ANNUAL REPORT
SOVEREIGN WEALTH FUNDS

- MINISTRY OF FINANCE -

2011

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The European economic crisis, associated with excessive debt and fiscal sustainability problems in several countries in the euro area, serves as a reminder of the importance of responsible fiscal policies. Chile is recognized worldwide for its achievements in this area. The country's fiscal policy, based on a structural fiscal rule, has become a benchmark for many economies at different levels of development, and has achieved broad support all across Chilean society.

Our government remains committed to perfecting the fiscal rule. Improvements include incorporating the recommendations of the Structural Balance Advisory Committee, chaired by Vittorio Corbo. This commitment was articulated publicly in October 2011, in the Public Finance Study on "A Second-Generation Structural Balance Policy for Chile."[1] We have also announced the creation of a Fiscal Council, made up of independent experts recognized for their experience in fiscal and budget issues, whose main role will be to guarantee independence in the estimation of the structural variables and to verify the structural balance estimates.

Our efforts to improve the transparency of our fiscal policy and minimize discretion in its application have been recognized by the Organization for Economic Cooperation and Development (OECD), of which Chile has been a member since 2010. In January 2012, the OECD issued a report assessing the recent improvements to the rule as follows:

> *"In an effort to increase transparency and diminish room for discretionary moves, the government has accepted several of the recommendations from a panel of experts (the Corbo Commission) it commissioned in 2010 to write a report about strengthening the fiscal framework. Transitory changes in tax rates will now be considered as affecting structural revenues, which is an improvement. As a result, the structural fiscal deficit is now considered to have reached 3% of GDP rather than 1.1% in 2009, when taxes were cut temporarily as part of the fiscal stimulus. The commission also recommended the creation of an independent fiscal council that would monitor fiscal policy and ensure the correct application of the fiscal rule (Corbo et al., 2011). The government plans to introduce such an institution, and this is very welcome."*
>
> *Source: OECD Economic Surveys – CHILE, January 2012*

Our rigorous fiscal policy is reflected in the savings accumulated in our sovereign wealth funds, namely, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). At the end of 2011, these funds together held a balance of $17,562 million dollars. This has contributed to the excellent reputation of Chile's fiscal policy and has allowed Chile to remain one of the few countries in the world with a net credit fiscal position. Since early 2010, both funds have received additional resources of $2,856 million dollars, mainly from new net contributions ($1,993 million dollars) and return on investment ($863 million dollars). Since their inception, the funds have recorded an annualized return in dollars of 5.1%.

1 "Una política de balance estructural de segunda generación para Chile," available online at http://www.dipres.gob.cl/572/articles-81713_doc_pdf.pdf.

Our macroeconomic management has also been recognized in the international financial markets. In February 2011, Fitch raised Chile's sovereign debt rating from A to A+ in foreign currency and from A+ to AA– in local currency. Moreover, bonds issued by the country in international markets in 2011 had the lowest rate in recorded history for ten-year dollar financing by a Latin American country.

We have also been working to improve the management of our sovereign wealth funds. In 2011, the PRF underwent a successful selection process for external managers for new asset classes: corporate bonds and equities. As explained in chapter nine of this report, this constitutes part of a new investment policy for this fund, implemented in the first quarter of 2012, which will allow the resources to be invested in a manner consistent with the liability they are supposed to finance: namely, pensions. In the case of the ESSF, the currency allocation of investments remains unchanged, with an exposure of 50% to the dollar, 40% to the euro and 10% to the yen. In May 2011, however, we decided to limit sovereign exposure to the different economies of the euro area, concentrating exclusively on German bonds. Over the course of this year, we will undertake a study of the ESSF investment policy, and the results will serve as an important element for assessing possible future changes in this area.

With regard to public information on the sovereign wealth funds, for the first time this report includes financial statements prepared by the General Treasury in accordance with International Financial Reporting Standards (IFRS) and audited, with no observations, by the Deloitte auditing firm. This initiative positions the General Treasury of Chile as a pioneer in the successful application of these accounting standards within the central government and reflects our commitment to the ongoing improvement of the management of the State.

The government also continues to make progress in improving the transparency of our sovereign wealth funds and implementing best practices in management, in line with the Santiago Principles. We have thus increased the frequency and coverage of our periodic reports on the funds. All these reports are available on our website, so that the Chilean public can have access to detailed information on how and where their resources are invested. These efforts have been recognized at the international level, and the Sovereign Wealth Fund Institute has once again awarded Chile the highest score on its transparency index.

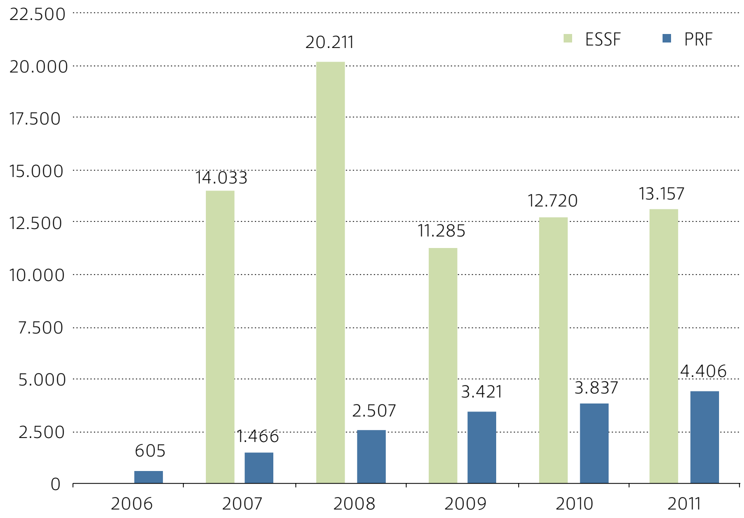
Many challenges remain, but we will continue to work tirelessly to maintain excellence in our fiscal conduct and to achieve the best possible financial management of Chile's savings.

Felipe Larraín
Minister of Finance

2. SUMMARY

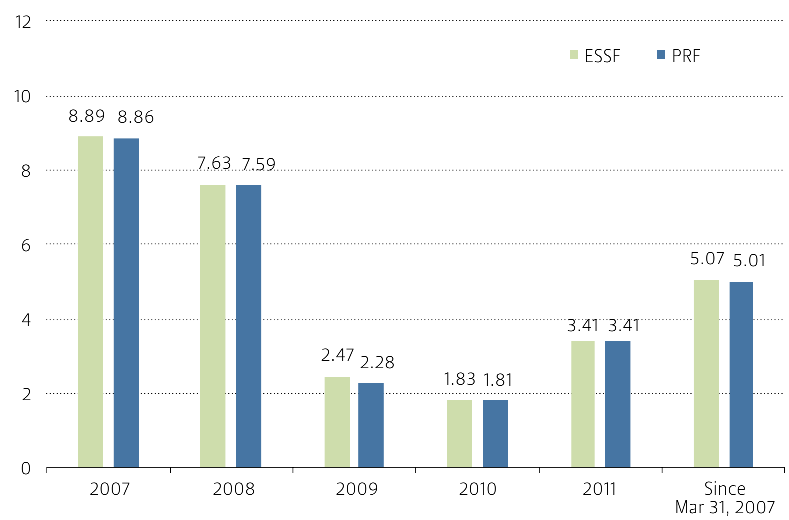
As of December 31, 2011, the Pension Reserve Fund (PRF) and the Economic and Social Stabilization Fund (ESSF) together had a market value of US$ 17,562 million and net returns in dollars of 5.06% since their inception.[2]

Figure 1: Market value
(millions of dollars)



Source: Ministry of Finance

Figure 2: Net annual return in dollars[3]
(percent)

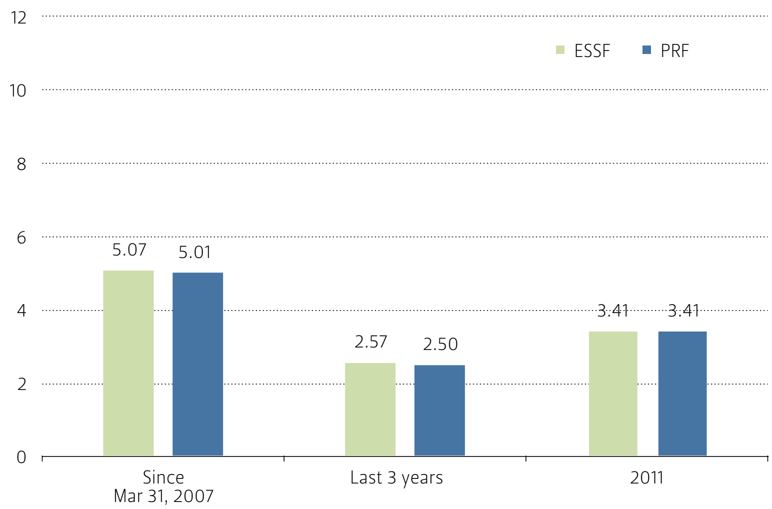


Source: Ministry of Finance

2 The returns published in this report are based on the time-weighted rate of return (TWR) methodology, unless 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 management costs from the CBC.

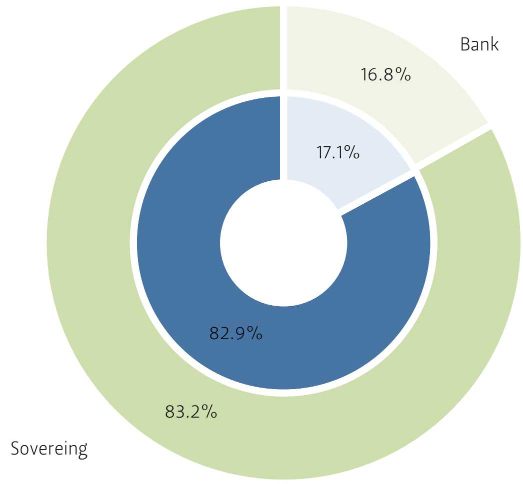
3 The use of the TWR methodology to measure returns dates to 31 March 2007, when the performance measure of the CBC was introduced.

Figure 3: Accumulated net annual return in dollars
(percent)



Source: Ministry of Finance

Figure 4: Composition of credit risk as of December 31, 2011
(percent of portfolio)



Source: Ministry of Finance

CHAPTER 3

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 created via Ministry of Finance Statutory Decree N°1 (DFL N° 1) of 2006, which combined into a single fund the resources saved in accordance with Decree Law N° 3.653 of 1981 and the Copper Revenue Compensation Fund.

BOX 1 A structural balance rule that has been improved over time

Chile implemented a structural balance rule in 2001 with the objective of establishing an annual fiscal spending level consistent with the central government's structural income. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity, the copper price and other factors that determine effective fiscal income. This is especially important in the case of a country like Chile, where the volatility of fiscal revenue largely depends on the copper price. This allows the government to save in boom times, thereby avoiding drastic adjustments to fiscal expenditures during unfavorable economic periods. It also naturally supports monetary policy, since it saves excess fiscal revenue when monetary policy is tight and uses it when monetary policy is loose. This policy has thus contributed to significantly reducing the volatility of fiscal spending and economic growth.

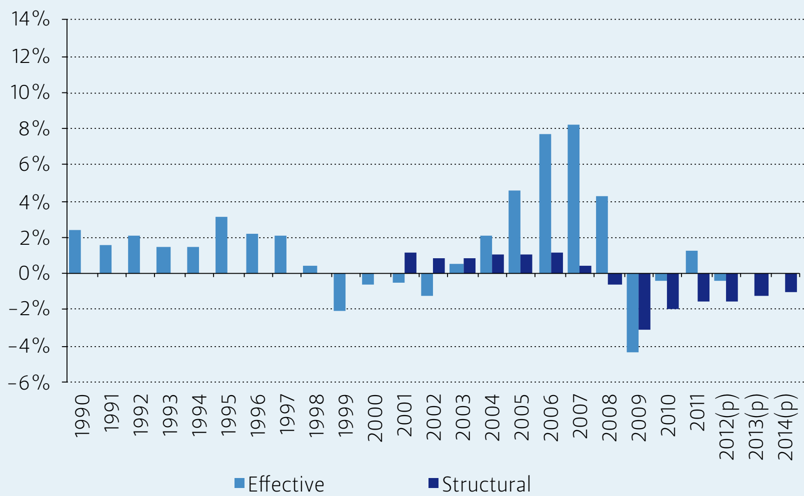
Initially, the structural balance rule depended on the political will of the government in power. However, once this was consolidated among the different sectors of the country, it became possible to formalize the savings accumulation rules. Thus, Law N°20.128 on Fiscal Responsibility was passed in the second half of 2006, establishing the regulations and institutional framework for the accumulation, management and operation of fiscal savings. The law created the PRF and authorized the President of the Republic to create the ESSF, which was officially founded in February 2007. The law further requires each Administration to announce its objective for the structural balance rule in its first year. In 2011 the Finance Minister announced the creation of a Fiscal Council, whose main role will be to guarantee independence in the estimation of the structural variables and to verify the structural balance estimates.

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

The structural balance target has also changed over time. The target was initially set at 1% of GDP in 2001. The 2008 budget reduced it to 0.5% of GDP, because substantial resources were being accumulated in the sovereign wealth funds. In 2009, the ex ante target was reduced to 0% to face the crisis that was then in full swing. Finally, the methodological change mentioned above implied that the 2009 target was converted to a structural deficit of 3%, and it has been adjusted each year since so as to converge to a structural deficit of 1% in 2014 (see figure B1.1).

The success of fiscal policy has led to broad support across all sectors of the country. At the international level, Chile has become a benchmark for many countries at different levels of development. In January 2012, the Organization for Economic Cooperation and Development (OECD) in its report "OECD Economic Surveys – CHILE" commended the recent improvements and refinement of the rule —such as the treatment of temporary tax changes and the creation of a fiscal council— as an important contribution to transparency and the reduction of discretionary power in the application of the rule.

Figure B1.1 Effective and structural fiscal balance
(percent of GDP)



Source: Ministry of Finance

1 The 2011 budget incorporates the recommendations contained in the preliminary report of the Advisory Committee for designing of a second-generation structural balance fiscal policy in Chile. Both the final report, *"Propuestas para perfeccionar la regla fiscal, Informe Final"* and the preliminary version, "Primer Informe," are available on the Budget Office's website (www.dipres.cl) in the Structural Balance Policy section.

3.1 PURPOSE OF THE SOVEREIGN WEALTH FUNDS

The ESSF was created to finance fiscal deficits that can occur in periods of low growth and/or a low copper price. This helps to reduce fluctuations in fiscal spending across the economic cycle. The ESSF can also finance the payment of public debt and recognition bonds as well as regular contributions to the PRF, as established under Ministry of Finance Statutory Decree DFL N°1 of 2006.

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

3.2 RULES ON CONTRIBUTIONS AND WITHDRAWALS

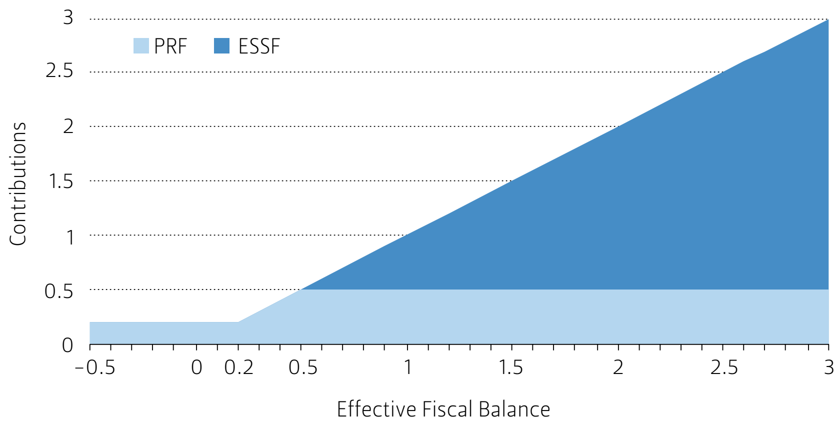
The Fiscal Responsibility Law of 2006 establishes the rules on fund contributions. The use of the funds is also established in the same law, as well as in the Pension Law of 2008 for the PRF and DFL N° 1 for the ESSF.

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

In the case of the ESSF, the fund must receive any positive balance remaining after subtracting the PRF contributions from the effective surplus, less the amortization of public debt and estimated contributions made in advance the previous year[4] (see figure 5).

Figure 5: Fund contribution rules

(percent of GDP)



Source: Ministry of Finance

The ESSF resources can be used at any time to complement fiscal revenue as needed in order to finance authorized public expenditures in the case of a fiscal deficit. They can also be used for the regular or extraordinary amortization of public debt (including bonos de reconocimiento) and for financing the annual contribution to the PRF when the Finance Minister so decides.

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

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

4 The law permits the use of resources from the current year's fiscal surplus, which must be deposited in the ESSF during the following year, to pay down public debt and make advance contributions to the ESSF.

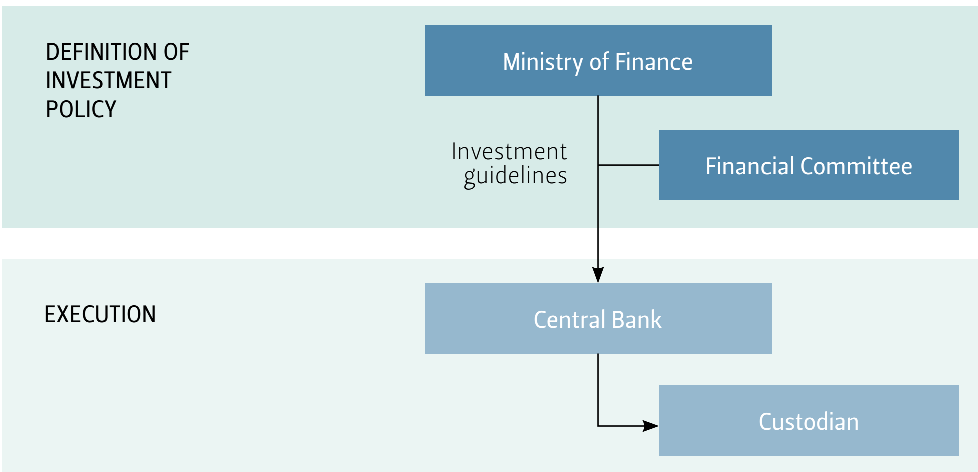
CHAPTER 4

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 the accountability and operational independence in the management of the funds.

The institutional basis of the funds is established in the Fiscal Responsibility Law, where Article 12 regulates the investment of fiscal resources (see diagram 1). Executive Decree N° 1.383, issued by the Ministry of Finance in 2006, appoints the Central Bank of Chile (CBC) as fiscal agent for management of the resources of both funds, following approval by the CBC Board; and also establishes the general framework for their management.[5] In addition, Executive Decree N° 621, issued by the Ministry of Finance in 2007, created the Financial Committee, which advises the Finance Minister on matters related to the investment of the ESSF and PRF resources, in compliance with Article 13 of the Fiscal Responsibility Law.[6]

Diagram 1: Institutional framework of the sovereign wealth funds



Source: Ministry of Finance

4.1 MINISTRY OF FINANCE AND DEPENDENT BODIES

The Fiscal Responsibility Law establishes that the funds are the property of the State Treasury of Chile and that the General Treasury holds the legal title to the resources. The law authorizes the Finance Minister to make decisions on investing and managing the resources in the sovereign wealth funds. This law also expressly grants the Minister the authority to delegate the operational management of the funds, whether to the Central Bank of Chile or to other external managers. In March 2007, the Finance Minister appointed the Central Bank to oversee these tasks in the role of fiscal agent, based on its reputation and experience in handling international reserves.

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

6 Published in the Official Gazette on 11 August 2007.

The Ministry of Finance reports the state of the sovereign wealth funds to the Chilean Congress and the general public through the publication of monthly, quarterly and annual reports.

The General Treasury is responsible for the fund accounting and for preparing the audited financial statements. The Budget Office is responsible for budgetary issues related to the funds.

4.2 CENTRAL BANK OF CHILE

The functions of the Central Bank of Chile (CBC) and the procedural guidelines for the funds' management were established by Executive Decree N° 1.383, issued by the Ministry of Finance in 2006. In accordance with this decree, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

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

In performing its duties as fiscal agent, the Central Bank 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.

The Central Bank has contracted J.P. Morgan Chase Bank N.A. to serve as custodian of the sovereign wealth fund investments, as well as to perform some middle office functions that are complemented by Finance Ministry personnel.[8]

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7 Following a selection process carried out in 2011, the CBC contracted Black Rock Institutional Trust Company N.A., Mellon Capital Management Corporation and Rogge Global Partners PLC to manage the investment of 35% of the PRF portfolio starting in January 2012.

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

4.3 FINANCIAL COMMITTEE[9]

In compliance with Article 13 of the Fiscal Responsibility Law, the Financial Committee was officially created through Executive Decree N° 621, issued by the Ministry of Finance in 2007, to advise the Minister on the analysis and design of the sovereign wealth fund investment strategy. The Financial Committee is an external advisory board, whose members have a vast experience in economic and financial areas. The current members are Klaus Schmidt-Hebbel Dunker (President), Cristián Eyzaguirre Johnston (Vice President), Arturo CiSources Ovalle, Martín Costabal Llona, Eric Parrado Herrera and Eduardo Walker Hitschfeld.

The main functions and responsibilities 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 ranges of deviation, eligible investments and the inclusion of new investment alternatives;
- To make recommendations to the Finance Minister regarding specific instructions on investment and custody, the selection of fund managers and the structure and content of reports;
- To provide an opinion, when requested by the Finance Minister, of the structure and content of the reports submitted to the Ministry of Finance by the agencies entrusted with the management and custody of the funds and to express an opinion on the quality of management and consistency with established investment policies;
- To express an opinion of the structure and content of the quarterly reports prepared by the Ministry of Finance; and
- To advise the Finance Minister, when so requested, on all matters relating to the investment of the funds.

9 For more information on the activities of the Financial Committee in 2011, see its Annual Report (available online at http://www.hacienda.cl/english/sovereign-wealth-funds/financial-committee.html).

CHAPTER 5

Principal Activities in 2011

5.1 SELECTION OF EXTERNAL MANAGERS FOR THE PRF

In 2011, the Central Bank undertook a selection process for external managers to handle the corporate bond and equity portfolios under the new PRF investment policy. With the support of an international consultant, Strategic Investment Solutions (SIS), and Finance Ministry staff, the Bank contacted the forty-six firms that participated in the call for proposals issued in 2008.[10] Of the firms contacted, fifteen submitted proposals for equities and twelve for corporate bonds. Following an exhaustive review of the proposals, ten firms (five for each category) were invited to San Francisco, California, USA, to be interviewed by staff from the Central Bank, the Finance Ministry and SIS. Three firms for each mandate were then invited to Santiago for a second round of interviews by the same entities as well as members of the Financial Committee. Based on these interviews and on the proposals submitted, and taking into consideration the opinion of SIS, the Central Bank issued a recommendation to the Financial Committee on which managers to contract.

Based on the Committee's recommendations, the Finance Minister authorized the contracting of two firms for each mandate in November 2011. The process came to a close with the approval of the CBC's Board and the formal communication of the decision to the selected firms. The firms contracted by the CBC are Black Rock Institutional Trust Company N.A. and Mellon Capital Management Corporation for the equity portfolio and Black Rock Institutional Trust Company N.A. and Rogge Global Partners PLC for the corporate bond portfolio.

5.2 STUDY OF STRATEGIC ASSET ALLOCATION FOR THE ESSF

In late 2010, the Finance Ministry commissioned Eduardo Walker to conduct a study on the ESSF investment policy, which was completed in 2011. The main conclusions of the study are as follows:

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

Based on this study and on additional analysis carried out by the Ministry of Finance, the Financial Committee will formulate a set of recommendations on the fund's investment policy, to be submitted to the Finance Minister in the first half of 2012. Based on these recommendations, the Minister will evaluate the possible changes that could be incorporated into the ESSF investment policy and the timing of their implementation.

10 The list was updated to reflect corporate events since 2008.

5.3 A MORE PASSIVE INVESTMENT POLICY

In the first part of the year, the Ministry of Finance drew up new investment guidelines for both sovereign wealth funds. These guidelines, which were approved by the CBC, require the Central Bank to more closely adhere to the portfolio's benchmarks, thus limiting the room for discretionary investment. The new guidelines went into effect on May 1, 2011. The returns earned in the year are consistent with this more passive approach (see chapters 8.3 and 9.3).

5.4 SELF-ASSESSMENT OF COMPLIANCE WITH THE SANTIAGO PRINCIPLES

In the first half of 2011, the Ministry of Finance conducted its first self-assessment of the degree to which the Chilean sovereign wealth funds comply with each of the Santiago Principles.[11] This is part of the government's systematic efforts to improve the information available to the general public and manage the funds in accordance with the international best practices. The self-assessment was included in the 2010 Annual Report on the Sovereign Wealth Funds, prepared by the Ministry of Finance.[12] Additionally, a special section was added to the website later in the year, to provide an English version of the self-assessment (www.hacienda.cl/english/sovereign-wealth-funds/good-governance-practices-santiago.html). The government plans to update the self-assessment every two years.

5.5 SOVEREIGN WEALTH FUND FINANCIAL STATEMENTS

In 2011 and part of 2012, the General Treasury prepared the financial statements for the sovereign wealth funds in accordance with International Financial Reporting Standards (IFRS); the statements were audited with no observations by the Deloitte accounting firm. The ESSF and PRF financial statements are presented in chapters 11 and 12 of this report, respectively. The preparation of these financial statements took over a year because it was necessary to allocate resources and develop technical skills in the Treasury to be able to prepare them in accordance with the international conventions. The construction and publication of this information positions the Chilean funds on the same level as other sovereign wealth funds that provide this type of information following international accounting standards and with an independent audit. It also gives both the national and international public a better understanding of the financial situation of our sovereign wealth funds, since the information is provided in a widely used format.

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

12 Available online at http://www.hacienda.gov.cl/english/sovereign-wealth-funds/annual-report.html.

5.6 FOREIGN CURRENCY DEPOSITS IN LOCAL BANKS

At the request of the Finance Ministry, the Financial Committee evaluated and later recommended the future consideration of foreign currency deposits in the local banking system as an investment alternative for the ESSF, subject to the same eligibility and risk criteria applied to overseas banks. The Committee's recommendation would expand the range of options for bank investments without increasing cross-border risk or affecting the local exchange rate, given that these are foreign currency investments in instruments issued and traded in Chile. This recommendation has not been implemented as of the publication of this report.

5.7 EXPANSION OF COLLATERAL IN THE SECURITIES LENDING PROGRAM

The new securities lending program entered into effect on May 1, featuring an expanded list of collateral in dollars that can be accepted by the program.[13] Prior to that date, only instruments issued by the U.S. government could be used as collateral. The change, which was studied and recommended by the Financial Committee in 2010, adds the following financial instruments to the list of eligible collateral: debt issued by U.S. government sponsored agencies and mortgage-backed securities (MBS) issued and guaranteed by U.S. government sponsored agencies.[14] The purpose of the change is to admit a larger number of counterparties, since this type of collateral is widely used. This change led to a substantial increase in income from the program (see chapters 8.5 and 9.5).

5.8 CODE OF ETHICS

For better compliance with principle 13 of the Santiago Principles, which requires that professional and ethical standards be clearly defined and made known to the members of the sovereign wealth fund's governing bodies, management and staff, the Ministry of Finance drew up a Code of Ethical Principles for the staff of the Ministry's International Finance Division that are involved in the management of the sovereign wealth funds (and debt). This code, which entered into effect in January 2011, complements the integrity standards that are already applied to civil servants. The code is available on the website (see Box 2).[15]

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13 The securities lending program operates in dollars and euros. The latter was unchanged.

14 J.P. Morgan Chase Bank N.A., which manages the securities lending program, provides 100% compensation if the collateral is insufficient to cover the value of the instrument provided on loan to a counterparty, in case the instrument is not returned. In addition, the value of the collateral received from the counterparty must be equivalent to 102% of the value of the instrument given on loan.

15 The CBC has defined professional and ethical standards for its employees, while the Financial Committee members are subject to ethical standards stipulated in the decree that established the Committee and to additional standards formulated internally.

BOX 2 Code of ethics

In an ongoing effort to set high standards of integrity and excellence, the International Finance Division of the Ministry of Finance, which is in charge of the sovereign wealth funds and the public debt, has developed a Code of Ethical Principles for its staff, in addition to the existing integrity standards.

The Code was formulated on the basis of both international experience, such as the CFA Institute's Code of Ethics and Standards of Professional Conduct, and national precedents, such as the Manual on Ethical Principles adopted by the Central Bank of Chile. The publication of this Code illustrates the Ministry's commitment to international best practices in funds' management, including the Santiago Principles.

The Code is available on the Ministry of Finance's website, in the sovereign wealth funds section (www.hacienda.gov.cl/fondos-soberanos/codigo-de-etica.html):

The areas regulated by the Code of Ethics include the following:

- Professionalism: Includes a description of the professional conduct expected of the team, which must act with integrity and in compliance with the law.
- Incompatibilities and conflicts of interest: Regulates the independence and objectivity of the staff, including the additional activities that staff members can undertake.
- Use and preservation of information: Establishes standards for the treatment of information to which team members have access.
- Duties to the Finance Ministry: Describes the team members' obligation to act for the benefit of the Ministry, as well as supervisors' responsibility for ensuring compliance with the Code.

Once a year, the International Finance Division staff makes a written commitment to comply with the Code.

CHAPTER 6

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' investment, 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, returns and risks, as well as other activities associated with fund management. For example, as mentioned earlier, the 2010 annual report published the first self-assessment of the Santiago Principles, and for the first time, this year's 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 funds returns was increased from quarterly to monthly, and more information on the investment portfolios was made available.

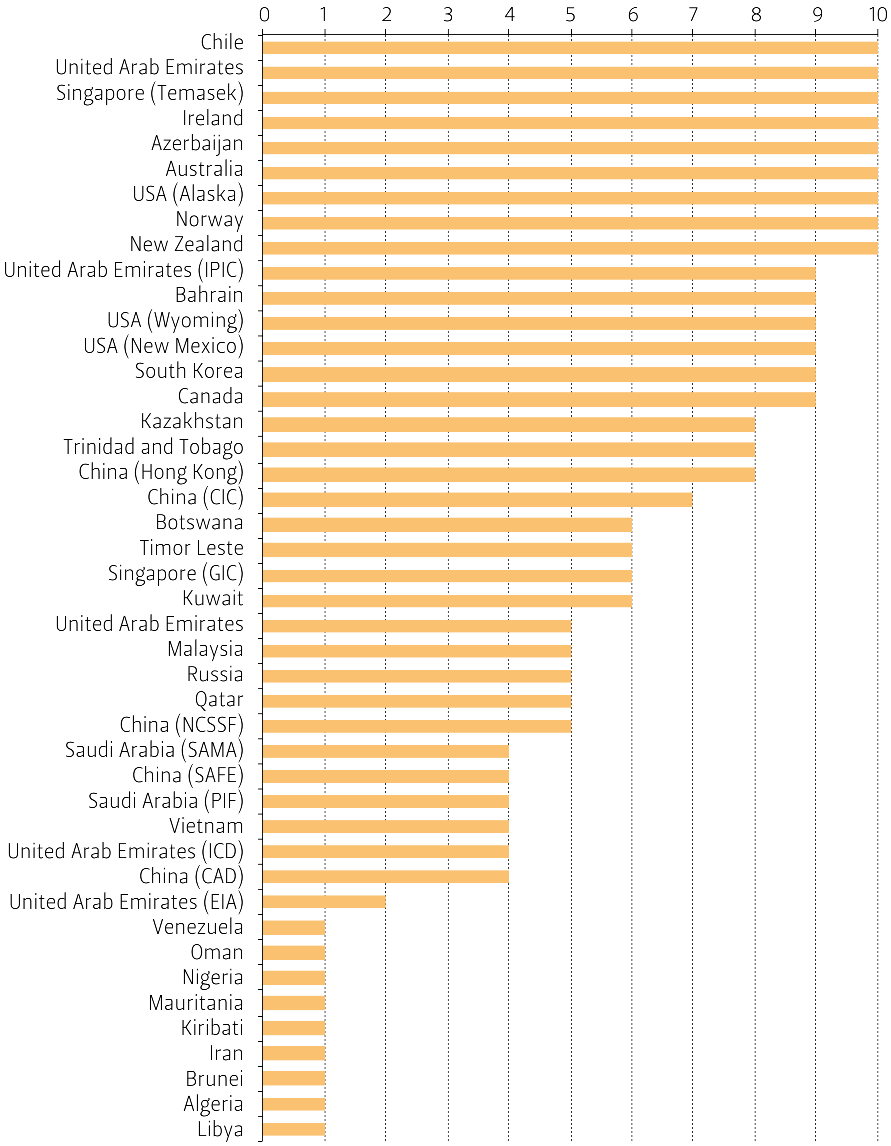
To guarantee public access to all important information on the ESSF and the PRF, the reports are published in Spanish and English and are available on the sovereign wealth funds' website.[16]

Chile also remains committed to international initiatives aimed at establishing a framework of generally accepted principles and practices for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance is an active participant in the International Forum of Sovereign Wealth Funds (IFSWF), which hosts an annual meeting of the world's main sovereign wealth funds to share and exchange opinions on key issues and facilitate understanding of their activities and of the Santiago Principles.

These efforts have been reflected in international recognition of the level of transparency of our funds. In particular, from the third quarter of 2009 to date, the Sovereign Wealth Fund Institute has awarded Chile the highest score on its Linaburg-Maduell Transparency Index, which measures the transparency of the main sovereign wealth funds (see figure 6).

16 Available online at http://www.hacienda.cl/english/sovereign-wealth-funds.html

Figure 6: Linaburg-Maduell Transparency Index, fourth quarter of 2011



Source: Sovereign Wealth Fund Institute.

CHAPTER 7

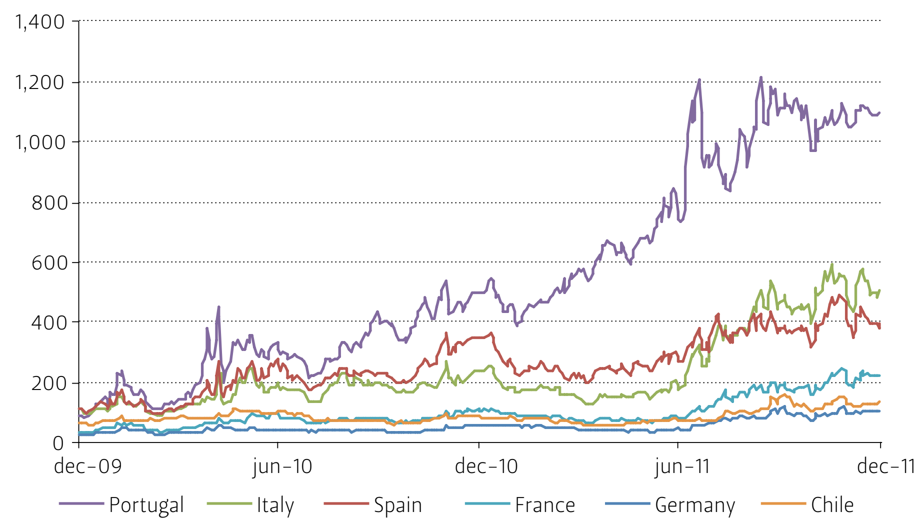
Analysis of the International Economy[17]

17 This chapter, in its entirety, corresponds to chapter 2.A "Market analysis" of the Financial Committee's 2011 Annual Report.

2011 was marked by the deepening of the European crisis and by a series of events that affected the main financial variables that have a direct impact on the performance of the portfolios of Chile's sovereign wealth funds.

In the euro zone, the deepening crisis had a significant effect on a number of systemically important countries such as Spain and Italy. Towards the end of the year, these two countries faced higher financing costs, reflecting greater uncertainty about the sustainability of their public debt and significant fiscal deficits. In Greece, the deterioration was such that markets reflected the expectation that holders of its sovereign bonds would sustain losses of over 50% in order to mitigate part of the short-term financial pressures on this country. Nonetheless, at the end of the year, there were still doubts as to whether Greece would comply with its financial obligations and adjust its spending in order to reduce its fiscal deficit. The situation in other countries such as Portugal also worsened in 2011 and, in the second quarter of the year, it became the third country, after Greece and Ireland, to request financial support from the European Community and the International Monetary Fund. In this situation, the financing costs of these countries and of financial institutions with exposure to them (principally European institutions) and the cost of credit default swaps (CDS)[18] increased considerably (see figure 7). In the last two months of the year, the European Central Bank responded by again reducing its monetary policy interest rate and launched a massive program of three-year lending at a 1% rate of interest for European banks in a bid to address the lack of liquidity seen in financial markets (see figure 8).

Figure 7: 5-year credit default swaps: Selected European countries and Chile, 2010-2011
(basis points)



Source: Bloomberg

18 This represents the cost of financial instruments to protect against default by an issuer.

Figure 8: TED Spread,[19] 2006–2011

(basis points)

Source: Bloomberg

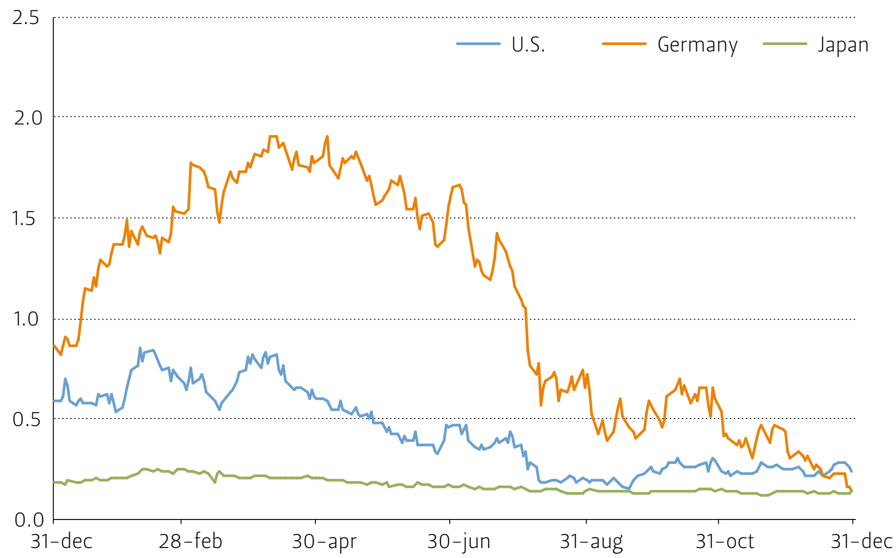
In the third quarter of 2011, Standard and Poor's reduced its risk rating for the United States from AAA to AA+ in view of this country's high level of government borrowing and political difficulties in reaching agreement on a significant fiscal adjustment (see Box 3). The US economy has, however, been showing a modest expansion, leading to a gradual improvement in its employment figures although significant weaknesses persist in the real estate sector and as regards household indebtedness and investment. This led the Federal Reserve to extend its public undertaking to hold its monetary policy interest rate in the range of 0-0.25% through to the end of 2014.

In May, the Japanese economy began to recover from the important adverse impact of the earthquake of March 2011. The Bank of Japan held its monetary policy interest rate in the range of 0-0.1% in order to stimulate this recovery.

Interest rates on bonds issued by the United States, Germany and Japan dropped to historically low levels in the second half of 2011, reflecting their use as a haven in the face of the deepening European crisis (see figure 9).

19 The TED spread is the difference between the interbank borrowing rate (LIBOR) and the risk-free rate (US Treasury bills). A higher TED spread typically indicates a lower level of market liquidity.

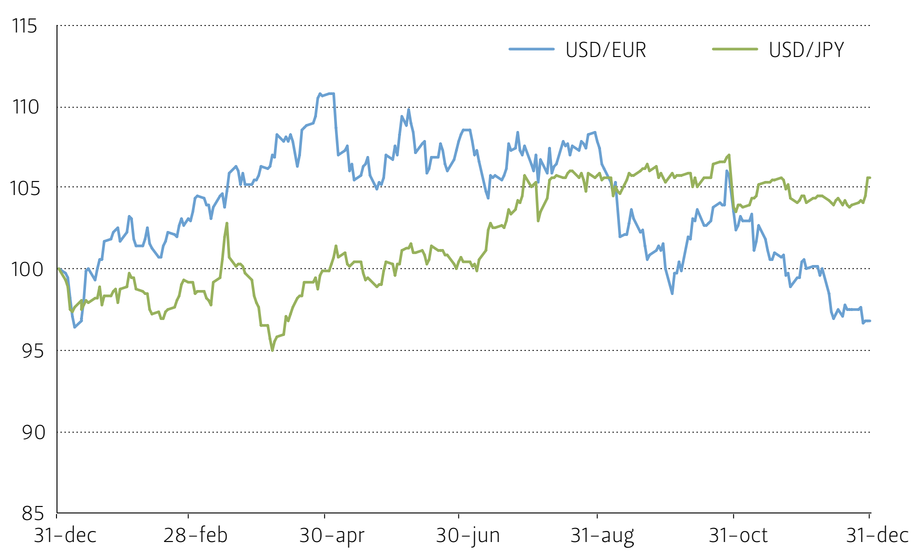
Figure 9: Yield to maturity on 2-year sovereign bonds: US, Germany and Japan, 2011
(percent)



Source: Bloomberg

Exchange rates fluctuated considerably in 2011. The euro (EUR) closed the year at 1.30 USD/EUR, representing a depreciation of 3.16% over the course of the year, while the yen (JPY) closed at 76.91 JPY/USD, equivalent to an annual appreciation of 5.5%. The value of the dollar against the yen reached a historic peak at the end of October, triggering the intervention of the Bank of Japan in a bid to depreciate the yen (see figure 10).

Figure 10: Exchange rates, 2011
(December 31, 2010 = 100)



Source: Bloomberg

The intense volatility of capital markets was reflected in the VIX Index, which represents the expected volatility of the Standard & Poor's 500 Index (S&P 500) in the United States (see figure 11).

Figure 11: Stock market (S&P 500) volatility (VIX), 2006 – 2011
(percent)

Source: Bloomberg

BOX 3 U.S. government borrowing limit and the implications for Chile’s sovereign wealth funds

The difficulties faced by the US government in mid-2011 in its bid to increase its borrowing limit - or, in other words, the maximum amount of debt that Congress authorizes the Treasury to take on - highlighted the country’s complex fiscal situation. The government was forced to seek authorization for an increase after reaching the existing limit in May 2011 since it would otherwise have been unable to cover its budget needs and/or financial obligations. However the process proved complex because authorization was tied to implementation of concrete measures for sustainable reduction of the fiscal deficit.

In this context, Standard and Poor’s warned that it would reduce its risk rating for the United States unless concrete measures were defined to ensure the sustainability of the country’s indebtedness. This triggered uncertainty in international financial markets which have historically viewed debt issued by the US government as the safest investment instrument.

After several months of debate in Congress and without reaching a specific agreement on how to reduce the fiscal deficit, an increase in the borrowing limit was approved at the beginning of August and a Committee was established to define reductions in the deficit. Moreover, if this Committee were unable to agree on which items of expenditure to cut by end-2011, automatic reductions would be triggered. However, Standard and Poor’s still reduced its rating for the US from AAA to AA+, arguing that the agreed measures were insufficient to reduce the country’s indebtedness in the medium term. It is important to note that other risk rating agencies such as Fitch and Moody’s maintained their ratings for the US and interest rates on its bonds not only did not increase (as would have occurred if financial markets considered sovereign risk to have increased) but even dropped after the announcement.

Chile’s sovereign wealth funds benefitted from the generalized market uncertainty about the financial solidity of different countries, particularly as a result of the European crisis, because their portfolios consist principally of US, German and Japanese fixed-income instruments which are considered reserve assets. This, in turn, confirmed that the Financial Committee was correct in taking a long-term view and recommending that no changes be made in the Funds’ investment policy despite the difficulties faced by the US government.

CHAPTER 8

Economic and Social Stabilization Fund

8.1 INVESTMENT POLICY

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

The investment policy considers a strategic asset allocation of 30% in money market instruments, 66.5% in nominal sovereign bonds and 3.5% in inflation-indexed sovereign bonds, with a currency allocation of 50% in dollars, 40% in euros and 10% in yens (see table 1). Since May 2011, the fund's investment policy has been based on a more passive management, which allows only marginal deviations from the strategic asset allocation. According to this benchmark, 85% of the fund must be invested in sovereign instruments, with the following distribution by country: 42.5% in instruments issued by the U.S. government, 34% in Germany and 8.5% in Japan. The remaining 15% is allocated to investment in banks, which are chosen by the Central Bank of Chile according to the issuer limits specified in the investment guidelines. Leveraging is not allowed in the fund, and the use of derivatives is limited exclusively to exchange rate hedging.

Table 1: Benchmarks
(percent)

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

Source: Ministry of Finance

The investment policy in force has been consistent with these objectives. It stipulates investment in fixed-income instruments denominated in reserve currencies which typically perform well at times of crisis. This permits not only the maximization of the value of the fund's accumulated resources measured in foreign currency but also their conversion into pesos (in which most fiscal spending takes place) when their use is most needed. During the 2008 crisis, for example, their returns were not affected and were, in fact, very favorable in pesos terms. This was in contrast to other countries' sovereign wealth funds which, with their more risky profile, suffered important short-term losses.

Despite the good results obtained under the current policy and as discussed in chapter 5, in 2012 the Financial Committee is expected to formulate recommendations on the investment policy to incorporate the results of the study carried out by Dr. Eduardo Walker in 2011, in order to better tailor the investment policy to the fund's objectives. Based on these recommendations, the Finance Minister will evaluate possible changes and the timing of their implementation, if deemed advisable.

8.2 MARKET VALUE

At the end of 2011, the market value of the ESSF was US$ 13,157 million, versus US$ 12,720 million at the end of 2010. The increase in the fund's value was due to net investment earnings of US$ 437 million. No contributions were made in 2011. Since its inception on 6 March 2007, the ESSF has received capital contributions of US$ 19,462 million, has recorded withdrawals of US$ 9,428 million (see table 2) and has generated net financial earnings of US$ 3,122 million (see table 3).

Table 2: ESSF: Contributions and withdrawals
(millions of dollars)

Period	Contributions		Withdrawals	
	Amount	% GDP	Amount	% GDP
2007	13,100	8.9	—	—
2008	5,000	3.1	—	—
2009	—	—	9,278	5.5
2010	1,362	0.8	150	0.1
2011	—	—	—	—
Total	19,462		9,428	

Source: Ministry of Finance

Table 3: ESSF: Evolution and decomposition of market value
(millions of dollars)

Decomposition	2007	2008	2009	2010	2011	Since Inception [(a)]
Starting Market Value	0	14,033	20,211	11,285	12,720	0
Contributions	13,100	5,000	0	1,362	0	19,462
Withdrawals	0	0	-9,278	-150	0	-9,428
Accrued Interest	326	624	404	228	237	1,819
Capital Gains (Losses)	607	556	-51	-4	201	1,309
Management, Custody and Other Costs	-0.3	-2.0	-1.6	-1.1	-1.2	-6.2
Net financial earnings	933	1,178	352	223	437	3,122
Ending Market Value	14,033	20,211	11,285	12,720	13,157	13,157

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

Source: Ministry of Finance

8.3 RETURNS

In 2011, the fund's return in dollars, net of management costs, was 3.41%. This reflects a return in local currency of 4.0%, combined with a loss of 0.59% from exchange rate effects.[20] The net return in pesos was 14.75%, mainly due to the depreciation of the peso against the dollar over the course of the year. Since March 31, 2007, the annualized net return in dollars was 5.07%, which was mostly driven by the net return in local currency (4.15%). In the same period, the net return in pesos was 4.36% (see table 4 and figure 12). The IRR in dollars was 3.42% in 2011, while the annualized IRR since the fund's inception was 4.93%.

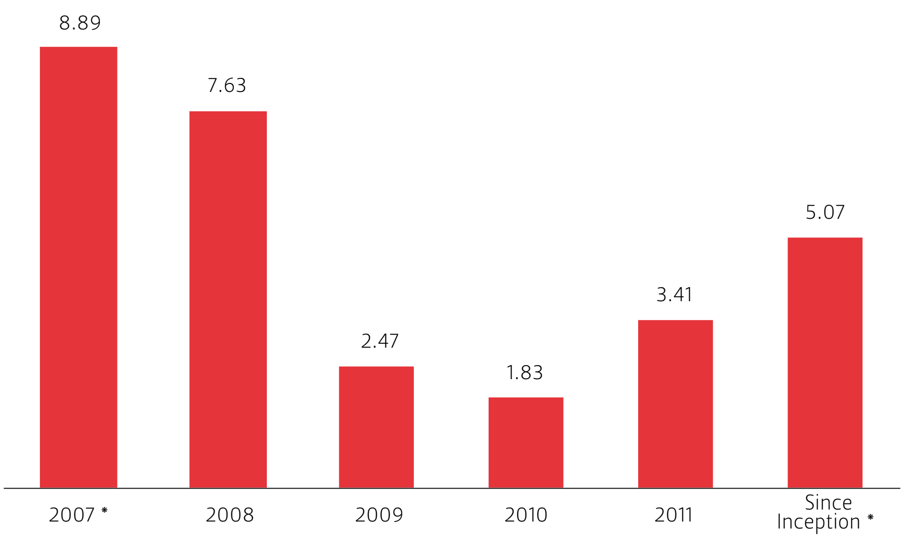
Table 4: ESSF: Net returns
(percent)

Returns [(a)]	2011	Last 3 years	Since Inception [(b)]
Local Currency	4.00	2.71	4.15
Exchange Rate Return	-0.59	-0.14	0.92
Return in USD	**3.41**	**2.57**	**5.07**
Exchange Rate CLP	11.34	-6.06	-0.71
Return in CLP [(c)]	**14.75**	**-3.49**	**4.36**

(a) Time-weighted return (return calculated as the growth rate of the funds that were invested throughout the period).
(b) Calculated from March 31, 2007, when the Central Bank's performance began to be measured.
(c) The return in CLP corresponds to the sum of the percentage variation in the peso-dollar exchange rate to the dollar return.

Source: Ministry of Finance

Figure 12: ESSF: Annual TWR
(percent)



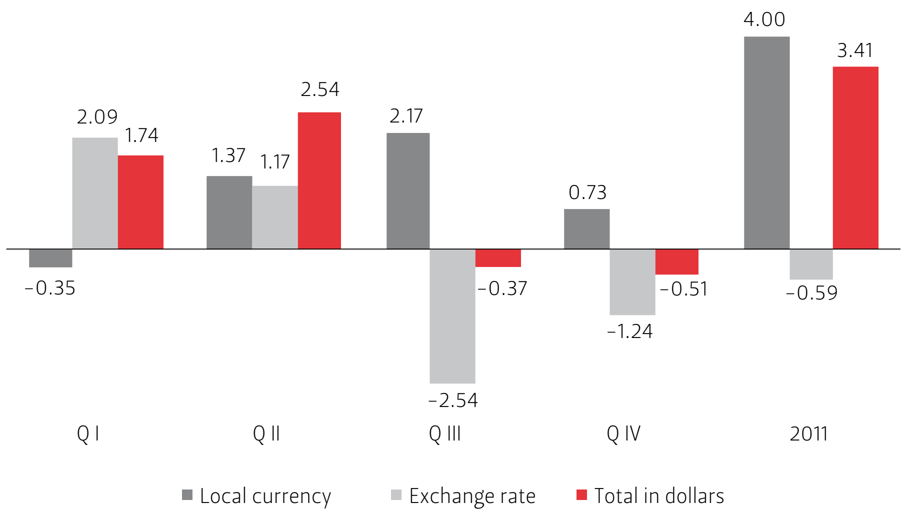
*Calculated from March 31, 2007.

Source: Ministry of Finance

20 The sovereign wealth funds' returns primarily reflect interest and exchange rates. The level and changes in interest rates largely determine the value of the financial instruments in their currency of denomination (local currency). However, given that the funds are invested in dollars, euros and yen and that the portfolio returns are measured in dollars, the exchange rate of the dollar against these currencies also affects the funds' returns.

Figure 13 shows the quarterly breakdown of net returns in 2011, decomposed into the return in local currency and the exchange rate effect. Returns were higher in the first and second quarters, at 1.74% and 2.54%, respectively. This reflects a positive exchange rate effect in both quarters (mainly due to the appreciation of the euro against the dollar) and, to a lesser extent, positive returns in local currency in the second quarter. Returns were negative in the third and fourth quarters, at −0.37% and −0.51%, respectively. After appreciating in the first half of the year, the euro depreciated strongly against the dollar in the second half, which had a negative impact on fund returns. This was partly offset by positive returns in local currency in the third and fourth quarters, as the instruments in which the ESSF is invested performed well against the deterioration in the international markets, and by the appreciation of the yen against the dollar in the same period.

Figure 13: ESSF: Net quarterly returns, by local currency and exchange rate
(percent)

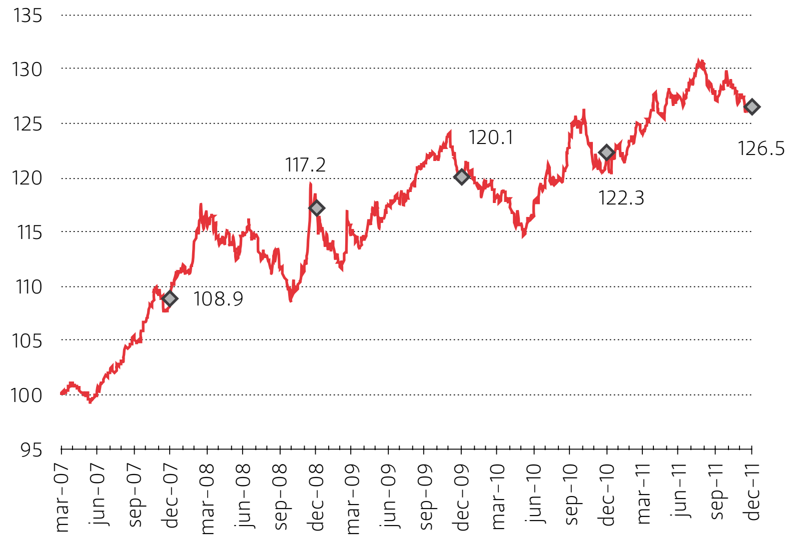


Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the daily returns of the portfolio. Taking a starting value of 100 on March 31, 2007, the index reached 126.5 at the end of 2011 (see figure 14).

Figure 14: ESSF: Return index

(March 31, 2007 = 100)

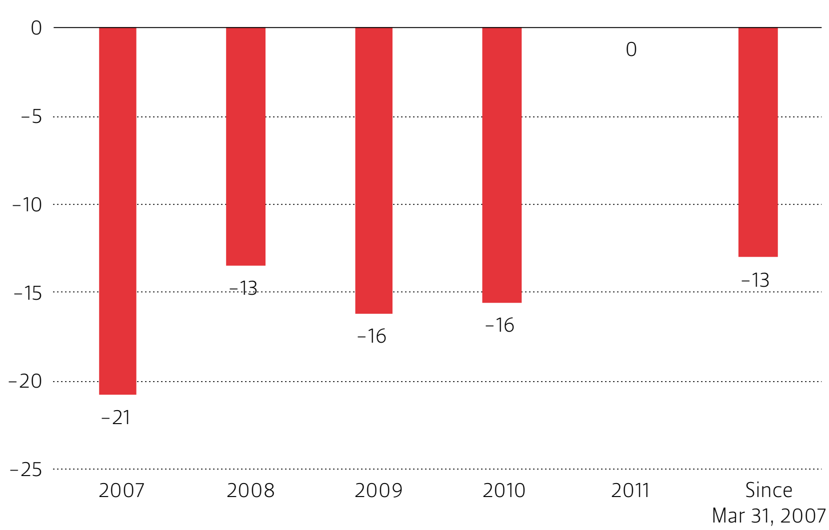


Source: Ministry of Finance

With regard to the Central Bank of Chile's performance, the ESSF's net return in dollars in 2011 equaled the benchmark, in line with the more passive approach implemented as of May 1, 2011. Going back to March 31, 2007, the Central Bank's annualized return was 13 basis points below the benchmark (see figure 15).

Figure 15: ESSF: Net returns against the benchmark

(basis points)



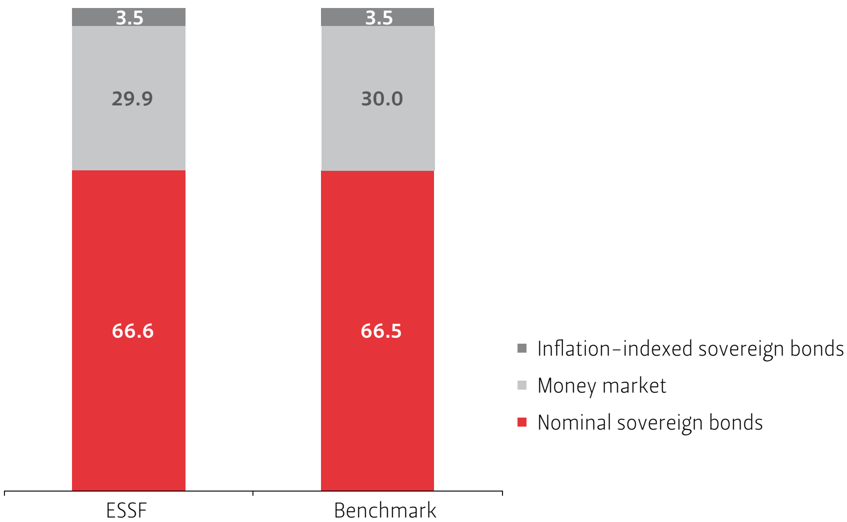
Source: Ministry of Finance

8.4 PORTFOLIO ALLOCATION

The allocation of the ESSF investment portfolio in 2011 was very similar to previous years. The distribution of investments by asset class, country and currency reflects the benchmark allocation, which has remained largely unchanged since the fund's inception.

As of December 2011, the allocation of the ESSF by asset class comprised US$ 8,756 million in nominal sovereign bonds, US$ 3,939 million in money market instruments[21] and US$ 461 million in inflation-indexed bonds. At the end of the year, the percent allocation by asset class and by currency was almost identical to the benchmark (see figures 16 and 17).

Figure 16: ESSF: Asset class allocation, December 31, 2011
(percent of portfolio)



Source: Ministry of Finance

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

Figure 17: ESSF: Currency allocation, December 31, 2011
(percent of portfolio)

Source: Ministry of Finance

Exposure by type of credit risk was relatively stable in 2011 (see figure 18). In the case of sovereign instruments, investments have been confined exclusively to in the United States, Germany and Japan since May 1, 2011, in line with the passive investment policy implemented on that date. At the end of 2011, the sovereign exposure of the ESSF was US$ 10,950 million, accounting for 83.2% (see table 5). Bank exposure was US$2,207 million, or 16.8% of the portfolio. These bank investments in 2011 are primarily time deposits in European banks, which were selected by the Central Bank based on the risk-return trade-off at the time the deposit was made. Table 6 lists the banks with deposits at the end of 2011.

Figure 18: ESSF: Allocation by credit risk exposure, 2011
(percent of portfolio)

Source: Ministry of Finance

Table 5: ESSF: Decomposition by type of credit risk exposure, December 31, 2011
(Millions of dollars; percent of total)

Exposure	Country	Millions of US$	% of total
Sovereign	United States	5,548	42.2
	Germany	4,272	32.5
	Japan	1,130	8.6
	Total	**10,950**	**83.2**
Bank	Germany	866	6.6
	Netherlands	564	4.3
	Austria	326	2.5
	Israel	129	1.0
	United Kingdom	122	0.9
	Japan	92	0.7
	Finland	53	0.4
	Denmark	50	0.4
	Other	4	0.0
	Total	**2,207**	**16.8**
	Fund total	**13,157**	**100**

Source: Ministry of Finance

Table 6: ESSF: Banks with deposits, December 31, 2011

Bank	Country
Bank Hapoalim	Israel
Bayerische Landesbank	Germany
Commerzbank ag	Germany
Danske Bank Aktieselskab	Denmark
Dekabank Deutsche Girozentra	Germany
Deutsche Bank AG	Germany
Dnb Nord Banka	Norway
Erste Group Bank AG	Austria
ING Bank NV	Netherlands
Landesbank Baden-Wuerttemberg	Germany
Lloyds TSB Bank PLC	United Kingdom
Mizuho Corp Bank	Japan
Nordea Bank Finland PLC	Finland
NV Bank Nederlandse	Netherlands
Rabobank Nederland	Netherlands
Raiffeisen Bank International AG (RBI)	Austria
The Bank of Tokyo Mitsubishi UFJ	Japan
Unicredit Bank	Germany

Source: Ministry of Finance

The credit quality of the sovereign investments included in the ESSF is directly related to the benchmark. That is, the distribution by risk rating depends on the shares established in the benchmark for the United States, Germany and Japan. Bank exposure, as explained previously, depends on the CBC's assessment of the risk-return trade-off of each bank at the time the deposit was made (see table 7). At the end of December, 1.2% of the fund was invested in time deposits with the German bank Bayerische Landesbank, whose risk rating was reduced to BBB+ on November 18, 2011, whereas the investment guidelines stipulate a minimum rating of A–. The situation was rectified in March 2012 when the deposits matured.

Table 7: ESSF: Credit risk exposure, December 31, 2011
(percent of total)

Issuer	Risk rating								
	AAA	AA+	AA	AA–	A+	A	A–	BBB+	Other	Total
Sovereign	74.6	0.0	8.6	0.0	0.0	0.0	0.0	0.0	0.0	83.2
Bank	3.2	0.0	0.0	0.4	2.7	8.3	1.0	1.2	0.0	16.7

Source: Ministry of Finance

8.5 INCOME FROM THE SECURITIES LENDING PROGRAM AND MANAGEMENT COSTS

The total cost of managing the ESSF included US$ 544.6 thousand for custody services and US$ 613.8 thousand to the Central Bank for management services, equivalent to 0.47 basis points (bp) of the portfolio. The income from the securities lending program (US$ 2,868.8 thousand) exceeded total management costs (see table 8). As mentioned in chapter 5, the income from the securities lending program in 2011 was more than double the income recorded in 2010 due to the expansion of the type of collateral that can be used in the program.

Table 8: ESSF: Management and custody costs and income from the securities lending program
(Thousand U.S dollars)

Item	2009	2010	2011
Custody (J.P. Morgan)	816.7	622.1	544.6
Management CBC	804.6	506.4	613.8
Other costs	—	—	—
Total costs	**1,621.3**	**1,128.5**	**1,158.400**
Securities lending program	**931.9**	**1,290.3**	**2,868.800**

Source: Ministry of Finance

CHAPTER 9

Pension Reserve Fund

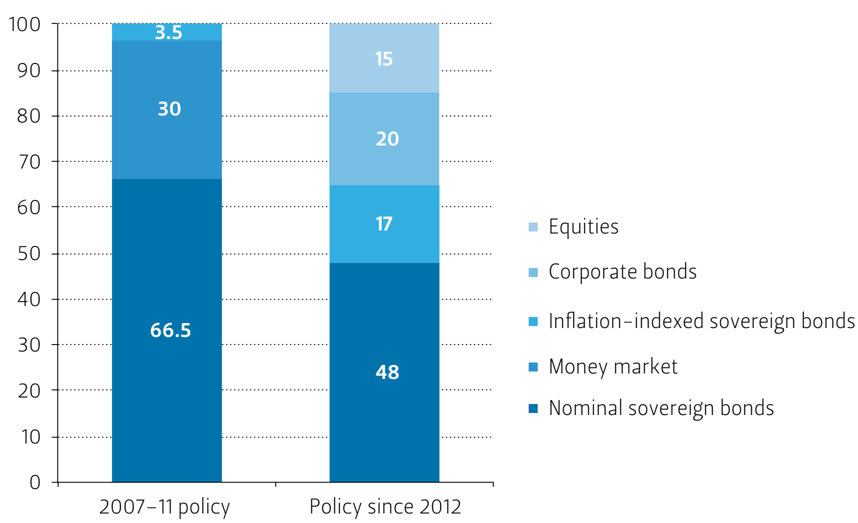
9.1 INVESTMENT POLICY

The PRF's principal objective is to generate resources to finance part of fiscal pension liabilities. To this end, it has established the specific objective of maximizing the expected return subject to a risk tolerance defined as a 95% probability that, in a given year, it will not suffer a loss of more than 10% of its value in dollars. Given the size and timing of the liabilities it is designed to finance, the PRF has a medium to long-term investment horizon.

At the end of 2011, the PRF investment policy (in force since the fund's inception) was similar to that of the ESSF. Specifically, the fund considered a strategic asset allocation of 30% in money market instruments, 66.5% in sovereign bonds and 3.5% in inflation-indexed sovereign bonds, with a currency allocation of 50% in dollars, 40% in euros and 10% in yen (for a complete description of this policy, see the second paragraph of chapter 8.1).

A new investment policy was implemented in early 2012 (see box 4), comprising a portfolio allocation of 48% in nominal sovereign bonds, 17% in inflation-indexed sovereign bonds, 15% in equities and 20% in corporate bonds (see figure 19). The new policy was recommended by the Financial Committee in late 2010, based on a study carried out by the Mercer consulting firm using the risk-return parameters described above. For this policy the CBC is responsible for managing the asset classes with sovereign risk exposure, while the external managers selected in 2011 (see chapter 5) manage the equity and corporate bond portfolios.

Figure 19: Comparison of strategic asset allocation
(percent of portfolio)



Source: Ministry of Finance

BOX 4 The new investment policy for Pension Reserve Fund

The new investment policy defined for the PRF is based on the fund's investment objectives, that is, maximizing expected returns while keeping risk within a 95% probability that the fund will not lose more than 10% of its value in dollars in a given year. The investment horizon is medium to long term, given the size and timeline of the liabilities that the fund has to finance (pensions).

The new policy specifies a portfolio allocation of 48% in nominal sovereign bonds, 17% in inflation-indexed sovereign bonds, 15% in equities and 20% in corporate bonds. The nominal and inflation-indexed sovereign bonds are managed directly by the Central Bank of Chile, while the corporate bond and equity portfolios are the responsibility of the external managers contracted by the Bank. The implementation of the new policy began in January 2012, and the stipulated asset allocation should be achieved by mid-March 2012.

The asset classes defined under this policy are invested according to highly diversified benchmarks (see table B4.1) and using a passive approach. The ex ante tracking error is capped at 50 basis points for the sovereign bond portfolio, 30 basis points for the equity portfolio and 50 basis points for the corporate bond portfolio.

Eligible instruments and issuers are determined by the benchmarks used. A very limited use of exchange traded funds (ETFs), mutual funds and futures is also allowed in order to facilitate benchmark tracking. The use of leverage is not permitted, and the authorized use of forwards is confined exclusively to exchange rate hedging.

A portfolio rebalancing policy has been established to allow convergence to the aforementioned asset allocation. Rebalancing will also be triggered whenever the PRF receives additional contributions and when any of the asset classes exceed their target ranges.

Given the nature of the liability financed by the PRF (pensions), the investment policy can be compared to the pension funds managed by the Pension Fund Administrators (AFPs).[1] From the perspective of asset classes and risk profiles, the previous PRF policy was even more conservative than a Type E fund, which allows up to 5% of the total fund portfolio to be invested in equities and also allows investment in corporate bonds. The new scheme moves closer to a Type D fund (15% in equities), which is more in line with the return objectives and risk profile identified for the PRF. In sum, the risk tolerance remains low, while the investment policy is more consistent with the underlying liability that needs to be financed in the future.

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

Table B4.1 : Strategic asset allocation and benchmarks
(percent of portfolio)

Strategic asset allocation		Benchmarks
Asset class	Percent of total	
Nominal sovereign bonds and related assets [(a)]	48%	Barclays Capital Global Aggregate: Treasury Bond Index (unhedged)
		Barclays Capital Global Aggregate: Government-Related (unhedged)
Inflation-indexed sovereign bonds	17%	Barclays Capital Global Inflation-Linked Index (unhedged)
Corporate bonds	20%	Barclays Capital Global Aggregate: Corporates Bond Index (unhedged)
Equities	15%	MSCI All Country World Index (unhedged with reinvested dividends)

(a) Each subcategory of this asset class is weighted by its relative capitalization.

Source: Ministry of Finance

9.2 MARKET VALUE

As of December 31, 2011, the PRF had a market value of US$ 4,406 million, an increase of US$ 569 million compared to the end of 2010. This growth is mainly due to a contribution of US$ 443 million, equivalent to 0.2% of 2010 GDP (see table 9), plus net financial gains of US$ 126 million.

Since its inception on December 28, 2006, the fund has received contributions totaling US$ 3,867 million, and its investments have generated net financial gains of US$ 538 million (see table 10).

Table 9: Annual contributions
(millions of dollars)

Period	Contribution	% GDP (prev. year)
2006	605	0.5
2007	736	0.5
2008	909	0.5
2009	837	0.5
2010	337	0.2
2011	443	0.2
Total	3,867	

Source: Ministry of Finance

Table 10: PRF: Evolution and decomposition of market value
(millions of dollars)

Decomposition	2007	2008	2009	2010	2011	Since Inception [(a)]
Starting Market Value	605	1,466	2,507	3,421	3,837	0
Contributions	736	909	837	337	443	3,867
Withdrawals	0	0	0	0	0	0
Accrued Interest	46	71	72	70	75	334
Capital Gains (Losses)	80	60	6	9	51	206
Management, Custody and Other Costs	0.0	–0.3	–0.3	–0.4	–0.4	–1.6
Net financial earnings	125	131	77	79	126	538
Ending Market Value	1,466	2,507	3,421	3,837	4,406	4,406

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

Source: Ministry of Finance

9.3 RETURNS

The fund's return in dollars, net of management costs, was 3.41% in 2011. This reflects a return in local currency of 4%, combined with a loss of 0.59% from exchange rate effects, mainly due to the depreciation of the euro over the course of the year. The net return in pesos was 14.75% in 2011, which is explained by the depreciation of the peso against the dollar. Since March 31, 2007, the annualized net return was 5.01% in dollars and 4.3% in pesos. Through the end of 2011, the ESSF and the PRF have had very similar returns on investment since their inception, because they had similar investment policies (see table 11 and figure 20). Finally, the PRF recorded an IRR in dollars of 3.06% in 2011, while the annualized IRR since the fund's inception was 4.03%.

Table 11: PRF: Net returns

(percent)

Returns [(a)]	2011	Last 3 years	Since inception [(b)]
Local Currency	4.00	2.64	4.09
Exchange Rate Return	-0.59	-0.14	0.92
Return in USD	3.41	2.50	5.01
Exchange Rate CLP	11.34	-6.06	-0.71
Return in CLP [(c)]	14.75	-3.56	4.30

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

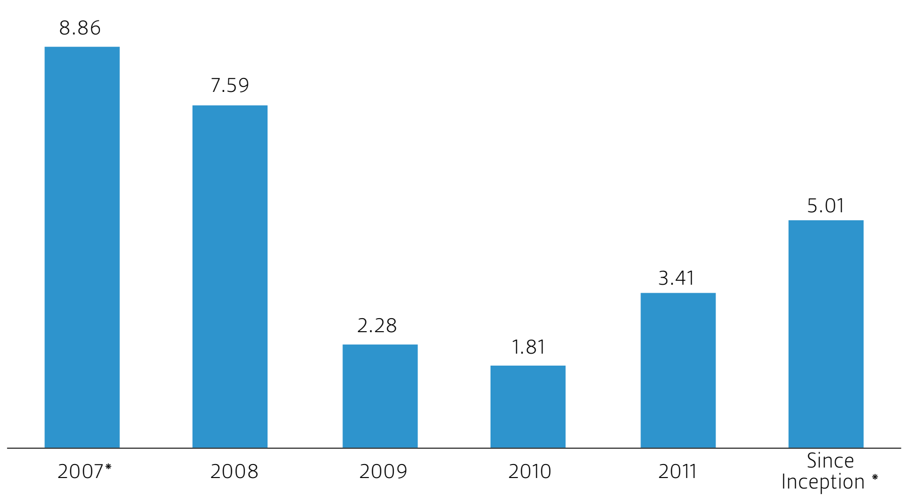
(b) Calculated from March 31, 2007, when the Central Bank's performance began to be measured.

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

Source: Ministry of Finance

Figure 20: PRF: Annual TWR

(percent)



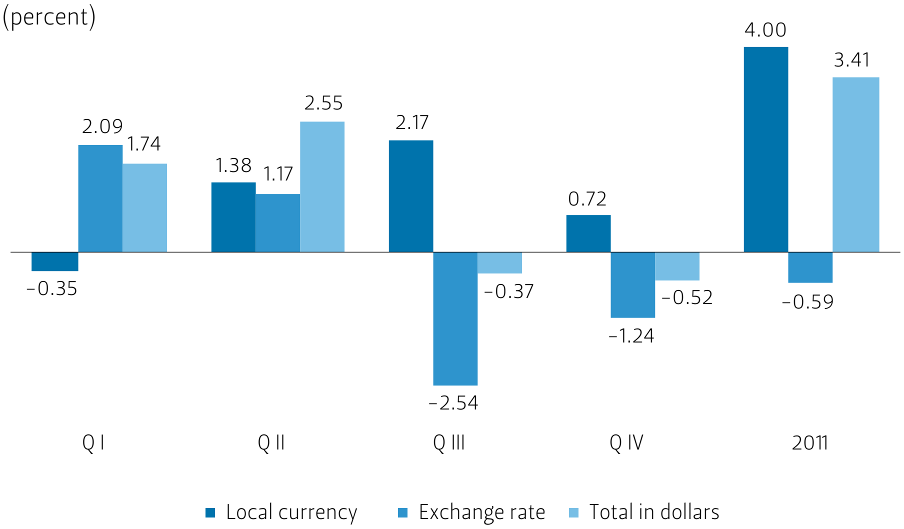
* Calculated from March 31, 2007.

Source: Ministry of Finance

Figure 21 shows the quarterly breakdown of the PRF's net returns in 2011, decomposed into the return in local currency and the exchange rate effect. See chapter 8.3 for a general explanation of the main factors affecting returns in 2011.

Figure 21: PRF: Net quarterly returns, by local currency and exchange rate

(percent)

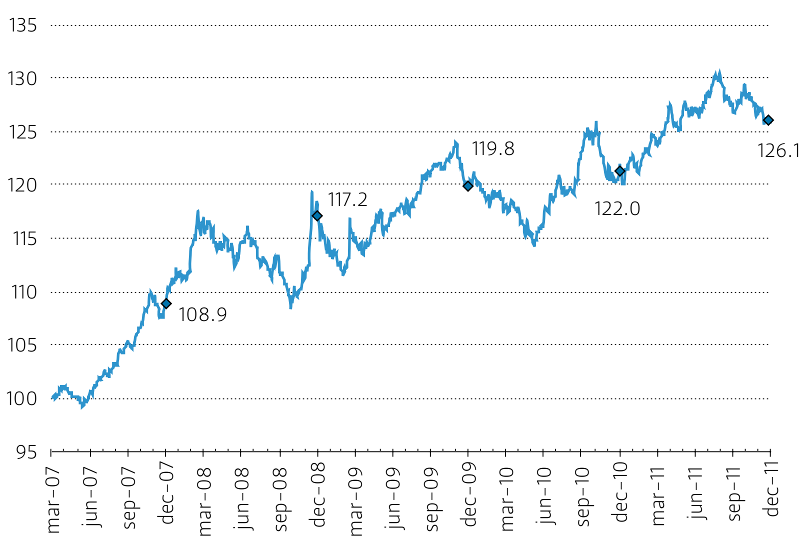


Source: Ministry of Finance

The fund's investment results can be illustrated using an index of the daily returns of the portfolio (see figure 22). Despite the volatility of the index, the value increased over prior years, to 126.1 at the end of 2011.

Figure 22: PRF: Return index

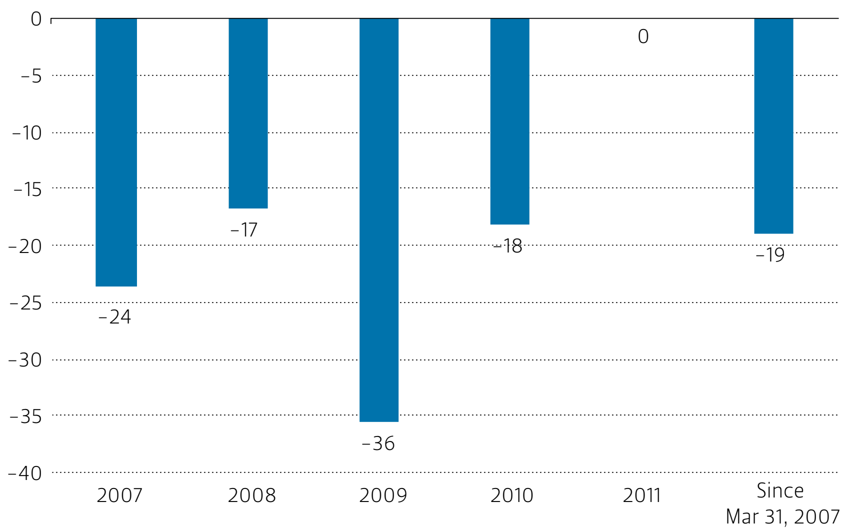
(March 31, 2007 = 100)



Source: Ministry of Finance

The Central Bank's performance, measured as the difference between the portfolio return and the benchmark, was 0 basis points in 2011, while the annualized return since March 31, 2007 was 19 basis points below the benchmark (see figure 23). As in the case of the ESSF, the 2011 result is consistent with the more passive approach to fund management implemented as of May 1, 2011.

Figure 23: PRF: Net returns against the benchmark
(basis points)



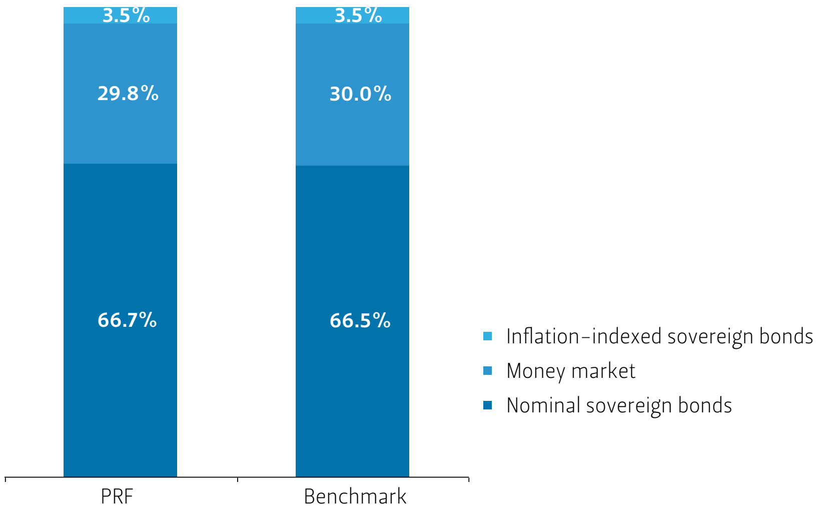
Source: Ministry of Finance

9.4 PORTFOLIO ALLOCATION

In 2011, the portfolio allocation of the PRF was very similar to that of the ESSF, primarily because both funds were managed with a passive approach and had the same the investment policy by the end of the year.

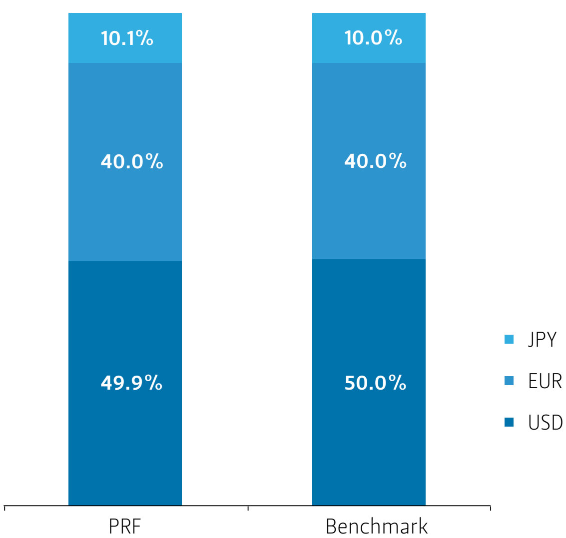
As of December 2011, the allocation of the PRF by asset class comprised US$ 2,940 million in nominal sovereign bonds, US$ 1,311 million in money market instruments and US$ 154 million in inflation-indexed sovereign bonds. The percent allocation by asset class and by currency was similar to the benchmark (see figure 24 and 25).

Figure 24: PRF: Asset class allocation, December 31, 2011
(percent of portfolio)



Source: Ministry of Finance

Figure 25: PRF: Currency allocation, December 31, 2011
(percent of portfolio)

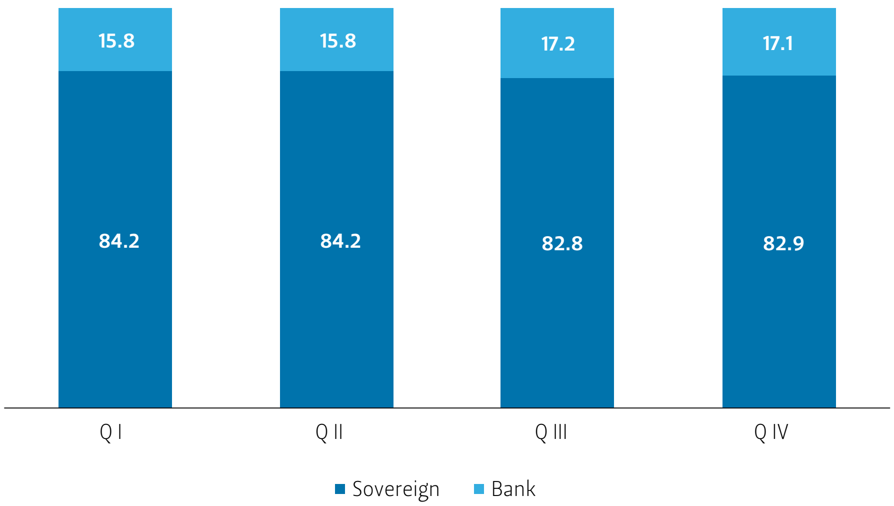


Source: Ministry of Finance

Likewise the ESSF, the distribution by type of risk (sovereign versus bank) was fairly stable in 2011 and closely followed the benchmark (see figure 26). However, the PRF's bank exposure approached 17% of the portfolio in the second half, as the Central Bank held a larger share in time deposits in anticipation of transferring resources to the external managers under the new investment policy. Thus, at the end of 2011, bank exposure was US$ 753 million, or 17.1% of the portfolio. Sovereign exposure, in turn, was US$ 3,653 million, or 82.9% of the portfolio (see table 12). Table 13 lists the banks with deposits at the end of 2011.

Figure 26: PRF: Allocation by credit risk exposure, 2011

(percent of portfolio)



Source: Ministry of Finance

Table 12: PRF: Decomposition of credit risk, December 31, 2011
(millions of dollars; percent of total)

Exposure	Country	Millions of US$	% of total
Sovereign	United States	1,839	41.8
	Germany	1,435	32.6
	Japan	378	8.6
	Total	**3,653**	**82.9**
Bank	Netherlands	265	6.0
	Germany	226	5.1
	Austria	79	1.8
	Norway	63	1.4
	Japan	38	0.9
	Denmark	32	0.7
	United Kingdom	25	0.6
	Sweden	23	0.5
	Other	2	0.0
	Total	**753**	**17.1**
	Fund total	**4,406**	**100.0**

Source: Ministry of Finance

Table 13: PRF: Banks with deposits, December 31, 2011

Bank	Country
Bayerische Landesbank	Germany
Danske Bank Aktieselskab	Denmark
Dekabank Deutsche Girozentra	Germany
Deutsche Bank AG	Germany
Dnb Nord Banka	Norway
Erste Group Bank AG	Austria
ING Bank NV	Netherlands
Landesbank Baden-Wuerttemberg	Germany
Lloyds TSB Bank PLC	United Kingdom
Mizuho Corp Bank	Japan
NV Bank Nederlandse	Netherlands
Rabobank Nederland	Netherlands
Raiffeisen Bank International AG	Austria
Skandinaviska Enskilda Banken	Sweden
Unicredit Bank	Germany

Source: Ministry of Finance

Table 14 presents the distribution by risk rating for both sovereign and bank bonds. As with the ESSF, at the end of December 2011, a small share of the PRF (0.7%) was invested in the German bank Bayerische Landesbank, which became ineligible for investment in mid-November following a drop in its risk rating. The situation was rectified in early 2012 when the deposits matured.

Table 14: PRF: Credit risk exposure, December 31, 2011
(percent of total)

Issuer	**Risk rating**									
	AAA	**AA+**	**AA**	**AA–**	**A+**	**A**	**A–**	**BBB+**	**Other**	**Total**
Sovereign	74.3	0.0	8.6	0.0	0.0	0.0	0.0	0.0	0.0	82.9
Bank	4.8	0.0	0.0	0.0	5.1	6.5	0.0	0.7	0.0	17.1

Source: Ministry of Finance

With the implementation of the new investment policy in 2012, the portfolio allocation will change substantially from its current composition, due to the incorporation of two new asset classes (equities and corporate bonds) and the diversification of fixed-income sovereign instruments to include a larger number of issuers.

9.5 INCOME FROM THE SECURITIES LENDING PROGRAM AND MANAGEMENT COSTS

The total cost of managing the PRF included US$ 217.8 thousand for custody services and US$ 194.7 thousand to the Central Bank for management services. The CBC's fees equaled 0.44 basis points (bp) of the portfolio in 2011. The income from the securities lending program totaled US$ 923.2 thousand, thus fully financing management and custody costs (see table 15). As in the case of the ESSF, the increase in income from the securities lending program relative to previous years was mainly due to the expansion of the types of instrument that can be used as collateral.

Table 15: PRF: Management and custody costs and income from the securities lending program
(Thousand U.S dollars)

Item	**2009**	**2010**	**2011**
Custody (J.P. Morgan)	192.9	252.8	217.8
Management (CBC)	155.4	153.6	194.7
Other Costs [(a)]	—	—	20.0
Total Costs	**348.3**	**406.4**	**432.5**
Securities Lending Program	**205.7**	**399.8**	**923.2**

(a) First payment to consultant Strategic Investment Solutions.

Source: Ministry of Finance

CHAPTER 10

Description of Financial Risks

Because sovereign wealth funds are invested in a variety of financial instruments, they are exposed to a wide range of risks, including market, credit, liquidity, active management and operational risks. To limit exposure to these risks, the Ministry of Finance includes investment restrictions in the investment guidelines, which must be taken into account by the Central Bank of Chile in its operations. Compliance is monitored by an independent area within the CBC, by the custodian and, ultimately, by the Finance Ministry. In addition, the institutional framework and infrastructure of the CBC provide controls for mitigating operational risk.

10.1 MARKET RISK

The market value of the financial instruments in the sovereign wealth funds can be exposed to losses as a result of changes in market conditions in terms of interest and exchange rates. This section describes how these risks affect the sovereign wealth funds.

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. A portfolio's duration is the parameter that measures its sensitivity to a change in the structure of interest rates, with a longer duration implying a greater risk of a loss in the face of an increase in rates.

In the case of the sovereign wealth funds, a reference duration was defined based on the indexes that make up the benchmark. This benchmark was 2.49 years at the end of 2011, while the actual duration of the ESSF and PRF was 2.46 and 2.50 years, respectively (see table 16). The investment guidelines stipulate that the actual duration cannot exceed the benchmark by more than one month. As of December 31, 2011, the difference between the benchmark and the portfolio duration did not surpass that limit.

Table 16: ESSF and PRF: Portfolio and benchmark duration, December 31, 2011
(years)

Fund	Portfolio	Benchmark
ESSF	2.46	2.49
PRF	2.50	2.49

Source: Ministry of Finance

Exchange rate risk

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

10.2 CREDIT RISK

The issuer of a fixed-income instrument can default if prevented from meeting its obligations by a lack of liquidity or capital. As a result, the credit risk to which a fund is exposed increases with the probability of default by an institution or government whose securities it holds. Moreover, changes in the market's perception of an issuer's solvency can cause a drop in the market value of its instruments. The sovereign wealth funds limit exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany and Japan, within specific ranges (see table 17). Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see table 18). In addition, no more than 20% of the portfolio can be invested in banks.[22]

Table 17: Sovereign exposure
(percent)

Country	Mid-point	Deviation Range
United States	50%	48–52%
Germany	40%	38–42%
Japan	10%	8–12%

Source: Ministry of Finance

Table 18: Maximum credit exposure by bank issuer

Risk rating	Maximum (US$ million)
AAA	3.0% * IP at close of last quarter
AA+ AA AA-	2,0% * IP at close of last quarter
A+ A A-	1,5% * IP at close of last quarter

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.

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

10.3 LIQUIDITY RISK

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

In the PRF and the ESSF, this risk is mitigated by maintaining a high percentage of liquid short-term assets. As of December 31, 2011, money market instruments accounted for 29.9% of the ESSF and 29.8% of the PRF. Liquid assets include Treasury bills, certificates of deposit and time deposits, all of which are less sensitive to interest rate fluctuations. In addition, the market for certificates of deposit and bills allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

10.4 ACTIVE MANAGEMENT RISK

Depending on their characteristics, objectives and specialization, portfolio managers can manage investments either actively or passively. Under a passive strategy, the manager invests in instruments that are very similar to the benchmark securities in order to achieve a similar performance in terms of risks and returns. In contrast, an active manager takes positions in different instruments in order to generate higher returns than the benchmark, which will be reflected, for example, in the portfolio duration or currency composition. These positions add another source of risk that is not present under passive management, known as active risk.

Active risk can be measured through the tracking error (TE),[23] which quantifies the degree to which the portfolio follows the benchmark. A higher TE indicates a more active management. At the end of 2011, the TE was 17 basis points for the ESSF and 18 basis points for the PRF, which is consistent with a passive management.

10.5 OPERATIONAL RISK

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

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

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

10.6 VOLATILITY AND OTHER INDICATORS

One of the indicators typically used to measure portfolio risk is the volatility of returns, calculated as their standard deviation. In 2011 the annual volatility of the ESSF and PRF was 4.8%, while annual volatility since March 31, 2007 was 6.1% (see table 19). Exchange rate fluctuations were the main source of volatility for the funds during 2011.

Table 19: ESSF and PRF: Annualized monthly volatility versus benchmark
(percent)

Volatility	2011	Since Inception
ESSF	4.8	6.1
PRF	4.8	6.1
Benchmark	4.7	6.1

Source: Ministry of Finance

Since the funds' inception, the highest monthly return was recorded in December 2008, with 5.44% for the ESSF and 5.47% for the PRF, while the lowest was –3.31% for the ESSF and –3.33% for the PRF (in January 2009). The highest quarterly return was 7.31% for the ESSF and 7.36% for the PRF (first quarter of 2008); the lowest was –2.52% for the ESSF and –2.51% for the PRF (third quarter of 2008) (see table 20).

Table 20: ESSF and PRF: Historic maximum and minimum returns
(percent)

Range	Monthly		Quarterly	
	ESSF	PRF	ESSF	PRF
Highest return	5.44 (Dec-08)	5.47 (Dec-08)	7.31 (QI 08)	7.36 (QI 08)
Lowest return	-3.31 (Jan-09)	-3.33 (Jan-09)	-2.52 (QIII 08)	-2.51 (QIII 08)

Source: Ministry of Finance

In late December 2011, the Value-at-Risk (VaR), a measure used to quantify potential losses in a given period of time and with a given probability, was US$ 52 million for the PRF and US$ 154 million for the ESSF.[24]

24 Monthly VaR is based on daily portfolio volatility, with an 84% confidence level.

CHAPTER 11

Financial Statements: Economic and Social Stabilization Fund

Financial statements for the years ended December 31, 2011 and 2010 and independent auditors' report[25]

25 The financial statements of the Economic and Social Stabilization Fund for the years ended on December 31, 2011 and 2010 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements and of Deloitte's report that were originally prepared and audited in Spanish

Deloitte.

Deloitte
Auditores y Consultores Limitada
RUT: 80.276.200-3
Av. Providencia 1760
Pisos 6, 7, 8, 9, 13 y 18
Providencia, Santiago
Chile
Fono: (56-2) 729 7000
Fax: (56-2) 374 9177
e-mail: deloittechile@deloitte.com
www.deloitte.cl

INDEPENDENT AUDITORS' REPORT

To the General Treasury of the Republic
Fondo de Estabilización Económica y Social

1. We have audited the accompanying statements of financial position of Fondo de Estabilización Económica y Social (hereinafter "Economic and Social Stabilization Fund") as of December 31, 2011 and 2010, and the related statements of comprehensive income, changes in net equity and cash flows for the years endings December 31, 2011 and 2010. The preparation of these financial statements (including the related notes) are the responsibility of the General Treasury of the Republic. Our responsibility is to express an opinion on these financial statements based on our audits.

2. We conducted our audits in accordance with generally accepted auditing standards in Chile. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Fund's Management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

3. In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of Economic and Social Stabilization Fund as of December 31, 2011 and 2010, and the results of its operations, changes in net equity, and its cash flows for the years endings December 31, 2011 and 2010 in conformity with international financial reporting standards.

4. As indicated in Note 1 and 2h, the use of the Economic and Social Stabilization Fund's resources is established in Statutory Decree N°1 issued on December 11, 2006.

5. The accompanying financial statements have been translated into English for the convenience of readers outside Chile.

Deloitte.

March 20, 2012

ECONOMIC AND SOCIAL STABILIZATION FUND

Statement of Financial Position as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

ASSETS	Notes	2011 (US$)	2010 (US$)
CURRENT ASSETS			
Cash and cash equivalents	9	4,110,279	621,982
FINANCIAL ASSETS AFFECTING INCOME			
Time deposits		2,203,016,101	2,607,262,476
Government bonds		8,755,831,787	8,501,341,879
Indexed bonds		461,479,981	445,263,240
Treasury bills		1,732,190,505	938,340,841
Commercial papers		-	227,270,737
Derivative instruments		13,778	-
Total investments	6	13,152,532,152	12,719,479,173
TOTAL ASSETS		**13,156,642,431**	**12,720,101,155**

NET EQUITY	Notes	2011 (US$)	2010 (US$)
Treasury resources		10,034,619,597	8,822,294,205
Contributions by the Treasury	7	-	1,362,325,392
Withdrawals by the Treasury	7	-	(150,000,000)
Accumulated results		2,685,481,558	2,462,490,328
Income in the year		436,541,276	222,991,230
NET EQUITY		**13,156,642,431**	**12,720,101,155**

The accompany notes are an integral pat of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

Statement of Comprehensive Income for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	2011 (US$)	2010 (US$)
OPERATING INCOME:			
Interest income	8	208,345,009	199,919,655
Income from investments		370,031,110	52,346,745
Total operating income		578,376,119	252,266,400
OPERATING LOSSES:			
Losses from investments		-	(19)
Net unrealized losses		(140,676,451)	(28,146,680)
Total operating losses		(140,676,451)	(28,146,699)
Total operating income		**437,699,668**	**224,119,701**
MANAGEMENT EXPENSES:			
Fiscal agent's fees	7	(613,758)	(506,400)
Custodian's fees	7	(544,634)	(622,071)
INCOME FOR THE YEAR		**436,541,276**	**222,991,230**

The accompany notes are an integral pat of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

Statement of Changes in Net Equity for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	Treasury resources (US$)	Accumulated results (US$)	Income for the year (US$)	Total (US$)
Opening balance, January 1, 2011		10,034,619,597	2,462,490,328	222,991,230	12,720,101,155
Distribution of income from previous year		-	222,991,230	(222,991,230)	-
Income for the year		-	-	436,541,276	436,541,276
Closing balance, December 31, 2011		**10,034,619,597**	**2,685,481,558**	**436,541,276**	**13,156,642,431**
Opening balance, January 1, 2010		8,822,294,205	2,110,675,538	351,814,790	11,284,784,533
Distribution of income from previous year		-	351,814,790	(351,814,790)	-
Contributions by the Treasury	7	1,362,325,392	-	-	1,362,325,392
Withdrawals by the Treasury	7	(150,000,000)	-	-	(150,000,000)
Income for the year		-	-	222,991,230	222,991,230
Closing balance, December 31, 2010		**10,034,619,597**	**2,462,490,328**	**222,991,230**	**12,720,101,155**

The accompany notes are an integral pat of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND

Statement of Cash Flows – Indirect Method for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	2011 (US$)	2010 (US$)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income from the year		436,541,276	222,991,230
Net unrealized losses		140,676,451	28,146,680
Changes in fund management and custody		(573,729,430)	(1,462,999,424)
Net cash flows from operating activities		3,488,297	(1,211,861,514)
CASH FLOWS FROM FINANCING ACTITIVITIES			
Increase from capital contributions	7	-	1,362,325,392
Decrease from capital withdrawals	7	-	(150,000,000)
Net cash flows from financing activities		-	1,212,325,392
NET INCREASE IN CASH AND CASH EQUIVALENTS		**3,488,297**	**463,878**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		**621,982**	**158,104**
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		**4,110,279**	**621,982**

The accompany notes are an integral pat of these financial statements.

ECONOMIC AND SOCIAL STABILIZATION FUND
NOTES TO THE FINANCIAL STATEMENTS
(Figures in U.S. dollars — US$)

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 September 30, 2006, which combined into a single fund the additional fiscal income stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under loan agreement BIRF N° 2625 CH, as specified in Statutory Decree N°1 of December 11, 2006.

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

a) Decree N° 1,383 of 2006, which authorizes the Central Bank of Chile to act as fiscal agent in managing the Economic and Social Stabilization Fund and establishes guidelines for reporting on the investments to the Finance Minister and the General Treasury.

b) Ministry of Finance Official Letter N° 433 of 2011, which informs the fiscal agent of the new investment guidelines for managing the Economic and Social Stabilization Fund.

c) General Comptroller Official Letter N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.

d) Decree N° 1,636 of 2010, which regulates the coordination and functioning of advisory activities, management support and auditing of the Public Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund.

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

   - To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.
   - To perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms and commission independent auditors for the annual financial statements. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.
   - To support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.
   - Verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records.
   - Process transactions associated with contributions to and withdrawals from the sovereign wealth funds, transfers between external managers and payments associated with the management of the sovereign wealth funds, as required.
   - Contract external managers and custodians for the fund.
   - Maintain a current manual of procedures for the handling of all functions and duties described in this Article.
   - Carry out any additional forms of management support, coordination or consulting necessary for the performance of these functions.

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

Qualitative characteristics of the ESSF financial statements

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

ii. The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence and the Principle of Full Disclosure, within an internal audit system based fundamentally on the CBC's responsibility, as fiscal agent, to verify the information prepared by the custodian.

iii. The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.

iv. The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

These financial statements were approved by the General Treasury on March 20, 2012.

2. MAIN ACCOUNTING CRITERIA USED

a. Basis of preparation and presentation of the financial statements

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

Additionally, the fund opted for the early application of IFRS 9: Financial Instruments (issued in November 2009 and modified in October 2010), with the initial application dating to January 1, 2009. IFRS 9 introduces new requirements for classifying and measuring financial assets under the scope of IAS 39: Financial Instruments. Specifically, IFRS 9 requires that all financial assets be classified and later measured either at amortized cost or fair value based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

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

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

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

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds that the custodian, J.P. Morgan, provided to the CBC, as fiscal agent.

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

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

b. Period covered

The financial statements cover the years between January 1 and December 31 of 2011 and 2010.

c. Functional and presentation currency

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

The figures are presented in U.S. dollars. Contributions to the ESSF have been made in dollars, and investments have primarily been made in U.S. dollars.

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

d. Investment classification and valuation

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

Financial assets and liabilities:

Classification:

The fund classifies investments in debt instruments, capitalization instruments and financial derivative instruments as financial assets at fair value through profit or loss.

Financial assets at net fair value through profit or loss:

A financial asset is classified at fair value through profit or loss if it is acquired principally for trading (short-term sale or repurchase) or is part of a portfolio of identified financial investments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Derivatives are also classified at fair value through profit or loss. The fund has adopted the policy of not using hedge accounting.

These overseas financial investments are recognized, valued and classified in accordance with international financial reporting standards, as follows:

Financial instruments at fair value through profit or loss:

Government bonds, indexed bonds, agency bullet bonds, Treasury bills, commercial papers and derivative instruments. The basis for classifying the securities in this investment category is that they have a reasonably active secondary market, under normal conditions. They are recorded at fair value, and any changes in value are recognized directly through profit or loss.

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

Financial assets at amortized cost:

Financial assets at amortized cost are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the fund manager intends to hold to maturity so as to receive interest, adjustment and exchange rate income in accordance with the contractual terms of the instrument.

Financial liabilities:

Financial liabilities at amortized cost will be classified like other liabilities.

Recognition, reduction and measurement:

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

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

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

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

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

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

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

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

Estimation of fair value:

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

The hierarchy of fair value is as follows:

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

e. Cash

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

f. Funds under management

These are securities delivered to the CBC, acting as fiscal agent for the management of ESSF resources. The securities can be totally or partially employed for the assigned objectives.

g. Funds in custody

These are securities delivered by the CBC, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for Fund securities and instruments.

h. Net equity

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

In accordance with the stipulations of Articles N°s 1, 2, 3 and 4 of Statutory Decree N° 1 of September11, 2006, the ESSF will be established and increased with the following resources:

The additional fiscal income stabilization resources stipulated in Decree Law N° 3,53 of 1981 and the Copper Revenue Compensation Fund established under Loan Agreement BIRF 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 resources deposited in current accounts held by the funds identified in Article 1, as of the date that the Statutory Decree enters into force;
(b) All resources deriving from the application of Transitory Article 2 of Law N° 19,030;
(c) An annual contribution equal to the balance remaining after subtracting from the effective surplus, the contributions stipulated in paragraph (a) of Article 6° and in Article 11, both of Law N° 20,128, provided the balance is positive; and
(d) Other extraordinary contributions designated for the fund via Finance Ministry decree, from the sale of assets or the issue of debt instruments; as well as other resources stipulated in other laws.

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

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

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

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

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

The ESSF's resources can be used as follows:

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

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

i. Statement of Cash Flows

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

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

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

j. Net or offset presentation of financial instruments

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

k. New accounting rules:

The following new rules and interpretations have been adopted in these financial statements.

IFRS amendments	Compulsory application date
IAS 24: Related party disclosures	Annual periods beginning on or after January 1, 2011.
IAS 32: Financial instruments: presentation. Classification of rights issues	Annual periods beginning on or after February 1, 2010.
Improvements to IFRSs, May 2010. A set of amendments to seven International Financial Reporting Standards	Annual periods beginning on or after January 1, 2011.

New interpretations	Compulsory application date
IFRIC 19: Extinguishing financial liabilities with equity instruments	Annual periods beginning on or after July 1, 2010.

Amendments to interpretations	Compulsory application date
IFRIC 14: The limit on a defined benefit asset, minimum funding requirements and their interaction	Annual periods beginning on or after January 1, 2011.

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

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

New IFRSs	Compulsory application date
IFRS 10: Consolidated Financial Statements	Annual periods beginning on or after January 1, 2013.
IFRS 11: Joint arrangements	Annual periods beginning on or after January 1, 2013.
IFRS 12: Disclosure of interests in other entities	Annual periods beginning on or after January 1, 2013.
IAS 27 (2011: Separate financial statements	Annual periods beginning on or after January 1, 2013.
IAS 28 (2011): Investments in associates and joint ventures	Annual periods beginning on or after January 1, 2013.
IFRS 13: Fair value measurement	Annual periods beginning on or after January 1, 2013.

Amendments to IFRSs	Compulsory application date
IAS 1: Presentation of financial statements: Presentation of items of other comprehensive income	Annual periods beginning on or after July 1, 2012
IAS 12: Deferred tax: recovery of underlying assets	Annual periods beginning on or after January 1, 2012
IAS 19: Employee benefits (2011)	Annual periods beginning on or after January 1, 2013
IAS 32: Financial instruments: Presentation. Clarification of the requirements for offsetting financial assets and financial liabilities	Annual periods beginning on or after January 1, 2014
IFRS 1 (Revised): First-time adoption of International Financial Reporting Standards. (i) Removal of fixed dates for first-time adopters; (ii) Severe hyperinflation	Annual periods beginning on or after July 1, 2011.
IFRS 7: Financial instruments: disclosures. (i) Disclosures—transfers of financial assets (ii) Amendments to Disclosures—offsetting financial assets and financial liabilities	Annual periods beginning on or after July 1, 2011 (for transfers of financial assets) Annual period beginning on or after January 1, 2013 (for amendments to disclosures of offsetting)

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

3. ESSF INVESTMENT POLICY

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

(a) **Asset classes:**

The fiscal resources in the investment portfolio are invested in three asset classes: (1) money market; (2) nominal sovereign bonds; and (3) inflation-indexed sovereign bonds. The asset class benchmark breaks down as follows:

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

b) Currency allocation and deviation from the benchmark:
The investment portfolio can be invested in the following eligible currencies:

- Primary currencies:
  - U.S. dollars (USD)
  - Euros (EUR)
  - Japanese yen (JPY)

- The investment portfolio must maintain the following currency allocation:

Currency	Mid-point	Deviation range
USD	50%	48% – 52%
EUR	40%	38% – 42%
JPY	10%	8% – 12%

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

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

- Eligible issuers

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

PI: Portafolio de Inversión

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

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

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

d) Other risks:

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

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

- Limit allocation by issue:
  Investment limits for eligible risk ratings (between AAA and A–) are as follows:

Clasificación de Riesgo	Máximo Permitido
AAA	3.0% *IP at close of last quarter
AA+ AA AA-	2.0%* IP at close of last quarter
A+ A A-	1.5% *IP at close of last quarter

e) Eligible foreign currency operations:

- Foreign currency spot contracts
- Foreign currency forwards

f) Limits or specific rules for instruments and operations:

- Inflation-indexed instruments: total indexed bonds cannot be less than 2.5% or more than 4.5% of the investment portfolio.
- Currency forward or swap operations: The following guidelines have been established for the use of currency hedging mechanisms involving foreign currency forward or swap operations:
  i. Forward or swap contracts can only be written or held between eligible currencies.
  ii. Foreign currency forward or swap contracts can only be held with eligible counterparties that have a risk rating of AA– or higher from at least two of the international risk rating agencies (Fitch, Moody's and Standard & Poor's).
  iii. Foreign currency forward or swap contracts can specify either cash delivery or net settlement.
  iv. The counterparty risk associated with each cash delivery contract will equal 100% of the notional value of the forward or swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The terms of these contracts will not exceed 90 days. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3, letter c).

g) The counterparty risk associated with each cash delivery contract will equal 100% of the notional value of the forward or swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The terms of these contracts will not exceed 90 days. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3, letter c).

h) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3, letter c). In the case of net settlement contracts without a close-out netting clause, counterparty risk will be treated the same as in cash delivery contracts.

i) The notional amount of open forward or swap contracts will not exceed a sum total of 5 % of the investment portfolio.

- Intermediaries: Investments can only be made in countries that are eligible for sovereign risk investments through the following broker/dealers:
  i. Entities that can operate in the primary market; that is, that are classified as primary dealers in the United States of America, the United Kingdom and France.
  ii. Banks that are eligible for investment can directly provide broker services; their subsidiaries can also provide direct services, under the condition that the corresponding parent bank has at least a 90% ownership share.
  iii. Investment banks that have the same long-term risk rating required for banks that are eligible for investment; or their subsidiaries, provided that one or more investment banks account for at least a 90% ownership share of the subsidiary.

- Additional restriction: The fund cannot be invested in financial instruments from Chilean issuers or in instruments that are expressed or paid in pesos.
- Valuation criteria: The valuation of the investment portfolio that must be reported to the Ministry of Finance is that which is prepared by the custodian(s) using mark-to-market accounting, based on their own pricing sources. At the same time, for internal accounting purposes and other grounds related to the Fiscal Agency Decree, the CBC can employ the same methodology that it uses for its own international reserve operations.
- Securities lending program: The fiscal agent can enter into agreements with custodian(s) to manage the ESSF securities lending programs (henceforth "the programs" or "securities lending"), provided that the custodians in question (henceforth "program managers") agree to comply with the operating criteria established in the Custodian Guidelines, including in particular the obligation to return the respective securities or, in the absence thereof, the corresponding market value.
- Other: Foreign currency operations will be considered spot operations whenever the period between the trade date and the settlement date does not exceed two days. At the same time, foreign currency operations related to the purchase or sale of an instrument will be considered spot operations whenever the number of days between the trade date and the settlement date corresponds to the market convention for the settlement period of the instrument being bought or sold. For the purposes of measuring management performance, the baseline currency of the IP is the U.S. dollar. Payments related to the performance of the duties of the fiscal agent will be financed with resources from the ESSF current account. In the case of insufficient funds in the ESSF current account, the fiscal agent will liquidate or transfer investments from the investment portfolio to the current account.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

4.1 Critical accounting estimates:

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

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

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

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

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

4.2 Critical judgments for applying accounting policies:

Functional currency

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

5. FINANCIAL RISK MANAGEMENT

The sovereign wealth funds are exposed to various types of risk as a result of their investment in different financial instruments, including market risk, credit risk, liquidity risk, active management risk and operational risk. To limit exposure to these different risks, the Ministry of Finance includes investment restrictions in its investment guidelines, which must be followed by the Central Bank of Chile (CBC) in carrying out its operations. Compliance is monitored by an independent area within the Bank, by the custodian and, ultimately, by the Finance Ministry. In addition, the institutional framework and infrastructure of the CBC provide adequate controls for mitigating operational risk.

5.1 Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions. In the specific case of international fixed-income investors, the financial variables with the biggest impact on the prices of the instruments in their portfolios are interest rates and exchange rates.

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

The sovereign wealth funds are subject to a benchmark duration that is calculated on the basis of the indexes that make up the benchmark portfolio. The investment guidelines stipulate that the effective duration of the funds cannot exceed the benchmark duration by more than 5 months. The CBC complied with this restriction throughout the year, and on December 31, 2011 and 2010 the difference between the benchmark duration and the effective duration was less than one month.

Exchange rate risk: Because the fund's return is measured in dollars while the portfolio includes investments denominated in euros and yen, the value of investments is also affected by exchange rate fluctuations. For example, the value in dollars of a sovereign bond issued in euros is affected by the USD/EUR exchange rate trend. An appreciation (depreciation) of the dollar thus generates additional losses (gains) over and above the effect of interest rate movements. The fund's exchange rate exposure, measured in dollars, is 50%, and it derives from investments in euros (40%) and yen (10%).

5.2 Credit risk:

The issuer of a fixed-income instrument can default if prevented from meeting its obligations by a lack of liquidity or capital. As a result, the credit risk to which a fund is exposed increases with the probability of default by an institution or government whose securities it holds. Moreover, changes in market perception about the solvency of an issuer can cause the market value of instruments issued by that entity to drop. Exposure to this type of risk is controlled through minimum risk ratings and limits on the maximum amount and degree of concentration by asset class and/or institution.

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

5.3 Liquidity risk:

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

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

5.4 Active management risk:

Depending on their characteristics, objectives and specialization, portfolio managers can manage investments either actively or passively. Under a passive strategy, the manager invests in instruments that are very similar to the benchmark securities in order to achieve a similar performance in terms of risks and returns. In contrast, an active manager takes positions in different instruments in order to generate higher returns than the benchmark, which will be reflected, for example, in the portfolio duration or currency composition. These positions add another source of risk that is not present under passive management, known as active risk.

5.5 Operational risk:

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

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

5.6 Volatility and other indicators:

One of the indicators typically used to measure portfolio risk is the volatility of returns, calculated as their standard deviation. In 2010 the annual volatility of the ESSF and PRF returns was 6.1%, versus 6.5% for both funds if measured from March 31, 2007 (table 16). Exchange rate fluctuations (6.5%) were the main cause of fund volatility in 2010.

6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US$13,152,532,152 on December 31, 2011 and US$12,719,479,173 on December 31, 2010.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2011 (US$)	2010 (US$)
Government bonds	1	8,755,831,787	8,501,341,879
Indexed bonds	1	461,479,981	445,263,240
Treasury bills	2	1,732,190,505	938,340,841
Commercial papers	2	-	227,270,737
Other investments in derivative instruments	2	13,778	-
Total investments		**10,949,516,051**	**10,112,216,697**

Custodian investments, Central Bank of Chile	Fair value hierarchy level	2011 (US$)	2010 (US$)
Time deposits	2	2,203,016,101	2,607,262,476

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

Fair value instruments, J.P. Morgan				
Currency of origin	2011		2010	
	(US$)	% of IP	(US$)	% of IP
U.S. Dollar	5,548,106,493	50.67%	5,062,887,287	50.07%
Euro	4,271,563,489	39.01%	4,061,025,957	40.16%
Yen	1,129,846,069	10.32%	988,303,453	9.77%
Total	**10,949,516,051**	**100.00%**	**10,112,216,697**	**100.00%**

Fair value instruments, Central Bank of Chile				
Currency of origin	2011		2010	
	(US$)	% of IP	(US$)	% of IP
U.S. Dollar	1,010,529,822	45.87%	1,198,443,558	45.97%
Euro	992,072,846	45.03%	1,088,348,079	41.74%
Yen	200,413,433	9.10%	320,470,839	12.29%
Total	**2,203,016,101**	**100.00%**	**2,607,262,476**	**100.00%**

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

	2011		2010	
Risk segment	**Market value (US$)**	**Market value (%)**	**Market value (US$)**	**Market value (%)**
Bank (*)	2,207,140,158	16.78%	2,607,884,458	20.50%
Sovereign	10,949,502,273	83.22%	10,112,216,697	79.50%
Total	**13,156,642,431**	**100.00%**	**12,720,101,155**	**100.00%**

	2011		2010	
Asset class	**Market value (US$)**	**Market value (%)**	**Market value(US$)**	**Market value (%)**
Money market (*)	3,939,330,663	29.94%	3,773,496,036	29.67%
Sovereign bonds	8,755,831,787	66.55%	8,501,341,879	66.83%
Inflation-indexed bonds	461,479,981	3.51%	445,263,240	3.50%
TOTAL	**13,156,642,431**	**100.00%**	**12,720,101,155**	**100.00%**

(*) Includes cash and cash equivalents.

7. CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2011 and 2010:

	2011			
	Contributions (US$)	Withdrawals (US$)	Commissions (US$)	Custodian fees (US$)
January	—	—	—	—
February	—	—	—	49,259
January	—	—	155,285	51,303
April	—	—	—	105,233
May	—	—	—	—
June	—	—	155,285	55,710
July	—	—	—	—
August	—	—	—	113,052
September	—	—	151,594	—
October	—	—	—	—
November	—	—	—	55,970
December	—	—	151,594	114,107
Total	**—**	**—**	**613,758**	**544,634**

	2010			
	Contributions (US$)	Withdrawals (US$)	Commissions (US$)	Custodian fees (US$)
January	—	—	—	52,356
February	—	—	—	49,705
January	—	—	126,600	—
April	—	—	—	—
May	—	—	—	—
June	—	150,000,000	126,600	269,452
July	—	—	—	—
August	1,362,325,392	—	—	44,442
September	—	—	126,600	46,170
October	—	—	—	—
November	—	—	—	49,563
December	—	—	126,600	110,383
Total	**1,362,325,392**	**150,000,000**	**506,400**	**622,071**

8. INTEREST AND ADJUSTMENTS

	2011 (US$)	2010 (US$)
Debt securities carried at fair value through profit or loss	208,345,009	199,919,655

9. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents is as follows:

	2011 (US$)	2010 (US$)
Cash on hand	4,110,279	621,982

10. 10.ESSF RETURN

Type of return	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	(0.82%)	3.41%	2.57%

11. LIENS AND RESTRICTIONS

As of December 31, 2011, the ESSF was not subject to any liens or restrictions on its assets.

12. SECURITIES CUSTODY

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

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

As of December 31, 2010, securities custody was as follows:

	Securities custody					
	National custody			Foreign custody		
Entity	Amount in custody (US$)	% of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody US$)	% of total investments in instruments issued by foreign issuers	% of total Fund assets
Securities depositories	—	—	—	—	—	—
Other entities	—	—	—	12,719,479,173	100%	99.99%
Total investment portfolio in custody	—	—	—	12,719,479,173	100%	99.99%

13. SUBSEQUENT EVENTS

Between January 1, 2012 and the date of issue of these financial statements, there have not been any subsequent events that could materially affect the balances or interpretation of the financial statements.

CHAPTER 12

Financial Statements: Pension Reserve Fund

Financial Statements for the years ended on December 31, 2011 and 2010 and the independent auditors' report[26]

26 The financial statements of the Pension Reserve Fund for the years ended on December 31, 2011 and 2010 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements and of Deloitte's report that were originally prepared and audited in Spanish.

Deloitte.

Deloitte
Auditores y Consultores Limitada
RUT: 80.276.200-3
Av. Providencia 1760
Pisos 6, 7, 8, 9, 13 y 18
Providencia, Santiago
Chile
Fono: (56-2) 729 7000
Fax: (56-2) 374 9177
e-mail: deloittechile@deloitte.com
www.deloitte.cl

INDEPENDENT AUDITORS' REPORT

To the General Treasury of the Republic
Fondo de Reserva de Pensiones

1. We have audited the accompanying statements of financial position of Fondo de Reserva de Pensiones (hereinafter "Pension Reserve Fund") as of December 31, 2011 and 2010, and the related statements of comprehensive income, changes in net equity and cash flows for the years endings December 31, 2011 and 2010. The preparation of these financial statements (including the related notes) are the responsibility of the General Treasury of the Republic. Our responsibility is to express an opinion on these financial statements based on our audits.

2. We conducted our audits in accordance with generally accepted auditing standards in Chile. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Fund's Management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

3. In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of Pension Reserve Fund as of December 31, 2011 and 2010, and the results of its operations, changes in net equity, and its cash flows for the years endings December 31, 2011 and 2010 in conformity with international financial reporting standards.

4. As indicated in Note 1, the Pension Reserve Fund was created to complement the financing of fiscal obligations related to 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.

5. The accompanying financial statements have been translated into English for the convenience of readers outside Chile.

Deloitte.

March 20, 2012

PENSION RESERVE FUND

Statement of Financial Position as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

ASSETS	Notes	2011 (US$)	2010 (US$)
CURRENT ASSETS			
Cash and cash equivalents	9	1,606,281	798,315
FINANCIAL ASSETS AFFECTING INCOME			
Time deposits		751,409,494	811,266,036
Government bonds		2,940,059,925	2,559,904,071
Indexed bonds		154,467,211	134,420,415
Treasury bills		558,051,381	264,347,054
Commercial papers		-	65,963,201
Derivative instruments		1,126	-
Total investments	6	4,403,989,137	3,835,900,777
TOTAL ASSETS		**4,405,595,418**	**3,836,699,092**

NET EQUITY	Notes	2011 (US$)	2010 (US$)
Treasury resources		3,431,926,387	3,094,629,615
Contributions by the Treasury	7	443,323,354	337,296,772
Accumulated results		404,772,705	326,203,412
Income in the year		125,572,972	78,569,293
NET EQUITY		**4,405,595,418**	**3,836,699,092**

The accompany notes are an integral pat of these financial statements.

PENSION RESERVE FUND

Statement of Comprehensive Income for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	2011 (US$)	2010 (US$)
OPERATING INCOME:			
Interest income	8	67,762,795	63,558,259
Income from investments		114,110,826	6,675,467
Net unrealized gains		-	17,397,910
Total net operating income		181,873,621	87,631,636
OPERATING LOSSES:			
Losses from investments		-	(8,655,955)
Net unrealized losses		(55,868,111)	-
Total operating losses		(55,868,111)	(8,655,955)
Net operating income		**126,005,510**	**78,975,681**
MANAGEMENT EXPENSES:			
Fiscal agent's fees	7	(194,742)	(153,600)
Other advisory fees	7	(20,000)	-
Custodian's fees	7	(217,796)	(252,788)
INCOME FOR THE YEAR		**125,572,972**	**78,569,293**

The accompany notes are an integral pat of these financial statements.

PENSION RESERVE FUND

Statement of Changes in Net Equity for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	Treasury resources (US$)	Accumulated results (US$)	Income for the year (US$)	Total (US$)
Opening balance, January 1, 2011		3,431,926,387	326,203,412	78,569,293	3,836,699,092
Distribution of income from previous year		-	78,569,293	(78,569,293)	-
Contributions by the Treasury	7	443,323,354	-	-	443,323,354
Income for the year		-	-	125,572,972	125,572,972
Closing balance, December 31, 2011		**3,875,249,741**	**404,772,705**	**125,572,972**	**4,405,595,418**
Opening balance, January 1, 2010		3,094,629,615	248,836,221	77,367,191	3,420,833,027
Distribution of income from previous year		-	77,367,191	(77,367,191)	-
Contributions by the Treasury	7	337,296,772	-	-	337,296,772
Income for the year		-	-	78,569,293	78,569,293
Closing balance, December 31, 2010		**3,431,926,387**	**326,203,412**	**78,569,293**	**3,836,699,092**

The accompany notes are an integral pat of these financial statements.

PENSION RESERVE FUND

Statement of Cash Flows – Indirect Method for the years ended as of December 31, 2011 and 2010

(Figures in U.S. dollars — US$)

	Notes	2011 (US$)	2010 (US$)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income from the year		125,572,972	78,569,293
Net unrealized losses		55,868,111	(17,397,910)
Changes in fund management and custody		(623,956,471)	(397,855,663)
Net cash flows from operating activities		(442,515,388)	(336,684,280)
CASH FLOWS FROM FINANCING ACTITIVITIES			
Increase from capital contributions	7	443,323,354	337,296,772
Net cash flows from financing activities		443,323,354	337,296,772
NET INCREASE IN CASH AND CASH EQUIVALANTS		**807,966**	**612,492**
CASH AND CASH EQUIVALANTS AT THE BEGINNING OF THE YEAR		**798,315**	**185,823**
CASH AND CASH EQUIVALANTS AT THE END OF THE YEAR	**9**	**1,606,281**	**798,315**

The accompany notes are an integral pat of these financial statements.

1. GENERAL INFORMATION

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

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

a) Decree N° 1,383 of 2006, which authorizes the Central Bank of Chile to act as fiscal agent in managing the Pension Reserve Fund and establishes guidelines for reporting on the investments to the Finance Minister and the General Treasury.

(b) Decree N° 1,382 de 2007, which establishes standards, limits, procedures and controls for investing PRF resources.

(c) Decree N° 1,649 de 2007, which modifies the limits on the fund's investments.

(d) Ministry of Finance Official Letter N° 432 of 2011, which informs the fiscal agent of the new investment guidelines for managing the Pension Reserve Fund.

(e) General Comptroller Official Letter N° 71,390 of 2009, which provides instructions on the fund's valuation criteria.

(f) Decree N° 1,636 of 2010, which regulates the coordination and functioning of advisory activities, management support and auditing of the Public Treasury's financial assets and liabilities, in particular the Pension Reserve Fund.

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

- To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.
- To perform the accounting of the sovereign wealth funds in accordance with internationally recognized accounting standards or their national equivalent, prepare quarterly and annual financial statements for the sovereign wealth funds in accordance with these norms and commission independent auditors for the annual financial statements. The audit firm(s) must be selected and contracted from among the pool of firms that have been authorized to provide their professional services to entities overseen by the Superintendence of Banks and Financial Institutions.
- To support the Ministry of Finance in the preparation of reports on the sovereign wealth funds and the Report on Public Debt Statistics.
- Verify that the nominal investment records of the sovereign wealth fund managers are consistent with the custodians' records.
- Process transactions associated with contributions to and withdrawals from the sovereign wealth funds, transfers between external managers and payments associated with the management of the sovereign wealth funds, as required.
- Contract external managers and custodians for the fund.
- Maintain a current manual of procedures for the handling of all functions and duties described in this Article.
- Carry out any additional forms of management support, coordination or consulting necessary for the performance of these functions.

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

Qualitative characteristics of the PRF financial statements:

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

ii. The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence and the Principle of Full Disclosure, within an internal audit system based fundamentally on the CBC's responsibility, as fiscal agent, to verify the information prepared by the custodian.

iii. The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.

iv. The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

These financial statements were approved by the General Treasury on March 20, 2012.

2. MAIN ACCOUNTING CRITERIA USED

Main accounting standards utilized for elaborating these financial statements are described below. These principles have been utilized systematically in each presented period unless otherwise indicated.

a.Basis of preparation and presentation of the financial statements

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

Additionally, the fund opted for the early application of IFRS 9: Financial Instruments (issued in November 2009 and modified in October 2010), with the initial application dating to January 1, 2009. IFRS 9 introduces new requirements for classifying and measuring financial assets under the scope of IAS 39: Financial Instruments. Specifically, IFRS 9 requires that all financial assets be classified and later measured either at amortized cost or fair value based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

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

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

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

The statements are presented in U.S. dollars and have been prepared on the basis of information on the sovereign wealth funds that the custodian, J.P. Morgan, provided to the CBC, as fiscal agent.

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

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

b. Period covered

The financial statements cover the years between 1 January and December 31, 2011 and 2010.

c. Functional and presentation currency

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

The figures are presented in U.S. dollars. Contributions to the PRF have been made in dollars, and investments have primarily been made in U.S. dollars.

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

d. Investment classification and valuation

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

Financial assets and liabilities:

Classification:

The fund classifies investments in debt instruments, capitalization instruments and financial derivative instruments as financial assets at fair value through profit or loss.

Financial assets at net fair value through profit or loss:

A financial asset is classified at fair value through profit or loss if it is acquired principally for trading (short-term sale or repurchase) or is part of a portfolio of identified financial investments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Derivatives are also classified at fair value through profit or loss. The fund has adopted the policy of not using hedge accounting.

These overseas financial investments are recognized, valued and classified in accordance with international financial reporting standards, as follows:

Government bonds, indexed bonds, agency bullet bonds, Treasury bills, commercial papers and derivative instruments. The basis for classifying securities in this investment category is that they have a reasonably active secondary market, under normal conditions. They are recorded at fair value, and any changes in value are recognized directly through profit or loss on the comprehensive income statement.

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

Financial assets at amortized cost:

Financial assets at amortized cost are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the fund manager intends to hold to maturity so as to receive interest, adjustment and exchange rate income in accordance with the contractual terms of the instrument.

Financial liabilities:

Financial liabilities at amortized cost will be classified like other liabilities.

Recognition, reduction and measurement:

The regular purchase and sale of investments is recognized on the date of the transaction, the date the fund commits to buying or selling the investment. Financial assets and financial liabilities are initially recognized at fair value. Transaction costs are charged to expenses on the income statement when they are incurred in the case of financial assets and liabilities at fair value through profit or loss, and they are recorded as part of the initial value of the instrument in the case of assets at amortized cost and other liabilities.

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

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

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

Dividend income from financial assets at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Dividend income” when the fund’s right to receive the payment has been established. Interest on debt securities at fair value through profit or loss is recognized on the Statement of Comprehensive Income under the item “Interest and adjustments” based on the effective interest rate.

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

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

Estimation of fair value:

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

The hierarchy of fair value is as follows:

(a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

(b) Variables other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, price derivatives) (Level 2); and

(c) Variables used for the asset or liability that are not based on observable market data (unobservable variables) (Level 3).

e. Cash

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

f. Funds under management

These are securities delivered to the CBC, acting as fiscal agent for the management of PRF resources. The securities can be totally or partially employed for the assigned objectives.

g. Funds in custody

These are securities delivered by the CBC, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for Fund securities and instruments.

h. Net equity

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

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

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

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

(b) The proceeds from the return on the PRF's investments; and

(c) Other contributions established by law.

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

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

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

i. Statement of Cash Flows

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

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

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

j. Net or offset presentation of financial instruments

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

k. New accounting rules

The following new rules and interpretations have been adopted in these financial statements:

IFRS amendments	Compulsory application date
IAS 24: Related party disclosures	Annual periods beginning on or after January 1, 2011.
IAS 32: Financial instruments: presentation. Classification of rights issues	Annual periods beginning on or after February 1, 2010.
Improvements to IFRSs, May 2010. A set of amendments to seven International Financial Reporting Standards	Annual periods beginning on or after January 1, 2011.

New interpretations	Compulsory application date
IFRIC 19: Extinguishing financial liabilities with equity instruments	Annual periods beginning on or after July 1, 2010.

Amendments to interpretations	Compulsory application date
IFRIC 14: The limit on a defined benefit asset, minimum funding requirements and their interaction	Annual periods beginning on or after January 1, 2011.

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

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

New IFRSs	Compulsory application date
IFRS 10: Consolidated Financial Statements	Annual periods beginning on or after January 1, 2013.
IFRS 11: Joint arrangements	Annual periods beginning on or after January 1, 2013.
IFRS 12: Disclosure of interests in other entities	Annual periods beginning on or after January 1, 2013.
IAS 27 (2011: Separate financial statements	Annual periods beginning on or after January 1, 2013.
IAS 28 (2011): Investments in associates and joint ventures	Annual periods beginning on or after January 1, 2013.
IFRS 13: Fair value measurement	Annual periods beginning on or after January 1, 2013.

Amendments to IFRSs	Compulsory application date
IAS 1: Presentation of financial statements: Presentation of items of other comprehensive income	Annual periods beginning on or after July 1, 2012
IAS 12: Deferred tax: recovery of underlying assets	Annual periods beginning on or after January 1, 2012
IAS 19: Employee benefits (2011)	Annual periods beginning on or after January 1, 2013
IAS 32: Financial instruments: Presentation. Clarification of the requirements for offsetting financial assets and financial liabilities	Annual periods beginning on or after January 1, 2014

IFRS 1 (Revised): First-time adoption of International Financial Reporting Standards. (i) Removal of fixed dates for first-time adopters; (ii) Severe hyperinflation	Annual periods beginning on or after July 1, 2011.
IFRS 7: Financial instruments: disclosures. (i) Disclosures—transfers of financial assets (ii) Amendments to Disclosures—offsetting financial assets and financial liabilities	Annual periods beginning on or after July 1, 2011 (for transfers of financial assets) Annual period beginning on or after January 1, 2013 (for amendments to disclosures of offsetting)

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

3. PRF INVESTMENT POLICY

The guidelines and parameters for managing the investment portfolio were given to the fiscal agent by the Ministry of Finance through Ordinary Official Letter N°432 dated April 12, 2011. They can be outlined as follows:

a) **Asset classes:**

The fiscal resources in the investment portfolio are invested in three asset classes: (1) money market; (2) nominal sovereign bonds; and (3) inflation-indexed sovereign bonds. The asset class benchmark breaks down as follows:

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

b) **Currency allocation and deviation from the benchmark.**

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

- **Primary currencies:**
  - U.S. dollars (USD)
  - Euros (EUR)
  - Japanese yen (JPY)

- **The investment portfolio must maintain the following currency allocation:**

Currency	Mid-point	Deviation range
USD	50%	48% – 52%
EUR	40%	38% – 42%
JPY	10%	8% – 12%

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

c) **Credit risk:**

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

- **Eligible issuers**

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

IP: Investment portfolio

- **Sovereign risk**

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

- Selection requirements: The countries eligible for selection are the United States of America, Germany and Japan. Investment in sovereign risk must abide by the following allocation by eligible country.
- Limit allocation: Investment limits on eligible sovereign risk (between AAA and A–) are as follows:

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

d) **Other risks:**

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

- **Selection requirements:**
  i. Credit ratings on long-term instruments must be A– or higher from at least two of the international risk rating agencies (Fitch, Moody’s and Standard & Poor’s).
  ii. Minimum equity must be equivalent to US$1,000 million for banking institutions.

- **Limit allocation by issue:**

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

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

e) Eligible foreign currency operations:

- Foreign currency spot contracts
- Foreign currency forwards

f) Limits or specific rules for instruments and operations:

- Inflation-indexed instruments: total indexed bonds cannot be less than 2.5% or more than 4.5% of the investment portfolio.
- Currency forward or swap operations: The following guidelines have been established for the use of currency hedging mechanisms involving foreign currency forward or swap operations:
  i. Forward or swap contracts can only be written or held between eligible currencies.
  ii. Foreign currency forward or swap contracts can only be held with eligible counterparties that have a risk rating of AA– or higher from at least two of the international risk rating agencies (Fitch, Moody's and Standard & Poor's).
  iii. Foreign currency forward or swap contracts can specify either cash delivery or net settlement.
  iv. The counterparty risk associated with each cash delivery contract will equal 100% of the notional value of the forward or swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The terms of these contracts will not exceed 90 days. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3, letter c).
  v. The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their equivalent in U.S. dollars. The counterparty risk will track the exchange rate between the US$ and the main currency of the corresponding forward or swap throughout the life of the contract. The associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3, letter c).

     In the case of net settlement contracts without a close-out netting clause, counterparty risk will be treated the same as in cash delivery contracts.

  vi. The notional amount of open forward or swap contracts will not exceed a sum total of 5 % of the investment portfolio.

- Intermediaries: Investments can only be made in countries that are eligible for sovereign risk investments through the following broker/dealers:
  i. Entities that can operate in the primary market; that is, that are classified as primary dealers in the United States of America, the United Kingdom and France.

ii. Banks that are eligible for investment can directly provide broker services; their subsidiaries can also provide direct services, under the condition that the corresponding parent bank has at least a 90% ownership share.
iii. Investment banks that have the same long-term risk rating required for banks that are eligible for investment; or their subsidiaries, provided that one or more investment banks account for at least a 90% ownership share of the subsidiary.

- Additional restriction: The PRF cannot be invested in financial instruments from Chilean issuers or in instruments that are expressed or paid in pesos.

- Valuation criteria: The valuation of the investment portfolio that must be reported to the Ministry of Finance is that which is prepared by the custodian(s) using mark-to-market accounting, based on their own pricing sources. At the same time, for internal accounting purposes and other grounds related to the Fiscal Agency Decree, the CBC can employ the same methodology that it uses for its own international reserve operations.

- Securities lending program: The fiscal agent can enter into agreements with custodian(s) to manage the PRF securities lending programs (henceforth "the programs" or "securities lending"), provided that the custodians in question (henceforth "program managers") agree to comply with the operating criteria established in the Custodian Guidelines, including in particular the obligation to return the respective securities or, in the absence thereof, the corresponding market value.

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

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

4.1 Critical accounting estimates:

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

Fair value of instruments that are not quoted on an active market or traded on the stock market:

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

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

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

4.2 Critical judgments for applying accounting policies:

Functional currency:

Management considers the U.S. dollar to be the currency that most faithfully represents the economic effect of transactions, events and underlying conditions. The U.S. dollar is the currency in which the PRF measures performance and reports earnings, as well as the currency in which it receives contributions from the Chilean government.

5. FINANCIAL RISK MANAGEMENT

The sovereign wealth funds are exposed to various types of risk as a result of their investment in different financial instruments, including market risk, credit risk, liquidity risk, active management risk and operational risk. To limit exposure to these different risks, the Ministry of Finance includes investment restrictions in its investment guidelines, which must be followed by the Central Bank of Chile (CBC) in carrying out its operations. Compliance is monitored by an independent area within the CBC, by the custodian and, ultimately, by the Finance Ministry. In addition, the institutional framework and infrastructure of the CBC provide adequate controls for mitigating operational risk.

5.1 Market risk:

The market value of financial instruments can be exposed to losses as a result of changes in market conditions. In the specific case of international fixed-income investors, the financial variables with the biggest impact on the prices of the instruments in their portfolios are interest rates and exchange rates.

Interest rate risk:

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

The sovereign wealth funds are subject to a benchmark duration that is calculated on the basis of the indexes that make up the benchmark portfolio. The investment guidelines stipulate that the effective duration of the funds cannot exceed the benchmark duration by more than 5 months. The CBC complied with this restriction throughout the year, and on December 31, 2010, the difference between the benchmark duration and the effective duration was less than one month.

Exchange rate risk:

Because the PRF's return is measured in dollars while the portfolio includes investments denominated in euros and yens, the value of investments is also affected by exchange rate fluctuations. For example, the value in dollars of a sovereign bond issued in euros is affected by the USD/EUR exchange rate trend. An appreciation (depreciation) of the dollar thus generates additional losses (gains) over and above the effect of interest rate movements. The fund's exchange rate exposure, measured in dollars, is 50%, and it derives from investments in euros (40%) and yens (10%).

5.2 Credit risk:

The issuer of a fixed-income instrument can default if prevented from meeting its obligations by a lack of liquidity or capital. As a result, the credit risk to which a fund is exposed increases with the probability of default by an institution or government whose securities it holds. Moreover, changes in market perception about the solvency of an issuer can cause the market value of instruments issued by that entity to drop. Exposure to this type of risk is controlled through minimum risk ratings and limits on the maximum amount and degree of concentration by asset class and/or institution.

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

5.3 Liquidity risk:

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

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

5.4 Active management risk:

Depending on their characteristics, objectives and specialization, portfolio managers can manage investments either actively or passively. Under a passive strategy, the manager invests in instruments that are very similar to the benchmark securities in order to achieve a similar performance in terms of risks and returns. In contrast, an active manager takes positions in different instruments in order to generate higher returns than the benchmark, which will be reflected, for example, in the portfolio duration or currency composition. These positions add another source of risk that is not present under passive management, known as active risk.

5.5 Operational risk:

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

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

5.6 Volatility and other indicators:

One of the indicators typically used to measure portfolio risk is the volatility of returns, calculated as their standard deviation. In 2010 the annual volatility of the ESSF and PRF returns was 6.1%, versus 6.5% for both funds if measured from March 31, 2007 (table 16). Exchange rate fluctuations (6.5%) were the main cause of fund volatility in 2010.

6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US$4,403,989,137 on December 31, 2011 and 3,835,900,777 on December 31, 2010.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2011 (US$)	2010 (US$)
Government bonds	1	2,940,059,925	2,559,904,071
Indexed bonds	1	154,467,211	134,420,415
Treasury bills	2	558,051,381	264,347,054
Commercial papers	2	-	65,963,201
Other investments in derivative instruments	2	1,126	-
Total investments		**3,652,579,643**	**3,024,634,741**

Custodian investments, Central Bank of Chile	Fair value hierarchy level	2011 (US$)	2010 (US$)
Time deposits	2	751,409,494	811,266,036

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

	Fair value instruments, J.P. Morgan			
Currency of origin	2011		2010	
	US$	% of IP	US$	% of IP
U.S. Dollar	1,839,116,779	50.35%	1,516,828,626	50.15%
Euro	1,435,188,826	39.29%	1,210,907,011	40.03%
Yen	378,274,038	10.36%	296,899,104	9.82%
Total	**3,652,579,643**	**100.00%**	**3,024,634,741**	**100.00%**

	Fair value instruments, Central Bank of Chile			
Currency of origin	2011		2010	
	US$	% of IP	US$	% of IP
U.S. Dollar	357,085,949	47.52%	371,877,179	45.84%
Euro	327,242,801	43.55%	342,524,285	42.22%
Yen	67,080,744	8.93%	96,864,572	11.94%
Total	**751,409,494**	**100.00%**	**811,266,036**	**100.00%**

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

	2011		2010	
Risk segment	Market value (US$)	Market value (%)	Market value (US$)	Market value (%)
Bank (*)	753,015,775	17.09%	812,064,351	21.17%
Sovereign	3,652,579,643	82.91%	3,024,634,741	78.83%
Total	**4,405,595,418**	**100.00%**	**3,836,699,092**	**100.00%**

	2011		2010	
Asset class	**Market value (US$)**	**Market value (%)**	**Market value (US$)**	**Market value (%)**
Money market (*)	1,311,068,282	29.76%	1,142,374,606	29.77%
Sovereign bonds	2,940,059,925	66.73%	2,559,904,071	66.73%
Inflation-indexed bonds	154,467,211	3.51%	134,420,415	3.50%
TOTAL	**4,405,595,418**	**100.00%**	**3,836,699,092**	**100.00%**

(*) Includes cash and cash equivalents.

7. CONSTITUTION OF THE FUND

The fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2011 and 2010:

	2011				
	Contributions (US$)	**Withdrawals (US$)**	**Commissions (US$)**	**Advisory fees (US$)**	**Custodian fees (US$)**
January	—	—	—	—	—
February	—	—	—	—	18,888
March	—	—	46,840	—	19,423
April	—	—	—	—	40,618
May	—	—	—	—	—
June	443,323,354	—	46,840	—	21,759
July	—	—	—	20,000	—
August	—	—	—	—	45,206
September	—	—	50,531	—	—
October	—	—	—	—	—
November	—	—	—	—	23,868
December	—	—	50,531	—	48,034
Total	**443,323,354**	**—**	**194,742**	**20,000**	**217,796**

	2010			
	Contributions (US$)	**Withdrawals (US$)**	**Commissions (US$)**	**Custodian fees (US$)**
January	—	—	—	17,709
February	—	—	—	18,158
March	—	—	38,400	—
April	—	—	—	—
May	—	—	—	—
June	337,296,772	—	38,400	112,242
July	—	—	—	—
August	—	—	—	19,129
September	—	—	38,400	20,063
October	—	—	—	—
November	—	—	—	18,807
December	—	—	38,400	46,680
Total	**337,296,772**	**—**	**153,600**	**252,788**

8. INTEREST AND ADJUSTMENTS

	2011 (US$)	2010 (US$)
Debt securities carried at fair value through profit or loss	67,762,795	63,558,259
Total	**67,762,795**	**63,558,259**

9. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents is as follows:

	2011 (US$)	2010 (US$)
Cash on hand	1,606,281	798,315

10. PRF RETURN

Type of return	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	(0.83%)	3.41%	2.50%

11. LIENS AND RESTRICTIONS

As of December 31, 2011, the fund was not subject to any liens or restrictions on its assets.

12. SECURITIES CUSTODY

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

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

As of December 31, 2010, securities custody was as follows:

Entity	Securities custody					
	National custody			Foreign custody		
	Amount in custody (US$)	% of total investments in instruments issued by national issuers	% of total Fund assets	Amount in custody (US$)	% of total investments in instruments issued by foreign issuers	% of total Fund assets
Securities depositories	—	—	—	—	—	—
Other entities	—	—	—	3,835,900,777	100%	99.98%
Total investment portfolio in custody	—	—	—	3,835,900,777	100%	99.98%

13. RELEVANT EVENTS

On November 18, 2011, the Finance Ministry issued new Investment Guidelines for the management of the resources pertaining to the Pension Reserve Fund (PRF), as outlined in Ordinary Official Letter N°1.637 to the Central Bank of Chile, acting as fiscal agent as authorized under Finance Ministry Decree N° 1.383 of 2006, and in terms of Articles 5 and 6 of that decree. These guidelines, which replace the previous investment guidelines, will enter into effect on January 2, 2012.

14. SUBSEQUENT EVENTS

Between January 1, 2012 and the date of issue of these financial statements, there have not been any subsequent events that could materially affect the balances or interpretation of the financial statements.

Active management — an investment strategy aimed at earning higher returns than a benchmark index.

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, 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%.

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

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.

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.

Exchange traded funds (ETFs) — financial instruments traded on the stock exchange, which typically replicate a market index. They have traditionally been used to obtain passive exposure to stock indexes, but their use has been expanding into fixed-income instruments, commodities and even active strategies.

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.

Inflation-indexed bond — a bond that is adjusted based on a specified inflation index. In the case of the United States, they 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.

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

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

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.

Portfolio — a collection of investment instruments held by an individual or an institutional investor.

Recognition bond (bonos de reconocimiento) —a bond issued by the 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 from exchange rate movements — the share of the return deriving from fluctuations in the exchange rate between the dollar and the other currencies in which investments are made.

Return in currency of origin — 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.

R**isk** — the possibility of suffering financial losses; the variability of an investment's return.

Risk rating — the degree of solvency of the issuer of a financial instrument (a company or country), as defined by a risk rating institution.

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.

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

Stock — an instrument that represents ownership or capital in a corporation or company. Buyers of these securities become owners or shareholders and thus share in the firm's earnings and losses.

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 currency of origin and the return from exchange rate movements.

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.

ABBREVIATIONS

bp	Basis points
CBC	Central Bank of Chile
CBJ	Central Bank of Japan
CDS	Credit default swaps
ECB	European Central Bank
ESSF	Economic and Social Stabilization Fund
EUR	Euro
FC	Financial Committee
Fed	U.S. Federal Reserve
GDP	Gross domestic product
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRR	Internal rate of return
JPM	J.P. Morgan
JPY	Japanese yen
LIBID	London interbank bid rate
LIBOR	London interbank offered rate
MBS	Mortgage-backed securities
M US$	Thousands of U.S. dollars
MM US$	Millions of U.S. dollars
PRF	Pension Reserve Fund
TE	Tracking error
TWR	Time-weighted rate of return
U.S.	United States of America
UF	Unidad de Fomento (an inflation-indexed unit of account)
US$	U.S. dollar
USD	U.S. dollar
VaR	Value at risk

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