



2018

ANNUAL REPORT
**SOVEREIGN
WEALTH FUNDS**

MINISTRY OF FINANCE

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01 FOREWORD BY THE MINISTER

Chile's fiscal position has improved significantly since early 2018. The good performance is the result of both higher revenues and efforts to contain costs. Fiscal policy has contributed to the recovery of growth and investment and responsible public spending. The fruit of these efforts has been reflected in a reduction in the fiscal deficit of 1.2 points of GDP in 2018, resulting in the smallest deficit since 2014. The increased revenues are mainly associated with the growth recovery of the Chilean economy, while the cost reductions resulted in the lowest growth rate of spending since 2011, below the growth rate of the economy.

At the same time, the fiscal institutional framework has been improved through measures such as the creation, by law, of the Autonomous Fiscal Council, which will have the necessary resources and powers to support the responsible and sustainable management of public finances. This Council will consist of five members who will have the authority to submit their opinion in the event of possible deviations from the structural balance, as well as to commission reports and studies as needed, whose results will be presented twice a year in the National Congress. In addition, the frequency of macro-fiscal forecasts has been increased from two to four times a year, in line with international best practices in fiscal transparency. Thus, starting in 2019, four Public Finance Reports will be issued annually, one per quarter.

We have also committed to stabilizing the ratio of public debt to gross domestic product (GDP), and we will try to recover Chile's sovereign credit rating. To this end, we have reduced the debt issue plans. Thus, the 2019 Budget Law includes an authorization to issue additional public debt up to a maximum of US\$ 9.0 billion, the lowest amount since 2014 and less than the US\$ 9.5 billion authorized for 2018.

Our two sovereign wealth funds are a fundamental component of the fiscal responsibility policy. During periods of economic booms and high copper prices, a large share of the fiscal surpluses are accumulated in the Economic and Social Stabilization Fund (ESSF), creating insurance for facing fiscal deficits during adverse economic times. The Pension Reserve Fund (PRF), in turn, receives an annual contribution to generate savings that will complement future pension payments to the most unfortunate sectors of our country. These two funds provide the resources to support the sustainable financing of social programs, independently of the economic cycle, and the implementation of countercyclical measures in times of crisis.

At year-end 2018, the sovereign wealth funds together had a market value of US\$ 23,797 million, down from US\$ 24,750 million one year earlier. The reduction of US\$ 953 million was mainly due to withdrawals from the PRF, in accordance with the stipulations of the Fiscal Responsibility Law, totaling US\$ 525 million, plus net losses on investments in the two funds of US\$ 428 million. The net return in dollars in 2018 was -0.41% for the ESSF and -3.56% for the PRF. The return on the PRF tends to be more volatile than the ESSF in the short term, as a larger share is invested in riskier asset classes, but it has higher expected returns in the long run. Thus, since the inception of the funds, the PRF has had an annualized net return in dollars of 3.22%, versus 2.41% for the ESSF.

With regard to investment policies, work began on the ESSF investment policy study. The final objective of the study is to improve the fund's expected return over time, while ensuring the availability of sufficient liquidity to face episodes of financial stress.

In 2018, significant progress was made on the implementation of the new PRF investment policy, which was approved in November 2017. In the year, the Central Bank of Chile, in its role as fiscal agent of the sovereign wealth funds, selected the firms that will be responsible for investing the U.S. agency mortgage-backed security portfolio and the high-yield bond portfolio. At the same time, equity exposure began to increase gradually, to converge to 40% in early 2021. In 2019, we will begin to implement the real estate investment mandate and the hedging strategy.

The Finance Committee was commissioned with analyzing and recommending alternatives for incorporating environmental, social, and governance (ESG) criteria in the investment processes of the Chilean sovereign wealth funds. This decision is in line with global trends, whereby institutional investors and sovereign wealth funds are incorporating ESG criteria in their investment decisions. Furthermore, evidence shows that including these criteria does not have a negative effect on value.

We remain committed to the timely delivery of information to national and international observers, who have ranked our sovereign wealth funds among the most transparent in the world. As a result of these efforts, our funds have maintained the highest rating on the Linaburg-Maduell transparency index, developed by the Sovereign Wealth Fund Institute, since late 2009.

Finally, I want to reiterate our commitment to implementing initiatives that will allow our country to stay on a comprehensive development path, while safeguarding responsible fiscal policy, so as to ensure the continuity of social programs. As an administration, we are proud to report significant improvement in the country's fiscal position.

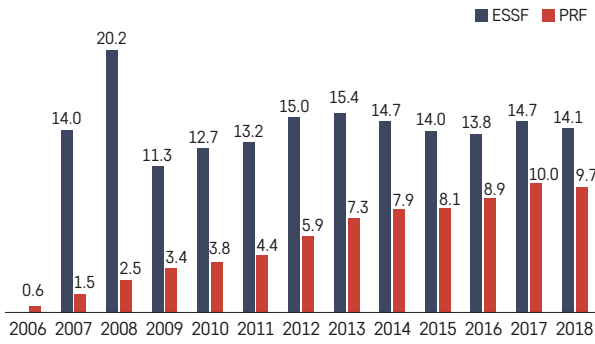
Felipe Larraín Bascuñán
Minister of Finance

02 SUMMARY

As of 31 December 2018, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US\$ 23,797 million. The net returns in dollars were -0.41% and -3.56% for the ESSF and PRF, respectively, in 2018 and 2.41% and 3.22% annual since their inception.¹

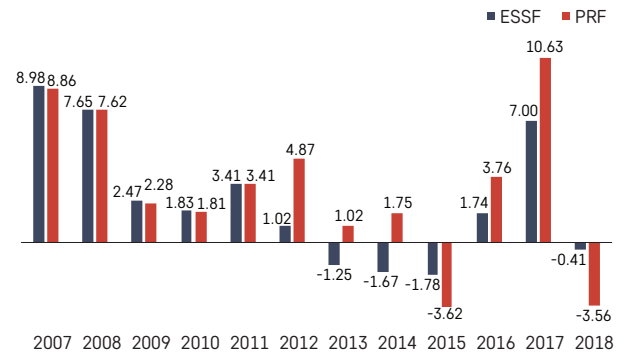
¹ The returns published in this report are based on the time-weighted rate of return (TWR) methodology, unless the use of the internal rate of return (IRR) is explicitly identified. Returns for periods of over one year are compound annualized rates. For periods of less than one year, the return corresponds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

F1 Market value (billions of dollars)



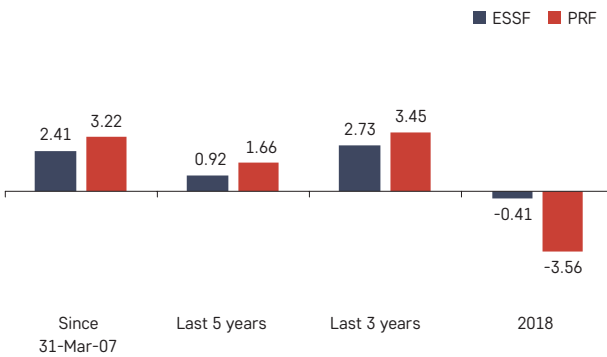
Source: Ministry of Finance

F2 Annual net return in dollars² (percent)



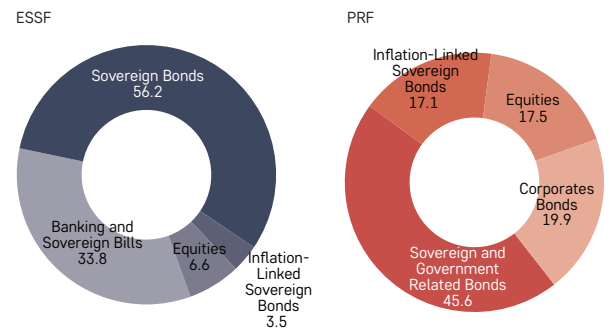
Source: Ministry of Finance

F3 Accumulated annual net return in dollars (percent)



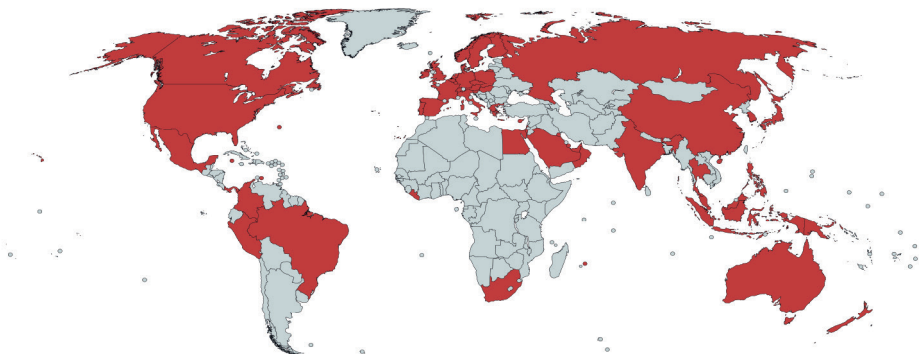
Source: Ministry of Finance

F4 Asset class allocation as of 31 December 2018 (percent of portfolio)



Source: Ministry of Finance

F5 Countries where the funds are invested as of 31 December 2018



Source: Ministry of Finance

2 The use of the TWR methodology to measure returns dates to 31 March 2007.

03 SOVEREIGN WEALTH FUNDS

Chile has two sovereign wealth funds, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). Both funds were created through the Fiscal Responsibility Law of 2006, which established the regulations and institutional framework for the accumulation, management and operation of the fiscal savings generated from the application of the structural balance rule (see *Box 1*). This law stipulated the creation of the PRF, which received its first contribution on 28 December 2006, and the ESSF, which received its first contribution on 6 March 2007. The ESSF was officially formed by combining into a single fund the resources saved in accordance with Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund, as specified in Ministry of Finance Statutory Decree N°1 (DFL N° 1) of 2006.

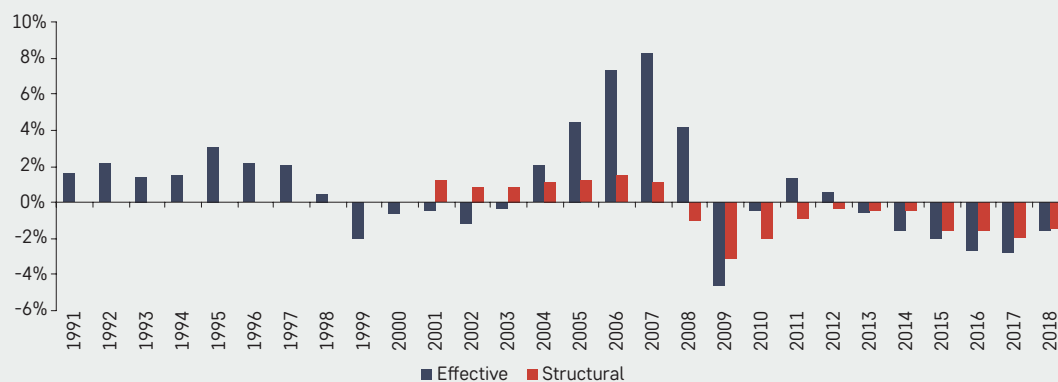
Chile implemented a structural balance rule in 2001 with the objective of establishing an annual fiscal spending level consistent with the central government's structural income. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity and the price of copper. This is especially important for a country like Chile, where the volatility of fiscal revenue largely depends on the copper price. This allows the government to save in boom times, thereby avoiding drastic adjustments to fiscal expenditures during unfavorable economic periods. At the same time, when fiscal policy is credible and sustainable, monetary policy can be used as the main policy instrument for boosting or slowing down economic activity as needed. This policy has thus contributed to significantly reducing the volatility of fiscal spending and economic growth.

Initially, the structural balance rule was a commitment adopted by the Government which was reflected each year in the corresponding budget law, but after several years of application, it was formalized in the legislation. Thus, Law N°20,128 on Fiscal Responsibility was passed in the second half of 2006, requiring each Presidential Administration to announce its objective for the structural balance rule in its first year. The law further established

the regulations and institutional framework for the accumulation, management and operation of fiscal savings. It created the PRF and authorized the President of the Republic to create the ESSF, which was officially founded in February 2007.

The structural balance target has changed over time. The target was initially set at 1% of structural surplus of GDP in 2001. The 2008 budget reduced it to 0.5% of GDP, because substantial resources were being accumulated in the sovereign wealth funds.¹ In 2009, the ex ante target was reduced to 0% to face the crisis that was then in full swing, nevertheless, the structural deficit for that year reached 3.1%. From 2010 to 2014, the government proposed reducing the structural deficit so as to converge to a 1% of GDP in 2014, reaching 0.5% at the end of 2014. The past government announced in 2015 that the structural deficit will gradually be adjusted around a quarter of a point of GDP each year through 2018, however, at the end of 2017 the structural deficit increased up to 2%. (see *Figure B1*). In 2018, the structural deficit decreased to 1.5% of GDP, widely exceeding the target of reducing the deficit by 0.2% of GDP per year. This shows the administration's commitment to reducing the fiscal deficit to 1% of GDP by 2022.²

B.1 Evolution of the real and structural fiscal balance (percent of GDP)



Source: Ministry of Finance

¹ In 2008, the structural deficit ended at 1% of GDP.

² The methodology for calculating the fiscal balance has changed over time. Information on past methodologies is available online, at www.dipres.cl/598/w3-propertyvalue-16156.html.

3.1 Purpose of the Sovereign Wealth Funds

The ESSF was created to finance fiscal deficits that could arise in periods of low growth and/or a low copper price. Thus, the ESSF's resources are an alternative to issuing debt to finance public expenditures. The ESSF can also finance the payment of public debt and recognition bonds as well as regular contributions to the PRF, as established under Ministry of Finance Statutory Decree DFL N°1 of 2006.

The purpose of the PRF is to complement the financing of fiscal liabilities in the area of pensions and social welfare. Specifically, the fund backs the state guarantee for old-age and disability solidarity pension benefits, as well as solidarity pension contributions, as established under the pension reform of 2008.³

3.2 Rules on Contributions and Withdrawals

The Fiscal Responsibility Law of 2006 establishes the rules on fund contributions. The rules on withdrawals and the use of the funds are established in the same law, as well as in the Pension Law of 2008 for the PRF and DFL N° 1 for the ESSF.

According to the Fiscal Responsibility Law, the PRF must receive a minimum annual contribution of 0.2% of the previous year's gross domestic product (GDP). If the effective fiscal surplus exceeds that amount, the contributions can be increased up to the amount of the surplus, with a maximum of 0.5% of the previous year's GDP. The transfer must occur in the first half of the year. This policy will be in place until the PRF reaches a balance equivalent to 900 million UFs (*unidad de fomento*).⁴

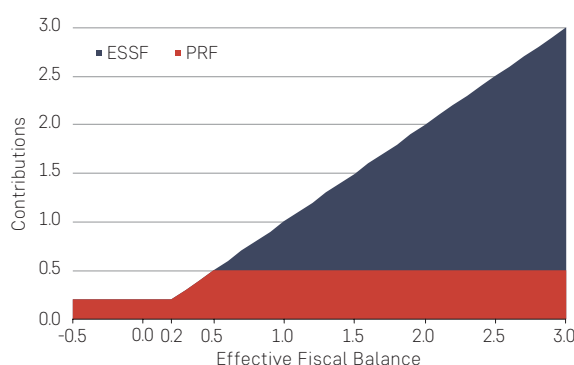
In the case of the ESSF, the fund must receive any positive balance remaining after subtracting the PRF contributions from the effective surplus, less the amortization of public debt and estimated contributions that were made in advance the previous year⁵ (see *Figure 6*).

Consistent with the objectives described above, and as it was mentioned before, the ESSF resources can be used at any time to complement fiscal revenue as needed in order to finance authorized public expenditures in the case of a fiscal deficit. They can also be used for the regular or extraordinary amortization of public debt (including recognition bonds) and for financing the annual contribution to the PRF when the Finance Minister so decides.

The PRF resources can only be used in accordance with the objectives cited earlier; that is, for the payment of pension and welfare system liabilities. Through 2015, annual withdrawals from the PRF must not exceed the fund's returns in the previous year. Starting in 2016, annual withdrawals will be capped at an amount equal to a third of the difference between the pension liabilities expense in the respective year and the inflation-adjusted pension liabilities expense in 2008. After September 2021, the PRF will cease to exist if the withdrawals in a calendar year do not exceed 5% of the total expenditures associated with the state guarantee for old-age and disability basic solidarity pension benefits and old-age and disability solidarity pension contributions as established in the budget for that year.

Contributions to and withdrawals from the ESSF and PRF are formalized through Ministry of Finance decree.

F6 Fund contribution rules (percent of GDP)



Source: Ministry of Finance

³ In 2008 the law 20,255 was enacted, it creates the solidarity pension system.

⁴ As of 31 December 2018, the PRF reached a market value of UF 243.9 million.

⁵ The current legislation allows a fiscal surplus in the current year, which must be transferred to the ESSF in the following year, to be used for the amortization of public debt or for estimated (advance) contributions to the fund.

04 INSTITUTIONAL FRAMEWORK

The institutional framework of the sovereign wealth funds is designed to facilitate decision making, performance execution, risk monitoring, and investment policy oversight. This provides an adequate separation of roles and responsibilities, which allows for accountability and operational independence in fund management. The entities that make up the institutional framework of the funds are the Ministry of Finance and its dependent bodies, the Financial Committee, the Central Bank of Chile, the external portfolio managers, the Treasury of Chile, and the custodian (see *Figure 7*).

4.1 Ministry of Finance and Dependent Bodies

The Fiscal Responsibility Law establishes that the sovereign wealth funds are the property of the Fisco of Chile and that the General Treasury of Chile (GTC) holds the legal title to the resources. The law authorizes the Finance Minister to make decisions on investing and managing the resources in the sovereign wealth funds, and it grants the Minister the authority to decide whether the operational management of the investment of the funds will be carried out directly through the GTC or delegated to the Central Bank or other external managers. Additionally, the Finance Minister created the Sovereign Wealth Funds Unit within the Ministry to support the activities associated with investing the funds. The Unit's functions include monitoring the performance of the fund managers, acting as Technical Secretariat for the Financial Committee (the Committee), and preparing monthly, quarterly, and annual reports on the state of the sovereign wealth funds for submission to the National Congress and the general public.

The GTC is responsible for the fund accounting, for preparing the audited financial statements, and for monitoring compliance with investment limits. The Budget Office is responsible for budgetary issues related to the funds.

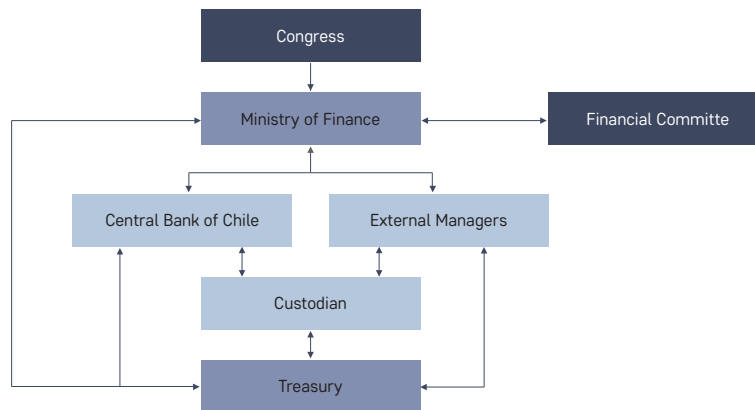
4.2 Financial Committee

The Financial Committee is an external advisory board, whose members have a vast experience in economic and financial areas. The Financial Committee was officially created through Decree N° 621, issued by the Ministry of Finance in 2007, to advise the Minister on the analysis and design of the sovereign wealth fund investment strategy, in compliance with Article 13 of the Fiscal Responsibility Law.

The main functions and powers of the Financial Committee are as follows:

- > To advise the Finance Minister, when requested, on the long-term investment policy of the sovereign wealth funds, including the selection of asset classes, benchmarks, the acceptable range of deviation, eligible investments, and the inclusion new investment alternatives;
- > To make recommendations to the Finance Minister regarding specific instructions on investment and custody, tender processes, the selection of fund managers, and the structure and content of reports;
- > To provide an assessment, when requested by the Finance Minister, of the structure and content of the reports submit-

F7 Institutional framework of the sovereign wealth funds



Source: Ministry of Finance

ted to the Ministry of Finance by the agencies entrusted with the management and custody of the funds and to express an opinion on the quality of management and compliance with established investment policies;

- > To provide an assessment of the structure and content of the quarterly reports prepared by the Ministry of Finance; and
- > To advise the Finance Minister, when requested, on all matters relating to the investment of the funds.

In 2018, the Committee members were José De Gregorio Rebeco (Chairman), Cristián Eyzaguirre Johnston (Vice Chairman), Ricardo Budinich Diez, Jaime Casassus Vargas, Martín Costabal Llona, and Paulina Yazigi Salamanca.⁶

For more information on the Finance Committee's activities in 2018, see their Annual Report, which is available online at www.hacienda.cl/english/sovereign-wealth-funds/financial-committee/annual-report.html.

4.3 Central Bank Of Chile

The functions of the Central Bank of Chile (CBC) in the management of the Chilean sovereign wealth funds were established by Executive Decree N° 1,383, issued by the Finance Ministry in 2006, which was later modified by Decree N° 1,618 of 2012.⁷ Pursuant to these decrees, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

- > To manage portfolios that include instruments that are eligible for the international reserves or other fixed-income instruments acceptable for CBC investments.⁸

⁶ Igal Magendzo stopped being a Financial Committee member in September 2018.

⁷ Finance Ministry Decree 1,618, of 2012, established that the Central Bank will only manage asset classes that are also eligible for investment under the Central Bank's international reserve management guidelines. Thus, the Central Bank is no longer responsible for supervising the external management of the corporate bond and equity portfolios, as it was in 2012 in representation of the Fisco.

⁸ According to this criteria, and as stipulated in Decree N° 1.618, the CBC does not longer manage the corporate bond and equity portfolios as of 1 January 2014.

- > To tender and delegate the management of all or part of the fiscal resources under its management to external managers in the name and on the account of the Fisco. As of 1 January 2014, the CBC can, at the request of the Ministry, carry out tenders for the selection of external managers of portfolios that are not under the management of the CBC (currently corporate bonds and equities).
- > To open separate current accounts in the course of performing its role as fiscal agent.
- > To maintain a register of transactions and other operations carried out in the management of the fiscal resources and, as of 1 January 2014, to reconcile the nominal daily positions of the portfolios that are not under its management.
- > To contract the services of a custodian institution and to manage that contract.
- > To supervise and evaluate the performance of appointed custodian institutions and external managers under the CBC's management.
- > To report daily on investment positions, prepare monthly, quarterly and annual reports on the management of the portfolios, and to prepare an annual report on the services provided by the custodian.
- > To make payments as needed in the performance of its role as fiscal agent. As of 1 January 2014, the CBC processes the payments to external corporate bond and equity managers, with prior authorization by the Ministry and the GTC.

The CBC, as fiscal agent, must comply with the investment guidelines established by the Ministry of Finance. These guidelines identify eligible assets, specify the strategic portfolio allocation, define the benchmarks for performance evaluation, and set investment limits and restrictions to control the sovereign wealth funds' risk exposure.

On the instruction of the Finance Ministry, the CBC contracted J.P. Morgan Chase Bank N.A. (J.P. Morgan) to serve as international custodian of the sovereign wealth fund investments. J.P. Morgan is also responsible for calculating the funds' returns, reporting on the investment portfolios and portfolio risk, monitoring compliance with investment limits, and performing some other middle office functions, which are complemented by Finance Ministry and GTC personnel.

4.4 External Portfolio Managers

The external managers are specialized portfolio investment companies that have been contracted to invest some asset classes to which the sovereign wealth funds have exposure. Like the CBC, the external managers must comply with the investment guidelines defined by the Ministry.

Table 1 presents the list of external portfolio managers that are investing part of the sovereign wealth funds as of year-end 2018 (see *Box 2*).

T1 List of External Managers by Fund

External Manager	PRF	ESSF
BlackRock Institutional Trust Company, N.A. (BlackRock)	Equities Corporates Bonds	Equities
Mellon Investments Corporation (Mellon)	Equities	Equities
Allianz Global Investors (Allianz)	Corporates Bonds	

Source: Ministry of Finance

As of 1 January 2014, the Ministry and the GTC are responsible for overseeing the external portfolio managers.⁹

⁹ In 2012, the CBC communicated to the Ministry that it would like to reduce its functions in relation to the external managers of the corporate bond and equity sovereign wealth fund portfolios, such that, in the long run, the CBC would operate exclusively as a portfolio manager of the funds it was responsible for investing, namely, the sovereign fixed-income and government-related (or semi-sovereign) bond portfolios. Thus, CBC asked the Ministry to issue a new decree that would reduce its responsibilities in relation to the externalized mandate. Under the new decree, published in April 2013, the CBC ceased to perform most of the activities associated with the oversight and monitoring of the externally managed portfolios, effective 1 January 2014. For more information on the functions that were transferred from the CBC to the Ministry and the GTC on 1 January 2014, see the 2013 Annual Report of the Sovereign Wealth Funds, available online at <https://www.hacienda.cl/english/sovereign-wealth-funds/annual-report.html>.

In 2011, following a detailed selection process, the CBC contracted BlackRock, Mellon, and Rogge Global Partners PLC (Rogge), which was later acquired by Allianz in 2016, to invest the corporate fixed-income and equity portfolios of the PRF. These companies began managing the investment of 35% of the PRF portfolio in January 2012. Subsequently, in 2013, following changes to the ESSF investment policy and in accordance with instructions from the Finance Minister, the CBC contracted two of the same firms—BlackRock and Mellon—to invest the ESSF equity portfolio.¹

In 2018, the CBC selected BlackRock and Nomura Asset Management Global (Nomura) for the external management of the high-yield bond portfolios; and BNP Paribas Asset Management (BNP) and Western Asset Management Company (Western) for the U.S. agency mortgage-backed security portfolios. Both asset classes are included in the new investment policy defined for the PRF, according to which the Ministry and the GTC will be responsible for the oversight and supervision of the high-yield bond portfolio managers and the Central Bank will oversee the U.S. agency mortgage-backed security portfolio managers. Both mandates were implemented in January 2019.

¹ The Finance Ministry decided to contract the same firms used for the PRF because the equity mandate is identical for the ESSF and the PRF.

05 TRANSPARENCY

The government of Chile is committed to developing and improving all aspects of the management of the sovereign wealth funds, including areas related to the transparency of decisions and access to pertinent information on their administration. Therefore, systematic reports are regularly prepared and published on the funds' investments, contributions, withdrawals and market value. In addition, the web page and press releases are used to inform the public about the main issues covered in all financial committee meetings and the resulting recommendations, together with all important decisions made by the Finance Ministry on the management of the sovereign wealth funds.

Although by law the Finance Ministry is only required to prepare monthly and quarterly reports on the activity of the Chilean sovereign wealth funds, since 2008 the Ministry has also released an annual report containing detailed information on the funds' investment policy, performance and risks, as well as other activities associated with funds' management. Starting in 2011, the annual report includes the audited financial statements, prepared in accordance with international accounting standards.

The quality of the information included in the monthly and quarterly reports has also been improved. For example, since mid-2010 the data frequency on fund performance was increased from quarterly to monthly, and more information on the investment portfolios was made available.

To guarantee public access to all important information on the ESSF and the PRF, many of the reports are published in both Spanish and English and are available on the sovereign wealth funds' website.¹⁰ Also, as of 2018, it is possible to subscribe to receive email notifications on the availability and updating of the monthly, quarterly, and annual reports that are published on the website.

Additionally, every two years the Ministry conducts a self-assessment of how well the Chilean sovereign wealth funds comply with each of the Santiago Principles.¹¹ The purpose of this exercise is to demonstrate to the public, both nationally and internationally, that the Chilean funds are managed in accordance with international best practices.¹²

These efforts have been reflected in international recognition of the level of transparency of our funds. In particular, from the third quarter of 2009 to date, the Sovereign Wealth Fund Institute has awarded Chile the highest score on its Linaburg-Ma-

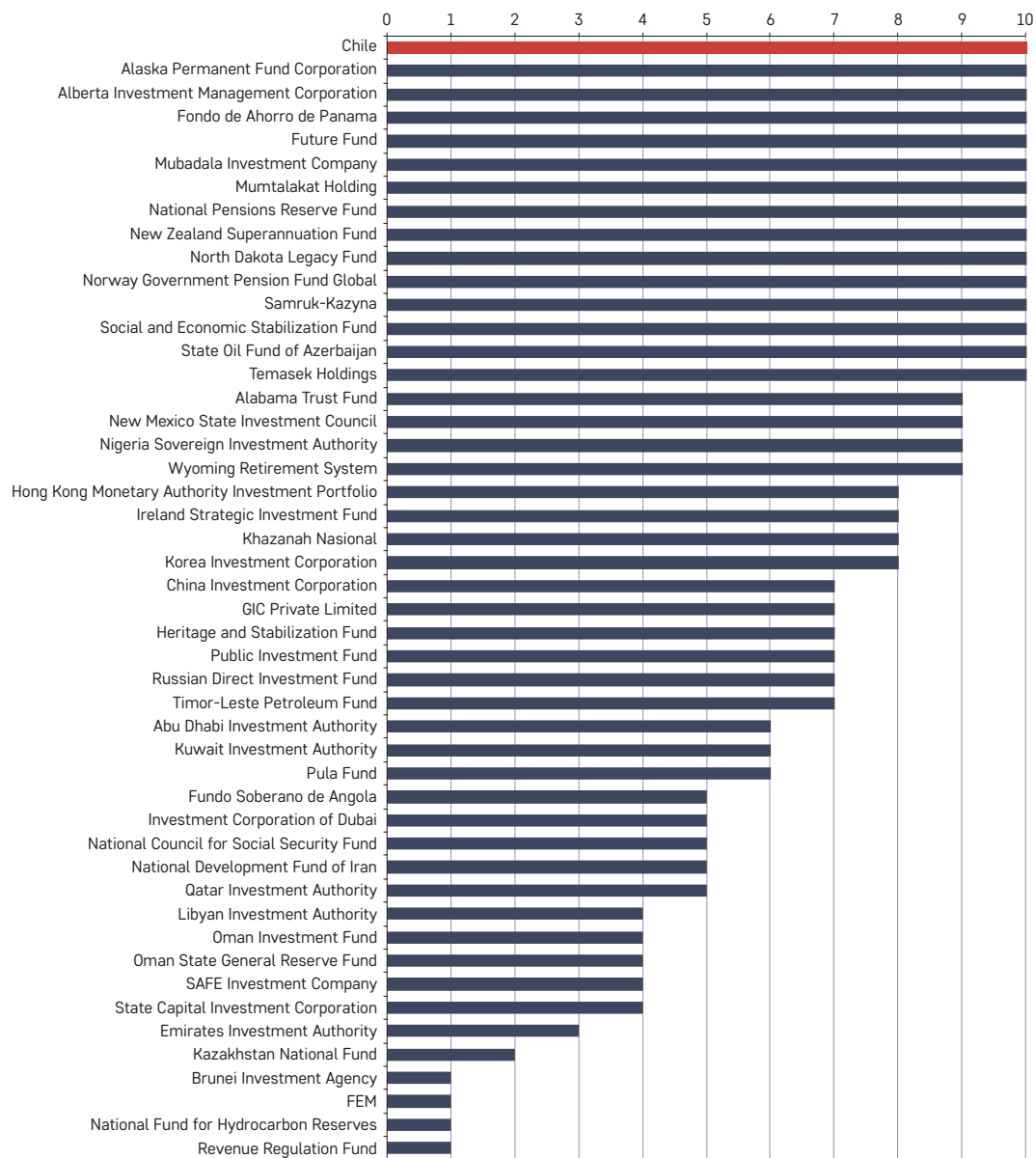
duell Transparency Index, which measures the transparency of the main sovereign wealth funds (see *Figure 8*). In addition, the Chilean sovereign wealth funds are ranked among the most transparent funds in the world by the Peterson Institute for International Economics. The institute's report entitled "Uneven Progress on Sovereign Wealth Fund Transparency and Accountability" published in October 2016, included a new version of the SWF Scoreboard, which measures the transparency and accountability of the sovereign wealth funds analyzed. On this occasion, the ESSF and the FRP were placed in sixth and seventh place, with 91 and 88 points, respectively. The above represents a maintenance in the score obtained by the ESSF with respect to the previous version of Scoreboard, published in 2013, and an improvement in the case of the PRF. Moreover, according to the Santiago Compliance Index 2014, published by GeoEconomica to measure the degree of implementation of the Santiago Principles in the world's main sovereign wealth funds, both Chilean funds received the highest rating. According to GeoEconomica, this indicates that the governance, transparency, accountability and disclosure practices of our sovereign wealth funds comply with the substance and disclosure guidelines of the Santiago Principles and that the funds are subject to an appropriate self-assessment of compliance.

¹⁰ www.hacienda.cl/english/sovereign-wealth-funds.html.

¹¹ The Santiago Principles are a series of principles and practices that have been accepted by the main countries with sovereign wealth funds. The purpose of the principles is to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as sound, prudent investment practices by the sovereign wealth funds (source: www.iwg-swf.org/pubs/esl/gaplists.pdf).

¹² Prior self-assessments are available online at www.hacienda.cl/english/sovereign-wealth-funds/good-governance-practices-santiago.html.

F8 Linaburg-Maduell transparency index¹³



Source: Sovereign Wealth Fund Institute.

¹³ Information at fourth quarter of 2018.

06 ANALYSIS OF THE INTERNATIONAL ECONOMY

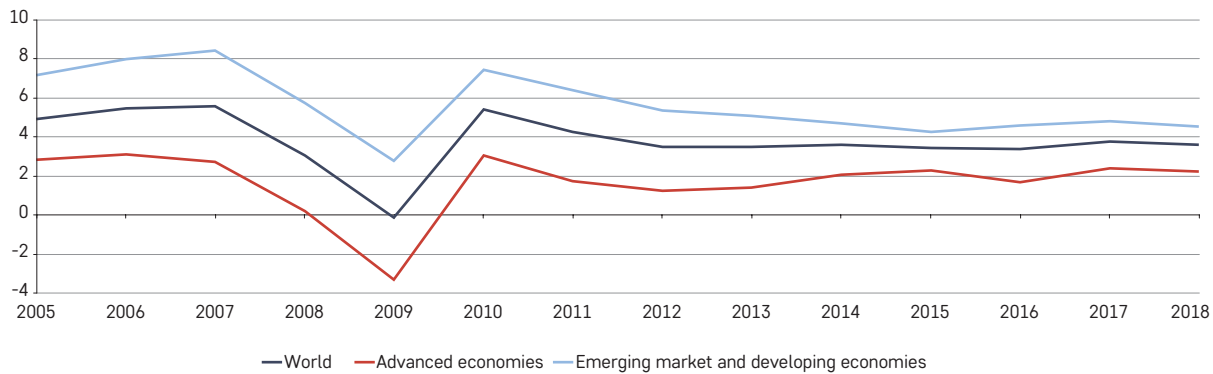
For a better understanding of the recent performance of the sovereign wealth funds, this section summarizes the main developments in the international economy in 2018.

According to estimates by the International Monetary Fund (IMF)¹⁴, the world economy grew 3.6% in 2018, which is somewhat lower than market expectations and reflects a sharper slowdown than expected in the largest economies toward the end of the year. The year was marked by the trade conflict between the United States and China, the strengthening of the dollar, and tighter international financial conditions.

On aggregate, the advanced economies slowed from an annual growth rate of 2.4% in 2017 to 2.2% in 2018. The

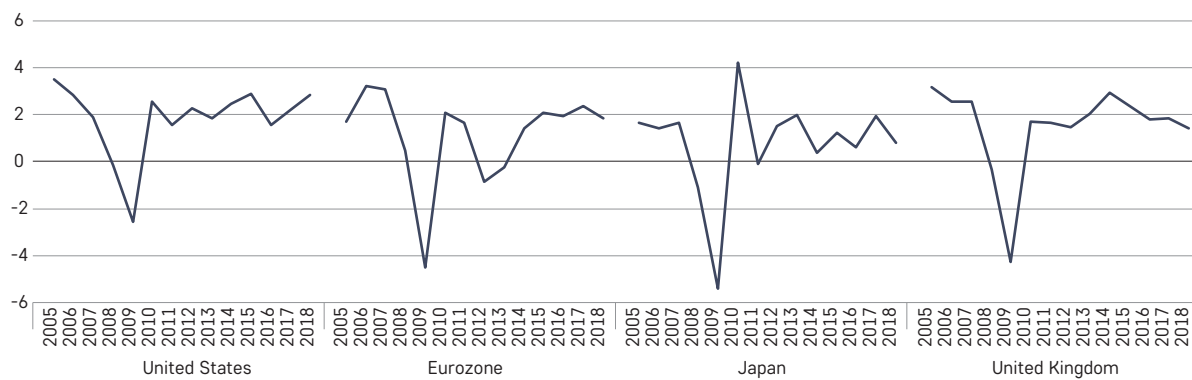
emerging and developing economies also recorded a slight downturn, from 4.8% in 2017 to 4.5% in 2018 (see *Figure 9*). Among the advanced economies, the slowdown was sharpest in the Eurozone, Japan, and the United Kingdom. The U.S. economy, in contrast, recorded higher growth, in response to a strong fiscal stimulus (see *Figure 10*). For the emerging and developing economies, notable trends included declines in China and India and a slight acceleration in the case of Brazil (see *Figure 11*).

F9 Real GDP growth, 2005 - 2018 (percent)



Source: International Monetary Fund

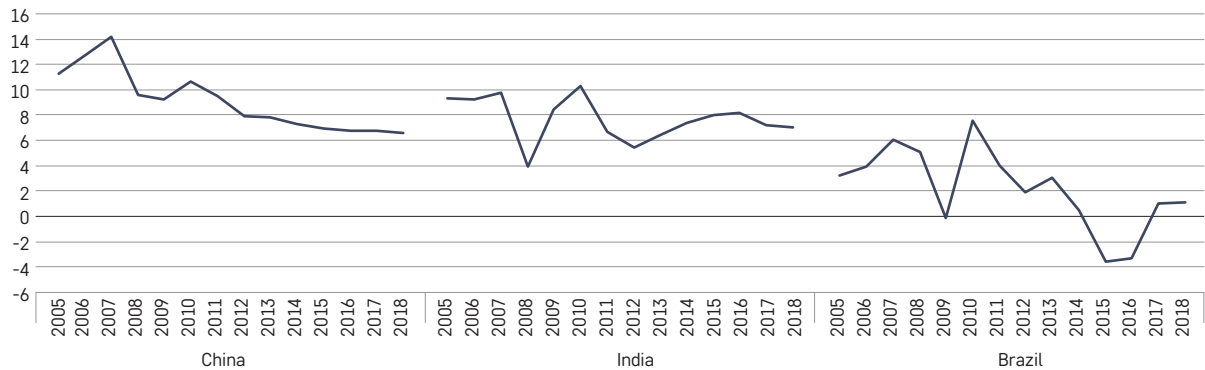
F10 Real GDP growth in specific developed economies, 2005-2018 (year-on-year change, percent)



Source: International Monetary Fund

¹⁴ The growth data presented in this section are extracted from the IMF World Economic Outlook database (April 2019).

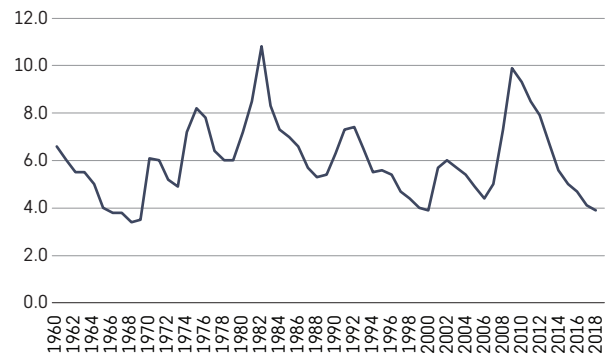
F11 Real GDP growth in specific emerging economies, 2005-2018 (year-on-year change, percent)



Source: International Monetary Fund

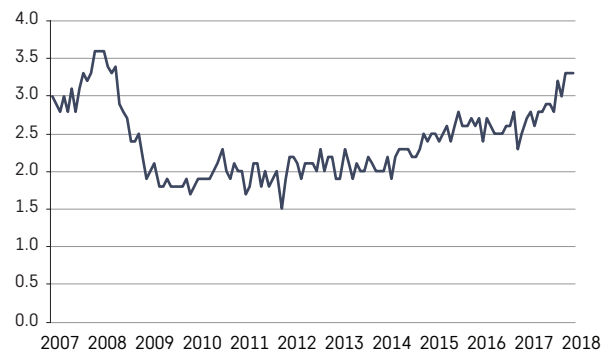
As mentioned, the U.S. economy picked up considerably in 2018, growing 2.9%, up from 2.2% in 2017. This trend was essentially in line with market expectations. As of December 2018, the unemployment rate had fallen to 3.9%, maintaining the downward trend recorded since 2010 and approaching historically low levels (see *Figure 12*). The nominal hourly wage at year-end grew 3.3% relative to one year previous (see *Figure 13*), in line with a tightening labor market. Despite the increased pressure in the labor market, inflation remained low. The general price index ended the year up 1.9% relative to 2017, which is around the 2% annual inflation target set by the U.S. Federal Reserve (the Fed), while core inflation, which excludes food and energy prices, was 2.2% in the year (see *Figure 14*). Given the dynamic U.S. economy, the narrowing output gap, and the low inflation, the Fed implemented four 25-basis-point increases in its monetary policy rate (the federal funds rate), which ended the year in a range of 2.25-2.50%.¹⁵ These increases were implemented in the context of the Fed's plan, initiated in December 2015, to gradually normalize the U.S. monetary policy to its neutral rate, which the Fed estimates to be in the range of 2.5-3.0%.¹⁶

F12 U.S. unemployment rate, 1960 - 2018 (percent)



Source: Bureau of Labor Statistics

F13 U.S. wage growth, 2007 - 2018 (year-on-year change, percent)



Source: Bloomberg

¹⁵ The Fed increased the range of its monetary policy rate from 1.25-1.50% to 1.50-1.75% in March, to 1.75-2.00% in June, to 2.00-2.25% in September, and to 2.25-2.50% in December.

¹⁶ The median estimate of long-run or neutral federal funds rate, according to the Federal Open Market Committee (FOMC) in December 2018.

F14 U.S. consumer price index , 2005 - 2018 (year-on-year change, percent)



Source: Bloomberg

F16 Eurozone annual inflation, 2005 - 2018¹⁷ (percent)



Source: Bloomberg

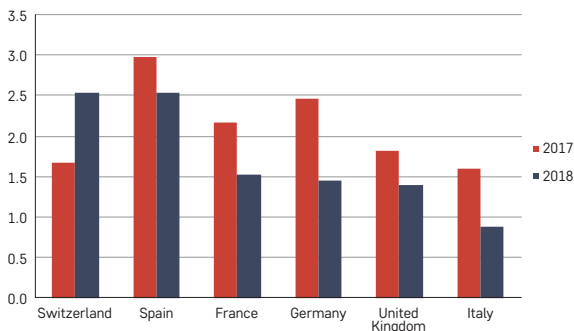
In the Eurozone, growth slowed from 2.4% in 2017 to 1.8% in 2018, reflecting a significant slowdown in the largest economies in the bloc, as well as in the peripheral economies (see *Figure 15*). Inflation in the Eurozone ended the year at 1.6% (see *Figure 16*). The unemployment rate declined over the course of the year, ending at 7.9%, thus continuing the downward trend recorded since 2013 (see *Figure 17*). In this scenario, the European Central Bank (ECB) maintained its quantitative easing program in 2018, through monthly asset purchases of 30 billion euros from January to September and 15 billion euros through December. In December, the ECB announced that it would end its net asset purchases in 2019, but would continue to reinvest principal payments from maturing securities in order to maintain favorable liquidity conditions.

F17 Eurozone unemployment rate, 2005 - 2018 (percent)



Source: Bloomberg

F15 Real GDP growth in selected Europe countries in 2018 (year-on-year change, percent)



Source: International Monetary Fund. Estimates

Japan also slowed sharply in the year, from a growth rate of 1.9% in 2017 to 0.8% in 2018. The Central Bank of Japan kept its short-term interest rate target at -0.1% and maintained its ten-year bond purchase program, in order to keep those rates around 0%.

China grew 6.6% in 2018, down slightly from 6.8% in 2017, but above the target of 6.5% set by the authorities. The lower growth occurred in an international context characterized by the trade tensions between China and the United States, which were triggered in March when the latter economy imposed tariffs on steel and aluminum imports from China and ramped up as both parties imposed retaliatory tariffs on various products.

¹⁷ Harmonised Index of Consumer Prices.

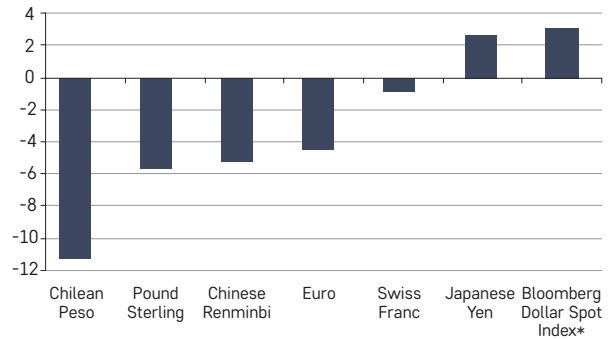
In this global context, the U.S. dollar strengthened 3.1% against the main global currencies.¹⁸ (see *Figure 18*). In terms of the currencies in which the sovereign wealth funds are invested, the pound sterling, the Chinese renminbi, and the euro depreciated the most (-5.6%, -5.2%, and -4.5%, respectively), while the Japanese yen appreciated (2.73%).

In 2018, stock prices fell significantly in most markets. In a selected sample (see *Figure 19*), all the stock exchanges posted negative returns. The stock markets with the worst performance in 2018 were China, Germany, and South Korea, whose returns, measured in local currency, were -20.9%, -20.0%, and -19.3%, respectively. The indexes with the highest yields in relative terms, in local currency, were in the United Kingdom, the United States, and Australia with -7.1%, -7.1%, and -6.3%, respectively.

The volatility of the stock market (S&P 500), measured through the Chicago Board Options Exchange (CBOE) equity volatility index (the VIX), was higher, on average, in 2018 than in the previous year, peaking at 37.2 in February and 36.1 in December. The minimum was recorded in January (9.15), which is similar to the minimum in 2017 (9.14) (see *Figure 20*).

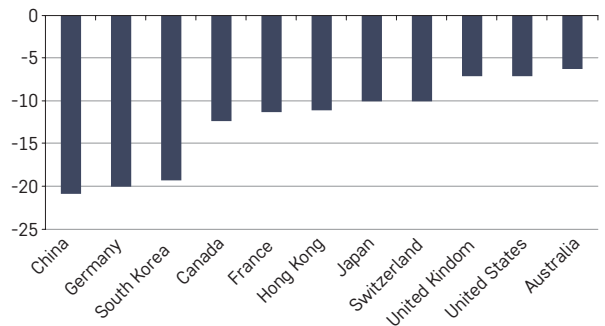
At year-end, two-year nominal sovereign interest rates had increased in the United States, Germany and Switzerland relative to year-end 2017 (see *Figure 21*), while in Japan the same interest rate decreased slightly. Ten-year nominal interest rates increased in the United States and decreased in Germany, Switzerland and Japan (see *Figure 22*).

F18 Selected currencies against the dollar in 2018¹⁹ (year-on-year change, percent)



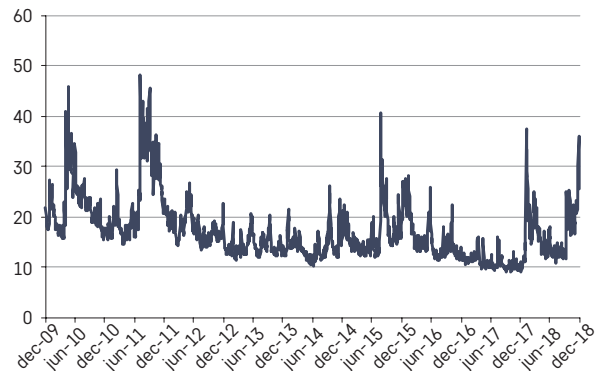
Source: Bloomberg

F19 MSCI equity indices returns in 2018 (year-on-year change, percent in local currency)



Source: Bloomberg

F20 Equity market volatility (VIX): S&P 500, 2009-2018 (in levels)

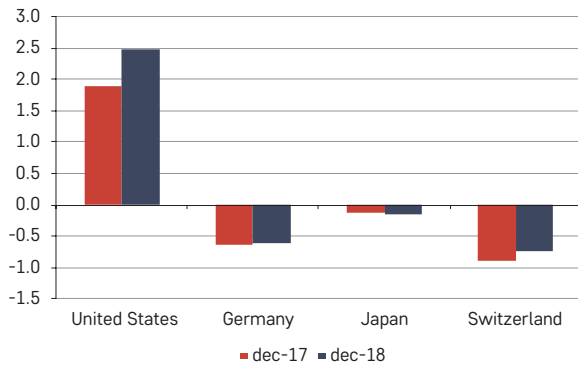


Source: Bloomberg

¹⁸ The Bloomberg Dollar Spot Index is a tradable index that shows the value of the dollar relative to the ten main global currencies. Index returns over zero indicate appreciation of the dollar against the basket of currencies, while negative returns indicate dollar depreciation.

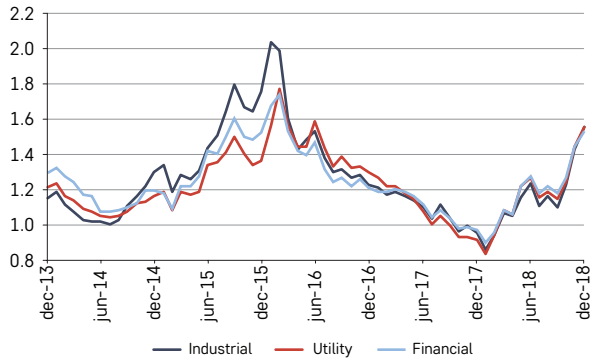
¹⁹ A negative return implies depreciation of the currency; a positive return, appreciation.

F21 Internal rate of return (IRR) on two-year bonds in selected countries, 2017-2018 (percent)



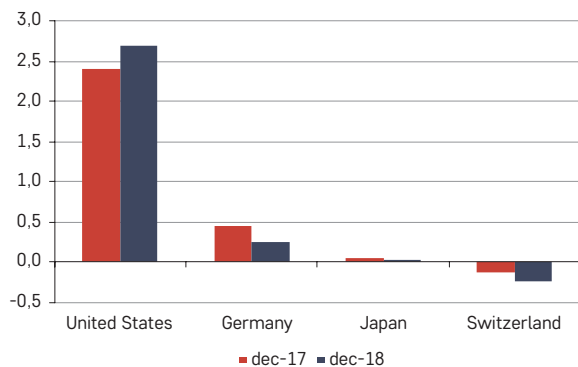
Source: Bloomberg

F23 Corporate spreads by industry, 2013-2018 (percent)



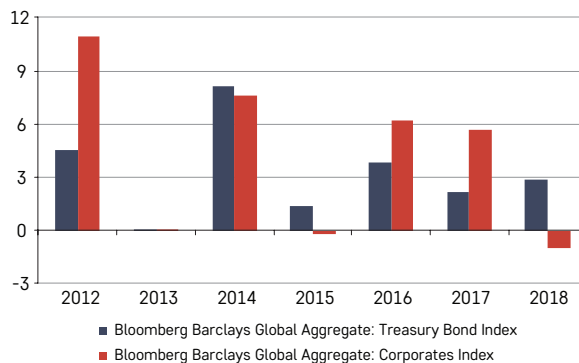
Source: Barclays

F22 Internal rate of return (IRR) on ten-year bonds in selected countries, 2017-2018 (percent)



Source: Bloomberg

F24 Bloomberg Barclays Global Aggregate: Treasury Bond Index and Corporate Bond Index (hedged), 2012-2018 (percent, measured in local currency)



Source: Barclays

In the corporate market, spreads increased in all sectors of the Bloomberg Barclays Global Aggregate Corporate index in 2018 vis-à-vis 2017²⁰ In the industrial, financial, and utility sectors, spreads grew 62%, 71%, and 58%, respectively (see *Figure 23*).²¹

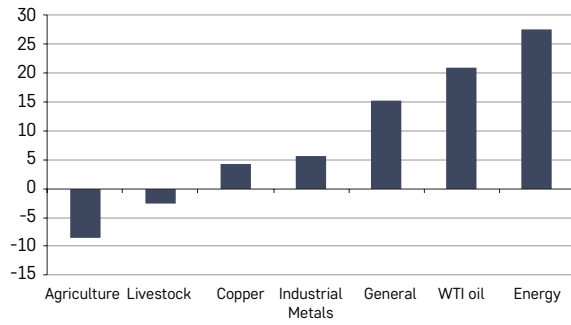
In 2018, returns in local currency were positive for sovereign bonds and negative for corporate bonds. Thus, the Bloomberg Barclays Global Aggregate: Treasury Bond Index (hedged) and the Bloomberg Barclays Global Aggregate: Corporates Index (hedged) closed the year with yields of 2.82% and -1.00% (see *Figure 24*).

²⁰ The Bloomberg Barclays Global Aggregate Corporate Index comprises global investment-grade fixed-income corporate bonds. It covers 54 countries, including both developed and developing economies. The index is subdivided into three sectors: namely, the industrial, financial, and utility sectors. At year-end 2018, the index measured 11,948 issues, of which 54% were in the industrial sector, 34% in the financial sector, and 12% in the utility sector.

²¹ The industrial sector includes commodities, capital goods, communications, cyclical consumption, noncyclical consumption, energy, technology, transport, and other.

Commodity prices increased, on average, between 2017 and 2018, with the exception of agriculture and livestock, which fell 8.3% and 2.5%, respectively. The copper price,²² which is the most critical for Chile, rose 4.3% relative to the previous year (see *Figure 25*).

F25 Standard & Poor's commodity index in 2018
(year-on-year change, percent)



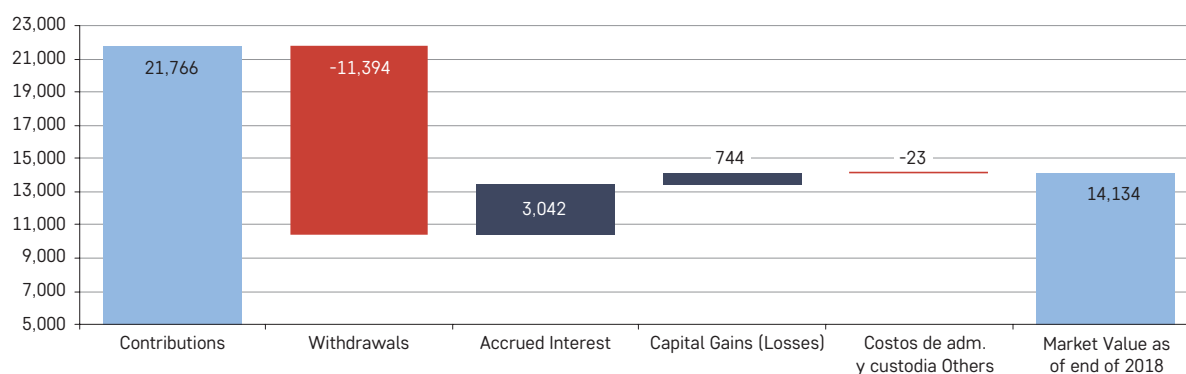
Source: Bloomberg

²² Metal prices, Chilean Copper Commission.

07 THE ECONOMIC AND SOCIAL STABILIZATION FUND

The market value of the ESSF at year-end 2018 was US\$ 14,134 million. Since its inception on 6 March 2007, the fund has recorded total capital contributions of US\$ 21,766 million, withdrawals of US\$ 11,394 million, and net investment income of US\$ 3,763 million. The latter breaks down into US\$ 3,042 million in interest earned, US\$ 744 million in capital gains, and US\$ 23 million in management and custody costs (see Figure 26). In 2018, the fund's return in dollars (net of management costs) was -0.41%; the equivalent net return in pesos was 12.61%. Since the fund's inception, the annualized net return in dollars has been 2.41%; in pesos, 4.65%. The IRR in dollars was -0.42% in 2018 and 2.40% annualized since the creation of the fund.

F26 Change in market value, March 2007 - December 2018 (US\$ million)



7.1 Investment Policy

In line with the objectives described in section 3.1, the main goal of the ESSF investment policy is to maximize the fund's accumulated value in order to partially cover cyclical reductions in fiscal revenue, while maintaining a low level of risk. This risk aversion is reflected in the choice of a highly liquid investment portfolio with low credit risk and low volatility, which ensures the timely availability of the resources to finance deficits and decreases the probability of being affected by significant losses in the fund's value.

The current ESSF investment policy, which was implemented in August 2013, is mainly centered on fixed-income investments in reserve currencies, which are typically favored in times of crisis. This maximizes not only the accumulated value of these resources measured in foreign currency, but also their conversion to pesos (the currency of most fiscal spending) when the resources are most needed. The investment policy also includes some equities exposure to improve the fund's expected long-term return. The strategic asset allocation is defined as 55% in sovereign bonds, 34% in money market instruments (15% in bank deposits and 19% in sovereign securities), 7.5% in equities and 3.5% in inflation-linked sovereign bonds. The currency allocation of the fixed-income portfolio is specified as 40% in dollars, 25% in euros, 20% in yen and 7.5% in Swiss francs, expressed as a percentage of the total portfolio.

The asset classes defined for this policy are invested under a passive mandate based on fixed-income benchmarks in line with the low risk tolerance defined for the fund and a highly diversified equity benchmark (see *Table 2*). The instruments in the fixed-income benchmark are fairly liquid. The aggregate fixed-income portfolio has an ex ante tracking error of 50 basis points; the equity portfolio, 60 basis points.²³

The fixed-income portfolio (93.4% of total assets) is managed by the CBC, acting as fiscal agent, while the equity portfolio is handled by external portfolio managers (BlackRock and Mellon).

The instruments and issuers that are eligible for investment are determined by the corresponding benchmarks. The portfolio managers are also allowed to make limited use of ETFs, ADRs, GDRs, mutual funds and futures in order to facilitate tracking the equity benchmark. Leveraging is not allowed, and forwards or swaps can only be used, to a limited extent, for currency hedging.

²³ The ex ante tracking error is used to measure how closely the portfolio tracks the benchmark. It is "ex ante" because it is a prediction of future performance. The smaller the tracking error, the more passive the management of the fund.

7.2 Market Value

To keep the fund aligned with its strategic asset allocation, a portfolio rebalancing policy was defined, which consists in returning to the strategic allocation once a year and whenever the percentage of equities is outside the range of 5.5%-9.5% of the total portfolio. The annual rebalancing is coordinated with fund contributions, to the extent possible.

The market value of the ESSF at year-end 2018 was US\$ 14,134 million, versus US\$ 14,739 million at year-end 2017. The decrease in value of the ESSF was mainly due to a withdrawal of US\$ 542 million, used to finance the annual contribution to the PRF, and net investment losses of US\$ 63 million. Since its inception on 6 March 2007, the ESSF has recorded capital contributions of US\$ 21,766 million and withdrawals of US\$ 11,394 million²⁴ and has generated net financial gains of US\$ 3,763 million (see *Tables 3 and 4*).

T2 Strategic asset allocation and benchmarks (percent)

Benchmark	USD	EUR	JPY	CHF	Equities	Total
1. Bank deposits	5.0	6.0	4.0	0.0	0.0	15.0
ICE BofaAML US Dollar 3 Month Deposit Bid Rate Average Index	5.0	—	—	—	—	5.0
ICE BofaAML Euro Currency 3 Month Deposit Bid Rate Average Index	—	6.0	—	—	—	6.0
ICE BofaAML Japanese Yen 3 Month Deposit Bid Rate Average Index	—	—	4.0	—	—	4.0
2. Treasury bills and sovereign bonds	32.5	18.0	16.0	7.5	0.0	74.0
2.1 Treasury bills	6.0	7.0	6.0	0.0	0.0	19.0
ICE BofaAML US Treasury Bills Index	6.0	—	—	—	—	6.0
ICE BofaAML Euro Treasury Bills Index	—	7.0	—	—	—	7.0
ICE BofaAML Japan Treasury Bills Index	—	—	6.0	—	—	6.0
2.2 Sovereign bonds	26.5	11.0	10.0	7.5	0.0	55.0
Bloomberg Barclays Global Aggregate - Treasury: U.S. 7-10 Yrs	26.5	—	—	—	—	26.5
Bloomberg Barclays Global Aggregate - Treasury: Germany 7-10 Yrs	—	11.0	—	—	—	11.0
Bloomberg Barclays Global Aggregate - Treasury: Japan 7-10 Yrs	—	—	10.0	—	—	10.0
Bloomberg Barclays Global Aggregate - Treasury: Switzerland 5-10 Yrs	—	—	—	7.5	—	7.5
3. Inflation-linked sovereign bonds	2.5	1.0	0.0	0.0	0.0	3.5
Bloomberg Barclays Global Inflation-Linked: U.S. TIPS 1-10 Yrs	2.5	—	—	—	—	2.5
Bloomberg Barclays Global Inflation-Linked: Germany 1-10 Yrs	—	1.0	—	—	—	1.0
4. Equities	—	—	—	—	7.5	7.5
MSCI All Country World Index (unhedged con dividendos reinvertidos) ex Chile	—	—	—	—	7.5	7.5
5. Total	40.0	25.0	20.0	7.5	7.5	100.0

Source: Ministry of Finance

²⁴ Most of the ESSF withdrawals were in 2009 (US\$ 9,278 million) to finance the fiscal deficit and a fiscal stimulus plan implemented by the government in response to the economic crisis that year.

T3 Contributions and withdrawals (millions of dollars)

Period	Contributions	Withdrawals
2007	13,100	—
2008	5,000	—
2009	—	9,278 ^(a)
2010	1,362	150 ^(b)
2011	—	—
2012	1,700	—
2013	603	—
2014	—	499 ^(c)
2015	—	464 ^(c)
2016	—	462 ^(c)
2017	—	—
2018	—	542 ^(c)
Total	21,766	11,394

(a) US\$ 837 million of the withdrawals were used to finance the full contribution to the PRF.

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

(c) The withdrawal was used to finance the full contribution to the PRF.

Source: Ministry of Finance

T4 Decomposition of market value (millions of dollars)

Decomposition	2012	2013	2014	2015	2016	2017	2018	Since inception ^(a)
Starting market value	13,157	14,998	15,419	14,689	13,966	13,772	14,739	0
Contributions	1,700	603	0	0	0	0	0	21,766
Withdrawals	0	0	-499	-464	-462	0	-542	-11,394
Accrued interest	202	184	188	167	162	153	167	3,042
Capital gains (losses)	-60	-364	-417	-423	109	817	-228	744
Management, custody and other costs	-1,3	-2,2	-2,7	-2,9	-2,6	-2,8	-2,8	-23,5
Net financial gains	141	-182	-231	-259	268	967	-63	3,763
Ending market value	14,998	15,419	14,689	13,966	13,772	14,739	14,134	14,134

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

Source: Ministry of Finance

7.3 Performance

In 2018, the return in dollars, net of management costs, was -0.41%. This was largely due to equity returns of -9.11% in the year, which more than offset the positive effect of the 0.20% return on the fixed income portfolio, which represents 93.4% of the fund. In the latter portfolio, the return reflects a 1.01% return in local currency, which was partially offset by a -0.80% exchange rate effect.²⁵ The equivalent net return in pesos in the year was 12.61%, explained by the depreciation of the Chilean peso against the dollar in the year. Since 31 March 2007, the annualized net return was 2.41% in dollars and 4.65% pesos (see Table 5). A look at the historical trend (see Figure 27) shows that from 2013 to 2015, the fund recorded negative returns in dollars, largely due to the exchange rate effect in the period. The IRR in dollars was -0.42% in 2018 and 2.40% annualized since the creation of the fund.

T5 Net return (percent)

Returns ^(a)	2018	Last 3 years	Since inception ^(b)
Fixed-income	0.20	2.29	2.18
Local currency	1.01	1.09	2.39
Exchange rate	-0.80	1.18	-0.21
Equities	-9.11	6.92	6.49
Return in USD	-0.41	2.73	2.41
Exchange rate return, CLP	13.08	-0.55	2.19
Return in CLP^(c)	12.61	2.16	4.65

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

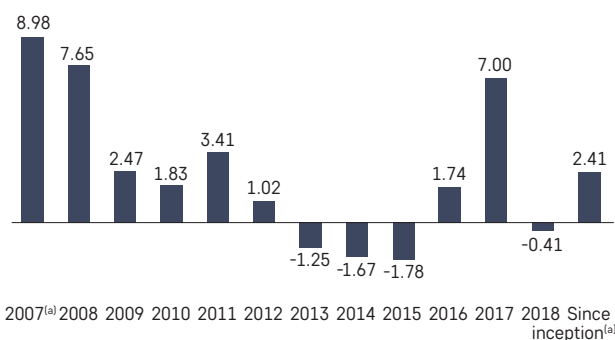
(b) The annualized return since the inception of the fund is calculated from 31 March 2007, the start date of the Central Bank's performance measure. The return since the inception of the equity portfolio is calculated from 31 July 2013.

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

Source: Ministry of Finance

²⁵ The performance of the ESSF fixed-income portfolio primarily reflects interest rates and exchange rates. The level and changes in interest rates largely determine the value of the financial instruments in their currency of issue (local currency). However, given that the funds are invested in dollars, euros, yen, and Swiss francs, while the portfolio performance is measured in dollars, the exchange rate of the dollar against these currencies also affects the fund's return.

F27 Annual net return in dollars (percent)

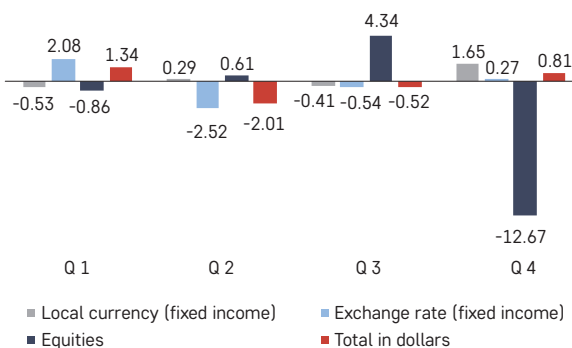


(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Figure 28 shows the fund's quarterly net return in dollars in 2018, including the total return as well as the return on the fixed-income portfolio, disaggregated into the local currency return and the exchange rate effect,²⁶ and on the equity portfolio. The highest return in dollars was recorded in the first quarter, at 1.34%, thanks to the positive exchange rate effect in the fixed-income portfolio. The lowest return, -2.01%, was in the second quarter, again due to the exchange rate effect in the fixed-income portfolio. In the third and fourth quarters, the returns were -0.52% and 0.81%, respectively, mainly explained by the behavior of the fixed-income portfolio. Finally, the equity portfolio recorded a loss of -12.67% in the last quarter.

F28 Net quarterly returns in 2018 (percent)



Source: Ministry of Finance

²⁶ See footnote 25.

The fund's investment performance can be illustrated using an index of the portfolio's daily returns. Taking a starting value of 100 on 31 March 2007, the index reached 132.2 at year-end 2018 (see *Figure 29*).

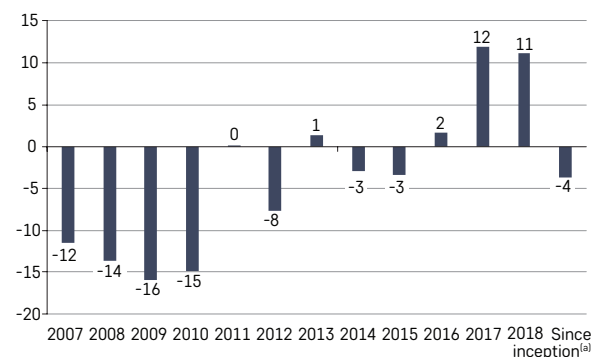
In 2018, the performance of the ESSF, measured as the difference between the portfolio return and the benchmark return, was 11 basis points. Since 31 March 2007, the annualized return of the ESSF was 4 basis points below the benchmark (see *Figure 30*).

F29 Return index in dollars (31 March 2007 = 100)



Source: Ministry of Finance

F30 Net returns against the benchmark (basis points)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

By asset class, the return on the fixed-income portfolio in 2018 was 8 basis points above the benchmark, while that of the equity portfolio was 19 basis points below (see *Table 6*). The equity performance in 2018 is in line with the annual impact of taxes on the portfolio relative to the benchmark.²⁷ Finally, the excess return since the inception of the portfolio was -4 basis points. This performance has mainly been influenced by the fixed-income portfolio, an asset class that has been included in the investment portfolio since the creation of the ESSF, and only in part by the equity portfolio, where exposure began in August 2013.

T6 Net returns against the benchmark²⁸, by asset class (basis points)

Asset class	2018	Last 3 years	Since inception ^{(a) (b)}
Fixed-income	8	6	-4
Equities	-19	-28	-3
Total portfolio	11	8	-4

(a) The equity portfolio was implemented in August 2013.

(b) The return since inception is calculated from 31 March 2007, the start date of the CBC performance measure.

Source: Ministry of Finance

²⁷ The equity portfolio return is generally lower than the benchmark because the latter does not take into account tax payments (for example, on dividends) whereas the equity portfolio return is subject to taxation. This effect amounts to approximately 2 basis points each month.

²⁸ The total excess return of the portfolio is calculated as the difference between the weighted sum of the returns of each asset class of the portfolio and the benchmark.

7.4 Portfolio Allocation

As of December 2018, the allocation of the ESSF by asset class comprised US\$ 9,538 million in Treasury bills and sovereign bonds, US\$ 488 million in inflation-linked sovereign bonds, US\$ 3,178 million in bank time deposits and US\$ 930 million in equities (see *Table 7*).

By country, the sovereign portfolio is invested in the United States, Japan, Germany, and Switzerland, where investments in the United States account for almost 41% of the portfolio and around a third of the total value of the ESSF. Bank deposits, as of year-end, are invested in banks from a number of countries, with exposures of over US\$ 170 million in France, Japan, Germany, China, Denmark, The Netherlands and Australia. These bank investments are time deposits in eligible banks selected by the CBC in accordance with the Finance Ministry's investment guidelines. *Table 8* presents the breakdown of bank deposits at the close of 2018. The equity portfolio at year-end was concentrated in the United States (around 56%) and, to a lesser extent, Japan, United Kingdom, France, Switzerland, Canada and Germany as well as 42 countries with investments of less than US\$ 20 million each. The equity distribution by country tracks the country allocation in the benchmark.

Relative to the benchmark, the asset allocation of the ESSF at year-end had an overweight in bank deposits by around 7%, at the expense of Treasury bills and sovereign bonds. This is due to the fact that the CBC, which is responsible for the ESSF fixed-income portfolio, prioritized investments in time deposits over Treasury bills due to the low—or even negative—interest rates in some of the countries where the ESSF is invested. Exposure to inflation-linked sovereign bonds is in line with the benchmark, with a share of 3.5% of the portfolio. Finally, there is an underexposure to equity of approximately 1%, mainly due to the negative return recorded by this asset class in the last quarter of the year (see *Figures 31* and *32*). With regard to the currency allocation, at year-end the portfolio was aligned with the benchmark (see *Figure 33*).

T7 Asset class allocation, 31 December 2018 (millions dollars and percent of the portfolio)

Exposure	Country	US\$ million	% of total
Sovereign	United States	3,754	4109.3
	Japan	3,112	0.41
	Germany	1,592	0.3
	Switzerland	1,079	7.6
	Total^(a)	9,538	67.5
Inflation-linked sovereign	United States	356	2.5
	Germany	133	0.9
	Total	488	3.5
Banking	France	615	4.4
	Japan	597	4.2
	Germany	520	3.7
	China	419	3.0
	Denmark	210	1.5
	The Netherlands	203	1.4
	Australia	175	1.2
	Israel	156	1.1
	Spain	142	1.0
	Singapore	78	0.6
	Canada	71	0.5
	Belgium	28	0.2
	Otros ^(b)	-35	-0.2
	Total	3,178	22.5
Equities	United States	518	0.56
	Japan	69	0.5
	United Kingdom	47	0.3
	France	29	0.2
	Switzerland	28	0.2
	Canada	28	0.2
	Germany	25	0.2
	Australia	19	0.1
	The Netherlands	17	0.1
	Hong Kong	16	0.1
	South Korea	15	0.1
	Ireland	12	0.1
	Spain	9	0.1
	Sweden	7	0.0
	Italy	6	0.0
	Denmark	5	0.0
	Mexico	3	0.0
	Belgium	3	0.0
	Otros ^(b)	73	0.5
	Total	930	6.6
Total Fund		14,134	100.0

(a) As of June 17, 2015, may include supranationals, agencies and state own companies with explicit guarantees.

(b) It includes cash, cash equivalents, and unsettled transactions.

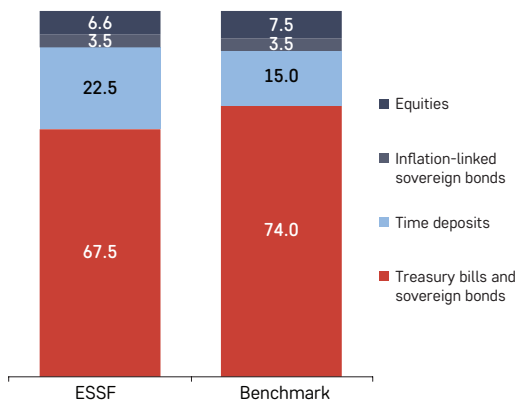
Source: Ministry of Finance

T8 Banks with deposits, 31 December 2018

Banks	Country
DekaBank Deutsche Girozentrale	Germany
China Construction Bank Corporation	China
Nykredit Bank	Denmark
Credit Agricole Corporate and Investment Bank	France
Bank of China (Hong Kong) Ltd.	China
Societe General	France
Cooperatieve Rabobank UA	The Netherlands
Australia & New Zealand Banking Group Limited	Australia
Landesbank Baden-Württemberg	Germany
Bank Hapoalim B.M.	Israel
Bred Banque Populaire	France
Sumitomo Mitsui Banking Corporation	Japan
Sumitomo Mitsui Trust Bank Ltd.	Japan
Mizuho Bank, Ltd.	Japan
The Chiba Bank, Ltd.	Japan
DZ BANK AG Deutsche Zentral-Genossenschaftsbank	Germany
Banco Santander SA	Spain
The Shizuoka Bank Ltd	Japan
DBS Bank Ltd	Singapore
Banco Bilbao Vizcaya Argentaria SA	Spain
National Bank of Canada	Canada
Bayerische Landesbank	Germany
HSBC France	France
BNP Paribas Fortis	Belgium
The Bank of Nova Scotia	Canada
Natixis SA	France
Oversea-Chinese Banking Corp Ltd.	Singapore

Source: Ministry of Finance

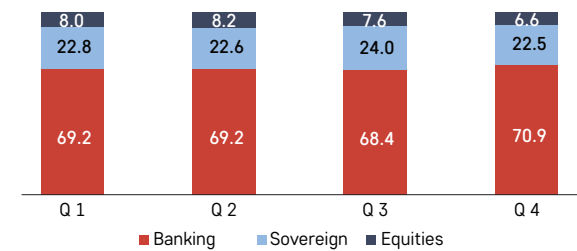
F31 Asset allocation, 31 December 2018 (percent of portfolio)



Source: Ministry of Finance

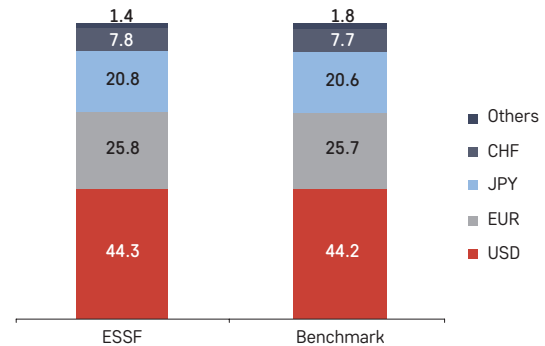
The credit quality of the sovereign investments included in the ESSF is directly related to the benchmark allocation. That is, the distribution by credit rating depends on the shares established in the benchmark for the United States, Germany, Japan, and Switzerland. Bank exposure depends on the CBC's assessment of the risk-return ratio of each bank at the time the deposit was made (see Table 9).

F32 Risk allocation in 2018 (percent of portfolio)



Source: Ministry of Finance

F33 Currency allocation on 31 December 2018



Source: Ministry of Finance

T9 Credit risk exposure, 31 December 2018 (percent of the fixed-income portfolio)

Issuer	Credit rating							Total
	AAA	AA+	AA	AA-	A+	A	A-	
Sovereign	52.4	0.0	0.0	0.0	23.6	0.0	0.0	75.9
Bank	0.0	0.0	0.0	4.7	6.6	11.1	2.0	24.1
Total	52.4	0.0	0.0	4.7	30.2	11.1	2.0	100.0

(a) It includes cash, cash equivalents, and unsettled transactions.

Source: Ministry of Finance

7.5 Management Costs And Income From The Securities Lending Program

The total cost of managing the ESSF in 2018 included US\$ 1,144,991 for custody services, US\$ 1,153,147,²⁹ for CBC management services, and US\$ 442,031 for external management services. In the year, there were also payments associated with others services (auditing and external advising services) for a total of US\$ 74,988. Total management costs were equivalent to 2 basis points of the average size of the fund in 2018. Income from the securities lending program was US\$ 2,057,520, which offset 73% of the total management costs of the ESSF (see *Table 10*).

7.6 Main Financial Risks

The ESSF is exposed to various types of risk as a result of the fund's investment in different financial instruments, including market risk, credit risk, liquidity risk and operational risk. Most of these risks are directly related to the asset and currency allocations and the choice of benchmarks, especially given the passive approach of the fund's investment policy. This section describes each risk in detail, together with the control mechanisms set up for controlling them.

7.6.1 Market Risk

The market value of the financial instruments in the ESSF investment portfolio can be exposed to possible losses as a result of changes in market conditions. In the case of the ESSF, the main variables affecting market value are interest rates, exchange rates, credit spread risk, and changes in stock values.

Interest rate risk

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

In the case of the ESSF, the interest rate risk that is tolerated in the benchmark is defined based on the duration of the individual indexes that make up the benchmark. This risk is monitored controlling that the portfolio duration stays near the benchmark duration. At year-end 2018, both the benchmark duration and the actual duration were approximately 4.8 years.

T10 Management and custody costs and income from the securities lending program (dollars)

	2012	2013	2014	2015	2016	2017	2018
Custody (J.P. Morgan)	530,901	1,379,420	1,302,645	1,295,073	1,113,997	1,186,530	1,144,991
Management (CBC)	768,014	789,277	802,573	957,404	935,495	932,360	1,153,147
External Managers	-	-	581,047	622,359	454,957	613,880	442,031
Others ^(a)	-	-	-	-	107,143	71,017	74,988
Total costs	1,298,915	2,168,697	2,686,265	2,874,836	2,611,593	2,803,787	2,815,156
Total costs in basis points ^(b)	1	1	2	2	2	2	2
Securities lending program	2,914,649	2,654,248	2,332,681	2,563,815	3,440,007	3,743,103	2,057,520

(a) It includes consulting, auditing, and tax consulting services.

(b) Calculated Based on the average fund's size for the year.

Source: Ministry of Finance

²⁹ The increase in the Central Bank's management fees in 2018 largely derives from expenses associated with upgrading a technology platform used for the management of the sovereign wealth funds.

Foreign exchange risk

Because the fund's performance is measured mainly in dollars, the value of investments in other currencies is affected by movements in the corresponding exchange rates. Most of the portfolio's fixed-income investments are denominated in dollars, euros, yen and Swiss francs, while the equity portfolio includes a small exposure to an additional 22 currencies. At the close of 2018, the foreign currency exposure, measured in dollars, deriving from investments in euros (25.8%), yen (20.8%), Swiss francs (7.8%), pounds sterling (0.4%) and other currencies with a minor share (1.0%).

Credit spread risk

The market value of the instruments in the ESSF fixed-income portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is low in the ESSF, because the fixed-income portfolio includes mainly sovereign issues from the United States, Japan, Germany, and Switzerland, for which the lowest credit rating is A+ (Japan). Finally, the portfolio also includes bonds issued by institutions with an explicit government guarantee, agencies, and supranational entities with a high credit rating.

Equity risk

The ESSF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2018, equities accounted for 6.6% of the ESSF.

Volatility, VaR, and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility,³⁰ the minimum and maximum returns, and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 3.6% in 2018, versus 5.0% since 31 March 2007. Since the fund's inception, the highest monthly return was 5.44% (in December 2008), while the lowest was -3.87% in November 2016. The highest quarterly return was 7.31% in the first quarter of 2008; the lowest was -6.45% in the fourth quarter of 2016 (see *Table 11*). At year-end 2018, the VaR, which quantifies potential losses in a given period with a given probability, was 4.40% at a one-year horizon, with a 95% confidence level.³¹

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At the close of 2018, the ex ante tracking error of the ESSF was 19 basis points, while the ex post tracking error³² was 8 basis points, consistent with a passive management strategy.

T11 Historical minimum and maximum returns (percent)

Range	Month	Quarter
Highest return	5.44 (Dec-08)	7.31 (I 08)
Lowest return	-3.87 (Nov-16)	-6.45 (IV 16)

Source: Ministry of Finance

³⁰ Volatility is the standard deviation of the returns; it indicates the degree of dispersion of returns around the average.

³¹ This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 4.40% of its nominal value in dollars.

³² The ex post tracking error is the standard deviation of the historical monthly excess returns recorded from 31 December 2015 through 31 December 2018.

7.6.2. Credit Risk

The issuer of a fixed-rate instrument could enter into default if a liquidity or capital shortage makes it unable to meet its financial obligations. The funds' credit risk thus rises in response to an increase in the default probability of any of their host institutions or governments. The ESSF limits exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany, Japan and Switzerland, all of which have a sovereign rating of A or higher, and securities issued by eligible entities with an explicit government guarantee, supranational institutions and agencies with a high credit rating, which are selected based on the eligibility criteria used by the CBC for investing its international reserves. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see *Table 12*). The credit risk associated with forward and swap operations is contained through minimum credit ratings for counterparties and maximum exposure to each one: eligible counterparties must have a minimum rating of A- from at least two of the international credit rating agencies (Fitch, Moody's and Standard & Poor's), and investment in any given counterparty is capped at 1% of the portfolio managed by the CBC and up to 3% in the case of an external manager. Furthermore, forward and swap operations cannot exceed a given percentage of the portfolio under management: for the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio; for the externally managed portfolios, forwards, swaps and futures cannot exceed 10% of each manager's portfolio.

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

7.6.3. Liquidity Risk

Liquidity risk arises from the losses that would occur from the early sale of securities in order to cover cash-flow needs. This risk is exacerbated during times of economic uncertainty, when some investments could be substantially discounted due to lack of demand or market depth.

In the ESSF, this risk is mitigated by maintaining a high percentage of liquid short-term assets. As of 31 December 2018, money market instruments accounted for 33.8%, which is in line with the 34% proposed under the current strategic allocation. Liquid assets include Treasury bills, certificates of deposit and time deposits, all of which are less sensitive to interest rate fluctuations. In addition, the market for Treasury bills and certificates of deposit allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

T12 Maximum credit exposure by bank issuer

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

(a) IP means Investment Portfolio managed by the CBC.

Source: Ministry of Finance

7.6.4. Operational Risk

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

This risk has been mitigated by delegating a large share of the operational management of the funds to the CBC, thereby taking advantage of the infrastructure that the CBC uses to manage its international reserves. The CBC has also set up a series of controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds and internal and external auditing processes to assess the effectiveness of the existing controls.

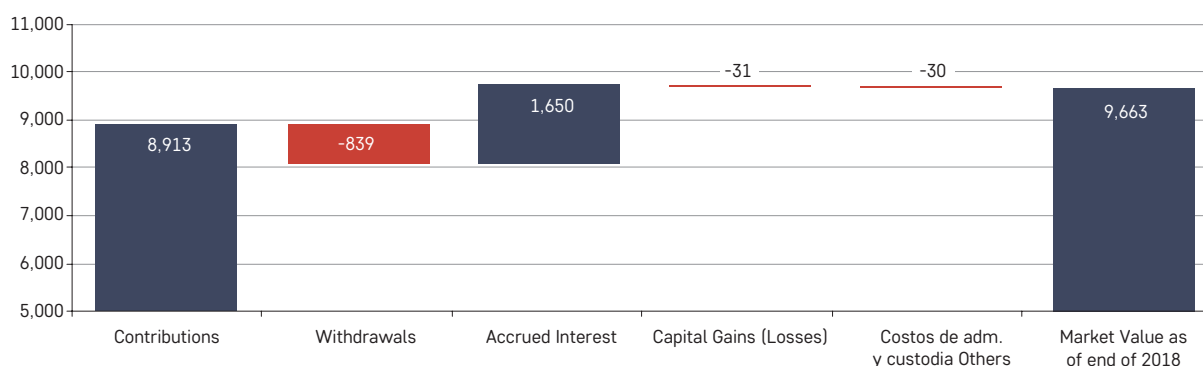
In the case of the external portfolio managers, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided. Starting in 2015, support for monitoring is provided by an international consulting firm.³³

³³ In 2015, the firm Verus was contracted to provide consulting services for the sovereign wealth funds through April 2018. Starting in May 2018, and following a selection process carried out by the CBC, RVK, Inc., was contracted to serve as the funds' international consultant.

08 PENSION RESERVE FUND

The market value of the PRF on 31 December 2018 was US\$ 9,663 million. Since its inception on 28 December 2006, the fund has recorded total capital contributions of US\$ 8,913 million, withdrawals of US\$ 839 million, and net investment income of US\$ 1,589 million, which breaks down into US\$ 1,650 million in interest earned, US\$ 31 million in capital losses, and US\$ 30 million in management and custody costs (see Figure 34). In 2018, the return in dollars, net of management costs, was -3.56%; the equivalent net return in pesos in the same period was 9.05%. Since the fund's inception, the annualized net return in dollars was 3.22%; the equivalent in pesos, 5.48%. The IRR in dollars was -3.59% in 2018 and 2.40% annualized since the creation of the fund.

F34 Change in market value, March 2007 - December 2018 (US\$ million)



Source: Ministry of Finance

8.1 Investment Policy³⁴

In November 2017, the Finance Minister approved a new PRF investment policy (see *Box 3*). The new policy was designed based on recommendations from the Financial Committee, which in turn took into account an assessment carried out by Mercer Investment Consulting in 2017.³⁵

As part of the process of defining the new policy, the decision was made to modify the fund's investment objective to take into account the fact that the resources will be used to finance part of the fiscal liabilities associated with the Solidarity Pillar, which are denominated in pesos. Thus, the new investment objective is **to obtain 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%**. At the same time, the risk tolerance was also redefined, so as to be consistent with the above investment objective and **establishes that the probability that the fund's real return will be less than -12%, expressed in pesos, must not exceed 5% in any given year.**

³⁴ This section was prepared based on the Finance Committee's 2018 Annual Report.

³⁵ For more information on the assessment and the new asset classes that will be incorporated into the PRF portfolio, see the Financial Committee's 2017 Annual Report, available online at <https://www.hacienda.cl/english/sovereign-wealth-funds/financial-committee/annual-report.html>.

BOX 3**Investment policy in place from January 2012 to September 2018**

The previous investment policy was in effect from January 2012 through September 2018, when the first increase in the equity portfolio was implemented to start the convergence process to the new PRF investment policy. The investment objective of the previous policy was to maximize the expected return, subject to a risk tolerance defined as a 95% probability that the fund would not record losses of over 10% of its value in dollars in a given year.

The portfolio allocation under that policy was 48% in sovereign bonds and government-related securities, 17%

in inflation-linked sovereign bonds, 20% in corporate bonds, and 15% in equity.

The asset classes stipulated under this policy were invested according to highly diversified benchmarks (see *Table B3*), using a predominantly passive investment strategy defined as an ex ante tracking error of 50 basis points for the aggregate portfolio of sovereign bonds, government-related securities, and inflation-linked sovereign bonds, 60 basis points for the equity portfolio, and 50 basis points for the corporate bond portfolio.

B3 Strategic asset allocation and benchmarks (percent of portfolio)

Asset class	Percent of total	Benchmarks
Sovereign and government-related bonds ^(a)	48	Bloomberg Barclays Global Aggregate: Treasuries Index (USD unhedged)
		Bloomberg Barclays Global Aggregate: Government-Related Index (USD unhedged) ^(b)
Inflation-linked sovereign bonds	17	Bloomberg Barclays Global Inflation-Linked Index (USD unhedged)
Corporates bonds	20	Bloomberg Barclays Global Aggregate: Corporates Bond Index (USD unhedged)
Equities	15	MSCI All Country World Index (USD unhedged con dividendos reinvertidos) ex Chile

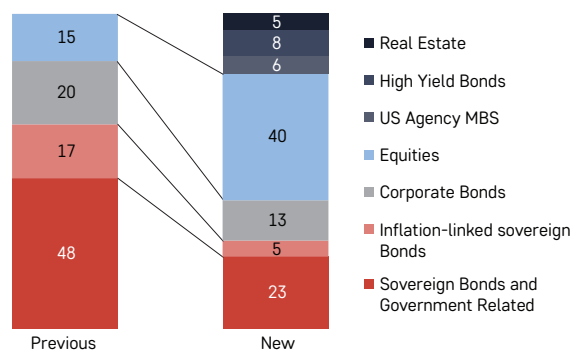
(a) The subindexes in this asset class are aggregated according to their relative capitalization.

(b) It includes other government-related issuers, such as municipalities, state-owned companies, agencies, etc.

Source: Ministry of Finance

The new strategic asset allocation was defined so as to be consistent with the new investment objective and defined risk tolerance. Under the new policy, 40% of the fund will be invested in equities, 23% in sovereign bonds and government-related securities, 5% in inflation-linked sovereign bonds, 13% in corporate bonds, 6% in mortgage-backed securities (MBS) issued by U.S. agencies (henceforth, U.S. agency MBS), 8% in high-yield bonds, and 5% in unlisted real estate assets (see *Figure 35*). All the asset classes, with the exception of U.S. agency MBS, will be invested globally. Additionally, the foreign currency exposure of the fixed-income portfolios will gradually be hedged to Chilean pesos. The benchmarks to be used for each asset class are listed in *Table 13*.

F35 Changes in the strategic asset allocation contained in the investment policy (percent of portfolio)



Source: Ministry of Finance

T13 New benchmarks

Asset Class	Benchmarks
Equities	MSCI All Country World Index (USD unhedged con dividendos reinvertidos) ex Chile
Sovereign and government-related bonds ^(a)	Bloomberg Barclays Global Aggregate: Treasuries Index (USD unhedged) Bloomberg Barclays Global Aggregate: Government-Related Index (USD unhedged) ^(b)
Corporates bonds	Bloomberg Barclays Global Aggregate: Corporates Bond Index (USD unhedged)
High yield bonds	Bloomberg Barclays Global High Yield Index (USD unhedged)
US Agency MBS	Bloomberg Barclays US Mortgage Backed Securities Index
Real Estate	<i>Benchmark to be defined</i>
Inflation-linked sovereign bonds	Bloomberg Barclays Global Inflation-Linked Index (USD unhedged)

(a) The subindexes in this asset class are aggregated according to their relative capitalization.

(b) It includes other government-related issuers, such as municipalities, state-owned companies, agencies, etc.

Source: Ministry of Finance

The implementation of the new investment policy began in 2018. The main activities in the year included initiating the convergence process to the new investment policy, contracting a consultant, and selecting the external managers for the U.S. agency MBS and high-yield bond portfolios.³⁶

Convergence process

The Finance Committee recommended a gradual convergence to the new strategic asset allocation. The proposal was to gradually increase the share of equities over three years, with purchases approximately every six months, to be coordinated with contributions to and withdrawals from the PRF.³⁷ Thus, if market conditions allow, the asset class will be increased in January and June of each year, starting in 2018.

With regard to the new asset classes, the Committee recommended implementing the new policy in two phases, starting with the U.S. agency MBS and high-yield bond asset classes. The real estate exposure and currency hedging strategy would then be implemented in a second phase.

The implementation of the real estate asset class was deferred to a second phase, because it requires an in-depth analysis of the operational, legal, and tax issues associated with this type of investment in the private market. The implementation of the currency hedging program was also left for a later phase, as it depends directly on the final currency composition of the fixed-in-

³⁶ The U.S. agency MBS and high-yield bond mandates were implemented in January 2019.

³⁷ Contributions to the PRF must be made in the first half of each year, usually in the month of June. The Ministry is working with the Budget Office (DIPRES) to coordinate the date of withdrawals and contributions to minimize transaction costs.

come portfolio once the fund has fully converged to the strategic asset allocation.

Taking into account the Committee’s recommendations, the Finance Ministry defined transitional strategic asset allocations that reflect the way the fund will converge to the definitive allocation (see *Table 14*).³⁸ Thus, the first equity increase was effected in September 2018,³⁹ and, as indicated above, further increases are expected to be implemented in January and June of each year. In January 2019, the fund began to invest in U.S. agency MBSs and high-yield bonds. The latter two mandates and the equity increase for that month were financed with resources from the sovereign, government-related, inflation-linked and corporate bonds portfolios. Investment in the real estate sector is expected to begin in January 2020. Future equity increases and the real estate sector mandate will be financed from the sovereign, government-related, and inflation-linked bonds portfolios.

Contracting a consultant

Based on the Finance Committee’s recommendations, the Finance Minister instructed the CBC in February 2018 to undertake a selection process for contracting a consulting firm. The CBC thus sent out a Request for Proposal and, after a careful review of the pro-

posals received, decided on the firm RVK.⁴⁰ The respective contract was signed on 31 May 2018.

Contracting external managers for the U.S. agency MBS and high-yield bond portfolios

Once RVK had been contracted, the CBC started on the next phase, namely, the selection of the external portfolio managers for the new U.S. agency MBS and high-yield bond mandates.

The process began in July 2018, when a Request for Information was sent to potential firms. The responses were reviewed to narrow the field, and a Request for Proposal was then sent to the remaining firms. The CBC and RVK evaluated the proposals received and chose six firms for each asset class, which were interviewed in New York by the Bank, the consulting firm, and personnel from the Finance Ministry.

Each firm was rated on their Request for Proposal and interview, using a weighted point system, and the CBC chose the three firms with the highest score in each mandate. Details on the selection process and the resulting finalists were presented to the Finance Committee at its meeting in November 2018. The CBC then proceeded to the final step in selection process, reviewing the cost

T14 Transitory and final strategic asset allocation

	Sovereign and government-related bonds	Inflation-linked sovereign bonds	Corporates bonds	Equities	US Agency MBS	High yield bonds	Real Estate	Total
31-12-17	48	17	20	15	0	0	0	100
30-09-18	44	17	20	19	0	0	0	100
31-01-19	39	11	13	23	6	8	0	100
30-06-19	35	11	13	27	6	8	0	100
31-01-20	32	5	13	31	6	8	5	100
30-06-20	28	5	13	35	6	8	5	100
31-01-21	23	5	13	40	6	8	5	100

Source: Ministry of Finance

³⁸ The transitional strategic allocations could be modified as more information becomes available on the operational and legal complexities associated with real estate investment.

³⁹ The first increase in the equity portfolio was scheduled for June 2018, when the PRF would receive its annual contribution, but it was deferred to September due to a delay in processing the PRF contribution decree.

⁴⁰ RVK is based in Portland, with offices in Chicago and New York, has a team of 115 professionals, and is independently owned, with no outside investors or parent company. It has over US\$ 900 billion in assets under advisement (AUA) and is one of the ten largest consultants in the financial investment industry. Finally, the company is 100% owned and managed by its employees.

proposals to choose the two least expensive firms. The winning firms were BNP and Western for U.S. agency MBSs, and Black-Rock and Nomura for high-yield bonds.

8.2 Market Value

The market value of the PRF on 31 December 2018 was US\$ 9,663 million, which represents a reduction of US\$ 348 million relative to year-end 2017. The decrease is mainly due to a net financial loss of US\$ 364 million, which was partially offset by a net contribution of US\$ 17 million. The latter breaks down into a contribution of US\$ 542 million, equivalent to 0.2% of 2017 GDP (see *Table 15*), and two withdrawals of US\$ 295 million and US\$ 230 million in September and December, respectively.

Since its inception on 28 December 2006, the fund has recorded contributions totaling US\$ 8,912 million, withdrawals of US\$ 839 million, and net investment income of US\$ 1,589 million (see *Table 16*).

T15 Annual contributions and withdrawals (millions of dollars)

Period	Contribution	% GDP of prev. year	Withdrawal ^(a)
2006	605	0.5	
2007	736	0.5	
2008	909	0.5	
2009	837	0.5	
2010	337	0.2	
2011	443	0.2	
2012	1,197	0.5	
2013	1,377	0.5	
2014	499	0.2	
2015	464	0.2	
2016	462	0.2	
2017	505	0.2	314
2018	542	0.2	525
Total	8,913		839

(a) For more information about the withdrawal rules of PRF see section 3.2 of this report.

Source: Ministry of Finance

T16 Decomposition of market value (millions of dollars)

Decomposition	2012	2013	2014	2015	2016	2017	2018	Since inception ^(a)
Starting market value	4,406	5,883	7,335	7,944	8,112	8,862	10,011	0
Contributions	1,197	1,377	499	464	462	505	542	8,913
Withdrawals	0	0	0	0	0	-314	-525	-839
Accrued interest	131	174	190	194	197	208	222	1,650
Capital gains (losses)	151	-95	-76	-485	94	755	-581	-31
Management, custody and other costs	-1.2	-4.4	-4.6	-4.5	-4.2	-4.9	-4.7	-30.1
Net financial gains	280	75	110	-295	288	958	-364	1,589
Ending market value	5,883	7,335	7,944	8,112	8,862	10,011	9,663	9,663

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

Source: Ministry of Finance

8.3 Performance

In 2018, the fund's return in dollars, net of management costs, was -3.56%, which breaks down as follows: sovereign and government-related bonds, -0.62%; inflation-linked sovereign bonds, -4.25%; corporate bonds, -3.77%; and equities, -9.07%. The equivalent net return in pesos in 2018 was 9.05%. The annualized net return in dollars over the last three years was 3.45%; in pesos, 2.88%. Since 31 March 2007, the annualized net return in dollars was 3.22%; in pesos, 5.48% (see *Table 17* and *Figure 36*). The IRR in dollars was -3.59% in 2018 and 2.40% annualized since the creation of the fund.

T17 Net return (percent)

Returns ^(a)	2018	Last 3 years	Since inception ^(b)
Sovereign and government-related bonds	-0.62	2.84	0.22
Inflation-linked sovereign bonds	-4.25	2.74	1.79
Corporate bonds	-3.77	3.03	2.49
Equities	-9.07	6.95	8.36
Return in USD	-3.56	3.45	3.22
Exchange rate effect, CLP	13.08	-0.55	2.19
Return in CLP^(c)	9.05	2.88	5.48

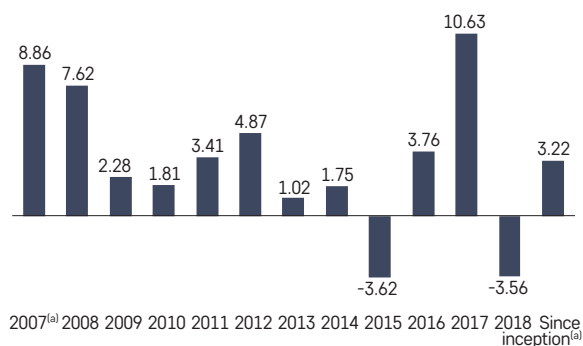
(a) Time-weighted rate of return (calculated as the growth rate of the funds that were invested throughout the entire period).

(b) The sovereign and government-related bond, inflation-linked sovereign bond, corporate bond, and equity portfolios date to 31 December 2011. For the total portfolio, the inception date was 31 March 2007.

(c) The return in CLP is the sum of the percent change in the peso-dollar exchange rate and the return in dollars.

Source: Ministry of Finance

F36 Annual net return in dollars (percent)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

An analysis of quarterly returns in dollars (see *Table 18*) shows that the fund recorded a positive return in the first quarter, driven by the solid performance of the sovereign fixed-income portfolio. The second quarter had the lowest returns of the year, with negative returns in both the sovereign and corporate fixed-income portfolios. For the third quarter, the return was negative and close to zero, as the poor performance of the sovereign fixed-income portfolio was partially offset by the better quarterly return on the equity portfolio. Finally, the last quarter had positive results close to zero, offset by the negative equity performance.

The fund's investment performance can be illustrated using an index of the portfolio's daily returns (see *Figure 37*). Taking a starting value of 100 on 31 March 2007, the index reached 145.1 at year-end 2018.

T18 Net quarterly return in dollars in 2018, by asset class (percent)

Returns	Q 1	Q 2	Q 3	Q 4
Sovereign and government-related bonds	2.52	-3.27	-1.42	1.67
Inflation-linked sovereign bonds	1.55	-3.22	-1.46	-1.14
Corporate bonds	-0.94	-2.45	0.52	-0.93
Equities	-0.84	0.63	4.34	-12.67
Total portfolio	1.13	-2.49	-0.12	-2.08

Source: Ministry of Finance

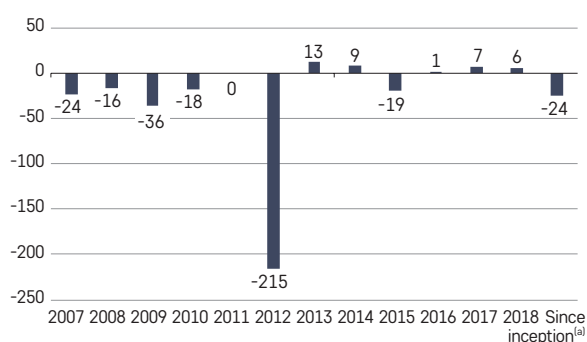
F37 Return index in dollars (31 March 2007 = 100)



Source: Ministry of Finance

The performance of the PRF, measured as the difference between the portfolio return and the benchmark return, was 6 basis points in 2018, while the annualized performance since 31 March 2007 was -24 basis points (see *Figure 38*). The negative performance of 215 basis points in 2012 was largely due to the implementation of the new investment policy. If the months of January and February 2012 are excluded to remove the implementation period, when the portfolio allocation had not yet been aligned with the new strategic asset allocation and the fund managers were granted a waiver from the asset allocation requirement, then the performance in 2012 was -3 basis points.⁴¹

F38 Returns against the benchmark (basis points)



(a) Calculated from 31 March 2017.

Source: Ministry of Finance

By asset class, in 2018 the sovereign bond portfolio (that is, the aggregate portfolio of sovereign, government-related, and inflation-linked sovereign bonds) and the corporate bond portfolio recorded an excess returns of 9 basis points and -20 basis points, respectively (see *Table 19*). In the case of the equity portfolio, the excess return was -16 basis points. In the last three years, the annualized excess return was 6 basis points for the sovereign portfolio, -11 basis points for corporate bonds, -24 basis points for equity, and -5 basis points for the total portfolio.⁴²

T19 Net returns against the benchmark,⁴³ by asset class (basis points)

Asset class	2018	Last 3 years	Since inception ^(a)
Sovereign portfolio ^(b)	9	6	-15
Corporate bonds	-20	-11	-34
Equities	-16	-24	-42
Total portfolio	6	5	-24

(a) The return since inception is calculated from 31 March 2007, the start date of the CBC performance measure.

(b) The sovereign portfolio represents the aggregate performance of sovereign bonds, government-related bonds and inflation-linked sovereign bonds.

Source: Ministry of Finance

41 The transfer of funds to the external managers of the corporate bond and equity portfolios, which was a necessary step for convergence to the strategic asset allocation of the new investment policy implemented in 2012, occurred on 17 January and 1 March 2012. Consequently, the external managers did not have the necessary resources to invest the PRF in accordance with the new strategic asset allocation until 1 March 2012. However, the PRF performance shown in *Figure 38* for 2012 represents the excess return that would have been recorded had the portfolio immediately converged to the new strategic asset allocation on 17 January 2012. If the months of January and February are excluded, since they represent a transition period during which the portfolio managers were granted waivers following the fund transfers, then the performance in 2012 was -3 basis points.

42 As in the case of the ESSF, the negative performance of the equity portfolio is mainly due to portfolio taxes, which are not considered in the benchmark return.

43 The excess return of the total portfolio is calculated as the difference between the weighted sum of the returns of each asset class of the portfolio and the benchmark.

8.4. Portfolio Allocation

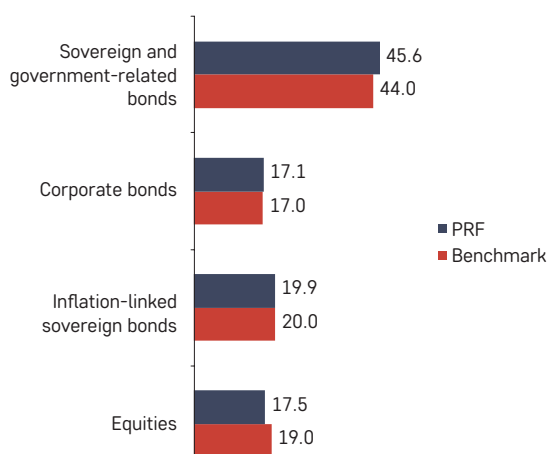
As of December 2018, the allocation of the PRF by asset class comprised US\$ 4,404 million in sovereign and government-related bonds, US\$ 1,650 million in inflation-linked sovereign bonds, US\$ 1,918 million in corporate bonds, and US\$ 1,691 million in equities. In terms of portfolio shares, the percent allocation by asset class and currency was relatively similar to the benchmark, although the share of the sovereign and government-related bonds portfolio was higher and for the equity portfolio was lower than the benchmark (see *Figure 39*). With regard to the currency allocation, at year-end 2018 the fund was in line with the benchmark, with around 90% of the fund invested in U.S. dollars, euros, Japanese yen, and pounds sterling (see *Figure 40*).

In terms of credit risk allocation, at year-end, 25.8% of the PRF fixed-income portfolio was invested in instruments rated AAA,

51.5% in AA+ y A-, and the remaining 22.6% between BBB+, BBB- and others (see *Table 20*).

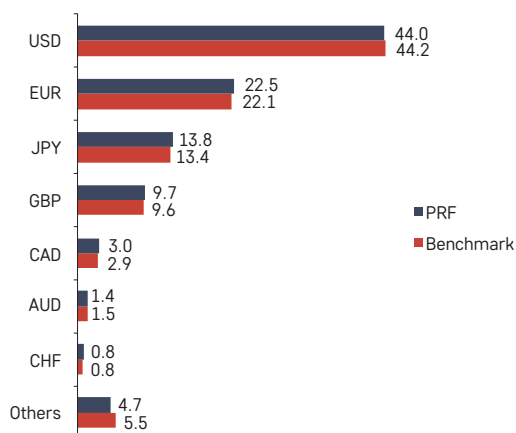
With regard to the geographical allocation, investments are mainly concentrated in North America, Europe, and Asia. At year-end 2018 the fund was in line with the benchmark in Africa, underweighted in North America and Europe by 0.62% and 3.49%, respectively. Additionally, overweighted in Asia and Latin America by 2.79% and 1.34% respectively (see *Figure 41*). These deviations mainly derive from positions held by the CBC, which favors the government-related segment of the sovereign bond asset class,⁴⁴ in search of a higher spread associated with a higher, though still limited, credit risk.

F39 Asset class allocation, 31 December 2018 (percent of portfolio)



Source: Ministry of Finance

F40 Currency allocation, 31 December 2018 (percent of portfolio)



Source: Ministry of Finance

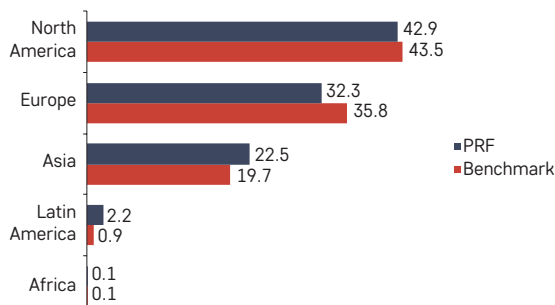
T20 Credit risk exposure, 31 December 2018 (percent of fixed-income portfolio)

	Sovereign and government-related bonds	Inflation-linked sovereign bonds	Corporates bonds	Total fixed-income
AAA	15.5	10.2	0.1	25.8
AA+	0.5	0.2	0.4	1.1
AA	6.1	8.8	0.3	15.2
AA-	3.1	0.0	1.1	4.3
A+	6.1	0.1	2.2	8.3
A	13.5	0.0	3.5	17.0
A-	1.8	0.0	3.9	5.7
BBB+	4.6	0.4	5.2	10.2
BBB	0.1	0.0	3.7	3.9
BBB-	3.7	0.9	3.2	7.8
Others ^(a)	0.2	0.0	0.5	0.7
Total	55.2	20.7	24.1	100.0

(a) It includes cash and cash equivalents.

Source: Ministry of Finance

F41 Regional allocation, 31 December 2018 (percent of portfolio)



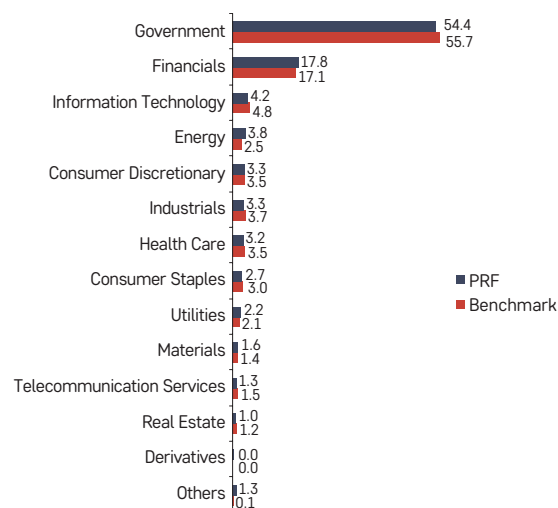
Source: Ministry of Finance

⁴⁴ State companies, multilateral organizations, etc.

By economic sector, over half of the fund is invested in the government sector, followed by the financial and technology sectors. Relative to the benchmark, at year-end 2018 the fund was slightly underweighted in the government, technology, durable goods, industrial, health, nondurable goods, communications, and real estate sectors, and overweighted in the financial, energy, public utility, and commodity sectors (see *Figure 42*).

By country, the fund's exposure is concentrated in the United States, with 37.6% of the total portfolio at year-end 2018, followed by Japan, with 14.1%. Exposure to the first five countries account for almost 70% of the total fund (see *Table 21*).

F42 Sectoral allocation, 31 December 2018 (percent of portfolio)



Source: Ministry of Finance

T21 Allocation by country, 31 December 2018 (percent of portfolio)

Country allocation	Sovereign and government-related bonds	Inflation-linked sovereign bonds	Corporate bonds	Equities	Total
United States	9.8	7.0	11.0	9.8	37.6
Japan	12.4	0.1	0.3	1.3	14.1
United Kingdom	2.3	5.1	1.7	0.9	9.9
France	2.2	2.2	1.2	0.5	6.1
Canada	1.8	0.4	1.0	0.5	3.7
Italy	2.1	0.8	0.2	0.1	3.2
Spain	2.0	0.4	0.3	0.2	2.9
Germany	1.1	0.5	0.4	0.5	2.5
South Korea	1.9	0.0	0.0	0.3	2.2
The Netherlands	0.6	0.0	1.3	0.3	2.2
Mexico	1.6	0.0	0.2	0.1	1.8
Australia	0.7	0.3	0.3	0.4	1.7
Switzerland	0.1	0.0	0.1	0.5	0.8
Others ^(a)	6.9	0.4	1.8	2.2	11.3
Total	45.6	17.1	19.9	17.5	100.0

(a) It includes cash and cash equivalents.

Source: Ministry of Finance

8.5 Management Costs and Income from the Securities Lending Program

The total cost of managing the PRF included US\$ 1,540,339 for custody services, US\$ 1,115,871⁴⁵ for the CBC's management services, and US\$ 1,545,941 for external portfolio managers. In the year, there were also payments associated with others external services (auditing and advising services) for a total of US\$ 537,400. Together, the total management and custody costs represented 5 basis points of the total PRF portfolio in 2018. The income from the securities lending program totaled US\$ 394,528, which partly offset the management and custody costs (see *Table 22*).

8.6 Main Financial Risks

The PRF portfolio is largely exposed to the same risks as the ESSF. However, credit risk is higher in the PRF due to its exposure to a larger number of countries. Moreover, because the fund invests in corporate bonds, it is exposed to the credit risk of the issuing companies. It also has a larger share of equity investments than the ESSF, which increases its exposure to the higher volatility of this asset class. As in the case of the ESSF, most of these risks depend directly on the asset class allocation and the chosen benchmarks, given the passive management stipulated in the fund's investment policy.

8.6.1. Market Risk

The market value of the financial instruments in the PRF portfolio can be exposed to losses as a result of changes in market conditions. As with the ESSF, the fixed-income portfolio is exposed to interest rate risk, foreign exchange risk and credit spread risk. In addition, the PRF is exposed to equity risk. This section describes these risk in detail, together with the control mechanisms set up for monitoring them.

Interest rate risk

In the PRF, interest rate risk is mainly a function of the benchmark portfolio duration, which is calculated from the duration of the indexes that make up the benchmark. In contrast to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk from a larger number of countries, and it is more sensitive due to its longer duration. This risk is monitored and controlled by keeping the portfolio duration close to the benchmark. The benchmark duration at the close of 2018 was 8.1 years, while the actual duration of the PRF was 8.0 years.

T22 Management and custody costs and income from the securities lending program (dollars)

Items	2012	2013	2014	2015	2016	2017	2018
Custody (J.P. Morgan) ^(a)	91,572	1,971,424	2,296,139	1,639,504	1,449,173	1,595,229	1,540,339
Management (CBC)	520,186	1,032,599	724,115	947,984	1,003,643	995,777	1,115,871
Management (external)	548,098	1,347,401	1,608,982	1,884,965	1,550,659	2,147,271	1,545,941
Other costs ^(b)	70,588	—	—	—	241,507	111,763	537,400
Total costs	1,230,443	4,351,424	4,629,236	4,472,453	4,244,983	4,850,040	4,739,550
Total Cost in basis points ^(c)	2	6	6	6	5	5	5
Securities lending program	219,422	235,855	567,458	278,184	307,653	338,324	394,528

(a) Custody costs in 2014 include payments for services rendered from May to December 2013.

(b) It includes consulting, auditing, and tax consulting services.

(c) It includes custody and administration expenses.

Source: Ministry of Finance

⁴⁵ The increase in 2018's CBC remuneration corresponds mainly to the expenses associated with the renovation of a technological platform used in the administration of sovereign wealth funds.

Foreign exchange risk

Because the fund's performance is measured in dollars, the value of investments in other currencies is affected by the corresponding exchange rate movements. Given the passive management strategy, the tolerance for foreign exchange risk is defined by the currency allocation of the benchmark. As of year-end 2018, approximately 97% of the portfolio was invested in 10 different currencies, including the dollar, while the remaining 3% was exposed to 26 currencies. Specifically, the fund's exposure to currency risk is mainly through investments denominated in euros (22.5%), yen (13.6%), pounds sterling (9.7%), Canadian dollars (3.0%), and Australian dollars (1.4%).

Credit spread risk

The market value of the instruments in the PRF fixed-income portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. The PRF is subject to higher credit spread risk than the ESSF because its fixed-income portfolio includes instruments from many issuers around the world, such as governments of developed and developing countries, public and semi-public agencies, multilateral financial institutions, corporations and so on. Credit spread risk is mitigated by having a well-diversified portfolio and investing only in investment-grade instruments (with a rating of BBB- or higher).

Equity risk

The PRF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2018, equities accounted for 17.50% of the fund, which is lower than the strategic asset allocation (19%).

Volatility, VaR, and tracking error

The annual volatility of the PRF was 4.1% in 2018, versus 5.3% for the period from 31 March 2007 onward. Since the fund's inception, the highest monthly return was 5.47% (in December 2008), while the lowest was -3.33% (in January 2009). The highest quarterly return was 7.36% in the first quarter of 2008; the lowest was -5.75% in the fourth quarter of 2016 (see *Table 23*). At year-end 2018, the VaR was 5.63% in a one-year horizon, with a 95% confidence level.⁴⁶

T23 Historical minimum and maximum returns (percent)

Range	Month	Quarter
Highest return	5.47 (Dec-08)	7.36 (I 08)
Lowest return	-3.33 (Jan-09)	-5.75 (IV 16)

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At year-end 2018, the ex ante tracking error of the PRF was 37 basis points, while the ex post tracking error was 14 basis points.

8.6.2 Credit Risk

In the PRF bond portfolio, exposure to this type of risk is mitigated by having a well-diversified portfolio and investing only in instruments from issuers included in the benchmark. For bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly associated with investing the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards and swaps is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see *Table 24*). In addition, forwards and swaps cannot exceed a stipulated percentage of each manager's portfolio. For the portfolio managed

⁴⁶ This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 5.63% of its nominal value in dollars.

by the CBC, forwards and swaps cannot exceed 4% of the portfolio. In the case of the external managers, forwards, swaps and futures cannot exceed 10% of each manager's portfolio.

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

8.6.3 Liquidity Risk

The PRF is exposed to fairly low liquidity risk because the fund has historically had little need for cash. Disbursements from the fund started in 2017 with a withdrawal of US\$ 314 million in September of that year, followed by two withdrawals of US\$ 295 million and US\$ 230 million in September and December 2018, respectively. To minimize transaction costs and the risk of having to generate liquidity at inopportune times, future withdrawals will be coordinated with the annual contributions to the fund, so as to offset the movements. Furthermore, the sale of instruments

in the PRF portfolio is mainly associated with changes in the benchmark, which can require the portfolio managers to make an adjustment (that is, to sell an instrument that left the benchmark in order to purchase one that was incorporated). In the event of changes in the benchmark, the investment guidelines allow some flexibility for managers to make the necessary adjustments, in order to reduce the impact of having to sell at an unfavorable time. Additionally, over the coming years it will be necessary to sell instruments in the sovereign fixed-income portfolio in order to converge to the new strategic asset allocation. The liquidity risk associated with this transition is fairly low, given that the dates and amounts of the cash movements are generally known in advance.

8.6.4 Operational Risk

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

For the portfolio managed by the CBC, this risk has been mitigated because the operational management of the funds is carried out using the same infrastructure that the CBC uses to manage its international reserves. The CBC has also set up a series of

T24 Credit limits on bank deposits and forwards

Limits		Time deposits	Forwards
Minimum rating		A-	A-
Maximum per issuer ^(a)	CBC portfolio	1.0% (above AA-) 0.5% (A- / A+)	1.0% (above AA-) 0.5% (A- / A+)
	Externally managed portfolios	5%	3%

(a) Percent of each manager's portfolio (CBC or a given external manager).

Source: Ministry of Finance

controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds and internal and external auditing processes to assess the effectiveness of the existing controls.

In the case of the external portfolio managers, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided. Starting in the second half of 2015, support for monitoring is provided by an international consulting firm.⁴⁷

⁴⁷ See footnote 33.

09 FINANCIAL STATEMENTS: ECONOMIC AND SOCIAL STABILIZATION FUND

Financial statements for the years ended on 31 December 2018 and 2017 and the independent auditors' report⁴⁸

⁴⁸ The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2018 and 2017 were prepared by the General Treasury and audited by Crowe Horwarth. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

INDEPENDENT AUDITORS' REPORT

Santiago, 29 March 2019

To the Office of the Treasury of Chile
Economic and Social Stabilization Fund

Report on the financial statements

We have conducted an audit of the attached financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2018 and 2017, with the corresponding income, comprehensive income, changes in net equity, and cash flow statements for these years, together with the corresponding notes.

Management's responsibility for the financial statements

The Treasury of Chile is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes the design, implementation, and maintenance of appropriate internal control procedures that ensure the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Chile. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves carrying out procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks associated with material misstatements on the financial statements, whether due to fraud or error. On making these risk assessments, the auditor considers the internal control procedures that are relevant to the preparation and fair presentation of the Fund's financial statements, in order to design auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. We therefore do not express such an opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the significant accounting estimates made by the Fund's management, as well as assessing the general presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate for providing the basis for our audit opinion.

Opinion

In our opinion, these financial statements fairly present, in all material aspects, the financial position of the Economic and Social Stabilization Fund as of 31 December 2018 and 2017 and its operating performance and cash flows for the years ended on those dates, in accordance with International Financial Reporting Standards.

Other matters

As indicated in Note 1, the Economic and Social Stabilization Fund's resources are intended to be used to provide additional resources for the stabilization of fiscal income, replacing the fund established for that purpose under Decree Law N° 3,653 of 1981 and the Copper Compensation Fund established under IBRD loan agreement N° 2,625 CH, as specified in Statutory Decree No. 1 issued on 11 December 2006.

Sergio Bascuñán Rivera

ECONOMIC AND SOCIAL STABILIZATION FUND

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ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF FINANCIAL POSITION

AS OF 31 DECEMBER 2018

<u>ASSETS</u>	<u>Notes</u>	<u>31 Dec 2018</u> US\$	<u>31 Dec 2017</u> US\$	<u>LIABILITIES AND NET EQUITY</u>	<u>Notes</u>	<u>31 Dec 2018</u> US\$	<u>31 Dec 2017</u> US\$
CURRENT ASSETS				LIABILITIES			
Cash and cash equivalents	12	<u>5,018,748</u>	<u>59,573,500</u>	Derivative financial instruments	8	<u>3,942,084</u>	<u>464,227</u>
Total current assets		<u>5,018,748</u>	<u>59,573,500</u>	Total liabilities		<u>3,942,084</u>	<u>464,227</u>
FINANCIAL ASSETS AFFECTING INCOME				NET EQUITY			
Equities	7	905,269,174	1,169,905,643	Fisco resources		10,912,903,120	10,912,903,120
Other capitalization instruments	7	20,181,112	25,456,877	Withdrawals by the Fisco in the year	9	(541,576,255)	-
Time deposits	7	3,181,369,668	3,357,869,337	Retained earnings		3,825,920,225	2,859,155,143
Government bonds	7	7,938,699,602	8,045,821,051	(Loss) income in the year		<u>(63,399,802)</u>	<u>966,765,082</u>
Indexed bonds	7	488,297,373	514,580,823	Total net equity		<u>14,133,847,288</u>	<u>14,738,823,345</u>
Treasury bills	7	1,598,802,754	1,565,510,121				
Derivatives		<u>150,941</u>	<u>570,220</u>				
Total investments		<u>14,132,770,624</u>	<u>14,679,714,072</u>				
Total assets		<u>14,132,789,372</u>	<u>14,739,287,572</u>	TOTAL LIABILITIES AND NET EQUITY		<u>14,137,789,372</u>	<u>14,739,287,572</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND
STATEMENT OF INCOME

		For the period starting in January first to	
	<u>Notes</u>	<u>31 Dec 2018</u> US\$	<u>31 Dec 2017</u> US\$
OPERATING INCOME			
Interest earned	10	140,869,343	126,715,047
Income from dividends	11	26,053,549	26,289,925
Net realized gains		-	121,892,430
Net unrealized gains		-	694,731,851
Total operating income		166,922,892	969,629,253
OPERATING LOSSES			
Net losses from sale of financial instruments		(14,545,312)	-
Net unrealized losses from price changes on financial instruments		(212,962,225)	-
Total operating losses		(227,507,537)	-
Total operating income		(60,584,645)	969,629,253
MANAGEMENT EXPENSES			
Fiscal agent's fee (Central Bank of Chile)	9	(1,595,178)	(1,546,240)
Custodian's fees and external managers' fees	9	(1,144,991)	(1,186,530)
Other custody and external management expenses	9	(74,988)	(71,017)
Adjustment, J.P. Morgan		-	(60,384)
(LOSS) INCOME IN THE YEAR		(63,399,802)	966,765,082

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND
STATEMENT OF COMPREHENSIVE INCOME

	For the period starting in January first to <u>31 Dec 2018</u>	<u>31 Dec 2017</u>
	US\$	US\$
Loss (income) in the year	(63,399,802)	966,765,082
Other comprehensive income reclassified to income in subsequent years	-	-
Other comprehensive income not reclassified to income in subsequent years	-	-
Total other comprehensive income	<u>-</u>	<u>-</u>
Comprehensive income in the year	<u><u>(63,399,802)</u></u>	<u><u>966,765,082</u></u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND
STATEMENT OF CHANGES IN NET EQUITY
AS 31 DECEMBER OF 2018 AND 2017

	<u>Notes</u>	<u>Fiscal income</u> US\$	<u>Accumulated income</u> US\$	<u>Comprehensive income in the year</u> US\$	<u>Total</u> US\$
Opening balance, 1 January 2018		10,912,903,120	2,859,155,143	966,765,082	14,738,823,345
Distribution of income from previous year		-	966,765,082	(966,765,082)	-
Withdrawals by the Fisco	9	(541,576,255)	-	-	(541,576,255)
Loss for the year		-	-	(63,399,802)	(63,399,802)
Closing balance, 31 December 2018		<u>10,371,326,865</u>	<u>3,825,920,225</u>	<u>(63,399,802)</u>	<u>14,133,847,288</u>
Opening balance, 1 January 2017		10,912,903,120	2,591,086,975	268,068,168	13,772,058,263
Distribution of income from previous year		-	268,068,168	(268,068,168)	-
Withdrawals by the Fisco	9	-	-	-	-
Income for the year		-	-	966,765,082	966,765,082
Closing balance, 31 December 2017		<u>10,912,903,120</u>	<u>2,859,155,143</u>	<u>966,765,082</u>	<u>14,738,823,345</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CASH FLOWS

(Indirect method)

	<u>Notes</u>	For the finished exercises on	
		<u>31 Dec 2018</u> US\$	<u>31 Dec 2017</u> US\$
CASH FLOWS FROM OPERATING ACTIVITIES			
(Loss) income in the year		(63,399,802)	966,765,082
Net unrealized losses (gains)		212,962,225	(694,731,851)
Changes in fund management and custody		<u>337,459,080</u>	<u>(272,942,552)</u>
Net cash flows from operating activities		<u>487,021,503</u>	<u>(909,321)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	-	-
Decrease from capital withdrawals		<u>(541,576,225)</u>	<u>-</u>
Net cash flows from financing activities		<u>(541,576,225)</u>	<u>-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS		(54,554,752)	(909,321)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		<u>59,573,500</u>	<u>60,482,821</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	<u>5,018,748</u>	<u>59,573,500</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

NOTES TO THE FINANCIAL STATEMENTS

AS 31 DECEMBER, 2018 AND 2017

NOTE 1 –GENERAL INFORMATION

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

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

- a) Decree N° 1,618 of April 18, 2013, which authorizes the Central Bank of Chile (CBC) to act as fiscal agent in managing the Economic and Social Stabilization Fund and establishes guidelines for reporting on the investments to the Finance Minister and the Treasury.
- b) Ministry of Finance Official Letter N° 1,567 of June 17, 2015, which informs the fiscal agent of the new performance guidelines for managing the Economic and Social Stabilization Fund.
- c) Comptroller General Official Letter N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.
- d) Decree N° 1,492 of 2015, which regulates the coordination and functioning of advisory activities, management support, and auditing of the Public Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund (and which abolishes Decree N° 1,636 of 2009).

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

- Record all investments of Treasury resources, as well as debt operations, in accordance with the accounting and budgetary standards established by the Comptroller General and/or the Budget Office, as applicable.
- Perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms, and commission independent auditors for the annual financial statements, subject to the stipulations of Article 7 of this Decree. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.
- Support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.

- Verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records. This provision was applied to the portfolios under the management of external fund managers on 1 January 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.
- Issue transaction instructions associated with contributions to and withdrawals from the sovereign wealth funds in accordance with instructions from the Finance Minister, validate payments associated with the management and custody of the sovereign wealth funds, as required, and issue instructions to the Central Bank of Chile on the payment of the different services provided by the external managers.
- Supervise compliance with the norms and limits established by the Ministry of Finance with regard to the capital market investment of Treasury resources that are held outside the sovereign wealth funds and to send periodic reports on the matter to the Budget Office and the Ministry of Finance.
- Maintain a current manual of procedures for the handling of all functions and duties described in this Article.
- Provide any additional management support, coordination or consulting as needed for the performance of these functions.

The information for the accounting of the sovereign wealth funds is provided by the Treasury, which is and will continue to be an institution in good standing, such that the data resulting from the accounting process are not estimated values.

- e) Ministry of Finance Decree N° 2,463 of December 13, 2018, which establishes the new custody guidelines.
- f) Ministry of Finance Official Letter N° 45 of October 11, 2017, which authorizes payment of compensation for 2018, for portfolio management and other services.
- g) Ministry of Finance Decree N° 1,618 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.

Article 15, paragraph (a), of Decree N° 1,618 of 2013 authorizes the fiscal agent to conduct, at the request of the Finance Minister, one or more tenders for the management of the externally managed portfolio and to contract the external managers thereof, in the name and on the account of the Treasury. Under this provision, the following external managers were contracted to perform custody services starting in 2013:

- BNY Mellon Equities;
- Blackrock Equities.

- h) Ministry of Finance Decree N° 892 of 2014, which establishes fiscal policy in accordance with the provisions of Article 1 of Law N° 20,128.

Qualitative characteristics of the ESSF financial statements

- i) The Principle of Relevance, as a category of the ESSF financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.

- ii) The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence, and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.
- iii) The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.
- iv) The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

On 17 June 2015 the Ministry of Finance issued Official Letter N° 1,567, which contains the new investment guidelines for the Economic and Social Stabilization Fund. These guidelines, which entered into force on 5 August 2015, replace and rescind the investment guidelines contained in Official Letter N° 1,267, issued by the Ministry of Finance in 2013.

NOTE 2 – MAIN ACCOUNTING CRITERIA USED

The main accounting criteria used in the preparation of these financial statements are described below. These criteria have been applied systematically to all the statements presented, unless otherwise indicated.

2.1 Basis of preparation and presentation of the financial statements

The ESSF financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

As of January 1, 2018 the Fund applies IFRS 9, which establish that debt instruments are measured at amortized cost if and only if (i) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows and (ii) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. If one of these criteria is not met, the debt instruments are classified at fair value through profit or loss. However, at the initial recognition of a debt instrument that meets the amortized cost criteria, the fund may choose to designate that instrument as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. In the current period, the fund has not decided to designate any debt instruments that meet the amortized cost criteria as measured at fair value through profit or loss.

Investments in equity instruments (equity) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for trade and is designated by the fund as measured at fair value through profit or loss in other comprehensive income. If the equity instrument is designated as measured at fair value through profit or loss in other comprehensive income, all gains and losses from revaluation, except dividend income that is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and cannot later be reclassified to profit or loss.

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds provided by the custodian, J.P. Morgan Chase & Co., to the Central Bank of Chile, which acts as fiscal agent.

The financial statements presented by the Treasury for the ESSF are as follows:

- Statement of Financial Position.
- Statement of Comprehensive Income.
- Statement of Changes in Net Equity.
- Statement of Cash Flows.
- Notes to the Financial Statements.

2.2 Accounting period

The financial statements cover the years between 1 January and 31 December 2018 and 2017, respectively.

2.3 Functional and presentation currency

The entries included in the ESSF financial statements are recorded using the currency of the primary economic environment in which the fund operates. Thus, the fund's securities are presented in U.S. dollars, as the functional and presentation currency.

Foreign currency transactions in currencies other than the U.S. dollar are converted to the functional currency using the exchange rate prevailing on the date of the transaction. Foreign currency gains and losses stemming from the settlement of these transactions or the conversion of monetary assets denominated in a foreign currency to the closing exchange rate are recognized on the Statement of Comprehensive Income.

2.4 Investment classification and valuation

The fund's investments comprise liquid foreign currency assets that are made by the Central Bank of Chile, as fiscal agent, J.P. Morgan as custodian bank, and the external managers. The investment objective is to maximize fiscal resources, which can be accessed immediately if needed to finance the activities of the sovereign wealth funds.

Financial assets and liabilities, Classification and measurement

As of January 1, 2018 the Fund applies IFRS 9, which establish that for classification and measurement of financial assets the Fund must consider its business model for managing their assets and its contractual cash flow characteristics. The Fund has classified its financial assets in the following categories

Financial assets at amortized cost

In this category are classified those financial instruments that are part of a business model, whose objective is to hold in order to collect contractual cash flows. At the same time, the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at fair value through other comprehensive income

In this category are classified those financial instruments that are part of a business model, whose objective is to hold in order to collect contractual cash flows or to sell those financial assets. At the same time, the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Likewise, the fund may make an election for particular investments in equity instruments, such as financial assets at fair value through other comprehensive income that would otherwise be measured at fair value through profit or loss.

Financial assets at net fair value through profit or loss

A financial asset is classified at fair value through profit or loss, unless is classified as amortized cost or at fair value through other comprehensive income. In addition, the fund may, at initial recognition, irrevocably designate a financial asset at net fair value through profit or loss if doing so eliminates an accounting mismatch that would otherwise arise. The fund has adopted the policy of not using hedge accounting.

The management objective of the fund is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, for which investment strategies are selected to achieve this objective.

The fund classifies the following instruments in this category: Government bonds, inflation-indexed bonds, corporate bonds, time deposits, common and preferred equities, ADRs, GDRs, REITs, Treasury bills, commercial papers, and derivative instruments. The basis for classifying the securities in this investment category is that they have a reasonably active secondary market, under normal conditions, and that they are also consistent with what is established in the Official Letter N° 1,567 of June 17, 2015 which contains the investment guidelines for the Economic and Social Stabilization Fund. These investments are recorded at fair value through profit or loss.

The custodian determines fair value using the last transaction price of the day at the close of the market in which they are traded.

Financial liabilities

All financial liabilities are measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss, including derivatives which are measured after their fair value.
- Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.
- Financial liabilities that arise from financial guarantee contracts.
- Financial liabilities that arise from commitments to provide a loan at a below-market interest rate
- Financial liabilities from a business combination.

The fund may, at initial recognition, designate a financial liability as measured at fair value through profit or loss, if it either eliminates or significantly reduces a measurement or recognition inconsistency, or a group of financial instruments is managed, and its performance is evaluated on a fair value basis, in accordance with its business model.

Recognition, reduction, and measurement

The regular purchase and sale of investments is recognized on the date of the transaction, or the date the fund commits to buying or selling the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are charged to expenses on the income statement when they are incurred in the case of financial assets and liabilities at fair value through profit or loss, and they are recorded as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are costs that are incurred in the process of acquiring financial assets or liabilities. They include all fees, commissions, and other items paid to agents, consultants, brokers, and operators in association with the operation.

Financial assets are reduced for accounting purposes when the rights to receive cash flows from the investment have expired or the fund has essentially transferred all the risks and benefits associated with ownership.

After the initial recognition, all financial assets and financial liabilities carried at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in fair value in the category "Financial assets or financial liabilities carried at fair value through profit or loss" are presented on the Statement of Comprehensive Income under the item "Net changes in fair value of financial assets and financial liabilities carried at fair value through profit or loss" in the period in which the change occurs.

Dividend income from financial assets at fair value through profit or loss is recognized on net income under the item "Dividend income" when the fund's right to receive the payment has been established. Interest on debt securities at fair value through profit or loss is recognized on net income under the item "Interest and adjustments" based on the effective interest rate.

Financial assets at amortized cost and other liabilities are valued, after initial recognition, using the effective interest rate method. Accrued interest and adjustments are recorded in the "Interest and adjustments" account of the Statement of Comprehensive Income.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating the financial income or financial expense over the period in question. The effective interest rate is the rate that exactly discounts effective future payments or receipts estimated over the life of the financial instrument, or, if appropriate, over a shorter period, relative to the accounting value of the financial asset or financial liability. To calculate the effective interest rate, the fund estimates cash flows taking into account all the contractual terms of the financial instrument, but not future credit losses.

The calculation includes all fees and points paid or received between the counterparties that are integral to the effective interest rate, transaction costs, and all other premiums or discounts.

Estimation of fair value

The fair value of financial assets and liabilities traded in active markets (such as derivatives and available-for-sale securities) is based on quoted market prices on the date of the Statement of Financial Position. The quoted market price used for financial assets held by the fund is the purchase price; the quoted market price taken for financial liabilities is the sale price (if the sale and purchase prices differ). When the fund holds derivative instruments that are netted, intermediate market prices are used as the basis for establishing the fair value for netting positions, and this purchase or sale price is applied to the net open position, as appropriate.

The hierarchy of fair value is as follows:

- a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- b) Variables other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, price derivatives) (Level 2); and
- c) Variables used for the asset or liability that are not based on observable market data (unobservable variables) (Level 3).

2.5 Cash

In the preparation of the ESSF financial statements, a distinction is made between cash held in the current account maintained for the fund by the Treasury and cash held by the custodian as a result of operations undertaken in the course of the custodial management of the fund.

2.6 Funds under management

These are securities delivered, under the mandate of managing ESSF resources, to the Central Bank of Chile, as fiscal agent; to J.P. Morgan, as custodian bank; and to the external portfolio managers. The securities can be totally or partially employed in the performance of the assigned duties

2.7 Funds in custody

These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co. and to the external portfolio managers, which provide general custody services for ESSF securities and instruments.

2.8 Net equity

The net equity of the sovereign wealth funds is derived from the opening balance of total assets at nominal value, plus fiscal contributions, minus fiscal withdrawals, plus income for the year.

In accordance with the stipulations of Articles N° 1, 2, 3, and 4 of Statutory Decree N° 1 of 11 September 2006, the ESSF will be established and increased with the following resources:

The additional fiscal income stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under IBRD Loan Agreement N° 2,625 CH are to be combined into a single fund, called the Economic Social Stabilization Fund (ESSF).

The following resources are also to be combined into the fund:

- a) All deposits in accounts held by the funds identified in Article 1, as of the date that the Statutory Decree enters into force;
- b) All resources deriving from the application of Transitory Article 2 of Law N° 19,030;
- c) An annual contribution equal to the balance remaining after subtracting from the real surplus, the contributions stipulated in paragraph (a) of Article 6 and in Article 11, both of Law N° 20,128, provided the balance is positive; and
- d) Other extraordinary contributions designated for the fund via Finance Ministry decree, from the sale of assets or the issue of debt instruments; as well as other resources stipulated in other laws.

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

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

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

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

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

The ESSF resources can be used as follows:

- a) To finance the budget, up to the amount established in the Budget Law and included in the corresponding General Revenues Calculation.
- b) To provide income replacement and/or to finance a fiscal deficit produced during budget execution, subject to the authorizations and limits established in the current legislation;
- c) To pay amortization, interest or other costs related to the Public Debt, including interest and/or exchange rate swap contracts;
- d) To pay amortization, interest or other costs related to recognition bonds (*bonos de reconocimiento*), as specified in Transitory Article 11 of Decree Law N° 3,500 on interest and/or exchange rates;
- e) To finance the contributions stipulated in Article 6, paragraph (a), of Law N° 20,128, when so determined by the Finance Minister; and
- f) To finance extraordinary contributions to the fund as described in Article 5 of Law N° 20,128, when so determined by the Finance Minister.

However, the Ministry of Finance can issue a decree stipulating that the resources which were allocated to pay for the items indicated in the above points in the last budget exercise, and which were included in the calculation of the contributions mandated in the last paragraph of Article 20 of Law N° 20,128, be reincorporated to the Nation's General Revenues, with a charge to the fund's resources.

2.9 Statement of Cash Flows

For the purpose of preparing the Statement of Cash Flows, the sovereign wealth funds use the following definitions:

- Cash and cash equivalents: Includes cash on hand, time deposits in credit institutions, and other highly liquid short-term investments.
- Cash flows provided by operating activities: Includes management costs for operating the sovereign wealth funds.
- Cash flow provided by financing activities: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

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

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are offset, and the net amount is reported on the Statement of Financial Position, when there is a legal right to offset the recognized amounts and there is a positive intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

2.11 New accounting rules

2.11.1 New accounting rules that are not yet effective

On the date of publication of these financial statements, a number of new rules and amendments, as well as improvements and new interpretations of existing rules, have been issued, but have not yet entered into force. The ESSF management has not adopted the new provisions in advance of the mandatory application date, which is indicated in the following table:

	New rules, improvements, and amendments	Mandatory application date:
IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019
IFRS 16	Leases	1 January 2019
Amendment to IAS 12	Income Tax	1 January 2019
Amendment to IAS 19	Employee Benefits	1 January 2019
Amendment to IAS 23	Borrowing costs	1 January 2019
Amendment to IAS 28	Investments in Associates and Joint Ventures	1 January 2019
Amendment to IAS 3	Business Combinations	1 January 2019
Amendment to IAS 9	Financial Instruments	1 January 2019
Amendment to IAS 11	Joint Agreements	1 January 2019

The ESSF management deems that the adoption of the new rules, improvements, amendments, and interpretations described above will not have a significant impact on the fund's financial statements in the initial application period.

2.11.2 Rules that have been used in the preparation of these financial statements

IAS 12 Income taxes

In January 2016, the IASB issued amendments to IAS 12, which clarify requirements regarding the recognition of deferred tax assets corresponding to debt instruments measured at fair value. Its recognition should be evaluated to the extent that it is probable that the entity has future taxable profits to use the deductible temporary difference.

This modification had no impact for the fund.

IFRS 9 Financial Instruments.

On July 24, 2014, the IASB concluded its improvement project on the accounting for financial instruments with the publication of IFRS 9 Financial Instruments. This standard includes new requirements based on principles for the classification and measurement, introduces a "prospective" model of expected credit losses on impairment accounting and changes in hedge accounting.

The designation of the classification, determining how financial assets and liabilities are accounted for in the financial statements and, in particular, how they are measured. IFRS 9 introduces a new approach to the classification of financial assets, based on the entity's business model for the management of financial assets and the characteristics of contractual flows.

In terms of impairment standard establishes a single model that applies to all financial instruments, thus eliminating a source of complexity associated with previous accounting requirements, which require a timely recognition of expected credit losses.

IFRS 9 introduces changes to the requirements for accounting hedge, and also new alternatives of strategies to use. The amendments mean a substantial overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements. In addition, as a result of these changes, users of the financial statements will be provided with better information about risk management and the effect of hedge accounting on the financial statements.

This standard also established that the change in fair value that corresponds to own credit risk will be recorded in Other Comprehensive Income, thus reducing any eventual volatility that would be generated in the income of the entity as a result of its recognition. Earlier application of this improvement is permitted, prior to any other requirement of IFRS 9.

Mandatory adoption date was January 1, 2018, allowing its early application.

IFRS 15 – Revenue from Contracts with Customers

In May 2014 was issued IFRS 15, which it has like purpose established the principles that will apply an entity to present useful information to users of financial statements about the nature, amount, opportunity and uncertainty of the income for ordinary activities and cash flows that it is related to a contract with a client. This new standard replace the following current standard and interpretations: IAS 18 – Revenue, IAS 11 – Construction contracts, IFRIC 13 – Customer Loyalty Programs, IFRIC 15 – Agreements for the Construction of Real State, IFRIC 18 – Transfers of Assets from Customers and SIC 31 – Revenue: Barter Transactions involving. The new model will apply to all contracts with customers, except those that are inside to the scope of the others IFRS, such as leases, insurance contracts and financial instruments.

On April 12, 2016, IASB issued amendments to IFRS 15, clarifying requirements and providing a temporary relief to companies that are implementing the new standard. In short the amendments clarify how:

- Identify a performance obligation (the promise to transfer a good or service to a customer) in a contract;
- Determining whether a company is the principal (the provider of a good or service) or an agent (the organization responsible for the good or service provided); and –
- Determine whether the product of a license must be recognized at a point in time or over time.
- The date of application of this new standard was from in January 1, 2018, allowing its early application. The adoption of IFRS 15 did not have an impact on the financial condition or results of the operations of the fund.

NOTE 3 – ESSF INVESTMENT GUIDELINES

I. Duties assigned to the fiscal agent

The following duties and function are assigned to the fiscal agent, in accordance with Articles N° 4 and 15 of Decree N° 1,383, of 2006, modified by Decree N° 1.,618, of 2012, both issued by the Ministry of Finance (henceforth, the Agency Decree):

I.1. Duties related to Central Bank transaction accounts

I.1.1. Portfolio governed under Article 4 of the Agency Decree (henceforth, the Article 4 portfolio):

- a. Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the ESSF Article 4 portfolio transaction account).
- b. Receive, record, and deposit in the ESSF Article 4 portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the fiscal agent.
- c. Receive, record, and deposit in the ESSF Article 4 portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, to the ESSF externally managed portfolio transaction account for the purpose of making third-party

payments corresponding that portfolio, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.

- d. Make payments, in the name and on the account of the Treasury, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (f) of Article 4 of the Agency Decree.
- e. Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.1.2. Portfolio governed under Article 15 of the Agency Decree (henceforth, the externally managed portfolio):

- a. Open and maintain a transaction account in the Central Bank of Chile in the name of the Treasury (henceforth, the ESSF externally managed portfolio transaction account).
- b. Receive, record, and deposit in the ESSF externally managed portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the external managers.
- c. Receive, record, and deposit in the ESSF externally managed portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination
- d. Make payments, in the name and on the account of the Treasury, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (e) of Article 15 of the Agency Decree.
- e. Make payments, in the name and on the account of the Treasury, to the external manager(s) or other third parties when so instructed by the Treasury.
- f. Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.2. Duties related to custody

I.2.1. Article 4 portfolio:

Contract, in the name of the Treasury, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (d) of Article 4 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Treasury, associated complementary services, such as tax advisors or international consultants.

I.2.2. Externally managed portfolio:

Contract, in the name of the Treasury, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (c) of Article 15 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Treasury, associated complementary services, such as tax advisors or international consultants.

I.3. Duties related to management

I.3.1. Article 4 portfolio:

- a. The fiscal agent will manage the fund's resources on the account and at the risk of the Treasury.

The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the fiscal agent.

The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the fiscal agent via a cash transfer to the ESSF Article 4 portfolio transaction account. Nevertheless, the resources can only be transferred to the fiscal agent on business days in the United States of America. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

- b. To fulfill this duty, and subject to the objectives, guidelines, and restrictions established in this document, the fiscal agent will have the full authority, in representation of the Treasury, to make decisions on investment, disposal, and related activities, including the ability to choose, buy, sell, hold, auction, recover, or exchange investment instruments of any type; underwrite the issue of instruments; enter into spot or forward foreign exchange contracts; instruct the custodian to make payments associated with the execution of transactions; earn dividends, interest, amortization, and other benefits; and engage in other operations, acts, and contracts that the fiscal agent deems appropriate with regard to the management of the portfolio and the fulfillment of the duties outlined in this document.

The fiscal agent will also have the authority to implement the acts and contracts described in the previous paragraph through banks, brokers or any other financial intermediaries.

- c. The fiscal agent will be able to aggregate transactions executed for the management of the portfolio with transactions executed for the Central Bank of Chile's international reserve portfolio, as well as for other fiscal resources managed by the fiscal agent.

The fiscal agent cannot directly acquire any instruments that are being removed from the ESSF Article 4 portfolio in representation of the Treasury or directly acquire for the ESSF Article 4 portfolio any instruments owned by the Central Bank of Chile that are being removed from the Bank's own portfolio.

- d. The fiscal agent will hold the funds and investments under its management in separate accounts, clearly indicating that they are the property of the Treasury of Chile for all legal purposes.

I.3.2. Externally managed portfolio:

- a. The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the external managers.
- b. The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the external managers, via the fiscal agent, in the form of a cash transfer to the ESSF externally managed portfolio transaction account. Nevertheless, the resources can only be transferred to the external managers on business days in the United States of America.

The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

- c. The custodian(s) will hold the funds in its custody in separate accounts, clearly indicating that they are the property of the Treasury of Chile for all legal purposes.

I.3.3. Rebalancing

The Ministry of Finance or the Treasury will instruct the fiscal agent on the contributions to and/or withdrawals and transfers from the Article 4 portfolio to the externally managed portfolio, or vice versa, as necessary to achieve compliance with the target ranges established in section II.3.8. The instructions must be issued at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

I.4. Duties related to monitoring and reports

I.4.1. Article 4 portfolio:

- a. Maintain full and detailed information on all transactions and other operations carried out in association with the management of the Article 4 portfolio, in accordance with the stipulations of paragraph (g) of Article 4 of the Agency Decree.
- b. Supervise, monitor, and evaluate the services provided by the custodian(s); establish daily and, if necessary, clarify any differences that might arise between the records maintained by the fiscal agent and the custodians, as well as any other discrepancies detected in relation to the contracted services; and report to the Finance Minister, or an authorized delegate, for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the custodians.
- c. Report to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, the daily investment position of the portfolio, with a lag of not more than three (3) business days from the date of the report. The reporting requirement outlined in this paragraph will be understood as fulfilled when the respective electronic communication has been sent, using the means and formats stipulated by the Finance Minister or an authorized delegate, under the exclusive responsibility of the sender. In the event of discrepancies between the information sent by the fiscal agent and the information received by the Ministry of Finance and the Treasury, the version contained in the fiscal agent's records will prevail.

- d. Report, under the terms described above, to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, any change or correction to the information described in the preceding paragraph (c), on the daily investment position of the portfolio.
- e. Submit to the Finance Ministry and the Treasurer, or their authorized delegates, monthly, quarterly, and annual reports on the management of the Article 4 portfolio.
- f. Submit to the same authorities an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records maintained by the fiscal agent on the Article 4 portfolio. The monthly reports will include a copy of the payment orders associated with the ESSF Article 4 portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.
- g. The Ministry will issue an opinion on the quarterly and annual reports described above, either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager and the General Manager of the Central Bank within a period of 30 consecutive days from the date the report was submitted. In the event that there are such observations, which must be well-founded and specific, the fiscal agent will have a period of 15 consecutive days to respond, with the specific objective of clarifying and resolving the issues raised, as appropriate. Subsequently, the Finance Minister or the International Finance Coordinator or the Head of the Sovereign Wealth Funds Unit will issue an opinion on the response received, via electronic mail, stating either approval or rejection, under the same requirements outlined above, within a period of 15 consecutive days from the date of reception.
- h. Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible banks and localities, in accordance with the criteria stipulated in points II.3.3.2 and II.3.4.5 of these guidelines. Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible supranational entities, agencies, and entities with an explicit government guarantee, in accordance with the criteria stipulated in point II.3.3.5.
- i. Meet monthly with Finance Ministry staff to discuss any aspect of the management of the ESSF Article 4 portfolio. These meetings will be held within five (5) business days of the submission of the monthly management report prepared by the fiscal agent. The Ministry of Finance can also request additional meetings as deemed appropriate.
- j. As established in Article 7 of the Agency Decree, the accounting of the fiscal resources and the preparation of the audited financial statements are the responsibility of the Treasury. At the same time, the management of the Article 4 portfolio will be subject to internal supervision and control by the fiscal agent in accordance with the terms established in the Central Bank of Chile's Basic Constitutional Act. In addition, at least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on Article 4 portfolio operations. Moreover, the Finance Minister, or an authorized delegate, can request that the fiscal agent submit reports on operations and processes carried out in the management of Article 4 portfolio. Finally, the fiscal agent has the option of

contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of its duties and functions.

I.4.2. Externally managed portfolio:

- a. Verify, in accordance with industry standards normally applied to investments in a given type of asset, that the records of transactions and other operations reported by the external manager(s) and by the custodian(s) of the fiscal resources are consistent at the close of each day, in terms of their notional amount, duration, and date, with the transactions reported at closure by the custodian(s). For the purposes of this paragraph (a), the daily closure is defined as the close of the fiscal agent's business day. In addition, the fiscal agent must subsequently verify the closures reported on non-business days for the fiscal agent that are business days for the custodian or external managers. The fiscal agent must report monthly to the Finance Minister and the Treasurer, or their authorized delegates, the results of the daily verification process. Furthermore, the fiscal agent must conduct a daily reconciliation of transactions and notional positions and report any differences that might arise between the records maintained by the fiscal agent and/or the external managers and the records maintained by the custodians, as well as any other discrepancies detected in relation to the contracted services; any such differences must be reported to the Finance Minister or authorized delegate for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal or administrative liability for any damages, crime or infringement committed by the external managers or the custodians.
- b. For the purposes of this section I.4.2., and in all matters concerning the externally managed portfolio, "records" are defined as the information received from the external manager(s) or the custodian(s), in order to verify that the custodian(s) have the same notional positions as reported by the external manager(s).
- c. Submit to the Finance Minister and the Treasurer, or their authorized delegates, an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records for the externally managed portfolio submitted by the external managers. The monthly reports described in the preceding paragraph will include a copy of the payment orders associated with the ESSF externally managed portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.
- d. The Ministry will issue an opinion on the reports described in the preceding paragraphs (a) and (c), either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager of the Central Bank when the opinion encompasses Article 4 portfolio reports, in accordance with the timeline and procedures outlined in paragraph I.4.1.g.

- e. At least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on all operations involving fiscal resources. Moreover, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of the custodian's duties and functions

The fiscal agent will only perform the duties described in paragraphs (a), (c), and (e) with regard to the custodian(s).

II. Portfolio investment guidelines

II.1. Management objective

II.1.1. Article 4 portfolio.

The management objective of the ESSF Article 4 portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy. The fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

II.1.2. Externally managed portfolio.

The management objective of the ESSF externally managed portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below.

II.2. Investment portfolio.

For the investment of the fiscal resources, an investment portfolio (IP) will be established comprising the sum of the Article 4 portfolio and the externally managed portfolio. The specific guidelines, parameters, and rules are contained in the following sections.

II.3. Guidelines and parameters

II.3.1 Asset classes

The fiscal resources in the investment portfolio (IP) will be invested in four asset classes: (1) Bank instruments; (2) Treasury bills and sovereign bonds; (3) Inflation-indexed sovereign bonds; and (4) Equities. The first three classes are allocated to the Article 4 portfolio; the fourth class (equities) is allocated to the externally managed portfolio. The benchmark allocation of the investment portfolio by asset class (henceforth, the benchmark allocation) is shown in Table 1.

Table 1: Benchmark allocation of the investment portfolio (IP).

Asset class	Percent of IP
Bank instruments	15.0%
Treasury bills and sovereign bonds	74.0%
Inflation-indexed sovereign bonds	3.5%
Equities	7.5%
Total	100%

The first three asset classes (bank assets; treasury bills and sovereign bonds; and inflation-indexed sovereign bonds) make up the Article 4 portfolio; they will be purchased directly by the Central Bank of Chile and managed directly by the Central Bank as the fiscal agent. The fourth asset class (equities and other assets) comprises the externally managed portfolio; these assets will be acquired by the external portfolio managers and managed directly by these external managers.

II.3.2. Benchmarks.

The benchmarks associated with each asset class are listed in Table 2, together with the required allocation (% of total resources).

Table 2: Benchmarks

Benchmark	Percent of IP
Merrill Lynch LIBID 3-Month Average USD	5.0%
Merrill Lynch LIBID 3-Month Average EUR	6.0%
Merrill Lynch LIBID 3-Month Average JPY	4.0%
Bank instruments	15.0%
Merrill Lynch Treasury Bills Index USD	6.0%
Merrill Lynch Treasury Bills Index EUR	7.0%
Merrill Lynch Treasury Bills Index JPY	6.0%
Treasury bills	19.0%
Barclays Capital Global Treasury: U.S. 7–10 yrs.	26.5
Barclays Capital Global Treasury: Germany 7–10 yrs.	11.0
Barclays Capital Global Treasury: Japan 7–10 yrs.	10.0
Barclays Capital Global Treasury: Switzerland 7–10 yrs.	7.5
Sovereign bonds	55.0%
Treasury bills and sovereign bonds	74.0%
Barclays Capital Global Inflation – Linked: U.S. Tips 1–10 yrs.	2.5%
Barclays Capital Global Inflation – Linked: Germany 1–10 yrs.	1.0%
Inflation-indexed sovereign bonds	3.5%
Equities: MSCI All Country World Index * (unhedged, with reinvested dividends)	7.5%
Total	100.0%

* Excluding Chile.

Performance and the tracking error are calculated based on pre-tax benchmarks.

II.3.3. Article 4 portfolio.

II.3.3.1 Risk budget

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

II.3.3.2. Eligible banks

The methodology for selecting institutions and allocating investment limits is based on international credit ratings.

- a) Selection criteria: The institution's long-term rating must be A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

- b) Issuer limits: The investment limits for each eligible rating category (AAA to A-) are listed in Table 3. They are calculated every quarter and in the event of contributions, based on the closing value of the investment portfolio in the previous quarter or the value on the day prior to the contribution plus the amount of the contribution.

Table 3: Bank exposure limits

Credit rating	Maximum permitted (1)
AAA	3.0% * IP at close of last quarter
AA+	2.0% * IP at close of last quarter
AA	
AA-	
A+	1.5% * IP at close of last quarter
A	
A-	

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

II.3.3.3. Eligible sovereign issuers

Issuers that are included in the benchmark are eligible for investment.

Also eligible are supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in its international reserve portfolio.

For the purpose of monitoring positions, performance, and risk indicators, any instruments issued by supranational entities, agencies, and entities with an explicit government guarantee that have a residual maturity of less than one year are included in the Treasury bills portfolio in Table 2. Instruments issued by supranational entities, agencies, and entities with an explicit government guarantee that have a residual maturity of one year or longer are included in the sovereign bonds portfolio in Table 2.

II.3.3.4. Eligible currencies

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

II.3.3.5. Eligible Instruments

- a) Bank: The only eligible bank instruments are bank transactional account balances, overnight and weekend deposits, time deposits, and certificates of deposit, as well as transactional account balances, overnight deposits, and time deposits held in central banks in eligible countries.
- b) Sovereign: Only instruments included in the benchmark are eligible for investment. However, instruments that meet the benchmark eligibility criteria and that therefore should be incorporated into the benchmark at the close of the respective month are also considered eligible for investment. In the event that an instrument is not actually incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of seven (7) business days to sell the instrument in question. In addition, portfolio managers are also allowed to maintain investments in instruments that are no longer eligible because their maturity has dropped below the minimum and

that have therefore been eliminated from the benchmark, provided that the issuer remains in the index.

- c) Supranational entities, agencies, and entities with an explicit government guarantee: Eligibility is restricted to discount bills and notes (including Euro Commercial Papers); callable and noncallable bullet bonds; with a residual maturity, in all cases, of less than or equal to 10 years

II.3.3.6. Currency forwards

The following rules apply to the use of currency hedging mechanisms involving forwards or swaps:

- a) Forwards or swaps can only be arranged between eligible currencies, and the contract duration cannot exceed 95 consecutive days.
- b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody’s, and Standard & Poor’s).
- c) Currency forward or swap contracts can specify either cash delivery or net settlement.
- d) The counterparty risk associated with each forward or swap contract will equal 100% of the notional value, in its U.S. dollar (USD) equivalent. For the purposes of these guidelines, the notional value of the forward or swap is defined as the amount associated with the purchase currency in the contract. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.3.2).
- e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their USD equivalent. If a forward or swap is contracted in order to fully or partially close a position associated with another forward or swap—and provided that both contracts include close-out netting clauses, are with the same counterparty, have the same maturity date and are in the same currencies—then the counterparty risk will be measured taking into account the net position of the different forwards and swaps involved. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.3.2).
- f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.
- g) The notional value of the forwards or swaps contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio. However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increased to 2% for that counterparty, for a period of two (2) business days starting on the

date of the roll. For the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (as established in Note II.3.3.2) for two (2) business days, starting on the date of the roll.

II.3.4. Externally managed portfolio.

II.3.4.1. Risk budget

The externally managed portfolio has an ex ante tracking error of 60 basis points for equities.

II.3.4.2. Eligible issuers and currencies

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

II.3.4.3. Eligible instruments

Only the types of instruments included in the benchmark are eligible for investment. However, the following instruments are also eligible:

- a) The Ministry of Finance will generate, maintain, and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds, which must be reported by the custodian.
- b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary receipts (GDRs) of equities included in the equity benchmark, provided that they do not necessitate the use of tax agents in the issuing country of the underlying asset.
- c) Exchange-traded equities index futures, used for hedging purposes to minimize differences vis-à-vis the equities benchmark (see Table 2) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivatives transaction. That is, the notional amount involved in each derivatives transaction cannot exceed the market value of the share of the underlying assets. If the underlying asset is cash, it must be held in eligible instruments allowed (Note II.3.4.5).

II.3.4.4. Instruments that are to be incorporated into the equities benchmark

External portfolio managers can invest in these instruments as soon as their inclusion is formally communicated by the benchmark supplier. If for any reason the instruments are not actually added to the benchmark as expected, the external manager will have a period of seven (7) business days in the local market to sell the instruments in question, starting on the date on which their inclusion was expected.

II.3.4.5. Eligible instruments for cash in foreign currency

The external portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the last 20 business days (based on the U.S. bank holiday calendar) of the portfolio of each external manager. The return on cash in foreign currency earned by each external manager will be incorporated in the calculation of that manager's total portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances and overnight and/or weekend deposits in banks with a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For the externally managed portfolio, each portfolio manager can invest up to US\$ 20 million in a given bank. However, in the event of a portfolio contribution, the external portfolio manager can invest a maximum equivalent to US\$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, when the external manager receives the instruction to generate liquidity for a cash withdrawal, that manager can invest up to US\$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.4.6. Limits on forwards and swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark currency allocation and solely with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section II.3.3.6, paragraphs (a) to (e). However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increased to 2% for that counterparty, for a period of two (2) business days starting on the date of the roll. The counterparty risk associated with the forward or swap must be taken into account for complying with the issuer risk limits (as established in Note II.3.4.5). However, for the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (Note II.3.4.5) for two (2) business days, starting on the date of the roll.

II.3.5. Limits on spot currency transactions

The external portfolio managers, or the fiscal agent, can carry out foreign currency spot transactions with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

II.3.6. Limits on investment with supranational entities, agencies, and entities with an explicit government guarantee

The limit on investment in instruments issued by supranational entities, agencies, and entities with an explicit government guarantee with a residual maturity of less than one year is 3.0% for USD-denominated instruments and 3.5% for EUR-denominated instruments, both expressed as a percentage of the investment portfolio. For these instruments, investment in JPY are not allowed.

The limit on investment in instruments issued by supranational entities, agencies, and entities with an explicit government guarantee with a residual maturity of one year or longer is 2.65% for USD-denominated instruments, 1.10% for EUR-denominated instruments,

1.00% for JPY-denominated instruments, and 0.75% for CHF-denominated instruments, all expressed as a percentage of the investment portfolio.

II.3.7. Special restrictions

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

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

The following restrictions apply specifically to the externally managed portfolio: (i) external managers can contract currency futures, forwards, or swaps, where the aggregate notional amounts cannot exceed 10% of the portfolio under management; (ii) mutual funds and exchange-traded funds (ETFs) together cannot represent, as a share of a given external manager's portfolio, more than the aggregate share of Egypt, India, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey in the equities benchmark indicated in Table 2, plus 2%; (iii) external managers cannot invest in the local markets of Chile, Egypt, India, Peru, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey; (iv) investments in China can only be made through the equities market in Hong Kong; and (v) external managers cannot invest in their own equities.

II.3.8. Rebalancing policy

The ESSF rebalancing policy requires that the portfolio converge to the benchmark established in Table 2 under the following situations: (i) in the event of a contribution to the ESSF; and (ii) in the event that the target ranges specified in Table 4 are exceeded. The Ministry of Finance will determine the specific date on which rebalancing associated with points (i) and (ii) of this paragraph will be implemented. In the event that situations (i) and (ii) do not occur, the Ministry of Finance will issue instructions for a rebalancing of the ESSF at least once a year and will also monitor compliance with the target ranges identified in Table 4.

The rebalancing could result either in cash contributions to the Article 4 portfolio and/or the externally managed portfolios or in withdrawals from the Article 4 portfolio and/or the externally managed portfolios. In the event of a contribution, the Ministry of Finance will issue instructions on the amounts to be transferred between the external managers and the Article 4 portfolio in order to achieve convergence to the benchmark established in Table 2. When the rebalancing results in a cash contribution to the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent or the external manager will have ten (10) bank business days to achieve this convergence, during which the fiscal agent and the external manager, if applicable, will be granted a waiver of compliance with the requirements of sections II.1.1., II.1.2., II.3.3.1., II.3.4.1, and the first paragraph of II.3.4.5. When the rebalancing results in a cash withdrawal from the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent and the external manager, if applicable, will be granted a waiver from compliance with the requirements of sections II.1.1., II.1.2., II.3.3.1., II.3.4.1, and the first paragraph of II.3.4.5, for a period of ten (10) bank business days before and including the date of the withdrawal. The waiver can be extended if either party submits a request for extension to the Ministry of Finance, with an explanation of the reasons for the request. In the event that the period between the date on which the cash withdrawal instructions are issued and the date on which the actual withdrawal is implemented is less than ten (10) bank business days, the waiver will cover only that period.

Table 4: Target range for rebalancing

Portfolio	Percent of IP	Target range (percent of IP)
Article 4 portfolio	92.5%	90.5% – 94.5%
Externally managed portfolio	7.5%	5.5% – 9.5%

In addition, in the event of rebalancing, the Director of the Financial Operations Division of the Central Bank of Chile can send a request, via electronic mail, to the Finance Ministry's Capital Markets and International Finance Coordinator for permission to maintain the relative positions of the Article 4 portfolio vis-à-vis the benchmark and thus not to have to converge to the benchmark established in Table 2. The Capital Markets and International Finance Coordinator must authorize the holding of said positions by sending an electronic mail to the Central Bank's Director of the Financial Operations Division.

II.4. Valuation criteria

The investment portfolio valuation that must be reported to the Finance Ministry is to be prepared by the custodian(s) using marked-to-market accounting, based on their own valuation sources. However, for the internal accounting of the Article 4 portfolio, the Central Bank of Chile can use the same methodology that it uses for operations involving its international reserves, as stipulated in paragraph (g) of Article 4 of the Agency Decree.

II.5. Securities lending program

II.5.1. Article 4 portfolio

The fiscal agent for the Article 4 portfolio can participate in securities lending programs with the ESSF custodian(s), provided that the custodians contracted to manage the securities lending programs (henceforth, the program managers) are obligated to comply with the operating criteria established in the custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

II.5.2 Externally managed portfolio

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

II.6 Other

Foreign exchange operations will be considered spot transactions, provided that the period between the trade date and the settlement date does not exceed two days. Foreign exchange operations that are related to the purchase or sale of an instrument will be considered spot operations when the period between the trade date and the settlement date follows the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purpose of measuring the performance of the fiscal agent and the external portfolio managers is the U.S. dollar.

In the event of noncompliance with any of the instructions described in this report, at any time, due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the fiscal agent or the external portfolio managers, in their respective mandates, the situation will not be considered noncompliance with the guidelines, provided that the necessary measures are taken to ensure compliance within seven (7) days of detecting the situation. This period can be extended by the Finance Ministry at the request of the fiscal agent or the external managers, as appropriate, when justified.

However, the external managers can temporarily hold any ineligible instruments that they receive due to corporate events or that have become ineligible due to corporate events. In that case, the external managers will have a period of 30 consecutive days to sell the instruments in question, starting on the date of the corporate event. If they are unable to do so, the external managers must notify the Treasury and communicate a plan of action to liquidate the instruments. In the particular case of entitlements, preferred equity, rights, warrants or other equivalent instruments received due to corporate events that grant the right to purchase equities, exchange for eligible equities or receive cash, these instruments can be kept in the portfolio until expiration.

NOTE 4 –CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1. Critical accounting estimates.

In preparing the financial statements, management must make estimates and formulate assumptions about the future. The resulting accounting estimates, by definition, are rarely going to correspond precisely to actual results. The estimates and assumptions that carry a strong risk of causing significant adjustments to the accounting value of assets and liabilities within the next accounting period are described below:

Fair value of instruments that are not quoted on an active market or traded on the equity market.

The fair value of instruments that are not quoted on an active market cannot be determined using pricing sources, such as price-setting agencies or indicative prices from market makers for bonds or debt, so they are obtained based on information from the custodian.

The models use observable data, to the extent possible. However, factors such as credit risk (both direct and counterparty), volatilities, and correlations require management to make estimates. Changes in assumptions about these factors could affect the fair value reported for financial instruments.

The determination of what constitutes “observable” represents a critical judgment by the fund’s manager. Therefore, observable data are defined as market data that can be easily obtained, are regularly distributed or updated, are trustworthy and verifiable, are not private (for exclusive use), and are provided by independent sources that are active participants in the relevant market.

4.2 Critical judgments for applying accounting policies

Functional currency

Management considers the U.S. dollar to be the currency that most faithfully represents the economic effect of transactions, events, and underlying conditions. The U.S. dollar is the currency in which the fund receives contributions from the Chilean government.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The ESSF is exposed to various types of risk as a result of its investment in different financial instruments, including market risk, credit risk, liquidity risk, and operational risk. Most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the ESSF investment policy. This section describes the risks in greater detail, together with the mechanisms established to mitigate them.

5.1 Market risk

Market risk: The market value of financial instruments can be exposed to losses as a result of changes in market conditions that affect the value of the instruments in the fund's investment portfolio. In the case of the ESSF, the variables with the biggest impact on market value are interest rates, exchange rates, credit spread risk, and changes in equity values.

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

Exchange rate risk: Because the fund's return is measured in dollars, the value of investments is also affected by exchange rate fluctuations. The portfolio is mostly made up of fixed-income investments denominated in dollars, euros, yen, and Swiss francs. There is also small exposure to an additional 28 currencies in the equity portfolio.

Credit spread risk: The market value of the fixed-income instruments in the ESSF portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is minimal in the ESSF, because the fixed-income portfolio includes only sovereign issues from the United States, Germany, Japan, and Switzerland, among which the lowest rating is A-. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have a high credit rating.

Equity risk: The ESSF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). The strategic asset allocation only allows 7.5% of the total portfolio to be invested in equities.

5.2 Credit risk

The issuer of a fixed-income instrument could enter into a default situation if it becomes unable to meet its financial obligations due to a lack of liquidity or capital. Thus, the fund's credit risk exposure increases to the extent that the default probability of a destination institution or government rises. The ESSF limits exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany, Japan, and Switzerland, all of which have a sovereign rating of over AA-. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio; these entities all have a high credit rating. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by counterparty (see Table 6).

Risk class	Maximum allowed (US\$ million)
AAA	3.0% * IP at close of last quarter (a)
AA+	2.0% * IP at close of last quarter
AA	
AA-	
A+	1.5% * IP at close of last quarter
A	
A-	

(a) IP: Investment portfolio.

Source: Ministry of Finance.

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

5.3 Liquidity risk

Liquidity risk arises from the losses that would occur from the early sale of securities in order to cover cash-flow needs. This risk is exacerbated during times of economic uncertainty, when some investments could be substantially discounted due to lack of demand or market depth.

In the ESSF, this risk is mitigated by maintaining a high percentage of liquid short-term assets. Liquid assets include Treasury bills, certificates of deposit, and time deposits, all of which are less sensitive to interest rate fluctuations. In addition, the market for Treasury bills and certificates of deposit allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

5.4 Operational risk

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

In the case of the portfolio managed by the Central Bank of Chile, the operational management of the funds utilizes the same infrastructure that the Central Bank uses to manage its international reserves.

The International Investments Area is in charge of managing the funds. The Central Bank has also set up a series of controls, including the division of responsibilities and functions, software in line with market

quality standards, backup systems to ensure the operational continuity of the funds, and internal and external auditing processes to assess the effectiveness of the existing controls.

In the case of the externally managed portfolio, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market, and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided.

NOTE 6 – ACCOUNTING CHANGES

On January 1, 2018, the fund adopted IFRS 9, regarding the classification and measurement of financial instruments. In addition, on the same date, the fund adopted IFRS 15, in the recognition of income from ordinary activities.

The application of this new standards did not generate a significant impact on the financial statements of the fund.

As of 31 December 2018, there were no others accounting changes relative to the previous year.

NOTE 7 –FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

- a) Investments carried at fair value were US\$ 14,132,770,624 on 31 December 2018 and US\$ 14,679,714,072 on 31 December 2017.

Custodian investments, J.P. Morgan	Fair value hierarchy level	2018 US\$	2017 US\$
Equities	1	905,269,174	1,169,905,643
Other capitalization instruments	1	20,181,112	25,456,877
Government bonds	1	7,938,699,602	8,045,821,051
Indexed bonds	1	488,297,373	514,580,823
Treasury bonds	1	1,598,802,754	1,565,510,121
Derivatives	1	150,941	570,220
Subtotal		10,951,400,956	11,321,844,735

Custodian investments, Central Bank of Chile	Fair value hierarchy level	2018 US\$	2017 US\$
Time deposits	1	3,181,369,668	3,357,869,337
Subtotal		3,181,369,668	3,357,869,337
Total		14,132,770,624	14,679,714,072

- b) The breakdown of investments by investment currency on 31 December 2018 and 2017 is as follows:

Local currency	Fair value instruments, J.P. Morgan			
	2018		2017	
	US\$	% del IP	US\$	% del IP
U.S. dollar	4,704,607,339	42.96	4,905,976,898	43.33
Euro	1,816,765,039	16.59	1,877,472,509	16.58
Yen	3,132,295,791	28.60	3,127,637,747	27.62
Other	1,297,732,787	11.85	1,410,757,581	12.47
Subtotal	10,951,400,956	100.00	11,321,844,735	100.00

Local currency	Fair value instruments, Central Bank of Chile			
	2018		2017	
	US\$	% del IP	US\$	% del IP
U.S. dollar	1,383,227,847	43.48	1,447,137,927	43.10
Euro	1,798,141,821	56.52	1,910,731,410	56.90
Yen	-	-	-	-
Other	-	-	-	-
Subtotal	3,181,369,668	100.00	3,357,869,337	100.00
Total	14,132,770,624		14,679,714,072	

c) The total value of assets by risk segment on 31 December 2018 and 2017 is as follows:

Risk segment	Market value			
	2018		2017	
	US\$	%	US\$	%
Capitalization instruments	925,450,286	6.55	1,195,362,520	8.11
Bank (*)	3,186,539,357	22.54	3,418,013,057	23.19
Bonds	10,025,799,729	70.91	10,125,911,995	68.70
Total	14,137,789,372	100.00	14,739,287,572	100.00

Asset class	Market value			
	2018		2017	
	US\$	%	US\$	%
Capitalization instruments	925,450,286	6.55	1,195,362,520	8.11
Money market (*)	4,785,342,111	33.85	4,983,523,178	33.81
Sovereign bonds	7,938,699,602	56.15	8,045,821,051	54.59
Inflation-indexed bonds	488,297,373	3.45	514,580,823	3.49
Total	14,137,789,372	100.00	14,739,287,572	100.00

(*) It includes cash and cash equivalents.

NOTE 8 – FINANCIAL DERIVATIVES INSTRUMENTS

Derivative financial liabilities carried at fair value were US\$ 3,942,084 on 31 December 2018 and US\$ 464,227 on 31 December 2017.

a) The breakdown of derivatives (liabilities), is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy level	2018 US\$	2017 US\$
Derivatives	2	3,942,084	464,227
Subtotal		3,942,084	464,227

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

Local currency	Fair value instruments, J.P. Morgan			
	2018		2017	
	US\$	% del IP	US\$	% del IP
U.S. dollar	1,516,186	38.46	196,404	42.30
Euro	758,093	19.23	17,855	3.85
Yen	1,667,805	42.31	107,129	23.08
Other	-	-	142,839	30.77
Total	3,942,084	100.00	464,227	100.00

c) The breakdown of derivatives by risk segment is as follows:

Risk segment	Market value			
	2018		2017	
	US\$	%	US\$	%
Bank	3,942,084	100.00	467,227	100.00
Total	3,942,084	100.00	467,227	100.00

Liability class	Market value			
	2018		2017	
	US\$	%	US\$	%
Money market	3,942,084	100.00	467,227	100.00
Total	3,942,084	100.00	467,227	100.00

NOTE 9 – CONSTITUTION OF THE FUND

The fund was established on September 30, 2006, designating the Central Bank of Chile for management, in the role of fiscal agent, JP. Morgan in the role of custodian bank, and also designating the external managers. The following movements were recorded as of 31 December 2018 and as of 31 December 2017:

	2018								
	Contributions US\$	Withdrawals US\$	Compensation to the CBC as fiscal agent (1) US\$	Custody of the portfolio managed by the CBC US\$	Custody of the externally managed portfolios US\$	BlackRock US\$	Mellon US\$	Rogge US\$	Other US\$
January	-	-	-	-	-	-	-	-	(34,941)
February	-	-	-	(134,672)	(66,951)	-	-	-	-
March	-	-	(288,287)	-	-	(64,696)	(77,524)	-	-
April	-	-	-	(136,041)	(62,094)	-	-	-	(24,518)
May	-	-	-	-	-	-	(78,667)	-	-
June	-	-	(288,287)	(68,306)	(30,672)	-	-	-	-
July	-	-	-	(135,784)	(70,194)	-	-	-	-
August	-	-	-	-	-	(65,644)	-	-	-
September	-	(541,576,255)	(288,287)	(133,756)	-	-	(78,003)	-	(15,529)
October	-	-	-	(66,443)	(64,550)	-	-	-	-
November	-	-	-	-	(36,091)	-	-	-	-
December	-	-	(288,287)	(63,985)	(75,451)	-	(77,497)	-	-
Total	-	(541,576,255)	(1,153,148)	(738,987)	(406,003)	(130,340)	(311,691)	-	(74,988)

(1) Ministry of Finance Res. N°33 of 27/Sep/2016 authorizes payment of compensation for 2017, for portfolio management and other services.

	2017								
	Contributions US\$	Withdrawals US\$	Compensation to the CBC as fiscal agent (1) US\$	Custody of the portfolio managed by the CBC US\$	Custody of the externally managed portfolios US\$	BlackRock US\$	Mellon US\$	Rogge US\$	Other US\$
January	-	-	-	(64,852)	(31,858)	(61,229)	-	-	-
February	-	-	-	(65,140)	(32,286)	-	-	-	-
March	-	-	(233,090)	(66,559)	(30,132)	-	-	-	(23,294)
April	-	-	-	(66,781)	(30,066)	(61,288)	(73,210)	-	-
May	-	-	-	-	-	-	(76,826)	-	(23,379)
June	-	-	(233,090)	(132,763)	(63,352)	-	-	-	-
July	-	-	-	(67,115)	(34,003)	-	-	-	-
August	-	-	-	(68,148)	(38,186)	-	-	-	-
September	-	-	(233,090)	-	-	(64,291)	(77,483)	-	(24,344)
October	-	-	-	(137,270)	(61,374)	(64,759)	-	-	-
November	-	-	-	(68,547)	(31,629)	-	-	-	-
December	-	-	(233,090)	(66,703)	(29,766)	(61,298)	(73,497)	-	-
Total	-	-	(932,360)	(803,878)	(382,652)	(312,865)	(301,016)	-	(71,017)

(1) Ministry of Finance Res. N°33 of 27/Sep/2016 authorizes payment of compensation for 2017, for portfolio management and other services.

NOTE 10 – INTEREST EARNED

The breakdown of interest income earned on investments in debt securities carried at fair value through profit or loss as of 31 December 2018 and 2017 is as follows:

	2018 US\$	2017 US\$
Interest earned, Art. 4 Portfolio	140,078,412	125,813,739
Interest earned, External managed Portfolio	790,931	901,308
Total	140,869,343	126,715,047

NOTE 11 – DIVIDEND INCOME

The breakdown of dividends income as of 31 December 2018 and 2017 is as follows:

Dividends from investments managed by	31 Dec 2018 US\$	31 Dec 2017 US\$
Mellon Capital Management Corporation	12,990,257	13,153,038
BlackRock Institutional Trust Company, N.A.	13,063,292	13,136,887
Total	26,053,549	26,289,925

NOTE 12 – CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2018 and 2017 breaks down as follows:

Cash in custodian and externally managed accounts	31 Dec 2018 US\$	31 Dec 2017 US\$
J.P. Morgan	927,573	52,987,644
Mellon Capital Management Corporation	1,984,936	2,874,600
BlackRock Institutional Trust Company, N.A.	2,106,239	3,711,236
Total	5,018,748	59,573,500

NOTE 13 – ESSF RETURNS

The breakdown of the fund's returns as of 31 December 2018 and 2017 is as follows:

Type of return	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	0.81%	(0.41%)	2.73%

NOTE 14 – FAIR VALUE

The ESSF applies IFRS 13 to determine the fair value of its financial assets and financial liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB).

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The transaction is carried out in the principal or most advantageous market and is not forced. That is, it does not take into account specific characteristics of the ESSF that could have an impact on the real transaction.

FINANCIAL ASSETS	31 Dec 2018			31 Dec 2017		
	Level	Net book value US\$	Fair value US\$	Level	Net book value US\$	Fair value US\$
Cash and cash equivalents	1	5,018,748	5,018,748	1	59,573,500	59,573,500
Equities	1	905,269,174	905,269,174	1	1,169,905,643	1,169,905,643
Other capitalization instruments	1	20,181,112	20,181,112	1	25,456,877	25,456,877
Time deposits	1	3,181,369,668	3,181,369,668	1	3,357,869,337	3,357,869,337
Government bonds	1	7,938,699,602	7,938,699,602	1	8,045,821,051	8,045,821,051
Indexed bonds	1	488,297,373	488,297,373	1	514,580,823	514,580,823
Treasury bills	1	1,598,802,754	1,598,802,754	1	1,565,510,121	1,565,510,121
Commercial papers	1	-	-	1	-	-
Derivatives	1	150,941	150,941	1	570,220	570,220
FINANCIAL LIABILITIES						
Derivative financial instruments	1	3,942,084	3,942,084	1	464,227	464,227

In 2018 and 2017, all the assets and liabilities in the ESSF were measured at fair value through net income, according to the prices quoted in the equity market (Level 1). As of December 31, 2018 and 2017, the fund has not made any changes in fair value hierarchies.

NOTE 15 – LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N° 1,267 of 4 June 2013, Section II N°5, the fiscal agent for the Article 4 portfolio can enter into agreements with the fund's custodian(s) to participate in securities lending, provided that the custodians comply with the operating criteria established in the ESSF custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay the corresponding market value. The resources earned or disbursed are to be recorded on the ESSF financial statements as income in the year.

On 31 December 2018 and 2017, the ESSF owned the following instruments under the item Securities lending:

2018		
Location	Notional value	Market value US\$
Europe	1,408,422,000	1,636,796,409
United States of America	201,046,000	208,518,321
Total	1,609,468,000	1,845,314,730

2017		
Location	Notional value	Market value US\$
Europe	1,180,096,200	1,435,865,191
United States of America	103,980,000	103,143,680
Total	1,284,076,200	1,539,008,871

NOTE 16 – SECURITIES CUSTODY

As of 31 December 2018 and 2017, securities custody is as follows:

31 December 2018:

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total ESSF assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total ESSF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	14,128,878,540	100	99.96
Total investment portfolio in custody	-	-	-	14,128,878,540	100	99.96

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

31 December 2017:

Entity	Securities custody					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total ESSF assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total ESSF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	14,679,249,844	100	99.6
Total investment portfolio in custody	-	-	-	14,679,249,844	100	99.6

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

NOTE 17 – RELEVANT EVENTS

As of the closing date of these financial statements, there were no relevant events that could materially affect the balances or interpretation of these financial statements.

NOTE 18 – SUBSEQUENT EVENTS

Between 1 January 2019 and the date of issue of these financial statements (29 March 2019), the following subsequent event has occurred:

- On January 11, 2019, the Minister of Finance informed the fiscal agent the new investment guidelines for the Economic and Social Stabilization Fund

10 FINANCIAL STATEMENTS: PENSION RESERVE FUND

Financial statements for the years ended on 31 December 2018 and 2017 and the independent auditors' report⁴⁹

⁴⁹ The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2018 and 2017 were prepared by the General Treasury and audited by Crowe Horwarth. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

INDEPENDENT AUDITORS' REPORT

Santiago, 29 March 2019

To the Office of the Treasury of Chile
Pension Reserve Fund

Report on the financial statements

We have conducted an audit of the attached financial statements of the Pension Reserve Fund for the years ended on 31 December 2018 and 2017, with the corresponding income, comprehensive income, changes in net equity, and cash flow statements for these years, together with the corresponding notes.

Management's responsibility for the financial statements

The Treasury of Chile is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes the design, implementation, and maintenance of appropriate internal control procedures that ensure the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Chile. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves carrying out procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The selected procedures depend on the auditor's judgment, including the assessment of the risks associated with material misstatements on the financial statements, whether due to fraud or error. On making these risk assessments, the auditor considers the internal control procedures that are relevant to the preparation and fair presentation of the Fund's financial statements, in order to design auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. We therefore do not express such an opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the significant accounting estimates made by the Fund's management, as well as assessing the general presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate for providing the basis for our audit opinion.

Santiago, 29 March 2019
Pension Reserve Fund
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In our opinion, these financial statements fairly present, in all material aspects, the financial position of the Pension Reserve Fund as of 31 December 2018 and 2017 and its operating performance and cash flows for the years ended on those dates, in accordance with International Financial Reporting Standards.

Other matters

As indicated in Note 1, the Pension Reserve Fund's resources are intended to be used to complement the financing of fiscal obligations stemming from the state guarantee of minimum old-age, disability, and survival pensions prescribed by Decree Law N° 3,500 of 1980 and the welfare pensions prescribed by Decree law N° 869 of 1975.

Sergio Bascuñán Rivera

PENSION RESERVE FUND

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PENSION RESERVE FUND
STATEMENT OF FINANCIAL POSITION

<u>ASSETS</u>	<u>Notes</u>	<u>31 Dec 2018</u>	<u>31 Dec 2017</u>	<u>LIABILITIES AND NET EQUITY</u>	<u>Notes</u>	<u>31 Dec 2018</u>	<u>31 Dec 2017</u>
		US\$	US\$			US\$	US\$
CURRENT ASSETS				LIABILITIES			
Cash and cash equivalents	12	40,339,768	26,694,941	Derivative financial instruments	8	257,583	10,284
Total current assets		40,339,768	26,694,941	Total liabilities		257,583	10,284
FINANCIAL ASSETS AFFECTING INCOME				NET EQUITY			
Equities	7	1,646,913,209	1,551,357,967	Fisco resources		8,065,673,883	7,874,470,281
Other capitalization instruments	7	36,863,216	33,999,912	Contributions by the Fisco in the year	9	541,576,255	505,150,199
Corporate bonds	7	1,986,132,197	2,098,068,913	Accumulated results		1,945,277,883	987,604,530
Time deposits	7	288,213	324,602	Income (loss) in the year	9	(364,225,836)	957,673,353
Government bonds	7	4,732,741,209	5,028,227,756	Withdrawals by the Fisco in the year		(525,052,667)	(313,946,597)
Indexed bonds	7	1,219,529,867	1,271,748,294	Total net equity		9,663,249,518	10,010,951,766
Derivatives		<u>699,422</u>	<u>539,665</u>				
Total investments		<u>9,623,167,333</u>	<u>9,984,267,109</u>				
Total assets		<u>9,663,507,101</u>	<u>10,010,962,050</u>	TOTAL LIABILITIES AND NET EQUITY		<u>9,663,507,101</u>	<u>10,010,962,050</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND

STATEMENT OF INCOME

		For the period starting in January first to.	
	<u>Notes</u>	<u>31 Dec 2018</u>	<u>31 Dec 2017</u>
		US\$	US\$
OPERATING INCOME			
Interest earned	10	184,883,144	173,515,076
Dividend income	11	36,820,694	34,197,797
Net realized gains from price changes on financial instruments		-	26,378,711
Net unrealized gains from price changes on financial instruments		-	728,607,706
		<hr/>	<hr/>
Total net operating income		221,703,838	962,699,290
OPERATING LOSSES			
Net realized losses from sale of financial instruments		(10,860,284)	-
Net unrealized losses from price changes on financial instruments		(570,329,888)	-
		<hr/>	<hr/>
Total net operating losses		(581,190,172)	-
		<hr/>	<hr/>
Net operating income (loss)		(359,486,334)	962,699,290
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(2,661,812)	(3,143,048)
Custodian's fees and external portfolio managers' fees	9	(1,540,339)	(1,595,229)
Other expenses		(537,400)	(111,763)
Adjustment, J.P. Morgan		49	(175,897)
		<hr/>	<hr/>
INCOME (LOSS) IN THE YEAR		(364,225,836)	957,673,353
		<hr/> <hr/>	<hr/> <hr/>

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND
STATEMENT OF COMPREHENSIVE INCOME

	For the period starting the January first to 31 Dec 2018	31 Dec 2017
	US\$	US\$
Income (loss) in the year	(364,225,836)	957,673,353
Other comprehensive income reclassified to income in subsequent years	—	—
Other comprehensive income not reclassified to income in subsequent years	—	—
Total other comprehensive income	<u>—</u>	<u>—</u>
Comprehensive income in the year	<u>(364,225,836)</u>	<u>957,673,353</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND
STATEMENT OF CHANGES IN NET EQUITY
AS OF 31 DECEMBER 2018 AND 2017

	<u>Notes</u>	<u>Fisco Resources</u> US\$	<u>Accumulated income</u> US\$	<u>Comprehensive income in the year</u> US\$	<u>Total</u> US\$
Opening balance, 1 January 2018		8,065,673,883	987,604,530	957,673,353	10,010,951,766
Distribution of income from the previous year		-	957,673,353	(957,673,353)	-
Contributions by the Fisco	9	541,576,255	-	-	541,576,255
Withdrawal by the Fisco	9	(525,052,667)	-	-	(525,052,667)
Comprehensive income for the year		-	-	(364,225,836)	(364,225,836)
Closing balance, 31 December 2018		<u>8,082,197,471</u>	<u>1,945,277,883</u>	<u>(364,225,836)</u>	<u>9,663,249,518</u>
Opening balance, 1 January 2017		7,784,470,282	700,020,803	287,583,727	8,862,074,812
Distribution of income from the previous year		-	287,583,727	(287,583,727)	-
Contributions by the Fisco	9	505,150,198	-	-	505,150,198
Withdrawal by the Fisco	9	(313,946,597)	-	-	(313,946,597)
Comprehensive income for the year		-	-	957,673,353	957,673,353
Closing balance, 31 December 2017		<u>8,065,673,883</u>	<u>987,604,530</u>	<u>957,673,353</u>	<u>10,010,951,766</u>

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND
STATEMENT OF CASH FLOWS
(Indirect method)

		For the exercises finished on	
	Notes	31 Dec 2018	31 Dec 2017
		US\$	US\$
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		(364,225,836)	957,673,353
Unrealized (losses) gains		570,329,888	(728,607,706)
Changes in fund management and custody		(208,982,813)	(417,772,068)
Cash flows from operating activities		(2,878,761)	(188,706,421)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	16,523,588	191,203,602
Cash flows from financing activities		16,523,588	191,203,602
NET INCREASE IN CASH AND CASH EQUIVALENTS		13,644,827	2,497,181
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		26,694,941	24,197,760
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	40,339,768	26,694,941

The accompanying notes 1 to 18 are an integral part of these financial statements.

PENSION RESERVE FUND
NOTES TO THE FINANCIAL STATEMENTS
AS OF 31 DECEMBER 2018 AND 2017

NOTE 1 –GENERAL INFORMATION

The Pension Reserve Fund (PRF) was created through Law N° 20,128, issued by the Ministry of Finance of Chile on 30 September 2006, to complement the financing of fiscal obligations stemming from the state guarantee of minimum old-age, disability, and survival pensions prescribed by Decree Law N° 3,500 of 1980 and the welfare pensions prescribed by Decree Law N° 869 of 1975.

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

- a) Decree N° 1,618 of 2013, which authorizes the Central Bank of Chile (CBC) to act as fiscal agent in managing the Pension Reserve Fund and establishes guidelines for reporting on the investments to the Finance Minister and the Treasury.
- b) Decree N° 1,274 of 31 August 2007, which establishes standards, limits, procedures, and controls for investing PRF resources.
- c) Decree N° 1,649 of 2007, which modifies the fund's investment limits.
- d) Comptroller General Official Letter N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.
- e) Decree N° 1,492 of 2015, which regulates the coordination and functioning of advisory activities, management support, and auditing of the Public Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund (and which abolishes Decree N° 1,636 of 2009).

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

- Record all investments of Treasury resources, as well as debt operations, in accordance with the accounting and budgetary standards established by the Comptroller General and/or the Budget Office, as applicable.
- Perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms, and commission independent auditors for the annual financial statements, subject to the stipulations of Article 7 of this Decree. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.
- Support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.

- Verify that the nominal investment records of the Sovereign Wealth Fund managers are consistent with the custodians' records. This provision was applied to the portfolios under the management of external fund managers on 1 January 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.
- Issue transaction instructions associated with contributions to and withdrawals from the sovereign wealth funds in accordance with instructions from the Finance Ministry, validate payments associated with the management and custody of the sovereign wealth funds, as required, and issue instructions to the Central Bank of Chile on the payment of the different services provided by the external managers.
- Supervise compliance, on the part of each portfolio manager, with the limits stipulated in the sovereign wealth fund investment policy, in accordance with the controls established by the Ministry of Finance by resolution. This provision was applied to the portfolios under the management of external fund managers on 1 April 2014 and to the portfolios under the management of the Central Bank of Chile on 1 July of the same year.
- Supervise compliance with the norms and limits established by the Ministry of Finance with regard to the capital market investment of Treasury resources that are held outside the sovereign wealth funds and to send periodic reports on the matter to the Budget Office and the Ministry of Finance.
- Maintain a current manual of procedures for the handling of all functions and duties described in this Article.
- Provide any additional management support, coordination, or consulting as needed for the performance of these functions.

The information for the accounting of the sovereign wealth funds is provided by the Treasury, which is and will continue to be an institution in good standing, such that the data resulting from the accounting process are not estimated values.

- f) Ministry of Finance Official Letter N° 2,424 of December 6, 2018, which establishes the new investment guidelines for the Pension Reserve Fund. It abolishes Official Letter N° 1,925 of 2013.
- g) Ministry of Finance Official Letter N° 2,463 of December 13, 2018, which establishes the new custody guidelines.
- h) Ministry of Finance Decree N° 1,378 of October 5, 2015, which establishes fiscal policy in accordance with the provisions of Article 1 of Law N° 20,128.
- i) Ministry of Finance Official Letter N° 45 of October 11, 2017, which authorizes payment of compensation for 2018, for portfolio management and other services.

Qualitative characteristics of the PRF financial statements

- i) The Principle of Relevance, as a category of the PRF financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.

- ii) The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence, and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.
- iii) The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.
- iv) The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

Pursuant to Article N° 7 of Law N° 20,128, the Ministry of Finance must commission an actuarial study every three years to assess the sustainability of the Pension Reserve Fund.

An actuarial study must also be carried out whenever there is a proposal to change the amount of the minimum or welfare pensions, with the exception of the automatic adjustment stipulated in Article 14 of Decree Law N° 2,448 of 1979 and Article 10 of Law N° 18,611. The results of these studies must be incorporated into the records considered in Article 14 of Law N° 18,918, the Basic Constitutional Act of the National Congress.

On 17 June 2015 the Ministry of Finance issued the new investment guidelines for the Pension Reserve Fund, which replace and rescind the investment guidelines contained in Official Letter N° 1,925, issued by the Ministry of Finance in 2013.

Article 15, paragraph (a), of Decree N° 1,618 of 2013 authorizes the fiscal agent to conduct, at the request of the Finance Minister, one or more tenders for the management of the externally managed portfolio and to contract the external managers thereof, in the name and on the account of the Treasury. Under this provision, the following external managers were contracted to perform custody services starting in 2013:

- Blackrock Corps.
- BNY Mellon Equities.
- Blackrock Equities.
- Allianz Global Investors Corps.

In July 2016, the Microdata Center of the Economics Department of the University of Chile issued a report on the Actuarial Study of the Sustainability of the Pension Reserve Fund. The study measured the expected evolution of the Pension Reserve Fund under different scenarios, to provide the basis for a sustainability analysis of the PRF over the next 20 years. The report finds that the PRF demonstrates sustainability in every one of the scenarios tested.

NOTE 2 – MAIN ACCOUNTING CRITERIA USED

The main accounting criteria used in the preparation of these financial statements are described below. These criteria have been applied systematically to all the statements presented, unless otherwise indicated.

2.1 Basis of preparation and presentation of the financial statements

The PRF financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

As of January 1, 2018 the Fund applies IFRS 9, which establish that debt instruments are measured at amortized cost if and only if (i) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows and (ii) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. If one of these criteria is not met, the debt instruments are classified at fair value through profit or loss. However, at the initial recognition of a debt instrument that meets the amortized cost criteria, the fund may choose to designate that instrument as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

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

Investments in equity instruments (equity) are classified and measured at fair value through profit or loss, unless the equity instrument is not held for trade and is designated by the fund as measured at fair value through profit or loss in other comprehensive income. If the equity instrument is designated as measured at fair value through profit or loss in other comprehensive income, all gains and losses from revaluation, except dividend income that is recognized in profit or loss in accordance with IAS 18, are recognized in other comprehensive income and cannot later be reclassified to profit or loss.

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds provided by the custodian, J.P. Morgan Chase & Co.

The financial statements presented by the Treasury for the PRF are as follows:

- Statement of Financial Position.
- Statement of Comprehensive Income.
- Statement of Changes in Net Equity.
- Statement of Cash Flows.
- Notes to the Financial Statements.

2.2 Accounting period

The financial statements cover the years between 1 January and 31 December 2018 and 2017, respectively.

2.3 Functional and presentation currency

The entries included in the PRF financial statements are recorded using the currency of the primary economic environment in which the fund operates. Thus, the fund's securities are presented in U.S. dollars, as the functional and presentation currency.

Foreign currency transactions in currencies other than the U.S. dollar are converted to the functional currency using the exchange rate prevailing on the date of the transaction. Foreign currency gains and losses stemming from the settlement of these transactions or the conversion of monetary assets denominated in a foreign currency to the closing exchange rate are recognized on the Statement of Comprehensive Income.

2.4 Investment classification and valuation

The fund's investments comprise liquid foreign currency assets that are made by the Central Bank of Chile, as fiscal agent, using eligible intermediaries, basically banks and financial institutions. The investment objective is to maximize fiscal resources, which can be accessed immediately if needed to finance the activities of the sovereign wealth funds.

Financial assets and liabilities, Classification and measurement

As of January 1, 2018 the fund applies IFRS 9, which establish that for classification and measurement of financial assets the fund must consider its business model for managing their assets and its contractual cash flow characteristics. The fund has classified its financial assets in the following categories

Financial assets at amortized cost

In this category are classified those financial instruments that are part of a business model, whose objective is to hold in order to collect contractual cash flows. At the same time, the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at fair value through other comprehensive income

In this category are classified those financial instruments that are part of a business model, whose objective is to hold in order to collect contractual cash flows or to sell those financial assets. At the same time, the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Likewise, the fund may make an election for particular investments in equity instruments, such as financial assets at fair value through other comprehensive income that would otherwise be measured at fair value through profit or loss.

Financial assets at net fair value through profit or loss

A financial asset is classified at fair value through profit or loss, unless is classified as amortized cost or at fair value through other comprehensive income. In addition, the fund may, at initial recognition, irrevocably designate a financial asset at net fair value through profit or loss if doing so eliminates an accounting mismatch that would otherwise arise. The fund has adopted the policy of not using hedge accounting.

The management objective of the fund is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, for which investment strategies are selected to achieve this objective.

The fund classifies the following instruments in this category: Government bonds, inflation-indexed bonds, corporate bonds, time deposits, common and preferred equities, ADRs, GDRs, REITs, Treasury bills, commercial papers, and derivative instruments. The basis for classifying the securities in this investment category is that they have a reasonably active secondary market, under normal conditions, and that they are also consistent with what is established in the Official Letter N° 1,567 of June 17, 2015 which contains the investment guidelines for the Pension Reserve Fund. These investments are recorded at fair value through profit or loss.

The custodian determines fair value using the last transaction price of the day at the close of the market in which they are traded.

Financial liabilities

All financial liabilities are measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss, including derivatives which are measured after their fair value.
- Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.
- Financial liabilities that arise from financial guarantee contracts.
- Financial liabilities that arise from commitments to provide a loan at a below-market interest rate
- Financial liabilities from a business combination.

The fund may, at initial recognition, designate a financial liability as measured at fair value through profit or loss, if it either eliminates or significantly reduces a measurement or recognition inconsistency, or a group of financial instruments is managed, and its performance is evaluated on a fair value basis, in accordance with its business model.

Recognition, reduction, and measurement

The regular purchase and sale of investments is recognized on the date of the transaction, or the date the fund commits to buying or selling the investment. Financial assets and financial liabilities are initially recognized at fair value.

Transaction costs are charged to expenses on the income statement when they are incurred in the case of financial assets and liabilities at fair value through profit or loss, and they are recorded as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

Transaction costs are costs that are incurred in the process of acquiring financial assets or liabilities. They include all fees, commissions, and other items paid to agents, consultants, brokers, and operators in association with the operation.

Financial assets are reduced for accounting purposes when the rights to receive cash flows from the investment have expired or the fund has essentially transferred all the risks and benefits associated with ownership.

After the initial recognition, all financial assets and financial liabilities carried at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in fair value in the category "Financial assets or financial liabilities carried at fair value through profit or loss" are presented on the Statement of Comprehensive Income under the item "Net changes in fair value of financial assets and financial liabilities carried at fair value through profit or loss" in the period in which the change occurs.

Dividend income from financial assets at fair value through profit or loss is recognized on net income under the item "Dividend income" when the fund's right to receive the payment has been established. Interest on debt securities at fair value through profit or loss is recognized on net income under the item "Interest and adjustments" based on the effective interest rate.

Financial assets at amortized cost and other liabilities are valued, after initial recognition, using the effective interest rate method. Accrued interest and adjustments are recorded in the "Interest and adjustments" account of the Statement of Comprehensive Income.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating the financial income or financial expense over the period in question. The effective interest rate is the rate that exactly discounts effective future payments or receipts estimated over the life of the financial instrument, or, if appropriate, over a shorter period, relative to the accounting value of the financial asset or financial liability. To calculate the effective interest rate, the fund estimates cash flows taking into account all the contractual terms of the financial instrument, but not future credit losses.

The calculation includes all fees and points paid or received between the counterparties that are integral to the effective interest rate, transaction costs, and all other premiums or discounts.

Estimation of fair value

The fair value of financial assets and liabilities traded in active markets (such as derivatives and available-for-sale securities) is based on quoted market prices on the date of the Statement of Financial Position. The quoted market price used for financial assets held by the fund is the purchase price; the quoted market price taken for financial liabilities is the sale price (if the sale and purchase prices differ). When the fund holds derivative instruments that are netted, intermediate market prices are used as the basis for establishing the fair value for netting positions, and this purchase or sale price is applied to the net open position, as appropriate.

The hierarchy of fair value is as follows:

- a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- b) Variables other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, price derivatives) (Level 2); and
- c) Variables used for the asset or liability that are not based on observable market data (unobservable variables) (Level 3).

2.5 Cash

In the preparation of the PRF financial statements, a distinction is made between cash held in the current account maintained for the fund by the Treasury and cash held by the custodian as a result of operations undertaken in the course of the custodial management of the fund.

2.6 Funds under management

These are securities delivered, under the mandate of managing PRF resources, to the Central Bank of Chile, as fiscal agent; to J.P. Morgan, as custodian bank; and to the external portfolio managers. The securities can be totally or partially employed in the performance of the assigned duties.

2.7 Funds in custody

These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co. and to the external managers, which provide general custody services for PRF securities and instruments.

2.8 Net equity

The net equity of the sovereign wealth funds is derived from the opening balance of total assets at nominal value, plus fiscal contributions, minus fiscal withdrawals, plus income for the year.

In accordance with the stipulations of Articles N° 6 and 7 of Law N° 20,128, the Pension Reserve Fund will be established and increased with the following resources:

- a) A contribution equal to the real fiscal surplus, with a cap of 0.5% of the previous year's gross domestic product. If the amount of the annual contribution indicated above is less than 0.2% of the previous year's gross domestic product, then an additional contribution should be paid so as to reach a total annual contribution of 0.2% of the previous year's gross domestic product.

The contribution described herein must be delivered to the Pension Reserve Fund within the first half of the year, in one or more installments until the total contribution has been made.

- b) The proceeds from the return on the PRF investments; and
- c) Other contributions established by law.

The contribution described in point (a) above will only be made until the year in which the PRF accumulates a balance equal to UF900 million. Once this amount has been reached, the obligation will be considered fulfilled, and no further contributions will be made under this item.

The exclusive objective of PRF assets is to complement the payment of the liabilities laid out in the PRF objective, and they can only be used for this purpose starting ten years from the effective date of Law N° 20,128.

The Pension Reserve Fund will cease to exist if, after fifteen years from the effective date of Law N° 20,128, the withdrawals to be made in a calendar year do not exceed 5% of the sum of expenditure on the state guarantee of minimum pensions and welfare pensions established in that year's budget.

2.9 Statement of cash flows

For the purpose of preparing the Statement of Cash Flows, the sovereign wealth funds use the following definitions:

- Cash and cash equivalents: Includes cash on hand, time deposits in credit institutions, and other highly liquid short-term investments.
- Cash flows provided by operating activities: Includes management costs for operating the sovereign wealth funds.
- Cash flow provided by financing activities: Includes activities that produce changes in the size and composition of net equity, such as income from fiscal contributions and expenses from fiscal withdrawals.

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

2.10 Net or offset presentation of financial instruments

Financial assets and liabilities are offset, and the net amount is reported on the Statement of Financial Position, when there is a legal right to offset the recognized amounts and there is a positive intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

2.11 New accounting rules

2.11.1 New accounting rules that are not yet effective

On the date of publication of these financial statements, a number of new rules and amendments, as well as improvements and new interpretations of existing rules, have been issued, but have not yet entered into force. The ESSF management has not adopted the new provisions in advance of the mandatory application date, which is indicated in the following table:

	New rules, improvements, and amendments	Mandatory application date:
IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019
IFRS 16	Leases	1 January 2019
Amendment to IAS 12	Income Tax	1 January 2019
Amendment to IAS 19	Employee Benefits	1 January 2019
Amendment to IAS 23	Borrowing costs.	1 January 2019
Amendment to IAS 28	Investments in Associates and Joint Ventures	1 January 2019
Amendment to IAS 3	Business Combinations	1 January 2019
Amendment to IAS 9	Financial Instruments	1 January 2019
Amendment to IAS 11	Joint Agreements	1 January 2019

The PRF management deems that the adoption of the new rules, improvements, amendments, and interpretations described above will not have a significant impact on the fund's financial statements in the initial application period.

2.11.2 Rules that have been used in the preparation of these financial statements

IAS 12 Income taxes

In January 2016, the IASB issued amendments to IAS 12, which clarify requirements regarding the recognition of deferred tax assets corresponding to debt instruments measured at fair value. Its recognition should be evaluated to the extent that it is probable that the entity has future taxable profits to use the deductible temporary difference.

This modification had no impact for the fund.

IFRS 9 Financial Instruments.

On July 24, 2014, the IASB concluded its improvement project on the accounting for financial instruments with the publication of IFRS 9 Financial Instruments. This standard includes new requirements based on principles for the classification and measurement, introduces a "prospective" model of expected credit losses on impairment accounting and changes in hedge accounting.

The designation of the classification, determining how financial assets and liabilities are accounted for in the financial statements and, in particular, how they are measured. IFRS 9 introduces a new approach to the classification of financial assets, based on the entity's business model for the management of financial assets and the characteristics of contractual flows.

In terms of impairment standard establishes a single model that applies to all financial instruments, thus eliminating a source of complexity associated with previous accounting requirements, which require a timely recognition of expected credit losses.

IFRS 9 introduces changes to the requirements for accounting hedge, and also new alternatives of strategies to use. The amendments mean a substantial overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements. In addition, as a result of these changes, users of the financial statements will be provided with better information about risk management and the effect of hedge accounting on the financial statements.

This standard also established that the change in fair value that corresponds to own credit risk will be recorded in Other Comprehensive Income, thus reducing any eventual volatility that would be generated in the income of the entity as a result of its recognition. Earlier application of this improvement is permitted, prior to any other requirement of IFRS 9.

Mandatory adoption date was January 1, 2018, allowing its early application.

IFRS 15 – Revenue from Contracts with Customers

In May 2014 was issued IFRS 15, which it has like purpose established the principles that will apply an entity to present useful information to users of financial statements about the nature, amount, opportunity and uncertainty of the income for ordinary activities and cash flows that it is related to a contract with a client. This new standard replaces the following current standard and interpretations: IAS 18 – Revenue, IAS 11 – Construction contracts, IFRIC 13 – Customer Loyalty Programs, IFRIC 15 – Agreements for the Construction of Real State, IFRIC 18 – Transfers of Assets from Customers and SIC 31 – Revenue: Barter Transactions involving. The new model will apply to all contracts with customers, except those that are inside to the scope of the others IFRS, such as leases, insurance contracts and financial instruments.

On April 12, 2016, IASB issued amendments to IFRS 15, clarifying requirements and providing a temporary relief to companies that are implementing the new standard. In short the amendments clarify how:

- Identify a performance obligation (the promise to transfer a good or service to a customer) in a contract;
- Determining whether a company is the principal (the provider of a good or service) or an agent (the organization responsible for the good or service provided); and –
- Determine whether the product of a license must be recognized at a point in time or over time.

The date of application of this new standard was from in January 1, 2018, allowing its early application. The adoption of IFRS 15 did not have an impact on the financial condition or results of the operations of the fund.

NOTE 3 – PRF INVESTMENT GUIDELINES

I. Duties assigned to the fiscal agent

The following duties and functions are assigned to the fiscal agent, in accordance with Articles N° 4 and 15 of Decree N° 1,383, of 2006, modified by Decree N° 1,618, of 2012, both issued by the Ministry of Finance (henceforth, the Agency Decree):

I.1. Duties related to Central Bank transaction accounts

I.1.1. Portfolio governed under Article 4 of the Agency Decree (henceforth, the Article 4 portfolio):

- a) Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the PRF Article 4 portfolio transaction account).
- b) Receive, record, and deposit in the PRF Article 4 portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the fiscal agent.
- c) Receive, record, and deposit in the PRF Article 4 portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, to the PRF externally managed portfolio transaction account for the purpose of making third-party payments corresponding that portfolio, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.
- d) Make payments, in the name and on the account of the Treasury, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (f) of Article 4 of the Agency Decree.
- e) Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.1.2. Portfolio governed under Article 15 of the Agency Decree (henceforth, the externally managed portfolio):

- a) Open and maintain a transaction account in the Central Bank of Chile in the name of the National Treasury of Chile (henceforth, the Treasury) for the fund's resources (henceforth, the PRF externally managed portfolio transaction account).
- b) Receive, record, and deposit in the PRF externally managed portfolio transaction account the sums of money transferred thereto by the Treasury, for the purpose of being managed by the external portfolio managers.
- c) Receive, record, and deposit in the PRF externally managed portfolio transaction account the sums of money deriving from the investment of the fund's resources or their settlement, which are going to be transferred to the Treasury, to other portfolios, or to whomever the Finance Minister indicates, for the duration of the fiscal agency or on its termination.
- d) Make payments, in the name and on the account of the Treasury, associated with the management or custody of the fund's resources, in accordance with the terms specified in paragraph (e) of Article 15 of the Agency Decree.

- e) Make payments, in the name and on the account of the Treasury, to the external manager(s) or other third parties when so instructed by the Treasury.
- f) Report daily, via electronic communication, to the Finance Minister and the Treasurer, or their authorized delegates, on movements in this transaction account.

I.2. Duties related to custody

I.2.1. Article 4 portfolio:

Contract, in the name of the Fisco, one or more foreign financial institutions or securities depositories (henceforth, custodians) to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (d) of Article 4 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.2.2. Externally managed portfolio

Contract, in the name of the Treasury, one or more foreign financial institutions or securities depositories to provide custody services for the securities and instruments acquired with the fund's resources in accordance with the provisions of paragraph (c) of Article 15 of the Agency Decree and the current custody guidelines.

Contract, in the name and on the account of the Fisco, associated complementary services, such as tax advisors or international consultants.

I.3. Duties related to management

I.3.1. Article 4 portfolio

- a) The fiscal agent will manage the fund's resources on the account and at the risk of the Treasury. The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the fiscal agent. The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the fiscal agent via a cash transfer to the PRF Article 4 portfolio transaction account. The resources can only be transferred to the fiscal agent on business days in the United States of America. Moreover, subject to the prior authorization of the Finance Minister, pursuant to the stipulations of Article 4, paragraph (f) of Statutory Decree D.F.L. N° 1, issued by the Ministry of Finance in 2006, all or part of the PRF contributions can come from the Economic and Social Stabilization Fund (ESSF). In that case, the fiscal agent will have the authority to determine whether the contributions from the ESSF will be effectuated through a direct transfer of financial instruments from the ESSF Article 4 portfolio to the PRF Article 4 portfolio, or through a cash transfer following the liquidation of such instruments. For this purpose, financial instruments will be valued on the date of the transfer, according to the criteria outlined in section II. 4 below. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.
- b) To fulfill this duty, and subject to the objectives, guidelines, and restrictions established in this document, the fiscal agent will have the full authority, in representation of the Treasury, to make decisions on investment, disposal, and related activities, including the ability to choose, buy, sell, hold, auction, recover, or exchange investment instruments of any type; underwrite the issue of instruments; enter into spot or forward foreign exchange contracts; instruct the custodian to make payments associated with the execution of transactions; earn dividends, interest, amortization, and other benefits; and engage in other operations, acts, and contracts that the fiscal agent deems appropriate with regard to the management of the portfolio and the fulfillment of the duties outlined in this document.

The fiscal agent will also have the authority to implement the acts and contracts described in the previous paragraph through banks, brokers or any other financial intermediaries.

- c) The fiscal agent will be able to aggregate transactions executed for the management of the portfolio with transactions executed for the Central Bank of Chile's international reserve portfolio, as well as for other fiscal resources managed by the fiscal agent.

The fiscal agent cannot directly acquire any instruments that are being removed the PRF Article 4 portfolio in representation of the Treasury or directly acquire for the PRF Article 4 portfolio any instruments owned by the Central Bank of Chile that are being removed from the Bank's own portfolio.

- d) The fiscal agent will hold the funds and investments under its management in separate accounts, clearly indicating that they are the property of the Treasury of Chile for all legal purposes.

I.3.2. Externally managed portfolio

- a) The net effective yields obtained from investing the resources will be considered additional amounts to be managed by the external managers.
- b) The Finance Minister can adjust the amount of the resources at any time. In the case of an increase, the additional resources must be delivered by the Treasury to the external managers, via the fiscal agent, in the form of a cash transfer to the PRF externally managed portfolio transaction account. Nevertheless, the resources can only be transferred to the external managers, through the fiscal agent, on business days in the United States of America. The Treasury must issue instructions for transferring contributions and withdrawals at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.
- c) The custodian(s) will hold the funds in its custody in separate accounts, clearly indicating that they are the property of the Treasury of Chile for all legal purposes.

I.3.3. Rebalancing

The Ministry of Finance or the Treasury will instruct the fiscal agent on the contributions, withdrawals, and transfers from the Article 4 portfolio to the externally managed portfolio, or vice versa, as necessary to achieve compliance with the target ranges established in section II.3.6. The instructions must be issued at least three (3) business days before the date on which the transfer is to occur, taking into account the calendar of bank holidays in the United States of America and Chile.

I.4. Duties related to monitoring and reports

I.4.1. Article 4 portfolio

- a) Maintain full and detailed information on all transactions and other operations carried out in association with the management of the Article 4 portfolio, in accordance with the stipulations of paragraph (g) of Article 4 of the Agency Decree.
- b) Supervise, monitor, and evaluate the services provided by the custodian(s); establish daily and, if necessary, clarify any differences that might arise between the records maintained by the fiscal agent and the custodians, as well as any other discrepancies detected in relation to the contracted services; and report to the Finance Minister, or an authorized delegate, for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the custodians.
- c) Report to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, the daily investment position of the portfolio, with a lag of not more than three (3) business days from the date of the report. The reporting requirement outlined in this paragraph will be understood as fulfilled when the respective electronic communication has been sent, using the means and formats stipulated by the Finance Minister or an authorized delegate, under the exclusive responsibility of the sender. In the event of discrepancies between the information sent by the fiscal agent and the information received by the Ministry of Finance and the Treasury, the version contained in the fiscal agent's records will prevail.

- d) Report, under the terms described above, to the Finance Ministry and the Treasurer, or their authorized delegates, using electronic communication, any change or correction to the information described in the preceding paragraph (c), on the daily investment position of the portfolio.
- e) Submit to the Finance Ministry and the Treasurer, or their authorized delegates, monthly, quarterly, and annual reports on the management of the Article 4 portfolio.
- f) Submit to the same authorities an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records maintained by the fiscal agent on the Article 4 portfolio. The monthly reports will include a copy of the payment orders associated with the PRF Article 4 portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.
- g) The Ministry will issue an opinion on the quarterly and annual reports described above, either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager and the General Manager of the Central Bank within a period of 30 consecutive days from the date the report was submitted. In the event that there are such observations, which must be well-founded and specific, the fiscal agent will have a period of 15 consecutive days to respond, with the specific objective of clarifying and resolving the issues raised, as appropriate. Subsequently, the Finance Minister or the International Finance Coordinator or the Head of the Sovereign Wealth Funds Unit will issue an opinion on the response received, via electronic mail, stating either approval or rejection, under the same requirements outlined above, within a period of 15 consecutive days from the date of reception.
- h) Generate, maintain, and submit to the Ministry of Finance at least once a month the list of eligible banks and localities, in accordance with the criteria stipulated in points II.3.2.4 and II.3.3.4 of these guidelines.
- i) Meet monthly with Finance Ministry staff to discuss any aspect of the management of the PRF Article 4 portfolio. These meetings will be held within five (5) business days of the submission of the monthly management report prepared by the fiscal agent. The Ministry of Finance can also request additional meetings as deemed appropriate.
- j) As established in Article 7 of the Agency Decree, the accounting of the fiscal resources and the preparation of the audited financial statements is the responsibility of the Treasury. At the same time, the management of the Article 4 portfolio will be subject to internal supervision and control by the fiscal agent in accordance with the terms established in the Central Bank of Chile's Basic Constitutional Act. In addition, at least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on Article 4 portfolio operations. Moreover, the Finance Minister, or an authorized delegate, can request that the fiscal agent submit reports on operations and processes carried out in the management of Article 4 portfolio. Finally, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of its duties and functions.

I.4.2. Externally managed portfolio

- a) Verify, in accordance with industry standards normally applied to investments in a given type of asset, that the records of transactions and other operations reported by the external manager(s) and by the custodian(s) of the fiscal resources are consistent at the close of each day in terms of their notional amount, duration, and date, with the transactions reported at closure by the custodian(s). For the purposes of this paragraph (a), the daily closure is defined as the close of the fiscal agent's business day. In addition, the fiscal agent must subsequently verify the closures reported on non-business days for the fiscal agent that are business days for the custodian or external managers. The fiscal agent must report monthly to the Finance Minister and the Treasurer, or their authorized delegates, the results of the daily verification process. Furthermore, the fiscal agent must conduct a daily reconciliation of transactions and notional positions and report any differences that might arise between the records maintained by the fiscal agent and/or the external managers and the records maintained by the custodians, as well as any other discrepancies detected in relation to the contracted services; any such differences must be reported to the Finance Minister or authorized delegate for the purpose of determining the exercise of legal or administrative action necessary for the defense or safeguarding of the fund's resources and to enforce the civil, criminal, or administrative liability for any damages, crime, or infringement committed by the external managers or the custodians.
- b) For the purposes of this section I.4.2., and in all matters concerning the externally managed portfolio, "records" are defined as the information received from the external manager(s) or the custodian(s), in order to verify that the custodian(s) have the same notional positions as reported by the external manager(s).
- c) Submit to the Finance Minister and the Treasurer, or their authorized delegates, an annual report on the methodology used by the custodians and the fiscal agent as the basis for preparing the management reports; as well as an annual report on the service provided by the custodian(s). These reports will be prepared by comparing the data and records provided by the custodian(s) with the data and records for the externally managed portfolio submitted by the external managers. The monthly reports described in the preceding paragraph (a) will include a copy of the payment orders associated with the PRF externally managed portfolio and the corresponding invoices, as well as information on any methodological change in the preparation of the reports.
- d) The Ministry will issue an opinion on the reports described in the preceding paragraphs (a) and (c), either to approve them or to formulate observations on some aspect(s) of the material contained therein, via electronic mail, which will be sent by the Finance Minister, the International Finance Coordinator of the Ministry of Finance, or the Head of the Sovereign Wealth Funds Unit of the Ministry of Finance to the International Markets Manager of the Central Bank when the opinion encompasses Article 4 portfolio reports, in accordance with the timeline and procedures outlined in paragraph I.4.1.g.
- e) At least once a year, the fiscal agent will instruct the custodian(s) to provide the reports issued by the corresponding supervisory agencies and/or their external auditors on all operations involving fiscal resources. Moreover, the fiscal agent has the option of contracting an external expert consultant to evaluate and monitor the management and processes employed in the performance of the custodian's duties and functions. The fiscal agent will only perform the duties described in paragraphs (a), (c), and (e) with regard to the custodian(s).

II. Portfolio investment guidelines

II.1. Management objective

II.1.1. Article 4 portfolio: The management objective of the PRF Article 4 portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy. The fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

II.1.2. The management objective of the PRF externally managed portfolio is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, within the risk standards specified in the relevant guidelines and parameters, as outlined in section II.3. below.

II.2. Investment portfolio

For the investment of the fiscal resources, an investment portfolio (IP) will be established comprising the sum of the Article 4 portfolio and the externally managed portfolio. The specific guidelines, parameters, and rules are contained in the following sections.

II.3. Guidelines and parameters

II.3.1. Asset classes and benchmarks

The fiscal resources in the investment portfolio (IP) will be invested in four asset classes: (1) Sovereign and government-related bonds; (2) Inflation-indexed sovereign bonds; (3) Corporate bonds; and (4) Equities. The first two classes are allocated to the Article 4 portfolio; the last two classes (corporate bonds and equities) are allocated to the externally managed portfolio. The benchmarks for each asset class are shown in Table 1, together with the benchmark allocation of the IP by asset class (henceforth the benchmark allocation).

Table 1: Benchmark allocation of the investment portfolio (IP)

Benchmark		Benchmarks
Asset class	Percent of IP	
Sovereign and government-related bonds ¹	48%	Barclays Capital Global Aggregate: Treasury Bond Index (unhedged)
		Barclays Capital Global Aggregate: Government-Related (unhedged)
Inflation-indexed sovereign bonds (real)	17%	Barclays Capital Global Inflation Linked Index (unhedged)
Corporate bonds	20%	Barclays Capital Global Aggregate: Corporate Bond Index (unhedged)
Equities	15%	MSCI All Country World Index (ACWI) ² (unhedged, with reinvested dividends)

1. Each subindex of this asset class is added according to its relative capitalization.
2. Excluding Chile.

Performance and the tracking error are calculated based on pre-tax benchmarks.

The first two asset classes (sovereign and government-related bonds; and inflation-indexed sovereign bonds) make up the Article 4 portfolio; they will be purchased directly by the Central Bank of Chile and managed directly by the CBC as the fiscal agent. The third and fourth asset classes (corporate bonds; and equities and other assets) make up the externally managed portfolio; they will be acquired and managed directly by the external managers.

II.3.2. Article 4 portfolio

II.3.2.1. Risk budget

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

II.3.2.2. Eligible issuers and currencies

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

II.3.2.3. Eligible instruments

II.3.2.3.1 Eligible instruments for sovereign and government-related bonds:

- a) Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, the fiscal agent will have a period of seven (7) business days to sell the instrument.
- b) Reopened securities are also eligible for investment, provided that the prospectus indicates that the ISIN will be harmonized to a security that is already included in the benchmark. Investment in this instrument will be allowed during the time necessary for harmonization. If the instrument is not harmonized as expected, the fiscal agent will have seven (7) business days to sell the instrument.
- c) Investment is allowed in instruments that are not included in the benchmark but that differ from other securities which are currently included in the benchmark or which will be included at the end of the month solely by having been issued under different regulatory rules. To be eligible, the instrument must, at the very least, conform in terms of the issuer, coupon, type of coupon (fixed, variable, etc.), maturity, credit rating from Fitch, Moody's, and Standard & Poor's, currency, payment priority (subordinated, unsecured, etc.), and embedded options (callable, puttable, etc.).

- d) Instruments that have ceased to be eligible and have thus been removed from the benchmark because their residual maturity is below the required minimum are still eligible for investment, provided that the issuer remains in the index. Similarly, instruments that were acquired under paragraph (c) above will also continue to be eligible if their equivalent in the benchmark is eliminated due to their maturity dropping below the required minimum, again provided that issuer remains in the index.

II.3.2.3.2. Eligible instruments for inflation-indexed sovereign bonds:

Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, the fiscal agent will have a period of seven (7) business days to sell the instrument. Instruments that have ceased to be eligible and have thus been removed from the benchmark solely because their residual maturity is below the required minimum are still eligible for investment, provided that the issuer remains in the index.

II.3.2.4. Eligible instruments for cash in foreign currency in the Article 4 portfolio.

The fiscal agent can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the Article 4 portfolio in the last 20 business days, based on the calendar of bank holidays in the United States.

The return on cash in foreign currency will be incorporated in the calculation of the Article 4 portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances, overnight and/or weekend deposits, and time deposits up to 15 calendar days in banks with a long-term credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For Article 4 portfolio, limits for any single bank issuer are as follows:

- (a) A maximum of 1.0% of the Article 4 portfolio for issuers with an average rating of AA– or higher.
- (b) A maximum of 0.5% of the Article 4 portfolio for issuers with an average rating of A– to A+.

However, in the event of a contribution to the Article 4 portfolio, the fiscal agent can invest a maximum equivalent to US\$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, on receiving the instruction to generate liquidity for a cash withdrawal, the fiscal agent can invest up to US\$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.2.5. Currency forwards or swaps

The following rules apply to the use of currency hedging mechanisms involving currency forwards or swaps:

- a) Forwards or swaps can only be arranged between eligible currencies, and the contract duration cannot exceed 95 consecutive days.
- b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).
- c) Currency forward or swap contracts can specify either cash delivery or net settlement.
- d) The counterparty risk associated with each forward or swap contract will equal 100% of the notional value, in its U.S. dollar (USD) equivalent. For the purposes of these guidelines, the notional value of the forward or swap is defined as the amount associated with the purchase currency in the contract. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note II.3.2.4).
- e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their USD equivalent. If a forward or swap is contracted in order to fully or partially close a position associated with another forward or swap—and provided that both contracts include close-out netting clauses, are with the same counterparty, have the same maturity date, and are in the same currencies—then the counterparty risk will be measured taking into account the net position of the different forwards and swaps involved. To measure counterparty risk, the forwards and swaps will be revalued daily in USD throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the established credit risk limits (Note II.3.2.4).
- f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.
- g) The notional value of the forwards or swaps contracted by the fiscal agent with an eligible counterparty cannot exceed the issuer limits established in paragraphs (a) and (b) of Note II.3.2.4. However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, these limits are doubled for that counterparty, for a period of two (2) business days starting on the date of the roll. For the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit—as established in paragraphs (a) and (b) of Note II.3.2.4—for two (2) business days, starting on the date of the roll.

II.3.2.6 Limits on sovereign and government-related bonds

The credit rating limits for investment in the sovereign and government-related bond asset class, as a share of the Article 4 portfolio (% of resources), are listed in Table 2.

Table 2: Credit rating limits for sovereign and government-related bonds

Credit rating	Maximum % of the portfolio
AAA	100%
AA+	
AA	
AA-	
A+	60%
A	
A-	
BBB+	40%
BBB	
BBB-	

For the purpose of monitoring the investment limits by asset class, the median credit rating on long-term instruments from the three international rating agencies (Standard & Poor's, Moody's, and Fitch) is used. If only two ratings are available, the lower of the two is taken. If there is only one, that rating is taken.

II.3.3. Externally managed portfolio

II.3.3.1. Risk budget

The externally managed portfolio is subject to the following risk budgets:

1. Corporate bonds: annual ex ante tracking error of 50 basis points.
2. Equities: annual ex ante tracking error of 60 basis points.

II.3.3.2. Eligible issuers and currencies

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

II.3.3.3. Eligible instruments

II.3.3.3.1 Eligible instruments for corporate bonds

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

- a) Exchange-traded futures on fixed-income instruments or indexes, used solely for hedging purposes to minimize differences relative to the applicable corporate bond benchmark (see Table 1) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in the instruments eligible for cash in foreign currency (Note II.3.3.4).
- b) Instruments that have ceased to be eligible and have been removed from the benchmark because their residual maturity or size is below the required minimum, provided that the issuer remains in the benchmark.
- c) Instruments that meet the benchmark's eligibility criteria and will thus be incorporated at the close of the month. In the event that an instrument is not incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of one month to sell the instrument.

II.3.3.3.2. Eligible instruments for equities

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

- a) The Finance Ministry will generate, maintain, and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds (ETFs), which the fiscal agent must, in turn, report to the custodian.
- b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of equities included in the equity benchmark, provided that they do not require the use of tax agents in the issuing country of the underlying asset.

- c) Exchange-traded futures on equity indexes, used for hedging purposes to minimize differences relative to the applicable equity benchmark (see Table 1) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in eligible instruments, as established in Note II.3.3.4.

II.3.3.3.3. Eligible instruments that are to be incorporated into the equity benchmark

External portfolio managers can invest in these instruments as soon as their inclusion is formally communicated by the benchmark supplier. If for any reason the instruments are not actually added to the benchmark as expected, the external manager will have a period of seven (7) business days in the local market to sell the instruments in question, starting on the date on which their inclusion was expected.

II.3.3.4. Eligible instruments for cash in foreign currency in the externally managed portfolio

External portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the moving average value of the externally managed portfolio in the last 20 business days, based on the calendar of bank holidays in the United States. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of that manager's total portfolio returns.

Eligible instruments for holding cash in foreign currency are transaction account balances and overnight and/or weekend deposits in banks with a long-term rating of A- or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's). The institutions eligible to receive cash investments are located in countries or jurisdictions where the eligible instruments of the respective mandates are quoted.

For the externally managed portfolio, each portfolio manager can invest up to US\$ 20 million in a given bank. However, in the event of a portfolio contribution, the external portfolio manager can invest a maximum equivalent to US\$ 80 million in a single bank issuer for a period ten (10) business days from the date of the contribution. In the event of a portfolio withdrawal, when the external manager receives the instruction to generate liquidity for a cash withdrawal, that manager can invest up to US\$ 80 million in a single bank issuer for the ten (10) business days before and including the date of the cash withdrawal.

II.3.3.5 Limits on forwards and swaps

The external portfolio managers can contract forwards or swaps to minimize differences relative to their respective benchmark currency allocation and solely with counterparties that have a long-term rating of A– or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section II.3.2.5, paragraphs (a) to (e). However, in the event that a forward contract is renewed (roll forwards) with the same counterparty and the same two currencies, but for an amount that could differ from the original, this limit is increased to 2% for that counterparty, for a period of two (2) business days starting on the date of the roll. The counterparty risk associated with the forward or swap must be taken into account for complying with the issuer risk limits (as established in Note II.3.3.4). However, for the purpose of measuring counterparty risk, the roll will not be included in the calculation of the issuer risk limit (Note II.3.3.4) for two (2) business days, starting on the date of the roll.

II.3.3.6. Issuer limits for corporate bonds

The limit by issuer for the corporate bond asset class as a share of the externally managed portfolio (% of resources) managed by each external portfolio manager is listed in Table 3, based on the issuer's credit rating.

Table 3: Issuer limits for corporate bonds, by credit quality

Credit rating	Issuer limit
AAA	15%
AA+	10%
AA	10%
AA–	10%
A+	5%
A	5%
A–	5%
BBB+	5%
BBB	5%
BBB–	5%

II.3.3.7 Credit rating limits for corporate bonds

The credit rating limits for investments in the corporate bond asset class, as a share of the externally managed portfolio (% of resources) managed by each external portfolio manager are listed in Table 4.

Table 4: Credit rating limits for corporate bonds

Credit rating	Maximum % of the externally managed portfolio
AAA	100%
AA+	
AA	
AA-	
A+	60%
A	
A-	
BBB+	50%
BBB	
BBB-	

For the purpose of monitoring the investment limits established by the Finance Ministry (sections II.3.3.6 and II.3.3.7), the median credit rating on long-term instruments from the three international rating agencies (Standard & Poor's, Moody's, and Fitch) is used. If only two ratings are available, the lower of the two is taken. If there is only one, that rating is taken.

II.3.4. Limits on spot currency transactions

The external portfolio managers, or the fiscal agent, can carry out foreign currency spot transactions with counterparties that have a long-term rating of A- or higher from at least two international credit rating agencies (Fitch, Moody's, and Standard & Poor's).

II.3.5. Special restrictions

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

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

External portfolio managers can contract currency futures, forwards, or swaps. However, the aggregate notional amounts cannot exceed 10% of the portfolio under management.

The following restrictions also apply specifically to the externally managed portfolio: (i) mutual funds and exchange-traded funds (ETFs) together cannot represent, as a share of a given external manager's portfolio, more than the aggregate share of Egypt, India, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey in the equity benchmark indicated in Table 2, plus 2%; (ii) external managers cannot invest in the local markets of Chile, Egypt, India, Peru, the Philippines, Poland, Russia, Taiwan, Thailand, and Turkey; and (iii) investments in China can only be made through the equity market in Hong Kong.

External equity managers cannot invest in their own equities; and external corporate bond managers cannot invest in their own bonds.

II.3.6. Rebalancing policy

The PRF rebalancing policy requires that the portfolio converge to the benchmark established in Table 1 under the following situations: (i) in the event of a contribution to the PRF; and (ii) in the event that the target ranges specified in Table 5 are exceeded. The Ministry of Finance will determine the specific date on which rebalancing associated with points (i) and (ii) of this paragraph will be implemented and will also monitor compliance with the target ranges identified in Table 5.

The rebalancing could result either in cash contributions to the Article 4 portfolio and/or the externally managed portfolios or in withdrawals from the Article 4 portfolio and/or the externally managed portfolios. In the event of a contribution, the Ministry of Finance will issue instructions on the amounts to be transferred between the external managers and the Article 4 portfolio in order to achieve convergence to the benchmark established in Table 1. When the rebalancing results in a cash contribution to the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent or the external manager will have ten (10) bank business days to achieve this convergence, during which the fiscal agent and the external manager, if applicable, will be granted a waiver of compliance with the requirements of sections II.1.1, II.1.2, II.3.2.1, the first paragraph of II.3.2.4, II.3.3.1, and the first paragraph of II.3.3.4. When the rebalancing results in a cash withdrawal from the Article 4 portfolio or one of the externally managed portfolios, the fiscal agent and the external manager, if applicable, will be granted a waiver from compliance with the requirements of sections II.1.1, II.1.2, II.3.2.1, the first paragraph of II.3.2.4, II.3.3.1, and the first paragraph of II.3.3.4, for a period of ten (10) bank business days before and including the date of the withdrawal. The waiver can be extended if either party submits a request for extension to the Ministry of Finance, with an explanation of the reasons for the request. In the event that the period between the date on which the cash withdrawal instructions are issued and the date on which the actual withdrawal is implemented is less than ten (10) bank business days, the waiver will cover only that period.

Table 5: Target ranges

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

In addition, in the event of rebalancing, the Director of the Financial Operations Division of the Central Bank of Chile can send a request, via electronic mail, to the Finance Ministry's Capital Markets and International Finance Coordinator for permission to maintain the relative positions of the Article 4 portfolio vis-à-vis the benchmark and thus not to have to converge to the benchmark established in Table 1. The Capital Markets and International Finance Coordinator must authorize the holding of said positions by sending an electronic mail to the Central Bank's Director of the Financial Operations Division.

II.4. Valuation criteria

The investment portfolio valuation that must be reported to the Finance Ministry is to be prepared by the custodian(s) using marked-to-market accounting, based on their own valuation sources. However, for the internal accounting of the Article 4 portfolio, the Central Bank of Chile can use the same methodology that it uses for operations involving its international reserves, as stipulated in paragraph (g) of Article 4 of the Agency Decree.

II.5. Securities lending program

II.5.1. Article 4 portfolio

The fiscal agent for the Article 4 portfolio can participate in securities lending programs with the PRF custodian(s), provided that the custodians contracted to manage the securities lending programs (henceforth, the program managers) are obligated to comply with the operating criteria established in the custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay their full market value.

II.5.2. Externally managed portfolio

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

II.6. Other

Foreign exchange operations will be considered spot transactions, provided that the period between the trade date and the settlement date does not exceed two (2) days. Foreign exchange operations that are related to the purchase or sale of an instrument will be considered spot operations when the period between the trade date and the settlement date follows the market convention for the settlement period of the instrument that is being bought or sold.

The base currency of the portfolio for the purpose of measuring the performance of the fiscal agent and the external portfolio managers is the U.S. dollar.

In the event of noncompliance with any of the instructions described in this report, at any time, due to fluctuations in market prices, abnormal market conditions, or any other reason beyond the control of the fiscal agent or the external portfolio managers, in their respective mandates, the situation will not be considered noncompliance with the guidelines, provided that the necessary measures are taken to ensure compliance within seven (7) days of detecting the situation. For the externally managed corporate bond portfolio, the period for ensuring compliance is extended to one calendar month from the date the situation is detected.

The Finance Minister, or an authorized delegate, can extend the period applicable to the Article 4 portfolio at the request of the fiscal agent, when justified, and can similarly extend the periods applicable to the externally managed portfolios at the request of the corresponding external manager, also when justified.

However, the external managers can temporarily hold any ineligible instruments that they receive due to corporate events or that have become ineligible due to corporate events. In that case, the external managers will have a period of 30 consecutive days to sell the instruments in question, starting on the date of the corporate event. If they are unable to do so, the external managers must notify the Treasury and communicate a plan of action to liquidate the instruments. In the particular case of entitlements, preferred stock, rights, warrants, or other equivalent instruments received due to corporate events that grant the right to purchase equities, exchange for eligible equities, or receive cash, these instruments can be kept in the portfolio until expiration.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1 Critical accounting estimates:

In preparing the financial statements, management must make estimates and formulate assumptions about the future. The resulting accounting estimates, by definition, are rarely going to correspond precisely to actual results. The estimates and assumptions that carry a strong risk of causing significant adjustments to the accounting value of assets and liabilities within the next accounting period are described below:

Fair value of instruments that are not quoted on an active market or traded on the equity market.

The fair value of instruments that are not quoted on an active market cannot be determined by the fund based on pricing sources (such as price-setting agencies, as applicable to each fund) or indicative prices from market makers for bonds or debt, which are obtained through the custodian.

The models use observable data, to the extent possible. However, factors such as credit risk (both direct and counterparty), volatilities, and correlations require management to make estimates. Changes in assumptions about these factors could affect the fair value reported for financial instruments.

The determination of what constitutes “observable” represents a critical judgment by the fund’s manager. Therefore, observable data are defined as market data that can be easily obtained, are regularly distributed or updated, are trustworthy and verifiable, are not private (for exclusive use), and are provided by independent sources that are active participants in the relevant market.

4.2. Critical judgments for applying accounting policies:

Functional currency:

Management considers the U.S. dollar to be the currency that most faithfully represents the economic effect of transactions, events, and underlying conditions. The U.S. dollar is the currency in which the fund receives contributions from the Chilean government.

NOTE 5 – FINANCIAL RISK MANAGEMENT

The PRF portfolio is exposed to many of the same risks as the ESSF. However, credit risk is higher in the PRF due to the fund's investments in a larger number of countries and in corporate bonds. As in the case of the ESSF, most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the PRF investment policy.

5.1. Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions that affect the value of the instruments in the fund's investment portfolio. Like the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk, exchange rate risk, and credit spread risk. In addition, the PRF is also exposed to equity risk. This section describes the risks in greater detail, together with the mechanisms established to mitigate them.

Interest rate risk: In the PRF, interest rate risk is mainly a function of the benchmark duration. This is calculated based on the duration of the indexes that make up the benchmark. Compared to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk in a larger number of countries, and it is more sensitive since it has a longer duration. This risk is controlled by keeping the duration close to the benchmark.

Exchange rate risk: Because the fund's return is measured in dollars, the value of investments is also affected by exchange rate fluctuations. Given the passive management mandate, the exchange rate exposure that the PRF is willing to accept depends on the benchmark currency allocation. Thus, the fund's exchange rate exposure mainly derives from investment denominated in euros (25%), yen (13%), pounds sterling (11%), Canadian dollars (3%), Australian dollars (2%) and other currencies with a smaller share.

Credit spread risk: The market value of the fixed-income instruments in the PRF portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is higher in the PRF than in the ESSF because the fixed-income portfolio includes investments in a large number of issuers from around the world. For example, the fund invests in instruments issued by the governments of developed and developing countries, public and semi-public agencies, multi-lateral financial institutions, corporations, and so on. This risk is mitigated by having a well-diversified portfolio and investing only in investment-grade instruments (with a rating of BBB– or higher). Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have a high credit rating.

Equity risk: The PRF is exposed to the risk of losses from a decrease in the price of the equities included in its portfolio. The intrinsic risk of an individual equity is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the equity index used as the benchmark (the MSCI ACWI excluding Chile). The strategic asset allocation only allows 15% of the total portfolio to be invested in equities.

Volatility, VaR and tracking error: Volatility is also measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. The PRF uses ex ante tracking error to predict, with some degree of confidence, the portfolio's deviation from the benchmark.

5.2. Credit risk:

In the PRF bond portfolio, credit risk exposure is controlled primarily by having a well-diversified portfolio and investing only in issuers included in the benchmark. In the case of bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly used to invest the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see Table 6). In addition, forwards cannot exceed a stipulated percentage of each manager's portfolio. For the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio. In the case of the external managers, the use of futures is also allowed so as to limit the total use of derivatives. Thus, forwards, swaps, and futures cannot exceed 10% of each external manager's portfolio. Starting in 2015, the fund is also allowed to invest in supranational entities, agencies, and entities with an explicit government guarantee that are eligible for investment by the Central Bank of Chile in the management of its international reserve portfolio. These entities all have a high credit rating.

**Table 6. Credit limits on bank deposits and forwards
(millions of U.S. dollars, unless otherwise indicated)**

Limit		Time deposits	Forwards
Minimum credit rating		A–	AA–
Maximum per counterparty	CBC portfolio	20	1% (a)
	Externally managed portfolios	20	1% (a)

(a) Percent of each manager's portfolio

Source: Ministry of Finance.

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

5.3. Liquidity risk:

The PRF is exposed to minimal liquidity risk because the fund has little need for cash, given that disbursements from the fund could not start before 2016. The sale of instruments in the portfolio is mainly associated with changes in the benchmark, which can require the portfolio managers to make an adjustment (that is, to sell an instrument that left the benchmark in order to purchase one that was incorporated), and with the possible need for rebalancing, which is triggered when an asset class exceeds the permissible deviation range or when the fund receives contributions. In the case of changes in the benchmark, the investment guidelines allow some flexibility for managers to make the necessary adjustments, in order to reduce the impact of having to sell at an unfavorable time. For rebalancing, there are clear rules on planning its implementation.

5.4. Operational risk:

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

In the case of the portfolio managed by the Central Bank of Chile, the operational management of the funds utilizes the same infrastructure that the Central Bank uses to manage its international reserves. The Central Bank has also set up a series of controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds, and internal and external auditing processes to assess the effectiveness of the existing controls.

In the case of the externally managed portfolio, operational risk has been mitigated by contracting managers with vast experience in the field, a strong reputation in the market, and robust management systems. Furthermore, the managers' performance is monitored, and the contract can be terminated in the event of dissatisfaction with some aspect of the services provided.

NOTE 6 – ACCOUNTING CHANGES

On January 1, 2018, the fund adopted IFRS 9, regarding the classification and measurement of financial instruments. In addition, on the same date, the fund adopted IFRS 15, in the recognition of income from ordinary activities. The application of this new standards did not generate a significant impact on the financial statements of the fund. As of December 31, 2018, there were no others accounting changes relative to the previous year.

NOTE 7 – FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US\$ 9,623,167,333 on 31 December 2018 and US\$ 9,984,267,009 on 31 December 2017.

a) The breakdown of investments carried at fair value on 31 December 2018 and 2017 is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy level	2018 US\$	2017 US\$
Equities	1	1,646,913,209	1,551,357,967
Other capitalization instruments	1	36,863,216	33,999,912
Corporate bonds	1	1,986,132,197	2,098,068,913
Government bonds	1	4,732,741,209	5,028,227,756
Indexed bonds	1	1,219,529,867	1,271,748,294
Derivatives	1	699,422	539,665
Subtotal		9,622,879,120	9,983,942,507

Custodian investments, Central Bank of Chile	Fair value hierarchy level	2018 US\$	2017 US\$
Time deposits	2	288,213	324,602
Subtotal		288,213	324,602
Total		9,623,167,333	9,984,267,109

b) The breakdown of investments by investment currency on 31 December 2018 and 2017 is as follows:

Local currency	Fair value instruments, J.P. Morgan			
	2018		2017	
	US\$	% del PI	US\$	% del PI
U.S. dollar	4,255,585,035	44.22	4,310,552,994	43.17
Euro	2,172,973,012	22.58	2,392,332,709	23.96
Yen	1,314,469,355	13.66	1,340,262,305	13.42
Other	1,879,851,718	19.54	1,940,794,499	19.45
Subtotal	9,622,879,120	100.00	9,983,942,507	100.00

Local currency	Fair value instruments, Central de Chile			
	2018		2017	
	US\$	% del PI	US\$	% del PI
U.S. dollar	-	-	-	-
Other	288,213	100.00	324,602	100.00
Subtotal	288,213	100.00	324,602	100.00
Total	9,623,167,333	-	9,984,267,109	-

c) The total value of assets by risk segment on 31 December 2018 and 2017 is as follows:

Risk segment	Market value			
	2018		2017	
	US\$	%	US\$	%
Capitalization instruments	1,683,776,425	17.42	1,585,357,878	15.83
Bank (*)	41,327,403	0.43	27,559,208	0.28
Bonds	7,938,403,273	82.15	8,398,044,964	83.89
Total	9,663,507,101	100.00	10,010,962,050	100.00

Asset class	Market value			
	2018		2017	
	US\$	%	US\$	%
Capitalization instruments	1,683,776,425	17.42	1,585,357,878	15.83
Money Market (*)	41,327,403	0.43	27,559,208	0.28
Corporate bonds	1,986,132,196	20.55	2,098,068,914	20.96
Sovereign bonds	4,732,741,209	48.98	5,028,227,756	50.23
Inflation-indexed bonds	1,219,529,867	12.62	1,271,748,294	12.70
Total	9,663,507,101	100.00	10,010,962,050	100.00

(*) Includes cash and cash equivalents.

NOTE 8 –FINANCIAL DERIVATIVE INSTRUMENTS

Derivative financial liabilities carried at fair value were US\$ 257,583 on 31 December 2018 and US\$ 10,284 on 31 December 2017.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2018 US\$	2017 US\$
Derivatives	1	257,583	10,284
Subtotal		257,583	10,284

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

Local currency	Fair value instruments, J.P. Morgan			
	2018		2017	
	US\$	% of IP	US\$	% of IP
USD	128,791	50.00	3,428	33.33
EUR	64,396	25.00	1,714	16.67
JPY	-	-	857	8.33
Otros	64,396	25.00	4,285	41.67
Total	257,583	100.00	10,284	100.00

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

Risk segment	Market value			
	2018		2017	
	US\$	%	US\$	%
Bank	257,583	100.00	10,284	100.00
Total	257,583	100.00	10,284	100.00

Liability class	Market value			
	2018		2017	
	US\$	%	US\$	%
Money market	257,583	100.00	10,284	100.00
Total	257,583	100.00	10,284	100.00

NOTE 9 – CONSTITUTION OF THE FUND

The fund was established on September 30, 2006, designating the Central Bank of Chile for management, in the role of fiscal agent, J.P. Morgan in the role of custodian bank, and also designating the external managers. The following movements were recorded as of 31 December 2018 and as of 31 December 2017:

	2018								
	Contributions US\$	Withdrawals US\$	Compensation to the CBC as fiscal agent (1) US\$	Custody of the portfolio managed by the CBC US\$	Custody of the externally managed portfolios US\$	BlackRock US\$	Mellon US\$	Allianz US\$	Other US\$
January	-	-	-	-	-	-	-	-	(70,941)
February	-	-	-	(148,942)	(126,293)	-	-	(160,894)	-
March	-	-	(278,968)	-	-	(243,091)	(102,644)	-	-
April	-	-	-	(149,762)	(120,622)	-	-	-	(363,711)
May	-	-	-	-	-	-	(104,171)	(161,122)	-
June	-	-	(278,968)	(75,909)	(61,469)	-	-	-	-
July	-	-	-	(148,585)	(128,195)	-	-	-	-
August	-	-	-	-	-	(241,157)	-	(157,706)	(630)
September	541,576,255	(295,225,185)	(278,968)	(149,965)	-	-	(103,285)	-	(31,529)
October	-	-	-	(77,102)	-	-	-	-	-
November	-	-	-	-	(187,886)	-	-	(157,782)	-
December	-	(229,827,482)	(278,968)	(76,303)	(89,308)	-	(114,089)	-	(70,588)
Total	541,576,255	(525,052,667)	(1,115,872)	(826,568)	(713,773)	(484,248)	(424,189)	(637,504)	(537,399)

(1) Ministry of Finance Res. N°33 of 27/Sep/2016 authorizes payment of compensation for 2017, for portfolio management and other services.

	2017								
	Contributions US\$	Withdrawals US\$	Compensation to the CBC as fiscal agent (1) US\$	Custody of the portfolio managed by the CBC US\$	Custody of the externally managed portfolios US\$	BlackRock US\$	Mellon US\$	Allianz US\$	Other US\$
January	-	-	-	(66,674)	(60,959)	(225,477)	-	-	-
February	-	-	-	(65,963)	(60,764)	-	-	(147,508)	-
March	-	-	(248,944)	(66,365)	(59,207)	-	-	-	(47,294)
April	-	-	-	(67,752)	(58,697)	(220,239)	(92,896)	-	-
May	-	-	-	-	-	-	(97,487)	(148,325)	(15,067)
June	505,150,199	-	(248,944)	(135,948)	(121,863)	-	-	-	-
July	-	-	-	(69,364)	(63,564)	-	-	-	-
August	-	-	-	(72,855)	(64,325)	-	-	(154,823)	-
September	-	(313,946,597)	(248,944)	-	-	(222,263)	(100,589)	-	(49,425)
October	-	-	-	(151,130)	(121,807)	(233,234)	-	-	(591)
November	-	-	-	(73,814)	(79,092)	-	-	(162,710)	-
December	-	-	(248,944)	(74,678)	(60,408)	(242,351)	(99,368)	-	-
Total	505,150,199	(313,946,597)	(995,776)	(844,543)	(750,686)	(1,143,564)	(390,340)	(613,366)	(112,377)

(1) Ministry of Finance Res. N°33 of 27/Sep/2016 authorizes payment of compensation for 2017, for portfolio management and other services.

NOTE 10 – INTEREST EARNED

The breakdown of interest income earned on investments in debt securities carried at fair value through profit or loss as of 31 December 2018 and 2017 is as follows:

	2018 US\$	2017 US\$
Interest earned, Art. 4 Portfolio	117,601,642	105,832,756
Interest earned, External managed Portfolio	67,281,502	67,682,320
Total	184,883,144	173,515,076

NOTE 11 –DIVIDEND INCOME

The breakdown of dividends received from equity investments as of 31 December 2018 and 2017 is as follows:

Dividends from investments managed by	31 Dec 2018 US\$	31 Dec 2017 US\$
Mellon Capital Management Corporation	18,336,914	17,092,317
BlackRock Institutional Trust Company, N.A.	18,483,780	17,105,480
Total	36,820,694	34,197,797

NOTE 12 – CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2018 and 2017 breaks down as follows:

Cash in custody and externally managed accounts	31 Dec 2018 US\$	31 Dec 2017 US\$
J.P. Morgan	18,858,887	742,757
Mellon Capital Management Corporation	3,221,275	3,773,605
Allianz Global Investors GmbH, UK Branch	4,790,323	5,844,659
BlackRock Institutional Trust Company, N.A.	13,469,283	16,333,920
Total	40,339,768	26,694,940

NOTE 13 – PRF RETURNS

The breakdown of the fund's returns as of 31 December 2018 and 2017 is as follows:

Type of return	Accumulated return		
	2018	Last 12 months	Last 24 months
Nominal	(2.08%)	(3.56%)	3.45%

NOTE 14 – FAIR VALUE

The PRF applies IFRS 13 to determine the fair value of its financial assets and financial liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB).

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (that is, an exit price). The transaction is carried out in the principal or most advantageous market and is not forced. That is, it does not take into account specific characteristics of the PRF that could have an impact on the real transaction.

FINANCIAL ASSETS	31 Dec 2018			31 Dec 2017		
	Level	Net book value US\$	Fair value US\$	Level	Net book value US\$	Fair value US\$
Cash and cash equivalents	1	40,339,768	40,339,768	1	26,694,940	26,694,940
Equities	1	1,646,913,209	1,646,913,209	1	1,551,357,967	1,551,357,967
Other capitalization instruments	1	36,863,216	36,863,216	1	33,999,912	33,999,912
Corporate Bonds	1	1,986,132,197	1,986,132,197	1	2,098,068,913	2,098,068,913
Time deposits	1	288,213	288,213	2	324,603	324,603
Government bonds	1	4,732,741,209	4,732,741,209	1	5,028,227,756	5,028,227,756
Indexed bonds	1	1,219,529,867	1,219,529,867	1	1,271,748,294	1,271,748,294
Derivatives	1	699,422	699,422	1	539,665	539,665
FINANCIAL LIABILITIES						
Derivative financial instruments	1	257,583	257,583	1	10,284	10,284

In 2018 and 2017, all the assets and liabilities in the PRF were measured at fair value through net income, according to the prices quoted in the equity market (Level 1). As of December 31, 2018 and 2017, the fund has not made any changes in fair value hierarchies.

NOTE 15 – LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N° 1,267 of 4 June 2013, Section II N° 5, the fiscal agent for the Article 4 portfolio can enter into agreements with the fund's custodian(s) to participate in securities lending, provided that the custodians comply with the operating criteria established in the PRF custody guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay the corresponding market value. The resources earned or disbursed are to be recorded on the PRF financial statements as income in the year.

On 31 December 2018 and 2017, the PRF owned the following instruments under the item Securities lending:

2018		
Location	Notional value	Market value US\$
Europe	147,449,000	217,579,417
United States of America	94,935,000	108,967,850
Total	242,384,000	326,547,267

2017		
Location	Notional value	Market value US\$
Europe	50,115,000	71,102,649
United States of America	27,700,000	27,585,709
Total	77,815,000	98,688,358

NOTE 16 – SECURITIES CUSTODY

As of 31 December 2018 and 2017, securities custody is as follows:

31 December 2018:

Entity	Securities custody in 2018					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total PRF assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total PRF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	9,622,909,750	100.00	99.58
Total investment portfolio in custody	-	-	-	9,622,909,750	100.00	99.58

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

31 December 2017:

Entity	Securities custody in 2017					
	Amount in custody (US\$)	National custody % of total investments in instruments issued by national issuers	% of total PRF assets	Amount in custody (US\$)	Foreign custody % of total investments in instruments issued by foreign issuers	% of total PRF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	9,984,256,825	100.00	99.73
Total investment portfolio in custody	-	-	-	9,984,256,825	100.00	99.73

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

NOTE 17 – RELEVANT EVENTS

As of the closing date of these financial statements, there were no relevant events that could materially affect the balances or interpretation of these financial statements.

NOTE 18 – SUBSEQUENT EVENTS

Between January 1, 2019 and the date of issue of these financial statements (29 March 2018), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

APPENDIXES

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Appendix 2: Glossary of Terms

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

American Depositary Receipt (ADR) — a financial security issued by a U.S. bank and negotiable in the United States, where the physical certificate represents a specific number of shares in a company that was incorporated outside that country.

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

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

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

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

Cash — Cash on hand and bank demand deposits.

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

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

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

Duration — A parameter that measures a bond's sensitivity to interest rate movements. The longer the bond's duration, the greater its exposure to loss in response to an interest rate hike.

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

Exchange rate return — The share of the return deriving from fluctuations in the exchange rate between the dollar and the other currencies in which investments are made.

Exchange traded funds (ETFs) — Financial instruments traded on the stock exchange, which typically replicate a market index. They have traditionally been used to obtain passive exposure to equity indexes, but their use has been expanding into fixed-income instruments, commodities and even active strategies.

Fiscal Responsibility Law — Chilean Law N° 20,128, published in the *Official Gazette* on 30 September 2006.

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

Global Depositary Receipt (GDR) — a financial security issued by a bank and negotiable in more than one country, where the physical certificate represents a specific number of shares in a company that was incorporated outside the countries in which the certificate is traded.

Inflation-linked sovereign bond — A bond that is adjusted based on a specified inflation index. In the case of the United States, these bonds are called Treasury Inflation-Protected Securities (TIPS).

Internal rate of return (IRR) — The effective rate of return on investments, calculated by setting the present value of all net cash flows to zero.

Investment policy — A set of criteria, principles and guidelines that regulate the amount, structure and dynamics of a portfolio's investments.

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

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

Liquidity — The facility with which an investment or instrument can be sold without significant loss of value.

Money market instruments — Short-term instruments with a maturity of less than one year, which are easily converted into cash and are less volatile than other asset classes.

Mutual funds (MFs) — An investment vehicle managed by an entity that pools capital from different investors in order to achieve exposure in different asset classes. Unlike ETFs, MFs are not traded on an exchange.

Passive management — An investment strategy aimed at replicating the returns of a representative index or indexes of a given asset class.

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Portfolio — A collection of investment instruments held by an individual or an institutional investor.

Quantitative easing — an unconventional monetary policy tool used by some central banks to increase the supply of mon-

ey, usually through the purchase of bonds issued by its own government.

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

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

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

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

Sovereign bond — A bond issued by a government.

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 rates at maturity of two fixed-income instruments, which is used to measure their relative risk.

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

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

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

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

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

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

Variable-income instruments — Equities.

Volatility — A measure of a financial asset's risk, based on the variability or dispersion of the asset's price over a period of time.

Appendix 3: Abbreviations

ADR	American Depositary Receipt
AUD	Australian dollar
bp	Basis points
CAD	Canadian dollar
CBC	Central Bank of Chile
CBJ	Central Bank of Japan
CDS	Credit Default Swaps
CHF	Swiss franc
ECB	European Central Bank
ETF	Exchange-Traded Fund
EUR	Euro
FC	Financial Committee
FED	U.S Federal Reserve
ESSF	Economic and Social Stabilization Fund
GAAP	Generally accepted accounting principles
GBP	Pound sterling
GDP	Gross domestic product
GDR	Global Depositary Receipt
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IIR	Internal rate of return
JPM	J.P. Morgan
JPY	Japanese yen
LIBID	London interbank bid rate
LIBOR	London interbank offered rate
M US\$	Thousands of U.S. dollars
MM US\$	Millions of U.S. dollars
MBS	Mortgage-backed securities
PRF	Pension Reserve Fund
TE	Tracking error
TWR	Time-weighted rate of return
UF	<i>Unidad de Fomento</i> (an inflation-linked unit of account)
USA	United States of America
USD	U.S. dollar
US\$	U.S. dollar
VaR	Value at risk

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Colaboraron:

Andrés Pérez Morales

Francisco Vergara Molina

Rodolfo Bustamante Beltrán

Paula Alonso Rendic

Marcela Quintanar Palominos

