Investment Guidelines Economic and Social Stabilization Fund

The following document corresponds to the translation of Section II of the Investment Guidelines for the Economic and Social Stabilization Fund (ESSF), Official Notice N° 68 from January, 2019. This section contains detailed information about the investment rules and restrictions that must be followed in order to invest the ESSF's resources.

II.- Guidelines for Investment of Resources

II.1 Management Objectives

The objective of managing the resources is to obtain exposure on the asset classes that are contained in the section II.3 below, also regarding with the specifics objectives defined in each investment guidelines showed in the section II.4.

II.2 Investment Portfolio

For the purpose of investing the Resources, an investment portfolio shall be created (hereinafter, "IP"), which shall be made up of the Portfolio managed by the Fiscal Agent, whose specific guidelines, parameters, and rules are contained in the sections below.

II.3 Asset Classes and Benchmarks

The fiscal resources of the IP shall be invested in two asset classes: 1) Treasury bills and sovereign bonds and 2) Inflation-indexed sovereign bonds (both of them for the Portfolio managed by the Fiscal Agent).

The benchmarks associated with each asset class are stipulated in Table 1 along with the composition that each asset class shall have as a percentage (%) of the total resources (hereinafter, "Strategic Asset Allocation").

Table 1: Strategic Asset Allocation and Benchmarks

Strategic Asset Allocation		
Asset Class	Benchmark	IP Percentage
Treasury bills and sovereign bonds	ICE BofA US Treasury Bill Index	11.9%
	ICE BofA Germany Treasury Bill Index	14.2%
	ICE BofA Japan Treasury Bill Index	10.8%
	Treasury bills	**36,9%**
	Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs	28.6%
	Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs	11.8%
	Bloomberg Barclays Global Aggregate - Treasury: Japan 7-10 Yrs	10.8%
	Bloomberg Barclays Global Aggregate - Treasury: Switzerland 5-10 Yrs	8.2%
	Sovereign bonds	**59.4%**
	Treasury bills and sovereign bonds total	**96.3%**
Inflation-indexed sovereign bonds	Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs	2.6%
	Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs	1.1%
	Inflation-indexed sovereign bonds total	**3.7%**
Total		**100.0%**

II.4 Investment Guidelines

The specific investment guidelines for each asset class portfolio are contained in the appendix which is indicated below:

- Appendix A: Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds investment guidelines.

II.5 Rebalancing Policy

The ESSF rebalancing policy requires convergence to the benchmark composition established in Table 1 in the following situations: i) when there is a cash contribution to the ESSF, and ii) when there is a cash withdrawal from the ESSF. However, the Ministry of Finance will determine the specific rebalancing date associated with i) and ii) of this paragraph. In the absence of i) and ii), the Ministry of Finance shall instruct a rebalancing of the ESSF at least once per year.

The aforementioned notwithstanding, when a rebalancing is instructed, the Financial Markets Division Manager of the Central Bank of Chile may request, via e-mail, to the International Finance Coordinator of the Ministry of Finance to maintain the positioning of the Portfolio managed by the Fiscal Agent relative to the benchmark and not converge to the benchmark established in Table 1. The International Finance Coordinator must authorize the maintenance of said positions via an e-mail addressed to the Financial Markets Division Manager of the Central Bank of Chile.

APPENDIX A

TREASURY BILLS AND SOVEREIGN BONDS, AND INFLATION-INDEXED SOVEREIGN BONDS INVESTMENT GUIDELINES.

1. Management Objectives

The objective of managing the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio of the ESSF is to obtain monthly total returns (gross of fees) similar to those of the benchmark by means of a passive management approach. The Fiscal Agent shall select the investment strategy that allows for achieving this objective, within the risk standards stipulated in the pertinent guidelines and parameters of section 2 below.

2. Guidelines and parameters

2.1 Benchmark

The benchmarks associated with the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio are stipulated in Table 1.

Table 1: Benchmarks

Asset Class		Benchmark
Treasury bills and sovereign bonds	US treasury bills	ICE BofA US Treasury Bill Index
	Germany treasury bills	ICE BofA Germany Treasury Bill Index
	Japan treasury bills	ICE BofA Japan Treasury Bill Index
	US sovereign bonds	Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs
	German sovereign bonds	Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs
	Japanese sovereign bonds	Bloomberg Barclays Global Aggregate - Treasury: Japan 7-10 Yrs
	Swiss sovereign bonds	Bloomberg Barclays Global Aggregate - Treasury: Switzerland 5-10 Yrs
Inflation-indexed sovereign bonds	US Inflation-indexed sovereign bonds	Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs
	German Inflation-indexed sovereign bonds	Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs

2.2 Risk Budget

The margins of deviation for the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio under management are subject to a risk budget. This allows for limiting overall deviations with regards to the Benchmark. The risk budget is measured in terms of basis points of ex ante tracking error and will be calculated daily by the custodian or the institution providing middle office services.

The following risk budget is assigned for the Portfolio managed by the Fiscal Agent: 50 basis points of annual tracking error (ex ante).

2.3 Eligible Issuers.

2.3.1 Eligible Instruments for Cash

The cash exposure shall not exceed 5% of the portfolio under management. The return obtained on the cash shall be included in the calculation of the return of the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio.

The following shall be eligible as cash: current account balances, overnight and/or weekend deposits and time deposits with a maximum limit of 15 calendar days at banks with long term instruments rating equal or over A- in at least two of the following international risk rating agencies: Fitch, Moody's, and Standard & Poor's. The eligible markets for investing cash shall be the countries or jurisdictions where the eligible instruments of the pertinent mandates are quoted.

For the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio, investments in the same bank issuer are allowed as follows:

a) A maximum of 1% of the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio, for issuers with an average rating of at least AA-.

b) A maximum of 0.5% of the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio, for issuers with an average rating between A- and A+.

Notwithstanding the above, whenever the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio receives a cash contribution, it may be invested in the same bank issuer for a maximum of ten business days from the day of the cash contribution and for a maximum amount equivalent up to US$ 80 million. In addition, whenever the Fiscal Agent is instructed to generate liquidity for a cash withdrawal, the Fiscal Agent may invest up to US$ 80 million in the same bank issuer for ten business days before and until the day of the cash withdrawal.

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

2.3.2. Treasury Bills and Sovereign Bonds

For treasury bills, the eligible issuers are the United States of America, Germany and Japan; for sovereign bonds, the eligible issuers are the United States of America, Germany, Japan and Switzerland; and for inflation-indexed bonds, the eligible issuers are the United States of America and Germany.

Additionally, eligible issuers include Supranational Entities, Agencies, and Entities with Explicit Government Guarantees that are eligible for investment in the International Reserves portfolio of the Central Bank of Chile.

In order to monitor positions, returns and risk indicators, the instruments issued by Supranational Entities, Agencies, and Entities with Explicit Government Guarantees with a remaining maturity of under one year will be considered part of the Treasury bills portfolio as indicated in Table 1. Likewise, instruments issued by Supranational Entities, Agencies, and Entities with Explicit Government Guarantees with a remaining maturity greater than or equal to one year will be considered part of the Sovereign Bonds portfolio as indicated in Table 1.

2.4 Eligible Currencies

The only eligible currencies shall be those included in the pertinent benchmark.

2.5 Eligible Instruments

The eligible instruments for the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio are the following:

a. Treasury bills, sovereign bonds and indexed sovereign bonds: in the case of sovereign bonds issued by the United States of America, Germany and Japan, only instruments with a remaining maturity between 7 years and 10 years and one month at the time of purchase are eligible. In the case of sovereign bonds issued by Switzerland, only instruments with a remaining maturity between 5 years and 10 years and one month at the time of purchase are eligible. In the case of inflation-linked sovereign bonds, only instruments with a remaining maturity between 1 year and 10 years and one month at the time of purchase are eligible. Notwithstanding the foregoing, it will not be necessary to sell the sovereign bonds or sovereign inflation-indexed bonds, as applicable, that cease to meet the minimum maturity requirement at the time of purchase. In the case of treasury bills, there are no restrictions per instrument.

b. Supranational Entities, Agencies, and Entities with Explicit Government Guarantees: only bills and discount notes (including Euro commercial papers); "Bullet" bonds, both "Callable" and "Non-Callable" will be eligible; in all cases with remaining maturities equal to or less than 10 years and one month.

2.6 Limits in currency Forwards or currency Swaps Transactions

For the Portfolio managed by the Fiscal Agent, the following rules are established regarding currency hedging procedures using currency forwards or swaps.

a. Forward or swap transactions shall only be made among eligible currencies.

b. Currency forward or swap contracts shall only be made with bank counterparties which have long-term instruments risk ratings equal to or over A- in at least two of the following international risk rating agencies: Fitch, Moody's, and Standard & Poor's.

c. Currency forward or swap contracts may be cash delivery or offsetting contracts.

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

e. The counterparty risk pertinent to each forward or swap contract shall be a 100% of the notional value of the contract, as denominated in USD. For the purpose of these investment guidelines, the notional value of the forward or swap shall be the long leg of the forward or swap contract. For measuring counterparty risk, forwards or swaps shall be valued in USD on a daily basis throughout the effective term of the contract.

f. Notwithstanding the above, the counterparty risk pertinent to each contract that includes a close-out netting clause in case of the counterparty's insolvency or bankruptcy shall be a 15% of the notional value of the forward and a 30% of the notional value of the swap, as denominated in its equivalent value in USD. Likewise, if the forward or swap contract is aimed to close or partially close a position associated with another forward or swap contract, and provided that these contracts have close out netting clauses, the same counterparty, the same maturity date, and the same pair of currencies, the total net position between the contracts of the forwards and swaps involved shall be taken into account for measuring counterparty risk. With regard to counterparty risk measurement, forwards and swaps contracts shall be valued in USD on a daily basis throughout the effective term of the contract for purposes of measuring counterparty risk. Regarding Section 2.6, letter h., said renewal cannot be considered within the derivate exposure.

g. The counterparty risk of each forward or swap contract will be considered as part of limits established in Section 2.3.1 above.

h. The notional amount of outstanding forward or swap contracts shall not exceed, in all, a 4% of the Portfolio managed by the Fiscal Agent.

i. The sum of the notional value of the forwards or swaps contracted by the Fiscal Agent with an eligible counterparty shall not exceed the limits per issuer set out in Section 2.3.1 (a) and (b) above. Nevertheless, if there is a rollover of a forward contract with the same counterparty and in the same pair of currencies, even if the amount may differ from the original contract, the limit will increase twice its value for said counterparty during two business days starting from the day the forward is renewed. Likewise, for the purposes of calculating the counterparty risk, this renewal shall not be taken into account for two business days, starting from the day the renewal begins, for the calculation of the risk limits by issuer established in Section 2.3.1 (a) and (b) above.

2.7 Limits to Currency Spot Transactions

The Fiscal Agent may execute currency spot transactions with counterparties with long-term instruments risk rating equal or over A- in at least two of the following international risk rating agencies: Fitch, Moody's, and Standard & Poor's.

2.8 Limits to the investments in Supranational Entities, Agencies, and Entities with Explicit Government Guarantee

The investment limit for instruments issued by Supranational Entities, Agencies, and Entities with Explicit Government Guarantee which have a remaining maturity of under one year is a maximum of 3.0% for USD denominated instruments, and 3.5% for EUR denominated instruments, both expressed as a percentage of the ESSF. Investments denominated in JPY are not permitted for these instruments.

The maximum limit for instruments issued by Supranational Entities, Agencies, and Entities with Explicit Government Guarantee which have a remaining maturity equal to or over one year is 2.65% for USD denominated instruments, 1.10% for EUR denominated instruments, 1.00% for JPY denominated instruments, and 0.75% for CHF denominated instruments, all expressed as a percentage of the ESSF.

2.9 Special Restrictions

Investment in instruments issued by Chilean issuers is not permitted, nor can investments be made in instruments denominated in Chilean pesos.

The Fiscal Agent may not use derivatives to increase exposure to financial instruments beyond the market value of the portfolio under management.

There is no leverage allowed for investment purposes except to cover any instrument liquidation issue.

2.10 External Cash Flows

The external cash flows in the Treasury bills and sovereign bonds, and Inflation-indexed sovereign bonds portfolio, will be instructed by the Minister of Finance.

When an external cash contribution is made to the Portfolio managed by the Fiscal Agent, the Fiscal Agent shall be granted a 10 banking days' special waiver regarding fulfillment of requirements of Sections 1, 2.2 and the first and last paragraph of Section 2.3.1 above, starting from the day of the cash contribution. For cash withdrawals from the Portfolio managed by the Fiscal Agent, the Fiscal Agency shall be granted a 10 banking days' special waiver regarding fulfillment of requirements of Sections 1, 2.2 and the first and last paragraph of Section 2.3.1 above, before and until the day of the cash withdrawal. This period may be extended upon request to the Ministry of Finance, justifying the reasons for said extension. In the case where the period between the instruction date of the cash withdrawal and the effective date of the withdrawal is less than 10 business days, said period shall apply to the special waiver.

The aforementioned notwithstanding, when a rebalancing is instructed, the Financial Market Division Manager of the Central Bank of Chile may request, via e-mail, to the International Finance Coordinator of the Ministry of Finance to maintain the positioning of the Portfolio managed by the Fiscal Agent relative to the benchmark and not converge to the benchmark. The International Finance Coordinator must authorize the maintenance of said positions via an e-mail directed to the Financial Markets Division Manager of the Central Bank of Chile.

3. Valuation Criteria

The portfolio valuation shall be prepared as per the “marked to market” criterion, by using the custodian bank’s own valuation sources. Notwithstanding the above, it should be noted that the Central Bank of Chile, for internal purposes related to the Portfolio managed by the Fiscal Agent, may use the same method it uses for its own international reserves transactions, in order to comply with letter g) of Section 4 of the Agency Decree.

4. Securities Lending Program

The Fiscal Agent for the Portfolio managed by the Fiscal Agent may agree securities lending programs with the ESSF custodians (hereinafter, “Programs” or “Securities Lending”), as long as the custodians with which the management of said Programs is agreed (hereinafter, “Program Managers”) oblige themselves to comply with the operating criteria set forth in the Custody Guidelines, specially including the obligation to restitute the pertinent securities or, failing that, the market value thereof.

5. Other

Foreign Exchange transactions are considered to be spot regarding each market convention. The aforementioned notwithstanding, foreign exchange transactions which are related to the purchase or sale of an instrument are considered to be spot when the number of days between the trade date and the settlement date equals the market convention settlement period of the instrument being purchased or sold.

The base currency of the portfolio for the effects of the performance of the Fiscal Agent is the USD.

If, at any time, any of the instructions herein described is defaulted due to market price fluctuations, abnormal market conditions, or any other reason beyond the Fiscal Agent’s control, the Fiscal Agent shall not be considered as defaulting the applicable guidelines if, within 7 business days after having detected such situation, they take the necessary steps to ensure their compliance. This period may be extended at the Fiscal Agent’s request to the Ministry of Finance, or to the person it may appoint, justifying the reasons for said extension.

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