ANNUAL REPORT
FINANCIAL COMMITTEE

Advisory Committee to the Ministry of Finance
for Chile’s Sovereign Wealth Funds

2023

This publication corresponds to the 2023 Annual Report of the Ministry of Finance's Financial Committee.

The electronic version of this document is available on the Ministry of Finance website:
https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/financial-committee/annual-report

April 2024, Santiago, Chile

ANNUAL REPORT
FINANCIAL COMMITTEE

Advisory Committee to the Ministry of Finance
for Chile’s Sovereign Wealth Funds

2023

Contents

Preface 6

Executive Summary 7

Members of the Financial Committee 8

Chapter 1 Fiscal Policy and the Funds' Objectives, Institutional Framework, and Investment Policy 10

A. Fiscal policy 11

B. Objectives and rules on the use of the funds 11

C. Institutional framework 14

D. Investment policy 17

Chapter 2 State of the Sovereign Wealth Funds 24

A. Analysis of the international economy 25

B. Market value 35

C. Returns 36

Chapter 3 Activities and Recommendations of the Financial Committee 39

A. New strategic asset allocation for the ESSF 40

B. Modifications to the ESSF investment guidelines 44

C. Analysis of the PRF 44

D. Tax management in Sovereign Wealth Funds 47

E. Responsible investing 48

F. ESSF rebalancing policy 48

G. Monitoring of external managers 49

Appendix 1: Current and former Financial Committee's members 50

Appendix 2: Summary of Meetings in 2023 51

References 54

Glossary 55

Preface

As stipulated in the Fiscal Responsibility Law of 2006, the Financial Committee was created in 2007 to advise the Finance Minister on the investment of Chile's two Sovereign Wealth Funds: The Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). The Financial Committee is an independent external advisory board, whose members have a vast experience in economic and financial areas. The Committee meets periodically to analyze matters relating to the investment of the funds. This Report—the seventeenth prepared by the Committee—describes its work and activities in 2023.

The publication of this Report fulfills the requirement established under Decree N° 621, issued by the Ministry of Finance in 2007, which stipulates that the Committee must present an annual report on its work to the Finance Minister and submit a copy of this report to the Finance Commissions of the Senate and the House of Representatives and to the Joint Budget Commission.

The Committee

Executive summary

At the close of 2023, the market value of the funds was US$ 14,669 million, of which US$ 6,030 million was in the Economic and Social Stabilization Fund (ESSF) and US$ 8,639 million was in the Pension Reserve Fund (PRF). The net return in dollars in the year was 2.36% for the ESSF and 11.35% for the PRF,[1] while in pesos it was 5.35% and 14.60%, respectively. In the case of the ESSF, the strategic asset allocation by year end[2] was 81% in sovereign bills and bonds, 4% in inflation-linked sovereign bonds and 15% in U.S. agency MBS. For the PRF, the strategic asset allocation was 34% in sovereign and government-related bonds, 8% in inflation-linked sovereign bonds, 6% in U.S. agency MBS, 13% in corporate bonds, 8% in high-yield bonds, and 31% in equities.

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 greater than one year are annualized. For periods of less than one year, the return corresponds to the change during the period. Net returns reported are net of management fees.

2 On 2 November 2023, the new strategic asset allocation was implemented, which was approved by the Minister of Finance in April of the same year. Prior to that date, the fund was invested solely in sovereign fixed income.

Members of the Financial Committee

President Juan Andrés Fontaine Talavera

Mr. Fontaine holds a degree in Business Administration from the Universidad Católica de Chile and a Master's degree in Economics from the University of Chicago, where he also undertook doctoral studies. He has previously served as Minister of Economy, Minister of Public Works, Research Director at the Central Bank of Chile, and board member for various companies. He was a Professor at the Universidad Católica de Chile and the Universidad de Chile, as well as a Visiting Professor at the University of California, Los Angeles (UCLA). He currently works as an economic and financial consultant. Mr. Fontaine joined the Committee in August 2021.

Vice President Macarena Pérez Ojeda

Ms. Pérez holds a degree in Business Administration from the Universidad Católica de Chile. She is currently a partner of Econsult, where she works as an investment advisor for families, individuals, and institutions. She is also a board member for Bbosch, Fundación Mujer Impacta, and Fundación la Fuente; a member of the development council of the Universidad Finnis Terrae, and a mentor for Women in Finance. Her previous positions include CEO of IM Trust AGF, Institutional Distribution Manager at IM Trust, Partner and CFO of Credicorp Capital, and board member of Empresas Volcán SA and Credicorp Capital. She joined the Committee in August 2021.

Member Pablo Castañeda Navarrete

Mr. Castañeda holds a degree in Business Administration from the University of Chile and a PhD in Economics from Boston University. He was Vice-Dean of the Business School of the Adolfo Ibáñez University, Senior Economist of the Superintendence of Pensions, and Advisor to the Ministry of Finance. He has been a Professor at the University of Chile. He is currently a professor of Finance at the Business School of the Adolfo Ibáñez University and carries out economic and financial consulting work. He joined the Committee in August 2022.

Member Nicolás Eyzaguirre Guzmán

Mr. Eyzaguirre holds a degree in Business Administration and a Master's degree in Economics from the Universidad de Chile, and a Master's degree in Economics from Harvard University, where he also undertook doctoral studies. He previously served as Minister of Finance, Secretary-General of the Presidency, Minister of Education, Research Manager and Director at the Central Bank of Chile, Executive Director and Director of the Western Hemisphere Department at the International Monetary Fund, Chairman of the Chilean National Innovation Council for Competitiveness, Chairman of the Canal 13 corporate group, and Professor at the Universidad de Chile, Universidad de Santiago de Chile, Harvard University, and other universities. He currently works as a consultant. He joined the Committee in August 2021.

Member Jennifer Soto Urra

Ms. Soto holds a degree in Business Administration and Master in Finance from the University of Chile. She currently serves as Director of different companies, including Banco Bice, Bicecorp, Bicevida, Paz Corp, and Fundación Camino. She is a lecturer on the Master's Degree in Finance at the University of Chile and the Executive Master's Degree in Finance and Investments at the ESE Business School. In addition, she is a member of the Circle of Directors and Women Corporate Directors. Previously, she was Fixed Income Manager at Bice Vida Compañía de Seguros. She joined the Committee in August 2022.

Member Marcela Valenzuela Bravo

Ms. Valenzuela holds a degree in Industrial Civil Engineer and Master of Science in Engineering from the Pontificia Universidad Católica de Chile, PhD in Finance from the London School of Economics and Political Science. She is currently a professor at the School of Management of the Pontificia Universidad Católica de Chile, an Associate Researcher at the Center for Systemic Risk at the London School of Economics and Political Science and an Associate Researcher at the Millennium Institute on Market Imperfections and Public Policies. In addition, she was a professor in the Department of Industrial Engineering at the University of Chile and a researcher at the Institute of Infrastructure and Environment of the School of Engineering of the University of Edinburgh. He joined the Committee in August 2022.

CHAPTER 1

Fiscal Policy and the Funds' Objectives, Institutional Framework and Investment Policy

A. Fiscal policy

Since 2001, Chile's fiscal policy is guided by a structural balance rule or, more precisely, a cyclically adjusted balance rule,[3] which mitigates the effect on public finances of fluctuations in economic activity and the copper price. This implies saving in boom times and being able to use those savings during periods of lower economic activity. On the other hand, as of 2022,[4] fiscal policy is anchored to a medium-term debt level to provide predictability to debt dynamics in that term.[5] Based on the above, the aim is to achieve fiscal sustainability. As a result, the fiscal rule has a stabilizing effect on public finances and the economic cycle and improves access to financing for both the public and private sectors.

B. Objectives and rules on the use of the funds

To ensure the sustainability of public spending overtime and contribute to the competitiveness of the economy, Law 20,128 on Fiscal Responsibility was passed in September 2006. This law created the PRF and authorized the President of the Republic to create the ESSF, which was then officially established in February 2007. These two funds accumulate the resources resulting from the application of the structural balance rule as detailed below.

Objectives

The funds created by the Fiscal Responsibility Law (henceforth, the Sovereign Wealth Funds) have specific objectives. In the case of the ESSF, its objective is to accumulate resources to finance fiscal deficits. The new administration reinforced this objective so that, within the framework authorized by the legal framework and following the structural balance cycle, the ESSF is used, especially, to complement the financing of infrequent and large fiscal deficits associated with high-cost events coinciding with a reduction in the government's borrowing capacity. In the case of the PRF, its objective is to complement the financing of fiscal obligations derived from the Universal Guaranteed Pension (henceforth, UGP), the basic solidarity disability pension and the solidarity pension contribution for disability (henceforth, Solidarity Pillar for Disability or SPD).[6] The PRF thus complements the financing of future pension-related contingencies.

Rules on fund contributions

The rules on establishing the funds and accumulating resources therein are established by law (see Figure 1).[7]

The PRF is increased each year by a minimum of 0.2% of the previous year's GDP. If the effective fiscal surplus exceeds 0.2% of GDP, the PRF receives a contribution equivalent to the surplus, up to 0.5% of GDP. PRF contributions only have to be made until the fund reaches UF 900 million (Unidad de Fomento, UF).[8]

3 The structural balance rule (or cyclically adjusted balance rule) has undergone some changes since it was first implemented. For a detailed discussion of its design, modifications, application and results, see Marcel, Tokman, Valdés and Benavides (2001); García, García and Piedrabuena (2005); Rodríguez, Tokman, and Vega (2006); Velasco, Arenas, Rodríguez, Jorratt and Gamboni (2010); Comité Asesor para el diseño de una política fiscal de balance estructural de segunda generación para Chile (2011); Larraín, Costa, Cerda, Villena and Tomaselli (2011); Schmidt Hebbel (2012); Velasco and Parrado (2012) and the Budget Office (2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, and 2022).

4 Decree 755, of 2022, which establishes the bases of fiscal policy in accordance with the provisions of Article 1 of Law N° 20,128 on fiscal responsibility.

5 The current administration established that the structural balance rule is anchored to a gross debt level of 45% of the Gross Domestic Product (GDP).

6 Law No. 21,419, which created the Universal Guaranteed Pension, modified the objective of the PRF in the Fiscal Responsibility Law in January 2022. Prior to this reform, the objective of the fund was to support the financing of the fiscal obligations arising from the 2008 Pension Reform, specifically, basic solidarity pensions for old age and disability, as well as solidarity pension contributions for old age and disability.

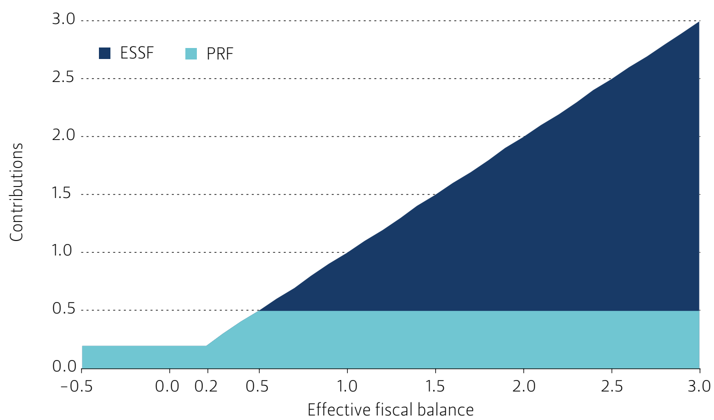
7 For the PRF, the Fiscal Responsibility Law; for the ESSF, Statutory Decree (DFL) N° 1, issued by the Ministry of Finance in 2006.

8 Within the framework of the health emergency, Law No. 21,225, which established measures to support families and micro, small and medium-sized enterprises due to the impact of the COVID-19 disease, in its fourth article suspended contributions to the PRF in the years 2020 and 2021.

The yearly contribution to the ESSF corresponds to the balance of the effective fiscal surplus (if positive) after subtracting the PRF contribution, less public debt pays downs and any advance contributions to the fund.[9] Additionally the fund can receive extraordinary contributions from the sale of assets or debt issue.

FIGURE 1

Fiscal savings rule
(percent of GDP)



SOURCE: Ministry of Finance of Chile

Rules on the use of the funds

As of 2022, the amount of PRF resources that can be used annually should not exceed 0.1% of the previous year's Gross Domestic Product.[10]

The PRF will be extinguished by operation of law if, as of 2021, the transfers to be made in a calendar year do not exceed five percent of the sum of the expenditure on the UGP, and SPD of the Budget Law of each year.[11] When the PRF is eliminated, the remaining balance will be transferred to the ESSF.

9 The current legislation allows the pay down of public debt and advance contributions to the ESSF using resources from the fiscal surplus of the current year, which must be deposited into the fund in the current or subsequent years.

10 Law N° 21,419, which created the Universal Guaranteed Pension, modified in January 2022 the PRF withdrawal rule established in the Fiscal Responsibility Law. Prior to this reform, the amount of PRF resources that could be used annually should not exceed one-third of the difference between the respective year's expenditure on pension obligations to the Fisco and the inflation-adjusted pension expenditure in 2008. Notwithstanding the foregoing, within the framework of the pandemic, Article 19 of Law No. 21,227 established that the amount of resources to be withdrawn from the PRF during the years 2020 and 2021 would correspond to the total difference between the social security obligations expenditure for the respective year and the total expenditure made for this concept in 2008, adjusted for inflation.

11 Law N° 21,419, which creates the Universal Guaranteed Pension, modified in January 2022 the PRF term rule established in the Fiscal Responsibility Law. Prior to this reform, the PRF was automatically extinguished if, as of 2021, the transfers to be made in a calendar year did not exceed five percent of the sum of the expenditure on the basic solidarity old-age pension, the basic solidarity disability pension, the old-age solidarity pension contribution and the disability solidarity pension contribution of the Budget Law of each year.

The ESSF resources can be used at any time to complement fiscal revenues as needed to finance authorized public spending in the event of a fiscal deficit. These resources can also be used for the regular or extraordinary paydown of public debt (including Recognition Bonds) and for financing the annual contribution to the PRF, as per a decision by the Finance Minister.

Withdrawals from the ESSF and the PRF are effectuated through a decree from the Ministry of Finance.

It should be noted that the current administration has presented in Congress some indications to the Fiscal Responsibility Law that could impact the ESSF and PRF (see Box 1).

BOX 1: Amendments to the Fiscal Responsibility Law that could impact the contribution, withdrawal, and termination rules of sovereign funds

Below are some proposals sent to Congress in August 2022 that could impact the funds:

PRF

- Contribution rule: The obligation to make an annual contribution of 0.2% of the previous year's GDP is eliminated.
- PRF Term Rule: If the proposed amendment is approved, the fund would be automatically terminated if, fifteen years after the entry into force of the Fiscal Responsibility Law,[1] the total value of the PRF's assets, valued at July of the respective year, does not exceed 0.5% of the previous year's Gross Domestic Product.[2]

ESSF

- Objective of the fund: The fund's main objective is established as maintaining fiscal stability and providing public goods and services over time, in the face of abrupt changes in the economic cycle and extraordinary events.
- Contribution Rule: The Natural Disaster Fund (henceforth, Foden), created by these amendments to the Fiscal Responsibility Law, will receive a contribution equivalent to the effective surplus after deducting the contributions to be made to the PRF, up to a limit of 0.1% of the previous year's GDP. If the market value of the Foden at the end of the first quarter of each year is equal to or greater than 0.5% of the previous year's GDP, this contribution shall not be made. That is, the ESSF will receive the balance of the effective surplus after contributing to the PRF and Foden. Additionally, it is indicated that if the effective surplus is less than the structural balance, the contribution to the ESSF will be optional.
- Withdrawals: The amendments establish that the increased fiscal expenditure associated with the Automatic Emergency Family Income in Case of Confinement[3] may be financed from the ESSF, without prejudice to other resources allocated for this purpose.

1 As of 2021.

2 Currently, the PRF termination rule, as modified by Law No. 21,419, which creates the Universal Guaranteed Pension, establishes that the fund shall be automatically terminated if, fifteen years after the entry into force of the Fiscal Responsibility Law, the disbursements to be made in a calendar year do not exceed five percent of the sum of the expenditure on the Universal Guaranteed Pension, basic solidarity pension for disability, and solidarity pension contribution for disability in the Budget Law for that year.

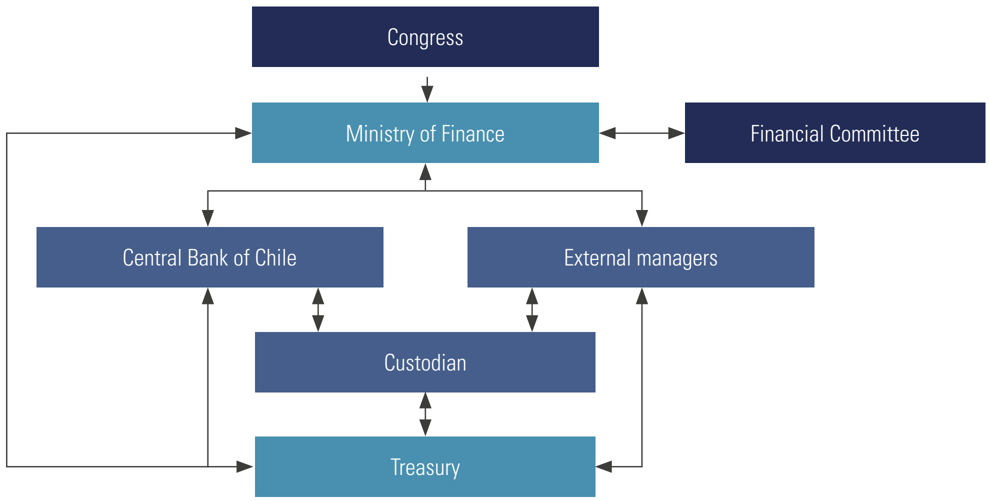
3 The amendments to the Fiscal Responsibility Law create the Automatic Emergency Family Income in Case of Confinement, which is an extraordinary monetary benefit in the event that all or part of the national territory is threatened by an emergency (including pandemics) that poses a serious risk to the health of the inhabitants, causes a significant decrease in household income, and there are restrictions on mobility.

C. Institutional framework

The legal framework establishes a clear division of roles and responsibilities in order to ensure accountability and operational independence in the management of the funds. This section provides a brief description of the roles of each of the bodies involved in fund management (see Figure 2).

FIGURE 2

Institutional framework for Chile's Sovereign Wealth Funds



SOURCE: Ministry of Finance of Chile

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 (GTR) holds the legal title to the resources. The law authorizes the Finance Minister to make decisions on how the funds are managed and to dictate their investment policies. To this end, the Ministry of Finance draws up the investment guidelines, which define the criteria that must be followed by the funds' managers. The Ministry monitors the managers' performance and compliance with the investment guidelines and issues monthly, quarterly and annual reports on the state of the funds.

The GTR is responsible for the funds' accounting and the preparation of their audited financial statements, for monitoring compliance with the investment limits, for reconciling information on the portfolios from the managers and the custodian and for approving payments to the managers. The Budget Office is responsible for budgetary issues related to the funds.

Central Bank of Chile

Through Decree N° 1,383 of 2006 ("Agency Decree"), modified by Decree N° 1,618 of 2012, the Ministry appointed the Central Bank of Chile (CBC) to the role of fiscal agent, with the following responsibilities: (i) manage portfolios comprising instruments that are eligible for investing the Bank's International Reserves; (ii) delegate the management of these portfolios to external managers; (iii) select external portfolio managers; and (iv) manage the custodian, among other duties. In carrying out these tasks, the CBC must follow the guidelines issued by the Finance Minister.

External Managers

The external managers are international companies that have been contracted to manage a share of the Sovereign Wealth Fund investments. These firms are chosen based on a selection process carried out by the CBC, with the support of international consultants and Finance Ministry personnel.

In most cases, the Ministry is responsible for supervising the external managers, with support from the GTR; however, the CBC supervises external managers that invest in instruments that are eligible for its International Reserves.

Table 1 lists the external portfolio managers that were under contract at year-end 2023.

TABLE 1

Sovereign Wealth Fund external managers, 31 December 2023

External Manager	Supervision	PRF	ESSF
BlackRock Institutional Trust Company, N.A. (BlackRock)	Ministry/GTR	High-yield bonds	
BNP Paribas Asset Management (BNP Paribas)	CBC	U.S. agency MBS	U.S. agency MBS
Mellon Investments Corporation (Mellon)	Ministry/GTR	Equities	
Nomura Asset Management (Nomura)	Ministry/GTR	High-yield bonds	
UBS Asset Management (Americas) Inc. (UBS)	Ministry/GTR	Equities	
		Corporate bonds	
Western Asset Management Company (Western Asset)	CBC	U.S. agency MBS	U.S. agency MBS

SOURCE: Ministry of Finance of Chile

It should be noted that as of November 2023, the ESSF began investing in U.S. agency MBS. To this end, the Ministry of Finance, taking into account the recommendations of the Financial Committee, decided to use the same administrators as those used in the PRF, considering that this portfolio will be invested under the same investment guidelines in both funds. These administrators were selected as the best in a selection process carried out by the CBC in 2018, and both have successfully managed their mandates.

Financial Committee

The Fiscal Responsibility Law stipulates that the Ministry of Finance must establish an Advisory Committee to give advice to the Finance Minister on the Sovereign Wealth Funds (henceforth, the Financial Committee). This Committee monitors the investment of the funds' resources and advises the Minister on the definition of the investment policies consistent with the funds' objectives. In compliance with these provisions, on 23 December 2006, the Finance Minister announced the establishment of both the Sovereign Wealth Funds and the Financial Committee. The Committee was then officially created through Decree N° 621, issued by the Ministry of Finance in 2007. In accordance with that decree, the Committee must be made up of six members who have experience in investment portfolio management, have held an executive position in a financial institution or have held or currently hold an academic post. The six Committee members are appointed for two years, with half the seats being renewed each year. The current and former members of the Financial Committee are presented in Appendix 1. The Committee's president receives a fee per session of 25.5 UTMs (Unidades Tributarias Mensuales, UTM), with an annual cap of 127.5 UTMs. The remaining members receive a fee of 17 UTMs per session, with an annual cap of 85 UTMs. The Committee must meet at least once every six months, but in practice it has met at least five times a year. A summary of the Committee's meetings during 2023 is presented in Appendix 2.

Decree N° 621 also stipulated the Financial Committee's functions and the rules of procedure for its proper functioning. Thus, the duties and powers of the Committee are as follows:

- To advise the Finance Minister, when requested, on key issues related to the funds' investment policy, such as the distribution of investments by asset class (asset allocation), the incorporation of new investment alternatives, the specification of portfolio benchmarks (see Box 2), the permissible range of deviation from the asset allocation and the limits on the funds' investment possibilities.
- To submit recommendations to the Finance Minister, when requested, on custody and investment instructions and on the tender and selection processes for the management of the funds' portfolios.
- To express an opinion at the request of the Finance Minister about the structure and content of the annual reports on the funds' portfolio management that are presented to the Ministry of Finance by the institution(s) responsible for their management or custody and, on the basis of these reports, to express an opinion about the funds' management and, particularly, its consistency with their investment policies.
- To express an opinion about the structure and content of the reports on the funds prepared quarterly by the Ministry of Finance.
- To advise the Finance Minister, when requested, on any matter related to the funds' investment.
- To express its views and recommendations regarding other matters related to the funds' investment policies, taking into account the principles, objectives, and rules that govern the funds.

To promote transparency, the Financial Committee decided that the decree regulating its activities, the minutes of its meetings, and the corresponding press releases should be publicly disclosed. The Ministry of Finance's website thus includes a special section containing all information on these issues.[12]

12 https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds.

BOX 2: Portfolio benchmarks

Portfolio benchmarks are representative market indexes for the different asset classes. In principle, they represent the passive investment performance of diversified portfolios invested in certain asset classes, where the return of each instrument is typically weighted by its relative share of market capitalization. The indexes are used as a reference for measuring the performance of the managers in charge of investing the funds.

Each asset class in an investment portfolio is associated with a benchmark. The benchmark for the total portfolio is thus constructed by weighting the selected indexes by the percentage allocation of each class, as defined in the investment policy.

Both the ESSF and the PRF have mainly passive investment policies. That is, their investment strategy aims to achieve the benchmark return.

D. Investment policy

Economic and Social Stabilization Fund

In 2023, a new strategic asset allocation for the ESSF was approved and implemented, taking into account the guidelines provided by the Minister of Finance at the beginning of the new administration, in relation to the fund's objective. The new allocation mainly modified the country exposure and incorporated U.S. agency MBS as a new asset class in the ESSF (see Box 3). Below are the main elements of the ESSF investment policy that was in effect at the end of 2023.

Investment objectives: While the fund size is up to 5.0% of GDP, it is recommended to invest in a defensive portfolio whose primary objective is to maximize its market value in Chilean pesos during times of financial stress. Under such circumstances, it may become inconvenient to finance fiscal needs through bond issuance due to higher borrowing costs and potential adverse effects on sovereign spreads. Therefore, it is anticipated that under financial stress, the economic authority would prefer to use the ESSF. As a result, a portfolio with a high value under such circumstances is sought. It is understood that these assets must have high liquidity when Fisco requires them in such situations. If the fund size exceeds 5.0% of GDP, it is suggested to review the strategic asset allocation again with the objective of achieving higher long-term returns, particularly with respect to the resources that exceed that limit.

Strategic asset allocation: The ESSF investment policy stipulates a strategic asset allocation of 81% in sovereign bills and bonds, 4% in inflation-linked sovereign bonds, and 15% in U.S. agency MBS. The fixed-income portfolio has a currency allocation of 69% in USD, 19% in EUR, 9% in JPY, and 3% in CNY, expressed as a percentage of the total portfolio.

BOX 3: Comparison between the new and previous strategic asset allocations of the ESSF

The new strategic asset allocation was approved in April 2023 and implemented in early November of the same year (see Table R3.1). It increases the participation in U.S. sovereign instruments, adds a small exposure to Chinese sovereign bonds, and reduces sovereign exposure to debt from European countries and Japan, in addition to eliminating those from Switzerland. It also incorporates U.S. agency MBS (Mortgage-Backed Securities).

TABLE R3.1

New and previous strategic asset allocations
(percent of portfolio)

Asset Class	New	Previous
U.S. Treasury bills	10.0	11.9
U.S. sovereign bonds (1-10 years)	40.0	28.6[1]
Europe sovereign bonds AAA/AA (1-10 years)	19.0	26.0[2]
Japan sovereign bonds (1-10 years)	9.0	21.6[3]
Switzerland sovereign bonds (5-10 years)	–[4]	8.2
China sovereign bonds (1-10 years)	3.0	–
Subtotal Treasury bills and sovereign bonds	**81.0**	**96.3**
U.S. inflation-linked sovereign bonds (1-10 years)	4.0	2.6
Germany inflation-linked sovereign bonds (1-10 years)	–[5]	1.1
Subtotal inflation-linked sovereign bonds	**4.0**	**3.7**
U.S. agency MBS	15.0	–[6]
Subtotal U.S. agency MBS	**15.0**	**–**
Total	**100.0**	**100.0**
Duration	3.9 years	4.8 years

[1] U.S. Treasury bonds with a maturity of 7-10 years only.
[2] Equivalent to 14.2% of German Treasury bills and 11.8% of German government bonds (7-10 year maturity).
[3] Equivalent to 10.8% of Japanese Treasury bills and 10.8% of Japanese government bonds (7-10 year maturity).
[4] No exposure to Swiss government bonds due to its minimal weight in the global sovereign fixed income index.
[5] No exposure to German inflation-linked bonds.
[6] Previous policy did not include U.S. agency MBS.

Portfolio benchmarks: A benchmark has been defined for each component of the strategic asset allocation, using a representative market index (see Table 2).

Management: The portfolio of Treasury bills and sovereign bonds, as well as the portfolio of inflation-indexed sovereign bonds, is managed by the CBC. The portfolio of U.S. agency MBS is managed by external managers.

TABLE 2

Benchmarks ESSF
(percent of portfolio)

Asset Class	Benchmarks	Percentage of Portfolio
U.S. Treasury bills	ICE BofaAML US Treasury Bills Index	10.0
U.S. sovereign bonds (1-10 years)	Bloomberg Global Aggregate - Treasury: U.S. 1-10 Yrs	40.0
Europe sovereign bonds AAA/AA (1-10 years)	Bloomberg Euro Aggregate - Treasury: Aaa 1-10 Yrs[1] Bloomberg Euro Aggregate - Treasury: Aa 1-10 Yrs[2]	19.0[3]
Japan sovereign bonds (1-10 years)	Bloomberg Global Aggregate - Treasury: Japan 1-10 Yrs	9.0
China sovereign bonds (1-10 years)	Bloomberg Global Aggregate - Treasury: China 1-10 Yrs	3.0
Subtotal Treasury bills and sovereign bonds		**81.0**
U.S. inflation-linked sovereign bonds (1-10 years)	Bloomberg Global Inflation-Linked: U.S. TIPS 1-10 Yrs	4.0
Subtotal inflation-linked sovereign bonds		**4.0**
U.S. agency MBS	Bloomberg US Mortgage-Backed Securities Index	15.0
Subtotal U.S. agency MBS		**15.0**
Total		**100.0**

[1] Luxembourg is excluded.

[2] Estonia and Ireland are excluded.

[3] Each subindex is aggregated according to its relative market capitalization.

SOURCE: Ministry of Finance of Chile

Ex ante tracking error:[13] The ex-ante tracking error is capped at 25 basis points for the sovereign fixed-income portfolio. For the U.S. agency MBS portfolio, the monthly average cannot exceed 20 basis points, provided that the maximum daily value does not exceed 30 basis points.

Eligible currencies and issuers: For each asset class, only currencies that are part of the corresponding benchmark are eligible. For issuers and instruments, those included in the benchmark are primarily allowed. Notwithstanding the foregoing, for each asset class, there are some eligible issuers and instruments that are not included in the corresponding benchmark and are allowed to provide greater flexibility to managers in the management of their portfolios. The most important ones are presented below:

- U.S. agency MBS: Debt instruments issued or guaranteed by the U.S. government or by MBS issuing agencies, interest rate futures, and TBAs.[14]

Leveraging and the use of derivatives: Leveraging is not allowed.[15] Regarding the use of derivatives, the use of forwards or swaps is allowed only for currency hedging, as well as futures for hedging purposes or that allow exposure to be obtained apart from the benchmark. The aggregate nominal amounts of futures, forwards and swaps may not exceed 10% of the portfolio.

Rebalancing policy: The portfolio must be rebalanced to the target asset allocation in the event of a fund inflow or outflow, or if any asset class deviates more than ± 2% from its target weight for thirty consecutive days.

13 The ex-ante tracking error is an estimate of the standard deviation of the difference between the portfolio and benchmark returns. The lower the ex-ante tracking error, the more passive the portfolio management.

14 TBA or To Be Announced: Corresponds to MBS forwards. The term TBA is derived from the fact that the specific MBS to be delivered in the future to fulfill the transaction is not designated at the time the transaction is made. Instead, it is announced 48 hours before the established settlement date.

15 Leveraging is the purchase of assets through debt.

TABLE 3

Rebalancing Policy ESSF
(percent of portfolio)

Asset Class	Strategic Asset Allocation (Percentage of portfolio)	Allowable Deviation Range (Percentage of portfolio)
Sovereign Fixed Income	85	83 – 87
U.S. agency MBS	15	13 – 17

SOURCE: Ministry of Finance of Chile

Investment guidelines: The investment guidelines, which are published in Spanish and English and available online at the Ministry of Finance website,[16] provide additional information on the ESSF investment policy, such as special restrictions on investment in specific countries and other relevant limits, as well as other aspects of portfolio management.

Pension Reserve Fund

The Minister of Finance, based on the recommendations of the Finance Committee, divided the PRF into two investment portfolios in 2020: the Short-Term Investment Portfolio (STIP) and the Long-Term Investment Portfolio (LTIP).[17] In the first, the STIP, created in October of that year, most of the resources that were disbursed from the fund until June 2021 were kept there. Since then, this portfolio has remained without resources. In the other, the LTIP, resources with a medium- to long-term investment horizon are invested.[18] The LTIP investment policy is described below:[19]

Long-term investment portfolio

Investment objective: The investment objective is to earn an expected annualized return in pesos of at least 2% over Chilean inflation in a ten-year period, with a probability of at least 60%. The risk tolerance establishes that the probability that the fund's real return will be less than –12%, expressed in pesos, must not be over 5% in any given year.[20]

Strategic asset allocation: The portfolio allocation is 31% equities, 34% sovereign and government-related bonds, 13% corporate bonds, 8% high-yield bonds, 6% U.S. agency MBS, and 8% inflation-linked bonds.[21] In contrast to the ESSF, which has a fixed investment currency allocation, in the PRF the currency composition derives from the share of each currency in the benchmarks (see Box 4).

16 https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/economic-and-social-stabilization-fund/investment-policy.

17 The Finance Committee recommended in 2020 to separate the PRF portfolio into two sub-portfolios. In the first, the STIP, the disbursements expected in 2020 and 2021 would be maintained, and in the other, the LTIP, the resources that would not be withdrawn in the short term would be maintained to invest them with a medium- to long-term investment horizon. For more information on this amendment, see Section B, Chapter 3, of the 2020 Financial Committee Report.

18 For more information on this amendment, see Section B, Chapter 3, of the 2020 Financial Committee Report.

19 For more information on the STIP's investment policy, see Section D, Chapter 1, of the 2021 Financial Committee Report.

20 This objective was defined in the investment policy approved by the Minister of Finance in late 2017 but it must be revised considering the Minister's decision in 2020 to stop convergence to the strategic asset allocation of said policy (for more information see Chapter 3, Section B of the Annual Report of the Financial Committee 2020).

21 The Finance Minister decided to maintain this strategic asset allocation that was in place for the fund in January 2020 when the decision was made to stop convergence to the investment policy defined in late 2017.

BOX 4: Currency composition of the ESSF and PRF

The currency composition of the ESSF is directly linked to the strategic asset allocation assigned to each country. As shown in Table R4.1, the fund primarily invests in reserve currencies, which tend to strengthen during international crises that could prompt withdrawals. The currency composition of the ESSF also closely mirrors that of its benchmark, reflecting a passive management strategy.

TABLE R4.1

Currencies composition in the ESSF as of 31 December 2023
(Percent of the portfolio)

Currency	ESSF	Benchmark
USD	69.0	69.0
EUR	18.9	19.0
JPY	9.1	9.0
CNY	2.9	3.0
Total	**100**	**100**

SOURCE: Ministry of Finance of Chile

The currency composition of the PRF is determined by the relative significance of each currency within the various benchmarks used by the fund. As shown in Table R4.2, the fund invests in a much broader range of currencies compared to the ESSF, due to its use of global indices across most asset classes.[1] Furthermore, the PRF's currency composition closely mirrors that of its benchmark,[2] reflecting a passive management approach in almost all asset classes.

TABLE R4.2

Currencies composition in the PRF as of 31 December 2023
(Percent of the portfolio)

Currency	PRF	Benchmark
USD	55.7	54.5
EUR	17.2	17.0
JPY	7.4	7.4
GBP	5.4	5.4
CNY	4.7	4.7
CAD	2.6	2.6
AUD	1.4	1.4
KRW	1.0	1.0

1 U.S. agency MBS is the only asset class in the PRF invested solely in US dollars.

2 The difference observed between the PRF and the benchmark in USD is due to the use of ETFs for some restricted markets in the equity asset class where it has been decided not to invest locally due to operational costs or increased complexity (e.g., Taiwan, India, among others). Since these ETFs are traded in the U.S., they are considered invested in USD. However, from the benchmark's perspective, these restricted markets are reported in the "other currencies" category.

Currency	PRF	Benchmark
CHF	0.9	0.9
HKD	0.8	0.8
SEK	0.4	0.4
Others	2.6	3.9
Total	**100.0**	**100.0**

SOURCE: Ministry of Finance of Chile

Benchmarks: A benchmark has been established for each component of the strategic asset allocation, using a representative market index (See Table 4).

TABLE 4

Benchmarks – LTIP
(percent of LTIP)

Asset class	Percent of LTIP	Benchmarks
Sovereign and government-related bonds[(a)]	34	Bloomberg Global Aggregate: Treasury Bond Index (unhedged)
		Bloomberg Global Aggregate: Government-Related (unhedged)
Inflation-linked sovereign bonds	8	Bloomberg Global Inflation-Linked Index (unhedged)
Corporate bonds	13	Bloomberg Global Aggregate: Corporates Index (unhedged)
U.S. agency MBS	6	Bloomberg US Mortgage-Backed Securities (MBS) Index
High yield bonds	8	Barclays Global High Yield Index (unhedged)
Equities	31	MSCI All Country World Index ex Chile (unhedged, with reinvested dividends)

[(a)] The two subindexes of this asset class are added in accordance with their relative capitalization.

SOURCE: Ministry of Finance of Chile

Management: The CBC directly manages the sovereign and government-related bonds portfolio and the inflation-linked bond portfolio. External portfolio managers manage the equity, corporate bond, high yield, and agency U.S. agency MBS portfolios.

Ex ante tracking error: The ex-ante tracking error has been set at 50 basis points for the aggregate portfolio of sovereign and government-related bonds and inflation-linked sovereign bonds, 60 basis points for the equity portfolio, 50 basis points for the corporate bond portfolio, and 150 basis points for the high yield bond portfolio. For the U.S. agency MBS portfolio, the monthly average cannot exceed 20 basis points, and the maximum daily value cannot exceed 30 basis points.

Eligible currencies, issuers, and instruments: For each asset class, only currencies that are included in the respective benchmarks are eligible for investment. Eligible issuers and instruments are mainly those included in the benchmark, but each asset class includes some eligible issuers and instruments that are not in the benchmark, so as to give the portfolio managers more flexibility in managing their portfolios. These include the following:

- U.S. agency MBS: debt instruments issued or guaranteed by the U.S. government or by MBS issuing agencies, interest rate futures and TBAs.
- Corporate bonds: market-traded futures and reopened issues that are comparable to the instruments included in the benchmark.
- High yield bonds: futures, reopened issues that are comparable to the instruments included in the benchmark, sovereign instruments and investment-grade bonds that leave the benchmark.
- Equities: ETFs, mutual funds, American Depositary Receipts (ADRs), Global Depositary Receipts (GDRs) and futures.

Leveraging and use of derivatives: The LTIP does not allow leveraging. The use of derivatives is differentiated by portfolio:

- Aggregate portfolio of sovereign and government-related bonds, and inflation-linked sovereign bonds: The use of forwards or swaps is allowed only for currency hedging, as well as futures for hedging purposes or that allow obtaining exposure to part of the benchmark. The nominal value of forwards or swaps contracted with a particular eligible counterparty may not exceed 1% of the market value of the portfolio if it has a risk rating of at least AA- and 0.5% if its risk rating is between A- and A+. The aggregate nominal amounts of futures, forwards and swaps may not exceed 10% of the portfolio.
- U.S. agency MBS: Exposure to TBAs cannot exceed 30% of the portfolio. The nominal amounts of U.S. interest rate futures valued at market price and expressed in absolute value cannot exceed 10% of the market value of the portfolio.
- Equities, corporate bond, and high yield bond portfolios: Each manager can only contract forwards or swaps for the purpose of currency hedging; and futures—equities or fixed-income, as indicated—for hedging purposes or to gain exposure to part of the benchmark. The nominal value of the forwards or swaps that are contracted by a given manager with a given eligible counterparty cannot exceed 3% of the market value of the portfolio under management. The aggregate nominal amount of futures, forwards, and swaps cannot exceed 10% of the portfolio of any given manager.

Investment guidelines: The investment guidelines for both, the STIP and LTIP, which are published on the Ministry of Finance's website,[22] provide additional information on the PRF investment policy, including details on the admissible instruments and other key limitations, as well as other issues related to fund management.

22 https://www.hacienda.cl/english/work-areas/international-finance/sovereign-wealth-funds/pension-reserve-fund/investment-policy.

CHAPTER 2

State of the Sovereign Wealth Funds

A. Analysis of the international economy

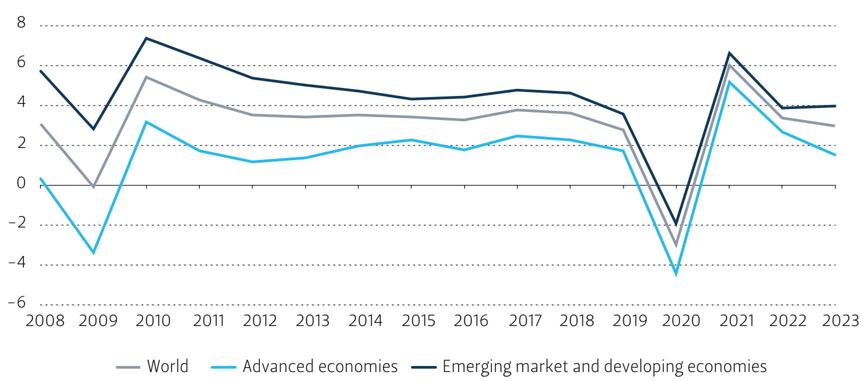
To better understand the recent performance of Sovereign Wealth Funds, this section summarizes the main events in the international economy during 2023.

In 2023, the global economy underwent a period of significant transition and challenges, marked by the lingering effects of the COVID-19 pandemic. Inflation emerged as a central concern in various regions, prompting many monetary authorities to adopt more restrictive policies to mitigate it. Throughout the year, inflation showed a downward trend, driven by rising interest rates and declining energy and food prices. However, underlying inflationary pressures persisted, albeit in a more controlled manner. Simultaneously, geopolitical tensions, including the conflict in Ukraine, escalating tensions in the Middle East, and strained relations between major economies such as the U.S. and China, continued to impact international trade and global markets. In this scenario, according to International Monetary Fund (IMF) estimates, the global economy grew by 3.0% in 2023, compared to 3.4% in 2022.

In aggregate and under this economic context, advanced economies grew by 1.5% in 2023, compared to a 2.7% expansion the previous year. On the other hand, emerging markets and developing economies registered a growth of 4.0% in 2023, similar to the 3.9% in 2022 (see Figure 3). Among advanced economies, Japan and the U.S. showed relative resilience, with growth of 2.0% and 2.1%, respectively (see Figure 4). In emerging market and developing economies, India stood out with a product growth of 6.3% (see Figure 5).

FIGURE 3

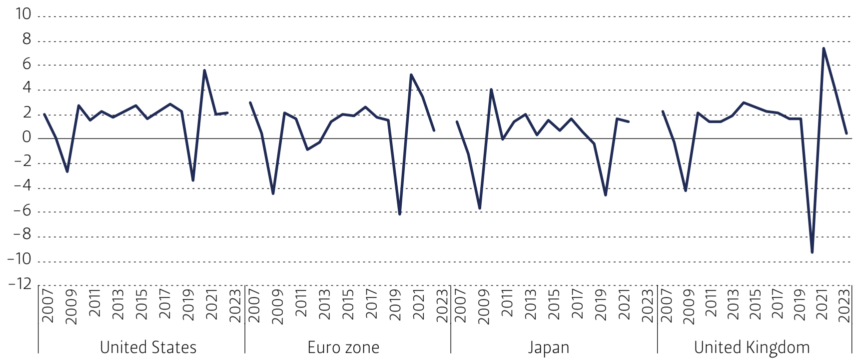
Real GDP growth, 2007 – 2023
(percent)



SOURCE: International Monetary Fund

FIGURE 4

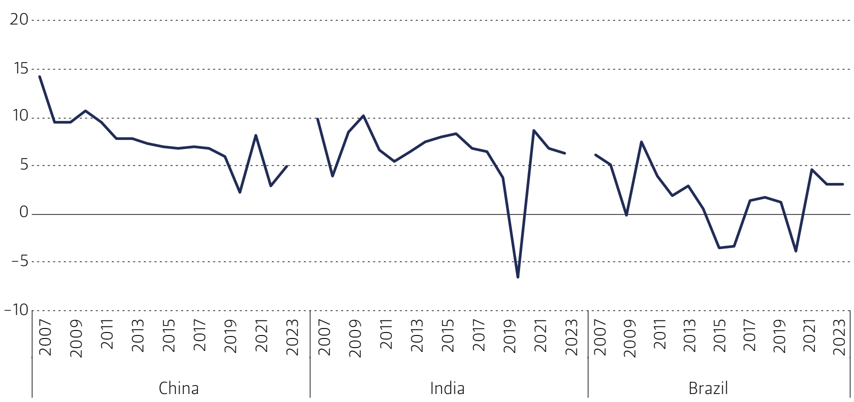
Real GDP growth in specific developed economies, 2007–2023
(year-on-year change, percent)



SOURCE: International Monetary Fund

FIGURE 5

Real GDP growth in specific emerging economies, 2007–2023
(year-on-year change, percent)



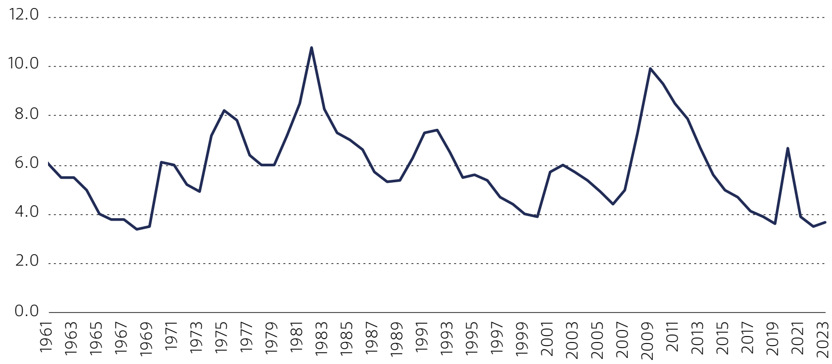
SOURCE: International Monetary Fund

In the U.S., the unemployment rate stood at 3.7% in December 2023, marking a slight increase from the previous year's 3.5% and aligning closely with pre-pandemic levels (see Figure 6). Meanwhile, hourly nominal wages rose by 4.1% at the end of the year (see Figure 7).[23] Inflation, as measured by the general price index, ended the year at 3.4%, a significant decline from the peak of 9.1% reached in June 2022 but still above the Fed's 2% target. Core inflation, excluding food and energy prices, increased by 3.9% for the year (see Figure 8). The Fed maintained a restrictive monetary policy, raising the federal funds rate until July 2023, when it reached the 5.25% to 5.50% range, where it remained for the rest of the year.

23 The low annual wage growth in April 2021 was primarily due to the high wage base in April of the previous year. Conversely, the wage increase in April 2020 was driven by a sharp decline in low-wage employment due to the pandemic.

FIGURE 6

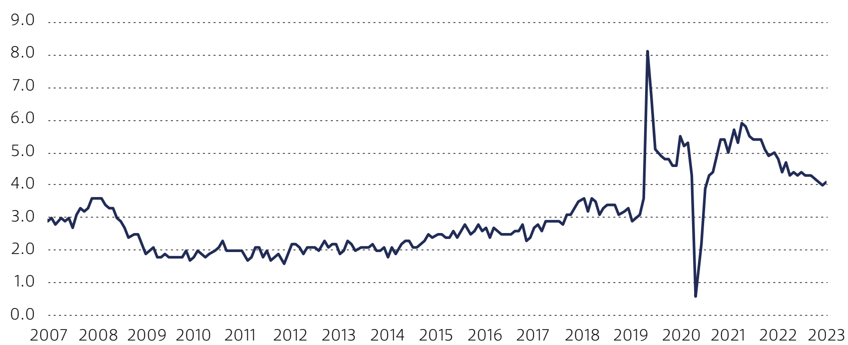
U.S. unemployment rate, 1961 - 2023
(percent)



SOURCE: Bureau of Labor Statistics

FIGURE 7

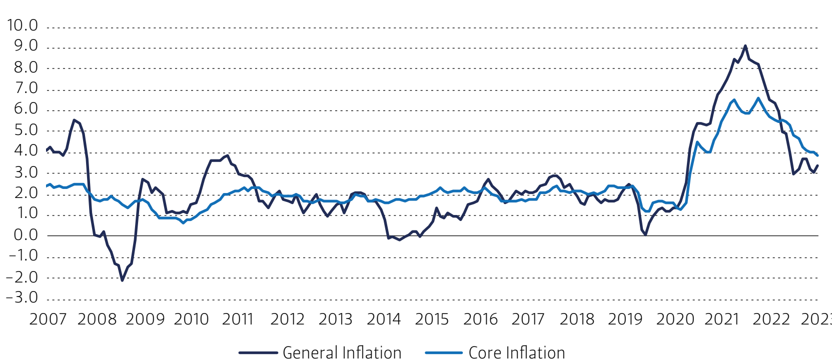
U.S. wage growth, 2007 - 2023
(year-on-year change, percent)



SOURCE: Bloomberg

FIGURE 8

U.S. consumer price index, 2007 - 2023
(year-on-year change, percent)

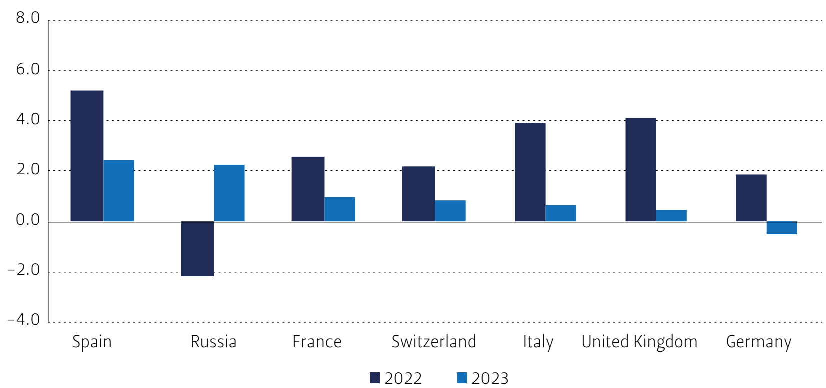


SOURCE: Bloomberg

The Eurozone underwent a significant economic slowdown, with growth decelerating from 3.5% in 2022 to a modest 0.7% in 2023. Among selected European countries (see Figure 9), Spain and Russia exhibited the best relative performances, recording GDP growth of 2.5% and 2.2%, respectively. Meanwhile, Eurozone inflation eased to 2.9% by year-end, down from 9.2% at the end of 2022 (see Figure 10). The unemployment rate declined throughout the year, reaching 6.6% in December (see Figure 11). To counteract inflationary pressures, the European Central Bank (ECB) tightened monetary policy by raising its key interest rates until September. As a result, the interest rates on main refinancing operations, the marginal lending facility, and the deposit facility stood at 4.50%, 4.75%, and 4.0%, respectively, at the end of the year.

FIGURE 9

Real GDP growth in selected European countries in 2022-2023
(year-on-year change, percent)



SOURCE: International Monetary Fund. Estimates

FIGURE 10

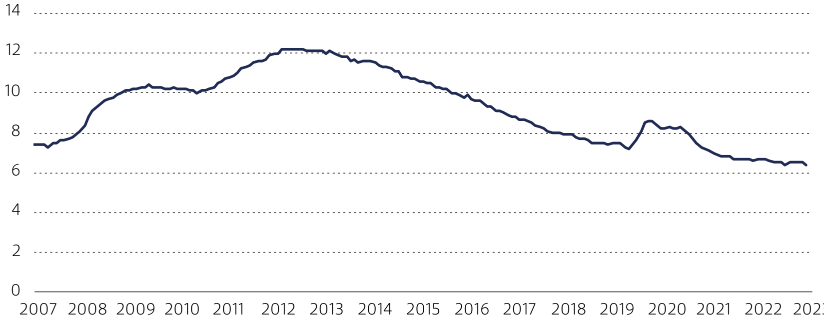
Eurozone annual inflation, 2007 – 2023[24]
(percent)

SOURCE: Bloomberg

24 The data corresponds to the Harmonized Index of Consumer Prices (HICP).

FIGURE 11

Eurozone unemployment rate, 2007 - 2023
(percent)



SOURCE: Bloomberg

Japan experienced a modest recovery in 2023, with GDP growth reaching 2.0%. This was primarily driven by the external sector, supported by a weaker yen. Notably, Japan saw inflation levels not seen since the early 1980s, exceeding the Bank of Japan's 2% target.

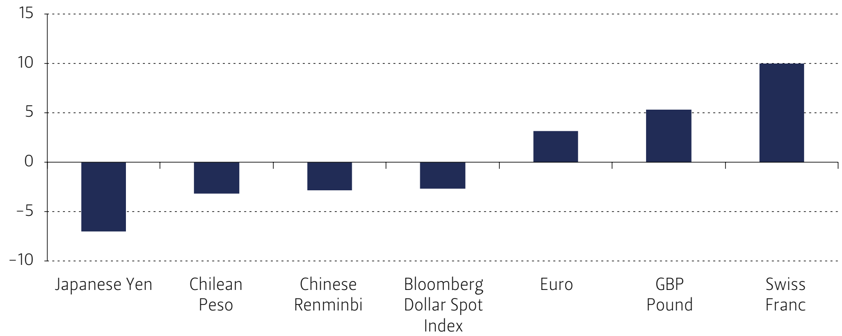
China's economy grew by 5.0% in 2023, surpassing the 3.1% growth achieved in 2022 but falling short of initial forecasts of 6.0%. To stimulate the slowing economy, the People's Bank of China cut interest rates and reduced reserve requirements for banks. Despite these measures, the real estate sector continued to weaken, prompting authorities to ease restrictions on home purchases and provide more financing to developers.

Globally, the U.S. dollar depreciated by 2.7% against major currencies, a reversal from its 6.7% appreciation in 2022 (see Figure 12).[25] Among the currencies selected, the Japanese yen experienced the most significant depreciation at 7.0%, while the Chilean peso weakened by 2.9%.

25 The Bloomberg Dollar Spot Index tracks the value of the dollar against ten major currencies. Positive returns indicate dollar appreciation, while negative returns indicate depreciation.

FIGURE 12

Selected currencies against the U.S. dollar in 2023[26]
(year-on-year change, percent)

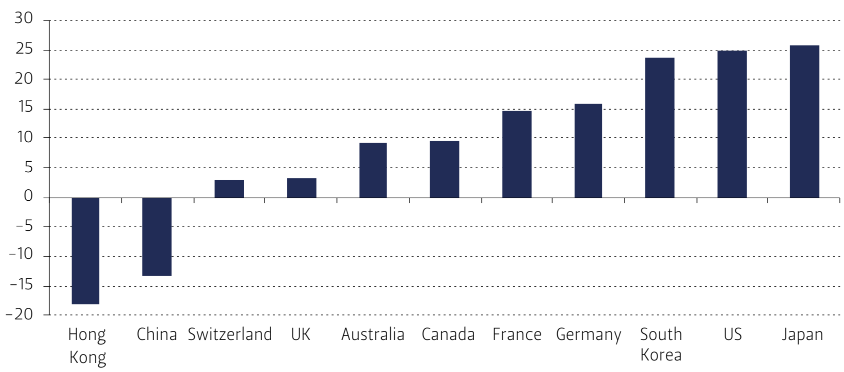


SOURCE: Bloomberg

Stock markets rebounded in 2023 after significant declines the previous year. Among the selected indices (see Figure 13), Japan, the U.S., and South Korea led the way with returns, in local currency, of 25.9%, 25.1%, and 23.9%, respectively. In contrast, Hong Kong and China's markets underperformed, posting returns of -17.8% and -13.2%, respectively.

FIGURE 13

MSCI equity indices returns in 2023
(percent, measured in local currency)



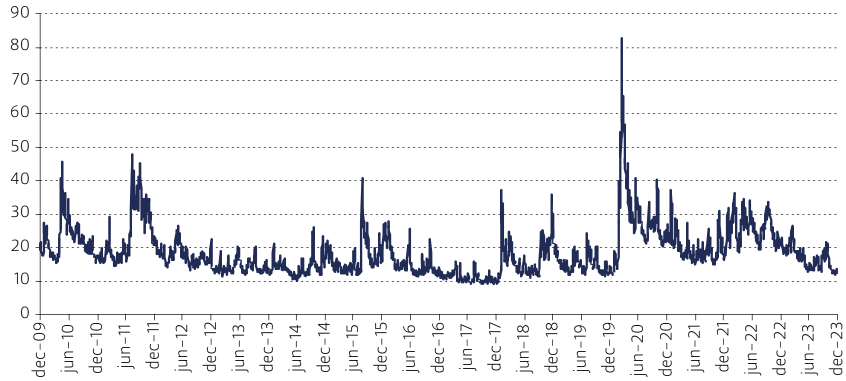
SOURCE: Bloomberg

Volatility of the stock market (S&P 500), as measured by the CBOE Volatility Index (VIX), averaged 17 points in 2023, down nearly 9 basis points from the previous year. The VIX peaked in March at 26.5. It should be noted that the average value of the index in 2023 was below the average value of the last 10 years (see Figure 14).

26 Negative performances indicate depreciation of the currency, while positive performance indicates appreciation.

FIGURE 14

Equity market volatility (VIX): S&P 500, 2009–2023
(in levels)

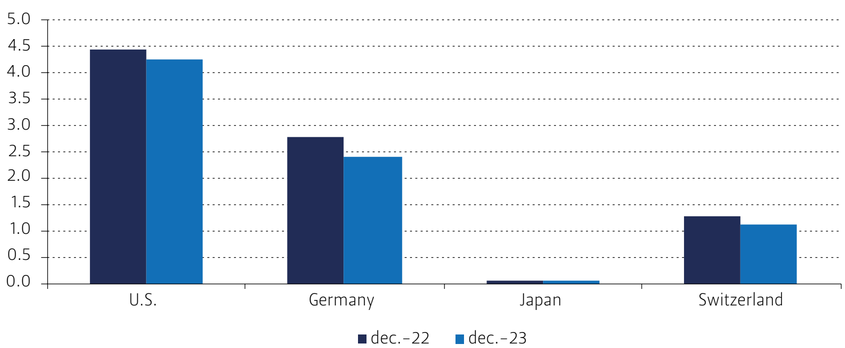


SOURCE: Bloomberg

At year-end, two-year and ten-year nominal sovereign interest rates had declined in the U.S., Germany, and Switzerland relative to the levels observed at the end of the previous year. Conversely, in Japan, yields for both maturities had increased (see Figures 15 and 16).

FIGURE 15

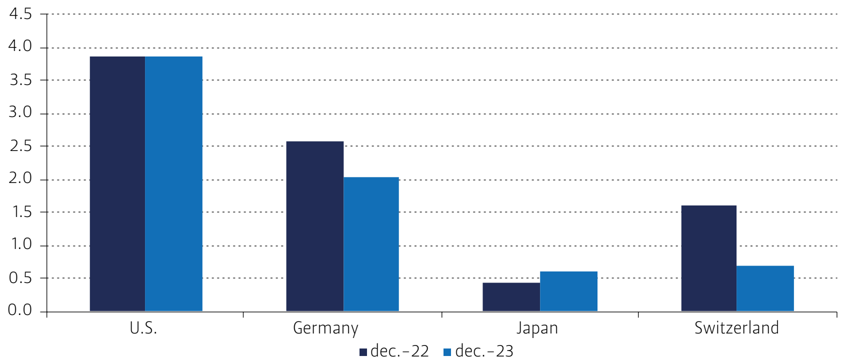
Internal rate of return (IRR) on two-year bonds in selected countries, 2022–2023
(percent)



SOURCE: Bloomberg

FIGURE 16

Internal rate of return (IRR) on ten-year bonds in selected countries, 2022-2023
(percent)

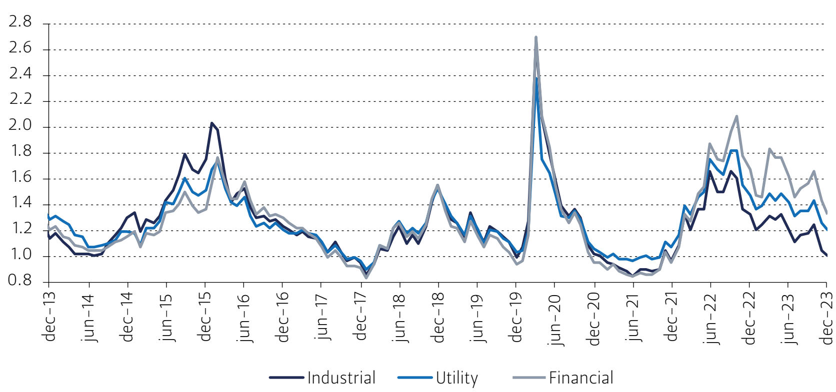


SOURCE: Bloomberg

Spreads tightened in the investment-grade corporate market in 2023, with the industrial, utilities, and financial sectors of the Bloomberg Global Aggregate Corporate index seeing declines. The industrial sector peaked in May, while utilities and financials peaked in March (see Figure 17). High-yield bonds also experienced spread compression, with the Bloomberg Global High Yield index ending the year at 4.2%, a 122 basis point decline from 2022 (see Figure 18).

FIGURE 17

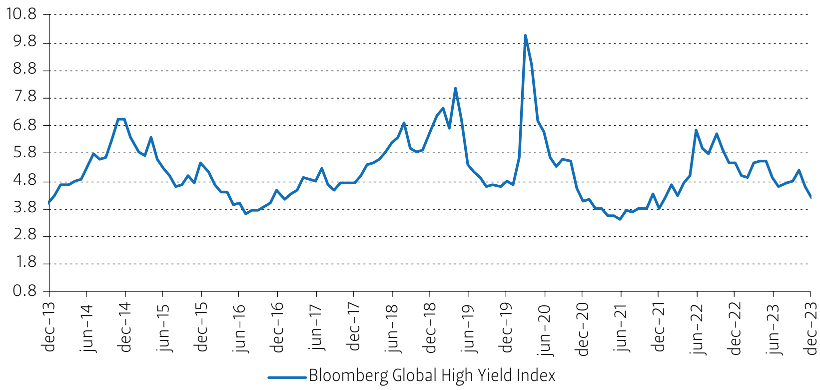
Investment grade corporate spreads by industry, 2013 – 2023
(percent)



SOURCE: Bloomberg

FIGURE 18

High yield bonds spreads, 2013 – 2023
(percent)

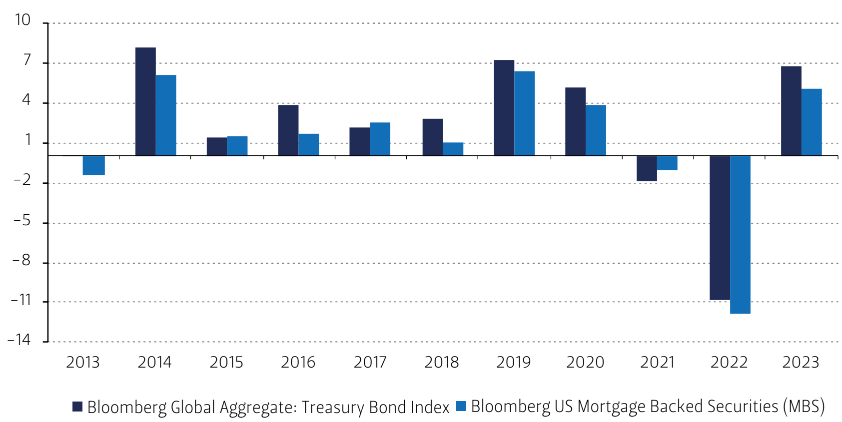


SOURCE: Bloomberg

Investment-grade sovereign bonds and U.S. agency MBS rebounded in 2023, delivering positive returns after last year's losses. The "Bloomberg Global Aggregate: Treasury Bond Index (hedged)" and the "Bloomberg US Mortgage-Backed Securities (MBS)" returned 6.7% and 5.1%, respectively (see Figure 19). Investment-grade corporate bonds, as measured by the "Bloomberg Global Aggregate: Corporates Index (hedged)", yielded 9.1%, while high-yield bonds, represented by the "Bloomberg Global High Yield Index (hedged)", returned 13.7% (see Figure 20).

FIGURE 19

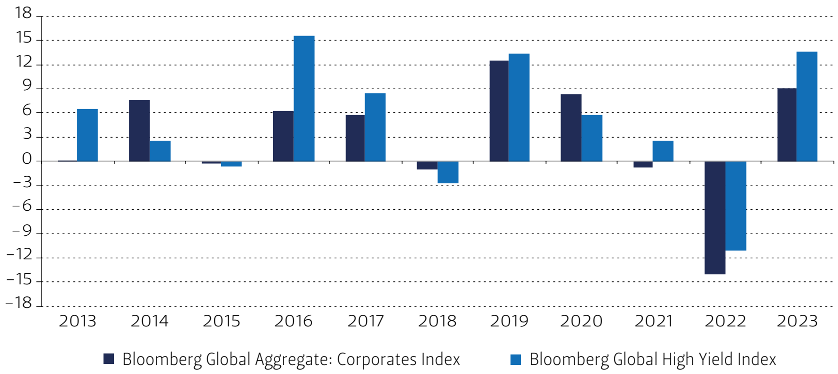
Bloomberg: Global Aggregate Treasury bonds (hedged) and U.S. MBS (hedged), 2013 - 2023
(percent, measured in local currency)



SOURCE: Bloomberg

FIGURE 20

Bloomberg Global: Aggregate Corporates (hedged) and High Yield (hedged), 2013 – 2023
(percent, measured in local currency)

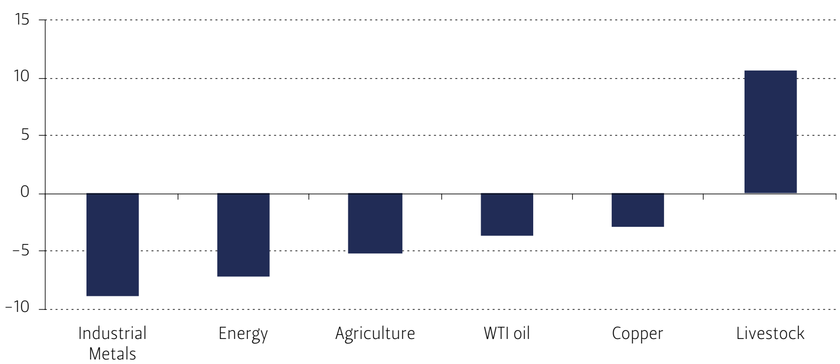


SOURCE: Bloomberg

Average commodity prices declined across most sectors in 2023 compared to 2022, with the exception of livestock. Industrial metals and energy experienced the steepest declines, falling 8.9% and 7.2%, respectively. Oil and copper prices also decreased by 2.3% and 3.7%, respectively (see Figure 21)

FIGURE 21

Standard & Poor's commodity index in 2023
(year-on-year change, percent)



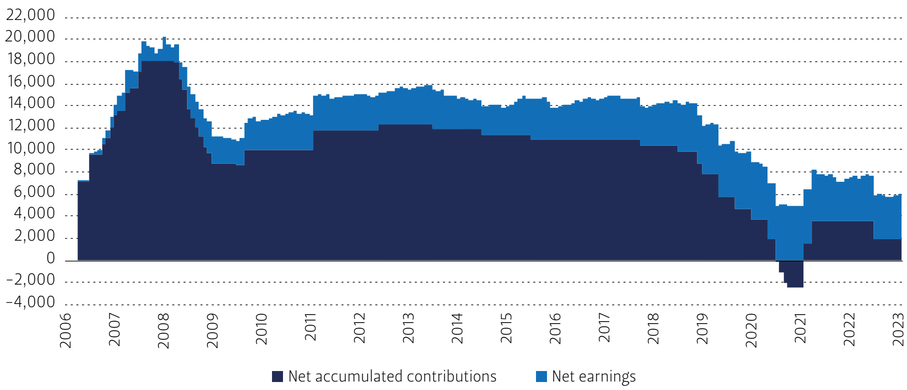
SOURCE: Bloomberg

B. Market value

At the end of 2023, the market values of the ESSF and the PRF reached US$ 6,030 million and US$ 8,639 million, respectively, compared to US$ 7,514 million and US$ 6,475 million at the end of 2022. The negative variation in the ESSF value was mainly due to a withdrawal of US$ 1,641 million, partially offset by net investment gains of US$ 156 million (see Figure 22). On the other hand, the positive variation in the PRF was mainly due to a contribution of US$ 1,641 million and net investment gains of US$ 823 million, offset by a withdrawal of US$ 300 million (see Figure 23). It should be noted that the contribution to the PRF was entirely funded by the ESSF.

FIGURE 22

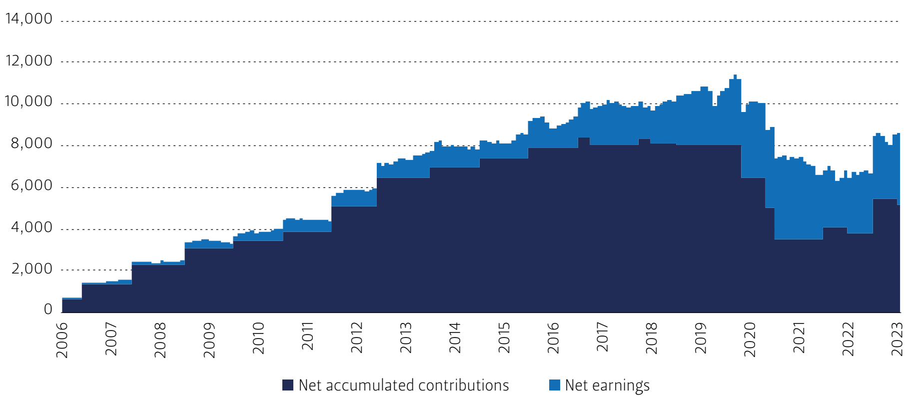
ESSF: Market value, March 2007 to December 2023
(millions of dollars)



SOURCE: Ministry of Finance of Chile

FIGURE 23

PRF: Market value, March 2007 to December 2023
(millions of dollars)



SOURCE: Ministry of Finance of Chile

C. Returns

In 2023, the net return in dollars was 2.36% in the ESSF and 11.35% in the PRF (see Table 5).

The ESSF' return for the year was primarily driven by the yield obtained from the Treasury bills and sovereign bond portfolio of 2% and inflation-linked sovereign bonds of 4.68%. It should be noted that starting from November 2nd, 15% of the fund was invested in U.S. agency MBS, which yielded a 6.58% return from the start of its investment until the end of the year, contributing to the overall portfolio return.

The PRF generated a positive return of 11.35% in 2023, as previously noted. This return is broken down into yields of 4.2% for sovereign and government-related bonds, 5.63% for inflation-linked bonds, 5.06% for U.S. agency MBS, 9.65% for corporate bonds, 13.96% for high yield bonds, and 22.43% for equities (see Box 5).

The funds' return expressed in Chilean pesos depends on the peso-dollar exchange rate. Thus, the value of the portfolio expressed in pesos increases (decreases) when the peso depreciates (appreciates) against the dollar. In 2023, the Chilean peso depreciated against the dollar in 2.92%, which explains the higher annual returns in national currency of 5.35% in the ESSF and 14.60% in the PRF. The real return of the funds, which is calculated by taking the nominal return in pesos and discounting the variation in the Unidad de Fomento (UF) for the respective period, was 0.54% for the ESSF and 9.37% for the PRF.

TABLE 5[27]

ESSF and PRF: Determinants of returns in dollars, 2023
(percent)

Fund	Component	Quarter				2023
		I	II	III	IV	
ESSF	Treasury bills and sovereign bonds	2.45	-1.76	-3.30	4.81	2.00
	Inflation-linked sovereign bonds	3.33	-0.89	-1.88	4.18	4.68
	U.S. agency MBS[(a)]				6.58	6.58
	Total return (USD)	**2.48**	**-1.73**	**-3.25**	**5.05**	**2.36**
	Total return (CLP)	-5.89	-0.07	9.30	2.48	5.35
	Total return (Real in UF)	-7.12	-1.49	8.98	0.83	0.54
PRF	Sovereign and government-related bonds	2.97	-2.28	-4.12	8.01	4.20
	Inflation-linked sovereign bonds	4.52	-1.78	-5.02	8.32	5.63
	U.S. agency MBS	2.45	-0.57	-4.09	7.52	5.06
	Corporate bonds	3.48	0.12	-2.73	8.81	9.65
	High Yield bonds	3.36	1.94	-0.26	8.44	13.96
	Equities	7.39	6.27	-3.37	11.02	22.43
	Return LTIP (USD)	**4.51**	**1.17**	**-3.46**	**9.10**	**11.35**
	Total return (USD)	**4.51**	**1.17**	**-3.46**	**9.10**	**11.35**
	Total return (CLP)	-4.03	2.88	9.07	6.42	14.60
	Total return (Real in UF)	-5.28	1.41	8.74	4.71	9.37

[(a)] Investments in U.S. agency MBS started on 2 November 2023.

SOURCE: Ministry of Finance of Chile

27 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.

Since the inception of the funds, the annual return in dollars as of year-end 2023 was 1.47% for the ESSF and 3.21% for the PRF. Expressed in Chilean pesos, the annual return for this full period was 4.51% for the ESSF and 6.30% for the PRF. Finally, the real annual return since inception was 0.27% for the ESSF and 1.99% for the PRF.

In 2023, the ESSF's and PRF's returns were 4 and 33 basis points lower than their benchmarks, respectively. Since 31 March 2007, the difference between the average annual return of the ESSF and PRF and their benchmarks was -4 basis points and -25 basis points, respectively.[28]

BOX 5: Factors affecting returns in the Sovereign Wealth Funds

The investment returns in the Sovereign Wealth Funds depend on a number of factors that affect the different types of instruments included in the different fund portfolios.

For the fixed-income portfolios, the main factors are interest rates, the credit quality of issuers, prepayment, and exchange rate fluctuations. Market interest rates level directly influence time deposit rates offered by financial institutions and sovereign bond rates at the time of issue. Moreover, changes in the interest rate level affect the price of fixed-income instruments that are traded in the market, especially in the case of medium- and long-term securities, where a rise has a negative effect, and a fall has a positive one. The credit quality of a fixed-income issuer also affects the price at which the security is traded in the market: a deterioration in quality causes the price to fall, while an improvement leads to an increase.[1] Additionally, all fixed-income instruments have some level of probability of default, that is, the probability that the issuer will not pay either the interest or the principal (or both). In investment-grade instruments, this probability is very low, but it increases with high-yield bonds.[2] Prepayment risk, in turn, mainly affects U.S. agency MBS, since the underlying assets are mortgage loans that can be refinanced if interest rates fall. If a mortgage is paid off early, the individual who refinances their mortgage loan returns the value of what is owed to the MBS investor.[3] Finally, since the funds' performance is measured in dollars and a large share of their portfolios are invested in instruments denominated in other currencies, exchange rate fluctuations against the dollar will have an effect on yields.

For the equity portfolios, returns will largely depend on the market's perception of the issuing corporation's income generation capacity and the risks associated with the company, as well as market financial conditions.

1 In the case of corporate bonds, credit quality is generally measured through the spread, that is, the difference between the bond's interest rate and the benchmark sovereign interest rate. An increase (decrease) in the spread on a corporate bond is associated with a reduction (increase) in the bond's value.

2 To mitigate this risk in high-yield bonds, the contracted external managers carry out an exhaustive analysis of each issuer in order to avoid these defaults to the extent possible.

3 If the par value is greater (less) than the present value of future payments, the investor experiences a gain (loss) on the prepayment. Also, prepayment risk also affects some corporate bonds that give the issuer the option of prepaying the debt it has issued.

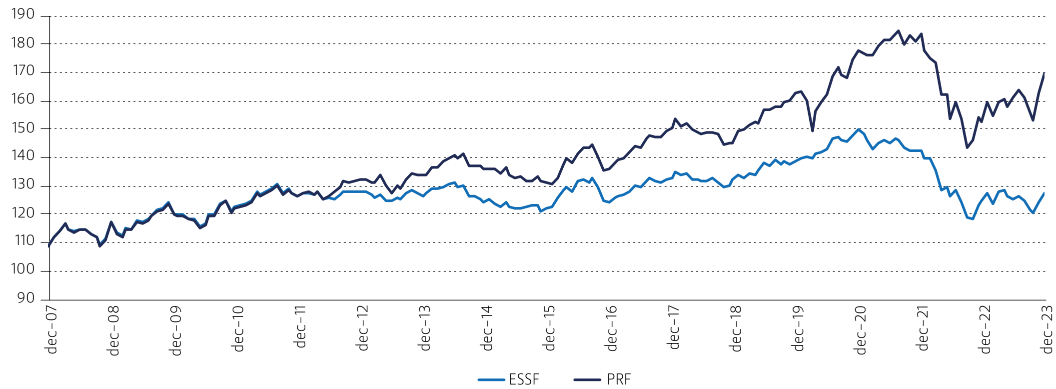
28 This means that the manager's portfolio generated lower returns, on average, than the implicit benchmark portfolio in the full period (2007–2023).

Figure 24 shows the index of accumulated returns for each fund. For the ESSF, the index increased 27.6% between 31 March 2007 and year-end 2023; for the PRF, the increase was 69.8% in the same period. The Figure illustrates how the two funds' returns began to differentiate in 2012, when the PRF investment policy was changed.[29]

The internal rate of return in 2023 was 2.35% and 11.35% for the ESSF and PRF, respectively.

FIGURE 24

ESSF and PRF: Accumulated returns index, in dollars
(31 March 2007 = 100)



SOURCE: Ministry of Finance of Chile

29 The investment policies of both funds were identical before 2012.

CHAPTER 3

Activities and Recommendations of the Financial Committee

A. New strategic asset allocation for the ESSF

In April, the Finance Committee advised the Minister of Finance to revise the ESSF' strategic asset allocation, considering: (i) the Minister's guidelines for the fund's purpose (see Chapter 1 Section B); (ii) the analysis conducted by the Technical Secretariat as summarized in this section; and (iii) the IMF's technical assistance on the fund's appropriate size (see Box 6).

BOX 6: IMF Technical Assistance on the Management of the Economic and Social Stabilization Fund under the Structural Balance Rule.

Following the recommendations of the Finance Committee, the Ministry of Finance requested technical assistance from the International Monetary Fund (IMF) in early 2023 to support the Committee's work in defining the strategic asset allocation of the ESSF. The terms of reference for the technical assistance included the following: i) reviewing relevant cases of international experience on the use of stabilization funds and their role in implementing structural balance rules; ii) describing different types of "tail" events that could affect the Chilean economy and explaining and quantifying the macroeconomic and financial implications of each event, as well as estimating how quickly financing would be required; and iii) estimating the minimum size of the ESSF necessary to support the financing of the aforementioned events.

The main recommendations of the International Monetary Fund to the Ministry of Finance are presented below:

1. Maintain a high degree of flexibility in contributions to and withdrawals from the ESSF.
2. Maintain sovereign fund investment policies aligned with their objectives and seek their integration into the sovereign asset and liability management strategy.
3. Periodically review investment strategies, taking into account the government's risk preferences and investment horizon.
4. Continue to strengthen fiscal risk management, for example, by developing an integrated framework for sovereign asset and liability management.
5. Rebuild fiscal buffers over the medium term through gradual fiscal efforts; adjusting the pace according to society's risk tolerance and the nature of shocks; avoid accumulating liquid reserves through borrowing.
6. Apply integrated asset and liability management, so that the level of gross debt and the size of the ESSF liquidity buffer are considered jointly.
    - Maintain the current limit of 45% of GDP for gross debt. Avoid establishing a double anchor in the Fiscal Responsibility Law on the debt ceiling and the minimum size of the ESSF.
    - Considering the current level of debt and the planned fiscal adjustments, it is considered prudent to maintain between 5% and 7% of GDP invested, in the medium term, in liquid reserves in the ESSF to be able to respond to adverse shocks.

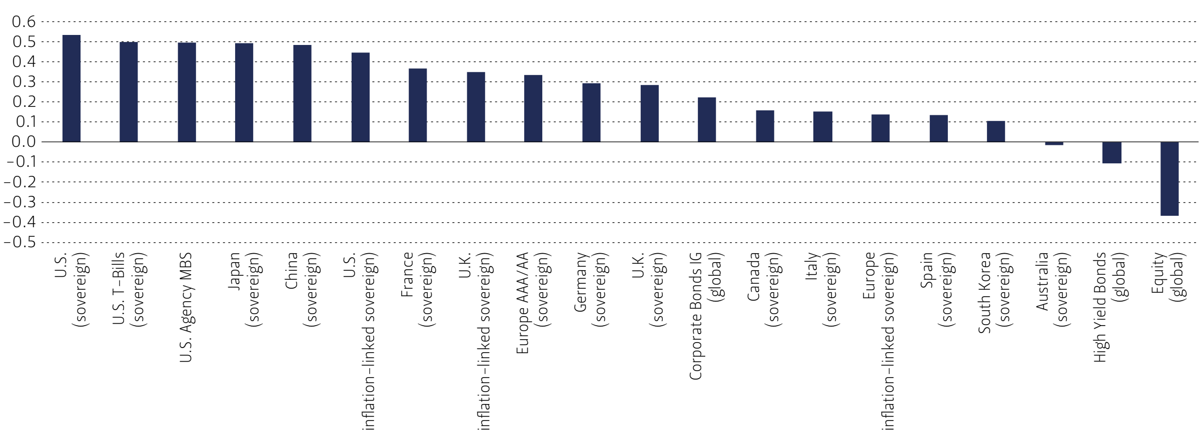
The Finance Committee recommended that, while the fund's size is up to 5% of GDP, it should be invested in a defensive portfolio whose primary objective is to maximize its market value in pesos during infrequent, high-impact events that can cause financial stress, at which point the probability of using the ESSF increases, relative to other events where, although less severe, the conditions for withdrawals are met. It should be noted that the suggestion of building a defensive portfolio for up to 5% of GDP is slightly less protective than what was proposed in the IMF technical assistance, which suggested a fund size of between 5% and 7% of GDP, as the high opportunity cost of reserving too many resources in this defensive fund was considered.

Considering that the size of the ESSF at the end of December 2023 was approximately equivalent to 1.9% of GDP, and as indicated in the previous paragraph, the Committee analyzed the fund's strategic asset allocation considering that it was a defensive portfolio. It was suggested that if the fund's size exceeds 5% of GDP, the investment policy should be reviewed again with the objective of obtaining higher returns, fundamentally in terms of the resources that exceed that limit.

The analysis of the strategic asset allocation was carried out in several stages. In the first stage, different market indices representing bonds issued by major countries, or by a group of them, or by companies, and stocks were selected to analyze their behavior at times when Chile faces financial stress. For the foregoing, the correlation of their real returns in pesos with the Credit Default Swaps (CDS) of Chilean sovereign bonds at 5 years was analyzed, selecting those indices that had the highest correlation (see Figure 25). Those with the lowest liquidity were also excluded (see Box 7), since it can be significantly affected in times of global market stress, a situation in which it is more likely to use the fund (see Figure 26). In the second stage, the expected return in real pesos, volatilities, and covariances of the chosen instruments were estimated. In the third, an optimization process was applied to derive efficient portfolio allocations that maximize expected returns across different risk levels.[30] In the fourth stage, the Committee conducted stress tests to analyze the behavior of the different portfolios on the efficient frontier and compared them with the one that the ESSF had at that time. Finally, taking the foregoing into account, it selected one that had a volatility level similar to that of the ESSF' previous strategic asset allocation, increased its expected return by approximately 30 basis points, and had good behavior in crises (see Figures 27 and 28). The selected strategic asset allocation was recommended to the Minister of Finance in April 2023 (see Figure 29).

FIGURE 25

Correlations of selected market index returns relative to 5-year Chilean CD[31]
(between -1 and 1)



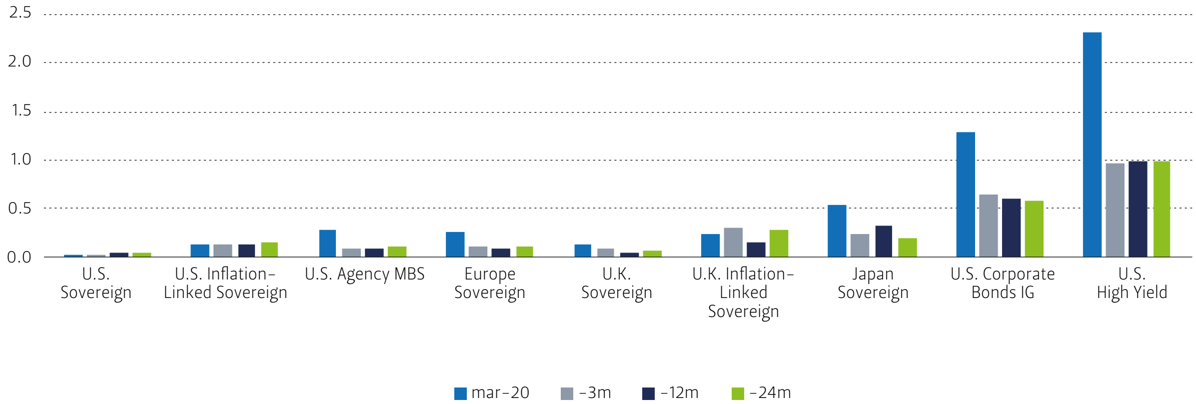
SOURCE: Ministry of Finance of Chile

30 To construct the efficient frontiers, constraints were applied to reflect the relative significance of various countries and instrument types within the global sovereign fixed-income index and the U.S. agency MBS index.

31 These correlations show the relationship between the monthly changes in market index returns and the monthly changes in 5-year Chilean CDS (from February 2003 to December 2022). A positive correlation suggests that the index return in peso strengthened when CDS rose.

FIGURE 26

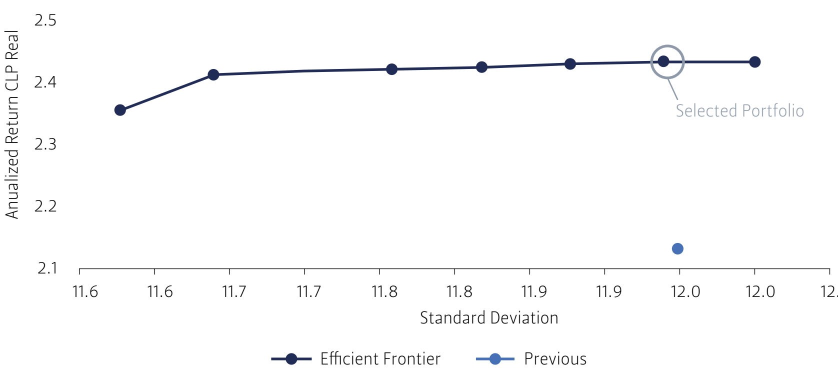
Bid-Ask Spread of Selected Instruments - March 2020, and 3, 12, and 24 months prior[32]
(percent)



SOURCE: Barclays

FIGURE 27

Efficient frontier and previous strategic asset allocation of the ESSF
(percent)

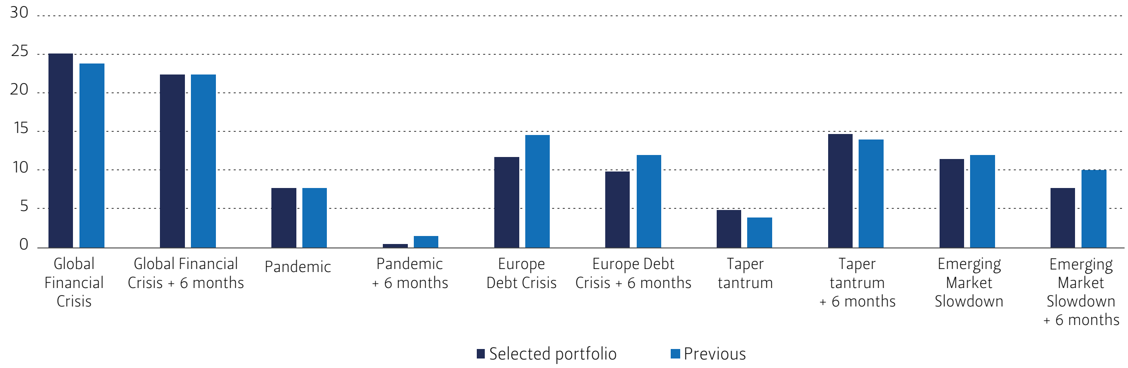


SOURCE: Ministry of Finance of Chile

32 "Market Liquidity Snapshot March 2020", Quantitative Portfolio Strategy, Barclays. The figure represents the time series of the Liquidity Cost Score (LCS), which measures the cost of buying and selling an instrument immediately and is calculated as a percentage of the bond price. The figure illustrates a comparison of how the liquidity of various instruments performed during the peak impact of the Covid-19 pandemic on financial markets in March 2020, relative to 3, 12, and 24 months earlier.

FIGURE 28

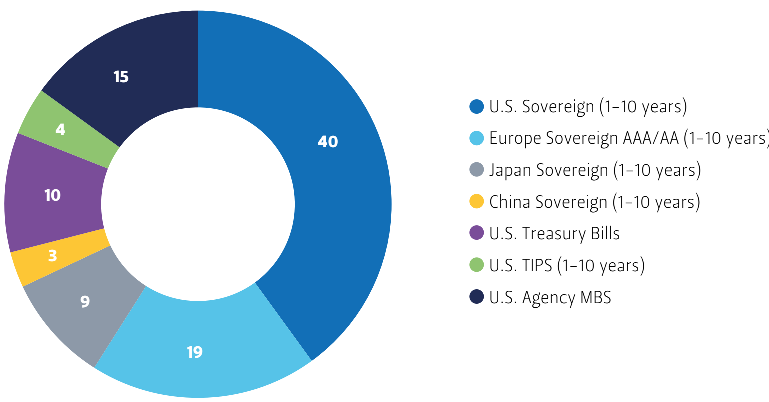
Backtesting of new and previous strategic asset allocation during crises[33]
(real return in CLP for the period)



SOURCE: Ministry of Finance of Chile

FIGURE 29

Proposed strategic asset allocation for the Ministry of Finance
(percent of portfolio)



SOURCE: Ministry of Finance of Chile

33 Crises in this analysis refer to periods of global stock market declines. While withdrawals from the ESSF may not always align with these events, the performance of the portfolios was also assessed six months after such crises.

BOX 7: Bid/Ask Spread and Transaction Cost

The Bid/Ask Spread represents the difference between the purchase price (Ask) and the selling price (Bid) of a financial instrument.

The Bid/Ask Spread is calculated as follows and is usually expressed in basis points:

$$\text{Bid/Ask Spread}_t = \frac{\text{Ask}_t - \text{Bid}_t}{\text{mid - point}_t} \times 10.000, \text{ where mid-point}_t = \frac{\text{Ask}_t + \text{Bid}_t}{2}$$

To the extent that this spread is smaller, it is understood that the instrument is more liquid.

Also, there are no explicit transaction costs for fixed income instruments (e.g. fees). The market convention is that the transaction cost is calculated from the Bid/Ask Spread. It is assumed that the fair price of the instrument is between the Ask and Bid price. Thus, an investor who buys the instrument at the Ask price is paying a little more than the fair price, and the one who sells it at the Bid price is receiving a little less. From this point of view, the transaction cost is usually calculated in relation to the average of the Bid/Ask Spread (mid-point).

B. Modifications to the ESSF investment guidelines

To implement the new strategic asset allocation of the ESSF, the Committee modified some aspects of the investment guidelines that were in effect until mid-2023. The main modifications are described below:

Portfolio managed by the CBC

- The ex-ante tracking error risk budget was reduced from 50 basis points to 25 basis points, which is more consistent with a passive mandate.
- The possibility of investing in instruments issued by supranational entities, agencies, and entities with explicit government guarantees was eliminated, as they were not part of the instruments included in the analysis to define the strategic asset allocation, and investing in them would diverge from a passive mandate.
- The benchmarks for the different countries were modified to be consistent with the market indices used in the strategic asset allocation analysis (see Table 2).

U.S. agency MBS

- U.S. agency MBS were incorporated as a new asset class, using investment guidelines identical to those used in the PRF.

C. Analysis of the PRF

The Committee analyzed the current and future situation of the PRF, considering the legal modifications it has undergone as a result of the creation of the UGP (see Table 6 and Box 1) and its size reduction due to the pandemic.

TABLE 6

Current rules for contributions, withdrawals, and termination of the PRF and proposals presented in 2022

Rules	Current Situation	Amendments submitted in August 2022*
Contributions	Minimum of 0.2% of the previous year's GDP If there is a surplus, up to 0.5% of the previous year's GDP is contributed	if there is a deficit, no contributions are made If there is a surplus, up to 0.5% of the previous year's GDP is contributed
Withdrawals	Up to 0.1% of the previous year's GDP	Up to 0.1% of the previous year's GDP
Termination	If the amount withdrawn is less than 5% of the annual expenditure of the UGP and SPD	If PRF is less than 0.5% of the previous year's GDP

*These amendments are not yet discussed in Congress.

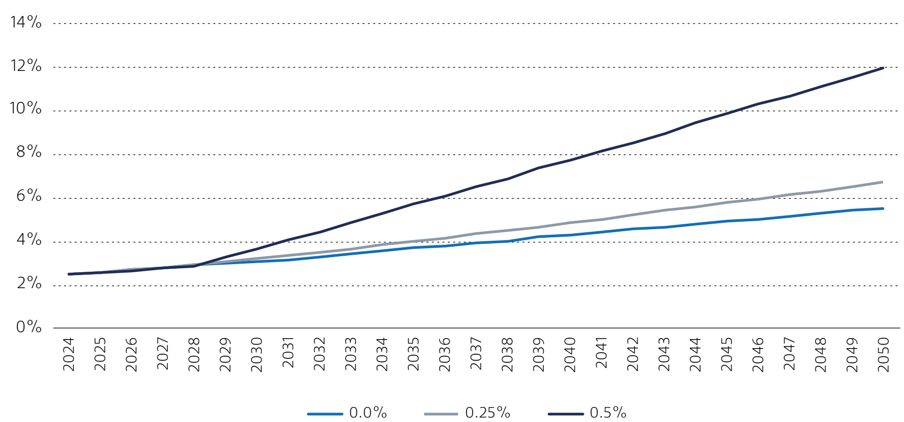
SOURCE: Ministry of Finance of Chile

Current Status

The PRF is currently mandated to receive a minimum contribution of 0.2% of the previous year's GDP, regardless of fiscal deficits. Additionally, it can receive contributions equivalent to fiscal surpluses up to a maximum of 0.5% of the previous year's GDP. Consequently, the fund has been steadily accumulating resources as annual contributions consistently exceed withdrawals, which are capped at 0.1% of GDP (refer to Figure 30). It's noteworthy that the current withdrawal limit of 0.1% of GDP is below the 5% threshold of annual expenditures on the UGP and SPD, which would normally trigger the fund's termination under existing rules. However, the 2024 Budget Law, enacted in mid-December 2023, has extended the PRF's existence until 31 December 2024, as a temporary measure.

FIGURE 30

PRF size under various fiscal balance scenarios - current regulations
(percent of GDP)



SOURCE: Ministry of Finance of Chile and Budget Office

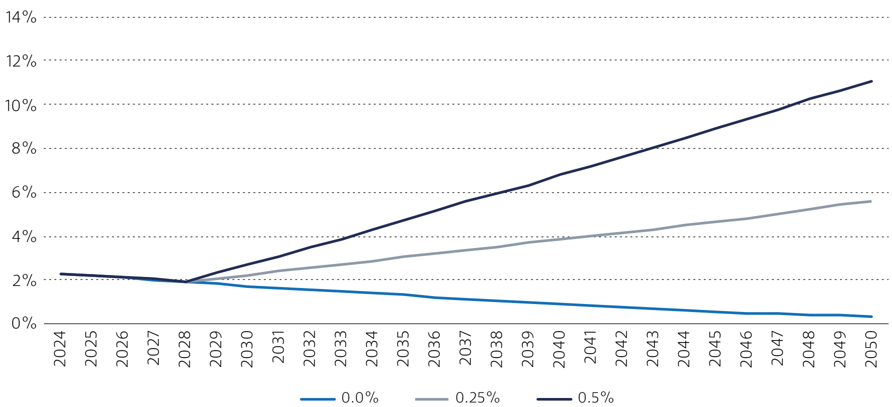
Situation of the proposals presented to the National Congress in 2022

The proposals presented to the National Congress in August 2022 have the main objective of avoiding having to contribute to the PRF during periods in which fiscal deficits are incurred. This prevents the government from going into debt to finance said contribution or from financing it through the ESSF. At the same time, they modify the fund's extinction rule so that it depends on its size and not on the relative importance of withdrawals in relation to the UGP and SPD.

Figure 31 shows the behavior of the PRF under different fiscal balance scenarios, assuming that the proposals are approved. In the case where fiscal surpluses greater than 0.2% of GDP were always experienced, it is found that the behavior of the PRF would be identical to that estimated under the current rules. However, in the scenario where only fiscal deficits were experienced in the future, the fund would gradually decrease in size until the extinction clause is triggered in the mid-2040s.

FIGURE 31

PRF size under various fiscal balance scenarios - after the approval of the proposals
(percent of GDP)



SOURCE: Ministry of Finance of Chile and Budget Office

Endowment Situation

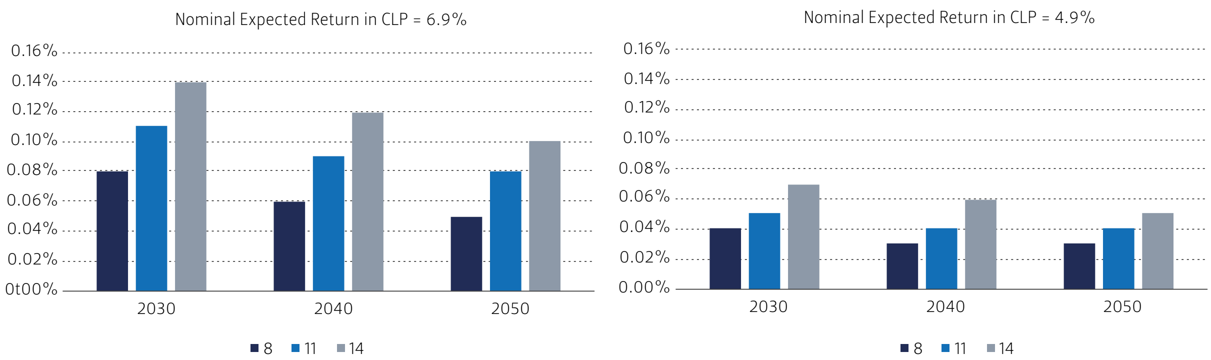
Alternatively, the Committee analyzed the possibility of the PRF operating under an endowment model, that is, withdrawing a portion of the obtained return in order to keep the real value of the fund constant. The foregoing, with the objective of exploring said model in order to make the PRF sustainable over time.

The analysis found that the current PRF size is insufficient to sustain withdrawals exceeding 0.1% of GDP while preserving the fund's real value, even under high-return scenarios. To achieve a 0.1% withdrawal rate, the PRF would need to be capitalized to US$ 14 billion and earn a 7% return. However, as a percentage of GDP, withdrawals would decline due to slower fund growth compared to the economy.

Consequently, an endowment model cannot fund a substantial share of the annual costs of UGP and SPD, which account for approximately 2.4% of GDP.

FIGURE 32

Expected PRF (endowment) withdrawals for different fund sizes (US$ 8, 11, and 14 billion) and nominal peso return scenarios (percent of GDP)



SOURCE: Ministry of Finance of Chile

D. Tax management in Sovereign Wealth Funds

The Finance Committee, in its October session, conducted an in-depth analysis of how tax management is carried out in Sovereign Wealth Funds and quantified its impact on their profitability. It was concluded that the most relevant entities in its management are the CBC, in its capacity as Fiscal Agent, and the custodian bank; however, it was observed that it is occasionally necessary to use the services of a Tax Advisor. The following describes the main functions of each.

CBC: prepares and manages tax documentation, pays and controls taxes, carries out procedures for tax refunds, and requests the services of a Tax Advisor if it deems necessary.

Custodian bank (and network of sub-custodians): carries out the withholding and payment of taxes to the tax authority of the corresponding country (in the case of non-custodial instruments it may be the counterparty);[34] completes tax claims for the recovery of taxes[35] and submits them to the corresponding tax authority; and informs the CBC about the current tax rates for each market and tax changes.

Tax Advisor: evaluates new markets and investments, pays taxes when there is no withholding agent, resolves differences between what is paid by the custodian bank and what the CBC believes should be paid. Additionally, it is used when the regulator requires the use of a tax advisor and when the custodian bank cannot perform certain tasks.

It is worth noting that the CBC reported that in 2022 the Sovereign Wealth Funds paid, after recoveries, the equivalent of 2.4 basis points of their value in taxes.

34 In some instances, the tax advisor is responsible for this task.

35 Either directly or via a network of sub-custodians or agents in each market.

E. Responsible investing

At the Finance Committee's final session of the year, the Ministry of Finance presented a series of general proposals on Environmental, Social, and Governance (ESG) matters for the Committee's information. These proposals represent the Ministry's views on ESG issues as they relate to Chilean Sovereign Wealth Funds. The proposals covered broad aspects such as the importance of considering all types of risk in fund management, including those associated with ESG factors, the relevance of active ownership, the flexibility offered by active management to incorporate ESG considerations, the impact that climate change can have on risk-adjusted returns in the long term, and the Ministry's commitment to transparently disclose how these types of considerations will be incorporated into Sovereign Wealth Funds. The Committee took note of the foregoing and stated that it would use these proposals as a guide for the work to be done regarding the Minister of Finance's request to evaluate the incorporation of Responsible Investment in the funds.

In this context, the consulting firm Mercer, contracted by the Ministry of Finance to assist in analyzing how to incorporate Responsible Investment into Chilean Sovereign Wealth Funds, presented evidence to the Committee underscoring the growing importance of these considerations for asset owners and regulators, who are increasingly demanding the evaluation of associated risks. It also presented how investors typically incorporate climate change into their portfolio management. Among its recommendations, it highlighted the need to initially focus on incorporating considerations related to climate change into a small portion of the PRF's equity portfolio. This recommendation was based on the priorities defined within the framework of the Ministry of Finance's ESG beliefs. In principle, the Committee expressed its agreement with the foregoing, but requested the Technical Secretariat to evaluate, together with the consulting firm, more specific proposals to understand their impact on portfolio returns and the risks involved.

F. ESSF rebalancing policy

The Finance Committee reviewed and proposed a rebalancing policy for the ESSF this year. This is to prevent highly volatile assets from significantly altering the portfolio's composition and risk profile, deviating from the investment policy.

The recommended policy triggers rebalancing to the target asset allocation when there are contributions/withdrawals or if any asset class diverges more than ± 2% from its target for 30 consecutive days.

FIGURE 33

ESSF rebalancing policy
(percent of portfolio)

Asset Class	Strategic Asset Allocation	Allowable Deviation Range
Sovereign Fixed Income	85	83 - 87
U.S. agency MBS	15	13 - 17

SOURCE: Ministry of Finance of Chile

G. Monitoring of external managers

The Finance Committee received delegations from the CBC, BNP Paribas, Mellon, and UBS, who must present annually to the members of the Finance Committee and the Ministry of Finance on the management of their portfolios. In these presentations, each manager details the results of their management, explaining the reasons for their performance, their investment methodologies and main positions, as well as the market situation. All these visits are part of the activities that these managers must carry out to account for their management.

APPENDIX 1 CURRENT AND FORMER FINANCIAL COMMITTEE'S MEMBERS

Members	Position	Incorporation Date	Departure Date
Juan Andrés Fontaine Talavera	President	August 2021	-
Macarena Pérez Ojeda	Vice-president	August 2021	-
Pablo Castañeda Navarrete	Counselor	August 2022	-
Nicolás Eyzaguirre Guzmán	Counselor	August 2021	-
Jennifer Soto Urra	Counselor	August 2022	-
Marcela Valenzuela Bravo	Counselor	August 2022	-
Mauricio Villena Chamorro	Counselor	August 2021	August 2022
Ricardo Budinich Diez	Counselor	August 2016	August 2022
Martín Costabal Llona	Counselor	August 2007	August 2022
José De Gregorio Rebeco	President	September 2014	August 2021
Cristián Eyzaguirre Johnston	Counselor Vice-president	March 2010 September 2011	August 2021
Jaime Casassus Vargas	Counselor	September 2014	August 2021
Paulina Yazigi Salamanca	Counselor	September 2018	August 2021
Igal Magendzo Weinberger	Counselor	September 2014	September 2018
Eduardo Walker Hitschfeld	Counselor	August 2007	August 2016
Arturo Cifuentes Ovalle	President Counselor	January 2014 August 2011	August 2014
Rodrigo Valdés Pulido	Counselor	February 2014	April 2014
Eric Parrado Herrera	Counselor	August 2011	March 2014
Klaus Schmidt-Hebbel Dunker	President Counselor	August 2011 September 2009	January 2014
Andrés Bianchi Larre	President	August 2007	August 2011
Ana María Jul Lagomarsino	Vice-president	August 2007	August 2011
Andrés Sanfuentes Vergara	Counselor	August 2007	March 2010
Oscar Landerretche Moreno	Counselor	August 2007	June 2009

APPENDIX 2 SUMMARY OF MEETINGS IN 2023

MEETING 1 | 23 JANUARY 2023

At its first meeting of the year, the Committee analyzed new data regarding the ESSF in order to make a recommendation to the Minister of Finance regarding its strategic asset allocation. In particular, it recommended that, given its current size, the ESSF should be invested according to a defensive portfolio that would increase in value when the CDS of bonds issued by the Chilean State increase. It recommended basing the selection of instruments for the strategic allocation study on their correlations with these CDS. Additionally, it suggested that the ESSF maintain 10% in U.S. Treasury bills. Furthermore, the Technical Secretariat was requested to incorporate constraints into the optimization process for obtaining the efficient frontier that reflect the relative weights of each country in the global fixed-income index. On the other hand, the Committee was informed that the IMF had been tasked with providing technical assistance to evaluate the size of the ESSF in the context of the objectives defined for the fund. Finally, the following stages for the preparation of the Finance Committee's annual report were agreed upon.

MEETING 2 | 23 MARCH 2023

In its second session, the Committee evaluated different investment portfolio alternatives for the ESSF, taking into account the fund's objective and the analyses presented by the Technical Secretariat. After an exchange of views, and unanimously, the strategic asset allocation to be recommended to the Minister of Finance was agreed upon. It was decided to submit the proposal to the Minister during the month of April for approval. On the other hand, an IMF representative presented the analysis and conclusions of the technical assistance provided regarding the ESSF. Considering the above, the Committee recommended that as long as the size of the fund is less than or equal to 5% of GDP, it should be invested defensively. Finally, representatives from the CBC, the institution responsible for investing sovereign mandates in the ESSF and PRF, presented the results of their management in 2022.

MEETING 3 | 27 APRIL 2023

At the third meeting, the Committee's President conveyed to the members the main messages from his meeting with the Minister of Finance, Mario Marcel, on 20 April 2023. It was reported that, during this meeting, the annual report of the Finance Committee was delivered and the recommendations for the new strategic asset allocation for the ESSF, which had been agreed upon at the last meeting, were presented. It was communicated that the Minister accepted all the Committee's proposals. Furthermore, it was reported that the Minister reiterated his intention for the PRF to maintain a long-term investment horizon, in alignment with the amendments to the Fiscal Responsibility Law submitted in August 2022. Subsequently, the main elements of the investment guidelines for the new strategic asset allocation of the ESSF were analyzed, highlighting the passive emphasis on its investments and the focus on investing primarily in the issuers and instruments that were considered in the asset allocation study conducted by the Technical Secretariat. Additionally, it was recommended to use the same managers who currently manage the U.S. agency MBS portfolio in the PRF: BNP Paribas and Western Asset. Subsequently, the scope of the main activities to be carried out by the consultant who will replace the consulting firm RVK, Inc., whose contract was terminated in 2022, was analyzed. On the other hand, it was recommended to hire a new corporate bond manager for the PRF, considering that UBS manages the entire asset class after the termination of the contract with Credit Suisse in 2022. Finally, the main results of the Sovereign Wealth Funds and their positioning relative to their respective benchmarks were analyzed.

MEETING 4 | 13 JULY 2023

In its fourth session, the Committee met with the Mellon team, responsible for investing part of the PRF's equity portfolio. On this occasion, the firm presented its management and provided an overview of the international markets. Subsequently, the Committee was informed about the status of the implementation of the new strategic asset allocation for the ESSF and that its launch is expected for the last quarter of the year. Next, a rebalancing policy for the fund was discussed and agreed upon. With respect to the FRP, it was recommended to align the timing of future contributions with withdrawals to mitigate the foreign exchange risk associated with the latter. Additionally, it was suggested to explore alternative methods for hedging this risk, in case the mandatory minimum annual contribution to the fund is eventually eliminated. In another point, a representative of the Ministry of Finance informed that, following a selection process carried out by the Sovereign Wealth Funds Unit of the Ministry, the consulting firm Mercer was selected to assume the functions previously performed by RVK. The Committee expressed no objections to the selection process or to the firm selected. Finally, the status of the Sovereign Wealth Funds was analyzed.

MEETING 5 | 24 AUGUST 2023

In its fifth session of the year, the Committee met with a delegation from UBS, the firm responsible for managing the corporate bond portfolio and half of the equity portfolio in the PRF. On this occasion, the firm presented its management of both portfolios and provided an analysis of the current state of the international markets. Subsequently, the importance of establishing the frequency with which the strategic asset allocations of each fund should be reviewed was discussed, and the Technical Secretariat was requested to make a proposal at a future meeting. Finally, the Committee was informed about the progress of the implementation of the changes to the investment policy of the ESSF and the status of the Sovereign Wealth Funds was reviewed.

MEETING 6 | 12 OCTOBER 2023

In its sixth session of the year, the Committee met with representatives from the CBC, who presented on the management of taxes in Sovereign Wealth Funds. Additionally, this entity reported on the implementation process of the new strategic asset allocation for the ESSF, indicating that its launch is expected for the beginning of November 2023. Next, a delegation from BNP Paribas, responsible for managing part of the U.S. agency MBS portfolio, presented the results of its management and reported on the current state of the international markets. Subsequently, the current situation of the PRF was analyzed in the context of the tax obligations associated with UGP and SPD, and a discussion was held regarding its objective and the scope that a strategic asset allocation study, expected to be carried out in 2024 for this fund, should have. On the other hand, the procedure that establishes the frequency with which the strategic asset compositions of Sovereign Wealth Funds should be reviewed was revised, and final comments were provided on this procedure. Finally, the status of the Sovereign Wealth Funds was analyzed.

MEETING 7 | 14 DECEMBER 2023

At its final meeting of the year, the Ministry of Finance presented to the Committee, for informational purposes, a series of general proposals on ESG matters that represent its view on how these issues are relevant to the investment of Chilean Sovereign Wealth Funds. Subsequently, Mercer presented to the Committee international trends in Responsible Investing and how it could be initially implemented in the funds. In this context, it recommended initially incorporating considerations related to climate change in a small portion of the PRF's equity portfolio. The Committee agreed with the above but requested the Technical Secretariat to evaluate, together with the consulting firm, more specific proposals to understand its impact on portfolio returns and the risks involved. On the other hand, the convenience of conducting an asset allocation study for the PRF was analyzed, taking into account the amendments to the Fiscal Responsibility Law submitted in August 2022, which could modify its current contribution and withdrawal rules. In relation to the foregoing, the fund's long-term projections were reviewed under different economic and regulatory scenarios. In conclusion, it was recommended to wait until there is more clarity regarding the modifications to the contribution and withdrawal rules before conducting a strategic asset allocation study for the fund. Then, it was reported that the new strategic asset allocation of the ESSF was successfully implemented at the beginning of November. Finally, the current status of the Sovereign Wealth Funds was analyzed.

References

> Castañeda P., Castro R., Fajnzylber E., y Medina J. (2020). "Estudio sobre la sustentabilidad del Fondo de Reserva de Pensiones", Budget Office (Dipres), Ministry of Finance, Chile.

> Comité Asesor para el diseño de una política fiscal de balance estructural de segunda generación para Chile (2011). "Propuestas para perfeccionar la regla fiscal, Informe Final," Paper prepared on request from the Ministry of Finance, Chile.

> García, M., P. García and B. Piedrabuena (2005). "Fiscal and Monetary Policy Rules: The Recent Chilean Experience," Working Paper, Central Bank of Chile.

> González L., J. Rivera (2020). "Nota de Investigación: Proyección de la Sostenibilidad Fiscal del Fondo de Reserva de Pensiones 2020-2050, Budget Office (Dipres), Ministry of Finance, Chile.

> Larraín, F., R. Costa, R. Cerda., M. Villena and A. Tomaselli (2011). "Una política fiscal de balance estructural de segunda generación para Chile," Estudios de Finanzas Públicas, Budget Office (Dipres), Ministry of Finance, Chile.

> Dirección de Presupuestos (2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, and 2022). "Indicador del Balance Cíclicamente Ajustado Metodología y Resultados", Budget Office (Dipres), Ministry of Finance, Chile.

> Marcel, M., M. Tokman, R. Valdés and P. Benavides (2001). "Balance estructural del gobierno central, metodología y estimaciones para Chile; 1987-2000," Estudios de Finanzas Públicas N° 1, Budget Office (Dipres), Ministry of Finance, Chile.

> Rodríguez, J., C. Tokman and A. Vega (2006). "Política de balance estructural: resultados y desafíos tras seis años de aplicación en Chile," Estudios de Finanzas Públicas N° 7, Budget Office (Dipres), Ministry of Finance, Chile.

> Schmidt-Hebbel, K. (2012). "Fiscal Institutions in Resource-Rich Economies: Lessons from Chile and Norway," Paper prepared for the conference "Understanding and Avoiding the Oil Curse in the Arab World," Kuwait.

> Velasco, A., A. Arenas, J. Rodríguez, M. Jorratt and C. Gamboni (2010). "El enfoque de balance estructural en la política fiscal en Chile: Resultados, metodología y aplicación al período 2006-2009," Estudios de Finanzas Públicas N° 15, Budget Office (Dipres), Ministry of Finance, Chile.

> Velasco, A., and E. Parrado (2012). "The Political Economy of Fiscal Policy: the Experience of Chile (95-133)," Oxford Handbook of Latin American Political Economy, Oxford University Press.

> Walker E. (2011). "Un asset allocation para el FEES," Paper prepared on request from the Ministry of Finance, Chile.

Glossary

Active management — an investment strategy that seeks to obtain a higher return than a given benchmark.

Alternative investments — investments other than those traditionally used (equities and fixed-income); they mainly include private equity, venture capital, hedge funds, commodities and real estate.

American depositary receipts (ADR) —negotiable certificate issued by a U.S. bank representing a specified number of shares (or one share) in a foreign stock traded on a U.S. exchange.

Asset class — a specific investment category such as equities, corporate bonds, sovereign bonds or money market instruments. Assets of the same class generally share characteristics that make them similar from a tax, legal and structural perspective, but this does not imply that they respond the same way to a given market event.

Basis point — one one-hundredth of a decimal point; 1 basis point = (1/100) of1%.

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

Cash — cash in hand and bank demand deposits.

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

Credit default swap (CDS) — a financial instrument used by investors as protection against default on a bond; can also be used to take a speculative position on a bond covered by the CDS.

Credit rating — the level of solvency of the issuer of a financial instrument (company or country) as defined by a credit rating agency.

Duration — a measure of the sensitivity of a bond's price to changes in interest rates: the longer the duration, the farther the bond's price will fall in response to an increase in interest rates.

Equities — securities that represent the ownership or capital of a company; buyers of equities become owners or shareholders of the company and thus have earnings or losses depending on the company's performance.

Ex ante tracking error— a measure of the difference between the return on an investment fund and its benchmark.

Exchange-traded fund (ETF) — a market-traded financial instrument that typically replicates a market index; traditionally used to obtain passive exposure to equity market indexes, but has expanded into fixed-income, commodities and even active strategies.

Fiscal Responsibility Law — Law N° 20,128, published in Chile's Official Gazette on 30 September 2006.

Fixed-income — investment instruments with a yield over a given period that is known at the time of their acquisition; sovereign and corporate bonds and bank deposits are fixed-income assets.

Global depositary receipts (GDR) —bank certificate issued in more than one country for shares in a foreign company. The shares are held by a foreign branch of an international bank. The shares trade as domestic shares but are offered for sale globally through the various bank branches.

Headline or reputational risk —the risk of an adverse public perception of an entity's management.

High Yield Bonds —non investment grade sovereign and corporate bonds.

Inflation-linked bond — a bond whose value varies in line with an inflation index; in the United States, these securities are known as Treasury Inflation-Protected Securities (TIPS).

Internal rate of return (IRR) — the effective yield on an investment, calculated taking the net present value of all cash flows as zero.

Investment policy — the set of criteria, guidelines and instructions that regulate the amount, structure and dynamics of an investment portfolio.

Leverage — the level of debt carried by a firm or investment vehicle.

LIBID — London interbank bid rate; the interest rate paid on interbank deposits. By definition, this rate is equal to the LIBOR minus 0.125%.

LIBOR — London interbank offered rate; the interest rate charged on interbank borrowing.

Liquidity —the degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price.

Money market instrument — a short-term asset with a maturity of less than a year, which can readily be converted into cash and is less volatile than other asset classes.

Mortgage-backed securities (MBS) from U.S. agencies — instruments that are secured by a mortgage related to the purchase of mortgage properties. These instruments are issued by Ginnie Mae, Fannie Mae and Freddie Mac.

Mutual fund — an investment vehicle managed by an entity that brings together the capital of different investors and provides them with exposure to different asset classes; unlike ETFs, mutual funds are not traded on the market.

Passive management — an investment strategy that seeks to replicate the return on a representative index of an asset class or combination of asset classes.

Portfolio — the combination of investments acquired by an individual or institutional investor.

Quantitative easing — an unconventional monetary policy tool used by some central banks to increase the money supply, usually through the purchase of the country's own government bonds.

Recognition bond (bono de reconocimiento) —an instrument issued by Chile's Pension Normalization Institute (Instituto de Normalización Previsional) representing a worker's contributions to the old pension system before joining the new (private) AFP system.

Return (total) — the combination of the return in local currency and the return generated by exchange rate fluctuations.

Return generated by exchange rate movements — the share of the return that is generated by variations in the value of the dollar against other currencies in which assets are held.

Return in local currency — the return generated by a financial instrument in the currency in which it is denominated; corresponds to the share of returns associated with the level of interest rates and their movements, creditworthiness and other factors.

Risk — the possibility of suffering a financial loss; the variability of the return on an investment.

Sovereign bond — a bond issued by a government.

Special Drawing Rights (SDR) — international reserve assets created by the IMF to supplement its member countries' official reserves. SDRs can be exchanged for freely usable currencies.

Spread — the difference between the yield rate at maturity of two fixed-income instruments; used to measure their level of relative risk.

Swift — Society for Worldwide Interbank Financial Telecommunication.

TED Spread — 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.

To Be Announced (TBA) — denotes the forward mortgage-backed securities (MBS) trade, and pass-through securities issued by Freddie Mac, Fannie Mae and Ginnie Mae.

Time-weighted rate of return (TWR) — a measure of return obtained by compounding or multiplying daily returns, excluding contributions and withdrawals; unlike the IRR, it excludes the effect of net cash flows.

Variable-income — equities.

VIX — the Chicago Board Options Exchange (CBOE) Volatility Index, which reflects market expectations for volatility over the next 30 days; based on the implied volatilities of a wide range of S&P500 index options.

Volatility — a measure of a financial asset's risk, representing the variation shown by its price over a period of time.