereign wealth funds were established by Decree Nº 1,383, issued by the Finance Ministry in 2006. As described above, Decree N° 1,618 of 2012 modified the general framework in order to transfer the management of the corporate fixed-income and stock portfolios, which were previously managed by the CBC, acting in representation of the Treasury, to external companies. In accordance with these decrees, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

1. To manage all or part of the fiscal resources in the name and on the account of the Fisco, either directly or though appointed external managers. As of 1 January 2014, the CBC can only manage portfolios that include instruments that are eligible for the international reserves or other fixed-income instruments acceptable for CBC investments[8].
2. To tender and delegate the management of all or part of the fiscal resources 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 (corporate bonds and stocks).
3. To open separate current accounts in the course of performing its role as fiscal agent.
4. 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 notional daily positions of the portfolios that are not under its management.
5. To contract the services of a custodian institution and to manage that contract.
6. To supervise and evaluate the performance of appointed external managers and custodian institutions[9]. As of 1 January 2014, to supervise the external managers, if any, of portfolios under the management of the CBC.
7. 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 institution(s).
8. To make payments as needed in the performance of its role as fiscal agent. As of 1 January 2014, the CBC will process the payments to external managers, with prior review and approval by the Treasury.

8 In accordance with this stipulation, as of 1 January 2014 the CBC will not manage corporate fixed-income and stock portfolios.

9 The CBC can contract external managers to manage part of its portfolio, in which case the CBC will be responsible for their supervision and monitoring.

In accordance with its authority, which allows it to delegate the management of portfolios of instruments that are not eligible for the investment of international reserves, and following a careful selection process, the CBC contracted BlackRock Institutional Trust Company N.A., Mellon Capital Management Corporation and Rogge Global Partners PLC to manage the investment of 35% of the PRF portfolio starting in January 2012. In 2013, the CBC contracted two of the same firms, BlackRock and Mellon, to manage the ESSF stock portfolio, following instructions from the Finance Ministry.

The CBC, as fiscal agent, and all contracted external portfolio managers 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 has contracted J.P. Morgan Chase Bank N.A. to serve as custodian of the sovereign wealth fund investments, as well as to perform some middle office functions that are complemented by Finance Ministry and Treasury personnel[10].

4.3 FINANCIAL COMMITTEE[11]

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.

In 2013, the Committee members were Klaus Schmidt-Hebbel Dunker (President), Cristián Eyzaguirre Johnston (Vice President), Arturo Cifuentes Ovalle, Martín Costabal Llona, Eric Parrado Herrera and Eduardo Walker Hitschfeld. In December 2013, Klaus Schmidt-Hebbel resigned from his position as president and member of the Financial Committee for personal reasons, effective 1 January 2014[12].

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 of 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 agencies entrusted with the management and custody of the funds and to express an opinion on the quality of management and compliance with established investment policies;
- To provide an assessment of the structure and content of the quarterly reports prepared by the Ministry of Finance; and
- To advise the Finance Minister, when requested, on all matters relating to the investment of the funds.

10 Other custodial functions include calculating fund returns and overseeing compliance with investment limits.

11 For more information on the activities of the Financial Committee in 2013, see its Annual Report (available online at www.hacienda.cl/english/sovereign-wealth-funds/financial-committee.html.

12 In February 2014, the Finance Ministry appointed Arturo Cifuentes as president of the Financial Committee and Rodrigo Valdés as new member.

CHAPTER 5

Main Activities in 2013

5.1 CHANGES TO THE INVESTMENT GUIDELINES FOR THE PENSION RESERVE FUND AND THE ECONOMIC AND SOCIAL STABILIZATION FUND

In 2013 a series of changes were made to the investment guidelines of both funds. In the case of the PRF, the changes aim to give the portfolio managers more flexibility to follow their benchmarks, minimize transaction costs or reduce operational complexity. In the case of the ESSF, a new investment policy was defined, and the changes to the investment guidelines outline the new investment parameters and limits.

5.1.1 PENSION RESERVE FUND

Stock portfolio

The main changes to the stock portfolio were associated with the CBC's suggestion to not invest in certain markets because some countries require specific processes for tax purposes and/or impose operating restrictions, such that investing in these countries adds a large administrative burden. From the Bank's perspective, the decision of whether to invest in these markets should also take into account their small shares in the benchmark (MSCI ACWI ex Chile). The Finance Ministry, in consultation with the Financial Committee, accepted the CBC's suggestion, but reduced the number of countries in which local investments are not allowed. However, on the advice of the Committee, the Ministry decided to provide more flexibility in the use of substitutes—namely, exchange-traded funds (ETFs), mutual funds, American Depositary Receipts (ADRs), Global Depositary Receipts (GDRs) and futures—in order to gain exposure to these countries. Since these substitutes do not perfectly follow the markets in question, it was necessary to increase the ex ante tracking error. In addition, some redundant restrictions were eliminated, as they are implicit in the allocated risk budget. Specifically, the most important changes to the PRF investment guidelines are as follows:

i. Investment was prohibited in the local markets of China, Egypt, India, Peru, the Philippines, Poland, Russia, Taiwan, Thailand and Turkey.
ii. The limit on investing in ETFs and mutual funds was increased.
iii. Investing through Hong Kong was allowed to gain exposure to Chinese firms.
iv. The use of derivatives (futures, forwards and swaps) was authorized up to 10% of the portfolio of each manager.
v. The ex ante tracking error (the risk budget) was increased from 30 basis points to 60 basis points.
vi. The following limits were eliminated because they are redundant in the context of the passive management defined for the fund:
    - Investment in the shares of a given firm shall not exceed 5% of the stock portfolio.
    - Investment in a given firm shall not exceed 5% of the total shares of that firm.
    - Certain investment limits by country.

Fixed-income portfolio

Based on experience in 2012, and taking into account suggestions by the portfolio managers, several changes were introduced to the investment guidelines for the PRF fixed-income portfolio. The main changes introduced by the Ministry, following recommendations from the Financial Committee, include the following:

i. Investment was allowed in instruments that are not yet included in the benchmark but that will be incorporated at the close of the month.[13]
ii. Instruments can be held after they have been removed from the benchmark because their residual maturity or size is below the required minimum, provided that the issuer is still in the benchmark.[14]
iii. The period for selling off corporate bonds that have become ineligible was extended to one month.
iv. The limit on corporate bonds with a rating between BBB+ and BBB– was raised to 45%.
v. An allowance was made for corporate bond portfolio managers to use derivatives (futures, forwards and swaps) up to 10% of their portfolios.

Fixed-income and stock portfolios

Some of the changes to the investment guidelines are applicable to both the fixed-income and stock portfolios. The main changes are as follows:

i. The limit on the amount that can be held in overnight bank deposits was raised from US$10 million to US$20 million. Additionally, the minimum rating of banks that receive these deposits was lowered from AA– a A–.
ii. External portfolio managers cannot invest in their own companies, even if they are included in the benchmark.
iii. Portfolio managers must notify the Ministry as soon as possible when they receive ineligible instruments due to corporate events. The Ministry must then define the steps to take—in consultation with the Financial Committee, via email, if deemed necessary.

5.1.2 ECONOMIC AND SOCIAL STABILIZATION FUND

In 2013 the Financial Committee revised the ESSF investment guidelines to be consistent with the new investment policy defined for this fund, which began to be implemented in August 2013.

Fixed-income portfolios

The new policy adjusted the currency allocation of the fixed-income portfolio and the benchmarks to make them consistent with the indexes used in the study that served as the basis for the definition of the policy, and incorporated an ex ante tracking error for the portfolio. The main changes were the following:

i. A new strategic asset and currency allocation was specified (see table 1).
ii. The benchmarks were changed (see table 2).
iii. A risk budget of 50 basis points was established for the fixed-income portfolio.
iv. Authorization was given for investing in instruments that are not yet part of the benchmark but that will be incorporated at the close of the month.
v. Authorization was given for holding instruments that have been removed from the benchmark because their residual maturity or size is below the required minimum, provided that the issuer is still in the benchmark.
vi. Some limits were eliminated because they are redundant in the context of the passive management defined for the fund and they are implicit in the ex ante tracking error.[15]

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13 This change is justified because a new bond issued by a corporation, which meets the eligibility criteria for being included in the benchmark, will only be incorporated into the benchmark at the end of the month, when the benchmark is updated.

14 The PRF fixed-income indexes require that bonds have a maturity of over one year and a specified minimum size (for example, US$ 300 million for bonds issued in the United States). With the passage of time, however, a bond naturally reaches a point when its residual maturity is less than one year, which triggers its removal from the benchmark. The same can happen when an issuer repurchases a bond, thereby reducing the quanitty in circulation.

15 For example, the permissible ranges of deviation on duration, currency, and so forth were eliminated.

vii. A portfolio rebalancing policy was defined, which consists in returning to the strategic allocation once a year and whenever the percentage of stocks exceeds the range of 5.5%–9.5% of the total portfolio. The annual rebalancing will be coordinated with fund contributions, to the extent possible.

Table 1: Strategic asset allocation
(percent)

Benchmark	USD	EUR	JPY	CHF	Stocks	Total
1. Time deposits	5.0	6.0	4.0	0.0	0.0	15.0
2. Treasury bills and sovereign bonds	32.5	18.0	16.0	7.5	0.0	74.0
3. Inflation-indexed sovereign bonds	2.5	1.0	0.0	0.0	0.0	3.5
4. Stocks	—	—	—	—	7.5	7.5
5. Total	**40.0**	**25.0**	**20.0**	**7.5**	**7.5**	**100.0**

Source: Ministry of Finance.

Stock portfolio

The ESSF stock portfolio investment guidelines were designed to be identical with those of the PRF, in order to maintain consistency between similar investment mandates.

5.2 TRANSFER OF ACTIVITIES FROM THE CENTRAL BANK OF CHILE

In 2012, the CBC informed the Ministry of its desire to reduce its functions with respect to the external managers of the corporate bond and stock portfolios of the sovereign wealth funds. The objective, in the long run, was that the Bank would operate solely as a portfolio manager of funds in which it already invests, such as fixed-income sovereign bonds and government-related bonds (semi-sovereigns). The CBC therefore asked the Ministry to issue a new decree that would reduce the Bank's responsibility with regard to the external mandates. Under the new decree, published in April 2013, the CBC will no longer perform much of the oversight and monitoring of the externally managed portfolios, effective 1 January 2014.

To ensure that the activities currently performed by the CBC would continue to be carried out in the future, the CBC organized a formal training program for the Treasury and the Ministry in 2013 so that they would be able to perform the related tasks satisfactorily starting in 2014.

The main activities to be transferred to the Treasury and the Finance Ministry as of 1 January 2014 are the following:

i. Daily reconciliation: Carry out the daily reconciliation of priced positions held by the external portfolio managers and the custodian bank.
ii. Invoice verification: Verify that the amount invoiced by the external portfolio managers is correct, in order to authorize the corresponding payment.
iii. Accounting: Prepare the audited financial statements for the portfolios managed by external managers[16].
iv. Monitoring compliance with investment limits: Monitor the external managers for compliance with the specified investment limits, based on information reported by the custodian bank.

16 The Treasury has performed the accounting of the sovereign wealth funds since 2011.

v. Monitoring and supervision of the external portfolio managers: Analyze the results, portfolios and investment strategies of the external managers.
vi. Rebalancing: Monitor the deviation limits and give instructions on the amounts to rebalance, if necessary.
vii. Instructions and contracts: Channel all instructions, notifications and approvals, as well as any contractual changes, to the external portfolio managers.
viii. Tax consultant: Direct any queries to the tax consultant contracted by the CBC, in the event of any tax-related questions regarding the investment of the funds associated with the externally managed portfolios.
ix. Proxy voting: Instruct the external managers on the exercise of voting rights and other economic or political rights deriving from the portfolio investments.
x. Negotiation of deliverables with the custodian bank for middle office and compliance: Request additional reports from the custodian bank as needed with regard to the external portfolio managers.

5.3 EVALUATION OF THE SOVEREIGN WEALTH FUND MANAGERS

In 2013 the PRF managers underwent a detailed performance analysis, in line with best practices and in preparation for the new functions to be taken over by the Ministry as of 1 January 2014, following the transfer of activities associated with overseeing the external portfolio managers. The analysis covered both quantitative and qualitative aspects. The quantitative aspects included the statistical analysis of whether the returns earned by the external portfolios differed from the respective benchmarks, the quantification of how much of the differential was due to factors such as transaction costs and taxes, and a review of the managers' investment strategies, especially their positions relative to their benchmarks. The qualitative aspects included an examination of whether there have been any changes in the company's organization, ownership, portfolio evolution, clients, investment teams, investment processes and so on. The assessment process highlighted the importance of developing an internal policy, with guidance from the Financial Committee, to establish the systematic evaluation of these portfolio managers.

5.4 SUSTAINABILITY STUDY FOR THE PENSION RESERVE FUND

The second PRF sustainability study was carried out in the second half of 2013. The study must be implemented every three years in accordance with the Fiscal Responsibility Law. The objective was to evaluate the fund's capacity to effectively complement the financing needs related to the government's pension expense. The Budget Office is responsible for implementing the study. Following a tender process, the study was commissioned to a team of consultants including Eduardo Fajnzylber (lead consultant), Pablo Castañeda, Rubén Castro, Luis Felipe Céspedes, Félix Villatoro and Michael Sherris.

During this period, three drafts of the report were submitted, and the consultant team made a number of presentations to the Financial Committee, the Ministry and the Budget Office. At the meetings, the consultants described their progress and general approach and were given recommendations for proceeding. The final report was submitted in early 2014.

The main conclusions of the study are as follows:

i. In all three deterministic scenarios considered in the study, the fund appears to be on a growth trend, even under the assumption of maximum annual withdrawals.
ii. The main explanation behind the finding of the general sustainability of the fund is that the minimum contributions defined by law (0.2% of GDP) are greater than the maximum withdrawals considered for the PRF (equivalent to a third of the difference between the total expense of the Solidarity Pension System in a given year and the expense in 2008).
iii. The main variables affecting contributions have to do with revenues, in particular income from copper, although its relative importance falls in the period.
iv. The main source of volatility in the PRF stems from variations in fund contributions, followed by the volatility of financial returns.
v. The deterministic analysis suggests that if instead of a rule setting the minimum contribution at 0.2% of GDP, the floor for contributions was lowered to 0.068% of output, the PRF would reach zero toward the end of the 20-year horizon (under the central scenario). In contrast, if the rule was adjusted to the structural balance target (assumed equal to 0 in the medium term), the PRF could not withstand the maximum withdrawals during the forecast horizon.
vi. If larger fund withdrawals are allowed, the PRF would be at the limit of sustainability if instead of a third of the difference in the expense in a given year and 2008, a factor of 0.64 of the difference was applied.
vii. On assessing the impact of allowing the solidarity system benefits to be adjusted in real terms (the law currently specifies only inflation adjustments), the study finds that, due to the accumulation of assets in the early years, the PRF would continue to be sustainable through the end of the period, although it would follow a decreasing trend in later years, particularly under the moderate scenario.
viii. The limit of UF 900 million would seem to be excessive: under the stress scenario (including the assumption that no more contributions are made to the fund), the fund would still have a positive balance at the end of 20 years.

CHAPTER 6

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 fund 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, the reports are published in Spanish and English and are available on the sovereign wealth funds' website[17].

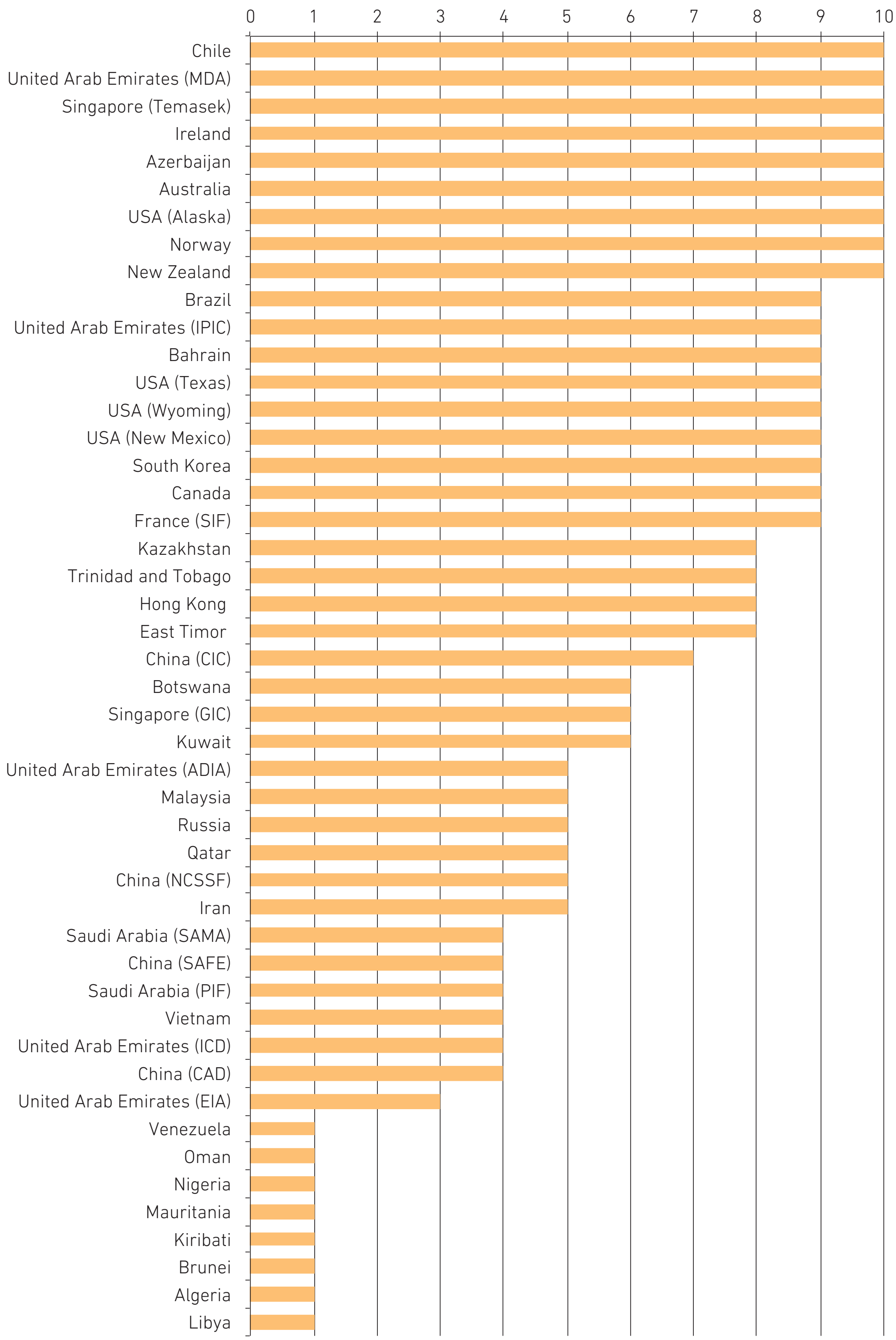
Chile also remains committed to international initiatives aimed at establishing a framework of generally accepted principles and practices for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance is an active participant in the International Forum of Sovereign 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.[18]

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 were recently ranked among the most transparent funds in the world by the Peterson Institute for International Economics. The institute's report entitled "Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard," published in September 2013, included a new version of the SWF Scoreboard, which measures the transparency and accountability of the sovereign wealth funds analyzed. The report ranked the ESSF in third place, with 91 points, after the funds of Norway, with 98 points, and New Zealand, with 94 points. The PRF was ranked tenth, with 85 points. Both of the Chilean sovereign wealth funds moved up considerably since the last Scoreboard, published 2011, in which the ESSF was ranked thirteenth, with 71 points, and the PRF fifteenth, with 68 points. This progress reflects our Government's commitment to managing the Chilean sovereign wealth funds in accordance with international best practices on transparency and thus to deliver adequate, timely information to the Chilean and international public.

17 www.hacienda.cl/english/sovereign-wealth-funds.html.

18 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: http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf).

Figure 6: Linaburg-Maduell transparency index, third quarter of 2013



Source: Sovereign Wealth Fund Institute.

CHAPTER 7

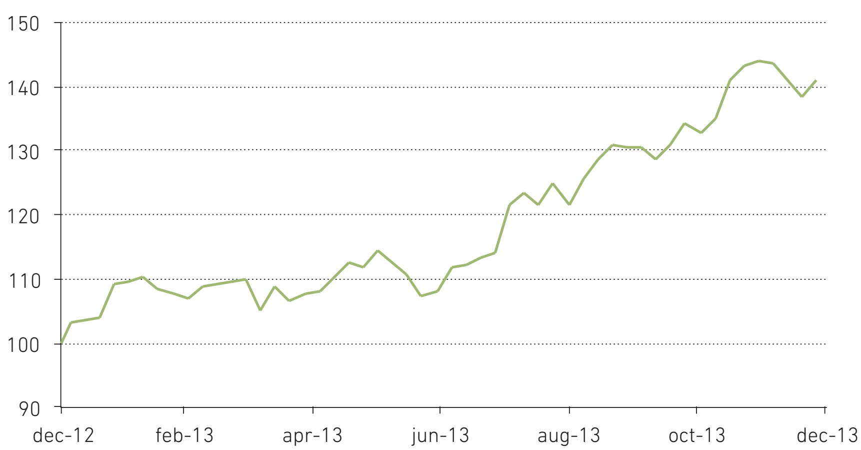
Analysis of the International Economy

In 2013, the international scenario was characterized by the recovery of the macroeconomic situation in the United States; greater tranquility in the European markets, despite the difficulties being faced in countries like Spain, Italy and Greece; an increased use of stimulus measures in Japan as a tool for escaping the long period of stagnation; and a reduction in the emerging economies' contribution to world growth.

The U.S. economy continued to expand in 2013, with annual growth of 1.9%. While the economy has yet to achieve a more dynamic growth rate, some indicators point to a better macroeconomic situation than in previous years. For example, unemployment fell to 7.4% in 2013, down from 8.1% in 2012 and far below the peak of around 10% during the crisis. The improved economic situation is reflected in the rise of the stock market in 2013 (see figure 7). Moreover, market volatility did not increase substantially, despite some domestic problems surrounding the approval of the U.S. budget and the raising of the debt limit (see figure 8). The evidence of a better situation in the country allowed the U.S. Federal Reserve System (the FED) to start scaling back its bond purchase program in December, for the first time since the crisis.[19] The sovereign yield curve recorded increases all along the curve, but with a lot of volatility in the face of uncertainty about the timing of the FED's announcement of the purchase program reduction. This had a negative impact on sovereign bond yields in 2013 (see figure 9).

Figure 7: The MSCI U.S. index in 2013

(31 December 2012 = 100)



Source: Bloomberg.

19 The FED reduced its bond purchase program from US$ 95 billion a month to US$ 85 billion.

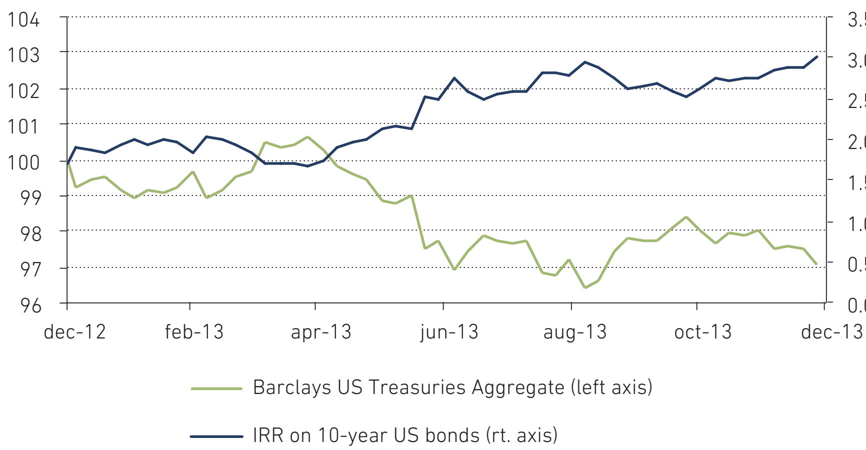
Figure 8: Volatility (VIX) in the stock market (S&P 500), 2011–2013

(percent)

Source: Bloomberg.

Figure 9: : Barclays US Treasuries Aggregate index and the internal rate of return (IRR) on 10-year U.S. bonds in 2013

(left: 31 December 2012 = 100), (rt: percent)

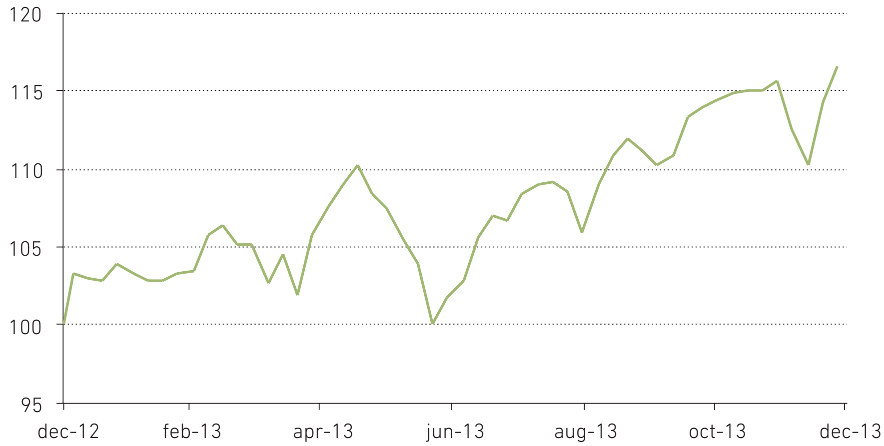


Source: Bloomberg.

In Europe, Germany remained on a growth path, with a modest growth rate of 0.4% in 2013, while the unemployment rate stayed just above 5%. In contrast, the countries that were more strongly affected by the European crisis recorded negative growth rates, with –1.2% in Spain and –1.8% in Italy, while their unemployment hit historical highs of around 26% and 13%, respectively. Nevertheless, manufacturing production grew in these countries in the second half of 2013. The European Central Bank (ECB) continued applying a stimulus to the region's economy, reducing its monetary policy rate from 0.75% to 0.50% in May and then to 0.25% in November. In this context, the stock market performed well in the region over the course of the year (see figure 10); the fears of a possible default in those countries eased (see figure 11); and the European money markets showed no signs of liquidity problems (see figure 12). With regard to interest rates, the German sovereign yield curve has stayed at historically low levels (see figure 13). In contrast to the United States, the index of the aggregate return of all sovereign instruments in Europe was positive, at 17%.

Figure 10: Índice MSCI Europa en 2013

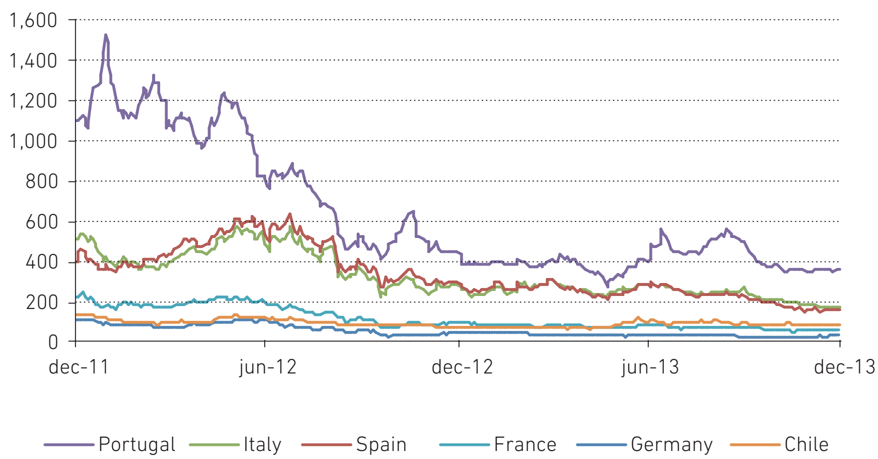
(31 December 2012 = 100)



Source: Bloomberg.

Figure 11: Five-year credit default swaps (CDS): Selected European countries and Chile, 2011–2013

(basis points)



Source: Bloomberg.

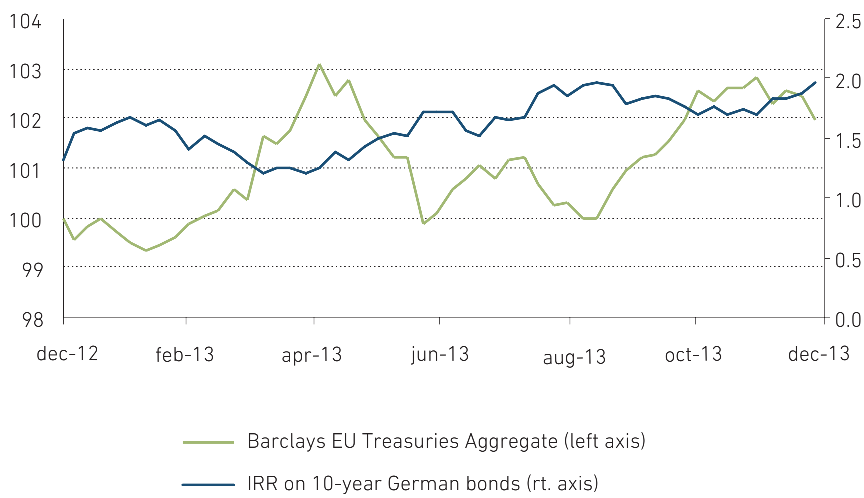
Figure 12: TED Spread,[20] 2007-2013

(basis points)

Source: Bloomberg.

Figure 13: Barclays EU Treasuries Aggregate and the internal rate of return (IRR) on 10–year German bonds in 2013

(left: 31 December 2012 = 100), (rt: percent).



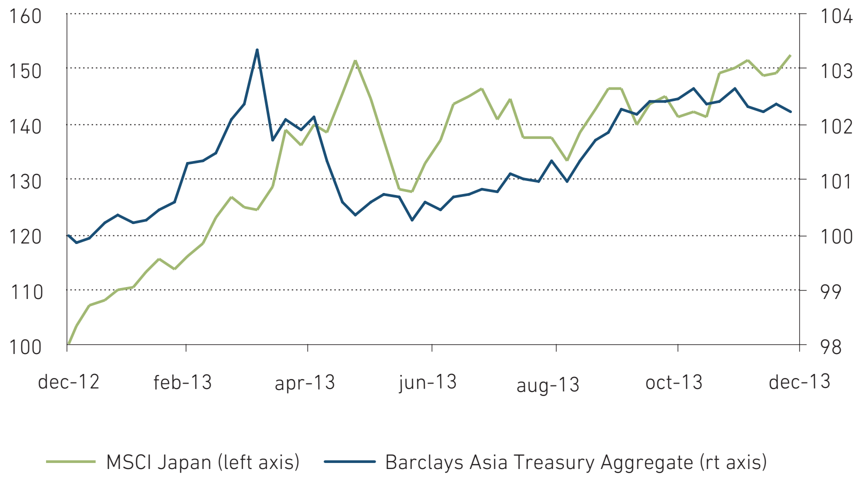
Source: Bloomberg.

In Japan, 2013 was marked by the implementation of a reactivation program aimed at overcoming the poor performance of the economy over the last two decades. The program consists in significant monetary stimulus measures, accompanied by an increase in government investment in infrastructure and the introduction of structural reforms to improve the economy's productivity. With these measures, the government hopes to achieve a GDP growth rate of 3% in nominal terms and 2% in real terms. In this scenario, the Japanese stock market recorded a sharp increase over the course of the year, while the sovereign yield curve declined, which favored the return on the sovereign portfolio (see figure 14).

20 The TED spread is the difference between the interbank borrowing rate (LIBOR) and the risk-free rate (U.S. Treasury bills). A higher TED spread typically indicates a lower level of market liquidity.

Figure 14: MSCI Japan index and Barclays Asia Treasuries Aggregate in 2013

(31 December 2012 = 100)

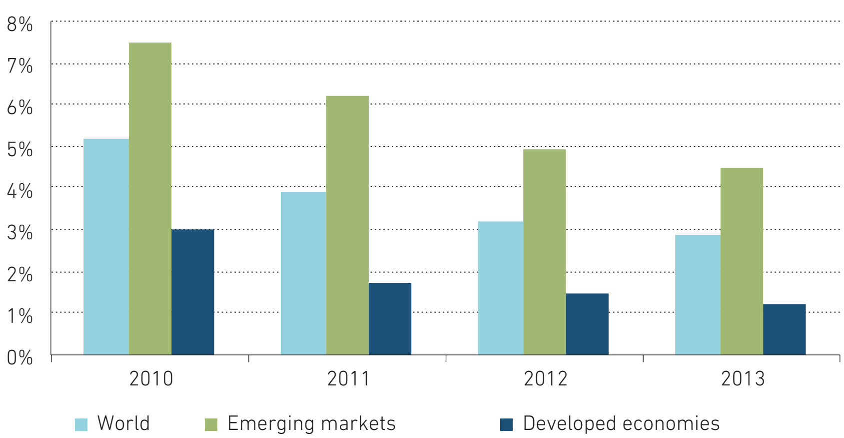


Source: Bloomberg.

The emerging economies saw an outflow of capital in 2013, as it shifted toward more developed markets. This occurred in context of lower growth relative to previous years (see figure 15) coupled with a strengthening of the developed markets. In the case of China, the growth rate declined to 7.7%, down from over 9% in 2011. This situation was mirrored in other large emerging economies, such as Brazil, Indonesia, Turkey and India. To counteract the capital outflows, central banks have raised interest rates to protect their currencies. This scenario had a negative effect on the emerging stock markets in the year (see figure 16).

Figure 15: World GDP growth, 2010-2013

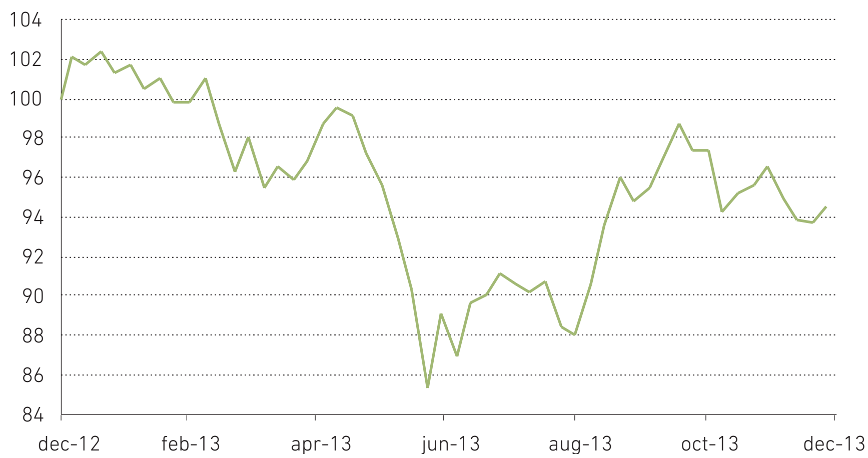
(percent)



Source: International Monetary Fund

Figure 16: MSCI Emerging Markets index 2013

(31 December 2012 = 100)

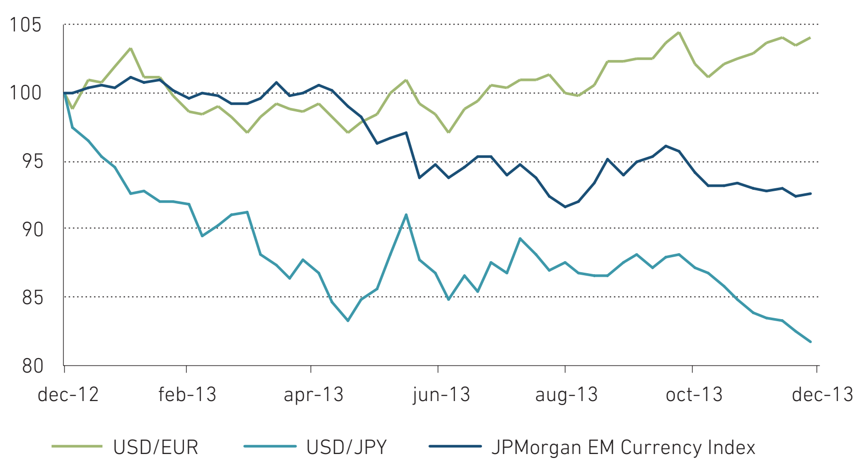


Source: Bloomberg.

With regard to exchange rates, the Japanese yen depreciated 19% in 2013. The emerging currencies also depreciated, as evidenced in the JP Morgan EM Currency index, which captures the exchange rate fluctuations of the main emerging economies. The euro appreciated 4% in the year, closing at 1.38 USD/EUR (see figure 17).

Figure 17: Exchange rates in 2013

(31 December 2012 = 100)



Source: Bloomberg.

CHAPTER 8

Economic and Social Stabilization 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 implementation of the new ESSF investment policy started in August 2013 and was completed in October of the same year (see box 2). The policy considers a strategic asset allocation of 55% in sovereign bonds, 34% in money market instruments (15% in time deposits and 19% in sovereign securities), 7.5% in stocks and 3.5% in inflation-indexed sovereign bonds. The currency composition is specified as 40% in dollars, 25% in euros, 20% in yen and 7.5% in Swiss francs for the fixed-income portfolio, expressed as a percentage of the total portfolio.

The asset classes defined for this policy are invested according to highly diversified benchmarks (table 2) and a passive investment strategy. The aggregate fixed-income portfolio has an ex ante tracking error of 50 basis points; the stock portfolio, 60 basis points.

Table 2: Strategic asset allocation and benchmarks
(percent)

Benchmark	USD	EUR	JPY	CHF	Stocks	Total
1. Time 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. Stocks	**—**	**—**	**—**	**—**	**7.5**	**7.5**
MSCI All Country World Index (unhedged with reinvesteed 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

Box 2: The ESSF investment policy from March 2007 to July 2013

Through July 2013, the strategic asset allocation of the ESSF was 30% in money market instruments, 66.5% in sovereign bonds and 3.5% U.S. inflation-indexed sovereign bonds, with an approximate duration of 2.5 years and a currency allocation of 50% in dollars, 40% in euros and 10% in yen. Half the money market portfolio was in time deposits in financial institutions with a rating of A– or higher, and the rest was in Treasury bills. The only sovereign exposure allowed was to the United States, Germany and Japan.

This policy was consistent with the objective of maximizing the fund's accumulated value in order to partially cover cyclical drops in fiscal revenue, while maintaining a low level of risk. This was clear during the 2008 crisis, when the investment policy led to an increase in the fund's resources when expressed in foreign currency and pesos (the currency in which most of the fiscal expense is incurred). Thus, the Government was able to withdraw approximately US$ 9 billion from the fund in 2009 to finance the fiscal deficit and a stimulus plan, in order to support the Chilean economy, which was being negatively affected by the international situation.

However, the Finance Minister decided to revise the ESSF investment policy in late 2010 to achieve a better alignment with the fund's objectives. The new policy, which was implemented in mid-2013, introduced changes oriented toward raising the fund's capacity to cover cyclical drops in fiscal revenues and increasing returns slightly.

The fixed-income portfolio (92.5% of total assets) is managed by the CBC, acting as fiscal agent, while the stock portfolio is handled by external portfolio managers, contracted by the CBC and previously selected for the PRF through a tender process.

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 equity benchmark. Leveraging is not allowed, and forwards or swaps can only be used, to a limited extent, for currency hedging.

The new investment policy is consistent with the objectives of the ESSF. It mainly considers investment in fixed-income instruments in reserve currencies, which typically perform well during times of crisis. This maximizes not only the accumulated value measured in foreign currency, but also the conversion to pesos (the currency of most fiscal spending) when it is most necessary to use the resources. In addition, with the incorporation of equity shares, returns are expected to improve in the long term.

8.2 MARKET VALUE

At the close of 2013, the market value of the ESSF was US$ 15,419 million, versus US$ 14,998 million at the close of 2012. The increase in the fund's value was due to a contribution of US$ 603 million, which was partially offset by a net loss from investments of US$ 182 million. Since its inception on 6 March 2007, the ESSF has received capital contributions of US$ 21,766 million, has recorded withdrawals of US$ 9,428 million and has generated net financial earnings of US$ 3,081 million (see tables 3 and 4).

Table 3: Contributions and withdrawals ESSF

(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	—
Total	**21,766**	**9,428**

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

Source: Ministry of Finance

Table 4: Evolution and decomposition of market value

(millions of dollars)

Decomposition	2007	2008	2009	2010	2011	2012	2013	Since Inception[(a)]
Starting market value	0	14,033	20,211	11,285	12,720	13,157	14,998	0
Contributions	13,100	5,000	0	1,362	0	1,700	603	21,766
Withdrawals	0	0	-9,278	-150	0	0	0	-9,428
Accrued interest	326	624	404	228	237	202	184	2,205
Capital gains (losses)	607	556	-51	-4	201	-60	-364	886
Mgmt, custody and other costs	-0.3	-2.0	-1.6	-1.1	-1.2	-1.3	-2.2	-9.7
Net financial gains	933	1,178	352	223	437	141	-182	3,081
Ending market value	14,033	20,211	11,285	12,720	13,157	14,998	15,419	15,419

(a) The ESSF was created by combining into a single fund the additional fiscal income stabilization resources, as specified in Executive Decree N° 3,653 of 1981, and the Copper Revenue Compensation Fund. The ESSF received its first contribution on 6 March 2007.

Source: Ministry of Finance

8.3 PERFORMANCE

In 2013, the fund's return in dollars, net of management costs, was –1.25%. This primarily reflects the negative return of the fixed-income portfolio, –2.02%, which was partially offset by the return on the equity portfolio, 12.06% since August, when the ESSF investment policy was changed. The fixed-income return breaks down into –1.08% in local currency and –0.94% from exchange rate effects.[21] The equivalent net return in pesos in the year was 8.19%, which is mainly explained by the appreciation of the dollar against the peso during the period. Since 31 March 2007, the annualized net return in dollars was 3.50%, mainly due to the effect of earnings in local currency (2.94%) of the fixed-income portfolio (see table 5 and figure 18). In the same period, the equivalent net return in pesos was 3.07%. The IRR in dollars was –1.18% in 2013 and 3.43% since the fund's inception.

21 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, since the portfolio performance is measured in dollars, the exchange rate of the dollar against these currencies also affects the fund's return.

Table 5: Net returns

(percent)

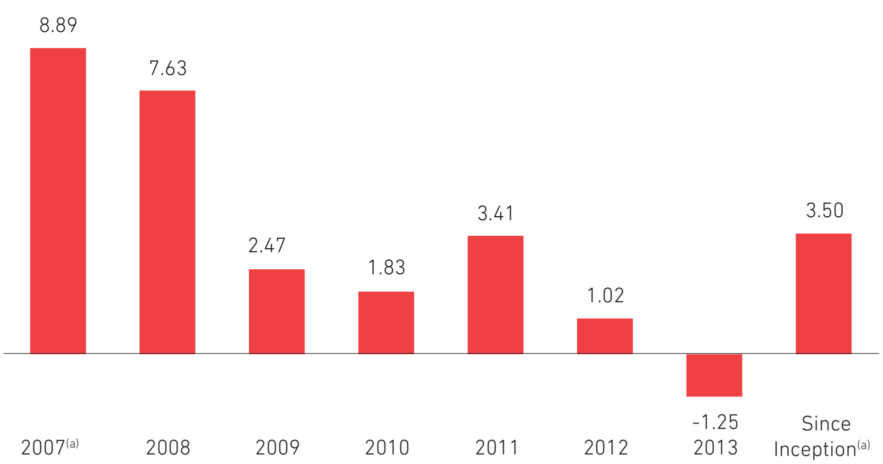
Returns [a]	2013	Last 3 years	Since Inception [b]
Local currency	-1.08	1.43	2.94
Exchange rate return	-0.94	-0.65	0.44
Fixed-income	-2.02	0.78	3.38
Stocks [c]	12.06	-	-
Return in USD	**-1.25**	**1.04**	**3.50**
Exchange rate return, CLP	9.44	3.79	-0.43
Return in CLP [d]	**8.19**	**4.83**	**3.07**

(a) Time Weighted Return (return calculated as the growth rate of the funds that were invested throughout the period).
(b) Calculated from 31 March 2007, when the Central Bank's performance began to be measured.
(c) The return on the stock portfolio for the third quarter and for 2013 were calculated starting in August, the month in which the new fund investment policy was implemented.
(d) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate.

Source: Ministry of Finance

Figure 18: Annual TWR

(percent)



(a) Calculated from 31 March 2007.

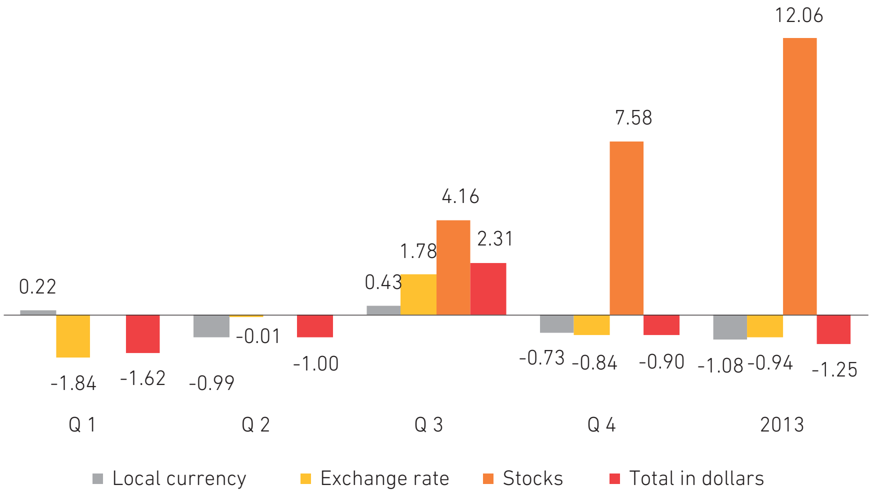
Source: Ministry of Finance

Figure 19 shows the quarterly breakdown of net returns in dollars in 2013, decomposed into the return in local currency and the exchange rate effect for the fixed-income and stock portfolios. The lowest quarterly return was recorded in the first quarter, at –1.62%, which was mainly due to the negative effect of the currency fluctuations against the dollar. Specifically, in this period, the exchange rate effect on returns was –1.84% due to the depreciation of the euro and the yen by 2.6% and 8.0%, respectively. In the second quarter, the interest rate hike, as reflected in the local currency return of –0.99%, was the main cause of the negative ESSF return of –1.00%. The third quarter recorded the highest return of the year, at 2.31%, which was mainly due to a positive exchange rate effect of 1.78%, caused by the appreciation of the euro, yen and Swiss franc by 4.1%, 1.2% and 2.8%, respectively, and to a lesser extent by a positive effect in local currency, 0.43%, and stocks, 4.16%, which were incorporated into the portfolio for the first time in August. Finally, a negative return was recorded in the fourth quarter,

–0.90%. This reflects losses associated with the interest rate increases, which caused a return in local currency of –0.73%, and the negative exchange rate effect of –0.84%, which mainly stemmed from the yen depreciation of 6.6%, which were partially offset by the positive stock returns of 7.58%. It is important to highlight the positive impact of the incorporation of stocks into the ESSF portfolio in the second half of the year.

Figure 19: Net quarterly returns, by local currency and exchange rate

(percent)

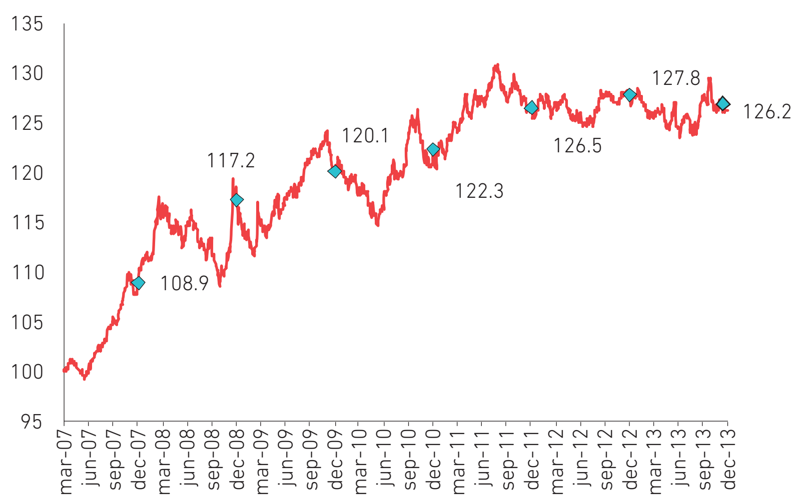


Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the daily returns of the portfolio. Taking a starting value of 100 on 31 March 2007, the index reached 126.2 at year-end 2013 (see figure 20).

Figure 20: Return index

(31 March 2007 = 100)

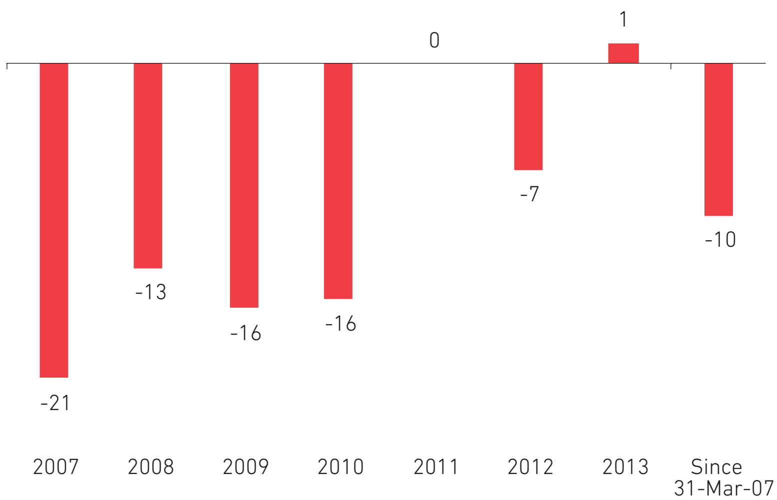


Source: Ministry of Finance.

In 2013, the performance of the ESSF, measured as the difference between the portfolio return and the benchmark return, was 1 basis point, which is consistent with the greater emphasis on a passive investment strategy as of 1 May 2011. Since 31 March 2007, the CBC's annualized return was 10 basis points below the benchmark (see figure 21).

Figure 21: Net returns against the benchmark

(basis points)



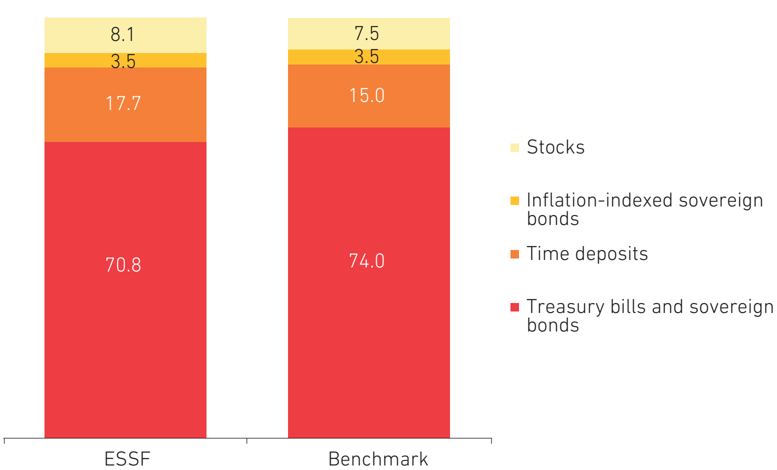
Source: Ministry of Finance.

8.4 PORTFOLIO ALLOCATION

As of December 2013, the allocation of the ESSF by asset class comprised US$ 10,909 million in Treasury bills and sovereign bonds, US$ 2,723 million in time deposits, US$ 1,246 million in stocks and US$ 542 million in inflation-indexed sovereign bonds (see table 6). At the close of the year, the percent allocation by asset class and by currency was almost identical to the benchmark (see figures 22 and 23).

Figure 22: Asset class allocation, 31 December 2013

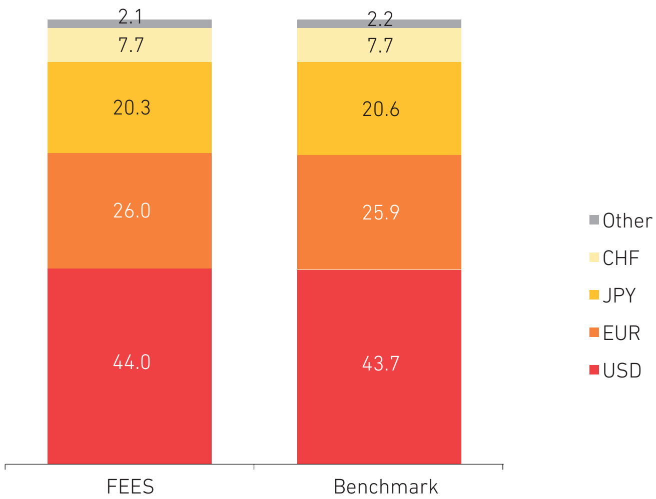
(percent of portfolio)



Source: Ministry of Finance.

Figure 23: Currency allocation, 31 December 2013

(percent of portfolio)

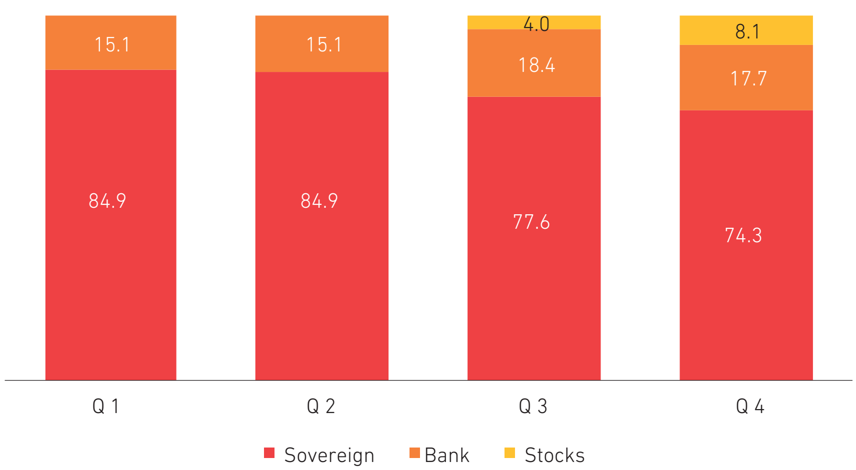


Source: Ministry of Finance.

Exposure by type of risk shifted in 2013, due to the change in the investment policy (see figure 24). Bank exposure was stable in the first two quarters, but then increased in the second half of the year, together with stock exposure, while sovereign risk exposure fell. The sovereign portfolio is invested in the United States, Germany and Japan, with the incorporation of Switzerland in the third quarter (see table 6). Time deposits, as of year-end, are invested in banks from a number of countries, with exposures of over US$ 200 million in Germany, Japan, France and Austria. These bank investments are mainly time deposits in eligible banks, in accordance with the investment guidelines. Table 7 presents the breakdown of time deposits at the close of 2013. The stock portfolio at year-end was concentrated in the United States (around 50%) and, to a lesser extent, the United Kingdom and Japan, as well as 40 countries with investments of less than US$ 50 million each. The stock distribution by country tracks the country allocation in the benchmark.

Figure 24: Allocation of credit risk, 2013

(percent of portfolio)



Source: Ministry of Finance.

Table 6: Decomposition of credit risk, 31 December 2013

(millions of dollars; percent of portfolio)

Exposure	Country	US$ MM	% of Total
Sovereign	USA	4,772	31.0
	Germany	2,707	17.6
	Japan	2,287	14.8
	Switzerland	1,143	7.4
	Total	**10,909**	**70.8**
Inflation-indexed sovereign	USA	384	2.5
	Germany	157	1.0
	Other [(1)]	0	0.0
	Total	**542**	**3.5**
Time deposits	Germany	774	5.0
	Japan	467	3.0
	France	379	2.5
	Austria	237	1.5
	Denmark	194	1.3
	United Kingdom	189	1.2
	Netherlands	150	1.0
	Sweden	113	0.7
	Hong Kong (China)	79	0.5
	Belgium	64	0.4
	Australia	61	0.4
	Israel	15	0.1
	Other [(1)]	1	0.0
	Total	**2,723**	**17.7**
Stocks	USA	639	4.1
	United Kingdom	103	0.7
	Japan	96	0.6
	Germany	47	0.3
	Canada	46	0.3
	France	44	0.3
	Switzerland	41	0.3
	Hong Kong (China)	40	0.3
	Australia	34	0.2
	South Korea	21	0.1
	Spain	15	0.1
	Sweden	15	0.1
	Brazil	14	0.1
	Netherlands	14	0.1
	Italy	11	0.1
	Other [(1)]	64	0.4
	Total	**1,246**	**8.1**
Total		**15,419**	**100.0**

(a) includes cash and cash equivalents.

Source: Ministry of Finance

Table 7: Banks with deposits, 31 December 2013

Bank	Country
Australia and New Zealand Banking Group Limited	Australia
Bank Hapoalim	Israel
Bank of China (Hong Kong) Ltd	China
BNP Paribas SA	France
Commerzbank AG	Germany
Danske Bank Aktieselskab	Denmark
Dekabank Deutsche Girozentrale	Germany
Deutsche Bank AG	Germany
Erste Group Bank AG	Austria
ING Bank NV	Netherlands
KBC Bank NV	Belgium
Landesbank Hessen-Thüringen Girozentrale	Germany
Lloyds TSB Bank PLC	United Kingdom
Mizuho Bank Ltd	Japan
Natixis	France
Norddeutsche Landesbank Girozentrale	Germany
Rabobank Nederland	Netherlands
Raiffeisen Bank International AG	Austria
Société Générale	France
Standard Chartered Bank	United Kingdom
Svenska Handelsbanken AB	Sweden
The Bank of Tokyo-Mitsubishi UFJ	Japan
The Norinchukin Bank	Japan
Unicredit Bank AG	Germany

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 risk 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).

Table 8: Credit risk exposure, 31 December 2013
(percent of fixed-income portfolio)

Issuer	Rating							
	AAA	AA+	AA	AA-	A+	A	A-	Total
Sovereign	64.7	0.0	0.0	16.1	0.0	0.0	0.0	80.8
Bank	0.0	0.0	2.3	0.4	5.5	9.8	1.1	19.2

Source: Ministry of Finance.

8.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the ESSF in 2013 included US$ 1,379,420 for custody services and US$ 789,277 to the CBC for management services, or 1.42 basis points of the portfolio. Income from the securities lending program exceeded total management costs, at US$ 2,654,248 (see table 9). The increase in custodial costs in 2013 relative to previous years is due, in part, to a lag in payments, which were carried over from 2012 to 2013.

Table 9: Management and custody costs and income from the securities lending program
(U.S. dollars)

Stocks	2009	2010	2011	2012	2013
Custody (J.P. Morgan)	816,668	622,071	544,634	530,901	1,379,420
Management (CBC)	804,600	506,400	613,758	768,014	789,277
Total costs	**1,621,268**	**1,128,471**	**1,158,392**	**1,298,915**	**2,168,697**
Securities lending program	**924,766**	**1,290,288**	**2,868,799**	**2,914,649**	**2,654,248**

Source: Ministry of Finance.

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 class and currency allocations and the chosen 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 monitoring 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 stock values.

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

In the case of the ESSF, the interest rate risk that is tolerated in the benchmark is defined based on the duration of the individual indexes that make up the benchmark. The benchmark duration at year-end 2013 was 4.70 while the actual duration of the ESSF was 4.74 years.

Foreign exchange risk

Because the fund's performance is measured in dollars, the value of investments in other currencies is affected by movements in the exchange rates. Most of the portfolio's fixed-income investments are denominated in dollars, euros, yen and Swiss francs, while the stock portfolio includes a small exposure to an additional 28 currencies. At the close of 2013, the foreign currency exposure, measured in dollars, was 56%, deriving from investments in euros (26%), yen (20%), Swiss francs (7.7%), pounds sterling (0.6%) and other currencies with a minor share (1.7%)

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 only sovereign issues from the United States, Germany, Japan and Switzerland, among which the lowest rating is AA–.

Stock risk

The ESSF is exposed to the risk of losses from a decrease in the price of the stocks 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 stock index used as the benchmark (the MSCI ACWI excluding Chile). Under the strategic asset allocation, only 7.5% of the total portfolio is invested in stocks.

Volatility, VaR and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility,[22] the minimum and maximum returns and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 3.8% in 2013, versus 5.5% for the period from 31 March 2007 onward. Since the fund's inception, the highest monthly return was 5.44% (in December 2008), while the lowest was –3.31% (in January 2009). The highest quarterly return was 7.31% in the first quarter of 2008; the lowest was –2.52% in the third quarter of 2008 (see table 10). The VaR, which quantifies potential losses in a given period and their probability of occurrence, was US$ 166 million in late December 2013.[23]

Table 10: Historical minimum and maximum returns

(percent)

Range	Month	Quarter
Highest return	5.44 (Dec-08)	7.31 (Q1 08)
Lowest return	-3.31 (Jan-09)	-2.52 (Q3 08)

Source: Ministry of Finance.

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

23 The Value-at-Risk (VaR) is calculated based on simulations using historical portfolio data, with a confidence level of 85%.

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. The indicator used for this measurement is the ex ante tracking error.[24] The smaller the tracking error, the more passive the management.[25] At year-end 2013, the ex ante tracking error of the ESSF was 7 basis points, consistent with a passive management strategy.

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 over AA–. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see table 11).

Table 11: Maximum credit exposure by bank issuer

Rating	Maximum (US$ MM)
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 in the name of the Republic of Chile and keeping them in separate accounts.

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

25 This is because the manager invests in instruments that are very similar to the contents of the benchmark, in order to achieve a similar behavior in terms of risk and returns.

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 2013, money market instruments accounted for 33.1% of the ESSF portfolio, which is in line with the 34% proposed under the new strategic allocation and 4% higher than under the policy in effect through July 2013. 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.

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 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.

CHAPTER 9

Pension Reserve 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 stocks and 20% in corporate bonds. The CBC manages asset classes with sovereign risk exposure, while the stock and corporate bond portfolios are administered by the external managers selected in 2011 (Mellon Capital Management Corporation and BlackRock Institutional Trust Company for stocks; and Rogge Global Partners PLC and BlackRock Institutional Trust Company 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 stock 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 stock 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 asset allocation described above. The policy is triggered whenever the PRF receives additional contributions and when any of the asset classes exceed their deviation ranges.

Table 12: Strategic asset allocation and benchmarks
(percent of portfolio)

Strategic asset allocation		
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	17%	Barclays Capital Global Inflation-Linked Index (unhedged)
Corporate bonds	20%	Barclays Capital Global Aggregate: Corporate Bond Index (unhedged)
Stocks	15%	MSCI All Country World Index (unhedged with reinvested dividends) ex Chile

(a) The benchmark is a market weighted aggregation of both sub indices.
(b) Includes semi-government issuers as local authorities, government-owned entities, agencies, etc.

Source: Ministry of Finance

9.2 MARKET VALUE

As of 31 December 2013, the PRF had a market value of US$ 7,335 million, an increase of US$ 1,452 million over the close of 2012. This growth is mainly due to a contribution of US$ 1,377 million, or 0.5% of 2012 GDP (see table 13) and net financial gains of US$ 75 million.

Since its inception on 28 December 2006, the fund has received contributions totaling US$ 6,441 million, and its investments have generated net financial gains of US$ 894 million (see table 14).

Table 13: Annual contributions PRF

(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
Total	**6,441**	

Source: Ministry of Finance

Table 14: Evolution and decomposition of market value

(millions of dollars)

Decomposition	2007	2008	2009	2010	2011	2012	2013	Since Inception[(a)]
Starting market value	605	1,466	2,507	3,421	3,837	4,406	5,883	0
Contributions	736	909	837	337	443	1,197	1,377	6,441
Withdrawals	0	0	0	0	0	0	0	0
Accrued interest	46	71	72	70	75	131	174	639
Captil gains (losses)	80	60	6	9	51	151	-95	262
Management, custody and other costs	0.0	-0.3	-0.3	-0.4	-0.4	-1.2	-4.4	-7.1
Net financial gains	125	131	77	79	126	280	75	894
Ending market value	1,466	2,507	3,421	3,837	4,406	5,883	7,335	7,335

(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 1.02% in 2013. The equivalent net return in pesos for the year was 10.46%, which is explained by the sharp appreciation of the dollar against the peso. Since 31 March 2007, the annualized net return was 4.38% in dollars and 3.95% in pesos (see table 15 and figure 25). The IRR in dollars was 1.15% in 2013, while the annualized IRR since the fund's inception was 3.60%. These results compare favorably against the returns that would have been earned under the previous investment policy (see box 3).

Table 15: Net returns

(percent)

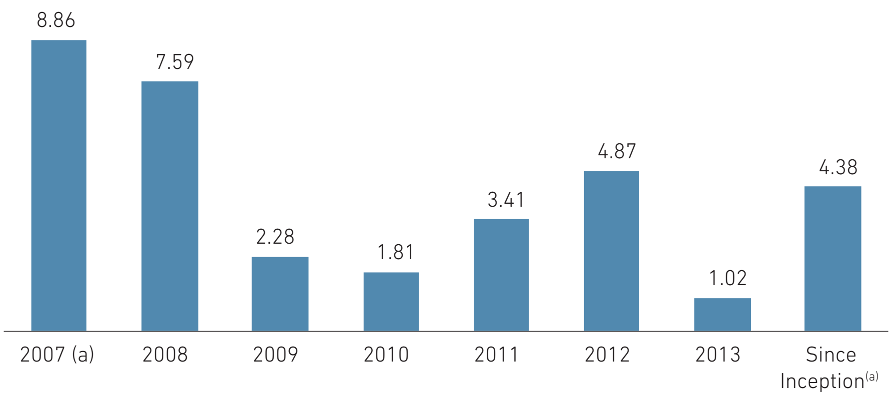
Returns [a]	2013	Last 3 years	Since Inception [b]
Return in USD	**1.02**	**3.09**	**4.38**
Exchange rate effect, CLP	9.44	3.79	-0.43
Return in CLP [c]	**10.46**	**6.88**	**3.95**

(a) Time Weighted Return (return calculated as the growth rate of the funds that were invested throughout the period).
(b) Calculated from 31 March 2007, when the Central Bank's performance began to be measured.
(c) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate.

Source: Ministry of Finance

Figure 25: Annual TWR

(percent)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Box 3: Investment gains due to the PRF new investment policy

The implementation of the new investment guidelines for the PRF, in early 2012, introduced some changes aimed at improving the risk-return profile to better reflect the pensions that the fund is intended to finance.

Since its implementation, the changes have contributed to earning an additional return of 2.62% over what would have been earned under the previous policy, equivalent to a gain of approximately US$ 320 million at the close of 2013.

The introduction of the stock portfolio, in particular, had a positive impact on the fund's performance, contributing an annualized return of 18.4% since its implementation. The corporate bond portfolio has also made a positive contribution, with an annualized return of 4.6%.

The PRF asset classes recorded a mixed performance in 2013, with positive returns on stocks and negative returns on fixed-income instruments. Specifically, the stock portfolio posted returns of 23.79%; corporate bonds, –0.08%; inflation-indexed bonds, –2.90%; and sovereign and government-related bonds, –4.32%. An analysis of quarterly returns reveals that the fund's performance is mainly explained by the strong performance of the stock portfolio in the first, third and fourth quarters, which was offset by low returns in the fixed-income portfolio, mainly in the first two quarters of the year (see table 16).

Table 16: Performance by asset class

(percent)

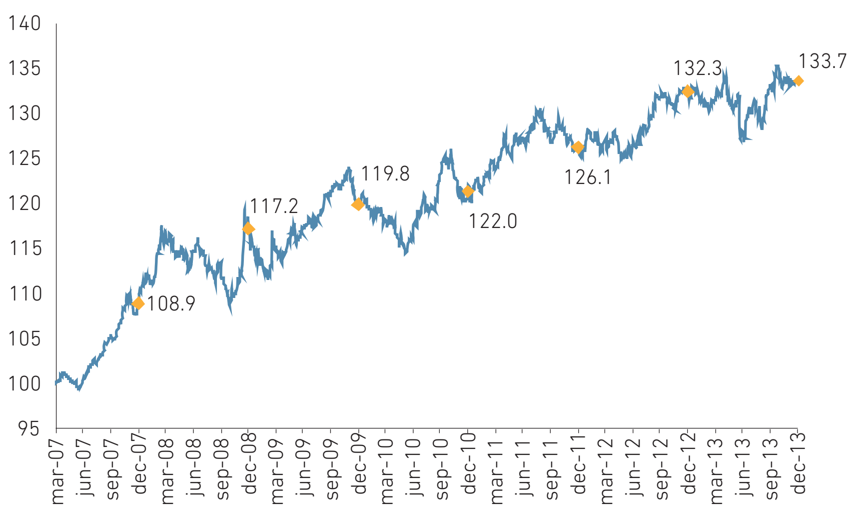
Returns	Q 1	Q 2	Q 3	Q 4	2013
Sovereign and government-related bonds	-2.71	-3.19	2.77	-1.16	-4.32
Inflation-indexed bonds	-1.36	-5.51	4.10	0.07	-2.90
Corporate bonds	-1.25	-2.76	2.86	1.16	-0.08
Stocks	6.75	-0.20	8.13	7.46	23.79
Total portfolio	**-0.65**	**-2.88**	**3.81**	**0.85**	**1.02**

Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the daily returns of the portfolio (see figure 26). Despite the volatility of the index, the value increased over prior years, to 133.7 at year-end 2013.

Figure 26: Return index

(31 March 2007 = 100)

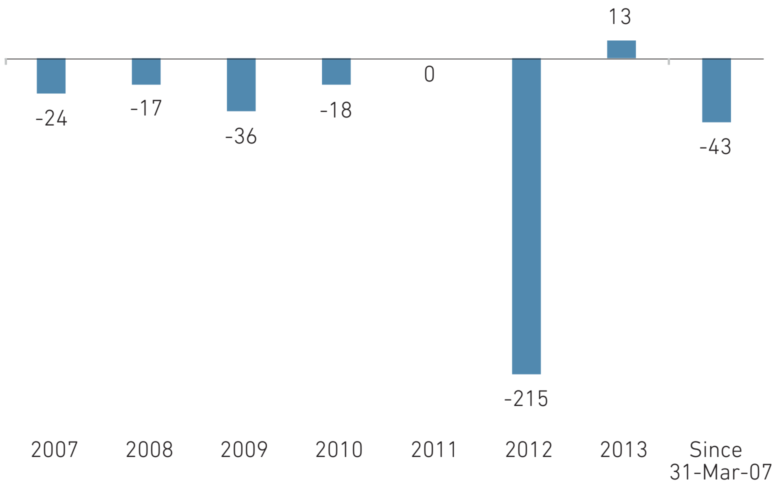


Source: Ministry of Finance

The performance of the PRF, measured as the difference between the portfolio return and the benchmark, was 13 basis points in 2013, while the annualized return since 31 March 2007 was –43 basis points (see figure 27). To a large extent, the return differential between the portfolio and the benchmark in 2013 was due to an overweighting of stocks.

Figure 27: Net returns against the benchmark[26]

(basis points)



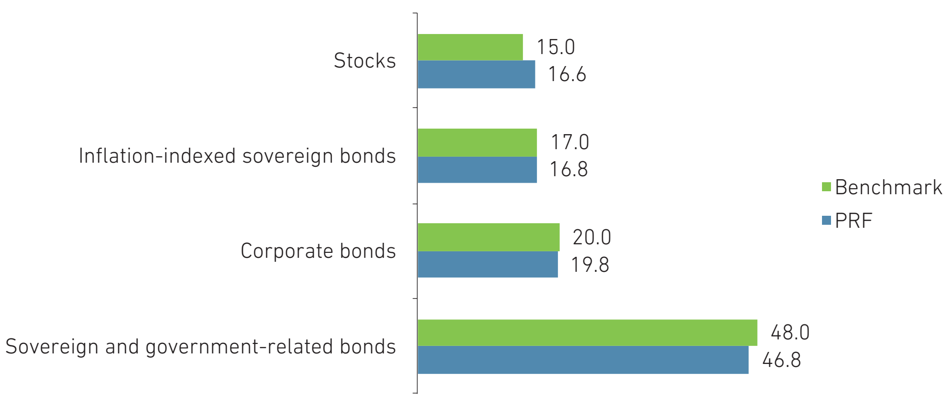
Source: Ministry of Finance

9.4 PORTFOLIO ALLOCATION

As of December 2013, the allocation of the PRF by asset class comprised US$ 3,432 million in sovereign and government-related bonds, US$ 1,233 million in inflation-indexed sovereign bonds, US$ 1,454 million in corporate bonds and US$ 1,217 million in stocks. In terms of shares, the percent allocation by asset class and currency was similar to the benchmark, although the share of sovereign and government-related bonds was slightly lower because returns were higher on other asset classes during the year (see figures 28 and 29).

Figure 28: Asset class allocation, 31 December 2013

(percent of portfolio)

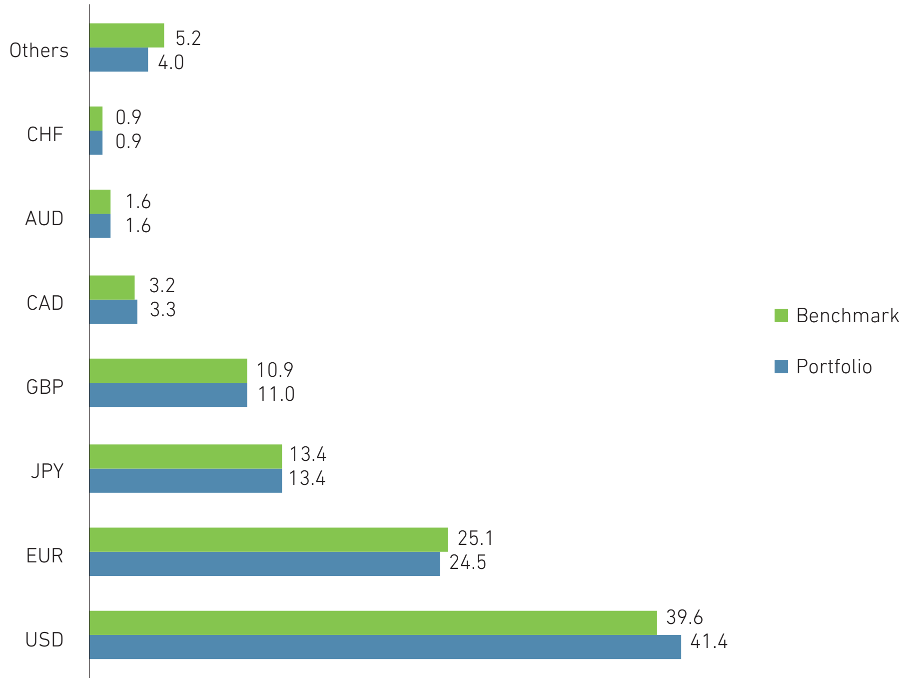


Source: Ministry of Finance

26 The new PRF investment policy was implemented in 2012. If the waiver periods granted to the managers during the implenentation of the new mandate are excluded, the excess return in 2012 would be –89 basis points. However, that figure was affected by the negative impact, relative to the benchmark, of holding around US$ 740 million invested in time deposits, to later transfer them to the external portfolio managers in early March 2012. The 2012 Annual Report published the figure including the waiver, but starting with this report, the figure is adjusted, following recommendation of the Financial Committee.

Figure 29: Currency allocation, 31 December 2013

(percent of portfolio)



Source: Ministry of Finance

In terms of credit risk allocation, at year-end, 51% of the PRF fixed-income portfolio had a rating of AA+ or higher, mainly in sovereign bonds, while 19% had a rating of BBB+ to BBB–, mainly in corporate bonds (see table 17).

Table 17: Credit risk exposure, 31 December 2013

(percent of fixed-income portfolio)

	Sovereign and govern-ment-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Total fixed-income
AAA	10%	10%	0%	20%
AA+	22%	8%	0%	31%
AA	1%	0%	1%	2%
AA-	2%	0%	2%	3%
A+	14%	0%	2%	16%
A	0%	0%	4%	4%
A-	1%	0%	4%	5%
BBB+	4%	2%	5%	11%
BBB	1%	0%	3%	4%
BBB-	2%	0%	2%	4%
Other[(a)]	0%	0%	0%	0%
Total	**56%**	**20%**	**24%**	**100%**

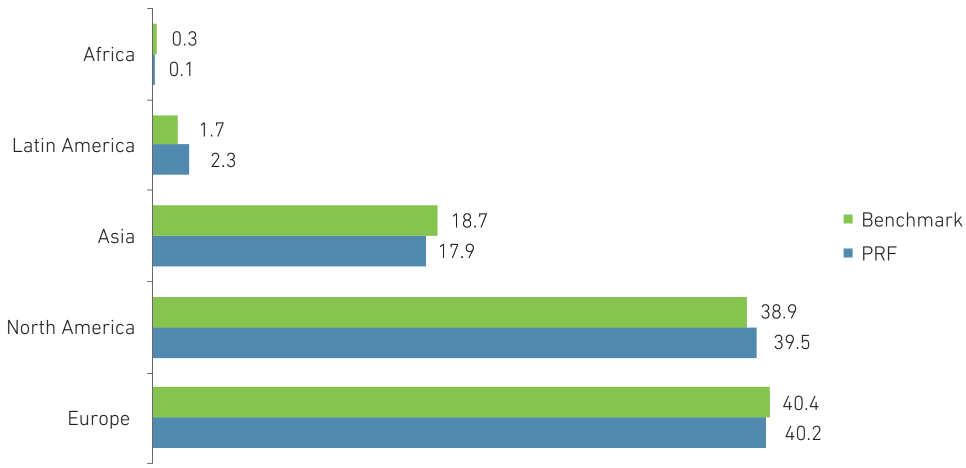
(a) Includes cash and cash equivalents.

Source: Ministry of Finance

With regard to the geographical and sectoral distribution of investments, the fund's allocation is again in line with the benchmark (see figures 30 and 31). At year-end, 80% of investments were in the United States and Europe, in almost equal shares, while 18% was in Asia, mainly Japan. The remainder was invested in countries in Latin America and Africa. The main economic sectors are the government (62%) and the financial sector (13%). Table 18 shows the percentage distribution of the main countries by asset class.

Figure 30: Regional allocation, 31 December 2013

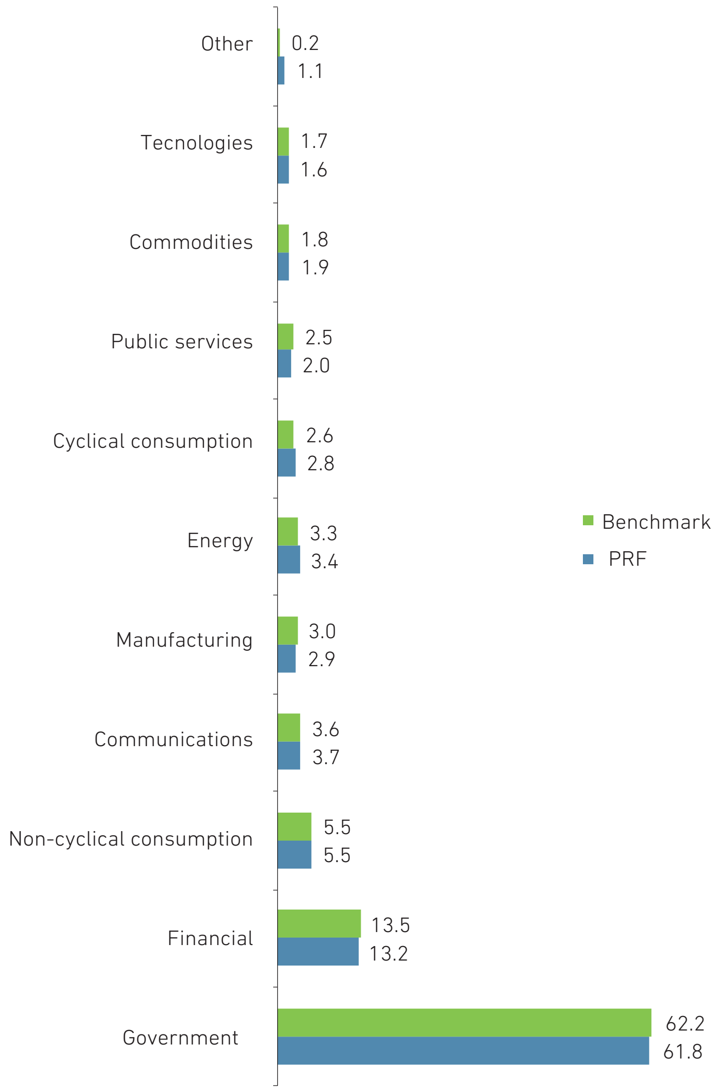
(percent of portfolio)



Source: Ministry of Finance

Figure 31: Sectoral allocation, 31 December 2013

(percent of portfolio)



Source: Ministry of Finance

Table 18: Allocation by asset class and by country, 31 December 2013

(percent of portfolio)

Country allocation	Sovereign and government-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Stocks	Total
Germany	3.5%	0.7%	0.3%	0.6%	5.0%
Australia	0.9%	0.1%	0.5%	0.5%	2.0%
Belgium	0.9%	0.0%	0.0%	0.1%	1.0%
Canada	2.2%	0.4%	1.0%	0.6%	4.2%
South Korea	0.7%	0.0%	0.1%	0.3%	1.1%
Spain	1.8%	0.0%	0.3%	0.2%	2.3%
United States	10.6%	6.8%	9.5%	8.5%	35.4%
france	3.0%	2.2%	1.3%	0.6%	7.1%
Netherlands	0.9%	0.0%	1.7%	0.2%	2.8%
Italy	2.6%	1.5%	0.3%	0.1%	4.6%
Japan	11.2%	0.3%	0.6%	1.3%	13.4%
United Kingdom	2.7%	4.8%	2.2%	1.4%	11.0%
Supranational	2.0%	0.0%	0.0%	0.0%	2.0%
Other (a)	3.8%	0.0%	2.0%	2.3%	8.1%
Total	46.8%	16.8%	19.8%	16.6%	100.0%

(a) Includes cash and cash equivalents.

Source: Ministry of Finance

9.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the PRF included US$ 1,971,424 for custody services, US$ 1,032,599 for the CBC's management services and US$ 1,347,401 for external portfolio managers. Together, the remuneration paid to the CBC and external managers equaled 4 basis points of the portfolio in 2013. The income from the securities lending program totaled US$ 235,855, which partly offset the management and custody costs (see table 19). The increase in management costs was related to a lag in payments to the external managers, which were carried over from 2012 to 2013. With regard to the custodial costs, the amounts paid in 2013 correspond to services received between January 2012 and April 2013, and the increase is due to the incorporation of the external managers in early 2012.

Table 19: Management and custody costs and income from the securities lending program
(dollars)

Item	2009	2010	2011	2012	2013
Custody (J.P. Morgan)	192,910	252,787	217,796	91,572	1,971,424
Management (CBC)	155,400	153,600	194,742	520,186	1,032,599
External management	—	—	—	548,098	1,347,401
Other costs [(a)]	—	—	20,000	70,588	-
Total costs	**348,310**	**406,387**	**432,538**	**1,230,443**	**4,351,424**
Securities lending program	**205,679**	**399,802**	**923,213**	**219,422**	**235,855**

(a) Payment to the consultant Strategic Investment Solutions

Source: Ministry of Finance

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 stock risk. This section describes these risks 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 2013 was 6.97 years, while the actual duration of the PRF was 7.12 years.

Foreign exchange risk
The value of the PRF is also affected by exchange rate movements, since the portfolio includes investments denominated in 31 currencies whereas the fund's performance is measured in dollars. Given the passive management strategy, the tolerance for foreign exchange risk is defined by the currency allocation of the benchmark. Thus, exposure to currency risk is mainly through investments 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 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. 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. 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).

Stock risk

The PRF is exposed to the risk of losses from a decrease in the price of the stocks 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 stock index used as the benchmark (the MSCI ACWI excluding Chile). Under the strategic asset allocation, only 15% of the total portfolio is invested in stocks.

Volatility, VaR and tracking error

The annual volatility of the PRF was 4.7% in 2013, versus 5.7% 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 –2.88% in the second quarter of 2013 (see table 20). The VaR was US$ 262 million in late December 2013[27].

Table 20: Historical minimum and maximum returns

(percent)

Range	Month	Quarter
Highest return	5,47 (Dec-08)	7,36 (Q1 08)
Lowest return	-3,33 (Jan-09)	-2,88 (Q2 13)

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. In the case of the PRF, the ex ante tracking error is used to forecast the portfolio's deviation from the benchmark, with a given level of confidence. At year-end 2013, the ex ante tracking error of the PRF was 20 basis points, consistent with a passive management strategy.

27 The Value-at-Risk (VaR) is calculated based on simulations using historical portfolio data, with a confidence level of 85%.

CREDIT RISK

In the PRF bond portfolio, exposure to credit risk is mainly controlled by having a well-diversified portfolio and investing only in issuers included in the benchmark. For time 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 is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see table 21). 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, this constraint also includes the use of futures. Thus, forwards, swaps and futures cannot exceed 10% of each external manager's portfolio.

Table 21: Credit limits on time deposits and forwards

(millions of dollars, unless otherwise indicated)

Limit		Time deposits	Forwards
Minimum rating		A-	AA-
Maximum per issuer	CBC portfolio	20	1% [(a)]
	External portfolio managers	20	

(a) Percent of each external manager's portafolio.

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 in the name of the Republic of Chile and keeping them in separate accounts.

9.6.2 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 not start until 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.

9.6.3 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.

Financial Statements: Economic and Social Stabilization Fund

Financial statements for the years ended 31 December 2013 and 2012 and independent auditors' report[28]

28 The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2013 and 2012 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish.

Deloitte.

Deloitte
Auditores y Consultores Limitada
Rosario Norte 407
RUT: 80.276.200-3
Las Condes, Santiago
Chile
Fono: (56-2) 2729 7000
Fax: (56-2) 2374 9177
deloittechile@deloitte.com
www.deloitte.cl

INFORME DE LOS AUDITORES INDEPENDIENTES

A los señores Tesorería General de la República
Fondo de Estabilización Económica y Social

Hemos efectuado una auditoría a los estados financieros adjuntos de Fondo de Estabilización Económica y Social (en adelante el "Fondo"), que comprenden los estados de situación financiera al 31 de diciembre de 2013 y 2012 y los correspondientes estados de resultados, de resultados integrales, de cambios en el patrimonio neto y de flujos de efectivo por los años terminados en esas fechas y las correspondientes notas a los estados financieros.

Responsabilidad de la Administración por los estados financieros

Tesorería General de la República, es responsable por la preparación y presentación razonable de estos estados financieros de acuerdo con Normas Internacionales de Información Financiera. Esta responsabilidad incluye el diseño, implementación y mantención de un control interno pertinente para la preparación y presentación razonable de los estados financieros, para que éstos estén exentos de representaciones incorrectas significativas, ya sea debido a fraude o error.

Responsabilidad del auditor

Nuestra responsabilidad consiste en expresar una opinión sobre estos estados financieros a base de nuestras auditorías. Efectuamos nuestras auditorías de acuerdo con normas de auditoría generalmente aceptadas en Chile. Tales normas requieren que planifiquemos y realicemos nuestro trabajo con el objeto de lograr un razonable grado de seguridad de que los estados financieros están exentos de representaciones incorrectas significativas.

Una auditoría comprende efectuar procedimientos para obtener evidencia de auditoría sobre los montos y revelaciones en los estados financieros. Los procedimientos seleccionados dependen del juicio del auditor, incluyendo la evaluación de los riesgos de representaciones incorrectas significativas de los estados financieros, ya sea debido a fraude o error. Al efectuar estas evaluaciones de los riesgos, el auditor considera el control interno pertinente para la preparación y presentación razonable de los estados financieros del Fondo con el objeto de diseñar procedimientos de auditoría que sean apropiados en las circunstancias, pero sin el propósito de expresar una opinión sobre la efectividad del control interno del Fondo. En consecuencia, no expresamos tal tipo de opinión. Una auditoría incluye, también, evaluar lo apropiadas que son las políticas de contabilidad utilizadas y la razonabilidad de las estimaciones contables significativas efectuadas por la administración del Fondo, así como una evaluación de la presentación general de los estados financieros.

Consideramos que la evidencia de auditoría que hemos obtenido es suficiente y apropiada para proporcionarnos una base para nuestra opinión de auditoría.

Opinión

En nuestra opinión, los mencionados estados financieros presentan razonablemente, en todos sus aspectos significativos, la situación financiera de Fondo de Estabilización Económica y Social al 31 de diciembre de 2013 y 2012 y los resultados de sus operaciones y los flujos de efectivo por los años terminados en esas fechas, de acuerdo con Normas Internacionales de Información Financiera.

Otros Asuntos

Como se indica en Notas 1 y 2h, el uso de recursos del Fondo de Estabilización Económica y Social está establecido en el Decreto con Fuerza de Ley N°1 del 11 de diciembre de 2006.

Como se indica en Nota 1, con fecha 4 de junio de 2013 el Fondo de Estabilización Económica y Social, informó adecuaciones y modificaciones efectuadas a las Directrices de inversión del Fondo.

Deloitte.

Marzo 31, 2014

Jorge Ortiz Martínez
12.070.100-2

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2013 AND 2012
Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	11	5,561,758	1,465,682
FINANCIAL ASSETS AFFECTING INCOME			
Stocks		1,223,124,745	-
Other capitalization instruments		17,965,114	-
Time deposits		2,721,845,688	2,250,214,418
Government bonds		8,524,084,599	9,987,367,297
Indexed bonds		541,570,158	522,013,590
Treasury bills		2,384,983,014	2,236,622,448
Derivatives		14,436	8,613
TOTAL INVESTMENTS	7	15,413,587,754	14,996,226,366
TOTAL ASSETS		15,419,149,512	14,997,692,048
LIABILITIES			
Derivative financial instruments	8	23,679	173,390
TOTAL LIABILITIES		23,679	173,390
NET EQUITY			
Fisco resources		11,734,619,597	10,034,619,597
Contributions by the Fisco	9	603,385,350	1,700,000,000
Accumulated results		3,262,899,061	3,122,022,834
Income (loss) in the year		(181,778,175)	140,876,227
NET EQUITY		15,419,125,833	14,997,518,658
TOTAL LIABILITIES AND NET EQUITY		15,419,149,512	14,997,692,048

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF INCOME
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
OPERATING INCOME			
Interest earned	10	177,632,287	201,889,951
Income from dividends		6,469,328	-
Net unrealized gains from price fluctuations		-	158,125,724
Total operating income		184,101,615	360,015,675
OPERATING LOSSES			
Net loss from the sale of financial instruments		(216,752,913)	(217,840,533)
Net unrealized loss from price fluctuations		(146,958,180)	-
Total operating loss		(363,711,093)	(217,840,533)
Total operating income (loss)		(179,609,478)	142,175,142
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(789,277)	(768,015)
Custodian's fees and external portfolio managers' fees	9	(1,379,420)	(530,900)
INCOME (LOSS) IN THE YEAR		(181,778,175)	140,876,227

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	2013 US$	**2012** US$
INCOME (LOSS) IN THE YEAR	(181,778,175)	140,876,227
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	-	-
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	-	-
TOTAL OTHER COMPREHENSIVE INCOME	-	-
COMPREHENSIVE INCOME IN THE YEAR	(181,778,175)	140,876,227

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CHANGES IN NET EQUITY
31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	**Fisco resources** US$	**Accumulated results** US$	**Income for the year** US$	**Total** US$
Opening balance, 1 January 2013		11,734,619,597	3,122,022,834	140,876,227	14,997,518,658
Distribution of income from previous year		-	140,876,227	(140,876,227)	-
Contributions by the Treasury	9	603,385,350	-	-	603,385,350
Income for the year		-	-	(181,778,175)	(181,778,175)
Closing balance, 31 December 2013		12,338,004,947	3,262,899,061	(181,778,175)	15,419,125,833
Opening balance, 1 January 2012		10,034,619,597	2,685,481,558	436,541,276	13,156,642,431
Distribution of income from previous year		-	436,541,276	(436,541,276)	-
Contributions by the Treasury	9	1,700,000,000	-	-	1,700,000,000
Income for the year		-	-	140,876,227	140,876,227
		-			
Closing balance, 31 December 2012		11,734,619,597	3,122,022,834	140,876,227	14,997,518,658

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CASH FLOW—INDIRECT METHOD
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
FLUJOS DE EFECTIVO POR ACTIVIDADES DE OPERACION			
Income in the year		(181,778,175)	140,876,227
Net unrealized gains (losses)		146,958,180	(158,125,724)
Changes in fund management and custody		(564,469,279)	(1,685,395,100)
Net cash flows from operating activities		(599,289,274)	(1,702,644,597)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	603,385,350	1,700,000,000
Net cash flows from financing activities		603,385,350	1,700,000,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		4,096,076	(2,644,597)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		1,465,682	4,110,279
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	11	5,561,758	1,465,682

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

ECONOMIC AND SOCIAL STABILIZATION FUND

NOTES TO THE FINANCIAL STATEMENTS
AS OF 31 DECEMBER 2013 and 2012
(Figures in U.S. dollars — US$)

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 resources for fiscal revenue stabilization stipulated in Decree Law Nº 3,653 of 1981 and the Copper Revenue Compensation Fund established under loan agreement BIRF Nº 2,625 CH, as specified in Decree with Force of Law 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 General Treasury.

(b) Ministry of Finance Official Letter Nº 433 of 2011, which informs the fiscal agent of the new performance guidelines for managing the Economic and Social Stabilization Fund.

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

(d) Decree Nº 1,636 of 2010, 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.

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

   - To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.

- To 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. 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.

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

- To verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records.

- To process transactions associated with contributions to and withdrawals from the sovereign wealth funds, transfers between external managers and payments associated with the management of the sovereign wealth funds, as required.

- To contract external managers and custodians for the fund.

- To maintain a current manual of procedures for the handling of all functions and duties described in this Article.

- To 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 General 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 Official Letter Nº 1,267 of 2013, which establishes the new investment guidelines for the Economic and Social Stabilization Fund.

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

(g) Ministry of Finance Official Letter Nº 1,617 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.

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 4 June 2013 the Ministry of Finance issued Official Letter N° 1,267, which contains the new investment guidelines for the Economic and Social Stabilization Fund. These guidelines, which entered into force on 5 August 2013, replace and rescind the investment guidelines contained in Official Letter Nº 433, issued by the Finance Ministry in 2011.

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.

a. 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).

Additionally, the fund opted for the early application of IFRS 9: Financial Instruments (issued in November 2009 and modified in October 2011), with the initial application dating to 1 January 2009. IFRS 9 introduces new requirements for classifying and measuring financial assets under the scope of IAS 39: Financial Instruments. Specifically, IFRS 9 requires that all financial assets be classified and later measured either at amortized cost or fair value based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

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 decided not to designate any debt instruments that meet the amortized cost criteria as measured at fair value through profit or loss.

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

Investments in equity instruments (stocks) 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 that the custodian, J.P. Morgan Chase & Co., provided to the Central Bank of Chile, as fiscal agent.

The financial statements presented by the General 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.

b. Period covered – The financial statements cover the years between 1 January and 31 December 2013 and 2012, respectively.

c. 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.

The figures are presented in U.S. dollars. Contributions to the ESSF have been made in dollars, and investments have primarily been made in U.S. dollars.

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.

d. Investment classification and valuation—The fund's investments comprise liquid foreign currency assets and 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, indexed bonds, agency bullet bonds, 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.

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 cost:

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, 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 like 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).

e. 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 General Treasury and cash held by the custodian as a result of operations undertaken in the course of the custodial management of the fund.

f. Funds under management—These are securities delivered to the CBC, acting as fiscal agent for the management of ESSF resources. The securities can be totally or partially employed in the performance of the assigned duties.

g. Funds in custody—These are securities delivered by the CBC, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for ESSF securities and instruments.

h. 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°s 1, 2, 3 and 4 of Decree with Force of Law N° 1 of 11 of September 2006, the ESSF will be established and increased with the following resources:

The additional resources for fiscal revenue stabilization stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under BIRF 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 Decree with Force of Law 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 Decree with Force of Law 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.

i. 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 financial 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.

j. 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.

k. Reclassification—The financial statements for 31 December 2012 have been reclassified relative to the financial statements presented last year. This reclassification does not have a significant impact on the financial statements of this year and is solely for the purpose of comparability.

l. New accounting rules:

(i) The following new rules and amendments have been adopted in these financial statements.

New IFRSs	**Compulsory application date**
IFRS 10: Consolidated financial statements	Annual periods beginning on or after 1 January 2013
IFRS 11: Joint arrangements	Annual periods beginning on or after 1 January 2013
IFRS 12: Disclosure of interest in other entities	Annual periods beginning on or after 1 January 2013
IAS 27 (2011): Separate financial statements	Annual periods beginning on or after 1 January 2013
IAS 28 (2011): Investments in associates and joint ventures	Annual periods beginning on or after 1 January 2013
IFRS 13: Fair value measurement	Annual periods beginning on or after 1 January 2013
IAS 19: Employee benefits (2011)	Annual periods beginning on or after 1 January 2013

IFRS amendments	**Compulsory application date**
IAS 1: Presentation of financial statements: Presentation of items of other comprehensive income	Annual periods beginning on or after 1 July 2012
IFRS 1: First-time adoption of IFRS – Government loans	Annual periods beginning on or after 1 January 2013
IFRS 7: Financial Instruments: Disclosures – Amendment on offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2013
Annual improvements cycle 2009–2011: Amendments to five IFRSs	Annual periods beginning on or after 1 January 2013
IFRS 10, 11 and 12: Consolidated financial statements, joint arrangements and disclosure of interest in other entities: Transition guidance	Annual periods beginning on or after 1 January 2013

The ESSF management deems that the adoption of the new rules and amendments described above has not had significant impact or effect on the fund's financial statements.

(ii) The following new amendments and interpretations have been issued, but they have not yet entered into force:

IFRS amendments	**Compulsory application date**
IAS 19: Employee benefits: Defined benefits plan—Employee contributions	Annual periods beginning on or after 1 July 2014
IAS 32: Financial instruments: Presentation – Clarification of the rules on offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014
Investment entities: Amendments to IFRS 10: Consolidated financial statements; IFRS 12: disclosure of interest in other entities; and IAS 27: Separate financial statements	Annual periods beginning on or after 1 January 2014
IAS 36: Impairment of assets: Recoverable amounts disclosures for nonfinancial assets	Annual periods beginning on or after 1 January 2014
IAS 39: Financial instruments: Recognition and measurement— Novation of derivatives and continuation of hedge accounting	Annual periods beginning on or after 1 January 2014
Annual improvements cycle 2010–2012: Amendments to six IFRSs	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2011–2013: Amendments to four IFRSs	Annual periods beginning on or after 1 July 2014

New interpretations	
IFRIC 21, Levies	Annual periods beginning on or after 1 January 2014

The ESSF management deems that the future adoption of the amendments and interpretations described above will not have a significant impact on the fund's financial statements.

3. ESSF INVESTMENT POLICY

The ESSF management objective is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, in both the Article 4 portfolio and the externally managed portfolio. To this end, an investment portfolio (IP) will be established from the sum of the two portfolios mentioned above. The specific guidelines, parameters and rules are contained in the following sections.

For the ESSF Article 4 portfolio, 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 the following section. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

3.1. Guidelines and parameters

3.1.1. Asset classes

The fiscal resources in the investment portfolio (IP) will be invested in four asset classes: (1) Bank; (2) Treasury bills and sovereign bonds; (3) Inflation-indexed sovereign bonds; and (4) Stocks. The first three classes are allocated to the Article 4 portfolio; the fourth class (stocks) is allocated to the externally managed portfolio. The benchmark allocation of the IP 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	15.0%
Treasury bills and sovereign bonds	74.0%
Inflation-indexed sovereign bonds	3.5%
Stocks	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 Bank as fiscal agent. The fourth asset class (stocks 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.

3.1.2. 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	**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%**
Stocks: 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.

3.1.3. Article 4 Portfolio

3.1.3.1. Risk budget

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

3.1.3.2. 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) Investment limits by issuer: 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 IP 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

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

3.1.3.3. Eligible sovereign issuers

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

3.1.3.4. Eligible currencies

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

3.1.3.5. Eligible instruments

(a) Bank: The only eligible bank instruments are bank transactional account balances, overnight and weekend deposits, time deposits and certificates of deposits, 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.

3.1.3.6. Currency forwards

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.
(b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of AA– 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 cash delivery or net settlement.
(d) The counterparty risk associated with each cash delivery contract will equal 100% of the notional value of the forward or swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The terms of these contracts will not exceed 90 days. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3.1.3.2).
(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 equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap 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 3.1.3.2). In the case of net settlement contracts without a close-out netting clause, counterparty risk will be treated the same as in cash delivery contracts.
(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 forwards contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio.

3.1.4. Externally managed portfolio

3.1.4.1. Risk budget

The stock portfolio has an ex ante tracking error of 60 basis points.

3.1.4.2. Eligible issuers and currencies

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

3.1.4.3. Eligible instruments

The types of instruments that are 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(s).
(b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of stocks included in the stock 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 stock benchmark (see Table 2) 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 an eligible instrument (Note 3.1.4.4).
(d) If the external portfolio managers receive an ineligible instrument as the result of corporate events affecting the stocks in which the portfolio is invested, the situation must be reported to the Finance Ministry through the fiscal agent up to 31 December 2013 and, after that date, directly by the external portfolio manager, so that the Ministry can evaluate the situation and stipulate the steps to be taken.

3.1.4.4. 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 average monthly value of the portfolio of each external manager. 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 current 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 U.S. dollars in a given bank.

3.1.4.5. Limits on forwards or swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark and solely with counterparties that have a long-term rating of AA– 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 3.1.3.6, letters (a) to (e).

3.1.5. Limits on currency spot 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).

3.1.6. Special restrictions

No part of the IP can be invested in any type of instrument from Chilean issuers or in instruments denominated in 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, Thailand, Taiwan and Turkey in the stock 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, Thailand, Taiwan 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 stocks.

3.1.7. Rebalancing policy

During the transition period established in the Agency Decree, through 31 December 2013, in the event that deviations by asset class deriving from changes in the price or market valuation of the instruments should exceed, at the close of any given day, the deviation ranges established in Table 5, the fiscal agent must implement or, as the case may be, instruct the external manager to implement convergence to the benchmark established in Table 2. The fiscal agent will have 10 bank business days to achieve this convergence, during which the fiscal agent and external managers will be granted a waiver of compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and 3.1.4.1. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

Table 5: Deviation range for rebalancing

Portfolio	Percent of IP	Deviation 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 any contributions made during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent must converge to the benchmark established in Table 2. In this case, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and 3.1.4.1.

The custodian will report the relative share of each asset class in the IP. Based on this information, the fiscal agent will carry out the rebalancing of asset classes, as required, during the transition period established in the Agency Decree, through 31 December 2013.

Starting on 1 January 2014, the Finance Ministry will monitor compliance with the target ranges and, at least once a year, will instruct the amounts to be rebalanced between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 2. In addition, in the event of any contributions, the Finance Ministry will instruct the amounts to be transferred to and/or between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 2. In the event of any withdrawals, the Finance Ministry will instruct the amounts to be withdrawn from the externally managed portfolios and the Article 4 portfolio. During each rebalancing episode, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and

3.1.4.1. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

3.1.8. Intermediaries.

The following entities are eligible to provide intermediation services:

i. Entities that are authorized to buy in the primary market; that is, that are classified as primary dealers in the United States of America, the United Kingdom or France.
ii. Banks that are eligible for investment and that directly provide intermediation services; or affiliates of these banks, provided that the corresponding parent bank(s) certify at least 90% ownership.
iii. Investment banks that have the same long-term credit rating required for banks that are eligible for investment; or their affiliates provided that the corresponding investment bank(s) certify at least 90% ownership.

3.2. Valuation criteria

The IP 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.

3.3. Securities lending program

3.3.1. 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 custodian guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

3.3.2. Externally managed portfolio

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

3.4. 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 days of detecting the situation. This period can be extended by the Finance Ministry at the request of the fiscal agent or its delegate, when justified. Should such an event arise in the externally managed portfolios during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent will report its opinion on submitting the request.

Starting on 1 January 2014, the external portfolio managers will make this request directly to the Finance Ministry.

3.5. Entry into force and transfer to external managers

The provisions of section 3.1. will enter into force on 5 August 2013, taking into account the waivers outlined below. Until that date, the portfolios will continue to be subject to the provisions of section II of the investment guidelines contained in Finance Ministry Official Letter N° 433 of 2011.

3.5.1. IP benchmark

The stipulations of Table 1 “Benchmark allocation of the investment portfolio (IP)” in section 3.1.1. will enter into force no later than 30 August 2013 with regard to the 7.5% share of stocks, taking into account the provisions of section 3.5.2. below. This date can be postponed at the request of the fiscal agent.

3.5.2. Externally managed portfolio

The stock benchmark identified in Table 2 in section 3.1.2. will enter into force no later than 30 August 2013, taking into account the waivers outlined below and at all times with due observance of the guidelines and parameters established in sections 3.1.4.2., 3.1.4.3., 3.1.4.4., 3.1.4.5., 3.1.5. and 3.1.6.

In 2013, the fiscal agent transferred the resources in question to the external portfolio managers. The transfers were made in U.S. dollars. The first transfer of US$300 million to Mellon Equity took place on 21 August, with an additional US$300 million to BlackRock Equity on 22 August. The second transfer of US$269 million to Mellon Equity and US$267 million to BlackRock Equity took place on 2 October.

3.5.3. Article 4 portfolio

The fiscal agent must achieve the benchmark allocation for the Article 4 portfolio (shown in Table 2 of these guidelines) no later than five business days from the date of each transfer of resources to the external portfolio managers. Thus, between the date that the guidelines enter into force and five business days after the date of the first transfer of resources and for five days after the second, the fiscal agent will have a waiver of compliance with the requirements of section 3.1.3.1. However, during that period the fiscal agent cannot invest in any instruments that are not authorized under either the previous guidelines or the new guidelines.

Thus, the resources corresponding to the 7.5% that will be invested in stocks will continue to be part of the Article 4 portfolio until they have been transferred to the external portfolio managers. To prepare for the delivery of these funds, the fiscal agent will choose a transition strategy for generating the necessary liquidity to be able to deliver the resources to the external portfolio managers.

3.6. Appointment of external managers for the externally managed portfolio

The fiscal agent is expressly authorized to contract, on this one occasion only and with no prior selection process, the management services for the externally managed portfolio, which will be provided by the companies that are currently contracted to manage the stock portfolio for the Pension Reserve Fund: namely, Mellon Capital Management Corporation and BlackRock Institutional Trust Company, N.A.

In December 2013, the fiscal agent reported to the Finance Minister (with a copy to the International Finance Coordinator and the Head of the Sovereign Wealth Funds Unit, both within the Ministry of Finance) on the contracts and/or the changes to the contracts held with Mellon Capital Management Corporation and BlackRock Institutional Trust Company, N.A., as applicable, in compliance with the provisions of the above paragraph, and submitted a copy of the documents in question. These documents expressly state that as of 1 January 2014, the contractual relationship established under these contracts will be managed directly by the Finance Ministry in representation of the Fisco of the Republic of Chile, upon completion of the transition period established in the Agency Decree on 31 December and the fulfillment of the additional responsibilities of the fiscal agent specified in Article 2 of Finance Ministry Decree N° 1,618 of 2012.

3.7. Other provisions related to the external managers during the transition period established in the Agency Decree, through 31 December 2013.

In the event that during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent exercises the early termination of the contract for the external management of fiscal resources held by one of the external portfolio managers, where the cause of early termination is problems of solvency, capacity, severe or recurrent noncompliance with instructions, fraud or any other serious situation, the fiscal agent is expressly authorized to transfer all or part of the fiscal resources managed under that contract to any other external portfolio manager with a current contract.

In the event that the fiscal agent cannot transfer the fiscal resources managed under the external portfolio management contract subject to early termination for the reasons outlined in the above paragraph, the fiscal agent can, with the prior approval of the Finance Minister, authorize or exercise the management or conservation functions that it deems necessary, during the transition period established in the Agency Decree, through 31 December 2013, until a new selection process can be initiated for choosing and contracting an external portfolio manager.

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 can 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 measures performance and reports earnings, as well as the currency in which it receives contributions from the Chilean government.

5. FINANCIAL RISK MANAGEMENT

The sovereign wealth funds are exposed to various types of risk as a result of their investment in different financial instruments, including market risk, credit risk, liquidity risk, active management risk and operational risk. To limit exposure to these different risks, the Ministry of Finance includes investment restrictions in its performance guidelines, which must be followed by the Central Bank of Chile (CBC) in carrying out its operations. Compliance is monitored by an independent area within the Bank, by the custodian and, ultimately, by the Finance Ministry. In addition, the institutional framework and infrastructure of the CBC provide adequate controls for mitigating operational risk.

5.1 Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions. In the specific case of international fixed-income investors, the financial variables with the biggest impact on the prices of the instruments in their portfolios are interest rates and exchange rates.

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.

Exchange rate risk: Because the fund's return is measured in dollars while the portfolio includes investments denominated in euros and yen, the value of investments is also affected by exchange rate fluctuations. For example, the value in dollars of a sovereign bond issued in euros is affected by the USD/EUR exchange rate trend. An appreciation (depreciation) of the dollar thus generates additional losses (gains) over and above the effect of interest rate movements. The fund's exchange rate exposure, measured in dollars, is 50%, and it derives from investments in euros (40%) and yen (10%).

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. Moreover, changes in market perception about the solvency of an issuer can cause the market value of instruments issued by that entity to drop. Exposure to this type of risk is controlled through minimum risk ratings and limits on the maximum amount and degree of concentration by asset class and/or institution.

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 Republic of Chile.

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 certificates of deposit and time deposits allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

5.4 Active management risk:

Depending on their characteristics, objectives and specialization, portfolio managers can manage investments either actively or passively. Under a passive strategy, the manager invests in instruments that are very similar to the benchmark securities in order to achieve a similar performance in terms of risks and returns. In contrast, an active manager takes positions in different instruments in order to generate higher returns than the benchmark, which will be reflected, for example, in the portfolio duration or currency composition. These positions add another source of risk that is not present under passive management, known as active risk.

5.5 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 the operational management of the funds to the CBC, thereby taking advantage of the infrastructure that the Central Bank uses to manage its international reserves. The International Investments Division 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.

6. ACCOUNTING CHANGES

As of 31 December 2013, there were no accounting changes relative to the previous year.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US$15,413,587,754 on 31 December 2013 and US$14,996,226,366 on 31 December 2012.

(a) The breakdown of investments carried at fair value on 31 December 2013 and 2012 is as follows:

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2013** US$	**2012** US$
Stocks	1	1,223,124,745	-
Other capitalization instruments	1	17,965,114	-
Government bonds	1	8,524,084,599	9,987,367,297
Indexed bonds	1	541,570,158	522,013,590
Treasury bills	1	2,384,983,014	2,236,622,448
Derivatives	1	14,436	8,613
Subtotal investments		12,691,742,066	12,746,011,948
Custodian investments, Central Bank of Chile	**Fair value hierarchy level**	**2013** US$	**2012** US$
Time deposits	1	2,721,845,688	2,250,214,418
Total		15,413,587,754	14,996,226,366

(b) The breakdown of investments by currency on 31 December 2013 and 2012 is as follows:

	Fair value instruments, J.P. Morgan			
	2013		2012	
Local Currency	**US$**	**% of IP**	**US$**	**% of IP**
U.S. Dollar	5,802,176,478	45.72%	6,388,576,673	50.12%
Euro	3,006,074,831	23.69%	5,107,380,094	40.07%
Yen	2,383,263,551	18.78%	1,250,055,181	9.81%
Other	1,500,227,206	11.81%	-	0.00%
Subtotal	12,691,742,066	100.00%	12,746,011,948	100.00%

	Fair value instruments, Central Bank of Chile			
	2013		2012	
Local Currency	**US$**	**% of IP**	**US$**	**% of IP**
U.S. Dollar	975,974,832	35.86%	1,137,551,408	50.55%
Euro	998,868,252	36.70%	899,265,270	39.97%
Yen	747,002,604	27.44%	213,397,740	9.48%
Subtotal	2,721,845,688	100.00%	2,250,214,418	100.00%
Total	15,413,587,754		14,996,226,366	

(c) The total value of assets by risk segment on 31 December 2013 and 2012 is as follows:

	2013		2012	
Risk segment	**Market value US$**	**% Market value**	**Market value US$**	**% Market value**
Capitalization instruments	1,241,089,859	8.05%	-	0.00%
Bank (*)	2,727,421,882	17.69%	2,251,688,714	15.01%
Sovereign bonds	11,450,637,771	74.26%	12,746,003,334	84.99%
Total	15,419,149,512	100.00%	14,997,692,048	100.00%

	2013		2012	
Asset class	**Market value US$**	**% Market value**	**Market value US$**	**% Market value**
Capitalization instruments	1,241,089,859	8.05%	-	0.00%
Money market (*)	5,112,404,896	33.16%	4,488,311,161	29.93%
Sovereign bonds	8,524,084,599	55.28%	9,987,367,297	66.59%
Inflation-indexed bonds	541,570,158	3.51%	522,013,590	3.48%
TOTAL	15,419,149,512	100.00%	14,997,692,048	100.00%

(*) Includes cash and cash equivalents.

8. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US$23,679 on 31 December 2013 and US$173,390 on 31 December 2012.

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

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2013** US$	**2012** US$
Derivatives	1	23,679	173,390
Total investments		23,679	173,390

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

	Fair value instruments, J.P. Morgan			
	2013		2012	
Local currency	**US$**	**% of IP**	**US$**	**% of IP**
U.S. Dollar	-	0.00%	28,904	16.67%
Euro	11,840	50.00%	57,791	33.33%
Yen	11,839	50.00%	86,695	50.00%
Total	23,679	100.00%	173,390	100.00%

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

	2013		2012	
Risk segment	**Market value US$**	**% Market value**	**Market value US$**	**%Market value**
Bank	23,679	100.00%	173,390	100.00%

	2013		2012	
Asset class	**Market value US$**	**% Market value**	**Market value US$**	**% Market value**
Money market	23,679	100.00%	173,390	100.00%

9. CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2013 and 2012:

	2013					2012			
	Contributions US$	**Withdrawals** US$	**Commissions** US$	**Custodian fees** US$		**Contributions** US$	**Withdrawals** US$	**Commissions** US$	**Custodian fees** US$
January	-	-	-	-	January	1,700,000,000	-	-	-
February	-	-	-	(312,612)	February	-	-	-	220,255
March	-	-	(197,320)	-	March	-	-	192,003	-
April	-	-	-	-	April	-	-	-	-
May	603,385,350	-	-	(126,127)	May	-	-	-	-
June	-	-	(197,319)	(188,745)	June	-	-	192,004	-
July	-	-	-	-	July	-	-	-	-
August	-	-	-	-	August	-	-	-	-
September	-	-	(197,319)	(189,738)	September	-	-	192,004	-
October	-	-	-	-	October	-	-	-	-
November	-	-	-	-	November	-	-	-	-
December	-	-	(197,319)	(562,198)	December	-	-	192,004	310,645
Total	603,385,350	-	(789,277)	(1,379,420)	Total	1,700,000,000	-	768,015	530,900

10. INTEREST EARNED

The breakdown of income from interest earned on 31 December 2013 and 2012 is as follows:

	2013 US$	2012 US$
Interest earned on debt securities at fair value through profit or loss	177,632,287	201,889,951

11. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2013 and 2012 is as follows:

	2013 US$	2012 US$
Cash in custodian accounts	5,561,758	1,465,682

12. ESSF RETURNS

The breakdown of the fund's returns as of 31 December 2013 and 2012 is as follows:

	Accumulated return		
Type of return	**Current period**	**Last 12 month**	**Last 24 months**
Nominal	(0.88%)	(1.25%)	1.04%

13. FAIR VALUE

The ESSF has applied IRFS 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) as of 1 January 2013. The application is prospective according to the IRFS rule, but the ESSR has opted to apply it retrospectively for purposes of comparability.

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.

	31/12/13			31/12/12		
	Level	Net book value	Fair value	Level	Net book value	Fair value
		M$	M$		M$	M$
Financial assets						
Cash and cash equivalents	1	5,561,758	5,561,758	1	1,465,682	1,465,682
Stocks	1	1,223,124,745	1,223,124,745		-	-
Other capitalization instruments	1	17,965,114	17,965,114		-	-
Time deposits	1	2,721,845,688	2,721,845,688	1	2,250,214,418	2,250,214,418
Government bonds	1	8,524,084,599	8,524,084,599	1	9,987,367,297	9,987,367,297
Indexed bonds	1	541,570,158	541,570,158	1	522,013,590	522,013,590
Treasury bills	1	2,384,983,014	2,384,983,014	1	2,236,622,448	2,236,622,448
Derivatives	1	14,436	14,436	1	8,613	8,613
Financial liabilities						
Derivative financial instruments		23,679	23,679		173,390	173,390

In 2013 and 2012, all the assets and liabilities in the ESSF were measured according to the prices quoted in the stock 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.

14. 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 Custodian 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 2013 and 2012, the ESSF owned the following instruments under the item Securities lending:

2013 **Location**	**Nominal value**	**Market value** **US$**
Europe	181,800,000	253,848,594
United States of America	2,215,900,000	2,135,582,142
Total	2,397,700,000	2,389,430,736

2012 **Location**	**Nominal value**	**Market value** **US$**
Europe	853,312,000	1,318,472,065
United States of America	3,405,115,000	3,539,273,074
Total	4,258,427,000	4,857,745,139

15. SECURITIES CUSTODY

As of 31 December 2013, 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 (*)	-	-	-	15,413,564,075	100%	99.964%
Total investment portfolio in custody				15,413,564,075	100%	99.964%

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

As of 31 December 2012, securities custody was 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 (*)	-	-	-	14,996,052,976	100%	99.990%
Total investment portfolio in custody				14,996,052,976	100%	99.990%

16. SUBSEQUENT EVENTS

On 31 January 2014, Mr. Sergio Frías Cervantes presented his voluntary and irrevocable resignation from the position of General Treasurer of Chile, effective 10 March 2014. He was replaced by Mr. Víctor Vidal Gana, Director of the Legal Division (provisional), as Interim General Treasurer. On 12 March, Mr. Hernán Frigolett Córdova was appointed General Treasurer of Chile (provisional).

Between 1 January 2014 and the date of issue of these financial statements (31 March 2014), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

Hernán Frigolett Córdova
Tesorero General de la República (T. y P.)

Jorge Obaid Cornejo
Jefe de División Finanzas Públicas
Tesorería General de la República

Jaime Del Solar Honorato
Jefe de Contabilidad Gubernamental
Tesorería General de la República

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CHAPTER 11

Financial Statements: Pension Reserve Fund

Financial statements for the years ended 31 December 2013 and 2012 and independent auditors' report[29]

29 The financial statements of the Pension Reserve Fund for the years ended on 31 December 2013 and 2012 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish.

Deloitte.

Deloitte
Auditores y Consultores Limitada
Rosario Norte 407
RUT: 80.276.200-3
Las Condes, Santiago
Chile
Fono: (56-2) 2729 7000
Fax: (56-2) 2374 9177
deloittechile@deloitte.com
www.deloitte.cl

INFORME DE LOS AUDITORES INDEPENDIENTES

A los señores Tesorería General de la República
Fondo de Reserva de Pensiones

Hemos efectuado una auditoría a los estados financieros adjuntos de Fondo de Reserva de Pensiones (en adelante el "Fondo"), que comprenden los estados de situación financiera al 31 de diciembre de 2013 y 2012 y los correspondientes estados de resultados, de resultados integrales, de cambios en el patrimonio neto y de flujos de efectivo por los años terminados en esas fechas y las correspondientes notas a los estados financieros.

Responsabilidad de la Administración por los estados financieros

Tesorería General de la República, es responsable por la preparación y presentación razonable de estos estados financieros de acuerdo con Normas Internacionales de Información Financiera. Esta responsabilidad incluye el diseño, implementación y mantención de un control interno pertinente para la preparación y presentación razonable de los estados financieros, para que éstos estén exentos de representaciones incorrectas significativas, ya sea debido a fraude o error.

Responsabilidad del auditor

Nuestra responsabilidad consiste en expresar una opinión sobre estos estados financieros a base de nuestras auditorías. Efectuamos nuestras auditorías de acuerdo con normas de auditoría generalmente aceptadas en Chile. Tales normas requieren que planifiquemos y realicemos nuestro trabajo con el objeto de lograr un razonable grado de seguridad de que los estados financieros están exentos de representaciones incorrectas significativas.

Una auditoría comprende efectuar procedimientos para obtener evidencia de auditoría sobre los montos y revelaciones en los estados financieros. Los procedimientos seleccionados dependen del juicio del auditor, incluyendo la evaluación de los riesgos de representaciones incorrectas significativas de los estados financieros, ya sea debido a fraude o error. Al efectuar estas evaluaciones de los riesgos, el auditor considera el control interno pertinente para la preparación y presentación razonable de los estados financieros del Fondo con el objeto de diseñar procedimientos de auditoría que sean apropiados en las circunstancias, pero sin el propósito de expresar una opinión sobre la efectividad del control interno del Fondo. En consecuencia, no expresamos tal tipo de opinión. Una auditoría incluye, también, evaluar lo apropiadas que son las políticas de contabilidad utilizadas y la razonabilidad de las estimaciones contables significativas efectuadas por la administración del Fondo, así como una evaluación de la presentación general de los estados financieros.

Consideramos que la evidencia de auditoría que hemos obtenido es suficiente y apropiada para proporcionarnos una base para nuestra opinión de auditoría.

Opinión

En nuestra opinión, los mencionados estados financieros presentan razonablemente, en todos sus aspectos significativos, la situación financiera de Fondo de Reserva de Pensiones al 31 de diciembre de 2013 y 2012 y los resultados de sus operaciones y los flujos de efectivo por los años terminados en esas fechas, de acuerdo con Normas Internacionales de Información Financiera.

Otros Asuntos

Como se indica en Nota 1, el Fondo de Reserva de Pensiones está destinado a completar el financiamiento de obligaciones fiscales derivadas de la garantía estatal de pensiones mínimas de vejez, invalidez y sobrevivencia regulada en el Decreto Ley N°3.500 de 1980 y de las pensiones asistenciales reguladas en el Decreto Ley N°869 de 1975.

Como se indica en Nota 1, con fecha 13 de agosto de 2013 el Fondo de Reserva de Pensiones, informó adecuaciones y modificaciones efectuadas a las directrices de inversión del Fondo.

Deloitte.

Marzo 31, 2014

Jorge Ortiz Martínez
12.070.100-2

PENSION RESERVE FUND

STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2013 AND 2012
Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	11	19,560,358	32,170,420
FINANCIAL ASSETS AFFECTING INCOME			
Stocks		1,193,788,399	926,580,864
Other capitalization instruments		17,512,332	16,079,305
Corporate bonds		1,416,294,791	1,125,867,507
Time deposits		8,751,703	12,176,171
Government bonds		3,699,548,640	2,984,292,505
Indexed bonds		979,372,236	786,109,583
Derivatives		373,370	31,918
TOTAL INVESTMENTS	7	7,315,641,471	5,851,137,853
TOTAL ASSETS		7,335,201,829	5,883,308,273
LIABILITIES			
Derivative financial instruments	8		
TOTAL LIABILITIES		87,324	54,008
NET EQUITY		87,324	54,008
Fisco resources		5,072,618,668	3,875,249,741
Contributions by the Fisco	9	1,376,749,786	1,197,368,927
Accumulated results		810,635,597	530,345,677
Income in the year		75,110,454	280,289,920
NET EQUITY		7,335,114,505	5,883,254,265
TOTAL LIABILITIES AND NET EQUITY		7,335,201,829	5,883,308,273

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

PENSION RESERVE FUND

STATEMENT OF INCOME
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
OPERATING INCOME			
Interest earned	10	148,191,596	111,091,492
Income from dividends		25,872,663	19,559,401
Net unrealized gains from price fluctuations		24,580,106	182,922,219
Total net operating income		198,644,365	313,573,112
OPERATING LOSSES			
Net loss from the sale of financial instruments		(119,182,487)	(32,052,748)
Total net operating loss		(119,182,487)	(32,052,748)
Net operating income		79,461,878	281,520,364
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(1,032,599)	(520,186)
Custodian's fees and external portfolio managers' fees	9	(3,318,825)	(639,669)
Other custodian expenses	9	-	(70,589)
INCOME IN THE YEAR		75,110,454	280,289,920

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

PENSION RESERVE FUND

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	**2013** US$	**2012** US$
INCOME IN THE YEAR		75,110,454	280,289,920
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS		-	-
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS		-	-
TOTAL OTHER COMPREHENSIVE INCOME		-	-
COMPREHENSIVE INCOME IN THE YEAR		75,110,454	280,289,920

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

PENSION RESERVE FUND

STATEMENT OF CHANGES IN NET EQUITY
31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	Fisco resources US$	Accumulated results US$	Income for the year US$	Total US$
Opening balance, 1 January 2013		5,072,618,668	530,345,677	280,289,920	5,883,254,265
Distribution of income from previous year		-	280,289,920	(280,289,920)	-
Contributions by the Fisco	9	1,376,749,786	-	-	1,376,749,786
Income for the year		-	-	75,110,454	75,110,454
Closing balance, 31 December 2013		6,449,368,454	810,635,597	75,110,454	7,335,114,505
Opening balance, 1 January 2012		3,875,249,741	404,772,705	125,572,972	4,405,595,418
Distribution of income from previous year		-	125,572,972	(125,572,972)	-
Contributions by the Fisco	9	1,197,368,927	-	-	1,197,368,927
Income for the year		-	-	280,289,920	280,289,920
		-			
Closing balance, 31 December 2012		5,072,618,668	530,345,677	280,289,920	5,883,254,265

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

PENSION RESERVE FUND

STATEMENT OF CASH FLOW—INDIRECT METHOD
FOR THE YEARS ENDING 31 DECEMBER 2013 AND 2012
(Figures in U.S. dollars - US$)

	Notes	2013 US$	2012 US$
FLUJOS DE EFECTIVO POR ACTIVIDADES DE OPERACION			
Income in the year		75,110,454	280,289,920
Net unrealized losses		(24,580,106)	(182,922,219)
Changes in fund management and custody		(1,439,890,196)	(1,264,172,489)
Net cash flows from operating activities		(1,389,359,848)	(1,166,804,788)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	1,376,749,786	1,197,368,927
Net cash flows from financing activities		1,376,749,786	1,197,368,927
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(12,610,062)	30,564,139
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		32,170,420	1,606,281
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	11	19,560,358	32,170,420

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

PENSION RESERVE FUND

NOTES TO THE FINANCIAL STATEMENTS
AS OF 31 DECEMBER 2013 and 2012
(Figures in U.S. dollars—US$)

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 General 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 limits on the fund's investments.

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

(f) Decree Nº 1,636 of 2010, 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 Pension Reserve Fund.

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

- To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.

- To 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. 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.

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

- To verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records.

- To process transactions associated with contributions to and withdrawals from the sovereign wealth funds, transfers between external managers and payments associated with the management of the sovereign wealth funds, as required.

- To contract external managers and custodians for the fund.

- To maintain a current manual of procedures for the handling of all functions and duties described in this Article.

- To carry out any additional forms of management support, coordination or consulting necessary for the performance of these functions.

The information for the accounting of the sovereign wealth funds is provided by an entity such as the General 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 1,925 of 2013, which establishes the new investment guidelines for the Pension Reserve Fund.

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

(i) Ministry of Finance Official Letter Nº 1,617 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.

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 CBC'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 13 August 2013, the Finance Ministry issued the new investment guidelines for the Pension Reserve Fund. These guidelines, which entered into force on 16 August 2013, replace and rescind the investment guidelines contained in Official Letter Nº 1,637, issued by the Finance Ministry in 2011.

On 26 February 2010, the Centro de Microdatos 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.

On 31 January 2014, a team of expert consultants commissioned by the Finance Ministry issued an Actuarial Study Report on 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.

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.

a. 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).

Additionally, the fund opted for the early application of IFRS 9: Financial Instruments (issued in November 2009 and modified in October 2010), with the initial application dating to 1 January 2009. IFRS 9 introduces new requirements for classifying and measuring financial assets under the scope of IAS 39: Financial Instruments. Specifically, IFRS 9 requires that all financial assets be classified and later measured either at amortized cost or fair value based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

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 decided not to designate any debt instruments that meet the amortized cost criteria as measured at fair value through profit or loss.

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

Investments in equity instruments (stocks) 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 that the custodian, J.P. Morgan Chase & Co., provided to the Central Bank of Chile, as fiscal agent.

The financial statements presented by the General 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

b. Period covered—The financial statements cover the years between 1 January and 31 December 2013 and 2012, respectively.

c. 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.

The figures are presented in U.S. dollars. Contributions to the PRF have been made in dollars, and investments have primarily been made in U.S. dollars.

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.

d. Investment classification and valuation—The fund's investments comprise liquid foreign currency assets and 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 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 identified 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:

Government bonds, corporate bonds, indexed bonds, agency bullet bonds, Treasury bills, commercial papers and derivative instruments. The basis for classifying 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 on the comprehensive income statement.

Stocks and other capitalization instruments are carried at fair value and any changes in value are recognized directly through profit or loss on the comprehensive income statement.

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 cost:

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, 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 PRF 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).

e. 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.

f. Funds under management—These are securities delivered to the CBC, acting as fiscal agent for the management of PRF resources. The securities can be totally or partially employed in the performance of the assigned duties.

g. Funds in custody—These are securities delivered by the CBC, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for PRF securities and instruments.

h. 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 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.

i. Statement of Cash Flows

For the purposes 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 financial 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.

j. 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.

k. Reclassification—The financial statements for 31 December 2012 have been reclassified relative to the financial statements presented last year. This reclassification does not have a significant impact on the financial statements of this year and is solely for the purpose of comparability.

l. New accounting rules

(i) The following new rules and amendments have been adopted in these financial statements.

New IFRSs	Compulsory application date
IFRS 10: Consolidated financial statements	Annual periods beginning on or after 1 January 2013
IFRS 11: Joint arrangements	Annual periods beginning on or after 1 January 2013
IFRS 12: Disclosure of interest in other entities	Annual periods beginning on or after 1 January 2013
IAS 27 (2011): Separate financial statements	Annual periods beginning on or after 1 January 2013
IAS 28 (2011): Investments in associates and joint ventures	Annual periods beginning on or after 1 January 2013
IFRS 13: Fair value measurement	Annual periods beginning on or after 1 January 2013
IAS 19: Employee benefits (2011)	Annual periods beginning on or after 1 January 2013

IFRS amendments	Compulsory application date
IAS 1: Presentation of financial statements: Presentation of items of other comprehensive income	Annual periods beginning on or after 1 July 2012
IFRS 1: First-time adoption of IFRS – Government loans	Annual periods beginning on or after 1 January 2013
IFRS 7: Financial Instruments: Disclosures – Amendment on offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2013
Annual improvements cycle 2009–2011: Amendments to five IFRSs	Annual periods beginning on or after 1 January 2013
IFRS 10, 11 and 12: Consolidated financial statements, joint arrangements and disclosure of interest in other entities: Transition guidance	Annual periods beginning on or after 1 January 2013

The PRF management deems that the adoption of the new rules and amendments described above has not had significant impact or effect on the fund’s financial statements.

(ii) The following new amendments and interpretations have been issued, but they have not yet entered into force:

IFRS amendments	Compulsory application date
IAS 19: Employee benefits: Defined benefits plan—Employee contributions	Annual periods beginning on or after 1 July 2014
IAS 32: Financial instruments: Presentation – Clarification of the rules on offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014
Investment entities: Amendments to IFRS 10: Consolidated financial statements; IFRS 12: disclosure of interest in other entities; and IAS 27: Separate financial statements	Annual periods beginning on or after 1 January 2014
IAS 36: Impairment of assets: Recoverable amounts disclosures for nonfinancial assets	Annual periods beginning on or after 1 January 2014
IAS 39: Financial instruments: Recognition and measurement—Novation of derivatives and continuation of hedge accounting	Annual periods beginning on or after 1 January 2014
Annual improvements cycle 2010–2012: Amendments to six IFRSs	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2011–2013: Amendments to four IFRSs	Annual periods beginning on or after 1 July 2014

New interpretations	
IFRIC 21, Levies	Annual periods beginning on or after 1 January 2014

The PRF management deems that the future adoption of the amendments and interpretations described above will not have a significant impact on the fund’s financial statements.

3. PRF INVESTMENT POLICY

The PRF management objective is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, in both the Article 4 portfolio and the externally managed portfolio. To this end, an investment portfolio (IP) will be established from the sum of the two portfolios mentioned above. The specific guidelines, parameters and rules are contained in the following sections.

For the PRF Article 4 portfolio, 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 the following section. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

3.1. Guidelines and parameters

3.1.1. 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) Stocks. The first two classes are allocated to the Article 4 portfolio; the last two classes (corporate bonds and stocks) 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 allocation		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: Corporates Bond Index (*unhedged*)
Stocks	15%	MSCI All Country World Index [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 Bank as fiscal agent. The third and fourth asset classes (corporate bonds; and stocks and other assets) make up the externally managed portfolio; they will be acquired by the external portfolio managers and managed directly by these external managers.

3.1.2 Article 4 portfolio

3.1.2.1 Risk budget

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

3.1.2.2 Eligible issuers and currencies

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

3.1.2.3 Eligible instruments

3.1.2.3.1 Eligible instruments for sovereign and government-related 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, for whatever reason, the fiscal agent will have a period of seven business days to sell the instrument.

3.1.2.3.2 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, for whatever reason, the fiscal agent will have a period of seven business days to sell the instrument.

3.1.2.4 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 average monthly value of the Article 4 portfolio. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of the Article 4 portfolio returns.

Eligible instruments for holding cash in foreign currency are current 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 Article 4 portfolio, a maximum amount equivalent to US$ 20 million U.S. dollars can be invested in a given bank. However, whenever a contribution is made to the Article 4 portfolio, a maximum amount equivalent to US$ 80 million U.S. dollars can be invested in a given bank during the waiver period established in section 3.1.6.

3.1.2.5 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.

(b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of AA– 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 cash delivery or net settlement.

(d) The counterparty risk associated with each cash delivery contract will equal 100% of the notional value of the forward or swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap 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 3.1.2.4).

(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 equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap 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 3.1.2.4). In the case of net settlement contracts without a close-out netting clause, counterparty risk will be treated the same as in cash delivery contracts.

(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 forwards contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio.

3.1.2.6 Limits on sovereign and government-related bonds

The investment limits by credit rating 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: Investment limits by credit rating for sovereign and government-related bonds.

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.

3.1.3 Externally managed portfolio

3.1.3.1 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. Stocks: annual ex ante tracking error of 60 basis points.

3.1.3.2 Eligible issuers and currencies

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

3.1.3.3 Eligible instruments

3.1.3.3.1 Eligible instruments for corporate bonds

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

- ✓ 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 in the externally managed portfolio.
- ✓ 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.
- ✓ 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.

3.1.3.3.2 Eligible instruments for stocks

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

- ✓ 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.
- ✓ Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of stocks included in the stock benchmark, provided that they do not require the use of tax agents in the issuing country of the underlying asset.
- ✓ Exchange-traded futures on stock indexes, used for hedging purposes to minimize differences relative to the applicable stock 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 in the externally managed portfolio.
- ✓ If the external portfolio managers receive an ineligible instrument as the result of corporate events affecting the stocks in which the portfolio is invested, the situation must be reported to the Finance Ministry through the fiscal agent up to 31 December 2013 and, after that date, directly by the external portfolio manager, so that the Ministry can evaluate the situation and stipulate the steps to be taken.

3.1.3.4 Eligible instruments for cash in foreign currency in the externally managed portfolio

The external portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the average monthly value of the portfolio of each external manager. 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 U.S. dollars in a given bank. However, whenever a contribution is made to the externally managed portfolios, a maximum amount equivalent to US$ 80 million U.S. dollars can be invested in a given bank during the waiver period established in section 3.1.6.

3.1.3.5 Limits on forwards or swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark and solely with counterparties that have a long-term rating of AA– 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 3.1.2.5. However, the associated counterparty risk must be taken into account for the purpose of compliance with the limits established in section 3.1.3.4.

3.1.3.6 Limits by issuer 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: Limits by issuer's credit quality for corporate bonds.

Credit rating	Limit by issuer
AAA	15%
AA+	10%
AA	10%
AA–	10%
A+	5%
A	5%
A–	5%
BBB+	5%
BBB	5%
BBB–	5%

3.1.3.7 Limits by credit rating for corporate bonds

The limit by credit rating 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 4.

Table 4: Limits by credit rating of corporate bonds

Rating	Maximum % of the externally managed portfolio
AAA	100%
AA+	
AA	
AA–	
A+	60%
A	
A–	
BBB+	45%
BBB	
BBB–	

During the transition period established in the Agency Decree, the fiscal agent is responsible for monitoring the investment limits by issuer and by credit rating in the corporate bond asset class; starting on 1 January 2014, this responsibility will be transferred to the Ministry of Finance. For the purpose of monitoring said limits, 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.

3.1.4 Limits on currency spot 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).

3.1.5 Special restrictions

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

For the externally managed portfolio, the external managers can contract currency futures, forwards or swaps, where the aggregate notional amount cannot exceed 10% of the portfolio under their management.

The following restrictions 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, Thailand, Taiwan and Turkey in the stock 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, Thailand, Taiwan and Turkey; and (iii) investments in China can only be made through the stock market in Hong Kong.

External managers cannot invest in their own stocks or in corporate bonds issued by their own companies.

3.1.6 Rebalancing

During the transition period established in the Agency Decree, through 31 December 2013, in the event that deviations by asset class deriving from changes in the price or market valuation of the instruments should exceed, at the close of any given day, the deviation ranges established in Table 5, the fiscal agent must implement or, as the case may be, instruct the external manager to implement convergence to the benchmark established in Table 1. The fiscal agent will have 10 bank business days to achieve this convergence, during which the fiscal agent and external managers will be granted a waiver of compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio and instruments eligible for cash in foreign currency applicable to the Article 4 portfolio. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

Table 5: Deviation range for rebalancing

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

In addition, in the event of any contributions made during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent must converge to the benchmark established in Table 1. In this case, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio, instruments eligible for cash in foreign currency applicable to the Article 4 portfolio, the risk budget for the externally managed portfolio and instruments eligible for cash in foreign currency applicable to the externally managed portfolio.

The custodian will report the relative share of each asset class in the investment portfolio. Based on this information, the fiscal agent will carry out the rebalancing of asset classes, as required, during the transition period established in the Agency Decree, through 31 December 2013.

Starting on 1 January 2014, the Finance Ministry will monitor compliance with the target ranges and, at least once a year, will instruct the amounts to be rebalanced between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 1, as needed. In addition, in the event of any contributions, the Finance Ministry will instruct the amounts to be transferred to and/or between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 1. In the event of any withdrawals, the Finance Ministry will instruct the amounts to be withdrawn from the externally managed portfolios and/or the Article 4 portfolio. During each rebalancing episode, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio, instruments eligible for cash in foreign currency applicable to the Article 4 portfolio, the risk budget for the externally managed portfolio and instruments eligible for cash in foreign currency applicable to the externally managed portfolio. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

3.2 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.

3.3 Securities lending program

3.3.1 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 custodian guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

3.3.2 Externally managed portfolio

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

3.4 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 days of detecting the situation. For the externally managed corporate bond portfolio, this period will be extended to one calendar month from the detection of the situation.

During the transition period established in the Agency Decree, the Ministry of Finance can extend the waiver period at the request of the fiscal agent or its delegate, when justified. Should such an event arise in the externally managed portfolios during the transition period, the fiscal agent will report its opinion on submitting the request. Starting on 1 January 2014, the Ministry of Finance can extend the waiver period applicable to the Article 4 portfolio at the request of the fiscal agent or its delegate, when justified; and can extend the waiver period applicable to the externally managed portfolio at the direct request of the external managers, when justified.

3.5 Entry into force

The provisions of section 3.1. will enter into force on 16 August 2013. Until that date, the portfolios will continue to be subject to the provisions of section II of the previous investment guidelines.

3.6 Other provisions related to the external managers during the transition period established in the Agency Decree, through 31 December 2013

In the event that during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent exercises the early termination of the contract for the external management of fiscal resources held by one of the external portfolio managers, where the cause of early termination is problems of solvency, capacity, severe or recurrent noncompliance with instructions, fraud or any other serious situation, the fiscal agent is expressly authorized to transfer all or part of the fiscal resources managed under that contract to any other external portfolio manager with a current contract.

In the event that the fiscal agent cannot transfer the fiscal resources managed under the external portfolio management contract subject to early termination for the reasons outlined in the above paragraph, the fiscal agent can, with the prior approval of the Finance Minister, authorize or exercise the management or conservation functions that it deems necessary, during the transition period established in the Agency Decree, through 31 December 2013, until a new selection process can be initiated for choosing and contracting an external portfolio manager.

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 can 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 measures performance and reports earnings, as well as the currency in which it receives contributions from the Chilean government.

5. FINANCIAL RISK MANAGEMENT

The sovereign wealth funds are exposed to various types of risk as a result of their investment in different financial instruments, including market risk, credit risk, liquidity risk, active management risk and operational risk. To limit exposure to these different risks, the Ministry of Finance includes investment restrictions in its performance guidelines, which must be followed by the Central Bank of Chile (CBC) in carrying out its operations. Compliance is monitored by an independent area within the Bank, by the custodian and, ultimately, by the Finance Ministry. In addition, the institutional framework and infrastructure of the CBC provide adequate controls for mitigating operational risk.

5.1 Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions. In the specific case of international fixed-income investors, the financial variables with the biggest impact on the prices of the instruments in their portfolios are interest rates and exchange rates.

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.

Exchange rate risk:

Because the fund's return is measured in dollars while the portfolio includes investments denominated in euros and yen, the value of investments is also affected by exchange rate fluctuations. For example, the value in dollars of a sovereign bond issued in euros is affected by the USD/EUR exchange rate trend. An appreciation (depreciation) of the dollar thus generates additional losses (gains) over and above the effect of interest rate movements. The fund's exchange rate exposure, measured in dollars, is 50%, and it derives from investments in euros (40%) and yen (10%).

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. Moreover, changes in market perception about the solvency of an issuer can cause the market value of instruments issued by that entity to drop. Exposure to this type of risk is controlled through minimum risk ratings and limits on the maximum amount and degree of concentration by asset class and/or institution.

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 Republic of Chile.

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 PRF, 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 certificates of deposit and time deposits allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

5.4 Active management risk:

Depending on their characteristics, objectives and specialization, portfolio managers can manage investments either actively or passively. Under a passive strategy, the manager invests in instruments that are very similar to the benchmark securities in order to achieve a similar performance in terms of risks and returns. In contrast, an active manager takes positions in different instruments in order to generate higher returns than the benchmark, which will be reflected, for example, in the portfolio duration or currency composition. These positions add another source of risk that is not present under passive management, known as active risk.

5.5 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 the operational management of the funds to the CBC, thereby taking advantage of the infrastructure that the Central Bank uses to manage its international reserves. The International Investments Division 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.

6. ACCOUNTING CHANGES

As of 31 December 2013, there were no accounting changes relative to the previous year.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US$7,315,641,471 on 31 December 2013 and US$5.851,137,853 on 31 December 2012.

(a) The breakdown of investments carried at fair value on 31 December 2013 and 2012 is as follows:

Custodian investments, J.P. Morgan	**Fair value hierarchy**	**2013** US$	**2012** US$
Stocks	1	1,193,788,399	926,580,864
Other capitalization instruments	1	17,512,332	16,079,305
Corporate bonds	1	1,416,294,791	1,125,867,507
Government bonds	1	3,699,548,640	2,984,292,505
Indexed bonds	1	979,372,236	786,109,583
Derivatives	1	373,370	31,918
Subtotal investments		7,306,889,768	5,838,961,682

Custodian investments Central Bank of Chile	**Fair value hierarchy**	**2013** US$	**2012** US$
Time deposits	1	8,751,703	12,176,171
Total		7,315,641,471	5,851,137,853

(b) The breakdown of investments by currency on 31 December 2013 and 2012 is as follows:

	Fair value instruments, J.P. Morgan			
	2013		**2012**	
Local currency	US$	**% of IP**	US$	**% of IP**
U.S. Dollar	3,034,390,393	41.53%	2,335,386,736	40.00%
Euro	1,796,451,425	24.59%	1,365,455,385	23.39%
Yen	976,996,626	13.37%	848,875,353	14.54%
Other	1,499,051,324	20.51%	1,289,244,208	22.08%
Subtotal	7,306,889,768	100.00%	5,838,961,682	100.00%

	Fair value instruments, Central Bank of Chile			
	2013		**2012**	
Local currency	US$	**% of IP**	US$	**% of IP**
U.S. Dollar	-	0.00%	3,400,094	27.92%
Other	8,751,703	100.00%	8,776,077	72.08%
Subtotal	8,751,703	100.00%	12,176,171	100.00%
Total	7,315,641,471		5,851,137,853	

(c) The total value of assets by risk segment on 31 December 2013 and 2012 is as follows:

	2013		**2012**	
Risk segment	**Market value** US$	**% Market value**	**Market value** US$	**% Market value**
Stocks	1,211,674,101	16.51%	942,692,087	16.05%
Bank (*)	28,312,061	0.39%	44,346,591	0.74%
Bonds	6,095,215,667	83.10%	4,896,269,595	83.21%
Total	7,335,201,829	100.00%	5,883,308,273	100.00%

	2013		**2012**	
Asset class	**Market value** US$	**% Market value**	**Market value** US$	**% Market value**
Stocks	1,211,674,101	16.51%	942,692,087	16.05%
Bank (*)	28,312,061	0.39%	44,346,591	0.74%
Corporate bonds	1,416,294,791	19.31%	1,125,867,507	19.13%
Sovereign bonds	3,699,548,640	50.44%	2,984,292,505	50.72%
Inflation-indexed bonds	979,372,236	13.35%	786,109,583	13.36%
Total	7,335,201,829	100.00%	5,883,308,273	100.00%

(*) Includes cash and cash equivalents.

8. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US$87,324 on 31 December 2013 and US$54,008 on 31 December 2012.

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

Custodian investments, J.P. Morgan	**Fair value hierarchy level**	**2013** US$	**2012** US$
Derivatives	1	87,324	54,008
Total investments		87,324	54,008

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

	Fair value instruments, J.P. Morgan			
	2013		**2012**	
Local currency	**US$**	**% of IP**	**US$**	**% of IP**
U.S. Dollar	43,662	50.00%	18,001	33.33%
Euro	8,732	10.00%	4,499	8.33%
Other	34,930	40.00%	31,508	58.34%
Total	87,324	100.00%	54,008	100.00%

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

	2013		**2012**	
Risk segment	**Market value** US$	**% Market value**	**Market value** US$	**% Market value**
Bank	87,324	100.00%	54,008	100.00%

	2013		**2012**	
Asset class	**Market value** US$	**% Market value**	**Market value** US$	**% Market value**
Money market	87,324	100.00%	54,008	100.00%

9. CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2013 and 2012:

	2013				2012				
	Contributions	**Withdrawals**	**Commissions**	**Custodian fees**	**Contributions**	**Withdrawals**	**Commissions**	**Custodial fees**	**Other expenses**
	US$	US$	US$	US$	US$	US$	US$	US$	US$
January	-	-	-	-	-	-	-	-	(70,589)
February	-	-	-	(314,065)	-	-	-	(91,572)	-
March	-	-	(258,149)	-	-	-	(130,047)	-	-
April	-	-	-	(1,166,662)	-	-	-	-	-
May	1,376,749,786	-	-	(469,461)	-	-	-	-	-
June		-	(258,150)	(467,175)	1,197,368,927	-	(130,047)	(132,413)	-
July	-	-	-	(221,550)	-	-	-	-	-
August	-	-	-	-	-	-	-	(48,801)	-
September	-	-	(258,150)	(355,881)	-	-	(130,047)	-	-
October	-	-	-	(117,810)	-	-	-	-	-
November	-	-	-	-	-	-	-	(366,884)	-
December	-	-	(258,150)	(206,221)	-	-	(130,047)	-	-
TOTAL	**1,376,749,786**	**-**	**(1,032,599)**	**(3,318,825)**	**1,197,368,927**	**-**	**(520,186)**	**(639,669)**	**(70,589)**

10. INTEREST EARNED

The breakdown of income from interest earned on 31 December 2013 and 2012 is as follows:

	2013 US$	2012 US$
Interest earned on debt securities at fair value through profit or loss	148,191,596	111,091,492

11. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2013 and 2012 is as follows:

	2013 US$	2012 US$
Cash in custodian accounts	19,560,358	32,170,420

12. PRF RETURNS

The breakdown of the fund's returns as of 31 December 2013 and 2012 is as follows:

		Accumulated return	
Type of return	**Current period**	**Last 12 months**	**Last 24 months**
Nominal	(0.26%)	1.02%	3.09%

13. FAIR VALUE

The PRF has applied IRFS 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) as of 1 January 2013. The application is prospective according to the IRFS rule, but the PRF has opted to apply it retrospectively for purposes of comparability.

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.

		31/12/13			31/12/12	
	Level	Net book value	Fair value	Level	Net book value	Fair value
Financial assets						
Cash and cash equivalents	1	19,560,358	19,560,358	1	32,170,420	32,170,420
Stocks	1	1,193,788,399	1,193,788,399	1	926,580,864	926,580,864
Other capitalization instruments	1	17,512,332	17,512,332	1	16,079,305	16,079,305
Corporate bonds	1	1,416,294,791	1,416,294,791	1	1,125,867,507	1,125,867,507
Time deposits	1	8,751,703	8,751,703	1	12,176,171	12,176,171
Government bonds	1	3,699,548,640	3,699,548,640	1	2,984,292,505	2,984,292,505
Indexed bonds	1	979,372,236	979,372,236	1	786,109,583	786,109,583
Derivatives	1	373,370	373,370	1	31,918	31,918
Financial liabilities						
Derivative financial instruments	1	87,324	87,324	1	54,008	54,008

In 2013 and 2012, all the assets and liabilities in the PRF were measured according to the prices quoted in the stock 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.

14. LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N°1,925 of 13 August 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 PRF Custodian 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 2013 and 2012, the PRF owned the following instruments under the item Securities lending:

2013

Location	**Nominal value**	**Market value US$**
Europe	40,950,000	62,341,161
United States of America	387,615,000	391,474,976
Total	428,565,000	453,816,137

2012 Location	**Nominal value**	**Market value US$**
Europe	18,000,000	27,650,230
United States of America	313,210,000	329,658,142
Total	331,210,000	357,308,372

15. SECURITIES CUSTODY

As of 31 December 2013, securities custody is as follows:

	Securities custody					
	National custody			Foreign custody		
Entity	**Amount in custody (US$)**	**% of total investments in instruments issued by national issuers**	**% of total PRF assets**	**Amount in custody (US$)**	**% of total investments in instruments issued by foreign issuers**	**% of total PRF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	7,315,554,147	100.00%	99.73%
Total investment portfolio in custody	-	-	-	7,315,554,147	100.00%	99.73%

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

As of 31 December 2012, securities custody was as follows:

	Securities custody					
	National custody			Foreign custody		
Entity	**Amount in custody (US$)**	**% of total investments in instruments issued by national issuers**	**% of total PRF assets**	**Amount in custody (US$)**	**% of total investments in instruments issued by foreign issuers**	**% of total PRF assets**
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	5,851,083,845	100%	99.45%
Total investment portfolio in custody	-	-	-	5,851,083,845	100%	99.45%

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

16. SUBSEQUENT EVENTS

On 31January 2014, in accordance with the provisions of Article N° 7 of Law N° 20,128, the Ministry of Finance received an Actuarial Study Report on the sustainability of the Pension Reserve Fund from an independent third party. 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.

On 31 January 2014, Mr. Sergio Frías Cervantes presented his voluntary and irrevocable resignation from the position of General Treasurer of Chile, effective 10 March 2014. He was replaced by Mr. Víctor Vidal Gana, Director of the Legal Division (provisional), as Interim General Treasurer. On 12 March, Mr. Hernán Frigolett Córdova was appointed General Treasurer of Chile (provisional).

Between 1 January 2014 and the date of issue of these financial statements (31 March 2014), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

TESORERO GENERAL DE LA REPÚBLICA (TYP)

Hernán Frigolett Córdova
Tesorero General de la República (T. y P.)

Jorge Obaid Cornejo
Jefe de División Finanzas Públicas
Tesorería General de la República

Jaime Del Solar Honorato
Jefe de Contabilidad Gubernamental
Tesorería General de la República

* * * * * *

Appendix 1

Index of tables, figures, boxes and diagrams

Appendix 2

Glossary of Terms

Active management — An investment strategy aimed at earning higher returns than a benchmark index.

Alternative investments — Investments in instruments other than traditional securities (such as stocks and fixed-income instruments), in particular private equity, hedge funds, commodities and real estate.

Asset class — A specific investment category, such as stocks, corporate bonds, sovereign bonds and money market instruments. The assets in a given class generally have similar risk characteristics, react similarly in the market and are subject to the same regulations.

Basis point — One one-hundredth of a percentage point: 1 basis point = (1/100) of 1%, or 0.01.

Bond — A financial liability of an organization (for example, a company or a government) to investors under which the issuer undertakes not only to return the capital, but also to pay an agreed interest rate at a specific date(as).

Cash — Cash on hand and bank demand deposits.

Corporate bond — A bond issued by a corporation or company.

Credit default swaps (CDS) — Financial instruments used by investors to protect against default on bond payments. They can also be used to take speculative positions on the bond covered by the CDS.

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.

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 stock 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 time deposists.

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.

Recognition bond (bonos de reconocimiento) — A bond issued by the Chilean Institute for Pension Normalization on account of contributions made by workers to the former pay-as-you-go pension system prior to joining the current AFP system.

Return in local currency — A financial instrument's return in the denomination currency. Corresponds to the share of the return deriving from the interest rate level, interest rate movements, changes in credit quality and other factors.

Risk — The possibility of suffering financial losses; the variability of an investment's return.

Risk rating — The degree of solvency of the issuer of a financial instrument (a company or country), as defined by a risk rating institution.

Securities risk (reputational risk or headline risk) —The risk that the public's perception of an entity will worsen.

Sovereign bond — A bond issued by a government.

Spread — The difference between the yield rates at maturity of two fixed-income instruments, which is used to measure their relative risk.

Standard & Poor's Depositary Receipts (SPDR) — The first ETF, created in 1993 with the goal of replicating the performance of the U.S. S&P500 stock index.

Stock — An instrument that represents ownership or capital in a corporation or company. Buyers of these securities become owners or shareholders and thus share in the firm's earnings and losses.

TED spread — The difference between the bank lending rate (LIBOR) and the risk-free rate (U.S. Treasury bills). A larger TED spread is typically associated with less liquidity in the market.

Time-weighted rate of return (TWR) — A measure of returns calculated by compounding or multiplying the daily returns without taking into account any contributions or withdrawals. In contrast to the IRR, the TWR eliminates the contribution of net cash flows.

Total return — The sum of the return in the local currency and the return from exchange rate movements.

Tracking error (ex post or ex ante) — An indicator used to measure how closely a portfolio tracks its benchmark. The ex post tracking error is calculated with historical data; the ex ante tracking error is a prediction of future performance.

Value-at-Risk (VaR) — A measure of the potential loss in a portfolio over a given period of time and with a given probability.

Variable-income instruments — Stocks.

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

bp	Basis points
CBC	Central Bank of Chile
CBJ	Central Bank of Japan
CDS	Credit default swaps
CHF	Swiss Franc
ECB	European Central Bank
ESSF	Economic and Social Stabilization Fund
EUR	Euro
FC	Financial Committee
FED	U.S. Federal Reserve
GAPP	Generally accepted principles and practices
GDP	Gross domestic product
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
MBS	Mortgage-backed securities
MM US$	Millions of U.S. dollars
PRF	Pension Reserve Fund
TE	Tracking error
TWR	Time-weighted rate of return
UF	Unidad de Fomento (an inflation-indexed unit of account)
US$	U.S. dollar
USA	United States of America
USD	U.S. dollar
VaR	Value-at-Risk

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