

Self-assessment of compliance with Santiago Principles: 2020

In line with Chile's commitment to international best practices, the Government of Chile has participated actively in international initiatives aimed at establishing an operational framework for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance played an active role in the International Working Group of Sovereign Wealth Funds (IWG-SWF), which was established in May 2008 to formulate and promote a common set of voluntary principles for sovereign wealth funds.

In 2008, the IWG-SWF held a series of meetings in which members shared opinions on the development and definition of these voluntary principles. The key meeting in this process took place in Santiago, Chile, in September 2008, when an agreement was reached on a series of Generally Accepted Principles and Practices backed by the main countries with sovereign wealth funds. This agreement is known internationally as the Santiago Principles. These principles are based on existing practices and are intended to facilitate the free circulation of cross-border investments and promote the openness and stability of financial systems.

Therefore, the Finance Ministry has decided to include in its annual report the sixth self-assessment of the sovereign wealth funds' compliance with each of the Santiago Principles. This is part of this Administration's efforts to improve the publicly available information on the funds and to demonstrate that they are managed in accordance with international best practices. The rest of this appendix describes the principles and assesses the Chilean funds' compliance with each one as of May 2020.

GAPP 1.¹ Principle:

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

GAPP 1.1 Subprinciple:

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

GAPP 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 of the Chilean sovereign wealth funds (SWFs) is established by different laws and decrees that define their operating rules. The main legal text is Law N° 20,128 on Fiscal Responsibility, which establishes the regulations and institutional framework for the accumulation and management of fiscal resources. Specifically, the Fiscal Responsibility Law (FRL) created Pension Reserve Fund (PRF) and authorized the creation of the Economic and Social Stabilization Fund (ESSF), which was officially established via Statutory Decree N° 1 of 2006, issued by the Ministry of Finance (DFL1). The FRL further stipulates that the Finance Ministry is responsible for defining the investment policy, with advice from the Financial Committee, and that it can delegate the management of the SWFs to the Central

¹ Generally accepted principles and practices.

Bank of Chile (CBC), the Treasury, or external managers.

The use of the two SWFs is defined in the FRL, DFL1, and Law N° 20.255 (the Pension Reform Law). Fund withdrawals must be authorized through Finance Ministry Decree and are executed by the CBC and the Treasury. The SWFs are subject to audit by the Office of the Comptroller General.

Executive Decree N° 1,383 of 2006, from the Ministry of Finance, delegates the management of both SWFs to the CBC, in the role of fiscal agent, and establishes the general regulatory framework for their management. This decree was modified in 2013 to reduce the CBC's responsibilities for supervising and monitoring those asset classes that are not eligible for its international reserves and that are managed by external portfolio managers. Since 2014, the relationship with external managers managing asset classes not eligible for the CBC's international reserves corresponds to the Ministry of Finance, which is also responsible for their supervision

Executive Decree N° 621 of 2007, from the Ministry of Finance, created the Financial Committee, with the purpose of advising the Finance Minister on the diverse issues that need to be taken into account in the definition of the SWF investment policy.

Thus, the regulatory framework governing the Chilean SWFs has solid, transparent foundations, supports efficient operations, and facilitates the achievement of the objectives for which they were created. The regulatory framework has been published in the Official Gazette and is also available online the SWF website (www.hacienda.cl/fondos-soberanos/normativa.html).

GAPP 2. Principle:

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

Assessment:

The objective of the PRF is established in the FRL and the Pension Reform Law; that of the ESSF, in the FRL and DFL1. All the legislations related to this principle available online at www.hacienda.cl/fondos-soberanos/normativa.html. In addition, the policy objectives of the SWFs are clearly described in the annual report prepared by the Finance Ministry, which is publicly available on its website: www.hacienda.cl/fondos-soberanos.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.

Assessment:

The resources held in the two SWFs are invested entirely in foreign currency and entirely overseas; the domestic macroeconomic impact is therefore minimal. However, the ESSF has direct consequences on the domestic macroeconomy, deriving from its objective of financing fiscal deficits that could arise in periods of low growth and/or low copper prices. The decision and timing of withdrawals from this fund are determined by the Finance Ministry, since they could affect the value of the peso-dollar exchange rate. To minimize this impact, withdrawals from the ESSF and their conversion to pesos, when necessary in the past, have been coordinated with the country's other fiscal and monetary authorities. In the case of the PRF, part of its capital can be used to finance fiscal pension liabilities as of 2016. However, the annual withdrawals from this fund are limited to a maximum amount equivalent to one-third of the difference between the pension expense in the year and the inflation-adjusted pension expense in 2008, which is a relatively small amount that does not have implications for the exchange rate.

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.

Assessment:

The rules on fund contributions are established in the FRL and DFL1; while the uses of the resources are defined in the FRL, the DFL1, and the Pension Reform Law, as part of their legal framework. The law authorizes the Ministry of Finance to determine the timing and amount of withdrawals, which is then publicly reported. Fiscal expenditures, in turn, must be approved by the Chilean National Congress each year in the budget process.

As indicated above, the legislation applicable to the SWFs is available on their website. Contributions and withdrawals, as well as the expenses associated with operating the funds, are periodically reported to the public. Contributions and withdrawals are published in monthly, quarterly, and annual reports. Expenses are divulged in quarterly and annual reports.

GAPP 5. Principle:

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

Assessment:

The CBC and the external managers prepare daily and monthly reports on the state of the SWFs and their investment performance. These reports are submitted to the Finance Ministry and the Treasury. Additionally, the CBC prepares quarterly and annual reports that are also sent to the Finance Ministry and the Treasury.

Based on information provided by the CBC and the custodian bank, the Finance Ministry publishes monthly reports that include information on the funds' investment returns, size, contributions, withdrawals, and portfolio allocation. The Finance Ministry also prepares quarterly reports that complement the publicly available information, as well as an annual report on the state of the SWFs. The Financial Committee prepares its own annual report on its activities and recommendations, which is submitted to the Finance Minister, the Finance Committees of the Senate and the House of Representatives, and the Special Budget Committee. All these reports are available on the SWF website.

GAPP 6. Principle:

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

Assessment:

The legal framework establishes a clear division of roles and responsibilities that facilitates accountability and the operational independence of fund management. The FRL establishes that the SWFs are the property of the Treasury of Chile and that the Treasury holds the title to the resources. In accordance with the provisions of the FRL, the Finance Minister is responsible for making decisions on the management of the SWFs and their investment policies.

For the definition of the SWF investment policy, the Finance Minister receives support from the Financial Committee, which assists with the analysis of various aspects that should be taken into account in the decision. The Ministry then prepares investment guidelines specifying the instruments and issuers eligible for investment, as well as other issues such as investment limits or the use of derivatives.

The external portfolio managers are responsible for investing the equity, investment-grade corporate bond, high-yield bond, and U.S. agency mortgage-backed security (MBS) portfolios, in accordance with their individual contracts. The CBC is responsible for investing the sovereign fixed-income portfolios (including bank deposits in the case of the ESSF) and of supervising the MBS external managers. Both the CBC and the external managers are fully independent to invest the SWFs, subject to the instructions and restrictions defined by the Ministry of Finance in the investment guidelines.

The custodian bank, contracted by the CBC in representation of the Treasury, is responsible for

securities custody and also performs middle-office tasks, such as reporting on compliance with investment limits, calculating the performance of each manager, and preparing financial and accounting reports on the SWFs.

The Sovereign Wealth Fund Unit within the finance Ministry's International Finance Area supervises the investment by the CBC and the external managers of equities, investment grade, corporate bonds and high yield bonds, based on information provided by the custodian bank, the CBC, and the external managers. The unit also prepares monthly, quarterly, and annual reports based on information provided by the custodian bank; acts as administrative secretary for the Financial Committee; and provides support in all areas related to the SWF investment policy.

The Treasury is responsible for the SWF accounting, including the preparation of the audited financial statements and incorporation in the national accounts. As of April 2014, the Treasury is also responsible for monitoring compliance with investment limits, verifying the external managers' fees, and other administrative duties.

Finally, the Budget Office is responsible for all budgetary aspects related to the funds, such as contributions and withdrawals.

GAPP 7. Principle:

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

Assessment:

The FRL establishes the objectives of the SWFs and identifies the Finance Minister as the chief officer in charge of the funds, responsible for making decisions on their management and investment policy. The FRL names the Treasury as owner of the resources. The Finance Minister is appointed by the President of the Republic. The members of the Finance Committee are appointed by the Finance Minister, according to criteria established in Executive Decree N° 621 of 2007, from the Ministry of Finance.

With regard to oversight, the Ministry of Finance is responsible for monitoring the investment performance and strategy of the CBC and the external managers. As mentioned, as of April 2014 the Treasury monitors compliance with the investment guidelines, by reviewing the custodian bank's reports on compliance with investment limits and also

undertaking an independent review of compliance with these limits.

Finally, the Office of the Comptroller General, an autonomous agency, is responsible for auditing the Chilean public sector finances and hence the SWFs.

GAPP 8. Principle:

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

Assessment:

The institutional framework is defined in the legislation cited above. The FRL establishes that the Finance Minister is the chief officer in charge of the SWFs, with the responsibility to make decisions on their management and investment policy. To ensure an adequate performance of this task, the FRL mandated the creation of a Financial Committee, which advises the Minister on the analysis and design of the investment policies. While the Minister is not obligated to follow the Committee's recommendations, they are public and thus carry a reputational risk. Finally, the Finance Minister also created the Sovereign Wealth Fund Unit within the International Finance Area. The unit carries out any tasks required in relation to the investment of the SWFs and provides support to the Financial Committee.

GAPP 9. Principle:

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

Assessment:

The Finance Minister has defined the SWF investment policy and delegated the operational management of the funds to the CBC, which manages the sovereign fixed-income mandate for both funds (including bank deposits in the case of the ESSF), and the external managers, who manage the equity mandate for the ESSF and PRF as well as mandates for investment grade corporate bonds, high yield bonds and US Agency Mortgage Backed Bonds (MBS) in the case of the PRF. All the fund managers follow the investment guidelines issued by the Ministry of Finance. These guidelines are reviewed and accepted by the CBC, which is a technical and autonomous agency and as such is independent of—and not subject to supervision by—the Government. The CBC and the external managers are fully independent to buy and sell instruments and decide on other operational aspects of fund management within the parameters established by the Finance Ministry in the investment guidelines. The CBC and the external managers submit periodic reports to the Finance Ministry (daily, monthly, quarterly, and annual reports in the case of the CBC; and daily and monthly reports in the case of

the external managers) on the performance of their duties, including details on the SWF investments.

GAPP 10. Principle:

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

Assessment:

The accountability framework is established in the laws and decrees cited in the assessment of Principle 1. These were duly published in the Official Gazette and are available on the SWF website (www.hacienda.cl/fondos-soberanos/normativa.html) from the Chilean Library of Congress (www.bcn.cl).

To ensure an adequate and effective accountability framework, several reports are prepared by the different entities involved in managing the SWFs.

Article 12 of the FRL and Article 7 of the DFL1, which regulate the PRF and the ESSF, respectively, establish that the Finance Ministry must submit quarterly reports on the state of the SWFs to the House and Senate Finance Committees and the Special Budget Committee. Additionally, although not required by law, the Finance Ministry publishes an annual report on the SWFs. All these reports are available to the public on the SWF website mentioned above.

The CBC must report to the Finance Minister on the operational management of the SWFs, as established in Executive Decree N° 1,383. The CBC submits to the Finance Ministry daily, monthly, quarterly, and annual reports on its management performance and on the service provided by the external managers and the custodian bank.

The Financial Committee is an advisory body whose reporting obligations are established in Executive Decree N° 621, cited above. Pursuant to Article 7 of that decree, the Committee must present an annual report on its work to the Finance Minister and submit a copy of the report to the House and Senate Finance Committees and the Special Budget Committee. This report is also available to the public on the SWF website.

Finally, the Office of the Comptroller General, an autonomous agency, is responsible for auditing the Chilean public sector finances and hence the SWFs.

GAPP 11. Principle:

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

Assessment:

The Ministry of Finance prepares an annual report on the SWFs based on information provided by the CBC, the external managers, and the custodian bank. This report includes financial information and is available to the public.

Since 2011, the Treasury prepares the financial statements, in accordance with IFRS, which are audited by an independent firm. The audited financial statements are published in the SWF annual report prepared by the Ministry of Finance.

GAPP 12. Principle:

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

Assessment:

SWF operations are audited by the Central Bank's internal auditors.

As indicated above, since 2011 the Treasury prepares the financial statements, in accordance with IFRS, which are audited by an independent firm following the auditing principles used in Chile.

GAPP 13. Principle:

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

Assessment:

The authorities and staff who perform tasks related to the Chilean SWFs are subject to professional and ethical standards by law, such as the principle of probity, which requires irreproachable professional conduct and the efficient and good-faith exercise of duties, in accordance with the general interest.

Additionally, all Finance Ministry staff and consultants are subject to a Code of Ethics, approved via Exempt Resolution N° 204, issued by the Undersecretary of Finance on 22 July 2016, which establishes legally applicable professional and ethical standards and is available on the SWF website (www.hacienda.cl/fondos-soberanos/codigo-de-etica.html).

Finally, the members of the Financial Committee are subject to ethical standards specified in the decree establishing the Committee, as well as additional standards defined internally.

GAPP 14. Principle:

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

Assessment:

All transactions with third parties are based on economic and financial considerations. In the case of the Finance Ministry, there are rules and procedures in place that establish the steps that must be followed by employees for contracting third-party goods

and/or services. The CBC and the Treasury must also comply with a series of clearly defined rules and procedures for this type of activity.

GAPP 15. Principle:

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

Assessment:

The procedures established by the CBC and the external managers are intended to guarantee that the operations and activities of the Chilean SWFs are executed in compliance with the applicable regulatory and reporting requirements in the countries in which they operate.

GAPP 16. Principle:

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

Assessment:

The objective and the institutional framework of the SWFs are defined in the legal framework described above under Principle. The operational management is carried out by the CBC and external managers, which are independent from and are not supervised by the government. The operational framework for CBC management is defined in Executive Decree N° 1,383, 2006, from the Ministry of Finance, which was published in the Official Gazette. This information is also available on the SWF website (www.hacienda.cl/fondos-soberanos/normativa.html) and from the Chilean Library of Congress (www.bcn.cl). The external managers invest according to investment guidelines established by the Finance Ministry for the ESSF and PRF, which are available on the following websites: www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/economic-and-social-stabilizationfund/investment-policy/investment-guidelines and www.hacienda.cl/english/work-areas/international-finance/sovereign-wealthfunds/pension-reserve-fund/investment-policy/investment-guidelines.

GAPP 17. Principle:

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

Assessment:

Information on the size, absolute returns, and investment countries of the SWFs is published in monthly and quarterly reports prepared by the Finance Ministry. The annual report, also prepared by the Ministry, contains additional information. All these reports are available on the SWF website.

GAPP 18. Principle:

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

GAPP 18.1 Subprinciple:

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

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.

Assessment:

The current investment policy for the ESSF and PRF is consistent with their objectives and risk tolerance. A description of the SWF objectives and investment policies is included in the annual report prepared by the Finance Ministry. The investment guidelines are also available on the SWF website in Spanish and English.

The investment policy for each fund determines the financial risks to which they are exposed. Given the passive management approach, these risks mainly depend on the funds' strategic asset allocations and benchmarks. To date, the use of debt has not been allowed, while the use of derivatives is allowed solely for hedging or for gaining exposure to part of the benchmark. Currently, the SWFs are operationally managed by the CBC and external managers. The Central Bank of Chile and the external portfolio managers are supervised by the Finance Ministry and the Treasury, with the exception of the external U.S. agency MBS portfolio managers, which are supervised by the Central Bank because this asset class is eligible for investment of CBC international reserves. In general, the external managers must be contracted through a selection process carried out by the CBC, in accordance with its internal policies and procedures. The scope of the external managers' responsibilities and activities, as well as their supervision, are established in the corresponding investment guidelines.

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.

Assessment:

The operational management of the SWFs has been delegated to the CBC and external managers, which make investment decisions autonomously, based solely on economic and financial grounds, and in accordance with the mandated passive management approach. The CBC uses the same operational standards as for its international reserves, which are audited and reviewed by international consultants. In the case of the external managers, the controls associated with the investment processes are audited independently, and the results of the audit are submitted annually to the Finance Ministry by the external managers. The Finance Ministry is responsible for defining the investment policy and

guidelines, taking into account the opinion of the Financial Committee.

GAPP 20. Principle:

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

Assessment:

Investment decisions are executed independently by the CBC and the external managers, which, in their management, use operating procedures and parameters that incorporate the highest standards of integrity. Furthermore, the regulatory framework requires that the members of the Financial Committee base their recommendations exclusively on public information.

GAPP 21. Principle:

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

Assessment:

The PRF began investing in equity in 2012; the ESSF, in 2013. However, given the passive investment approach—subject to a previously established benchmark—and the small volume relative to the size of each instrument in the benchmark, the Finance Ministry has chosen to follow a neutral strategy with regard to the voting rights associated with these investments.

GAPP 22. Principle:

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

Assessment:

The different entities that make up the organizational structure of the SWFs have in place procedures and controls, which together provide an adequate framework for managing the risks to which the SWFs are exposed. A detailed analysis of these risks is included in the SWF annual report published by the Finance Ministry.

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.

The Finance Ministry defines the investment guidelines, which stipulate the maximum exposure to the main risks deriving from the SWF investments. The CBC and the external managers, who are responsible for determining and executing financial operations, monitor their investments to ensure that the limits established in the guidelines are not exceeded. Moreover, in its SWF management, the CBC uses the same operational framework applied to the investment of its international reserves, including a series of procedures and controls that allow mitigating not only operational risk, but also reputational and market risk. The external managers also implement a range of procedures, which are audited by external firms and reported annually to the Finance Ministry.

GAPP 22.2 Subprinciple:

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

The custodian bank reports to the Finance Ministry's SWF Unit on the Central Bank's and external managers' compliance with the investment limits and on the portfolio risk level. As of April 2014, the Treasury supervises compliance with the investment guidelines on the part of the CBC and the external managers.

The reports submitted by the custodian bank, the CBC, and the external managers contain important information on the managed portfolios, ensuring the proper management of the SWFs. Finally, as indicated earlier, the main risks to which the SWFs are exposed are reported to the public in the annual report prepared by the Finance Ministry.

GAPP 23. Principle:

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

Assessment:

SWF returns are measured both in absolute terms and relative to the corresponding benchmark. The CBC, the external managers, and the custodian bank report the returns to the Finance Ministry, which, in turn, reports to the Financial Committee and also publishes the information. The methodology used to calculate returns and performance is based on Global Investment Performance Standards (GIPS®).

GAPP 24. Principle:

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

Assessment:

This is the sixth self-assessment of the Santiago Principles. As indicated in the first assessment in 2010, the exercise is carried out every two years. This self-assessment is also available on the SWF website.