

ANNUAL REPORT SOVEREIGN WEALTH FUNDS

· MINISTRY OF FINANCE ·

2012



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1. 1. FOREWORD BY THE MINISTER



One of Chile's most important reputational assets is its fiscal policy, which is anchored in a structural income rule in which current expenditures are determined as a function of long-term revenue, not current revenue. This rule, which has received wide international recognition, makes public spending sustainable while also providing a series of virtuous effects at the macroeconomic level: it generates countercyclical public spending, is naturally aligned with monetary policy, contributes to exchange rate stability and sets a de facto limit on public debt. This is reflected in the fact that Chile has one of the lowest levels of gross public debt worldwide (10.8% of GDP in March 2013) and is one of the few countries on the planet with a net credit position (6.4% of GDP in March 2013).

The current administration inherited a structural fiscal deficit of 3.1% of GDP, according to the new methodology devised by the Advisory Committee for Designing a Second-Generation Structural Balance Fiscal Policy for Chile in 2010. In spite of the devastating earthquake in February of that year and the substantial extraordinary expenditures associated with the reconstruction, our Government took on the commitment to reduce that deficit by more than two percentage points of GDP, to bring it to 1.0% of GDP by the end of the term. That path of fiscal consolidation has been fully achieved as planned. In 2012, the structural fiscal deficit was 0.4% of GDP, and the effective fiscal surplus was 0.6% of GDP.

This process of consolidation has translated into a significant increase in our sovereign wealth funds, which have returned to their pre-crisis levels. At year-end 2009, the value of the funds totaled US\$ 14,706 million; in December 2012, they held US\$ 20,881 million. The increase reflects net contributions of US\$ 4,890 million and net earnings on investments of US\$ 1,285 million. For 2013, the funds have already received new contributions of almost US\$ 2,000 million, which brings the total value to US\$ 22,389 million as of May 2013.

With regard to the investment strategy of the sovereign wealth funds, a new policy was implemented for the Pension Reserve Fund (PRF) in 2012. Thus, for the first time in its history, the fund invested in stocks and bonds issued by companies overseas. In the past, the funds were mainly invested in financial instruments issued exclusively by the governments of the United States, Germany and Japan. Starting in 2012, however, the investments of the Pension Reserve Fund have a risk profile that is more in line with the pensions it is intended to finance.

While the results of the investment policy can only be fully analyzed in the long term, thus far the corporate bond and stock investments have contributed to a net return in dollars of 4.87%, more than four times what the fund would have earned under the old policy. This higher differential return corresponded to US\$ 280 million in 2012.

In the case of the Economic and Social Stabilization Fund (ESSF), the investments yielded a net return in dollars of 1.02% in 2012. While this is lower than the PRF, it is consistent with a more conservative strategy of investing in reserve currencies and assets that, while lower yielding, tend to increase in value in adverse economic times. In this regard, we designed a new policy in 2012 that will improve the fund's hedging against a possible future decline in fiscal revenue. This policy will be implemented in the second half of 2013.

Our Government is committed to using international best practices in the management of our sovereign wealth funds. To this end, we have strengthened the team in charge of fund management in the Finance Ministry, in order to improve the monitoring of the new investment policies. We also remain committed to the timely disclosure of pertinent information for the national and international public. Thanks to these efforts, the Chilean sovereign wealth funds remain in first place among the most transparent funds in the world, according to the Linaburg-Maduell SWF Transparency Index prepared by the Sovereign Wealth Fund Institute.

The soundness of our policies has received wide international recognition. The G20, a group of the twenty largest economies in the world, invited Chile to participate in the group's meetings in 2012, where our fiscal policy and the sovereign wealth funds were explicitly cited as examples of good practices in managing the commodity price cycle (in our case, copper). In addition, the International Monetary Fund and the Organization for Economic Cooperation and Development have supported the improvements introduced to the fiscal rule under this Government, commending the changes for their contribution to increasing transparency and decreasing discretion in the application of the rule.

The four main global credit rating agencies have upgraded Chile's sovereign rating during the current administration, citing the country's low level of public debt and net credit position due in large part to the savings accumulated in the sovereign wealth funds. We are very proud of this unprecedented development. Thus, in December 2012, Standard and Poor's raised Chile's credit rating from A+ to AA-, thereby positioning our country among the twenty highest-rated economies in the world. This opinion has been confirmed by foreign investors: the markets spoke clearly in 2012, financing Chile at the lowest rates and credit spreads in our history and in the emerging world.

Finally, I would like to express my firm conviction that through intense, hard work, this ministry will continue to responsibly manage Chile's resources with the primary goal of ensuring the sustainability of the country's social programs and thereby improving the quality of life of the most disadvantaged sectors. The wealth of these funds belongs to all Chileans, and it must therefore be safeguarded to the highest degree possible. This has been and will continue to be a core commitment of our Government.

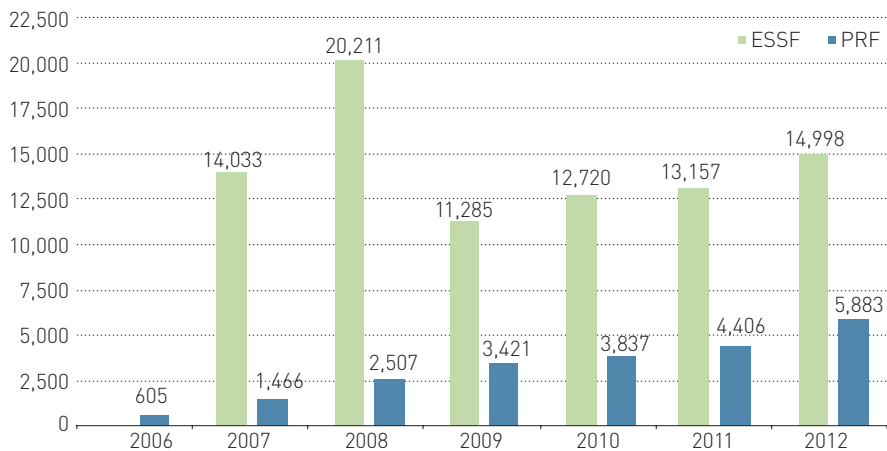
Felipe Larraín
MINISTER OF FINANCE

2. SUMMARY

As of 31 December 2012, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US\$ 20,881 million and net returns in dollars of 4.35% and 4.98% respectively, since their inception.¹

Figure 1: Market value

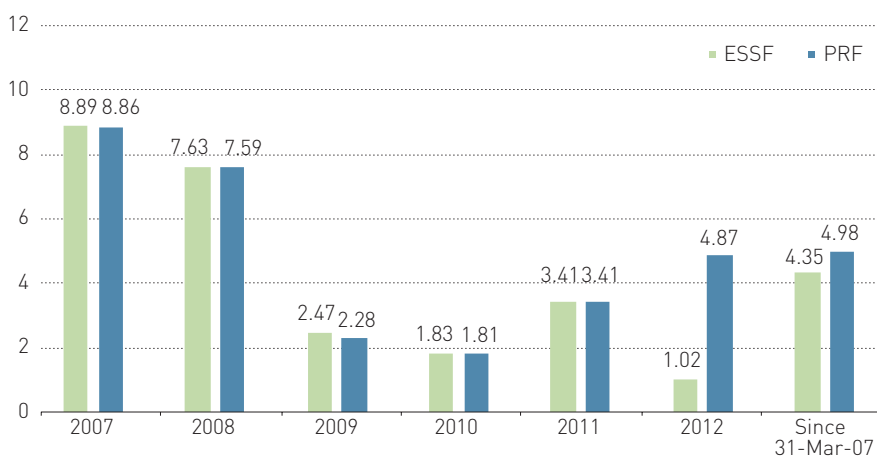
(millions of dollars)



Source: Ministry of Finance

Figure 2: Net annual return in dollars²

(percent)



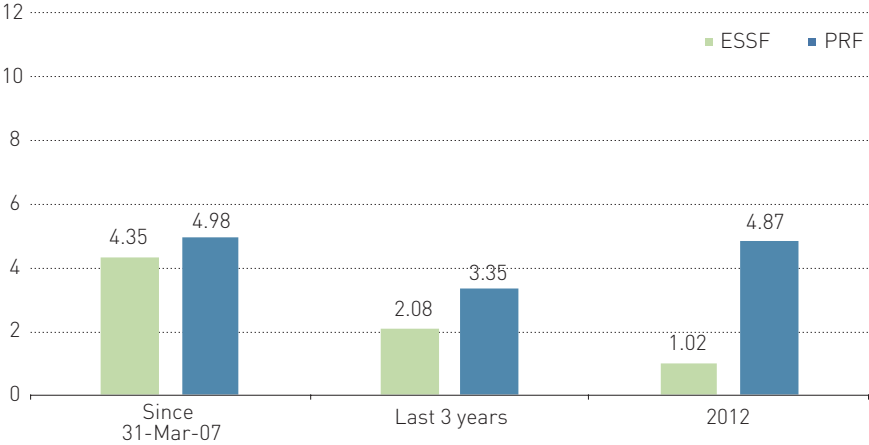
Source: Ministry of Finance

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

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

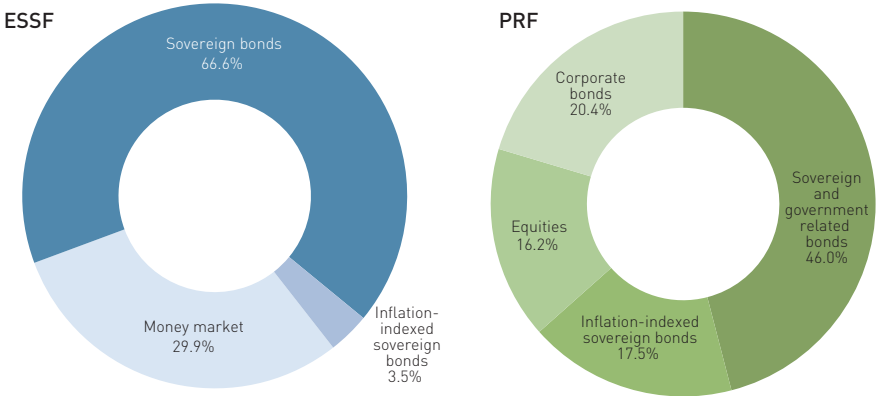
(percent)



Source: Ministry of Finance

Figure 4: Asset class allocation as of 31 December 2012

(percent of portfolio)



Source: Ministry of Finance

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 N° 3,653 of 1981 and the Copper Revenue Compensation Fund, as specified in Ministry of Finance Statutory Decree N°1 (DFL N° 1) of 2006.

BOX 1: A structural balance rule that has been 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 income. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity, the copper price and other factors that determine effective fiscal income. 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 2011 the Finance Minister announced the creation of a Fiscal Council, whose main role will be to guarantee independence in the estimation of the structural variables and to verify the structural balance estimates.

The methodology used to calculate the structural balance has also undergone improvements, mainly in relation to the cyclical adjustments that must be taken into account to determine structural income. For example, the most recent changes, introduced in the 2011 budget, included the elimination of adjustments for temporary tax measures that were expiring, cyclical adjustments to the item "other income" and cyclical adjustments to interest income on financial assets held by the Treasury. These changes were implemented based on a study commissioned by the Finance Ministry and carried out by an Advisory Committee.¹

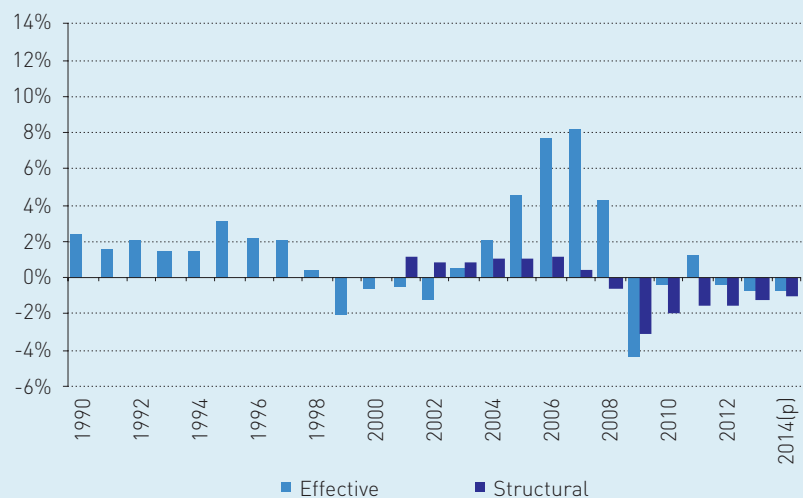
The structural balance target has also changed over time. The target was initially set at 1% of GDP in 2001. The 2008 budget reduced it to 0.5% of GDP, because substantial resources were being accumulated in the sovereign wealth funds. In 2009, the ex ante target was reduced to 0% to face the crisis that was then in full swing. Finally, the methodological change mentioned above implied that the 2009 target was converted to a structural deficit of 3%, and it has been adjusted each year since 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 Council has been very well received by various international organizations, including the Organization for Economic Cooperation and Deve-

lopment (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 R1: Evolution of the 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 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.

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 use of the funds is also established in the same law, as well as in the Pension Law of 2008 for the PRF and DFL N° 1 for the ESSF.

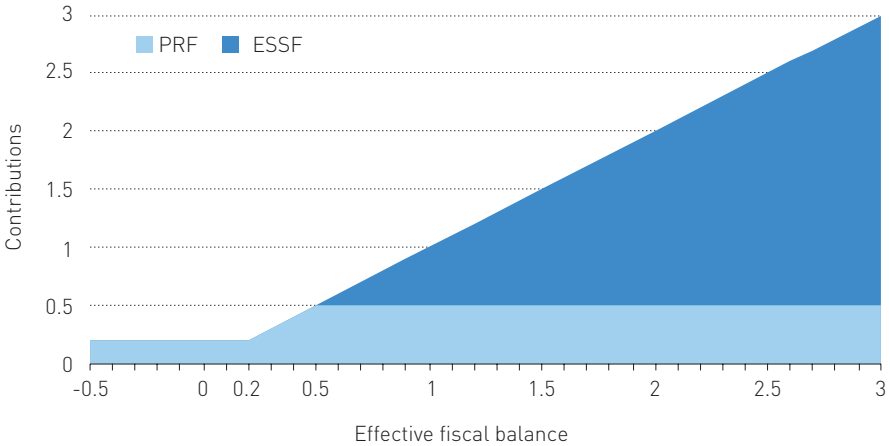
According to the Fiscal Responsibility Law, the PRF must receive a minimum annual contribution of 0.2% of the previous year’s gross domestic product (GDP). If the effective fiscal surplus exceeds that amount, the contributions can be increased

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, an inflation-indexed unit of account).

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 year³ (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 year⁴. 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 and make advance contributions to the ESSF.

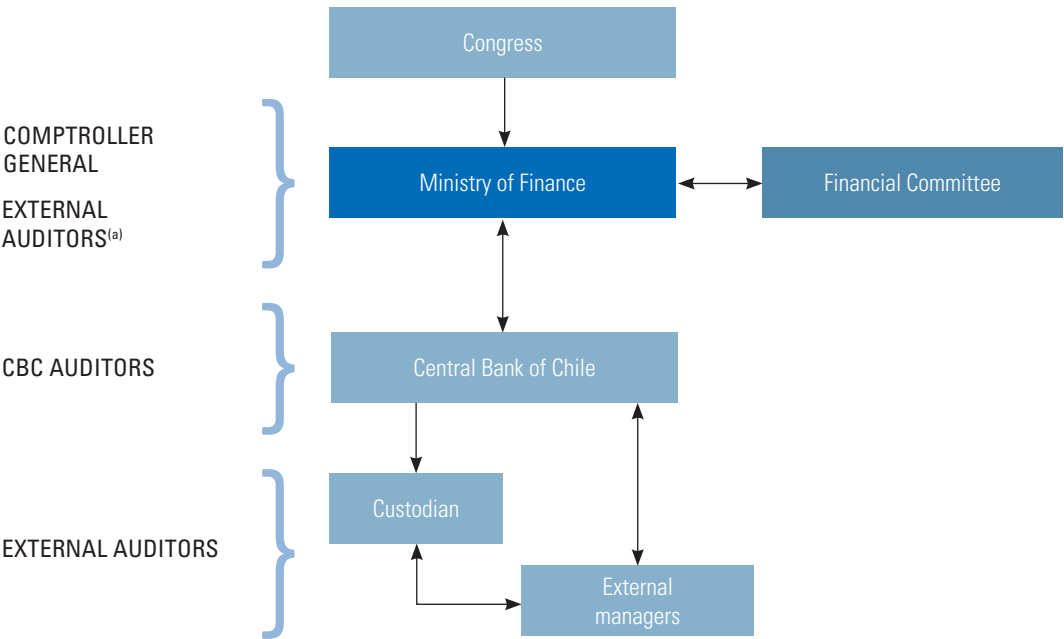
⁴ No withdrawals have occurred as of the publication date of this report.

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 the rendition of accounts and operational independence in fund management.

The institutional basis of the funds is established in the Fiscal Responsibility Law, where Article 12 regulates the investment of fiscal resources (see diagram 1). Executive Decree N° 1,383, issued by the Ministry of Finance in 2006, appoints the Central Bank of Chile (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 In addition, Executive Decree N° 621, issued by the Ministry of Finance in 2007, created the Financial Committee, which advises the Finance Minister on 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



(a) 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 the 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 delegate the operational management of the funds, whether to the Central Bank of Chile or to other external managers. In March 2007, the Finance Minister appointed the Central Bank to oversee these tasks in the role of fiscal agent, based on its reputation and experience in handling international reserves.

⁵ The Decree was published in the Official Gazette on 17 February 2007. The resolution of the Central Bank Board accepting the appointment was published in the Official Gazette on 24 February 2007.

⁶ Published in the Official Gazette on 11 August 2007.

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 the 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.

4.2 CENTRAL BANK OF CHILE

The functions of the Central Bank of Chile (CBC) and the procedural guidelines for the funds' management were established by Executive Decree N° 1,383, issued by the Ministry of Finance in 2006. In accordance with this decree, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

1. To directly manage all or part of the fiscal resources in the name and on the account of the Treasurer;
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 Treasurer ;
3. To open separate current accounts in the performance of its role as fiscal agent;
4. To maintain a register of transactions and other operations carried out in the management of the fiscal resources;
5. To contract the services of a custodian institution;
6. To supervise and evaluate the performance of appointed external managers and custodian institutions;
7. To report daily on investment positions, prepare monthly, quarterly and annual reports on the management of the portfolios, and prepare an annual report on the services provided by the custodian institution(s); and
8. To make payments as needed in the performance of its role as fiscal agent.

In accordance with its authority, the Central Bank contracted Black Rock Institutional Trust Company NA, Mellon Capital Management Corporation and Rogge Global Partners PLC to manage the investment of 35% of the PRF portfolio starting in January 2012.⁷

In performing its duties as fiscal agent, the Central Bank must comply with the investment guidelines established by the Ministry of Finance, as must any portfolio managers that are contracted by the CBC. 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.

The Central Bank 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 personnel.⁸

⁷ The external managers were appointed following a selection process carried out in 2011.

⁸ Other custodial functions include calculating fund returns and overseeing compliance with investment limits.

4.3 FINANCIAL COMMITTEE⁹

In compliance with Article 13 of the Fiscal Responsibility Law, the Financial Committee was officially created through Executive Decree N° 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. The Financial Committee is an external advisory board, whose members have a vast experience in economic and financial areas. The current members are Klaus Schmidt-Hebbel Dunker (President), Cristián Eyzaguirre Johnston (Vice President), Arturo Cifuentes Ovalle, Martín Costabal Llona, Eric Parrado Herrera and Eduardo Walker Hitschfeld.

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.

⁹ For more information on the activities of the Financial Committee in 2012, see its Annual Report (available online at www.hacienda.cl/fondos-soberanos/comite-financiero.html).

Principal activities in 2012

5.1 NEW INVESTMENT POLICY FOR THE ESSF

In 2011, an assessment was made of the ESSF investment policy to ensure that it complies with the fund's original objectives. The Ministry of Finance commissioned Eduardo Walker, Professor at the Catholic University of Chile, to conduct the study in late 2010. The main conclusions of the study are as follows:

- In the medium and long term, the volatility of total fiscal revenue is largely determined by the volatility of mining income, despite the fact that mining represents less than 20% of total revenue.
- The results indicate that, by their nature, the portfolios that help provide risk coverage for fiscal revenue are highly volatile (measured in UFs), on a level similar to stock investments. This volatility is necessary for covering a liability (fiscal revenue) that is, in turn, highly volatile. Consequently, there is a trade-off between short-term volatility (which implies a potential reputational risk or headline risk) and better hedging against a negative surprise to fiscal income.
- Short- and long-term investments in yen and, to a lesser extent, investments in long-term Swiss franc (CHF) bonds and long-term euro bonds are the main asset classes that can help provide risk coverage for fiscal revenue.
- The practical recommendations deriving from this study point to increasing the relative weight of the yen and other currencies and reducing the relative weight of the U.S. dollar and the euro.

The Financial Committee analyzed the results of the study and, in line with academic best practices, invited three external specialists to undertake a peer review of Professor Walker's study in early 2012. To this end, the study was sent to professors Luis Viceira (Harvard University), Eduardo Schwartz (University of California) and Luis Reyna (Swiss Re Capital Markets Corporation). The Committee was satisfied with the comments received from the external specialists and with Professor Walker's responses.

In the first half of 2012, the Committee asked the Ministry of Finance to carry out additional simulations using the same model as the study. The objective of these new simulations was to complement the study's conclusions, in order to obtain more information for making recommendations on the ESSF investment policy. These simulations were used to evaluate the impact of incorporating sovereign bonds denominated in Norwegian kroner as a new asset class, tightening the limit on exposure to yen-denominated sovereign instruments, establishing minimum investment levels for dollar- and euro-denominated sovereign instruments and reducing the size of the ESSF. The Committee concluded that krone-denominated bonds would not improve the hedging ability of the investment portfolio and that for a low to medium risk tolerance, the optimal asset allocation had a share of yen-denominated sovereign bonds around the maximum allowed for that currency. In contrast, the dollar and euro allocations were adjusted downward to the established minimums. These results are consistent with the results of the study. As risk tolerance decreases, the model allocates an increasing share to yen because, according to the data used in the model, yen-denominated sovereign instruments offer the most risk coverage for fiscal revenue. With regard to the impact of a possible reduction in the size of the fund, the committee concluded that, as expected, the optimal solution was to increase the yen allocation, in the absence of the aforementioned restrictions. This is because a smaller fund goes hand in hand with a lower risk tolerance, which heightens the importance of hedging fiscal revenue. This impact was not seen, however, when there was a ceiling on exposure to the yen.

Based on the Financial Committee's recommendations, the Finance Minister established a new investment policy for the ESSF. Table 1 outlines the strategic asset allocation, which is expected to be implemented in 2013.

Table 1: New strategic asset allocation

(percent)

Benchmark	USD	EUR	JPY	CHF	Equities	Total
1. Bank deposits	5.0	6.0	4.0	0.0	0.0	15.0
Merrill Lynch Libid 3 Month Average USD	5.0	—	—	—	—	5.0
Merrill Lynch Libid 3 Month Average EUR	—	6.0	—	—	—	6.0
Merrill Lynch Libid 3 Month Average JPY	—	—	4.0	—	—	4.0
2. Treasury bills and sovereign bonds	6.0	7.0	6.0	0.0	0.0	19.0
2.1 Treasury bills						
Merrill Lynch Treasury Bills Index USD	6.0	—	—	—	—	6.0
Merrill Lynch Treasury Bills Index EUR	—	7.0	—	—	—	7.0
Merrill Lynch Treasury Bills Index JPY	—	—	6.0	—	—	6.0
2.2 Sovereign bonds	26.5	11.0	10.0	7.5	0.0	55.0
Barclays Capital Global Treasury: U.S. 7-10 Yrs	26.5	—	—	—	—	26.5
Barclays Capital Global Treasury: Germany 7-10 Yrs	—	11.0	—	—	—	11.0
Barclays Capital Global Treasury: Japan 7-10 Yrs	—	—	10.0	—	—	10.0
Barclays Capital Global Treasury: Switzerland 5-10 Yrs	—	—	—	7.5	—	7.5
3. Inflation-indexed sovereign bonds	2.5	1.0	0.0	0.0	0.0	3.5
Barclays Capital Global Inflation-Linked: U.S. TIPS 1-10 Yrs	2.5	—	—	—	—	2.5
Barclays Capital Global Inflation-Linked: Germany 1-10 Yrs	—	1.0	—	—	—	1.0
4. Equities	—	—	—	—	7.5	7.5
MSCI All Country World Index (unhedged with reinvested dividends) excl. Chile	—	—	—	—	7.5	7.5
5. Total	40.0	25.0	20.0	7.5	7.5	100.0

Source: Ministry of Finance

5.2 NEW REBALANCING POLICY FOR THE PRF

In the second half of 2012, the Ministry of Finance accepted the Financial Committee's recommendation to modify the rebalancing policy for the PRF. The policy under review stipulated that if, at the close of a given business day, the deviation by asset class resulting from price variations or market revaluations exceeds the range of $\pm 5\%$ for any asset class (see table 2), then the fiscal agent must bring about convergence to the benchmark or instruct the relevant party to do so, as applicable. The fiscal agent has 10 bank business days to achieve said convergence, although the period can be extended by the Finance Minister at the request of the fiscal agent. In addition, the fiscal agent must also converge to the benchmark in the event of contributions to the fund.

After analyzing the Financial Committee's recommendation, and considering the historical performance of various alternatives, transaction costs and the experiences of other institutional and international investors, the Ministry of Finance decided to reduce the permissible range of deviation from $\pm 5\%$ to $\pm 3\%$. With this change, the investment portfolio is expected to stay more in line with its strategic asset allocation, but without incurring the excessive transaction costs associated with very frequent rebalancing.

Table 2: Deviation ranges for the PRF investment policy

(percent)

Asset class	Benchmark (Mid-point)	Deviation range (± 5%)	Committee's recommendation (± 3%)
Sovereign and government related bonds	48	43 - 53	45 - 51
Inflation-indexed sovereign bonds	17	12 - 22	14 - 20
Corporate bonds	20	15 - 25	17 - 23
Equities	15	10 - 20	12 - 18

Source: Ministry of Finance

5.3 SELF-ASSESSMENT OF COMPLIANCE WITH THE SANTIAGO PRINCIPLES

In the second half of 2012, the Ministry of Finance conducted its second self-assessment of the degree to which the Chilean sovereign wealth funds comply with each of the Santiago Principles.¹⁰ This is part of the government's systematic efforts to improve the information available to the general public and manage the sovereign wealth funds in accordance with international best practices. The self-assessment is presented in the Appendix 1.¹¹ The implementation of the second self-assessment is consistent with Chile's commitment to update the self-assessment every two years.¹²

10 The Santiago Principles are a series of generally accepted principles and practices that have been approved by the world's main sovereign wealth funds with the goal of improving their practices, especially with regard to the information that is provided to the national and international public. The aim is to facilitate understanding of their investment performance and demonstrate their financial orientation in making investments, so as to mitigate any concerns among the many host countries.

11 Additionally, an English version of the self-assessment is available in a special section of the website (www.hacienda.cl/english/sovereign-wealth-funds/good-governance-practices-santiago.html).

12 The first self-assessment was carried out in the second half of 2010 and published in that year's annual report.

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.

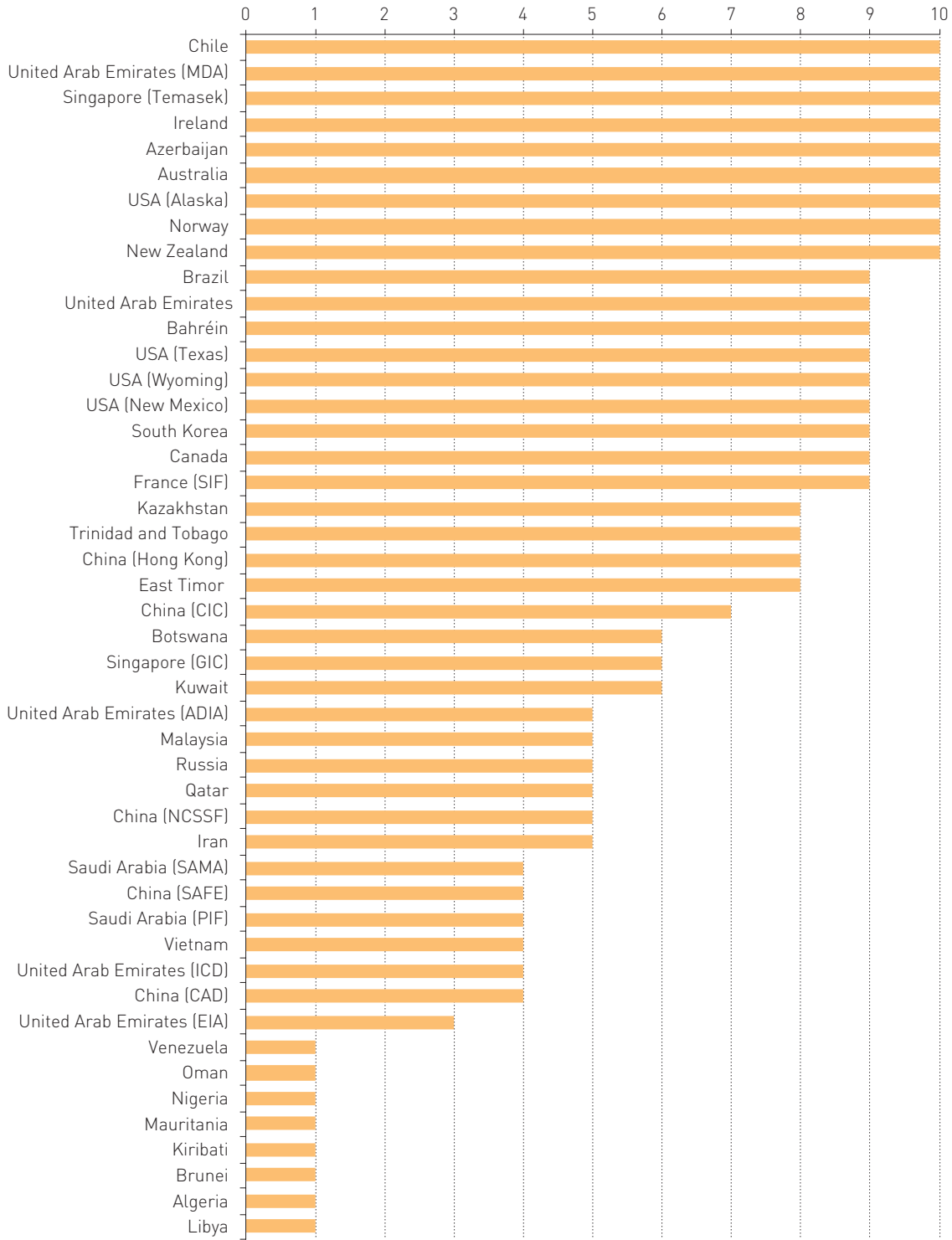
To guarantee public access to all important information on the ESSF and the PRF, the reports are published in Spanish and English and are available on the sovereign wealth funds' website.¹³

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.

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).

¹³ www.hacienda.cl/english/sovereign-wealth-funds.html.

Figure 6: Linaburg-Maduell Transparency Index, fourth quarter of 2012



Source: Sovereign Wealth Fund Institute.

Analysis of the International Economy¹⁴

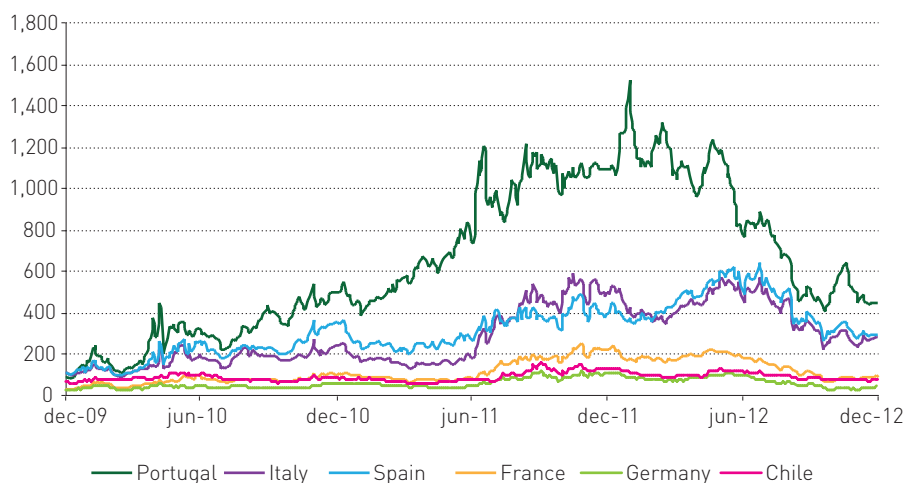
¹⁴ This chapter, in its entirety, corresponds to chapter 2 "Análisis de mercado" of the Financial Committee's 2012.

In 2012, the year was marked by the ongoing European crisis and by a series of events that affected the main financial variables with a direct impact on the performance of Chile's sovereign wealth fund portfolios.

In Europe, the fears associated with a Greek default, exacerbated by political uncertainty in the country, and the potential for a disordered Greek exit from the euro area generated a lot of tension in the international financial markets in the first part of the year. These factors had a negative effect on other countries in the region, which had to face increased financing costs, while the spreads on their credit default swaps (CDS)¹⁵ peaked in late May (see figure 7). However, the situation was partially resolved in the second half, after the Greek political situation improved and the European Central Bank (ECB) implemented a series of extraordinary measures, such as cutting its monetary policy rate to a new historical low of 75 basis points and undertaking outright monetary transactions (OMT),¹⁶ to provide support to countries that were facing high financing costs. Nevertheless, the economic situation of the euro area countries remained very fragile, given that many of them did not record positive real growth in 2012.

Figure 7: Five-year credit default swaps (CDS): Selected European countries and Chile, 2010 – 2012

(basis points)



Source: Bloomberg.

In the United States, the economy has shown some signs of recovery, but it remains below its pre-crisis growth rate, with growth of 2.2% in the year. This has hindered the reduction of the unemployment level, which was 7.8% at year-end 2012. Furthermore, political difficulties continued over the course of the year, such that the U.S. Congress was unable to reach an agreement on reducing its fiscal deficit and avoiding a series of automatic adjustments that would enter into effect in 2013 (the so-called fiscal cliff).¹⁷ In September 2012, the U.S. Federal Reserve announced an asset purchase program (Quantitative Easing III), with the goal of supporting the mortgage market and holding down long-term interest rates, and it publically com-

¹⁵ CDSs represent the cost of financial instruments to protect against default by an issuer.

¹⁶ A program for purchasing short-term sovereign bonds in the secondary market.

¹⁷ The fiscal cliff corresponds to a number of automatic adjustments (tax increases and fiscal expenditure reductions) that were scheduled for implementation starting in 2013 if the U.S. Congress had not been able to agree on measures to reduce the fiscal deficit by US\$ 1.2 trillion over ten years. As of the publication of this report, the Congress had already agreed to a number of tax increases as part of the set of initiatives to reduce the fiscal deficit (the agreement was reached in January 2013). Nonetheless, the Congress was not able to agree on how to cut expenditures. As a result, several expenditure reductions were triggered automatically on March 1st, 2013 and would become effective as of March 27.

mitted to keeping the monetary policy rate low at least through mid-2015.¹⁸ This measure, together with the actions taken by the Central European Central Bank, contributed to an easing of financial uncertainty (on the part of banks) in the second half of 2012, which was reflected in reductions in the TED spread (see figure 8).

Figure 8: TED Spread¹⁹, 2007 - 2012

(basis points)



Source: Bloomberg.

With regard to Asia, the Japanese economy grew 2% in 2012, but it went into recession in the third quarter of the year. To stimulate the economy and to mitigate the appreciation of the yen and the strong deflationary pressures, the Bank of Japan expanded its asset purchase program to ¥ 120 trillion (equivalent to US\$ 1.4 trillion) and held the interest rate in the range of 0.0–0.1%. In addition, the new government, elected in December 2012, is expected to implement a series of measures to stimulate the economy.²⁰ In China, the second-largest economy in the world, the growth rate was 7.8% in 2012, down from 9.3% in 2011. However, in the last quarter of 2012, the growth rate reversed the downward trend recorded quarterly since the close of 2010.

In this context, the interest rates on bonds issued by the United States, Germany and Japan in national currency have remained at historically low levels, and they have even dropped into negative territory in the case of German bonds (see figure 9).

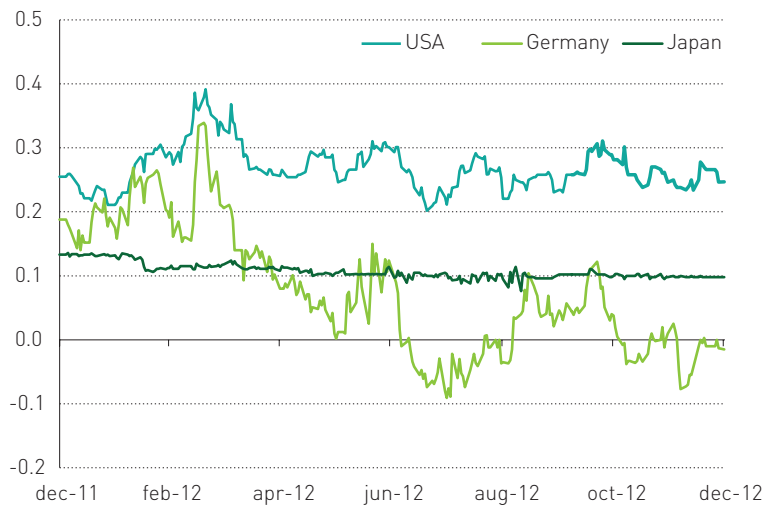
¹⁸ In December 2012, the U.S. Federal Reserve announced additional measures, explicitly stating, for the first time, that it would maintain an expansive monetary policy as long as the unemployment rate remains over 6.5% and two-year-ahead inflation expectations are below 2.5%.

¹⁹ 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

²⁰ In early 2013, a fiscal stimulus plan was announced for ¥ 10 trillion (US\$ 116 billion).

Figure 9: Yield to maturity on two-year sovereign bonds: United States, Germany and Japan, 2012

(percent)

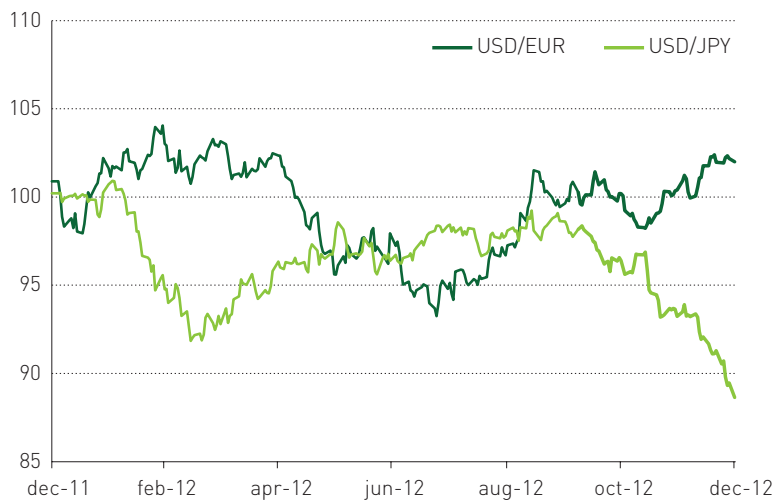


Source: Bloomberg.

With regard to exchange rates, the Japanese yen depreciated 12.8% in 2012, closing the year at 86.8 JPY/USD. In contrast, the euro hardly fluctuated at all, appreciating just 2% over the course of the year and ending at 1.319 USD/EUR (see figure 10).

Figure 10: Exchange rates, 2012

(31 December 2011 = 100)



Source: Bloomberg.

The reduction in market volatility was reflected in the VIX Index, which represents the expected volatility of the Standard & Poor's 500 Index (S&P 500) in the United States. The current levels are far below the peaks recorded at the height of the financial crisis and the later European crisis (see figure 11).

Figure 11: Stock market (S&P 500) volatility (VIX), 2006 – 2012

(percent)



Source: Bloomberg.

The corporate fixed-income market recorded a positive performance in 2012. This can be seen in the evolution of the Barclays Capital Global Aggregate: Corporates Bond Index,²¹ which yielded returns of 11% in the year (see figure 12).

Figure 12: Evolution of the Barclays Capital Global Aggregate: Corporates Bond Index, 2012

(31 December 2011 = 100)



Source: Bloomberg.

²¹ The Barclays Capital Global Aggregate: Corporates Bond Index tracks the value of a portfolio made up of investment-grade fixed-income instruments issued by companies in different countries and economic sectors.

The MSCI ACWI index,²² which captures the behavior of the global stock market, closed the year with a return of 16.6% (see figure 13). The index's lowest value of the year was recorded at the worst point of the European crisis.

Figure 13: Evolution of the MSCI ACWI Index, 2012

(31 December 2011 = 100)



Source: Bloomberg.

²² The MSCI All Country World Index (ACWI) includes stocks from 45 countries (24 developed and 21 emerging).

Economic and Social Stabilization Fund

8.1 INVESTMENT POLICY

In line with the objectives described in chapter 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.

As of year-end 2012, the investment policy considers a strategic asset allocation of 30% in money market instruments, 66.5% in nominal sovereign bonds and 3.5% in inflation-indexed sovereign bonds, with a currency allocation of 50% in dollars, 40% in euros and 10% in yens (see table 3). Since May 2011, the fund's investment policy has been based on a more passive management, which allows only marginal deviations from the strategic asset allocation. According to this benchmark, 85% of the fund must be invested in sovereign instruments, with the following distribution by country: 42.5% in instruments issued by the U.S. government, 34% in Germany and 8.5% in Japan. The remaining 15% is allocated to investment in banks, which are chosen by the Central Bank of Chile according to the issuer limits specified in the investment guidelines. Leveraging is not allowed in the fund, and the use of derivatives is limited exclusively to exchange rate hedging

Table 3: Benchmarks

(percent)

Benchmark	USD	EUR	JPY	Total
Money market	15.0	12.0	3.0	30.0
Merrill Lynch Libid 3 Month Average	7.5	6.0	1.5	15.0
Merrill Lynch Treasury Bills Index	7.5	6.0	1.5	15.0
Sovereign bonds (nominal)	31.5	28.0	7.0	66.5
Barclays Capital Global Treasury: USA	31.5	—	—	31.5
Barclays Capital Global Treasury: Germany	—	28.0	—	28.0
Barclays Capital Global Treasury: Japan	—	—	7.0	7.0
Inflation linked sovereign bonds (real)	3.5			3.5
Barclays Capital U.S. Treasury: U.S. TIPS 1-10 years	3.5			
Total	50.0	40.0	10.0	100.0

Source: Ministry of Finance

The current investment policy is consistent with the objectives of the ESSF. It centers on investment in fixed-income instruments in reserve currencies, which typically perform well in times of crisis. This not only maximizes the fund's accumulated value measured in foreign currency, but also facilitates its conversion into pesos (the currency used for most fiscal spending) when the resources are most needed. For example, the fund's returns were not affected during the 2008 crisis, but rather posted a very favorable performance in pesos. This contrasts with the performance of other world funds, whose riskier profile resulted in significant losses in the short term.

A new investment policy is expected to be implemented for this fund in 2013. The main changes relative to the current policy are a reduction in the fund's exposure to dollars (from 50% to 40%) and to euros (from 40% to 25%) and an increase in ex-

posure to yen (from 10% to 20%). A new currency, the Swiss franc, will account for an exposure of 7.5%, and stocks will be incorporated with a share of 7.5% of the total portfolio (see table 1). The new policy was recommended by the Financial Committee in mid-2012, following a review and analysis of various sources, including the portfolio composition study commissioned by the Finance Minister and carried out by out by Dr. Eduardo Walker of the Catholic University of Chile. The fixed-income portfolio will be managed by the CBC, while the stock portfolio will be handled by external managers to be selected in 2013, as discussed in chapter 5.

8.2 MARKET VALUE

At the close of 2012, the market value of the ESSF was US\$ 14,998 million, versus US\$ 13,157 million at the close of 2011. The increase in the fund's value was due to net investment earnings of US\$ 141 million and a contribution of US\$ 1,700 million. Since its inception on 6 March 2007, the ESSF has received capital contributions of US\$ 21,162 million, has recorded withdrawals of US\$ 9,428 million (see table 4) and has generated net financial earnings of US\$ 3,263 million (see table 5).

Table 4: Contributions and withdrawals

(millions of dollars)

Period	Contributions	Withdrawals
2007	13,100	—
2008	5,000	—
2009	—	9,278
2010	1,362	150
2011	—	—
2012	1,700	—
Total	21,162	9,428

Source: Ministry of Finance

Table 5: Evolution and decomposition of market value

(millions of dollars)

Descomposition	2007	2008	2009	2010	2011	2012	Since Inception ^(a)
Starting value	0	14,033	20,211	11,285	12,720	13,157	0
Contributions	13,100	5,000	0	1,362	0	1,700	21,162
Withdrawals	0	0	-9,278	-150	0	0	-9,428
Accrued interest	326	624	404	228	237	202	2,021
Capital gains (losses)	607	556	-51	-4	201	-60	1,250
Management, custody and other costs	-0,3	-2,0	-1,6	-1,1	-1,2	-1,3	-7,5
Net financial gains	933	1,178	352	223	437	141	3,263
Ending value	14,033	20,211	11,285	12,720	13,157	14,998	14,998

(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 RETURNS

In 2012, the fund's return in dollars, net of management costs, was 1.02%. This reflects a return in local currency of 1.44% combined with a loss of 0.42% from exchange rate effects.²³ The net return in pesos was -7.20%, mainly due to the depreciation of the peso against the dollar over the course of the year. Since 31 March 2007, the annualized net return in dollars was 4.35%, which was mostly driven by the net return in local currency (3.66%). In the same period, the net return in pesos was 2.30% (see table 6 and figure 14). The IRR in dollars was 0.96% in 2012 and 4.25% since the fund's inception.

Table 6: Net returns

(percent)

Returns ^(a)	2012	Last 3 years	Since inception ^(b)
Local currency	1.44	2.78	3.66
Exchange rate return	-0.42	-0.70	0.69
Return in USD	1.02	2.08	4.35
Exchange rate return, CLP	-8.22	-1.86	-2.05
Return in CLP ^(c)	-7.20	0.22	2.30

(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.

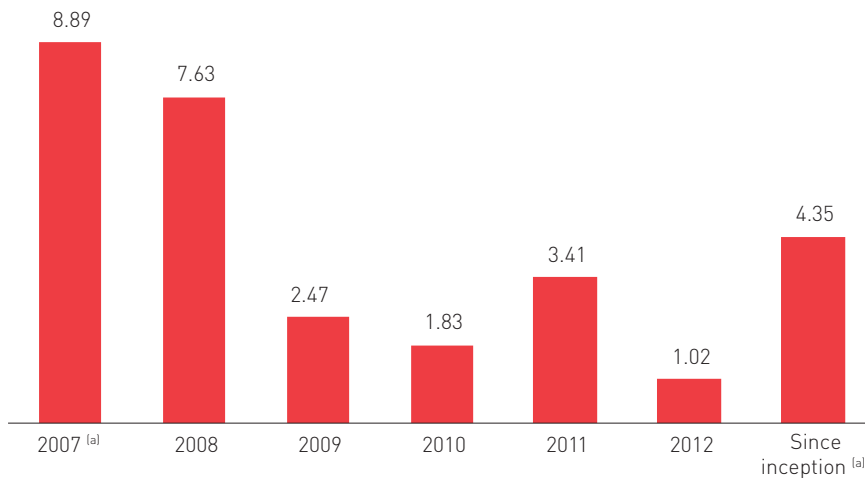
(c) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate.

Source: Ministry of Finance

²³ The sovereign wealth funds' performance primarily reflect interest 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 and yen and that the portfolio performance is measured in dollars, the exchange rate of the dollar against these currencies also affects the funds' returns.

Figure 14: Annual TWR

(percent)



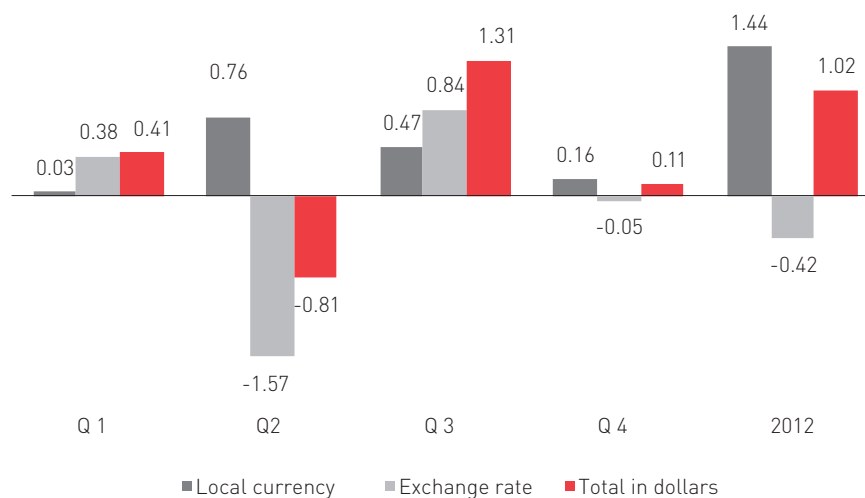
(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Figure 15 shows the quarterly breakdown of net returns in 2012, decomposed into the return in local currency and the exchange rate effect. Returns were higher in the first and third quarters, at 0.41% and 1.31% respectively. This reflects a positive exchange rate effect in both quarters, mainly due to the appreciation of the different currencies in the portfolio against the dollar (the euro in the first quarter and the yen in the third quarter), and, to a lesser extent, positive returns in local currency. In the second and fourth quarter, returns were -0.81% and 0.11%, respectively. In contrast to the first part of the year, the euro depreciated strongly against the dollar in the second half, which had a negative effect on the fund's returns. This was partially offset by the positive returns in local currency in the second quarter, due to a positive yield on the fund's instruments.

Figure 15: Net quarterly returns, by local currency and exchange rate

(percent)

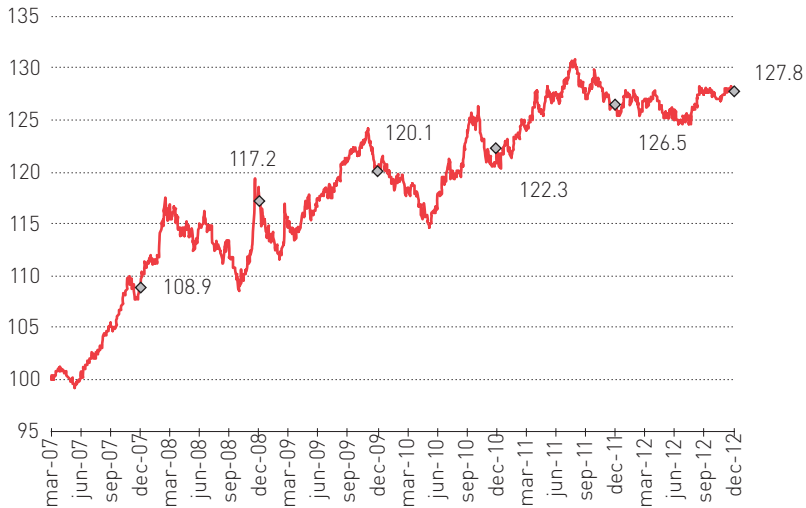


Source: Ministry of Finance

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 127.8 at year-end 2012 (see figure 16).

Figure 16: Return index

(31 March 2007 = 100)

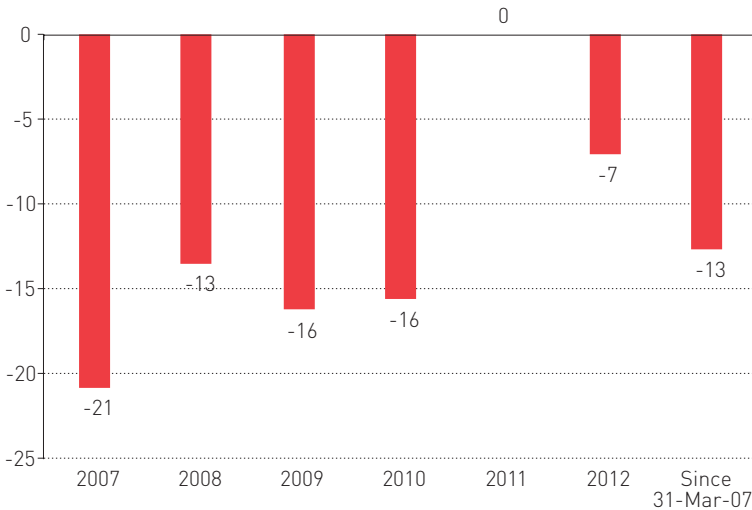


Source: Ministry of Finance

With regard to the Central Bank of Chile's performance, the ESSF's net return in dollars in 2012 was 7 basis points below the benchmark. This result is in line with the more passive approach implemented as of 1 May 2011, as evidenced by a comparison with the results before 2011. Going back to 31 March 2007, the Central Bank's annualized return was 13 basis points below the benchmark (see figure 17).

Figure 17: Net returns against the benchmark

(basis points)



Source: Ministry of Finance

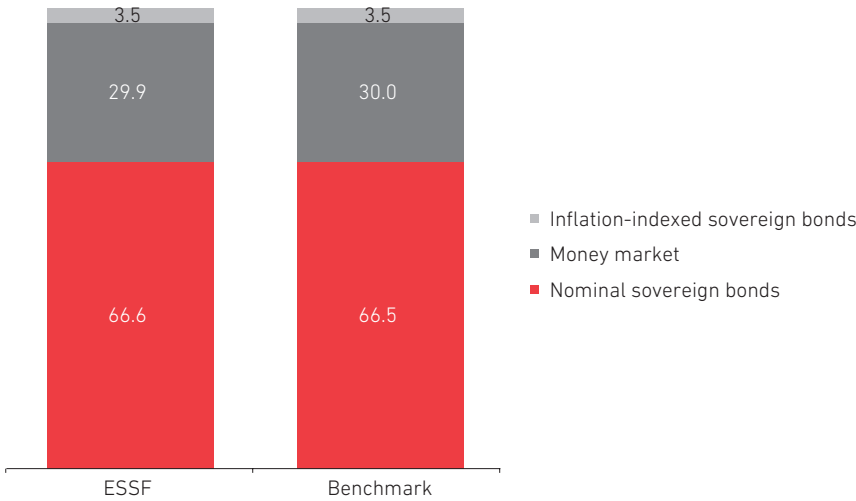
8.4 PORTFOLIO ALLOCATION

The allocation of the ESSF investment portfolio in 2012 was very similar to previous years. The distribution of investments by asset class, country and currency reflects the benchmark allocation, which has remained largely unchanged since the fund's inception.

As of December 2012, the allocation of the ESSF by asset class comprised US\$ 9,987 million in nominal sovereign bonds, US\$ 4,488 million in money market instruments²⁴ and US\$ 522 million in inflation-indexed sovereign bonds. At the close of the year, the percent allocation by asset class and by currency was almost identical to the benchmark (see figures 18 and 19).

Figure 18: Asset class allocation, 31 December 2012

(percent of portfolio)

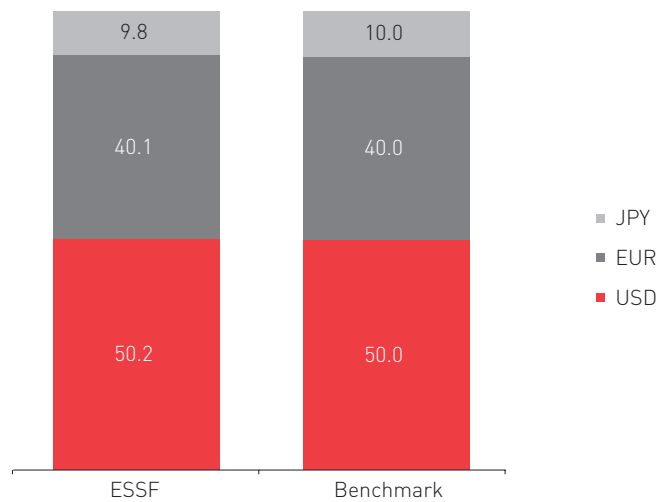


Source: Ministry of Finance

²⁴ Includes sovereign securities with a maturity of less than one year.

Figure 19: Currency allocation, 31 December 2012

(percent of portfolio)

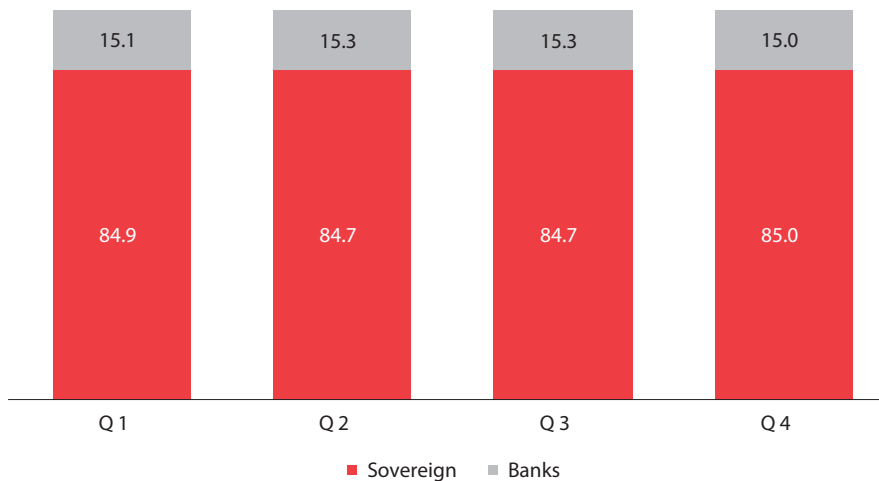


Source: Ministry of Finance

Exposure by type of credit risk was relatively stable in 2012 (see figure 20). In the case of sovereign instruments, investments have been confined exclusively to the United States, Germany and Japan since 1 May 2011, in line with the passive investment policy implemented on that date. At the close of 2012, the sovereign exposure of the ESSF was US\$ 12,746 million, accounting for 85.0% of the portfolio (see table 7). Bank exposure was US\$2,252 million, or 15.0% of the portfolio. These bank investments are primarily time deposits in banks that were selected by the Central Bank based on the risk-return ratio at the time the deposit was made. Table 8 lists the banks with deposits at year-end 2012.

Figure 20: Allocation of credit risk, 2012

(percent of portfolio)



Source: Ministry of Finance

Table 7: Decomposition of credit risk, 31 December 2012

(millions of dollars; percent of total)

Exposure	Country	Millions of US\$	% of total
Sovereign	United States	6,389	42.6
	Germany	5,107	34.1
	Japan	1,250	8.3
	Total	12,746	85.0
Bank	Japan	886	5.9
	France	296	2.0
	Netherlands	274	1.8
	Australia	270	1.8
	Germany	247	1.6
	Sweden	198	1.3
	Norway	80	0.5
	Other	1	0.0
	Total	2,252	15.0
Fund total	14,998	100	

Source: Ministry of Finance

Table 8: Banks with deposits, 31 December 2012

Bank	Country
Australia and New Zealand Banking Group Limited	Australia
BNP Paribas SA	France
Commerzbank AG	Germany
Deutsche Bank AG	Germany
Dnb Nord Banka	Norway
DZ Bank AG	Germany
HSBC Bank PLC	United Kingdom
HSBC France	France
ING Bank NV	Netherlands
Mizuho Corporate Bank	Japan
Norinchukin Bank	Japan
Rabobank Nederland	Netherlands
Skandinaviska Enskilda Banken	Sweden
Sumitomo Mitsui Banking Corporation	Japan
Sumitomo Mitsui Trust Bank Ltd	Japan
Svenska Handelsbanken	Sweden
The Bank of Tokyo Mitsubishi UFJ	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 and Japan. Bank exposure, as explained previously, depends on the CBC's assessment of the risk-return ratio of each bank at the time the deposit was made (see table 9).

Table 9: Credit risk exposure, 31 December 2012

(percent of total)

Issuer	Credit rating									Total
	AAA	AA+	AA	AA-	A+	A	A-	BBB+	Other	
Sovereign	76.7	0.0	0.0	8.3	0.0	0.0	0.0	0.0	0.0	85.0
Bank	0.0	0.0	5.0	0.0	9.4	0.6	0.0	0.0	0.0	15.0

Source: Ministry of Finance

8.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the ESSF in 2012 included US\$ 0.53 million for custody services and US\$ 0.77 million to the Central Bank for management services, or 0.87 basis points of the portfolio. The income from the securities lending program exceeded total management costs, at US\$ 2.91 million (see table 10).

Table 10: Management and custody costs and income from the securities lending program

(U.S. million dollars)

Item	2009	2010	2011	2012
Custody (J.P. Morgan)	0.82	0.62	0.54	0.53
Management (CBC)	0.80	0.51	0.61	0.77
Total costs	1.62	1.13	1.16	1.30
Securities lending program	0.93	1.29	2.87	2.91

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 and exchange rates.²⁵

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 2012 was 2.53 years, while the actual duration of the ESSF was 2.54 years.²⁶

Foreign exchange risk

The value of the funds is also affected by exchange rate movements, since the portfolio includes investments denominated in euros and yen whereas the funds' performance is measured in dollars. Thus, the value of a sovereign bond issued in euros is affected by fluctuations in the USD/EUR exchange rate. An appreciation (depreciation) of the dollar generates additional losses (gains) to those produced by interest rate movements. For the ESSF, the funds' exchange rate exposure, measured in dollars, is 50% and derives from investments in euros (40%) and yen (10%).

Volatility, VaR and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility,²⁷ the minimum and maximum returns and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 3.4% in 2012, versus 5.0% 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 11). The VaR, which quantifies potential losses in a given period and their probability of occurrence, was US\$ 79 million in late December 2012.²⁸

Table 11: Historical minimum and maximum returns

(percent)

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

Source: Ministry of Finance

25 Another factor that affects the market value of a fixed-income portfolio is credit spread risk, which changes according to the market perception of an issuer's solvency. An increase in spreads causes a decrease in the market value of instruments from that issuer. This type of risk is much less important for the ESSF, since all the fund's sovereign investments have a high credit rating.

26 The guidelines stipulate that the difference between the actual duration of the ESSF and the benchmark cannot exceed one month.

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

28 The monthly VaR is calculated based on the daily volatility of the portfolio, with a confidence level of 84%.

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 post tracking error.²⁹ The smaller the tracking error, the more passive the management.³⁰ At year-end 2012, the tracking error del ESSF was 16 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 probabilities of any of the institutions or governments where investments are made. 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 and Japan, within specific ranges (see table 12). Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see table 13). In addition, no more than 20% of the portfolio can be invested in banks.³¹

Table 12: Sovereign exposure

(percent)

Country	Mid-point	Target range
United States	50	48-52
Germany	40	38-42
Japan	10	8-12

Source: Ministry of Finance

Table 13: Maximum credit exposure by bank issuer

Credit Ratings	Maximum Exposure (US\$ millions)
AAA	3.0% * IP at close of last quarter ^(a)
AA+	
AA	2.0% * IP at close of last quarter
AA-	
A+	
A	1.5% * IP at close of last quarter
A-	

(a) IP: Investment portfolio.

Source: Ministry of Finance

29 The tracking error is the monthly standard deviations of returns from the benchmark over a period of three years, which is annualized.

30 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.

31 At the same time, bank exposure cannot be less than 10% of the portfolio in each fund.

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.

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 2012, money market instruments accounted for 29.9% of the ESSF portfolio. 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 Central Bank, thereby taking advantage of the infrastructure that the CBC uses to manage its international reserves. The International Markets Division is in charge of managing the funds. 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.

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 PRF investment policy stipulates a portfolio allocation of 48% in nominal sovereign bonds, 17% in inflation-indexed sovereign bonds, 15% in stocks, and 20% in corporate bonds. The implementation of this policy began in January 2012, and the allocation described above was in place by mid-March 2012.³² 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 Black Rock Institutional Trust Company for stocks; and Rogge Global Partners PLC and Black Rock Institutional Trust Company for corporate bonds).

The asset classes defined under this policy are invested according to highly diversified benchmarks (see table 14) and using a largely passive approach. The ex ante tracking error is capped at 50 basis points for the sovereign bond portfolio, 30 basis points for the stock portfolio and 50 basis points for the corporate bond portfolio.

Eligible instruments and issuers are determined by the benchmarks used. A very limited use of exchange traded funds (ETFs), mutual funds and futures is also allowed in order to facilitate benchmark tracking. Leveraging is not permitted, and the authorized use of forwards 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 will also be triggered whenever the PRF receives additional contributions and when any of the asset classes exceed their target ranges.

Given the nature of the liability financed by the PRF (pensions), the investment policy can be compared to the pension funds managed by the Pension Fund Administrators (AFPs).³³ From the perspective of asset classes and risk profiles, the previous PRF policy in force through the end of 2011 was even more conservative than a Type E fund, which allows up to 5% of the total fund portfolio to be invested in stocks and also allows investment in corporate bonds. The new scheme moves closer to a Type D fund (15% in variable income), which is more in line with the return objectives and risk profile identified for the PRF. In sum, the risk tolerance remains low, while the investment policy is more consistent with the underlying liability that needs to be financed in the future.

³² The new policy was recommended by the Financial Committee in late 2010, based on a study carried out by the Mercer consulting firm using the risk-return parameters described above. The fund's previous investment policy was identical to that of the ESSF.

³³ The majority of the fixed-income investments in the multifunds managed by the AFPs (including D and E funds) are in national fixed-income instruments (in both pesos and UFs), which have no exchange rate risk. In contrast, PRF resources are invested abroad, and there is no exchange rate hedging.

Table 14: Strategic asset allocation and benchmarks

(percent of portfolio)

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

(a) For this asset class, the subindexes are weighted by their relative capitalization.

(b) Includes other related sovereign issuers such as municipalities, state-owned companies, agencies, etc.

Source: Ministry of Finance

9.2 MARKET VALUE

As of 31 December 2012, the PRF had a market value of US\$ 5,883 million, an increase of US\$ 1,477 million over year-end 2011. This growth is mainly due to a contribution of US\$ 1,197 million, or 0.5% of 2011 GDP (see table 15), plus net financial gains of US\$ 280 million.

Since its inception on 28 December 2006, the fund has received contributions totaling US\$ 5,065 million, and its investments have generated net financial gains of US\$ 819 million (see table 16).

Table 15: Annual contributions

(millions of dollars)

Period	Contribution	% GDP (previous 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
Total	5,065	

Source: Ministry of Finance

Table 16: Evolution and decomposition of market value

(millions of dollars)

Descomposition	2007	2008	2009	2010	2011	2012	Since Inception ^(a)
Starting value	605	1,466	2,507	3,421	3,837	4,406	0
Contributions	736	909	837	337	443	1,197	5,065
Withdrawals	0	0	0	0	0	0	0
Accrued interest	46	71	72	70	75	130,65	465
Capital gains (losses)	80	60	6	9	51	151	357
Management, custody and other costs	0.0	-0.3	-0.3	-0.4	-0.4	-1.23	-2.8
Net financial gains	125	131	77	79	126	280	819
Ending value	1,466	2,507	3,421	3,837	4,406	5,883	5,883

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

Source: Ministry of Finance

9.3 RETURNS

The fund's return in dollars, net of management costs, was 4.87% in 2012. The net return in pesos for the year was -3.35%, which is explained by the sharp depreciation of the dollar against the peso. Since 31 March 2007, the annualized net return was 4.98% in dollars and 2.93% in pesos. Through the close of 2011, the ESSF and the PRF had very similar returns on investment, because they had similar investment policies since their inception (see table 17 and figure 21). Finally, the PRF recorded an IRR in dollars of 5.55% in 2012, while the annualized IRR since the fund's inception was 4.42%.

Table 17: Net returns

(percent)

Returns ^(a)	2012	Last 3 years	Since Inception ^(b)
Return in USD	4.87	3.35	4.98
Exchange rate return, CLP	-8.22	-1.86	-2.05
Return in CLP ^(c)	-3.35	1.49	2.93

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

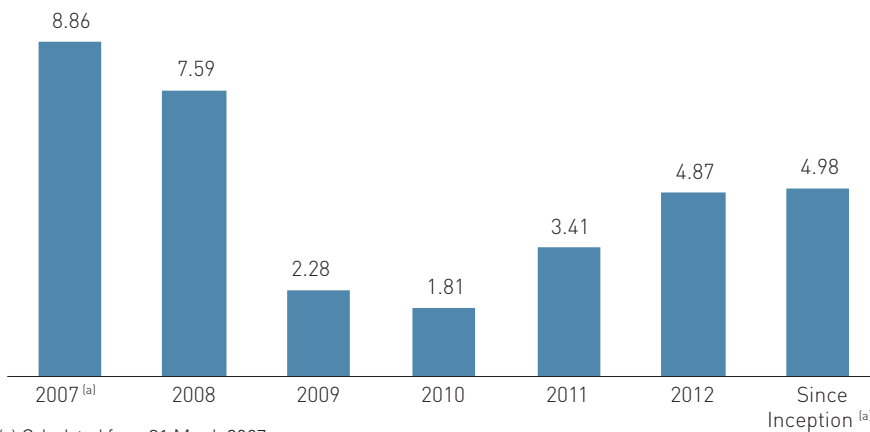
(b) Calculated from 31 March 2007, when the Central Bank's performance began to be measured.

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

Source: Ministry of Finance

Figure 21: Annual TWR

(percent)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

All asset classes recorded a positive performance in 2012. Stocks were the most profitable, with returns of 13.2%, followed by inflation-indexed bonds at 9.92% and corporate bonds at 9.41%. The sovereign bond asset class and other related assets posted returns of just 1.51%. An analysis of quarterly returns reveals that the stock portfolio recorded the widest fluctuations, with its highest quarterly returns in the first quarter (8.59%) and lowest in the second (-5.4%); this performance is consistent with the greater volatility associated with this asset class (see table 18).

Table 18: Performance by asset class

(percent)

Returns	Q 1 ^(a)	Q 2	Q 3	Q 4	2012 ^(a)
Sovereign bonds and related assets	-0.67	0.93	3.10	-1.79	1.51
Inflation-indexed bonds	3.53	-0.44	3.51	3.03	9.92
Corporate bonds	2.46	0.00	4.86	1.83	9.41
Equities	8.59	-5.40	6.87	3.07	13.15
Total portfolio	0.69	-0.46	4.10	0.52	4.87

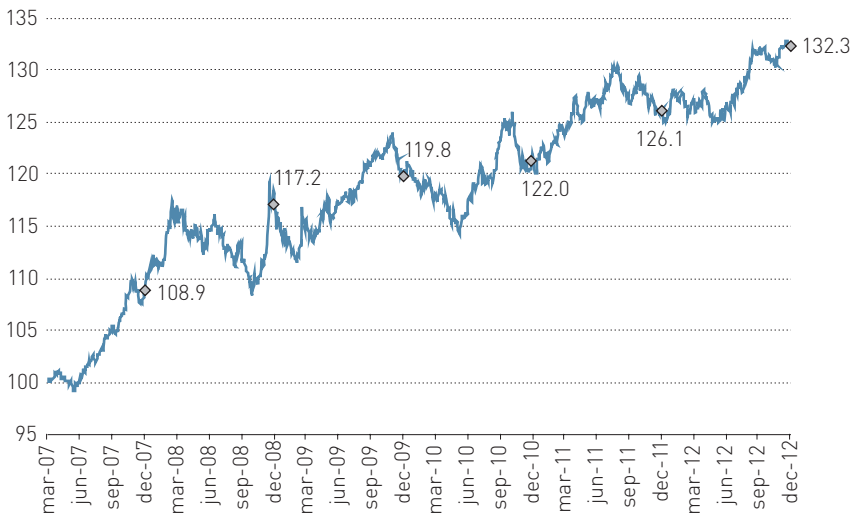
(a) Investment in corporate bonds and stocks began on 17 January 2012.

Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the daily returns of the portfolio (see figure 22). Despite the volatility of the index, the value increased over prior years, to 132.3 at year-end 2012.

Figure 22: Return index

(31 March 2007 = 100)

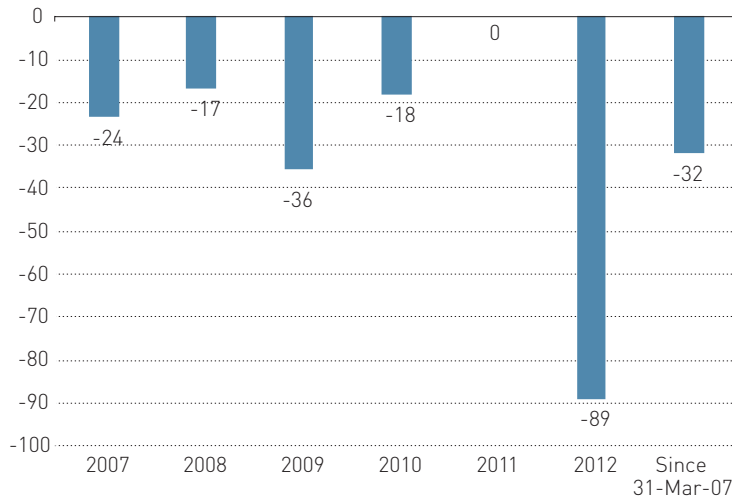


Source: Ministry of Finance

The performance of the PRF, measured as the difference between the portfolio return and the benchmark, was –89 basis points in 2012,³⁴ while the annualized return since 31 March 2007 was 32 basis points below the benchmark (see figure 23). To a large extent, the return differential between the portfolio and the benchmark in 2012 was due to the implementation of the new investment policy, which took place gradually over the period.

Figure 23: Net returns against the benchmark

(basis points)



Source: Ministry of Finance

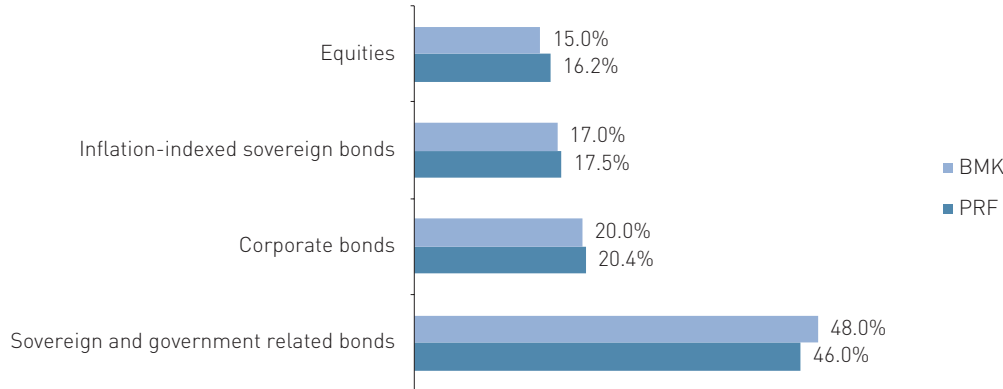
³⁴ This figure includes the impact of approximately US\$ 800 million held in time deposits until 1 March 2013, when the CBC transferred the resources to the external managers. If the first quarter is excluded, the portfolio was only 7 basis points below its benchmark.

9.4 PORTFOLIO ALLOCATION

As of December 2012, the allocation of the PRF by asset class comprised US\$ 2,704 million in nominal sovereign and government related bonds, US\$ 1,029 million in inflation-indexed sovereign bonds, US\$ 1,199 million in corporate bonds and US\$ 951 million in stocks. The percent allocation by asset class and by currency was similar to the benchmark, although the share of sovereign bonds and related assets was slightly lower because returns were higher on other asset classes during the year (see figures 24 and 25).

Figure 24: Asset class allocation, 31 December 2012

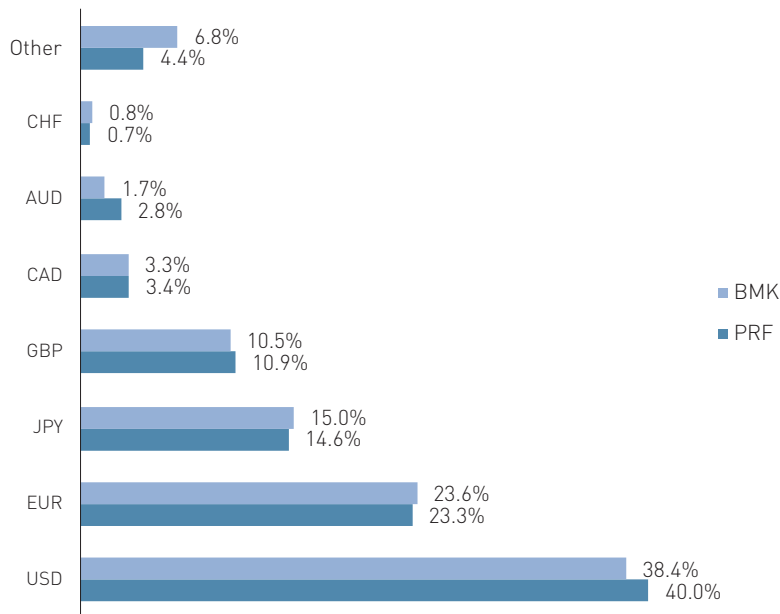
(percent of portfolio)



Source: Ministry of Finance

Figure 25: Currency allocation, 31 December 2012

(percent of portfolio)



Source: Ministry of Finance

In terms of credit risk, at year end, 52% of the PRF fixed-income portfolio had a rating of AA+ or higher, mainly in sovereign bonds, while 15% had a rating of BBB+ to BBB-, mainly in corporate bonds (see table 19).

Table 19: Credit risk exposure, 31 December 2012

(percent of the fixed-income portfolio)

	Sovereign and government related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Total fixed income
AAA	13%	8%	0%	21%
AA+	20%	11%	0%	31%
AA	2%	0%	1%	2%
AA-	1%	0%	2%	2%
A+	14%	0%	3%	17%
A	0%	0%	5%	5%
A-	1%	0%	4%	5%
BBB+	4%	2%	4%	10%
BBB	0%	0%	3%	3%
BBB-	0%	0%	2%	2%
Other ^(a)	0%	0%	0%	0%
Total	55%	21%	24%	100%

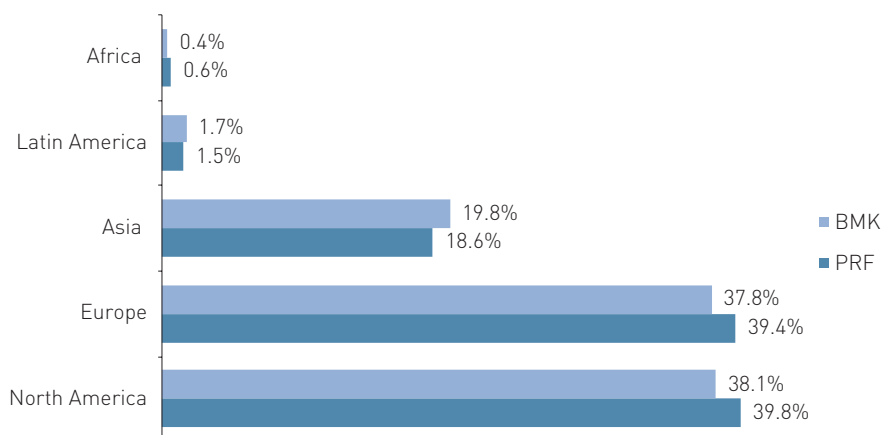
(a) Includes cash and time deposits.

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 26 and 27). At year end, 80% of investments were in the United States and Europe, in almost equal shares, while 19% was in Asia, mainly Japan. The remainder was invested in countries in Latin America and Africa. The main economic sectors are the government (61%) and the financial sector (14%). Table 20 shows the percentage distribution of the main countries.

Figure 26: Regional allocation, 31 December 2012

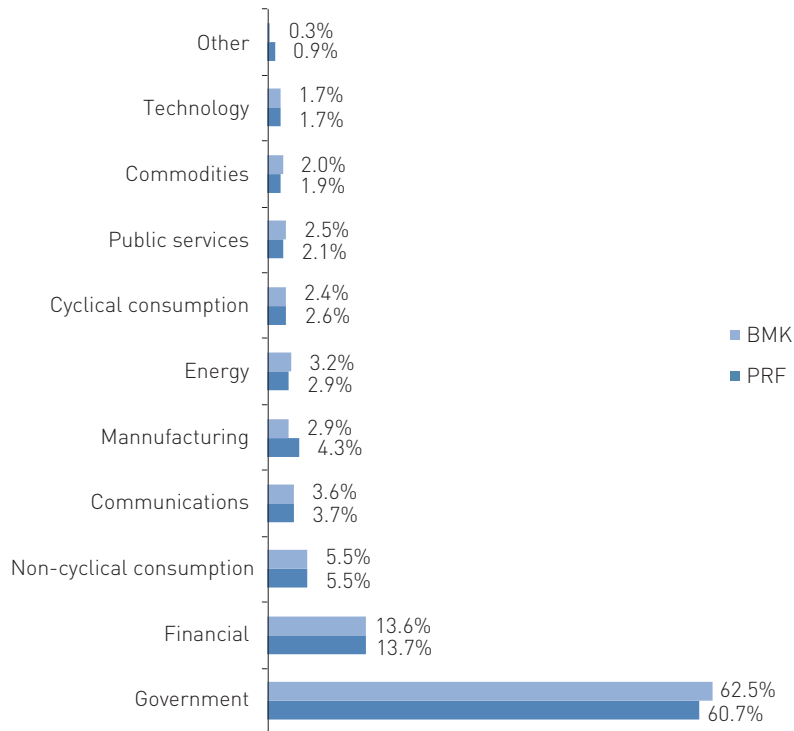
(percent of portfolio)



Source: Ministry of Finance

Figure 27: Allocation by economic sector, 31 December 2012

(percent of portfolio)



Source: Ministry of Finance

Table 20: Allocation by asset class and by country, 31 December 2012

(percent of portfolio)

Allocation by country	Sovereign and government related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Equities	Total
Germany	3.0%	0.4%	0.2%	0.6%	4.2%
Australia	1.9%	0.2%	0.6%	0.5%	3.2%
Belgium	1.1%	0.0%	0.0%	0.1%	1.2%
Canada	1.5%	0.6%	1.1%	0.7%	3.9%
United States	11.3%	7.0%	9.3%	7.5%	35.2%
France	3.1%	2.1%	1.1%	0.6%	6.9%
Netherlands	1.3%	0.0%	1.4%	0.2%	2.9%
Italy	1.9%	1.6%	0.2%	0.1%	3.9%
Japan	11.9%	0.0%	0.8%	1.2%	13.9%
United Kingdom	2.8%	4.7%	2.6%	1.4%	11.5%
Supranational	2.2%	0.0%	0.0%	0.0%	2.2%
Other ^(a)	3.9%	0.8%	3.1%	3.3%	11.1%
Total	46.0%	17.5%	20.4%	16.2%	100.0%

(a) Includes cash and time deposits.

Source: Ministry of Finance

9.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the PRF included US\$ 0.09 million for custody services, US\$ 0.52 million for the Central Bank's management services and US\$ 0.55 million for external managers. Together, the remuneration paid to the CBC and external managers equaled 2 basis points of the portfolio in 2012. The income from the securities lending program totaled US\$ 0.22 million, which partly offset the management and custody costs (see table 21). The increase in management costs was related to the implementation of the new investment policy, which is more complex than the previous policy.

Table 21: Management and custody costs and income from the securities lending program

(U.S. million dollars)

Item	2009	2010	2011	2012
Custody (J.P. Morgan)	0.19	0.25	0.22	0.09
Management (CBC)	0.16	0.15	0.19	0.52
External management	-	-	-	0.55
Other costs ^(a)	-	-	0.02	0.07
Total costs	0.35	0.41	0.43	1.23
Securities lending program	0.21	0.40	0.92	0.22

(a) Payment to consultant Strategic Investment Solutions.

Source: Ministry of Finance

9.6 MAIN FINANCIAL RISKS

Because the PRF portfolio is concentrated in fixed-income instruments (85%), the portfolio is exposed to many of the same risks as the ESSF. However, credit risk is higher due to the larger number of countries and the investment in corporate bonds. Also, in addition to the market risks described earlier, the PRF is exposed to stock risk. 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 risk in detail, together with the control mechanisms set up for monitoring them

Interest rate risk

In the PRF, interest rate risk is mainly a function of the benchmark portfolio duration, which is calculated from the duration of the indexes that make up the benchmark. In contrast to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk from a larger number of countries, and it is more sensitive due to its longer duration. This risk is monitored and controlled by keeping the portfolio duration close to the benchmark. The benchmark duration at year-end 2012 was 7.13 years, while the actual duration of the PRF was 6.93 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 mandate, 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 (23%), yen (15%), pounds sterling (11%), Canadian dollars (3%), Australian dollars (3%) and other currencies with a smaller share.

Credit spread risk

The market value of the instruments in the PRF fixed-income portfolio are also exposed to changes in the market perception of the issuer's solvency. 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 4.1% in 2012, versus 5.2% 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 -3.33% (in January 2009). The highest quarterly return was 7.36% in the first quarter of 2008; the lowest was -2.51% in the third quarter of 2008 (see table 22). The VaR was US\$ 161 million in late December 2012.³⁵

Table 22: historical minimum and maximum returns

(percent)

Range	Month	Quarter
Highest return	5.47 (Dec-08)	7.36 (I-08)
Lowest return	-3.33 (Jan-09)	-2.51 (III-08)

Source: Ministry of Finance

³⁵ The monthly VaR is calculated based on the daily volatility of the portfolio, with a confidence level of 84%.

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 2012, the ex ante tracking error of the PRF was 18 basis points, consistent with a passive management strategy.

9.6.2 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 bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly associated with investing the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see table 23). In addition, forwards cannot exceed a stipulated percentage of each manager's portfolio (4% for the internally managed portfolio and 2% for the external managers).

Table 23: Credit limits on bank deposits and forwards

(millions of U.S. dollars, unless otherwise indicated)

Limits		Time deposits	Forwards
Minimum credit rating		AA-	AA-
Maximum by issuer	CBC portfolio	20	1% ^(a)
	External managers	10	

(a) Percent of each manager's portfolio.

Source: Ministry of Finance

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

9.6.3 LIQUIDITY RISK

The PRF is exposed to minimal liquidity risk because the fund has little need for cash, given that disbursements from the fund will 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 guidelines allow some flexibility for managers to make the necessary adjustments, in order to reduce the impact of having to sell at an unfavorable time. For rebalancing, there are clear rules on planning its implementation.

9.6.4 OPERATIONAL RISK

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

This risk has been mitigated by delegating the operational management of the funds to the Central Bank, thereby taking advantage of the infrastructure that the CBC uses to manage its international reserves. The International Markets Division is in charge of managing the funds. 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.

Financial Statements: Economic and Social Stabilization Fund

Financial statements for the years ended 31 December 2012 and 2011 and independent auditors' report³⁶

³⁶ The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2012 and 2011 were prepared by the Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish.

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, que comprenden los estados de situación financiera al 31 de diciembre de 2012 y 2011 y los correspondientes estados 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 de la entidad 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 de la entidad. 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.

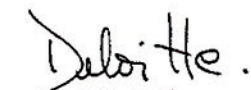
Consideramos que la evidencia de auditoría que hemos obtenido es suficiente y apropiada para proporcionarnos una base para nuestra opinión de auditoría.

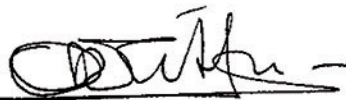
Opinión

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 2012 y 2011 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 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.


Abril 30, 2013



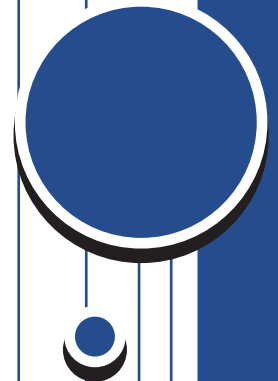
Jorge Ortiz Martínez
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TESORERIA GENERAL
DE LA REPUBLICA

FINANCIAL STATEMENTS ECONOMIC AND SOCIAL STABILIZATION FUND

TESORERÍA GENERAL DE LA REPÚBLICA
For the years ended December 31, 2012 and 2011.



ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2012 AND 2011
(Figures in U.S. Dollars - US\$)

	Notes	2012 (US\$)	2011 (US\$)
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	11	1,465,682	4,110,279
FINANCIAL ASSETS AFFECTING INCOME			
Time deposits		2,250,214,418	2,203,016,101
Government bonds		9,987,367,297	8,755,831,787
Indexed bonds		522,013,590	461,479,981
Treasury bills		2,236,622,448	1,732,190,505
Derivatives		8,613	13,778
TOTAL INVESTMENTS	7	<u>14,996,226,366</u>	<u>13,152,532,152</u>
TOTAL ASSETS		<u>14,997,692,048</u>	<u>13,156,642,431</u>
LIABILITIES			
Derivative financial instruments	8	173,390	-
TOTAL LIABILITIES		<u>173,390</u>	<u>-</u>
NET EQUITY			
Treasury resources		10,034,619,597	10,034,619,597
Contributions by the Treasury	9	1,700,000,000	-
Accumulated results		3,122,022,834	2,685,481,558
Income in the year		140,876,227	436,541,276
NET EQUITY		<u>14,997,518,658</u>	<u>13,156,642,431</u>
TOTAL LIABILITIES AND NET EQUITY		<u>14,997,692,048</u>	<u>13,156,642,431</u>

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 2012 AND 2011
(Figures in U.S. Dollars - US\$)**

	Notes	2012 (US\$)	2011 (US\$)
OPERATING INCOME			
Interest earned	10	180,185,481	208,345,009
Income from the sale of financial instruments		21,704,470	370,031,110
Net unrealized gains from price fluctuations		158,125,724	-
Total operating income		360,015,675	578,376,119
OPERATING LOSSES			
Losses from the sale of financial instruments		(217,840,533)	-
Net unrealized losses from price fluctuations			
Total operating income		(217,840,533)	(140,676,451)
MANAGEMENT EXPENSES			
Fiscal agent's fees	9	(768,015)	(613,758)
Custodian's fees	9	(530,900)	(544,634)
INCOME FOR THE YEAR		140,876,227	436,541,276

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CHANGES IN NET EQUITY
31 DECEMBER 2012 AND 2011
(Figures in U.S. Dollars - US\$)

	Notes	Treasury resources (US\$)	Accumulated results (US\$)	Income for the year (US\$)	Total (US\$)
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
Opening balance, 1 January 2011		10,034,619,597	2,462,490,328	222,991,230	12,720,101,155
Distribution of income from previous year		-	222,991,230	(222,991,230)	-
Income for the year		-	-	436,541,276	436,541,276
Closing balance, 31 December 2011		10,034,619,597	2,685,481,558	436,541,276	13,156,642,431

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 2012 AND 2011
(Figures in U.S. Dollars - US\$)

	Notes	2012 (US\$)	2011 (US\$)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		140,876,227	436,541,276
Net unrealized gains (losses)		(158,125,724)	140,676,451
Changes in fund management and custody		(1,685,395,100)	(573,729,430)
Net cash flows from operating activities		<u>(1,702,644,597)</u>	<u>3,488,297</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	<u>1,700,000,000</u>	-
Net cash flows from financing activities		<u>1,700,000,000</u>	<u>3,488,297</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		<u>(2,644,597)</u>	<u>3,488,297</u>
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		<u>4,110,279</u>	<u>621,982</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	11	<u>1,465,682</u>	<u>4,110,279</u>

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 2012 AND 2011

(Figures in U.S. dollars—US\$)

1. GENERAL

The Economic and Social Stabilization Fund (ESSF) was created through Law N° 20,128, issued by the Ministry of Finance of Chile on 30 September 2006, which combined into a single fund the additional fiscal income stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under loan agreement BIRF N° 2625 CH, as specified in Statutory Decree N° 1 of 11 December 2006.

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

- a) Decree N° 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 N° 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 N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.
- d) Decree N° 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 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 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.

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.

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

Debt instruments that are 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 CBC, 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 2012 and 2011, respectively.

c. Functional and presentation currency - The entries included in the ESSF's 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 CBC, 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.

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, 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) Precios cotizados (sin ajustar) en mercados activos para activos o pasivos idénticos (Nivel 1);
- (b) Variables distintas a los precios cotizados incluidos en el Nivel 1 que sean observables para el activo o pasivo, directamente (es decir, como precios) o indirectamente (es decir, derivadas de los precios) (Nivel 2); y
- (c) Variables utilizadas para el activo o pasivo que no estén basadas en datos de mercado observables (variables no observables) (Nivel 3).

e. Cash—In the preparation of the ESSF’s 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 Statutory Decree N° 1 of 11 of September 2006, the ESSF will be established and increased with the following resources:

The additional fiscal income stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under 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 Statutory Decree enters into force;
- (b) All resources deriving from the application of Transitory Article 2 of Law N° 19,030;
- (c) An annual contribution equal to the balance remaining after subtracting from the effective surplus, the contributions stipulated in paragraph (a) of Article 6 and in Article 11, both of Law N° 20,128, provided the balance is positive; and
- (d) Other extraordinary contributions designated for the fund via Finance Ministry decree, from the sale of assets or the issue of debt instruments; as well as other resources stipulated in other laws.

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

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

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

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

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

The ESSF's 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 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 credit institutions and other highly liquid short-term investments.
- Net operating income: Includes management costs for operating the sovereign wealth funds.
- Net financing income: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

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

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. New accounting rules:

The following new amendments have been adopted in these financial statements.

IFRS amendments	Compulsory application date
IAS 12: Deferred tax: recovery of underlying assets	Annual periods beginning on or after 1 January 2011.
IFRS 1 (Revised): First-time adoption of International Financial Reporting Standards. (i) Removal of fixed dates for first-time adopters; (ii) Severe hyperinflation	Annual periods beginning on or after 1 July 2011.
IFRS 7: Financial instruments: disclosures. Disclosures—transfers of financial assets	Annual periods beginning on or after 1 July 2011.

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

The following new rules and interpretations have been issued, but they have not yet entered into effect:

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 interests 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.

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
IAS 19: Employee benefits (2011)	Annual periods beginning on or after 1 January 2013
IAS 32: Financial instruments: Presentation. Clarification of the requirements for offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014
IFRS 7: Financial instruments: disclosures. (i) Disclosures—transfers of financial assets (ii) Amendments to Disclosures—offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2013
IFRS 10, IFRS 11 and IFRS 12: Consolidated financial statements, Joint agreements and Disclosure of interest in other entities—Transition guidance	Annual periods beginning on or after 1 January 2013
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.

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

3. ESSF INVESTMENT POLICY

The guidelines and parameters for managing the investment portfolio were given to the fiscal agent by the Ministry of Finance through Ordinary Official Letter N°433 dated 12 April 2011. They can be outlined as follows:

a) Asset classes:

The fiscal resources in the investment portfolio are invested in three asset classes:

(1) money market; (2) nominal sovereign bonds; and (3) inflation-indexed sovereign bonds. The asset class benchmark breaks down as follows

Asset class	Percent of portfolio
Money market	30.0%
Nominal sovereign bonds	66.5%
Inflation-indexed sovereign bonds	3.5%
Total	100.0%

b) Currency allocation and deviation from the benchmark:

The investment portfolio can be invested in the following eligible currencies:

- Primary currencies:
 - U.S. dollars (USD)
 - Euros (EUR)
 - Japanese yen (JPY)
- The investment portfolio must maintain the following currency allocation:

Currency	Punto Central	Rango Desviación
USD	50%	48% – 52%
EUR	40%	38% – 42%
JPY	10%	8% – 12%

Investments in secondary currencies or in instruments denominated in secondary currencies must be hedged through currency forwards or swaps with one of the primary currencies.

c) Credit risk:

Investments of ESSF resources must comply with the following conditions and requirements with regard to credit risk:

- Eligible issuers

Issuer	Minimum permitted (% of IP)	Maximum permitted (% of IP)
Sovereign	80%	90%
Bank	10%	20%

IP: Investment portfolio

- Sovereign risk

The following methodology must be used for country selection and limit allocation:

Selection requirements: The countries eligible for selection are the United States of America, Germany and Japan. Investment in sovereign risk must abide by the following allocation by eligible country:

Country	Mid-point	Target range
United States of America	50%	48% – 52%
Germany	40%	38% – 42%
Japan	10%	8% – 12%

d) Other risks:

The methodology for selecting institutions and risk allocations is based on international risk ratings and the size of the institutions.

- Selection requirements:
 - i. Credit ratings on long-term instruments must be A– or higher from at least two of the international risk rating agencies (Fitch, Moody's and Standard & Poor's).
- Limit allocation by issuer:

Investment limits for eligible credit ratings (between AAA and A–) are as follows:

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

e) Eligible foreign currency operations:

- Foreign currency spot contracts
- Foreign currency forwards

f) Limits or specific rules for instruments and operations:

- Inflation-indexed instruments: total indexed bonds cannot be less than 2.5% or more than 4.5% of the investment portfolio.
- The following guidelines have been established for the use of currency hedging mechanisms involving foreign currency forward or swap operations:
 - i. Forward or swap contracts can only be written or held between eligible currencies.
 - ii. Foreign currency forward or swap contracts can only be held with eligible counterparties that have a risk rating of AA– or higher from at least two of the international risk rating agencies (Fitch, Moody's and Standard & Poor's).

- iii. Foreign currency forward or swap contracts can specify either cash delivery or net settlement.
 - iv. 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, letter c).
- g) 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, letter c).
- (h) 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, letter c). 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.
- (i) The notional amount of open forward or swap contracts will not exceed a sum total of 5% of the investment portfolio.
- Intermediaries: Investments can only be made in countries that are eligible for sovereign risk investments through the following broker/dealers:
 - i. Entities that can operate in the primary market; that is, that are classified as primary dealers in the United States of America, the United Kingdom and France.
 - ii. Banks that are eligible for investment can directly provide broker services; their subsidiaries can also provide direct services, under the condition that the corresponding parent bank has at least a 90% ownership share
 - iii. Investment banks that have the same long-term risk rating required for banks that are eligible for investment; or their subsidiaries, provided that one or more investment banks account for at least a 90% ownership share of the subsidiary.
 - Additional restriction: The fund cannot be invested in financial instruments from Chilean issuers or in instruments that are expressed or paid in pesos.
 - Valuation criteria: The valuation of the investment portfolio that must be reported to the Ministry of Finance is that which is prepared by the custodian(s) using mark-to-market accounting, based on their own pricing sources. At the same time, for internal accounting purposes and other grounds related to the Fiscal Agency Decree, the CBC can employ the same methodology that it uses for its own international reserve operations.
 - Securities lending program: The fiscal agent can enter into agreements with custodian(s) to manage the ESSF securities lending programs (henceforth “the programs” or “securities lending”), provided that the custodians in question (henceforth “program managers”) agree to comply with the operating criteria established in the Custodian Guidelines, including in particular the obligation to return the respective securities or, in the absence thereof, the corresponding market value.

- Other: Foreign currency operations will be considered spot operations whenever the period between the trade date and the settlement date does not exceed two days. At the same time, foreign currency operations related to the purchase or sale of an instrument will be considered spot operations whenever the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument being bought or sold. For the purposes of measuring management performance, the baseline currency of the IP is the U.S. dollar. Payments related to the performance of the duties of the fiscal agent will be financed with resources from the ESSF current account. In the case of insufficient funds in the ESSF current account, the fiscal agent will liquidate or transfer investments from the investment portfolio to the current account.

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 Fisco.

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 2012, 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\$14,996,226,366 on 31 December 2012 and US\$13,152,532,152 on 31 December 2011.

(a) The breakdown of investments carried at fair value on 31 December 2012 and 2011 is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy level	2012 (US\$)	2011 (US\$)
Government bonds	1	9,987,367,297	8,755,831,787
Indexed bonds	1	522,013,590	461,479,981
Treasury bills	1	2,236,622,448	1,732,190,505
Derivatives	1	8,613	13,778
Total investments		12,746,011,948	10,949,516,051

Custodian investments, Central Bank of Chile	Fair value hierarchy level	2012 (US\$)	2011 (US\$)
Time deposits	1	2,250,214,418	2,203,016,101

b) The breakdown of investments by investment currency on 31 December 2012 and 2011 is as follows:

Fair value instruments, JP Morgan				
Currency of origin	2012		2011	
	US\$	% of IP	US\$	% of IP
U.S. Dollar	6,388,576,673	50.12%	5,548,106,493	50.67%
Euro	5,107,380,094	40.07%	4,271,563,489	39.01%
Yen	1,250,055,181	9.81%	1,129,846,069	10.32%
Subtotal	12,746,011,948	100.00%	10,949,516,051	100.00%

Fair value instruments, JP Morgan				
Currency of origin	2012		2011	
	US\$	% of IP	US\$	% of IP
U.S. Dollar	1,137,551,408	50.55%	1,010,529,822	45.87%
Euro	899,265,270	39.97%	992,072,846	45.03%
Yen	213,397,740	9.48%	200,413,433	9.10%
Subtotal	2,250,214,418	100.00%	2,203,016,101	100.00%
Total	14,996,226,366		13,152,532,152	

c) The total value of assets by risk segment on 31 December 2012 and 2011 is as follows:

Risk segment	2012		2011	
	Market value US\$	Market value (%)	Market value US\$	Market value (%)
Bank (*)	2,251,688,714	15.01%	2,207,140,158	16.78%
Sovereign	12,746,003,334	84.99%	10,949,502,273	83.22%
Total	14,997,692,048	100.00%	13,156,642,431	100.00%

(*) Includes cash and cash equivalents.

Asset class	2012		2011	
	Market value (US\$)	Market value %	Market value (US\$)	Market value %
Money market [*]	4,488,311,162	29.93%	3,939,330,663	29.94%
Sovereign bonds	9,987,367,297	66.59%	8,755,831,787	66.55%
Inflation-indexed bonds	522,013,589	3.48%	461,479,981	3.51%
Total	14,997,692,048	100.00%	13,156,642,431	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\$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	2012 (US\$)	2011 (US\$)
Derivatives	1	173,390	-
Total investments		173,390	-

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

Fair value instruments, J.P. Morgan					
Currency of origin	2012		2011		% of IP
	US\$	% of IP	US\$	% of IP	
Dólar US\$	-	0.00%	-	-	0.00%
Euro	-	0.00%	-	-	0.00%
Yen	173,390	100.00%	-	-	0.00%
Total	173,390	100.00%	-	-	0.00%

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

Risk segment	2012		2011	
	Market value US\$	Market value (%)	Market value US\$	Market value (%)
Bank	173,390	100.00%	-	0.00%

Asset class	2012		2011	
	Market value US\$	Market value (%)	Market value US\$	Market value (%)
Money market	173,390	100.00%	-	0.00%

On 31 December 2011, this item had a zero balance.

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 2012 and 2011:

	2012				2011			
	Contributions (US\$)	Withdrawals (US\$)	Commissions (US\$)	Custodian fees (US\$)	Contributions (US\$)	Withdrawals (US\$)	Commissions (US\$)	Custodian fees (US\$)
January	1,700,000,000	-	-	-	-	-	-	-
February	-	-	-	220,255	-	-	-	49,259
March	-	-	192,003	-	-	-	155,285	51,303
April	-	-	-	-	-	-	-	105,233
May	-	-	-	-	-	-	-	-
June	-	-	192,004	-	-	-	155,285	55,710
July	-	-	-	-	-	-	-	-
August	-	-	-	-	-	-	-	113,052
September	-	-	192,004	-	-	-	151,594	-
October	-	-	-	-	-	-	-	-
November	-	-	-	-	-	-	-	55,970
December	-	-	192,004	310,645	-	-	151,594	114,107
Total	1,700,000,000	-	768,015	530,900	-	-	613,758	544,634

10. INTEREST EARNED

The breakdown of income from interest earned on 31 December 2012 and 2011 is as follows:

	2012 (US\$)	2011 (US\$)
Interest earned on debt securities carried at fair value through profit or loss	180,185,481	208,345,009

11. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2012 and 2011 is as follows:

	2012 (US\$)	2011 (US\$)
Cash in custodian accounts	1,465,682	4,110,279

12. ESSF RETURN

The breakdown of the fund's returns as of 31 December 2012 and 2011 is as follows:

Type of return	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	0.05%	1.02%	2.08%

13. LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N° 433, Section II N°5, the fiscal agent 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 2012 and 2011, the ESSF owned the following instruments under the item Securities lending

2012 Location	Notional amount	Market value
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

2012 Location	Notional amount	Market value
Europe	942,489,000	1,359,055,145
United States of America	3,695,242,000	3,945,894,827
Total	4,637,731,000	5,304,949,972

Al 31 de diciembre de 2012 y 2011, el Fondo posee los siguientes instrumentos bajo el concepto de "Securities Lending":

14. SECURITIES CUSTODY

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

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total Fund assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	14,996,052,976	100%	99.99%
Total investment portfolio in custody				14,996,052,976	100%	99.99%

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

As of 31 December 2011, securities custody was as follows:

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total Fund assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	13,152,532,152	100%	99.97%
Total investment portfolio in custody				13,152,532,152	100%	99.97%

15. SUBSEQUENT EVENTS

On 20 February 2013, The Ministry of Finance of Chile, through the Minister of Finance, Mr. Felipe Larraín, announced a fiscal contribution for 2013 of US\$2.0 billion to be distributed between the Chilean sovereign wealth funds.

The Economic and Social Stabilization Fund will receive a total contribution of approximately US\$700 million, in the form of ordinary resources of about US\$200 million and an additional contribution of US\$500 million representing an early (advance) payment charged to future budget executions.

In accordance with Article 2°, paragraph (c) of Statutory Decree N° 1 (D.F.L. N° 1), which created the Economic and Social Stabilization Fund, contributions are made on an annual basis and are equivalent to the effective fiscal surplus minus the contribution stipulated in paragraph (a) of Article 6° of Law N° 20,128 and minus the contribution made pursuant to the power conferred under Article 11° of the same law, provided that the balance is positive.

As of the date of these financial statements, the contribution has not yet been transferred to the fund.

Between 1 January 2013 and the date of issue of these financial statements (30 April 2013), there have not been other subsequent events that could materially affect the balances or interpretation of these financial statements.

Financial Statements: Pension Reserve Fund

Financial statements for the years ended 31 December 2012 and 2011 and independent auditors' report³⁷

³⁷ The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2012 and 2011 were prepared by the Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish.

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, que comprenden los estados de situación financiera al 31 de diciembre de 2012 y 2011 y los correspondientes estados 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 de la entidad 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 de la entidad. 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.

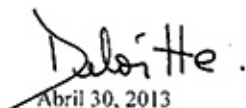
Consideramos que la evidencia de auditoría que hemos obtenido es suficiente y apropiada para proporcionarnos una base para nuestra opinión de auditoría.

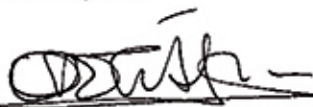
Opinión

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 2012 y 2011 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.


Abril 30, 2013

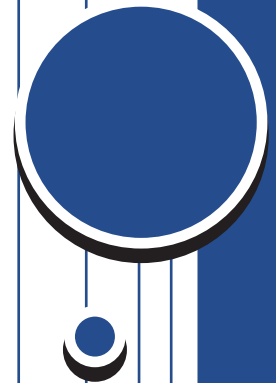

Jorge Ortiz Martínez
12.070.100-2



TESORERIA GENERAL
DE LA REPUBLICA

FINANCIAL STATEMENTS PENSION RESERVE FUND

TESORERÍA GENERAL DE LA REPÚBLICA
For the years ended December 31, 2012 and 2011.



PENSION RESERVE FUND

STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2012 AND 2011
(Figures in U.S. dollars - US\$)

	Notes	2012 (US\$)	2011 (US\$)
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	11	32,170,420	1,606,281
FINANCIAL ASSETS AFFECTING INCOME			
Stocks		928,919,034	-
Other capitalization instruments		13,741,135	-
Corporate bonds		1,123,503,197	-
Time deposits		12,176,171	751,409,494
Government bonds		2,963,793,100	2,940,059,925
Indexed bonds		808,441,950	154,467,211
Treasury bills		-	558,051,381
Structured notes		531,348	-
Derivatives		31,918	1,126
TOTAL INVESTMENTS	7	5,851,137,853	4,403,989,137
TOTAL ASSETS		5,883,308,273	4,405,595,418
LIABILITIES			
Derivative financial instruments	8	54,008	-
TOTAL LIABILITIES		54,008	-
NET EQUITY			
Treasury resources		3,875,249,741	3,431,926,387
Contributions by the Treasury	9	1,197,368,927	443,323,354
Accumulated results		530,345,677	404,772,705
Income in the year		280,289,920	125,572,972
NET EQUITY		5,883,254,265	4,405,595,418
TOTAL LIABILITIES AND NET EQUITY		5,883,308,273	4,405,595,418

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

PENSION RESERVE FUND**STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEARS ENDING 31 DECEMBER 2012 AND 2011
(Figures in U.S. dollars - US\$)**

	Notes	2012 (US\$)	2011 (US\$)
OPERATING INCOME			
Interest earned	10	137,885,171	67,762,795
Income from the sale of financial instruments		-	114,110,826
Net unrealized gains from price fluctuations		182,922,219	-
Total operating income		<u>320,807,390</u>	<u>181,873,621</u>
OPERATING LOSSES			
Losses from the sale of financial instruments		(39,287,026)	-
Net unrealized losses from price fluctuations		-	(55,868,111)
Total operating losses		<u>(39,287,026)</u>	<u>(55,868,111)</u>
Net operating income		<u>281,520,364</u>	<u>126,005,510</u>
MANAGEMENT EXPENSES			
Fiscal agent's fees	9	(520,186)	(194,742)
Custodian's fees	9	(639,669)	(217,796)
Other custody fees	9	(70,589)	(20,000)
INCOME FOR THE YEAR		<u>280,289,920</u>	<u>125,572,972</u>

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

PENSION RESERVE FUND

STATEMENT OF CHANGES IN NET EQUITY 31 DECEMBER 2012 AND 2011 (Figures in U.S. dollars - US\$)

	Notes	Treasury resources (US\$)	Accumulated results (US\$)	Income for the year (US\$)	Total (US\$)
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 Treasury	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
Opening balance, 1 January 2011		3,431,926,387	326,203,412	78,569,293	3,836,699,092
Distribution of income from previous year		-	78,569,293	(78,569,293)	-
Contributions by the Treasury	9	443,323,354	-	-	443,323,354
Income for the year		-	-	125,572,972	125,572,972
Closing balance, 31 December 2011		3,875,249,741	404,772,705	125,572,972	4,405,595,418

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

PENSION RESERVE FUND

STATEMENT OF CASH FLOWS—INDIRECT METHOD
FOR THE YEARS ENDING 31 DECEMBER 2012 AND 2011
(Figures in U.S. dollars - US\$)

	Notes	2012 (US\$)	2011 (US\$)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		280,289,920	125,572,972
Net unrealized gains (losses)		(182,922,219)	55,868,111
Changes in fund management and custody		(1,264,172,489)	(623,956,471)
Net cash flows from operating activities		(1,166,804,788)	(442,515,388)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	1,197,368,927	443,323,354
Net cash flows from financing activities		1,197,368,927	443,323,354
NET INCREASE IN CASH AND CASH EQUIVALENTS			
		30,564,139	807,966
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR			
		1,606,281	798,315
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR			
	11	32,170,420	1,606,281

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

PENSION RESERVE FUND

NOTES TO THE FINANCIAL STATEMENTS

As of 31 DECEMBER 2012 and 2011

(Figures in U.S. dollars—US\$)

1. GENERAL INFORMATION

The Pension Reserve Fund (PRF) was created through Law N° 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 N° 3,500 of 1980 and the welfare pensions prescribed by Decree Law N° 869 of 1975.

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

- a) Decree N° 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 N° 1,382 de 2007, which establishes standards, limits, procedures and controls for investing PRF resources.
- c) Decree N° 1,649 de 2007, which modifies the limits on the fund's investments.
- d) Ministry of Finance Official Letter N° 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 N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.
- f) Decree N° 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.

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 26 February 2010, the Microdata Center of the Economics Department of the University of Chile issued a report on the Actuarial Study of the Sustainability of the Pension Reserve Fund. The study measured the expected evolution of the Pension Reserve Fund under different scenarios, to provide the basis for a sustainability analysis of the PRF over the next 20 years. The report indicates that the PRF demonstrates sustainability in each of the scenarios tested.

As of the date of these financial statements, the PRF is in the process of tendering the actuarial calculation for the period 2010–2012.

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's 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, 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—Current financial statements cover the years between 1 January and 31 December 2012 and 2011, respectively.

c. Functional and presentation currency—The entries included in the PRF's 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, comparative 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.

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, 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’s 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 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 N° 6 and 7 of Law N° 20,128, the Pension Reserve Fund will be established and increased with the following resources:

- a) A contribution equal to the effective fiscal surplus, with a cap of 0.5% of the previous year’s gross domestic product. If the amount of the annual contribution indicated above is less than 0.2% of the previous year’s gross domestic product, then an additional contribution should be paid so as to reach a total annual contribution of 0.2% of the previous year’s gross domestic product.
The contribution described herein must be delivered to the Pension Reserve Fund within the first half of the year, in one or more installments until the total contribution has been made.
- b) The proceeds from the return on the PRF’s 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's objective, and they can only be used for this purpose starting ten years from the effective date of Law N° 20,128.

The Pension Reserve Fund will cease to exist if, after fifteen years from the effective date of Law N° 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 credit institutions and other highly liquid short-term investments.
- Net operating income: Includes management costs for operating the sovereign wealth funds.
- Net financing income: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

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

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. New accounting rules

The following new amendments have been adopted in these financial statements:

IFRS amendments	Compulsory application date
IAS 12: Deferred tax: recovery of underlying assets	Annual periods beginning on or after 1 January 2011.
IFRS 1 (Revised): First-time adoption of International Financial Reporting Standards. (i) Removal of fixed dates for first-time adopters; (ii) Severe hyperinflation	Annual periods beginning on or after 1 July 2011.
IFRS 7: Financial instruments: disclosures. Disclosures—transfers of financial assets	Annual periods beginning on or after 1 July 2011.

The PRF's management deems that the adoption of the amendments described above has not had a significant impact or effect on the fund's financial statements

The following new rules and amendments have been issued, but they have not yet entered into effect:

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 interests 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.

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.
IAS 19: Employee benefits (2011)	Annual periods beginning on or after 1 January 2013
IAS 32: Financial instruments: Presentation. Clarification of the requirements for offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014
IFRS 7: Financial instruments: disclosures. (i) Disclosures—transfers of financial assets (ii) Amendments to Disclosures—offsetting financial assets and financial liabilities	Annual periods beginning on or after 1 July 2011 (for transfers of financial assets).
Annual period beginning on or after 1 January 2013 (for amendments to disclosures of offsetting).	Períodos anuales iniciados en o después del 1 de enero de 2013 (para modificaciones a revelaciones acerca de neteo).
IFRS 10, IFRS 11 and IFRS 12: Consolidated financial statements, Joint agreements and Disclosure of interest in other entities—Transition guidance	Annual periods beginning on or after 1 January 2013
<i>Investment entities—Amendments to IFRS 10: Consolidated financial statements; IFRS 12 Disclosure of interest in other entities; and IAS 27 Separate financial statements.</i>	Annual periods beginning on or after 1 January 2014.

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

3. PRF INVESTMENT POLICY

The guidelines and parameters for managing the investment portfolio were given to the fiscal agent by the Ministry of Finance through Ordinary Official Letter N°1,637 dated 18 November 2011. They can be outlined as follows:

a) Asset classes:

The fiscal resources in the investment portfolio are invested in four asset classes: (1) sovereign bonds and other government-related assets; (2) inflation-indexed sovereign bonds; (3) corporate bonds; and (4) stocks. The benchmarks associated with each asset class are identified in table 1, together with the allocation (%) of total resources in each asset class.

Table 1: Asset allocation and benchmarks

Asset allocation		Benchmarks
Asset class	Share of IP	
Sovereign bonds and other government-related assets ¹	48%	Barclays Capital Global Aggregate: Treasury Bond Index (unhedged) Barclays Capital Global Aggregate: Government-Related Bond Index (unhedged)
Inflation-indexed sovereign bonds (real)	17%	Barclays Capital Global Inflation-Linked Index (unhedged)
Corporate bonds	20%	Barclays Capital Global Aggregate: Corporate Bond Index (unhedged)
Stocks	15%	MSCI All Country World Index (unhedged, with reinvested dividends)

¹ Each subindex of this asset class is weighted by its relative capitalization.

The above benchmarks are used to calculate performance and tracking error.

Two of the asset classes—Sovereign bonds and other government-related assets and Inflation-indexed bonds—are managed directly by the fiscal agent (henceforth, the internally managed portfolio). The remaining two asset classes—Corporate bonds and Stocks—are managed directly by external managers (henceforth, the externally managed portfolio).

The fiscal agent and each external manager can hold cash in foreign currency in the instruments established in paragraph E, for a maximum amount equal to 3% of the average monthly value of the portfolio of each manager. The return from cash in foreign currency in the portfolios managed by the fiscal agent and each external manager will be incorporated into the return calculation for the total portfolio of each manager.

(b) Risk budget

Investment deviations from the benchmark are subject to a risk budget, which establishes an overall limit on the portfolio's deviation from the benchmark. The ex ante tracking error is used to measure risk in basis points; it is calculated daily either by the custodian or by the institution providing middle office services. The following risk budgets have been allocated:

- Internally managed portfolio: annual ex ante tracking error of 50 basis points.
- Externally managed portfolio:
 - Corporate bonds: annual ex ante tracking error of 50 basis points.
 - Stocks: annual ex ante tracking error of 30 basis points.

c) Eligible currencies, issuers and instruments:

For each asset class, investments can only be made in eligible currencies and issuers that are included in the corresponding benchmark:

- A. Instruments eligible for Inflation-indexed sovereign bonds:
- B. Only instruments included in the benchmark are eligible.
- C. Instruments eligible for Corporate bonds:
 - Instruments included in the benchmark are eligible.. In addition, the following instruments are also eligible:

i. Exchange-traded futures on fixed-income instruments or indexes, used solely for hedging purposes, which allow minimizing differences against the benchmark for Corporate bonds, as indicated in table 1. At the start of each derivative transaction, no leveraging is permitted. That is, the notional amount involved in each derivative transaction cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in one of the eligible instruments specified for cash in foreign currency, as described in paragraph E.

D. Instruments eligible for Stocks:

Instruments included in the benchmark are eligible.. In addition, the following instruments are also eligible:

- i. Mutual funds and exchange-traded funds (ETFs), with the goal of replicating all or part of the stock benchmark.
- ii. Exchange-traded American depository receipts (ADRs) and global depository receipts (GDRs) of the stocks that make up the stock benchmark.
- iii. Exchange-traded futures on stock indexes, used solely for hedging purposes, that allow minimizing differences against the benchmark for Corporate bonds, as indicated in table 1. At the start of each derivative transaction, no leveraging is permitted. That is, the notional amount involved in each derivative transaction cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in one of the eligible instruments specified for cash in foreign currency, as described in paragraph E.

E. Instruments eligible for cash in foreign currency applicable to the IP.

Eligible cash instruments are current account balances, overnight deposits and/or weekend deposits in banks whose long-term instruments are rated AA– or better by at least two international credit rating agencies (Fitch, Moody's and Standard & Poor's). Eligible markets for cash investments are those countries or jurisdictions where the eligible instruments for the respective mandate are quoted.

d) Eligible foreign currency operations:

Eligible foreign currency operations are as follows:

- Foreign exchange spot operations.
- Foreign exchange forward operations.

e) Credit risk:

The following limits have been defined for credit risk, which complement the risk budgets (ex ante tracking error) defined in paragraph (b). The limits defined in this section are monitored based on the median of the credit ratings on long-term instruments given by the three international credit rating agencies (Standard and Poor's, Moody's or Fitch). When only two credit ratings are available, the lower rating is used. If there is only one, that rating is used.

A. Limits by bank issuer applicable to cash in foreign currency for the IP.

For the internally managed portfolio, investments in a given bank issuer cannot exceed US\$ 20 million.

For the externally managed portfolio, each portfolio manager can invest in a given bank issuer for up to US\$ 10 million.

B. Limits by issuer for the Corporate bond portfolio applicable to the externally managed portfolio.

The limit by issuer for the Corporate bond portfolio, as a percentage (%) of the Corporate bond portfolio, is defined by credit rating, as indicated in the following table:

Table 2: Limits on corporate bond issuers, by credit rating

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%

C. Portfolio limits for sovereign bonds, other government-related assets and corporate bonds:

The investment limits by credit rating on the sovereign bond, other government-related assets and corporate bond portfolios, as a share of the corresponding portfolio (%), are outlined in table 3.

Table 3: Limits by credit rating of sovereign bonds, other government-related bonds and corporate bonds

Credit rating	Maximum share of corresponding portfolio [%]
AAA	100%
AA+	
AA	
AA-	
A+	60%
A	
A-	
BBB+	40%
BBB	
BBB-	

f) Limits by stock issuer.

Investments in the stock of a given company cannot exceed 5% of the Stock portfolio.

At the same time, an investment in a given company cannot represent more than 5% of that company's total stock.

Additional limits are established on stock investments in specific economies, as described in table 4.

Table 4: Stock investment limits by economy

Economy	% of the stock portfolio	Economy	% of the stock portfolio
Australia	20	Malaysia	10
Austria	10	Mexico	10
Belgium	10	Netherlands	20
Canada	20	New Zealand	10
Denmark	10	Norway	10
Finland	10	Portugal	10
France	20	Singapore	10
Germany	20	Spain	10
Greece	10	Sweden	10
Hong Kong	10	Switzerland	20
Ireland	10	United Kingdom	30
Italy	10	United States	70
Japan	30	Chile	0

The sum of stock investments in economies that are included in the index but not listed in table 4 cannot exceed 20% of the stock portfolio.

Limits on forward contracts:

The fiscal agent and the external managers can contract forwards to minimize differences relative to the benchmark currency allocation. Forward contracts can only be signed with counterparties that have a credit rating of AA- or higher on their long-term instruments from at least two of the international rating agencies (Fitch's, Moody's and Standard & Poor's).

In addition, the total notional amount of the forwards contracted by a given external manager cannot exceed 2% of the market value of the portfolio administered by that manager. The limit for the internally managed portfolio is 4%.

The notional amount of the forwards contracted by the fiscal agent or any of the external managers with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management.

g) Special restrictions:

No investments can be made in any type of instrument from Chilean issuers or in instruments denominated in Chilean pesos.

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

The external managers can contract futures, provided that the aggregate notional amount does not exceed 2% of the portfolio under their management.

Mutual funds and exchange-traded funds (ETFs) together cannot exceed 2% of the portfolio of a given external stock portfolio manager.

h) Rebalancing.

If, at the close of a given business day, the deviation by asset class resulting from price variations or market revaluations exceeds the ranges specified in table 5, then the fiscal agent must bring about convergence to the benchmark established in table 1 or instruct the relevant party to do so, as applicable. The fiscal agent has 10 bank business days to achieve said convergence, although the period can be extended by the Finance Minister at the request of the fiscal agent (with justification).

Table 5: Deviation ranges

Benchmark		Deviation range (% IP)
Asset class	Share of the IP (%)	
Sovereign bonds and other government-related assets	48%	43%–53%
Inflation-indexed sovereign bonds (Real)	17%	12%–22%
Corporate bonds	20%	15%–25%
Stocks	15%	10%–20%

The fiscal agent must also converge to the benchmark specified in table 1 in the event of contributions to the fund.

It is the custodian's duty to report the relative share of each asset class in the IP. Based on this information, the fiscal agent must perform any corresponding asset class rebalancing.

i) Valuation criteria:

The valuation of the investment portfolio that must be reported to the Ministry of Finance is that which is prepared by the custodians using mark-to-market accounting, based on their own pricing sources. At the same time, for internal accounting purposes and other grounds related to the Fiscal Agency Decree, the Central Bank of Chile can employ the same methodology that it uses for its own international reserve operations, as stipulated in Article 4, paragraph (g) of that decree.

j) Securities lending program:

For the internally managed portfolio, the fiscal agent can enter into agreements with custodians to manage the PRF securities lending programs (henceforth “the programs” or “securities lending”), provided that the custodians in question (henceforth “program managers”) agree to comply with the operating criteria established in the Custodian Guidelines, including in particular the obligation to return the respective securities or, in the absence thereof, the corresponding market value.

External managers cannot implement or contract out securities lending programs.

k) Other

Foreign currency operations will be considered spot operations whenever the period between the trade date and the settlement date does not exceed two days. At the same time, foreign currency operations related to the purchase or sale of an instrument will be considered spot operations whenever the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument being bought or sold.

For the purposes of measuring the performance of the fiscal agent and external managers, the baseline currency of the IP is the U.S. dollar.

If at any time the guidelines described in this report are breached due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the fiscal agent or the external managers in their respective mandates, the relevant party will not be considered negligent provided that within seven days of the breach, the necessary measures are taken to achieve compliance with the guidelines. This period can be extended by the Finance Minister at the request of the fiscal agent, which must provide justification for the extension. In the event that this situation arises in the external portfolio mandate, the fiscal agent will add its opinion to the external managers' request for an extension.

l) Transfers to the external managers and entry into force:

The provisions of the Guidelines and Parameters Section will enter into force on 2 January 2012, taking into account the special waivers described below. Until that date, the provisions of the Guidelines and Parameters Section of the individualized Investment Guidelines will continue to be applied.

The fiscal agent must deliver the resources in two transfers to each external manager. The transfers are to be made in U.S. dollars. The first transfer will be executed on 17 January 2012 and the second on 1 March 2012, provided that the external managers' contracts have been signed in advance. If the contracts have not been signed on time, the Finance Minister or his designated replacement will announce the date on which the transfers are to be made.

For the externally managed stock portfolios, the first transfer will be US\$ 150 million and the second for the balance remaining in order to converge to the benchmark indicated in table 1.

For the externally managed corporate bond portfolios, the first transfer will be US\$ 250 million and the second for the balance remaining in order to converge to the benchmark indicated in table 1.

To achieve the benchmark, the external managers will be granted a special waiver for 10 bank business days following each transfer, to adjust for possible deviations that might exceed the margins stipulated in these guidelines. Their management during this period will not affect their performance evaluation.

For the internally managed portfolio, the fiscal agent must achieve the benchmark no later than 1 February 2012. Therefore, management results in the month of January will not be subject to a performance evaluation. The internally managed portfolio will be constituted excluding the resources that are to be transferred to the external managers on 17 January and 1 March 2012, which can be held in overnight, weekend or time deposits in U.S. dollars following the bank eligibility criteria stipulated in paragraph E, point III. The amount of the resources that are to be transferred to the external managers, and that the fiscal agent can hold in overnight, weekend or time deposits, will be calculated on 2 January 2012. The initial value will equal 35% of the value of the IP at the close of 2011, as reported by the custodian bank. These resources will be subject to a special waiver exempting them from consideration in the benchmark calculation and related matters; and as such they cannot be deemed as infractions or breaches of these guidelines. This waiver will be applied to 35% of resources through 17 January (the date of the first transfer to the external managers) and to the remaining balance through 1 March 2012.

m) Other provisions related to external managers:

In the event that the fiscal agent exercises the early termination of an external manager's contract to manage fiscal resources, and if the cause of the early termination involves problems related to solvency, capacity, severe or repeated infringement of the instructions, fraud or any other grave situation, then the fiscal agent is expressly authorized to transfer the management of all or part of the fiscal resources corresponding to the terminated contract to any other external manager with a current and valid contract.

If the fiscal agent is unable to transfer the fiscal resources corresponding to the external management contract that is subject to early termination due to the causes cited in the previous paragraph, the fiscal agent, with the prior approval of the Ministry of Finance, can arrange or perform the management or conservation functions deemed necessary, while awaiting the selection and contracting of a new external 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 PRF 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 CBC, 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 PRF'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 PRF'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 Fisco.

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 Treasury bills and certificates of deposit allows for quick sale without heavy penalization, while 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 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.

6. ACCOUNTING CHANGES

As of 31 December 2012, 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\$5,851,137,853 on 31 December 2012 and US\$4,403,989,137 on 31 December 2011.

a) The breakdown of investments carried at fair value on 31 December 2012 and 2011 is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy level	2012	2011
		(US\$)	(US\$)
Stocks	1	928,919,034	—
Other capitalization instruments	1	13,741,135	—
Corporate bonds	1	1,123,503,197	—
Government bonds	1	2,963,793,100	2,940,059,925
Indexed bonds	1	808,441,950	154,467,211
Treasury bills	1	—	558,051,381
Structured notes	1	531,348	—
Derivatives	1	31,918	1,126
Total investments		5,838,961,682	3,652,579,643

Custodian investments, J.P. Morgan	Fair value hierarchy level	2012	2011
		(US\$)	(US\$)
Time deposits	1	12,176,171	751,409,494

b) The breakdown of investments by investment currency on 31 December 2012 and 2011 is as follows:

Fair value instruments, J.P. Morgan				
	2012		2011	
Currency of origin	US\$	% of IP	US\$	% of IP
U.S. Dollar	2,335,354,973	40.00%	1,839,116,779	50.35%
Euro	1,365,455,385	23.39%	1,435,188,826	39.29%
Yen	848,875,352	14.54%	378,274,038	10.36%
Other	1,289,275,972	22.08%	—	0.00%
Subtotal	5,838,961,682	100.00%	3,652,579,643	100.00%

Fair value instruments, Central Bank of Chile				
	2012		2011	
Currency of origin	US\$	% of IP	US\$	% of IP
U.S. Dollar	3,400,094	27.92%	357,085,949	47.52%
Euro	—	0.00%	327,242,801	43.55%
Yen	—	0.00%	67,080,744	8.93%
Other	8,776,077	72.08%	—	0.00%
Subtotal	12,176,171	100.00%	751,409,494	100.00%
Total	5,851,137,853		4,403,989,137	

c) The total value of assets by risk segment on 31 December 2012 and 2011 is as follows:

Risk segment	2012		2011	
	Market value (US\$)	Market value (%)	Market value (US\$)	Market value (%)
Stocks	945,867,821	16.08%	—	0.00%
Bank (*)	37,106,766	0.63%	753,015,775	17.09%
Corporate bonds	1,186,740,370	20.17%	—	0.00%
Government bonds and other government-related assets	3,713,593,316	63.12%	—	0.00%
Sovereign bonds	—	0.00%	3,652,579,643	82.91%
Total	5,883,308,273	100.00%	4,405,595,418	100.00%

Asset class	2012		2011	
	Market value (US\$)	Market value (%)	Market value (US\$)	Market value (%)
Stocks	951,310,431	16.08%	—	0.00%
Corporate bonds	1,198,963,137	0.63%	—	0.00%
Government bonds and other government-related assets	2,703,670,587	20.17%	2,940,059,925	66.73%
Inflation-indexed bonds	1,029,364,118	63.12%	154,467,211	3.51%
Sovereign bonds	—	0.00%	—	0.00%
Money market (*)	—	—	1,311,068,282	29.76%
Total	5,883,308,273	100.00%	4,405,595,418	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\$54,008 on 31 December 2010.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2012 (US\$)	2011 (US\$)
Derivatives	1	54,008	—
Total investments		54,008	—

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

Currency of origin	Fair value instruments, J.P. Morgan			
	2012		2011	
	US\$	% of IP	US\$	% of IP
U.S. Dollar	54,008	100.00%	-	0.00%
Euro	-	0.00%	-	0.00%
Yen	-	0.00%	-	0.00%
Total	54,008	100.00%	-	0.00%

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

Risk segment	2012		2011	
	Market value (US\$)	Market value (%)	Market value (US\$)	Market value (%)
Bank	54,008	100.00%	-	0.00%

Asset class	2012		2011	
	Market value (US\$)	Market value (%)	Market value (US\$)	Market value (%)
Money market	54,008	100.00%	-	0.00%

On 31 December 2011, this item had a zero balance.

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 2012 and 2011:

	2012					2011				
	Contributions (US\$)	Withdrawals (US\$)	Commissions (US\$)	Custodian fees (US\$)	Other expenses (US\$)	Contributions (US\$)	Withdrawals (US\$)	Commissions (US\$)	Custodian fees (US\$)	Other expenses (US\$)
January	—	—	—	—	(70,589)	—	—	—	—	—
February	—	—	—	(91,572)	—	—	—	—	(18,888)	—
March	—	—	(130,047)	—	—	—	—	(46,840)	(19,423)	—
April	—	—	—	—	—	—	—	—	(40,618)	—
May	—	—	—	—	—	—	—	—	—	—
June	1,197,368,927	—	(130,047)	(132,413)	—	—	—	(46,840)	(21,759)	—
July	—	—	—	—	—	443,323,354	—	—	—	(20,000)
August	—	—	—	(48,801)	—	—	—	—	(45,206)	—
September	—	—	(130,047)	—	—	—	—	(50,531)	—	—
October	—	—	—	—	—	—	—	—	—	—
November	—	—	—	(366,884)	—	—	—	—	(23,868)	—
December	—	—	(130,047)	—	—	—	—	(50,531)	(48,033)	—
TOTAL	1,197,368,927	—	(520,186)	(639,669)	(70,589)	443,323,354	—	(194,742)	(217,796)	(20,000)

10. INTEREST EARNED

The breakdown of income from interest earned on 31 December 2012 and 2011 is as follows:

	2012 (US\$)	2011 (US\$)
Interest earned on debt securities carried at fair value through profit or loss	137,885,171	67,762,795

11. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2012 and 2011 is as follows:

	2012 (US\$)	2011 (US\$)
Cash in custodian accounts	32,170,420	1,606,281

12. PRF RETURN

The breakdown of the fund's returns as of 31 December 2012 and 2011 is as follows:

Tipo Rentabilidad	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	0.23%	4.87%	3.35%

13. LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N° 1,637, Section II N°5, the fiscal agent 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 2012 and 2011, the PRF owned the following instruments under the item Securities lending:

2012 Location	Notional amount	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

2011 Location	Notional amount	Market value [US\$]
Europe	220,283,000	317,744,814
United States of America	912,904,000	967,985,219
Total	1,133,187,000	1,285,730,033

14. SECURITIES CUSTODY

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

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total Fund 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.

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

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total Fund assets
Securities depositories	—	—	—	—	—	—
Other entities	—	—	—	4,403,989,137	100%	99.96%
Total investment portfolio in custody	—	—	—	4,403,989,137	100%	99.96%

15. SIGNIFICANT EVENTS

On 18 November 2011, the Ministry of Finance issued Official Letter N° 1,637 addressed to the Central Bank of Chile in its role of fiscal agent, pursuant to Ministry of Finance Decree N° 1,383 of 2006 and in accordance with Articles 5 and 6 of that decree, wherein new Investment Guidelines were stipulated for the management of the resources in the Pension Reserve Fund (PRF) by the fiscal agent. These guidelines, which replaced the previous Performance Guidelines, entered into force on 2 January 2012.

16. SUBSEQUENT EVENTS

On 20 February 2013, The Ministry of Finance of Chile, through the Minister of Finance, Mr. Felipe Larraín, announced a fiscal contribution for 2013 of US\$2.0 billion to be distributed between the Chilean sovereign wealth funds.

The Pension Reserve Fund will receive a US\$ 1,300 million, which corresponds to the Legal Contribution of 0.5% of GDP, given the effective surplus of 0.6% of GDP in 2012.

In accordance with Article 6, paragraph (a), of Ministry of Finance Law N° 20,128, the contribution described in this note must be transferred to the fund during the first half of each year, through one or more deposits until the total contribution has been fulfilled.

As of the date of these financial statements, the contribution has not yet been transferred to the fund.

Between 1 January 2013 and the date of issue of these financial statements (30 April 2013), there have not been other subsequent events that could materially affect the balances or interpretation of these financial statements.

Appendix 1:

Self-assessment of the Santiago Principles

Pursuant to a decision by the Government of Chile, the Ministry of Finance's annual report presents the second self-assessment of the degree to which the Chilean sovereign wealth funds comply with each of the Santiago Principles. This is part of the Government's systematic effort to provide the public with more information on the funds and to demonstrate that the funds are managed in accordance with international best practices. This appendix thus provides details on the degree of compliance of the Chilean sovereign wealth funds with each principle as of December 2012.

PPGA 138. Principle:

The legal framework for the sovereign wealth fund (SWF) should be sound and support its effective operation and the achievement of its stated objective(s).

PPGA 1.1 Subprinciple:

The legal framework for the SWF should ensure the legal soundness of the SWF and its transactions.

PPGA 1.2 Subprinciple:

The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

ASSESSMENT:

The institutional framework for Chile's SWFs is established in a number of laws and decrees that define the rules for their operation. The most important piece of legislation is the Fiscal Responsibility Law (FRL) which sets out the norms and institutional framework for the saving and management of fiscal resources. The FRL created the Pension Reserve Fund (PRF) and permitted the creation of the Economic and Social Stabilization Fund (ESSF) which was officially established under Decree with Force of Law (DFL) N° 1 issued by the Finance Ministry in 2006. The FRL also specifies that the Finance Ministry will define the SWFs' investment policies with the advice of a Financial Committee and may entrust their management to the Central Bank of Chile (CBC).

The uses to which the two funds may be put is defined in the FRL, DFL N° 1 and the Pension Law. Withdrawals must be authorized by decree by the Finance Minister, are implemented by the CBC and the General Treasury of the Republic (GTR) and are subject to review by the Comptroller General's Office (CGR).

GAPP 2. Principle:

The policy purpose of the SWF should be clearly defined and publicly disclosed.

Supreme Decree N° 1.383, issued by the Finance Ministry in 2006, delegated the administration of the two funds to the CBC, as Fiscal Agent, and established the general framework for their management.

Supreme Decree N° 621, issued by the Finance Ministry in 2007, created the Financial Committee to advise the Finance Minister on all aspects related to funds' investment policy definition.

As a result, the legal framework for Chile's SWFs rests on sound foundations and is publicly disclosed, favoring efficient funds operations and facilitating achievement of the objectives for which they were created. These laws and decrees were published in the Diario Oficial (Official Gazette) and are available on the SWF website at www.hacienda.cl/fondos-soberanos/legislacion.html.

ASSESSMENT:

The purpose of the PRF is established in the FRL and the Pension Law and, in the case of the ESSF, in the FRL and DFL N° 1. All the corresponding legislation is posted at www.hacienda.cl/fondos-soberanos/legislacion.html. Their policy objectives are also clearly set out in the annual report prepared by the Finance Ministry which is available for public consultation at www.hacienda.cl/english/sovereign-wealth-funds.html.

GAPP 3. Principle:

Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle:

There should be clear and publicly disclosed policies, rules, procedures or arrangements in relation to the SWF's general approach to funding, withdrawal and spending operations.

GAPP 4.1 SubPrinciple:

The source of SWF funding should be publicly disclosed.

GAPP 4.2 SubPrinciple:

The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle:

The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

ASSESSMENT:

The funds invest exclusively in foreign currencies and overseas assets. Therefore, their domestic macroeconomic implications are minimal. Only the ESSF has direct domestic macroeconomic implications arising from its objective of financing the fiscal deficits that may occur during periods of low growth and/or low copper prices. The Finance Ministry makes the decision to withdraw resources from the fund and their timing since they could affect the peso-dollar exchange rate. In a bid to minimize this impact, withdrawals from the ESSF and their conversion into pesos have, in the past, been coordinated with other fiscal and monetary authorities and made using a system of auctions with a pre-set calendar. This mechanism provides for enough public information to minimize its market impact.

ASSESSMENT:

The rules for contributions to the SWFs are clearly established in the FRL while the uses to which they can be put are established in the FRL, DFL N° 1 and the Pension Law as part of their legal framework. Legislation authorizes the Minister of Finance to define the timing and the amount of withdrawals, and then publicly disclose this information. However, fiscal expenditures must be approved by Congress. As indicated above, this legislation is posted on the funds' website. Contributions and withdrawals as well as the expenses involved in the funds' operation are publicly disclosed in a clear manner, with contributions and withdrawals set out in the funds' monthly, quarterly and annual reports and expenses in their quarterly and annual reports.

ASSESSMENT:

The CBC prepares daily, monthly, quarterly and annual reports on the state of the funds and the performance of their investments. These reports are supplied to staff of the Finance Ministry and to the GTR.

Based on the information supplied by the CBC and the custodian bank, the Finance Ministry publishes monthly reports that include information about the return on the funds' investments, their size, contributions, withdrawals and their portfolio composition. Quarterly reports prepared by the

Finance Ministry complement the information that is publicly available. In addition, the Ministry publishes an annual report on the SWFs while the Financial Committee prepares its own annual report about its activities and recommendations which is presented to the Finance Minister, the Finance Commissions of both houses of Congress and the Joint Budget Commission of Congress.

GAPP 6. Principle:

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

ASSESSMENT:

The clear division of roles and responsibilities established by the funds' legal framework facilitates accountability and operational independence in their management. The FRL specifies that the funds are the property of the State of Chile and that the GTR is the bearer of the resources. Under this law, the Finance Minister is responsible for deciding how the funds are managed and their investment policies.

In defining their investment policies, the Finance Minister is supported by a Financial Committee which provides advice on the aspects related to this decision. The Finance Ministry draws up investment guidelines defining the eligible instruments and issuers as well as other matters such as investment limits and the use of derivatives.

The CBC was appointed by the Finance Minister as the Fiscal Agent responsible for the funds' operational management. The CBC accepted this role and invests the funds' resources with complete independence in accordance with the instructions and restrictions established by the Finance Ministry in their investment guidelines. Since 2012, the CBC has hired external managers to manage the equity and corporate bonds mandates in the PRF, invested according to the guidelines prepared by the Finance Ministry.

The custodian bank, hired by the CBC on behalf of the government, is responsible for custody of securities and also provides a number of middle-office services such as monitoring compliance with investment limits, calculating each manager's performance and preparing financial and accounting reports on the funds.

Finance Ministry staff monitor the CBC and external managers compliance with the funds' investment guidelines, using information provided by the custodian bank, and pre-

pare monthly, quarterly and annual reports on the basis of information provided by the custodian bank and the CBC. In addition, Finance Ministry's staff acts as the Financial Committee's Secretariat and provides support in all tasks related to the funds' investment policies.

The GTR is responsible for the funds' accounting, for preparing their audited financial statements and for their incorporation into Chile's national accounts. The Finance Ministry's Budget Office is responsible for aspects of the SWFs related to the budget such as contributions and withdrawals.

GAPP 7. Principle:

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

ASSESSMENT:

The FRL establishes the funds' policy objectives and also defined the Finance Ministry as the body principally responsible for their governance and the Finance Minister as responsible for decisions about their management and investment policies. The FRL also named the GTR as the bearer of the resources. The Finance Minister is appointed by the President of the Republic while the members of the Financial Committee are appointed by the Finance Minister according to criteria established in Supreme Decree N° 621 issued in 2007 by the Finance Ministry.

In the case of oversight, Finance Ministry staff monitor compliance with the funds' investment guidelines, reviewing the reports on compliance with investment limits prepared by the custodian bank and also carrying out independent reviews of compliance with these limits.

The Comptroller General's Office, an autonomous body, is responsible for auditing public-sector finances and, therefore, the SWFs.

GAPP 8. Principle:

The governing body(ies) should act in the best interests of the SWF and have a clear mandate and adequate authority and competency to carry out its functions.

ASSESSMENT:

The institutional framework for the SWFs is defined in the legislation discussed above. Under the FRL, the Finance Ministry is the body primarily responsible for their governance and the Finance Minister is responsible for decisions about their management and investment policies. To assist the Finance Minister in this task, the FRL also created the Financial Committee which advises him on the analysis and de-

sign of the funds' investment policies. Although the Finance Minister is not obliged to follow the Committee's independent recommendations, these are public and the government is publicly responsible for the Finance Minister's decisions. In addition, the Finance Minister has set up a unit within the Ministry for all activities relating to investment of the funds' assets and to provide support to the Financial Committee.

GAPP 9. Principle:

The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

ASSESSMENT:

The Finance Minister has defined the funds' investment policy and delegated their operational management to the CBC who has delegated to external managers, as requested by the Finance Ministry, the equity and corporate bonds mandates in the PRF. All of them invest their assets in accordance with the investment guidelines drawn up by the Finance Ministry. These guidelines are reviewed and accepted by the CBC which is an autonomous public body not related to the government. The CBC and external managers have total independence to buy and sell instruments and make other operational decisions within the parameters established by the Finance Ministry in the funds' investment guidelines. The CBC provides the Finance Ministry with daily, monthly, quarterly and annual reports about its fulfillment of its role, including details of the funds' investments and external managers' relevant information.

GAPP 10. Principle:

The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents or management agreement.

ASSESSMENT:

The accountability framework for the funds' operations is established in the laws and decrees discussed under Principle 1. They were published in the Diario Oficial (Official Gazette) and are available on the funds' website at www.hacienda.cl/fondos-soberanos/legislacion.html and from the Library of Congress (www.bcn.cl).

In order to ensure a proper and effective accountability framework, a range of reports are prepared by the different bodies involved in the funds' management.

Article 12 of the FRL and Article 7 of DFL N° 1, which regulate the PRF and the ESSF, respectively, establish that the Finance Ministry must present to the Finance Commissions of both houses of Congress and to the Joint Budget Commission of Congress monthly and quarterly reports about

the funds. In addition, and although not so required by law, the Finance Ministry publishes an annual report about the funds. All these reports are publicly available on the website indicated above.

Under Supreme Decree N° 1.383, the CBC is accountable to the Finance Minister for the funds' operational management and provides the Finance Ministry with daily, monthly, quarterly and annual reports about the funds, the services provided by the external managers and the custodian. The Finance Minister is responsible for the funds' investment policies and decides how they should be managed.

The Financial Committee is an advisory body and is accountable for its obligations as established in Supreme Decree N° 621. Under Article 7 of this Decree, it must present an annual report on its work to the Finance Minister and send a copy of this report to the Finance Commissions of both houses of Congress and to the Joint Budget Commission of Congress. This report is also available on the funds' website.

In addition, the Comptroller General's Office, an autonomous body, is responsible for auditing public-sector finances and, therefore, the SWFs.

GAPP 11. Principle:

An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

ASSESSMENT:

The Finance Ministry prepares an annual report on the funds using the information supplied by the CBC, which includes the information provided by the external managers, and the custodian bank. This report includes financial information and is publicly available.

As of 2011 the GTR prepares the financial statements according to IFRS, which are independently audited and included in the annual report prepared by the Finance Ministry.

GAPP 12. Principle:

The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

ASSESSMENT:

The funds' operations are audited by internal CBC auditors.

As of 2011 the GTR prepares the financial statements according to IFRS, which are independently audited in keeping with Chilean auditing standards.

GAPP 13. Principle:

Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management and staff.

ASSESSMENT:

The authorities and staff involved in work relating to Chile's SWFs are subject to legally-established professional and ethical norms, such as the principle of probity, which call for impeccable professional conduct and efficient and loyal exercise of their functions in accordance with the common good. In addition, the CBC has defined professional and ethical standards that are made known to its employees and are available on its website (www.bcentral.cl/transparencia/pdf/Manual_probidad/Manualdeprobidad.pdf). Members of the Financial Committee are subject to the ethical norms established in the Decree which created the Committee as well as to other internally-defined norms. Finance Ministry staff and advisors involved in the funds' management have internally adopted a code of ethics along the same lines of communicating and complying in the best possible way with the legally-applicable professional and ethical norms. This code of ethics is available at <http://www.hacienda.cl/fondos-sobranos/codigo-de-etica.html>. Staff and advisors may, in addition, be subject to other codes of professional ethics (such as that of the CFA Institute).

GAPP 14. Principle:

Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

ASSESSMENT:

All transactions with third parties are based on economic and financial grounds. The Finance Ministry has rules and procedures that define the steps to be followed in acquiring or hiring services from third parties and the CBC and GTR also have a series of clearly defined rules and procedures for these situations.

GAPP 15. PRINCIPLE:

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

ASSESSMENT:

The procedures established by the CBC aim to ensure that the funds' operations and activities are implemented in accordance with the applicable regulatory and disclosure requirements of host countries.

GAPP 16. PRINCIPLE:

The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

ASSESSMENT:

The funds' institutional framework and objectives are defined by the legal framework discussed under Principle 1 above. Operational management is carried out by the CBC and

external managers, both independent bodies of the government. The operational framework for management by the CBC and external managers is defined in Supreme Decree N° 1.383 which was published in the Diario Oficial (Official Gazette). All relevant legislation is published in the Official Gazette and is also available on the funds' website (www.hacienda.cl/fondos-soberanos/legislacion.html) and from the Library of Congress (www.bcn.cl).

GAPP 17. PRINCIPLE:

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

ASSESSMENT:

The size of the funds, their absolute returns and the countries where their assets are invested are reported monthly while a report on the CBC's performance is published quarterly. The funds' annual report contains additional financial information. All these reports are available on the funds' website.

GAPP 18. PRINCIPLE:

The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance and investment strategy, as set by the owner or the governing bodies, and be based on sound portfolio management principles.

ASSESSMENT:

In our view, the investment policy in force for the ESSF is consistent with its objectives and risk tolerance. In the case of the PRF, the new investment policy implemented at the beginning of 2012 better reflects its objectives and nature when compared to the previous policy.

GAPP 18.1 SUBPRINCIPLE:

The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

The financial risks to which each fund is exposed are determined by its investment policy. Given their essentially passive management, these risks depend principally on their strategic portfolios and benchmarks. As of today, the use of leverage is not permitted while the use of derivatives is permitted only for hedging purposes. At present, the funds' operational management is mainly in the hands of the CBC and supervised by the custodian bank and the Finance Ministry. In addition, according to instructions provided by the Finance Ministry and recommendations by the Financial Committee, a thorough selection process was undertaken to select external managers for the investment of PRF's new asset classes, equity and corporate bonds, given the CBC's lack of expertise in investing in those asset classes. The scope of external managers' responsibilities and activities is set forth in the corresponding investment guidelines as well as their monitoring by the custodian bank, the CBC, and the Finance Ministry.

GAPP 18.2 SUBPRINCIPLE:

The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

GAPP 18.3 SUBPRINCIPLE:

A description of the investment policy of the SWF should be publicly disclosed.

As of 2012 the investment guidelines are disclosed in Spanish in the section available for each fund on the web site www.hacienda.cl/fondos-soberanos.html

GAPP 19. PRINCIPLE:

The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAPP 19.1 SUBPRINCIPLE:

If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

GAPP 19.2 SUBPRINCIPLE:

The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

GAPP 20. PRINCIPLE:

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. PRINCIPLE:

SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

ASSESSMENT:

The funds' operational management has been delegated to the CBC and external managers which implement investment decisions autonomously based only on economic and financial grounds and according to a passive investment approach. The CBC applies the same operational standards as for the international reserves and it has been audited and reviewed by international consultants. Likewise, external managers investment processes controls are independently audited. The results from this audit are disclosed to the Finance Ministry annually. The funds' investment policies and guidelines are, moreover, established by the Finance Ministry, taking into account the opinion of the Financial Committee.

ASSESSMENT:

Investment decisions are implemented independently by the CBC and external managers which apply standards and operating procedures that meet high probity standards. In addition, when making recommendations, the members of the Financial Committee must do so using only public information.

ASSESSMENT:

The PRF invested in equities for the first time in 2012. Nonetheless, given that the fund is invested with a passive approach and that the size of the investment is small relative to each instrument's size in the benchmark, the Finance Ministry decided to follow a neutral approach for exercising ownership rights.

GAPP 22. PRINCIPLE:

The SWF should have a framework that identifies, assesses and manages the risks of its operations.

GAPP 22.1 SUBPRINCIPLE:

The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning and an independent audit function.

GAPP 22.2 SUBPRINCIPLE:

The general approach to the SWF's risk management framework should be publicly disclosed.

GAPP 23. PRINCIPLE:

The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

ASSESSMENT:

The different bodies that comprise the SWFs' organizational structure have procedures and controls in place that, together, constitute a proper framework for managing the risks to which they are exposed. The annual report prepared by the Finance Ministry includes a description of the main risks.

The investment guidelines defined by the Finance Ministry determine the funds' maximum permitted exposure to the main risks arising from investment of their assets. In addition, the CBC and external managers, responsible for deciding and implementing financial transactions, monitor the funds' compliance with the limits established by these guidelines. Moreover, the CBC applies the same operating framework as for investment of the international reserves which includes a series of procedures and controls that mitigate not only operational but also reputational and market risk. External managers investment processes controls are independently audited. The results from this audit are disclosed to the Finance Ministry annually. The custodian bank also reports to Finance Ministry staff on the CBC and external managers' compliance with investment limits and the level of portfolio risk while specialized Ministry staff oversee the CBC and external managers compliance with the funds' investment guidelines and monitor the information supplied by the custodian bank. The daily, monthly, quarterly and annual reports presented by the custodian bank and the CBC contain relevant information about the resources managed by the latter and the external managers ensuring the funds' correct management. As stated hereinabove, the principal risks to which they are exposed are publicly disclosed in the annual report prepared by the Finance Ministry.

ASSESSMENT:

The returns are reported in absolute terms and relative to the benchmark. The CBC and the custodian bank report to the Finance Minister the returns. The latter informs them to the Financial Committee and the public. The methodology used to calculate the funds' return and performance is publicly disclosed in their quarterly reports. It is based on Global Investment Performance Standards (GIPS®).

GAPP 24. PRINCIPLE:

A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

ASSESSMENT:

This is the second self-assessment of compliance with the Santiago Principles and, as indicated in the first self assessment carried out in 2010, it will be updated every two years.

Appendix 2:

Index of tables, figures, boxes and diagrams

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Appendix 3:

Glossary of terms

- 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.
- Passive management** — An investment strategy aimed at replicating the returns of a representative index or indexes of a given asset class.
- Active management** — An investment strategy aimed at earning higher returns than a benchmark index.
- 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).
- Corporate bond** — A bond issued by a corporation or company.
- 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.
- 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).
- Sovereign bond** — A bond issued by a government.
- 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.
- 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.
- Risk rating** — The degree of solvency of the issuer of a financial instrument (a company or country), as defined by a risk rating institution.
- Duration** — A parameter that measures a bond's sensitivity to interest rate movements. The longer the bond's duration, the greater its exposure to loss in response to an interest rate hike.
- Cash** — Cash on hand and bank demand deposits.
- 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.
- 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.
- 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.
- 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.
- Fiscal Responsibility Law** — Chilean Law N° 20,128, published in the Official Gazette on 30 September 2006.
- Liquidity** — The facility with which an investment or instrument can be sold without significant loss of value.
- Investment policy** — A set of criteria, principles and guidelines that regulate the amount, structure and dynamics of a portfolio's investments.
- Portfolio** — A collection of investment instruments held by an individual or an institutional investor.

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

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.

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.

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

Fixed-income instruments — Investment instruments that pay a fixed return at a specified time, which is known when the investment is made. Examples of fixed-income instruments include sovereign bonds, corporate bonds and bank deposits.

Variable-income instruments — Stocks.

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

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

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

LIBOR — The London interbank offered rate is the rate charged on interbank loans.

LIBID — The London interbank bid rate is the rate paid on interbank deposits; defined as the LIBOR less 0.125%.

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.

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.

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.

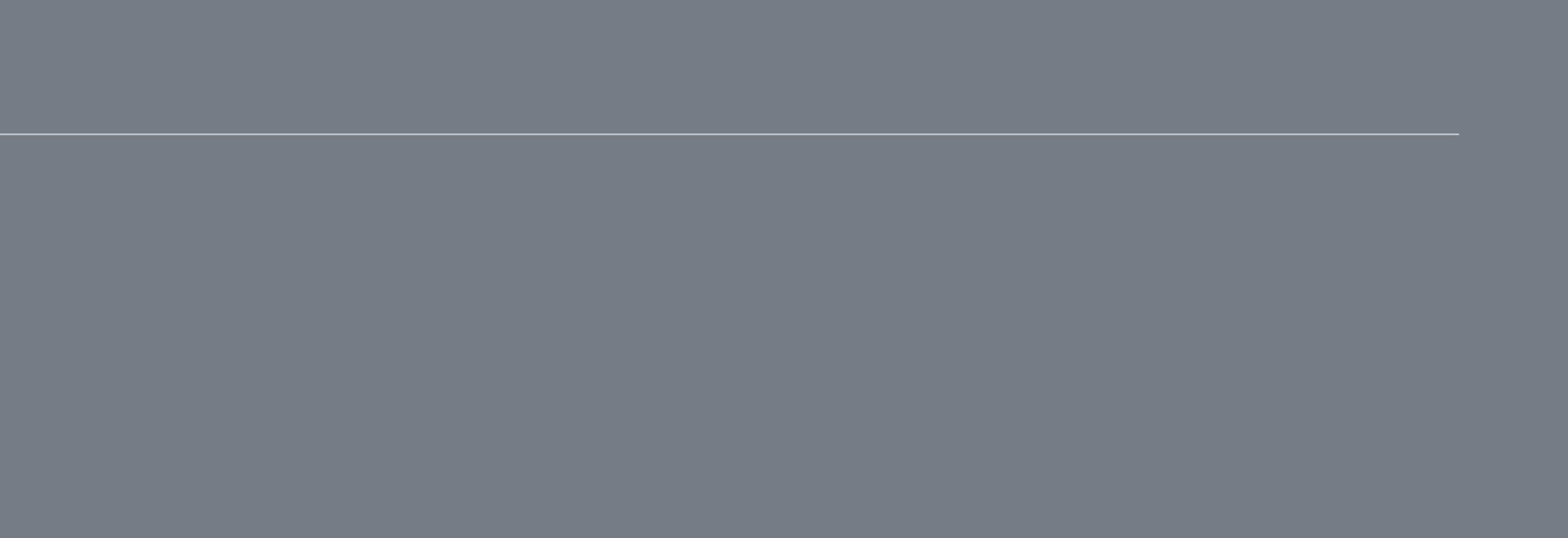
Value at Risk (VaR) — A measure of the potential loss in value over a period of time for a given probability.

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 4:

Acronyms

bp	Basis points
CBC	Central Bank of Chile
CBJ	Central Bank of Japan
CDS	Credit default swaps
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 [translator's note: these are not used in the translated text]
MBS	Mortgage-backed securities
MM US\$	Millions of U.S. dollars [translator's note: these are not used in the translated text]
PRF	Pension Reserve Fund
TE	Tracking error
TWR	Time-weighted rate of return
U.S.	United States of America
UF	Unidad de Fomento (an inflation-indexed unit of account)
US\$	U.S. dollar
USD	U.S. dollar
VaR	Value at Risk



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