

ANNUAL REPORT SOVEREIGN WEALTH FUNDS

• MINISTRY OF FINANCE •

2014



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1. FOREWORD BY THE MINISTER

During the first administration of President Michelle Bachelet, we made important steps forward in strengthening fiscal policy in Chile. The Fiscal Responsibility Law was passed in 2006, legally formalizing the structural balance rule as the guiding principle for fiscal policy. This rule has been the cornerstone of fiscal policy since 2001. It is one of the legacies of the Concertación's governments, providing a safeguard for economic and social stability in the long term.

The Fiscal Responsibility Law established the creation of two sovereign wealth funds: the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF). The objective of the former is to accumulate resources during economic booms and/or periods of high copper prices, in order to finance fiscal spending during recessions and/or periods of low copper prices. The objective of the latter fund is to ensure the sustainable financing of future pension expenditures deriving from the solidarity pillar.

The funds have nearly recovered their pre-crisis level of 2009, following withdrawals of over US\$ 9,000 million that year to mitigate the negative impact of the international crisis on the Chilean economy. Thus, at year-end 2014, the two funds together totaled US\$ 22,633 million, of which US\$ 14,689 million was in the Economic and Social Stabilization Fund and US\$ 7,944 million in the Pension Reserve Fund. Our solid funds' investment policies have led to the accumulation of additional resources of US\$ 3,853 million (net of management costs) since the establishment of the sovereign wealth funds.

During this second administration of President Michelle Bachelet, the Government has committed to continuing to strengthen the nation's fiscal position and institutional structure. This is by no means an easy task, given that it implies balancing Government revenues and expenses under a long-term perspective, in order to ensure the sustainability of the fiscal programs.

With regard to the sovereign wealth funds, the Ministry of Finance has decided to review the PRF investment policy, to verify that it is consistent with the fund's objective of complementing the financing of fiscal liabilities stemming from the 2008 Pension Reform.

In terms of the ESSF, in 2015 the Central Bank of Chile was given more flexibility to endure the international investment climate and, in particular, to minimize the effect of low (even negative) interest rates in some of the countries where the fixed-income portfolio is invested.

The fiscal soundness of Chile was recognized by the financial markets in 2014. The credit rating agencies maintained their ratings on government bonds issued by the Republic of Chile, while their reports highlighted the strength of the fiscal accounts. Institutional investors reaffirmed their confidence in our economy through the high demand for placements in overseas markets in late 2014, where we obtained the lowest rate among emerging countries.

The solid performance of the sovereign wealth funds continues to receive international recognition. In the “Santiago Compliance Assessment” published by GeoEconomica in September 2014, our sovereign wealth funds received the maximum rating for compliance with the Santiago Principles. These principles, which were established by the world’s main sovereign wealth funds in Santiago, Chile, in 2008, describe best practices for sovereign wealth fund management and transparency. Moreover, Chile has held the top position in the Linaburg-Maduell transparency index of the Sovereign Wealth Fund Institute since the third quarter of 2009. This is not a coincidence, but rather reflects the ongoing conscientious work and commitment of the different governments that have been involved in managing the sovereign wealth funds.

Today, the nation’s fiscal policy and the maintenance of the sovereign wealth funds have broad support among the different political sectors in Chile, which has given credibility of our responsible handling of public finances to both citizens and investors. We are committed to continuing to contribute in this area in order to guarantee a stable economy, which serves as a foundation for building a more equitable society and a stronger solidarity for all Chileans.

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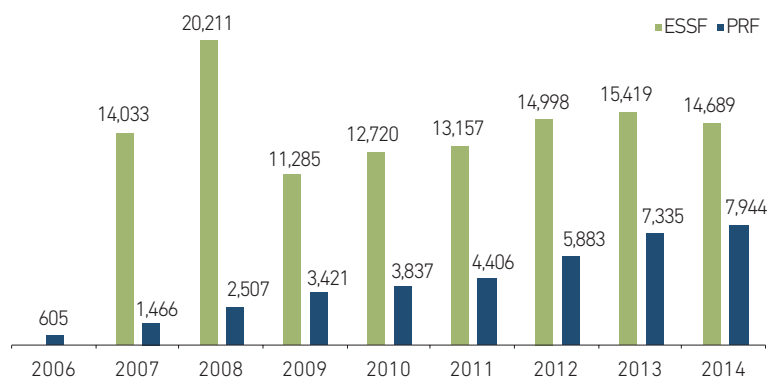
Rodrigo Valdés Pulido
MINISTER OF FINANCE

2. SUMMARY

As of 31 December 2014, the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) together had a market value of US\$ 22,633 million. The net returns in dollars were –1.67% and 1.75%, respectively, in 2014 and 2.82% and 4.04% since their inception¹.

Figure 1: Market value

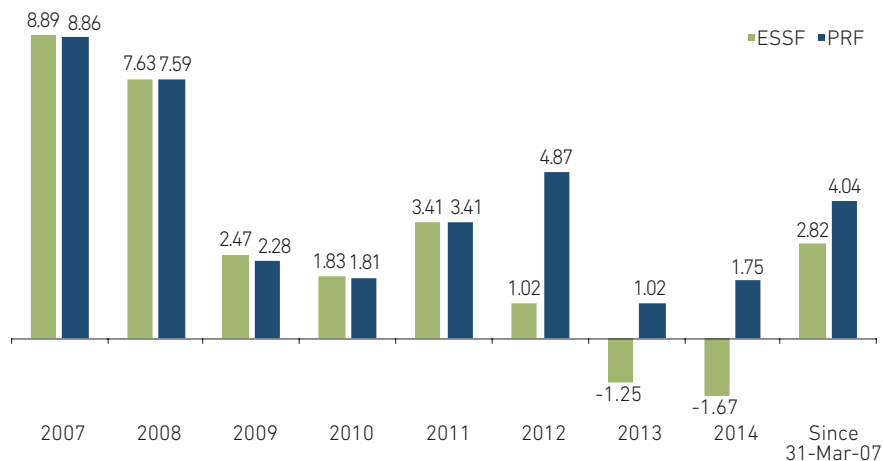
(millions of dollars)



Source: Ministry of Finance

Figure 2: Net return in dollars²

(percent)

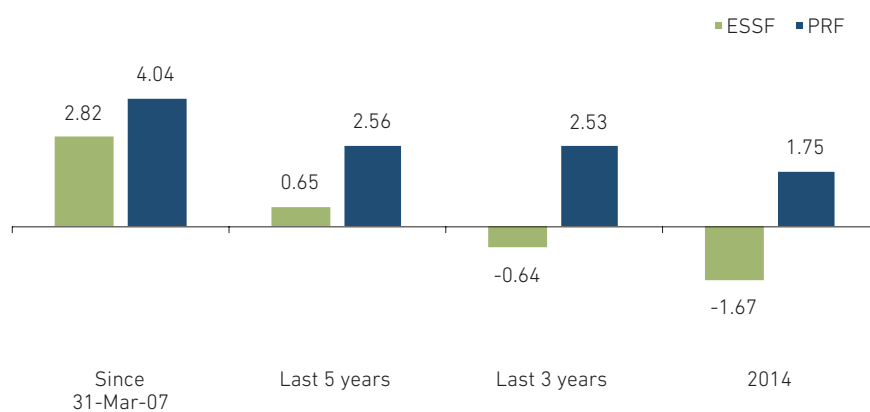


Source: Ministry of Finance

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

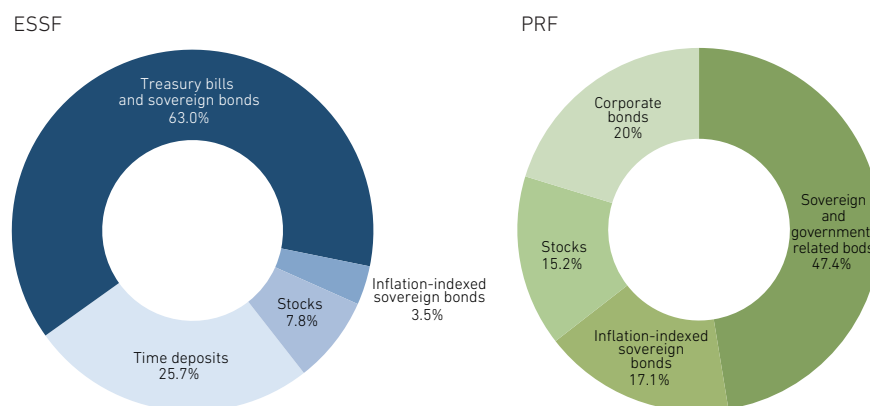
² The use of the TWR methodology to measure returns dates to 31 March 2007.

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



Source: Ministry of Finance

Figure 4: Asset class allocation as of 31 December 2014
(percent of portfolio)



Source: Ministry of Finance

Sovereign Wealth Funds

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

Box 1: The structural balance rule

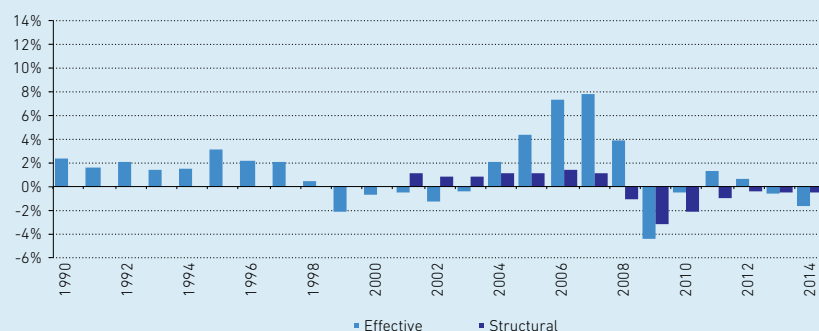
Chile implemented a structural balance rule in 2001 with the objective of establishing an annual fiscal spending level consistent with the central Government's structural income. Through this rule, fiscal spending is detached from the cyclical fluctuations of economic activity and the price of copper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

Initially, the structural balance rule depended on the political will of the Government in power, but after several years of application, it was formalized in the legislation. Thus, Law N°20,128 on Fiscal Responsibility was passed in the second half of 2006, requiring each Presidential Administration to announce its objective for the structural balance rule in its first year. The law further established the regulations and institutional framework for the accumulation, management and operation of fiscal savings. It created the PRF and authorized the President of the Republic to create the ESSF, which was officially founded in February 2007.

The structural balance target has changed over time. The target was initially set at 1% of GDP in 2001. The 2008 budget reduced it to 0.5% of GDP, because substantial resources were being accumulated in the sovereign wealth funds.¹ In 2009, the ex-ante target was reduced to 0% to face the crisis that was then in full swing, although the structural deficit in 2009 was ultimately 3.1% of GDP. From 2010 to 2014, the Government proposed reducing the structural deficit so as to converge to 1% of GDP in 2014. That year, the structural deficit ended at 0.5% of GDP. The current Government has announced that the structural deficit will gradually be adjusted to converge to 0% of GDP in 2018 (see figure B1).

Figure B1: Evolution of the effective and structural fiscal balance

(percent of GDP)



Source: Ministry of Finance

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

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 low copper prices. 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 of 2008.

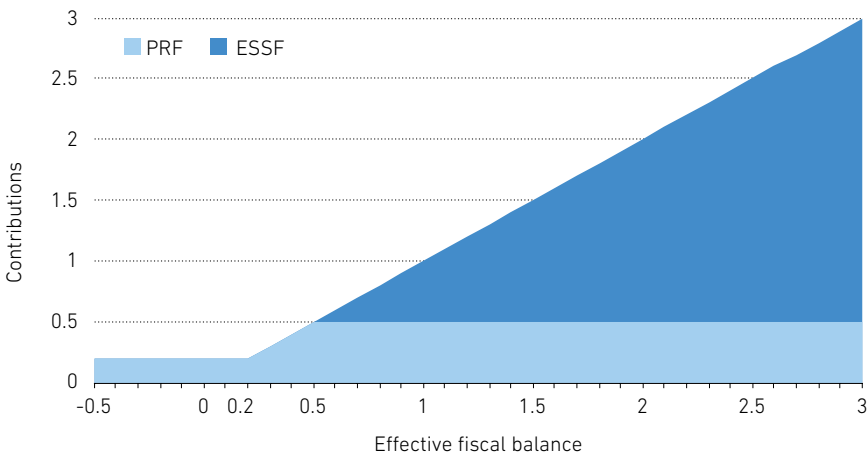
3.2 RULES ON CONTRIBUTIONS AND WITHDRAWALS

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

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

In the case of the ESSF, the fund must receive any positive balance remaining after subtracting the PRF contributions from the effective surplus, less the amortization of public debt and estimated contributions that were made in advance the previous year³ (see figure 5).

Figure 5: Fund contribution rules
(percent of GDP)



Source: Ministry of Finance

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

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

The PRF resources can only be used in accordance with the objectives cited earlier; that is, for the payment of pension and welfare system liabilities. Through 2016, annual withdrawals from the PRF must not exceed the fund's returns in the previous year⁴. Starting in 2016, annual withdrawals will be capped at an amount equal to a third of the difference between the pension liabilities expense in the respective year and the inflation-adjusted pension liabilities expense in 2008. After September 2021, the PRF will cease to exist if the withdrawals in a calendar year do not exceed 5% of the total expenditures associated with the state guarantee for old-age and disability basic solidarity pension benefits and old-age and disability solidarity pension contributions as established in the budget for that year.

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

4 As of the date of publication of this report, no withdrawals have been made from the fund.

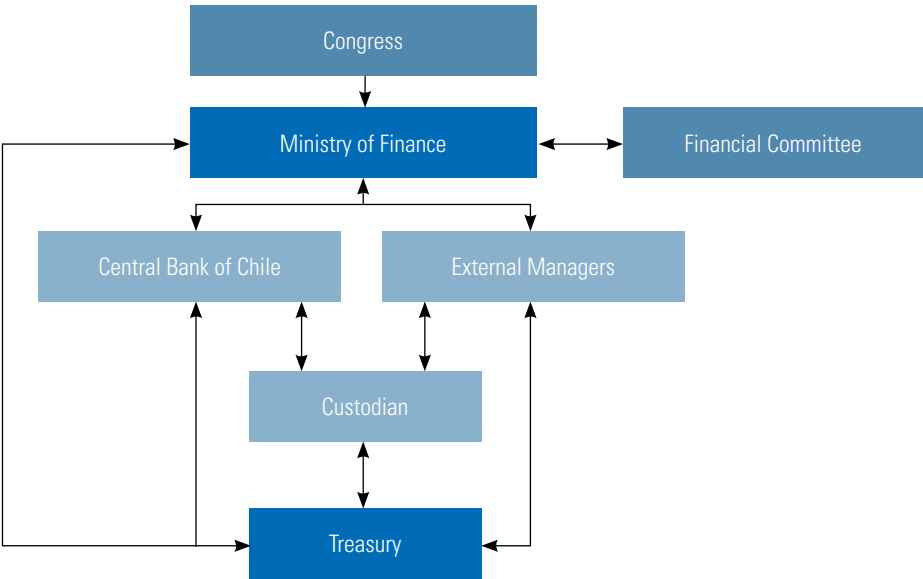
Institutional Framework

The institutional framework of the sovereign wealth funds is designed to facilitate decision making, performance execution, risk monitoring and investment policy oversight. This provides an adequate separation of roles and responsibilities, which allows for accountability and operational independence in fund management.

The institutional basis of the funds is established in the Fiscal Responsibility Law (see diagram 1). Article 12 of that law establishes the institutional framework for managing the investment of fiscal resources, authorizing the Finance Minister to define whether this is done directly through the General Treasury of Chile (GTC), through the Central Bank of Chile (CBC) or through contracted external managers. Executive Decree N° 1,383, issued by the Ministry of Finance in 2006, appoints the CBC to oversee the management of the resources in both funds and to act as fiscal agent, following approval by the CBC Board; and also establishes the general framework for managing the resources in question. At the request of the CBC, Executive Decree N° 1,618 of 2012 modified the general framework so that, as of 1 January 2014, the management of the corporate fixed-income and equity portfolios of the ESSF and PRF would be transferred from the CBC to external managers⁵.

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 Law⁶.

Diagram 1: Institutional framework of the sovereign wealth funds



Source: Ministry of Finance

5 Decree 1,383 of 2006 was published in the Official Gazette on 17 February 2007. Decree N° 1,618 of 2012 was published on 18 April 2013.

6 Published in the Official Gazette on 11 August 2007.

4.1 MINISTRY OF FINANCE AND DEPENDENT BODIES

The Fiscal Responsibility Law establishes that the funds are the property of the Fisco of Chile and that the GTC holds the legal title to the resources. The law authorizes the Finance Minister to make decisions on investing and managing the resources in the sovereign wealth funds, and it grants the Minister the authority to decide whether the operational management of the investment of the funds will be carried out directly through the GTC or delegated to the CBC or other external managers. This law also expressly authorizes the Finance Minister to determine the investment policy of the resources in the two funds.

In March 2007, the Finance Minister appointed the CBC to oversee the tasks of managing the ESSF and the PRF, in the role of fiscal agent, based on its reputation and experience in handling international reserves. At the same time, the Minister issued guidelines governing the CBC's management of the investment of the funds.

In addition, the Finance Minister created the Sovereign Wealth Funds Unit within the Ministry to perform support activities related to the investment of the funds. The functions carried out by this Unit include monitoring the performance of the fund managers, acting as Technical Secretary to the Financial Committee and preparing the monthly, quarterly and annual reports on the state of the sovereign wealth funds for submission to the National Congress and the general public.

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

As of 1 January 2014, the Ministry and the GTC are responsible for the contractual relationship with the external managers and for monitoring their performance, as well as other tasks associated with the external corporate fixed-income and equity portfolios⁷. These external managers were previously contracted by the CBC, which supervised their performance through year-end 2013.

4.2 CENTRAL BANK OF CHILE

The functions of the CBC in the management of the Chilean sovereign wealth funds were established by Executive Decree N° 1,383, issued by the Ministry of Finance in 2006. As described above, Decree N° 1,618 of 2012 modified the general framework in order to transfer the management of the corporate fixed-income and equity portfolios, which were previously managed by the CBC, acting in representation of the Fisco, to external companies. In accordance with these decrees, the CBC can perform the following functions in relation to the sovereign wealth funds at the request of the Finance Minister:

1. To manage portfolios that include instruments that are eligible for the international reserves or other fixed-income instruments acceptable for CBC investments.⁸
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 Fisco. As of 1 January 2014, the CBC can, at the request of the Ministry, carry out tenders for the selection of external managers of portfolios that are not under the management of the CBC (corporate bonds and stocks).

⁷ For more information on the responsibilities that were transferred from the CBC to the Ministry of Finance and the GTC on 1 January 2014, see the 2013 Sovereign Wealth Fund Annual Report, available online at www.hacienda.cl/english/sovereign-wealth-funds/annual-report.html.

⁸ In accordance with this criterion and as stipulated in Decree N° 1,618, as of 1 January 2014 the CBC does not manage corporate fixed-income and equity portfolios.

3. To open separate current accounts in the course of performing its role as fiscal agent.
4. To maintain a register of transactions and other operations carried out in the management of the fiscal resources and, as of 1 January 2014, to reconcile the nominal daily positions of the portfolios that are not under its management.
5. To contract the services of a custodian institution and to manage that contract.
6. To supervise and evaluate the performance of appointed external managers and custodian institutions.⁹
7. To report daily on investment positions, prepare monthly, quarterly and annual reports on the management of the portfolios, and to prepare an annual report on the services provided by the custodian institution(s).
8. To make payments as needed in the performance of its role as fiscal agent. As of 1 January 2014, the CBC processes the payments to external corporate bond and stock managers, with prior authorization by the GTC.

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

On the instruction of the Ministry of Finance, the CBC 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 Ministry of Finance and GTC personnel.¹⁰

4.3 EXTERNAL PORTFOLIO MANAGERS

The external portfolio managers are entities specialized in portfolio investment that have been contracted to invest the ESSF and PRF equity portfolios and the PRF corporate fixed-income portfolio. These managers were initially contracted by the CBC in 2011 for the PRF, in accordance with the Bank's express authority to delegate the management of portfolios of instruments that were not eligible for the investment of international reserves. Following a careful selection process, the CBC contracted BlackRock Institutional Trust Company N.A. (BlackRock), Mellon Capital Management Corporation (Mellon) and Rogge Global Partners PLC (Rogge) to manage the investment of 35% of the PRF portfolio starting in January 2012. In 2013, the CBC contracted two of the same firms, BlackRock and Mellon, to manage the ESSF equity portfolio, following instructions from the Ministry of Finance.¹¹ As mentioned earlier, starting on 1 January 2014, monitoring the performance of the external managers is the responsibility of the Ministry and the GTC.

Like the CBC, the external managers must comply with the investment guidelines defined by the Ministry of Finance.

9 The CBC can contract external managers to manage part of its portfolio, in which case the CBC will be responsible for their supervision and monitoring.

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

11 The Finance Minister decided to contract the same firms as for the PRF, given that the equity mandates for the ESSF and the PRF are identical.

4.4 FINANCIAL COMMITTEE

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

The makeup of the Committee changed in 2014, with three of the six members leaving over the course of the year. Since September 2014, the acting members are José De Gregorio (Chairman), Cristián Eyzaguirre Johnston (Vice Chairman), Jaime Casassus, Martín Costabal Llona, Igal Magendzo Weinberger and Eduardo Walker Hitschfeld. The members who left the Committee were Arturo Cifuentes, Eric Parrado and Rodrigo Valdés.

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

- To advise the Finance Minister, when requested, on the long-term investment policy of the sovereign wealth funds, including the selection of asset classes, benchmarks, the acceptable range of deviation, eligible investments and the inclusion of new investment alternatives;
- To make recommendations to the Finance Minister regarding specific instructions on investment and custody, tender processes, the selection of fund managers and the structure and content of reports;
- To provide an assessment, when requested by the Finance Minister, of the structure and content of the reports submitted to the Ministry of Finance by the agencies entrusted with the management and custody of the funds and to express an opinion on the quality of management and compliance with established investment policies;
- To provide an assessment of the structure and content of the quarterly reports prepared by the Ministry of Finance; and
- To advise the Finance Minister, when requested, on all matters relating to the investment of the funds.

For more information on the Finance Committee's activities in 2014, see the Annual Report, which is available online at www.hacienda.cl/english/sovereign-wealth-funds/financial-committee/annual-report.html.

Main Activities in 2014

5.1 REVIEW OF THE ESSF AND PRF INVESTMENT GUIDELINES

In 2014 a series of changes to the investment guidelines were analyzed for both the ESSF and the PRF, after being proposed by both the CBC and the external managers in order to give the portfolio managers more flexibility in investing the resources. These changes to the guidelines were reviewed by the Financial Committee and will be implemented in the first half of 2015.

Changes approved for both funds:

- The minimum rating of banks eligible for forward and swap operations was lowered from AA– to A–.

Changes approved for the PRF¹²:

- For the portfolio managed by the CBC, the limits on the amount that can be deposited in any given bank were changed as follows: up to 1% of the market value of the portfolio managed by the CBC can be invested in issuers with a minimum credit rating of AA–, and up to 0.5% of the portfolio managed by the CBC can be invested in issuers with a minimum credit rating of A–. This limit applies to the aggregate exposure of cash deposited in a given bank and forward and swap operations with the same bank.
- Time deposits up to 15 days were included in the set of eligible instruments for foreign currency cash in the portfolio managed by the CBC.

5.2 MONITORING OF THE SOVEREIGN WEALTH FUND MANAGERS

In the last quarter of 2014, the Ministry of Finance and the Financial Committee received delegations from the external portfolio managers and the CBC, who introduced their fund management teams and described their investment processes, portfolio performance, attribution analysis of earnings and other issues related to the investment of the sovereign wealth funds.¹³ The presentations by the external portfolio managers are part of the activities that were transferred from the CBC to the Ministry on 1 January 2014.

In other areas, the Ministry of Finance, in consultation with the Financial Committee, established the general guidelines for selecting new external managers, for effectively monitoring the managers currently under contract and for identifying critical areas, among other issues.

The Ministry also decided to start the process of contracting an international consultant to provide support on issues related to the supervision of the portfolio managers.¹⁴ The contracting process will be carried out in 2015.

¹² These changes were evaluated in 2014, and the final decision to approve them was made at the Financial Committee meeting held on 5 January 2015.

¹³ Mellon Capital Management Corporation gave its presentation to the Financial Committee on 5 January 2015.

¹⁴ The final decision was made at the Financial Committee meeting held on 5 January 2015.

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

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

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

To guarantee public access to all important information on the ESSF and the PRF, many of the reports are published in both Spanish and English and are available on the sovereign wealth funds' website.¹⁵

Chile also remains committed to international initiatives aimed at establishing a framework of generally accepted principles and practices for sovereign wealth funds and promoting their transparency. In particular, the Ministry of Finance is an active participant in the International Forum of Sovereign Wealth Funds (IFSWF), which hosts an annual meeting of the world's main sovereign wealth funds to share ideas and exchange opinions on key issues and to facilitate understanding of their activities and of the Santiago Principles.¹⁶

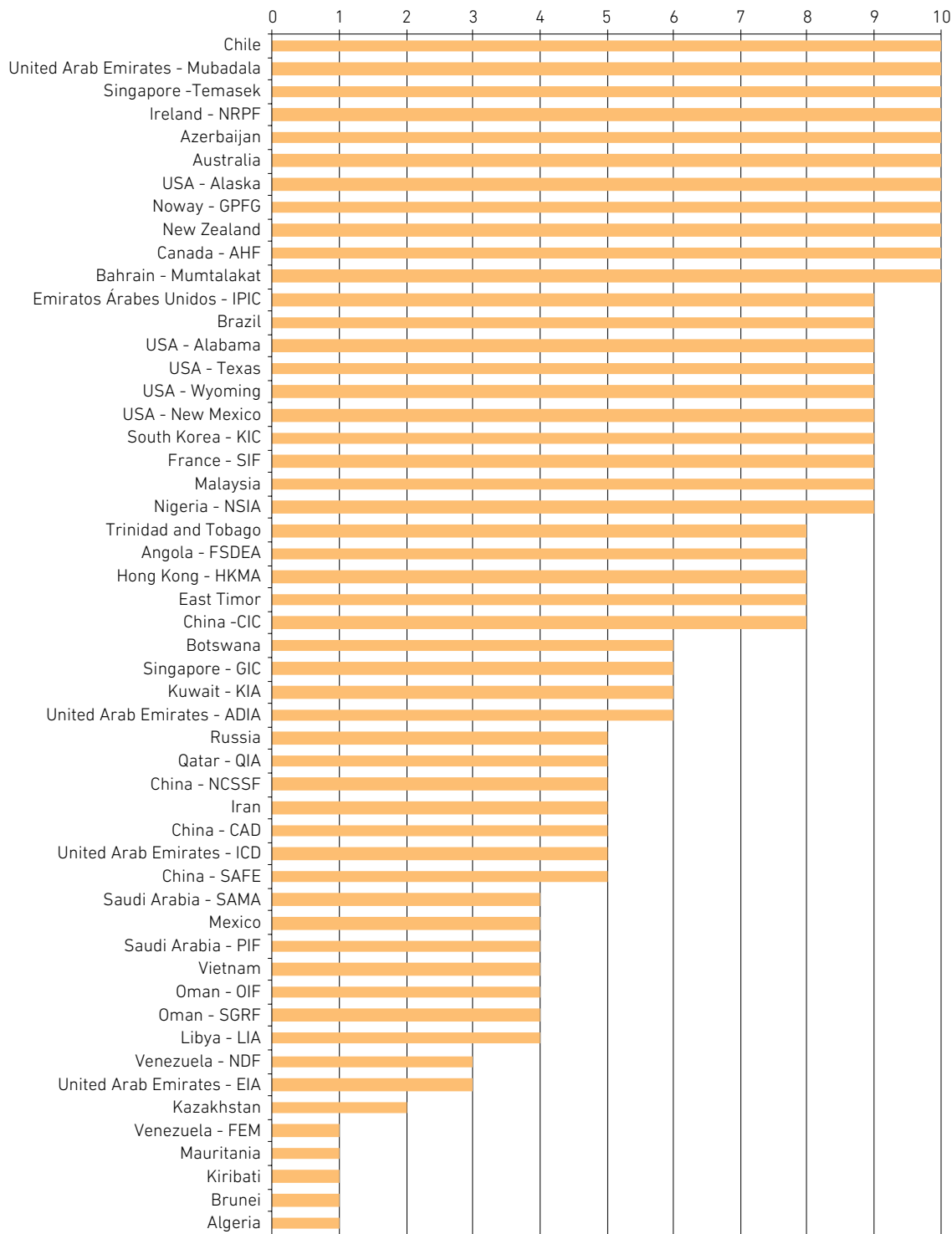
These efforts have been reflected in international recognition of the level of transparency of our funds. In particular, from the third quarter of 2009 to date, the Sovereign Wealth Fund Institute has awarded Chile the highest score on its Linaburg-Maduell Transparency Index, which measures the transparency of the main sovereign wealth funds (see figure 6). In addition, the Chilean sovereign wealth funds were recently ranked among the most transparent funds in the world by the Peterson Institute for International Economics. The institute's report entitled "Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard," published in September 2013, included a new version of the SWF Scoreboard, which measures the transparency and accountability of the sovereign wealth funds analyzed. The report ranked the ESSF in third place, with 91 points, after the funds of Norway, with 98 points, and New Zealand, with 94 points. The PRF was ranked tenth, with 85 points. Both of the Chilean sovereign wealth funds moved up considerably since the last Scoreboard, published 2011, in which the ESSF was ranked thirteenth, with 71 points, and the PRF fifteenth, with 68 points. Moreover, according to the Santiago Compliance Index 2014, published by GeoEconomica to measure the degree of implementation of the Santiago Principles in the world's main sovereign wealth funds, both Chilean funds received the highest rating. According to GeoEconomica, this indicates that the governance, transparency, accountability and disclosure practices of our sovereign wealth funds comply with the substance and disclosure guidelines of the Santiago Principles and that the funds are subject to an appro-

¹⁵ www.hacienda.cl/fondos-soberanos.html and www.hacienda.cl/english/sovereign-wealth-funds.html.

¹⁶ The Santiago Principles are a series of principles and practices accepted by the main countries that have created sovereign wealth funds. These principles aim to identify a framework of generally accepted principles and practices that properly reflect sound governance and accountability structures, as well as prudent and well-founded investment practices for sovereign wealth funds (source: www.iwg-swf.org/pubs/esl/gaplists.pdf).

private self-assessment of compliance.

Figure 6: Linaburg-Maduell transparency index, fourth quarter of 2014



Source: Sovereign Wealth Fund Institute

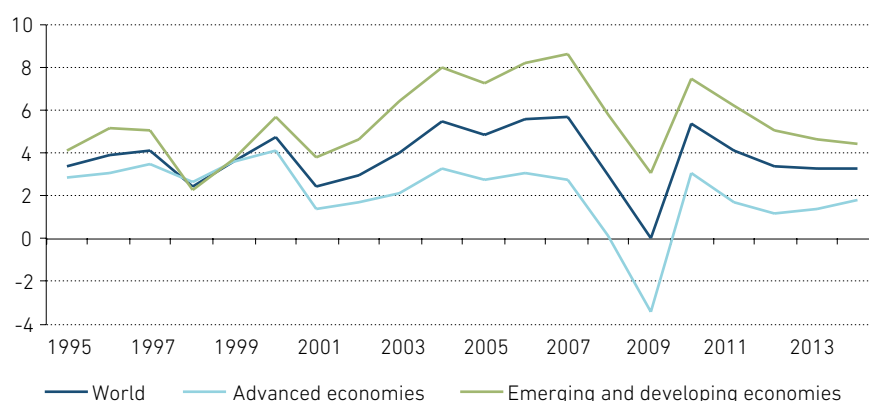
Analysis of the International Economy

7.1 MAIN DEVELOPMENTS

In 2014 world growth remained moderate in the wake of the economic crisis that started in 2008 (see figure 7). Although there are signs of recovery, the improvement has been gradual and asymmetrical among the different economies. Thus, the recovery of world growth has mainly been concentrated in the United States and the United Kingdom, which have already recovered their pre-crisis GDP levels. Low- and medium-income countries also contributed substantially to world growth (see figure 8). In contrast, the Eurozone and Japan continue to record very low growth rates, providing only a minimal contribution to world growth.

Figure 7: GDP growth, 1995–2014

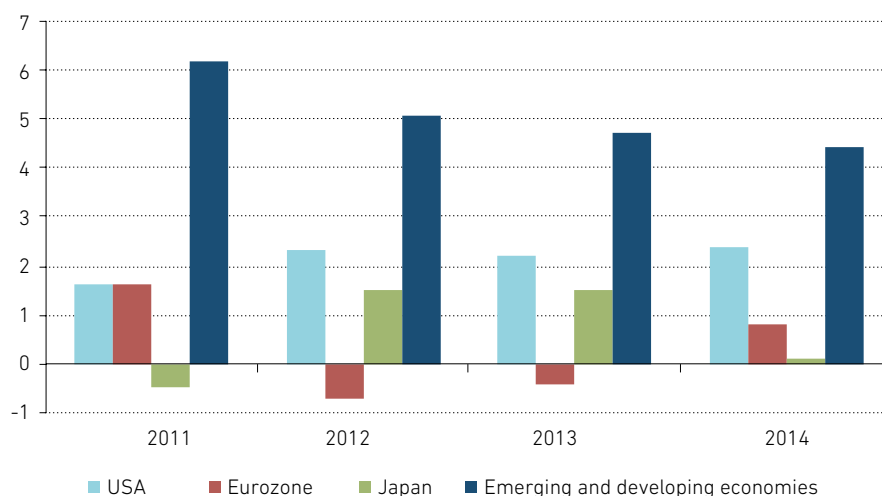
(percent)



Source: International Monetary Fund

Figure 8: GDP growth in selected economies, 2011–2014

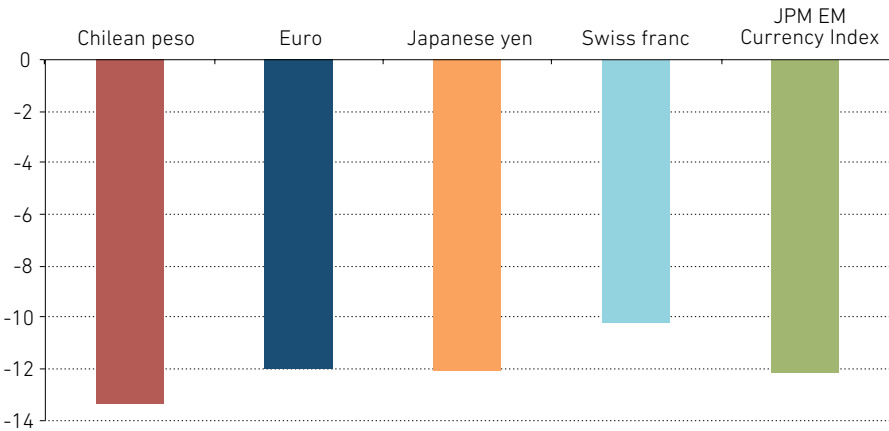
(percent)



Source: International Monetary Fund

The United States began the process of normalizing monetary policy by winding down its quantitative easing program. In contrast, the Eurozone and Japan maintained their expansionary monetary policies in order to mitigate the deflationary pressures in their economies. The U.S. dollar strengthened against most of the world’s currencies, especially the other advanced economies and commodity exporters (see figure 9).

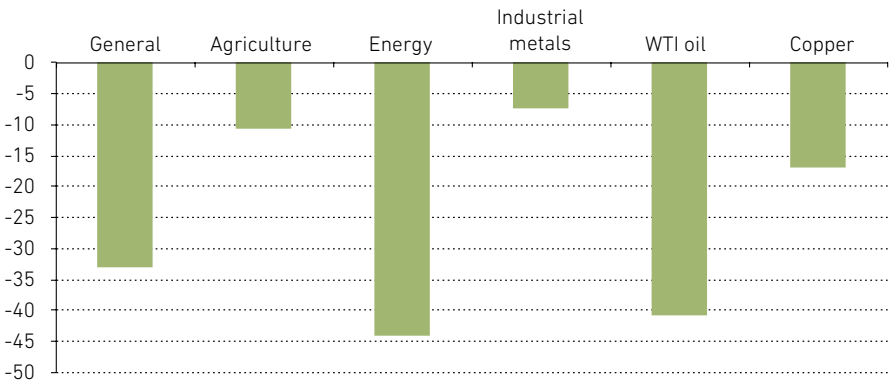
Figure 9: Change in the value of selected currencies against the dollar in 2014¹⁷
(percent)



Source: Bloomberg

International commodity prices generally declined in the second half of 2014 (see figure 10). Most notably, the WTI oil price dropped nearly 41% over the course of the year.

Figure 10: Commodity index yields in 2014: Standard & Poor’s, WTI oil and copper
(percent)

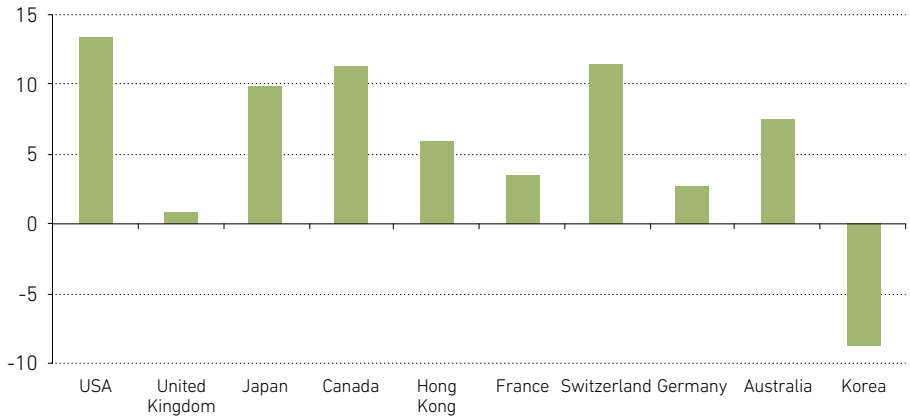


Source: Bloomberg

17 The J.P. Morgan EM Currency Index is a tradable index that comprises 10 emerging market currencies against the dollar. A negative value indicates a depreciation of the currencies against the dollar.

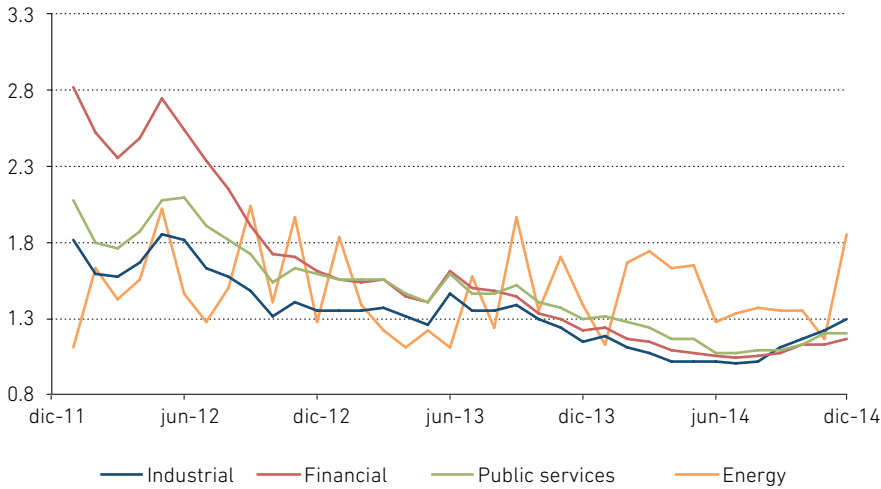
With regard to financial markets, various international stock indexes increased strongly in 2014, measured in local currency, while corporate spreads recorded historical lows and volatility was generally low (see figures 11, 12 and 13). The last quarter of the year saw an increase in sovereign spreads for emerging economies (mainly commodity exporters), together with the corporate spreads of companies whose income is exposed to energy prices. In contrast, long-term interest rates dropped in developed economies (see figure 14). This scenario contributed to generating positive yields on sovereign and corporate bonds in the year (in local currency) (see figure 15).

Figure 11: MSCI stock index yields in 2014
(percent, measured in local currency)



Source: Bloomberg

Figure 12: Corporate spreads by industry, 2012–2014
(percent)



Source: Barclay's

Figure 13: Stock market volatility (VIX), 2010–2014

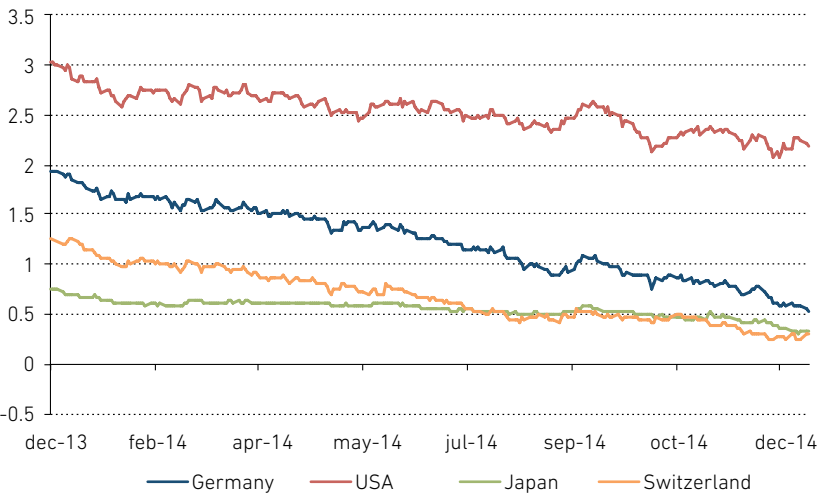
(percent)



Source: Bloomberg

Figure 14: Internal rate of return (IRR) on 10-year bonds in 2014, selected countries

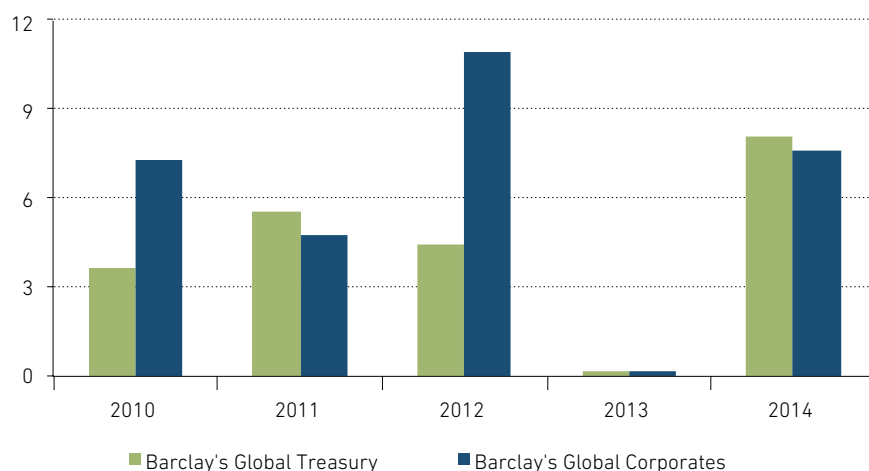
(percent)



Source: Bloomberg

Figure 15: Return on Barclays Global Treasury and Global Corporate (Hedged) indexes, 2010–2014

(percent, measured in local currency)



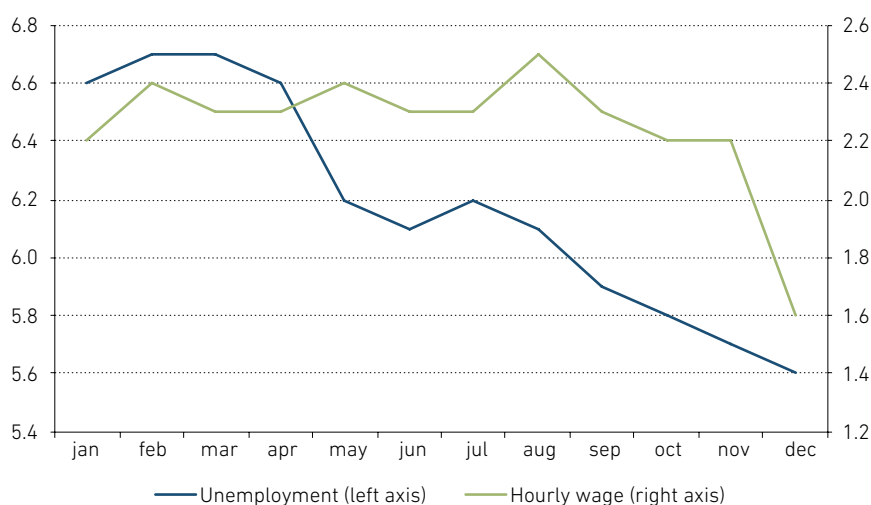
Source: Barclay's

7.2 REGIONAL DEVELOPMENTS

The United States is projected to have grown 2.4% in 2014, mainly thanks to growth in the second half of the year (3.6%) and despite a contraction in the first quarter (–2.1%). The year's growth was accompanied by a reduction in the unemployment level, which reached 5.6% (see figure 16). Based on the evolution of output and inflation, in October the U.S. Federal Reserve (the Fed) terminated its most recent quantitative easing program, initiated in 2012, but maintained an expansionary monetary policy with the federal funds rate at virtually zero (see figure 17).

Figure 16: Unemployment rate and wage growth in the United States, 2014

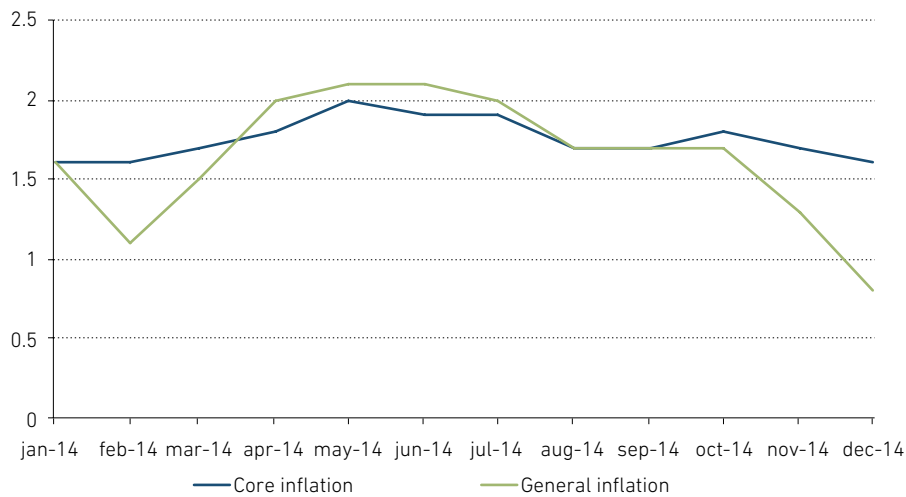
(left: percent)(right: year-on-year change, percent)



Source: Bloomberg

Figure 17: U.S. consumer price index, 2014

(year-on-year change, percent)

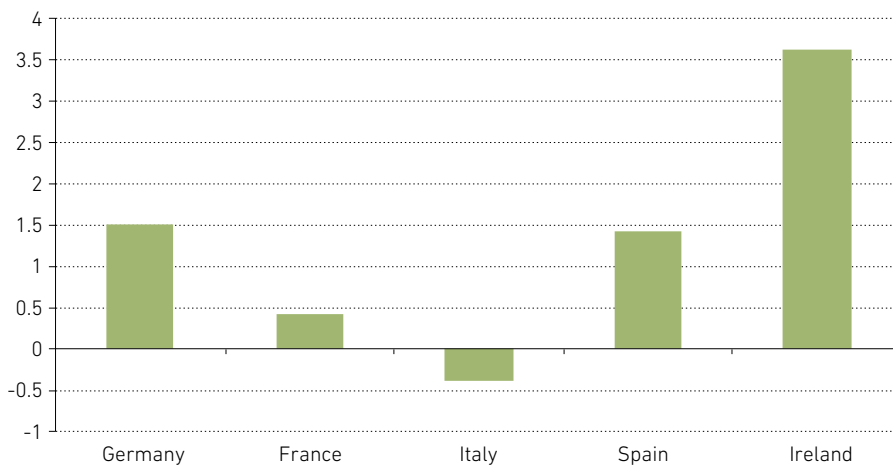


Source: Bloomberg

In the Eurozone, the 2014 growth estimate is 0.8%, which mainly reflects the low growth of investment and exports. By country, GDP growth was 0.4% in France and -0.4% in Italy, while Germany, Spain and Ireland grew 1.5%, 1.4% and 3.6%, respectively (see figure 18). Inflation was below the target set by the European Central Bank (BCE), which led to the announcement and implementation of some policy measures aimed at returning to the target (see figure 19).¹⁸

Figure 18: GDP growth in the Eurozone, 2014: selected countries

(percent)

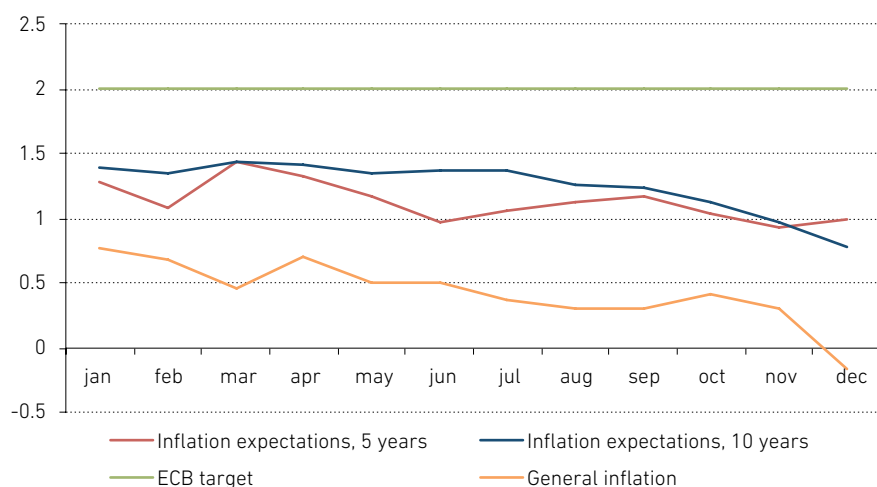


Source: World Bank.

¹⁸ In September 2014, the President of the ECB announced the implementation of an asset-backed securities and covered bond purchase program, which was launched in mid-October.

Figure 19: Breakeven inflation expectations (Germany) and actual inflation in the Eurozone,¹⁹ 2014

(year-on-year change, percent)



Source: Bloomberg, European Central Bank, Eurostat

Japan implemented a series of structural reforms in 2014, in addition to the Bank of Japan's quantitative and qualitative monetary easing program initiated in 2013. In April 2014, the Government increased the consumption tax as a means of consolidating its fiscal position. As a result, the Japanese economy recorded 0% growth in the year.

With regard to the emerging economies, China grew 7.4% in 2014, while the Asia-Pacific region (excluding China) grew 4.6% in the year. The Russian economy expanded 0.6% in 2014. Finally, in Latin America the regional growth rate was 0.9%, with practically null growth in Brazil and contractions in Argentina and Venezuela.

¹⁹ Inflation is the Harmonized Index of Consumer Prices, reported by Eurostat.

Economic and Social Stabilization Fund

8.1 INVESTMENT POLICY

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

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

The asset classes defined for this policy are invested under a passive mandate based on fixed-income benchmarks in line with the low risk tolerance defined for the fund and a highly diversified equity benchmark. The instruments in the fixed-income benchmark are fairly liquid. The aggregate fixed-income portfolio has an ex ante tracking error of 50 basis points; the equity portfolio, 60 basis points.²⁰

Table 1: Strategic asset allocation and benchmarks

(percent)

Benchmark	USD	EUR	JPY	CHF	Stocks	Total
1. Bank deposits	5.0	6.0	4.0	0.0	0.0	15.0
Merrill Lynch Libid 3 Month Average USD	5.0	—	—	—	—	5.0
Merrill Lynch Libid 3 Month Average EUR	—	6.0	—	—	—	6.0
Merrill Lynch Libid 3 Month Average JPY	—	—	4.0	—	—	4.0
2. Treasury bills and sovereign bonds	32.5	18.0	16.0	7.5	0.0	74.0
2.1 Treasury bills	6.0	7.0	6.0	0.0	0.0	19.0
Merrill Lynch Treasury Bills Index USD	6.0	—	—	—	—	6.0
Merrill Lynch Treasury Bills Index EUR	—	7.0	—	—	—	7.0
Merrill Lynch Treasury Bills Index JPY	—	—	6.0	—	—	6.0
2.2 Sovereign bonds	26.5	11.0	10.0	7.5	0.0	55.0
Barclays Capital Global Treasury: U.S. 7-10 Yrs	26.5	—	—	—	—	26.5
Barclays Capital Global Treasury: Germany 7-10 Yrs	—	11.0	—	—	—	11.0
Barclays Capital Global Treasury: Japan 7-10 Yrs	—	—	10.0	—	—	10.0
Barclays Capital Global Treasury: Switzerland 5-10 Yrs	—	—	—	7.5	—	7.5
3. Inflation-indexed sovereign bonds	2.5	1.0	0.0	0.0	0.0	3.5
Barclays Capital Global Inflation-Linked: U.S. TIPS 1-10 Yrs	2.5	—	—	—	—	2.5
Barclays Capital Global Inflation-Linked: Germany 1-10 Yrs	—	1.0	—	—	—	1.0
4. Stocks	—	—	—	—	7.5	7.5
MSCI All Country World Index (unhedged with reinvested dividends) ex Chile	—	—	—	—	7.5	7.5
5. Total	40.0	25.0	20.0	7.5	7.5	100.0

Source: Ministry of Finance

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

The fixed-income portfolio (92.5% of total assets) is managed by the CBC, acting as fiscal agent, while the equity portfolio is handled by external portfolio managers (BlackRock and Mellon).

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

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

8.2 MARKET VALUE

At the close of 2014, the market value of the ESSF was US\$ 14,689 million, versus US\$ 15,419 million at the close of 2013. The reduction in the fund's value was due to a withdrawal of US\$ 499 million, used to finance the legally mandated contribution to the PRF, and a net loss from investments of US\$ 231 million. Since its inception on 6 March 2007, the ESSF has received capital contributions of US\$ 21,766 million, has recorded withdrawals of US\$ 9,927 million²¹ and has generated net financial earnings of US\$ 2,850 million (see tables 2 and 3).

Table 2: Contributions and withdrawals

(millions of dollars)

Period	Contributions	Withdrawals
2007	13,100	—
2008	5,000	—
2009	—	9,278
2010	1,362	150 ^(a)
2011	—	—
2012	1,700	—
2013	603	—
2014	—	499 ^(b)
Total	21,766	9,927

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

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

Source: Ministry of Finance

21 Most of the withdrawals from the ESSF were made in 2009 (US\$ 9,278 million); the funds were mainly used to finance the fiscal deficit and a fiscal stimulus plan implemented by the Government in response to the economic crisis that year.

Table 3: Evolution and decomposition of market value

(millions of dollars)

Descomposition	2009	2010	2011	2012	2013	2014	Since inception ^(a)
Starting market value	20,211	11,285	12,720	13,157	14,998	15,419	0
Contributions	0	1,362	0	1,700	603	0	21,766
Withdrawals	-9,278	-150	0	0	0	-499	-9,927
Accrued interest	404	228	237	202	184	188	2,393
Capital gains (losses)	-51	-4	201	-60	-364	-417	469
Management, custody and other costs	-1.6	-1.1	-1.2	-1.3	-2.2	-2.7	-12.4
Net financial gains	352	223	437	141	-182	-231	2,850
Ending market value	11,285	12,720	13,157	14,998	15,419	14,689	14,689

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

Source: Ministry of Finance

8.3 PERFORMANCE

In 2014 the fund's return in dollars, net of management costs, was -1.67%. This primarily reflects the negative return of the fixed-income portfolio, -2.18%, representing 92% of the fund, which was partially offset by the positive return on the equity portfolio, 4.46%. The fixed-income return breaks down into 4.59% in local currency and -6.77% from exchange rate effects.²² The equivalent net return in pesos in the year was 14.30%, which is mainly explained by the appreciation of the dollar against the peso during the period. Since 31 March 2007, the annualized net return in dollars was 2.82%, mainly due to the effect of earnings in local currency (3.21%) of the fixed-income portfolio (see table 4 and figure 20). In the same period, the equivalent annualized net return in pesos was 4.36%. The IRR in dollars was -1.52% in 2014 and 2.78% (annualized) since the fund's inception.

²² The performance of the ESSF fixed-income portfolio primarily reflects interest rates and exchange rates. The level and changes in interest rates largely determine the value of the financial instruments in their currency of issue (local currency). However, given that the funds are invested in dollars, euros, yen and Swiss francs, while the portfolio performance is measured in dollars, the exchange rate of the dollar against these currencies also affects the fund's return.

Table 4: Net returns in dollars

(percent)

Returns ^(a)	2014	Last 3 years	Since inception ^(b)
Local currency	4.59	1.73	3.21
Exchange rate	-6.77	-2.80	-0.56
Fixed-income	-2.18	-1.07	2.65
Stocks ^(c)	4.46	-	-
Return in USD	-1.67	-0.64	2.82
Exchange rate return, CLP	15.97	5.21	1.54
Return in CLP ^(d)	14.30	4.57	4.36

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

(b) The return since inception calculated from 31 March 2007, when the performance of the CBC began to be measured.

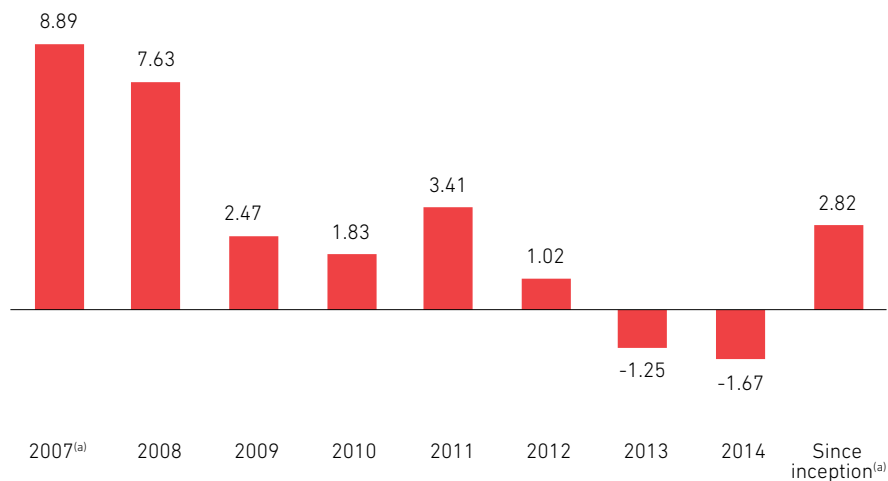
(c) The equity portfolio was implemented in August 2013, so only the return in 2014 is included.

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

Source: Ministry of Finance

Figure 20: Annual TWR in dollars

(percent)



(a) Calculated from 31 March 2007.

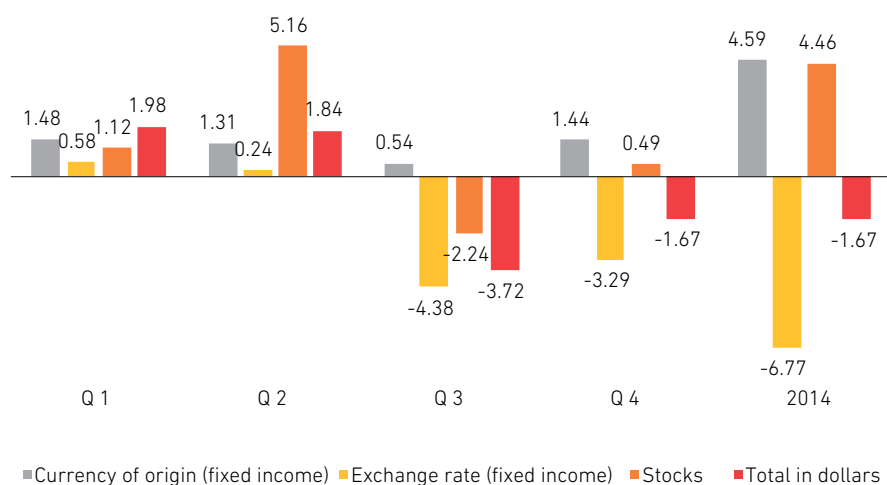
Source: Ministry of Finance

Figure 21 shows the quarterly breakdown of the net returns in dollars in 2014, decomposed into the return in local currency and the exchange rate effect for the fixed-income portfolio and the return of the equity portfolios. The fund recorded positive returns in the first and second quarters, mainly due to the decline in interest rates, as reflected the return in local currency of the fixed-income portfolio of 1.48% and 1.31%, respectively. The return on the equity portfolio was also positive, at 1.12% in the first quarter and 5.16% in the second. The exchange rate effect was also positive in the first two quarters due to the appreciation of the yen against the dollar of almost 2% in each quarter. In the third quarter, the ESSF recorded its lowest return of the year, -3.72%, which is largely explained by the negative effect of exchange rate fluctuations against the dollar. Specifically, in the period, the exchange rate effect on the fixed-income portfolio return was -4.38%, reflecting depreciation rates of 7.75% for the euro, 7.59% for the yen and 7.14% for the Swiss franc. Finally, the fourth quarter recorded a negative return of -1.67%,

caused by the depreciation of the currencies in the fixed-income portfolio against the dollar of –3.29%, which was partially offset by the same portfolio's return in local currency of 1.44%, and, to a lesser extent, the equity portfolio return of 0.49%.

Figure 21: Net quarterly returns in 2014

(percent)

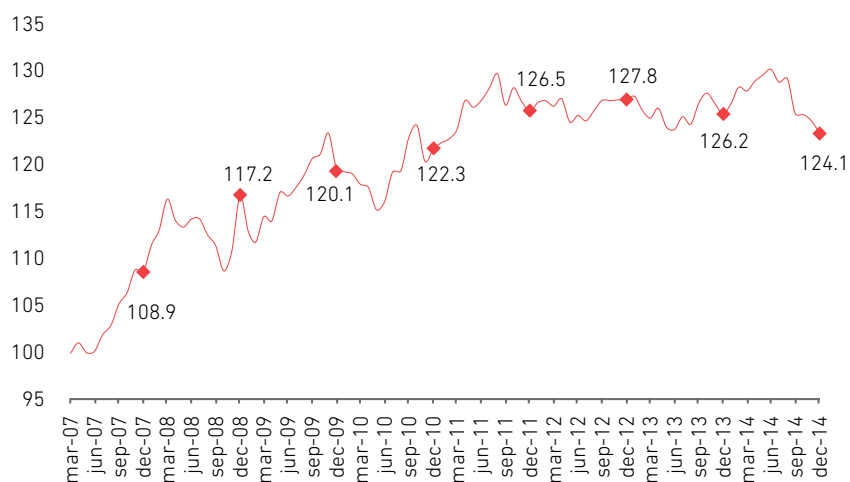


Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the portfolio's daily returns. Taking a starting value of 100 on 31 March 2007, the index reached 124.1 at year-end 2014 (see figure 22).

Figure 22: Return index in dollars - ESSF

(31 March 2007 = 100)

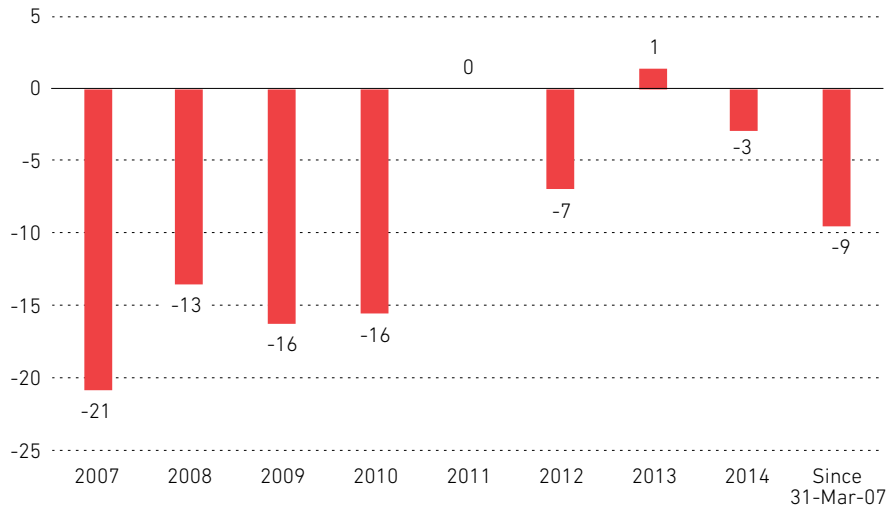


Source: Ministry of Finance

In 2014, the performance of the ESSF, measured as the difference between the portfolio return and the benchmark return, was –3 basis points, which is consistent with the greater emphasis on a passive investment strategy as of 1 May 2011. Since 31 March 2007, the annualized return of the ESSF was 9 basis points below the benchmark (see figure 23).

Figure 23: Net returns against the benchmark

(basis points)



Source: Ministry of Finance

By asset class, the fixed-income portfolio recorded an excess return of 1 basis point over the benchmark in 2014, while the equity portfolio was 26 basis points below the benchmark (see table 5). The difference in returns between the equity portfolio and its benchmark is largely explained by the fact that the benchmark portfolio does not take into account tax payments associated with the portfolio investments, whereas the portfolio managers are subject to these charges, which affects the profitability of their portfolios. Since inception, the total excess return of the ESSF was –9 basis points; this primarily stems from the fixed-income portfolio, given that the equity investments only date to August 2013.

Table 5: Net returns against the benchmark , by asset class²³.

(basis points)

Asset class	2014	Last 3 years ^(a)	Since inception ^(b)
Fixed-income	1	-5	-10
Stocks	-26	-	-
Total portfolio	-3	-3	-9

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

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

Source: Ministry of Finance

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

8.4 PORTFOLIO ALLOCATION

As of December 2014, the allocation of the ESSF by asset class comprised US\$ 9,261 million in Treasury bills and sovereign bonds, US\$ 3,773 million in bank time deposits, US\$ 1,142 million in stocks and US\$ 512 million in inflation-indexed sovereign bonds (see table 6).

The sovereign portfolio is invested in the United States, Germany, Japan and Switzerland, where investments in the United States account for almost half the portfolio and around a third of the total value of the ESSF. Bank deposits, as of year-end, are invested in banks from a number of countries, with exposures of over US\$ 400 million in Germany, France, Japan and Denmark. These bank investments are mainly time deposits in eligible banks, selected by the CBC in accordance with the Ministry of Finance's investment guidelines. Table 7 presents the breakdown of bank deposits at the close of 2014. The equity portfolio at year-end was concentrated in the United States (around 50%) and, to a lesser extent, the United Kingdom and Japan, as well as 38 countries with investments of less than US\$ 50 million each. The stock distribution by country tracks the country allocation in the benchmark.

Relative to the benchmark, the asset allocation of the ESSF at year-end had excess weight in bank deposits by around 11%, at the expense of Treasury bills and sovereign bonds (see figure 24). Starting in the second quarter of 2014, the CBC, which is responsible for the fund's fixed-income portfolio, prioritized investments in time deposits over Treasury bills due to the low—or even negative—interest rates in some of the countries where the ESSF is invested (see figure 25). With regard to the currency allocation, at year-end the U.S. dollar was over-weighted while the Japanese yen was under-weighted, which mainly reflects CBC positions in the fixed-income portfolio (see figure 26).

Table 6: Asset class allocation, 31 December 2014

(millions of dollars and percent of portfolio)

Exposure	Country	US\$ million	% of total
Sovereign	USA	4,722	32.1
	Japan	1,861	12.7
	Germany	1,594	10.9
	Switzerland	1,084	7.4
	Total	9,261	63.0
Inflation-indexed sovereign	USA	368	2.5
	Germany	144	1.0
	Other ^(a)	0	0.0
	Total	512	3.5
Banking	Germany	725	4.9
	France	681	4.6
	Japan	488	3.3
	Denmark	400	2.7
	United Kingdom	361	2.5
	Netherlands	258	1.8
	Belgium	225	1.5
	Australia	167	1.1
	Israel	36	0.2
	Sweden	29	0.2
	Other ^(a)	403	2.7
	Total	3,773	25.7
Stocks	USA	621	4.2
	United Kingdom	82	0.6
	Japan	81	0.6
	Germany	47	0.3
	Canada	41	0.3
	Hong Kong	38	0.3
	France	36	0.2
	Switzerland	36	0.2
	Australia	29	0.2
	South Korea	17	0.1
	Spain	13	0.1
	Netherlands	12	0.1
	Sweden	12	0.1
	Brazil	11	0.1
	Other ^(a)	68	0.5
	Total	1,142	7.8
Total Fund		14,689	100.0

(a) Includes cash and cash equivalents.

Source: Ministry of Finance

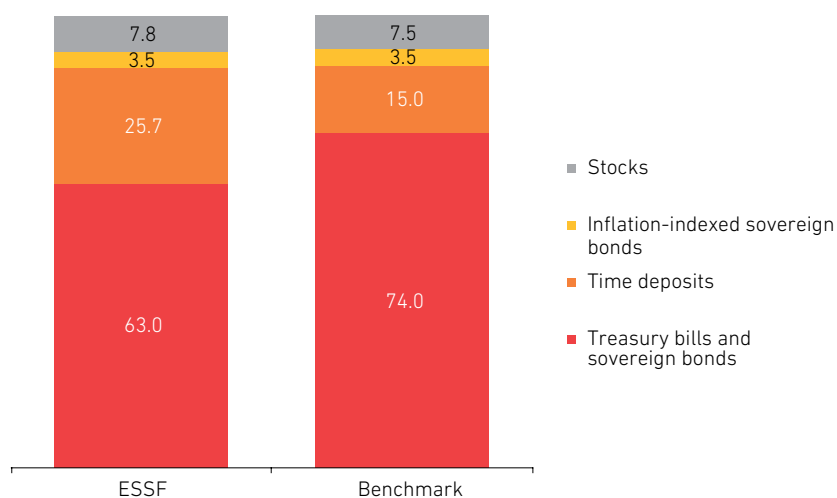
Table 7: Banks with deposits, 31 December 2014

Bank	Country
Australia and New Zealand Banking Group Limited	Australia
Bank Hapoalim	Israel
BNP Paribas SA	France
Credit Agricole Corporate and Investment Bank	France
Danske Bank Aktieselskab	Denmark
Dekabank Deutsche Girozentrale	Germany
Deutsche Bank AG	Germany
HSBC France	France
ING Bank NV	Netherlands
KBC Bank NV	Belgium
Landesbank Hessen-Thüringen Girozentrale	Germany
Mizuho Bank Ltd	Japan
Natixis	France
Norddeutsche Landesbank Girozentrale	Germany
Nykredit Bank A/S	Denmark
Rabobank Nederland	Netherlands
Santander UK PLC	United Kingdom
Societe Generale	France
Standard Chartered Bank	United Kingdom
Svenska Handelsbanken AB	Sweden
The Bank of Tokyo-Mitsubishi UFJ	Japan
The Chiba Bank Ltd	Japan

Source: Ministry of Finance

Figure 24: Asset allocation, 31 December 2014

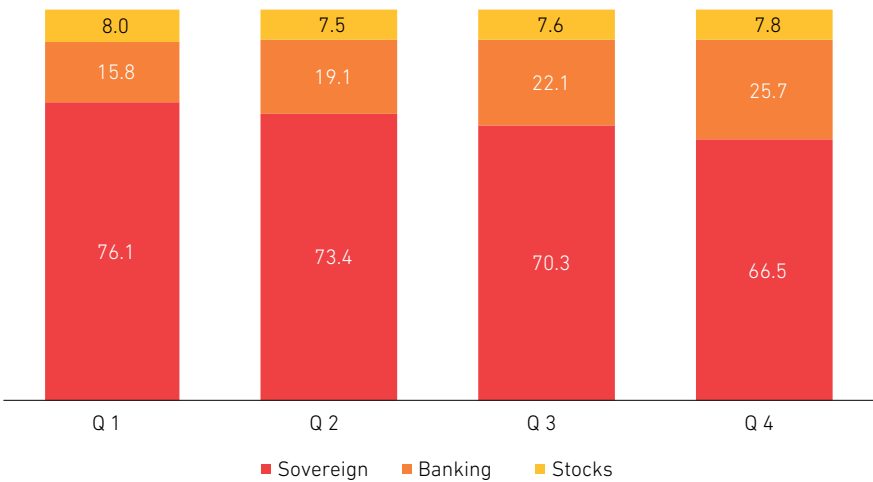
(percent of portfolio)



Source: Ministry of Finance

Figure 25: Risk allocation in 2014

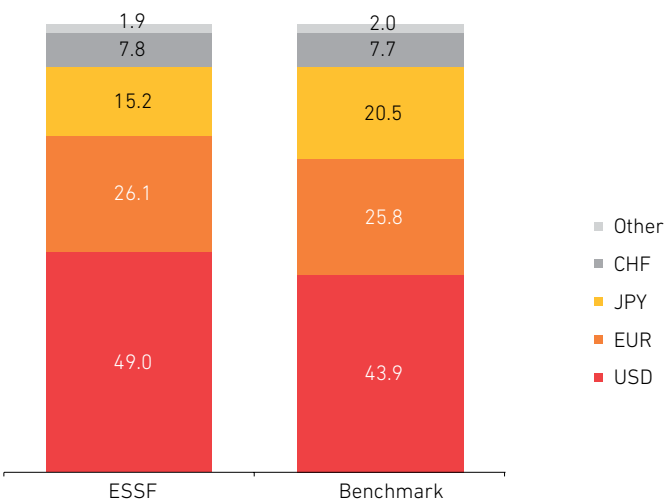
(percent of portfolio)



Source: Ministry of Finance

Figure 26: Currency allocation in 2014

(percent of portfolio)



Source: Ministry of Finance

The credit quality of the sovereign investments included in the ESSF is directly related to the benchmark allocation. That is, the distribution by risk rating depends on the shares established in the benchmark for the United States, Germany, Japan and Switzerland. Bank exposure depends on the CBC's assessment of the risk-return ratio of each bank at the time the deposit was made (see table 8).

Table 8: Credit risk exposure, 31 December 2014

(percent of fixed-income portfolio)

Issuer	Credit rating							
	AAA	AA+	AA	AA–	A+	A	A–	Others
Sovereign	58.4	0.0	0.0	0.0	13.7	0.0	0.0	0.0
Bank	0.0	0.0	0.0	2.5	5.4	14.5	2.5	3.0

Source: Ministry of Finance

8.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the ESSF in 2014 included US\$ 1,302,645 for custody services, US\$ 802,573 to the CBC for management services and US\$ 581,047 to the external managers. Total management costs were equivalent to 2 basis points of the total portfolio. Income from the securities lending program was US\$ 2,332,681, which largely offset the total management costs of the ESSF (see table 9).

Table 9: Management and custody costs and income from the securities lending program

(dollars)

	2009	2010	2011	2012	2013	2014
Custody (J.P. Morgan)	816,668	622,071	544,634	530,901	1,379,420	1,302,645
Management (CBC)	804,600	506,400	613,758	768,014	789,277	802,573
External Managers	-	-	-	-	-	581,047
Total costs	1,621,268	1,128,471	1,158,392	1,298,915	2,168,697	2,686,265
Securities lending program	924,766	1,290,288	2,868,799	2,914,649	2,654,248	2,332,681

Source: Ministry of Finance

8.6 MAIN FINANCIAL RISKS

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

8.6.1 MARKET RISK

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

Interest rate risk

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

In the case of the ESSF, the interest rate risk that is tolerated in the benchmark is defined based on the duration of the individual indexes that make up the benchmark. The benchmark duration at year-end 2014 was 4.82 while the actual duration of the ESSF was 4.90 years.

Foreign exchange risk

Because the fund's performance is measured in dollars, the value of investments in other currencies is affected by movements in the corresponding exchange rates. Most of the portfolio's fixed-income investments are denominated in dollars, euros, yen and Swiss francs, while the equity portfolio includes a small exposure to an additional 21 currencies. At the close of 2014, the foreign currency exposure, measured in dollars, was 51.0%, deriving from investments in euros (26.1%), yen (15.2%), Swiss francs (7.8%), pounds sterling (0.6%) and other currencies with a minor share (1.3%).

Credit spread risk

The market value of the instruments in the ESSF fixed-income portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is minimal in the ESSF, because the fixed-income portfolio includes only sovereign issues from the United States, Germany, Japan and Switzerland, among which the lowest rating is A+ (Japan).

Equity risk

The ESSF is exposed to the risk of losses from a decrease in the price of the stocks included in its portfolio. The intrinsic risk of an individual stock is eliminated by investing in a highly diversified portfolio. The fund's tolerance for equity risk is defined as the systemic risk associated with the stock index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2014, stocks accounted for 7.8% of the ESSF, which is very close to the strategic allocation (7.5%).

Volatility, VaR and tracking error

Some indicators that are commonly used to monitor market risk in absolute terms are return volatility,²⁴ the minimum and maximum returns and the Value-at-Risk (VaR). In the case of the ESSF, the annual volatility of the fund was 4.1% in 2014, versus 5.3% for the period from 31 March 2007 onward. Since the fund's inception, the highest monthly return was 5.44% (in December 2008), while the lowest was -3.31% (in January 2009). The highest quarterly return was 7.31% in the first quarter of 2008; the lowest was -3.72% in the third quarter of 2014 (see table 10). At year-end 2014, the VaR, which quantifies potential losses in a given period with a given probability, was 8.11% at a one-year horizon, with a 95% confidence level.²⁵

²⁴ Volatility is the standard deviation of the returns; it indicates the degree of dispersion of returns around the average.

²⁵ This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 8.11% of its nominal value in dollars.

Table 10: Historical minimum and maximum returns

(percent)

Range	Month	Quarter
Highest return	5.44 (Dec-08)	7.31 (Q1 08)
Lowest return	-3.31 (Jan-09)	-3.72 (Q3 14)

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At the close of 2014 the ex ante tracking error of the ESSF was 6 basis points, consistent with a passive management strategy.

8.6.2 CREDIT RISK

The issuer of a fixed-rate instrument could enter into default if a liquidity or capital shortage makes it unable to meet its financial obligations. The funds' credit risk thus rises in response to an increase in the default probability of any of their host institutions or governments. The ESSF limits exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany, Japan and Switzerland, all of which have a sovereign rating of over A+. ²⁶ Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see table 11). The credit risk associated with forward and swap operations is contained through minimum credit ratings for counterparties and maximum exposure to each one. Furthermore, forward and swap operations cannot exceed a given percentage of the portfolio under management: for the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio; for the externally managed portfolios, forwards, swaps and futures cannot exceed 10% of each manager's portfolio.

26 On 1 December 2014, Moody's changed Japan's credit rating from AA– to A+.

Table 11: Maximum credit exposure by bank issuer

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

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 in the name of the Republic of Chile and keeping them in separate accounts.

8.6.3 LIQUIDITY RISK

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

In the ESSF, this risk is mitigated by maintaining a high percentage of liquid short-term assets. As of 31 December 2014, money market instruments accounted for 33.6%, which is in line with the 34% proposed under the current strategic allocation and 4% higher than under the policy in effect through July 2013. Liquid assets include Treasury bills, certificates of deposit and time deposits, all of which are less sensitive to interest rate fluctuations. In addition, the market for Treasury bills and certificates of deposit allows for quick sale without heavy penalization, and time deposits provide liquidity as they reach their maturity date.

8.6.4 OPERATIONAL RISK

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

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

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

Pension Reserve Fund

9.1 INVESTMENT POLICY

The main objective of PRF investment is to generate resources for financing a share of the Government's pension liabilities. To achieve this, the investment policy incorporates the specific objective of maximizing expected returns while keeping risk within a 95% probability that the fund will not lose more than 10% of its value in dollars in a given year. The investment horizon is medium to long term, given the size and timeline of the liabilities that the fund has to finance.

The current PRF investment policy, implemented in January 2012, stipulates a portfolio allocation of 48% in sovereign and government-related bonds, 17% in inflation-indexed sovereign bonds, 15% in stocks and 20% in corporate bonds. The CBC manages asset classes with sovereign risk exposure, while the stock and corporate bond portfolios are managed externally (BlackRock and Mellon for stocks; and BlackRock and Rogge for corporate bonds).

The asset classes defined under this policy are invested according to highly diversified benchmarks (see table 12) and using a largely passive approach. The ex ante tracking error is capped at 50 basis points for the aggregate portfolio of sovereign bonds, government-related bonds and inflation-indexed bonds, 60 basis points for the stock portfolio and 50 basis points for the corporate bond portfolio.

The eligible instruments and issuers are determined by the benchmarks used. A limited use of ETFs, ADRs, GDRs, mutual funds and futures is also allowed in order to facilitate tracking the equity benchmark. Leveraging is not permitted, and the authorized use of forwards or swaps is confined exclusively to exchange rate hedging.

A portfolio rebalancing policy has been established to allow convergence to the strategic asset allocation described above. The policy is triggered whenever the PRF receives additional contributions and when any of the asset classes exceed the following target ranges: 45–51% for sovereign and government-related bonds, 14–20% for inflation-indexed sovereign bonds, 17–23% for corporate bonds and 12–18% for stocks.

Table 12: Strategic asset allocation and benchmarks

(percent of portfolio)

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

(a) Each subindex of this asset class is added according to its relative capitalization.

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

Source: Ministry of Finance

9.2 MARKET VALUE

As of 31 December 2014, the PRF had a market value of US\$ 7,944 million, an increase of US\$ 609 million over the close of 2013. This growth is mainly due to a contribution of US\$ 499 million, equivalent to 0.2% of 2013 GDP (see table 13) and net financial gains of US\$ 110 million.

Since its inception on 28 December 2006, the fund has received contributions totaling US\$ 6,940 million and earned net financial gains on investments of US\$ 1,003 million (see table 14).

Table 13: Annual contributions

(millions of dollars)

Period	Contribution	% GDP of 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
2012	1,197	0.5
2013	1,377	0.5
2014	499	0.2
Total	6,940	

Source: Ministry of Finance

Table 14: Evolution and decomposition of market value

(millions of dollars)

Decomposition	2009	2010	2011	2012	2013	2014	Since inception ^(a)
Starting market value	2,507	3,421	3,837	4,406	5,883	7,335	0
Contributions	837	337	443	1,197	1,377	499	6,940
Withdrawals	0	0	0	0	0	0	0
Accrued interest	72	70	75	130.65	174	190	829
Capital gains (losses)	6	9	51	151	-95	-76	186
Management, custody and other costs	-0.3	-0.4	-0.4	-1.2	-4.4	-4.6	-11.8
Net financial gains	77	79	126	280	75	110	1,003
Ending market value	3,421	3,837	4,406	5,883	7,335	7,944	7,944

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

Source: Ministry of Finance

9.3 PERFORMANCE

The fund's return in dollars, net of management costs, was 1.75% in 2014, which is mainly explained by positive returns on stocks (4.41%), inflation-indexed bonds (3.20%) and corporate bonds (3.18%) and was partially offset by negative returns on sovereign and government-related bonds (−0.21%). The equivalent net return in pesos for the year was 17.72%, which reflects the sharp appreciation of the dollar against the peso. The fund's return in the last three years represents approximately the return obtained since the implementation of the new PRF investment policy in January 2012. The annualized net return of the new investment policy was 2.53% in dollars, and the new asset classes had the highest returns: 13.49% for stocks and 4.09% for corporate bonds. The annualized net return in pesos of the new investment policy was approximately 7.74%. Since 31 March 2007, the annualized net return was 4.04% in dollars and 5.58% in pesos (see table 15 and figure 27). The IRR in dollars was 1.48% in 2014, while the annualized IRR since the fund's inception was 3.14%.

Table 15: Net return in dollars
(percent)

Returns ^(a)	2014	Last 3 years ^(b)	Since inception ^(c)
Sovereign and government-related bonds	-0.21	-1.04	-
Inflation-indexed sovereign bonds	3.20	3.27	-
Corporate bonds	3.18	4.09	-
Stocks	4.41	13.49	-
Return in USD	1.75	2.53	4.04
Exchange rate effect, CLP	15.97	5.21	1.54
Return in CLP ^(d)	17.72	7.74	5.58

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

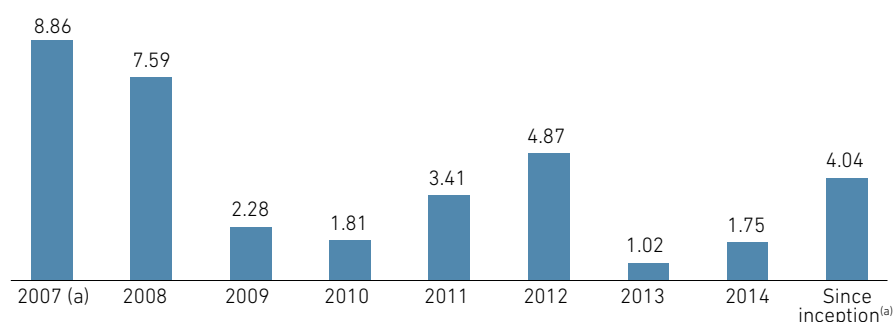
(b) The return on corporate bonds and stocks is calculated from 17 January 2012.

(c) The return since inception is calculated from 31 March 2007, when the performance of the CBC began to be measured.

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

Source: Ministry of Finance

Figure 27: Annual TWR in dollars
(percent)



(a) Calculated from 31 March 2007.

Source: Ministry of Finance

Broken down by quarter, the fund's total return is mainly explained by a strong performance in the first and second quarters. These results were then partially reversed in the third quarter (see table 16), primarily due to the depreciation of the main investment currencies against the dollar.

Table 16: Net quarterly return in dollars in 2014, by asset class

(percent)

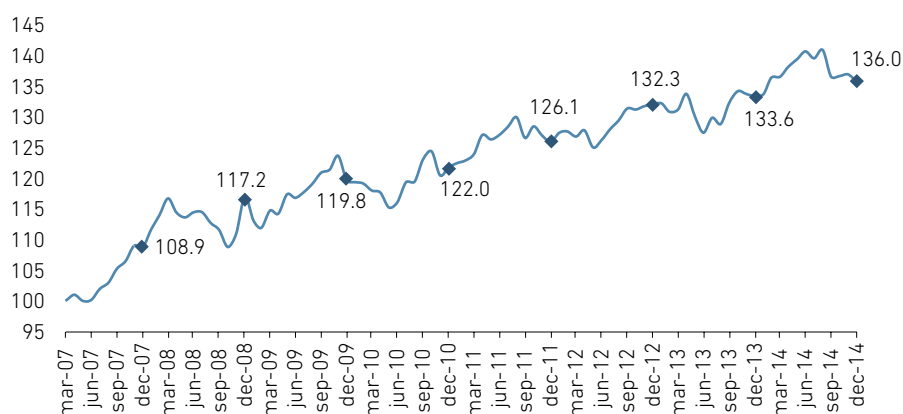
Returns	Q 1	Q 2	Q 3	Q 4	2014
Sovereign and government-related bonds	2.59	2.32	-3.58	-1.41	-0.21
Inflation-indexed bonds	2.72	3.45	-2.67	-0.22	3.20
Corporate bonds	2.60	2.69	-2.18	0.11	3.18
Stocks	1.09	5.15	-2.25	0.48	4.41
Total portfolio	2.36	3.04	-2.94	-0.61	1.75

Source: Ministry of Finance

The fund's investment performance can be illustrated using an index of the portfolio's daily returns (see figure 28). Despite the volatility of the index, the value increased over prior years to 136.0 at year-end 2014.

Figure 28: Daily return index - PRF

(31 March 2007 = 100)



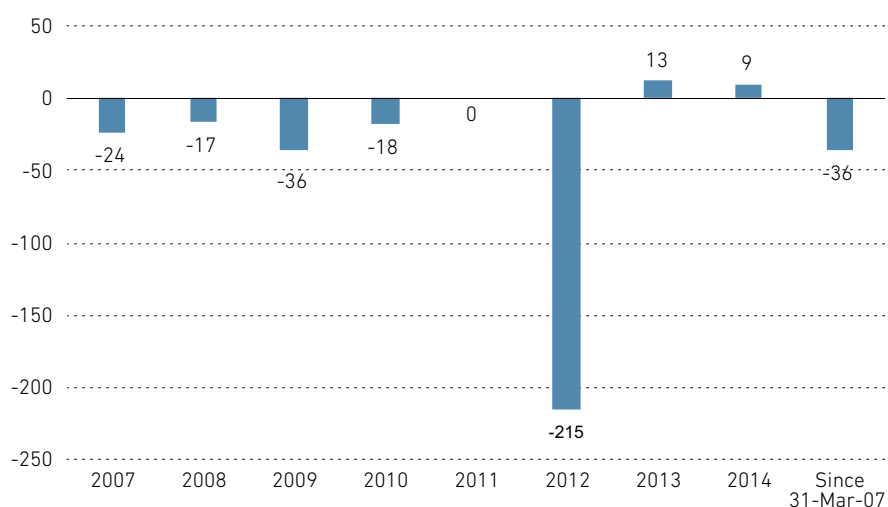
Source: Ministry of Finance

The performance of the PRF, measured as the difference between the portfolio return and the benchmark, was 9 basis points in 2014, while the annualized return since 31 March 2007 was –36 basis points (see figure 29). The negative performance of –215 basis points in 2012 was largely due to the implementation of the new investment policy. If the months of January and February 2012 are excluded to remove the implementation period, when the portfolio allocation had not yet been aligned with the new strategic asset allocation and the fund managers were granted a waiver from the asset allocation requirement, then the performance in 2012 was –3 basis points.²⁷

²⁷ The transfers of funds to the external managers of the corporate bond and stock portfolios, which were a necessary step for convergence to the strategic asset allocation of the new investment policy implemented in 2012, occurred on 17 January and 1 March 2012. Consequently, the external managers did not have the necessary resources to invest the PRF in accordance with the new strategic asset allocation until 1 March 2012. However, the PRF performance shown in figure 29 for 2012 represents the excess return that would have been recorded had the portfolio immediately converged to the new strategic asset allocation on 17 January 2012. If the months of January and February are excluded, since they represent a transition period, and are also excluded the periods in which the portfolio managers were granted waivers following the fund transfers, then the performance in 2012 was –3 basis points.

Figure 29: Net returns against the benchmark²⁸

(basis points)



Source: Ministry of Finance

By asset class, the sovereign portfolio (the aggregate portfolio of sovereign bonds, government-related bonds and inflation-indexed bonds) recorded a positive excess return of 28 basis points over the benchmark in 2014, while the corporate bond portfolio had an excess return of 4 basis points (see table 17). The stock portfolio had a negative net return vis-à-vis the benchmark in 2014, largely due to the effect of tax payments associated with this portfolio, which are not taken into account in the benchmark return. As mentioned above, the performance of the last three years mainly reflects the management results under the new investment policy, which was negatively affected by the implementation period. Excluding the transition period of January and February (when the new policy was being implemented) and taking into account the waivers granted to the portfolio managers, the annualized excess return in the last three years would be 4 basis points for the sovereign portfolio, -18 basis points for corporate bonds, -20 basis points for stocks and 5 basis points for the total portfolio.

Table 17: Net returns against the benchmark, by asset class²⁹

(basis points)

Asset class	2014	Last 3 years ^(b)	Since inception ^(c)
Sovereign portfolio ^(a)	28	-30	-
Corporate bonds	4	-66	-
Stocks	-32	-71	-
Total portfolio	9	-62	-36

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

(b) The performance of the corporate bond and stock portfolios is calculated from 17 January 2012.

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

Source: Ministry of Finance

28 The 2012 Annual Report published the figure taking into account the waiver granted to the portfolio managers, but starting with the 2013 Annual Report, the figure is not adjusted for the waiver, following the recommendation of the Financial Committee.

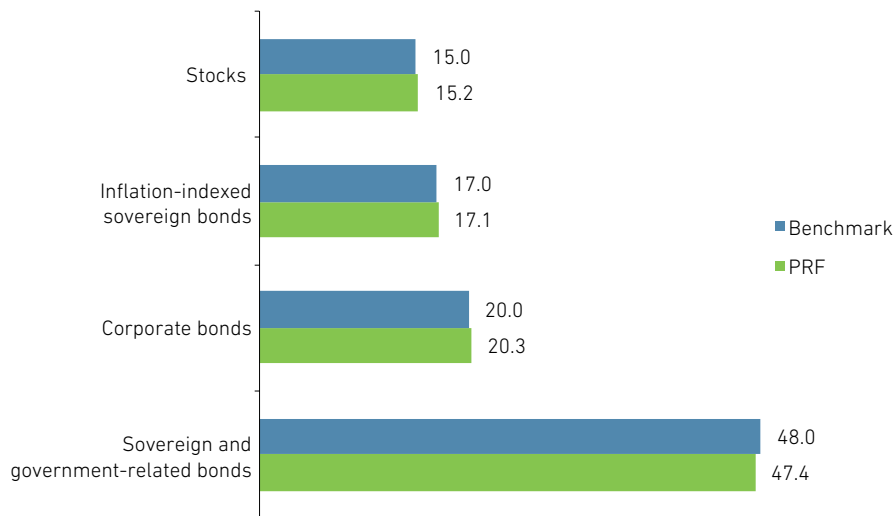
29 The excess return of the total portfolio is calculated as the difference between the weighted sum of the returns of each asset class of the portfolio and the benchmark.

9.4 PORTFOLIO ALLOCATION

As of December 2014, the allocation of the PRF by asset class comprised US\$ 3,767 million in sovereign and government-related bonds, US\$ 1,356 million in inflation-indexed sovereign bonds, US\$ 1,610 million in corporate bonds and US\$ 1,211 million in stocks. In terms of portfolio composition, the percent allocation by asset class and currency was similar to the benchmark, although the share of sovereign and government-related bonds was slightly lower because yields were higher on other asset classes during the year (see figure 30). With regard to the currency allocation, the U.S. dollar was over-weighted relative to the benchmark, while the Japanese yen was under-weighted (see figure 31).

Figure 30: Asset class allocation, 31 December 2014

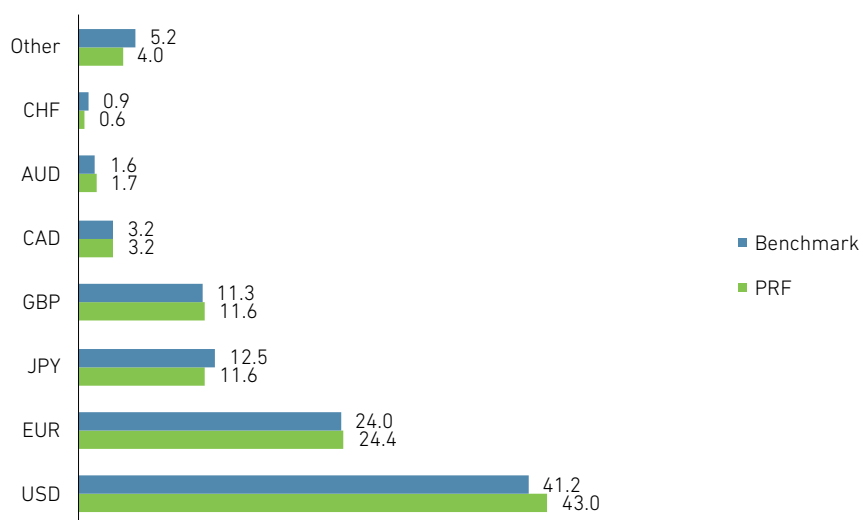
(percent of portfolio)



Source: Ministry of Finance

Figure 31: Currency allocation, 31 December 2014

(percent of portfolio)



Source: Ministry of Finance

In terms of credit risk allocation, at year-end, 44% of the PRF fixed-income portfolio had a rating of AA+ or higher, mainly in sovereign bonds, while 23% had a rating of BBB+ to BBB– (see table 18).

Table 18: Credit risk exposure, 31 December 2014

(percent of fixed-income portfolio)

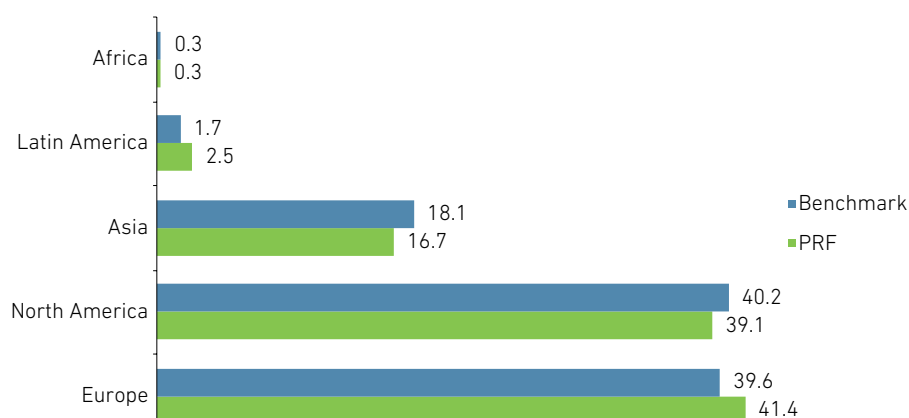
	Sovereign and government-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Total fixed-income
AAA	6.2	9.6	0.2	15.9
AA+	19.6	8.7	0.2	28.5
AA	2.5	0.0	0.5	3.0
AA–	2.5	0.0	1.8	4.2
A+	13.3	0.3	1.8	15.5
A	0.0	0.0	4.2	4.2
A–	1.5	0.0	4.6	6.0
BBB+	6.2	1.5	4.8	12.5
BBB	4.2	0.1	3.5	7.8
BBB–	0.0	0.0	2.4	2.4
Other ^(a)	0.0	0.0	0.0	0.0
Total	55.9	20.1	23.9	100.0

Source: Ministry of Finance

With regard to the geographical and sectoral distribution of investments, the fund's allocation is again in line with the benchmark (see figures 32 and 33). At year-end, 81% of investments were in the United States and Europe, in almost equal shares, while 17% was in Asia, mainly Japan. The remainder was invested in countries in Latin America and Africa. The main economic sectors are government (62%) and the financial sector (13%). Table 19 shows the percentage distribution of the main countries by asset class.

Figure 32: Regional allocation, 31 December 2014

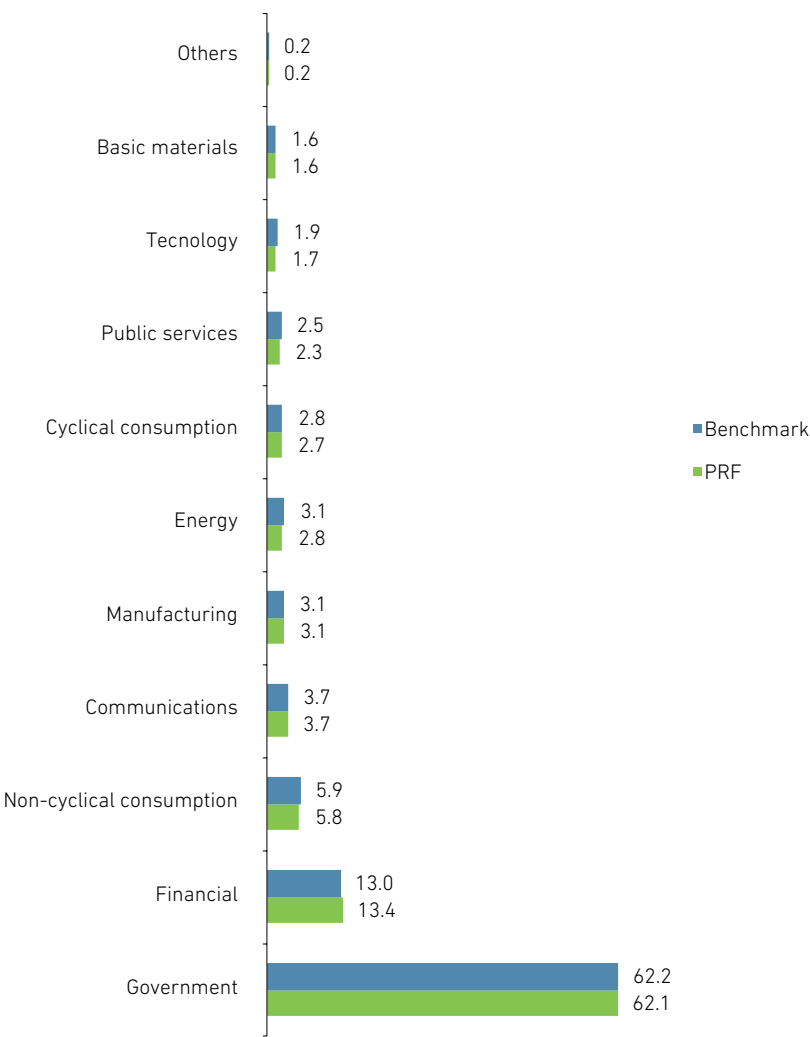
(percent of portfolio)



Source: Ministry of Finance

Figure 33: Sectoral allocation, 31 December 2014

(percent of portfolio)



Source: Ministry of Finance

Table 19: Allocation by asset class and by country, 31 December 2014

(percent of portfolio)

Country allocation	Sovereign and government-related bonds	Inflation-indexed sovereign bonds	Corporate bonds	Stocks	Total
Germany	2.5	0.6	0.3	0.6	4.0
Australia	0.5	0.2	0.3	0.4	1.4
Belgium	0.6	0.0	0.0	0.1	0.7
Canada	2.8	0.4	0.9	0.5	4.8
South Korea	0.8	0.0	0.0	0.2	1.1
Spain	3.5	0.0	0.2	0.2	3.9
USA	9.9	6.6	10.3	8.3	35.1
France	2.9	2.0	1.3	0.5	6.7
Netherlands	1.2	0.0	1.6	0.2	3.0
Italy	4.1	1.3	0.4	0.1	5.9
Japan	10.1	0.2	0.5	1.1	12.0
United Kingdom	2.2	5.3	2.0	1.1	10.5
Supranational	1.7	0.0	0.0	0.0	1.7
Other ^(a)	4.7	0.4	2.3	2.0	9.3
Total	47.4	17.1	20.3	15.2	100.0

(a) Other includes cash and cash equivalents.

Source: Ministry of Finance

9.5 MANAGEMENT COSTS AND INCOME FROM THE SECURITIES LENDING PROGRAM

The total cost of managing the PRF included US\$ 2,296,139 for custody services, US\$ 724,115 for the CBC's management services and US\$ 1,608,982 for external portfolio managers. Together, the remuneration paid to the CBC and external managers equaled 6 basis points of the portfolio in 2014. The income from the securities lending program totaled US\$ 567,458, which partly offset the management and custody costs (see table 20).

Table 20: Management and custody costs and income from the securities lending program

(U.S. dollars)

FRP						
	2009	2010	2011	2012	2013	2014
Custody (J.P. Morgan) ^(a)	192,910	252,787	217,796	91,572	1,971,424	2,296,139
Management (CBC)	155,400	153,600	194,742	520,186	1,032,599	724,115
External Managers	—	—	—	548,098	1,347,401	1,608,982
Other costs ^(b)	—	—	20,000	70,588	—	—
Total costs	348,310	406,387	432,538	1,230,443	4,351,424	4,629,236
Securities lending program	205,679	399,802	923,213	219,422	235,855	567,458

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

(b) Payment to the consulting firm, Strategic Investment Solutions.

Source: Ministry of Finance

9.6 MAIN FINANCIAL RISKS

The PRF portfolio is exposed to many of the same risks as the ESSF. However, credit risk is higher in the PRF due to investment in a larger number of countries and in corporate bonds. As with the ESSF, most of these risks are directly related to the asset class allocation and the choice of benchmarks, given the passive approach of the fund's investment policy.

9.6.1 MARKET RISK

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

Interest rate risk

In the PRF, interest rate risk is mainly a function of the benchmark portfolio duration, which is calculated from the duration of the indexes that make up the benchmark. In contrast to the ESSF, the PRF fixed-income portfolio is exposed to interest rate risk from a larger number of countries, and it is more sensitive due to its longer duration. This risk is monitored and controlled by keeping the portfolio duration close to the benchmark. The benchmark duration at the close of 2014 was 7.59 years, while the actual duration of the PRF was 7.92 years.

Foreign exchange risk

Because the fund's performance is measured in dollars, the value of investments in other currencies is affected by the corresponding exchange rate movements. Given the passive management strategy, the tolerance for foreign exchange risk is defined by the currency allocation of the benchmark. As of year-end 2014, the portfolio included investments denominated in 28 currencies. The fund's exposure to currency risk is mainly through investments denominated in euros (24%), yen (12%), pounds sterling (12%), Canadian dollars (3%), Australian dollars (2%) and other currencies with a smaller share.

Credit spread risk

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

Equity risk

The PRF is exposed to the risk of losses from a decrease in the price of the stocks included in its portfolio. The intrinsic risk of an individual stock is eliminated by investing in a highly diversified portfolio. The fund's tolerance for stock risk is defined as the systemic risk associated with the stock index used as the benchmark (the MSCI ACWI excluding Chile). At the close of 2014, stocks accounted for 15.2% of the fund, which is very close to the strategic asset allocation (15%).

Volatility, VaR and tracking error

The annual volatility of the PRF was 4.5% in 2014, versus 5.5% for the period from 31 March 2007 onward. Since the fund's inception, the highest monthly return was 5.47% (in December 2008), while the lowest was de –3.33% (in January 2009). The

highest quarterly return was 7.36% in the first quarter of 2008; the lowest was –2.94% in the third quarter of 2014 (see table 21). At year-end 2014, the VaR was 6.85% in a one-year horizon, with a 95% confidence level.³⁰

Table 21: Historical minimum and maximum returns

(percent)

Range	Month	Quarter
Highest return	5.47 (Dec-08)	7.36 (Q1 08)
Lowest return	-3.33 (Jan-09)	-2.94 (Q3 14)

Source: Ministry of Finance

Volatility can also be measured relative to the benchmark, in order to assess how close the portfolio is to the stipulated benchmark. At year-end 2014, the ex-ante tracking error of the PRF was 16 basis points, while the ex post tracking error³¹ was 47 basis points. If January and February 2012 are excluded to remove the implementation period of the new investment policy, then the ex post tracking error is reduced to 20 basis points. Thus, both indicators are consistent with a passive management strategy³².

9.6.2 CREDIT RISK

In the PRF bond portfolio, exposure to credit risk is mainly controlled by having a well-diversified portfolio and investing only in issuers included in the benchmark. For bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly associated with investing the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards and swaps is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see table 22). In addition, forwards and swaps cannot exceed a stipulated percentage of each manager's portfolio. For the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio. In the case of the external managers, the use of futures is also allowed so as to limit the total use of derivatives. Thus, forwards, swaps and futures cannot exceed 10% of each external manager's portfolio.

30 This means that 95% of the time, the losses in the fund over a horizon of one year would not exceed 6.85% of its nominal value in dollars.

31 The ex post tracking error is the standard deviation of the historical monthly excess returns recorded from 31 March 2012 through 31 December 2014.

32 Passive management mandates seek to minimize the tracking error, so as to obtain similar returns to the benchmark. .

Table 22: Credit limits on bank deposits and forwards

(millions of dollars, unless otherwise indicated)

Limits		Time deposits	Forwards
Minimum rating		A-	AA-
Maximum per issuer	CBC portfolio	20	1% ^(a)
	Externally managed portfolios	20	

(a) Percent of each manager's portfolio.

Source: Ministry of Finance

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

9.6.3 LIQUIDITY RISK

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

9.6.4 OPERATIONAL RISK

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

This risk has been mitigated by delegating a large share of 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 CBC has also set up a series of controls, including the division of responsibilities and functions, software in line with market quality standards, backup systems to ensure the operational continuity of the funds and internal and external auditing processes to assess the effectiveness of the existing controls.

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

Financial Statements: Economic and Social Stabilization Fund

Financial statements for the years ended on 31 December 2014 and 2013 and the independent auditors' report³³

³³ The financial statements of the Economic and Social Stabilization Fund for the years ended on 31 December 2014 and 2013 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

INFORME DE LOS AUDITORES INDEPENDIENTES

A los señores Tesorería General de la República
Fondo de Estabilización Económica y Social

Hemos efectuado una auditoría a los estados financieros adjuntos de Fondo de Estabilización Económica y Social (en adelante el “Fondo”), que comprenden los estados de situación financiera al 31 de diciembre de 2014 y 2013 y los correspondientes estados de resultados, de resultados integrales, de cambios en el patrimonio neto y de flujos de efectivo por los años terminados en esas fechas y las correspondientes notas a los estados financieros.

Responsabilidad de la Administración por los estados financieros

Tesorería General de la República, es responsable por la preparación y presentación razonable de estos estados financieros de acuerdo con Normas Internacionales de Información Financiera. Esta responsabilidad incluye el diseño, implementación y mantención de un control interno pertinente para la preparación y presentación razonable de los estados financieros, para que éstos estén exentos de representaciones incorrectas significativas, ya sea debido a fraude o error.

Responsabilidad del auditor

Nuestra responsabilidad consiste en expresar una opinión sobre estos estados financieros a base de nuestras auditorías. Efectuamos nuestras auditorías de acuerdo con normas de auditoría generalmente aceptadas en Chile. Tales normas requieren que planifiquemos y realicemos nuestro trabajo con el objeto de lograr un razonable grado de seguridad de que los estados financieros están exentos de representaciones incorrectas significativas.

Una auditoría comprende efectuar procedimientos para obtener evidencia de auditoría sobre los montos y revelaciones en los estados financieros. Los procedimientos seleccionados dependen del juicio del auditor, incluyendo la evaluación de los riesgos de representaciones incorrectas significativas de los estados financieros, ya sea debido a fraude o error. Al efectuar estas evaluaciones de los riesgos, el auditor considera el control interno pertinente para la preparación y presentación razonable de los estados financieros del Fondo con el objeto de diseñar procedimientos de auditoría que sean apropiados en las circunstancias, pero sin el propósito de expresar una opinión sobre la efectividad del control interno del Fondo. En consecuencia, no expresamos tal tipo de opinión. Una auditoría incluye, también, evaluar lo apropiadas que son las políticas de contabilidad utilizadas y la razonabilidad de las estimaciones contables significativas efectuadas por la administración del Fondo, así como una evaluación de la presentación general de los estados financieros.

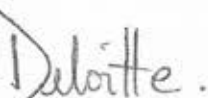
Consideramos que la evidencia de auditoría que hemos obtenido es suficiente y apropiada para proporcionarnos una base para nuestra opinión de auditoría.

Opinión

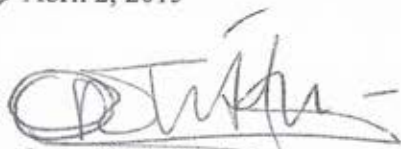
En nuestra opinión, los mencionados estados financieros presentan razonablemente, en todos sus aspectos significativos, la situación financiera de Fondo de Estabilización Económica y Social al 31 de diciembre de 2014 y 2013 y los resultados de sus operaciones y los flujos de efectivo por los años terminados en esas fechas, de acuerdo con Normas Internacionales de Información Financiera.

Otros Asuntos

Como se indica en Notas 1 y 2h, el uso de recursos del Fondo de Estabilización Económica y Social está establecido en el Decreto con Fuerza de Ley N°1 del 11 de diciembre de 2006.

 Deloitte.

Abril 2, 2015



Jorge Ortiz Martínez
12.070.100-2

ECONOMIC AND SOCIAL STABILIZATION FUNDSTATEMENT OF FINANCIAL POSITION
31 DECEMBER 2014 AND 2013
Figures in U.S. dollars - US\$

	Notes	2014 US\$	2013 US\$
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	12	420,253,241	5,561,758
FINANCIAL ASSETS AFFECTING INCOME			
Stocks		1,117,875,671	1,223,124,745
Other capitalization instruments		20,947,313	17,965,114
Time deposits		3,370,372,800	2,721,845,688
Government bonds		8,099,281,868	8,524,084,599
Indexed bonds		512,287,180	541,570,158
Treasury bills		1,161,515,449	2,384,983,014
Derivatives		547,841	14,436
TOTAL INVESTMENTS	7	<u>14,282,828,122</u>	<u>15,413,587,754</u>
TOTAL ASSETS		<u>14,703,081,363</u>	<u>15,419,149,512</u>
LIABILITIES			
Derivative financial instruments	8	<u>14,260,395</u>	<u>23,679</u>
NET EQUITY			
Fisco resources		12,338,004,947	11,734,619,597
Contributions by the Fisco	9	-	603,385,350
Withdrawals by the Fisco	9	(498,934,816)	-
Accumulated results		3,081,120,886	3,262,899,061
Income (loss) in the year		<u>(231,370,049)</u>	<u>(181,778,175)</u>
NET EQUITY		<u>14,688,820,968</u>	<u>15,419,125,833</u>
TOTAL LIABILITIES AND NET EQUITY		<u>14,703,081,363</u>	<u>15,419,149,512</u>

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

ECONOMIC AND SOCIAL STABILIZATION FUND**STATEMENT OF INCOME****FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013****(Figures in U.S. dollars - US\$)**

	Notes	2014 US\$	2013 US\$
OPERATING INCOME			
Interest earned	10	160,968,285	177,632,287
Income from dividends	11	<u>27,313,559</u>	<u>6,469,328</u>
Total operating income		<u>188,281,844</u>	<u>184,101,615</u>
OPERATING LOSSES			
Net loss from the sale of financial instruments		(219,825,061)	(216,752,913)
Net unrealized loss from price changes on financial instruments		<u>(197,140,562)</u>	<u>(146,958,180)</u>
Total operating loss		<u>(416,965,623)</u>	<u>(363,711,093)</u>
Total operating income (loss)		<u>(228,683,779)</u>	<u>(179,609,478)</u>
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(1,558,603)	(789,277)
Custodian's fees and external portfolio managers' fees	9	(1,127,662)	(1,379,420)
Other custody and external management expenses	9	<u>(5)</u>	<u>-</u>
INCOME (LOSS) IN THE YEAR		<u><u>(231,370,049)</u></u>	<u><u>(181,778,175)</u></u>

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013
(Figures in U.S. dollars - US\$)

	2014 US\$	2013 US\$
LOSS IN THE YEAR	<u>(231,370,049)</u>	<u>(181,778,175)</u>
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	<u>-</u>	<u>-</u>
OTHER COMPREHENSIVE INCOME NOT RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	<u>-</u>	<u>-</u>
TOTAL OTHER COMPREHENSIVE INCOME	<u>-</u>	<u>-</u>
COMPREHENSIVE INCOME IN THE YEAR	<u>(231,370,049)</u>	<u>(181,778,175)</u>

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

ECONOMIC AND SOCIAL STABILIZATION FUND**STATEMENT OF CASH FLOW—INDIRECT METHOD
FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013
(Figures in U.S. dollars - US\$)**

	Notes	2014 US\$	2013 US\$
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		(231,370,049)	(181,778,175)
Net unrealized gains (losses)		197,140,562	146,958,180
Changes in fund management and custody		<u>947,855,785</u>	<u>(564,469,279)</u>
Net cash flows from operating activities		<u>913,626,299</u>	<u>(599,289,274)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	-	603,385,350
Decrease from capital withdrawals	9	<u>(498,934,816)</u>	<u>-</u>
Net cash flows from financing activities		<u>(498,934,816)</u>	<u>603,385,350</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS		<u>414,691,483</u>	<u>4,096,076</u>
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		<u>5,561,758</u>	<u>1,465,682</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	<u><u>420,253,241</u></u>	<u><u>5,561,758</u></u>

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

ECONOMIC AND SOCIAL STABILIZATION FUND

STATEMENT OF CHANGES IN NET EQUITY

31 DECEMBER 2014 AND 2013

Figures in U.S. dollars - US\$)

	Notes	Fisco resources US\$	Accumulated results US\$	Income for the year US\$	Total US\$
Opening balance, 1 January 2014		12,338,004,947	3,262,899,061	(181,778,175)	15,419,125,833
Distribution of income from previous year		-	(181,778,175)	181,778,175	-
Contributions by the Fisco	9	-	-	-	-
Withdrawals by the Fisco		(498,934,816)	-	-	(498,934,816)
Income for the year		-	-	(231,370,049)	(231,370,049)
Closing balance, 31 December 2014		11,839,070,131	3,081,120,886	(231,370,049)	14,688,820,968
Opening balance, 1 January 2013		11,734,619,597	3,122,022,834	140,876,227	14,997,518,658
Distribution of income from previous year		-	140,876,227	(140,876,227)	-
Contributions by the Fisco	9	603,385,350	-	-	603,385,350
Income for the year		-	-	(181,778,175)	(181,778,175)
Closing balance, 31 December 2013		12,338,004,947	3,262,899,061	(181,778,175)	15,419,125,833

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

ECONOMIC AND SOCIAL STABILIZATION FUND

NOTES TO THE FINANCIAL STATEMENTS

AS OF 31 DECEMBER 2014 and 2013

(Figures in U.S. dollars — US\$)

1. GENERAL INFORMATION

The Economic and Social Stabilization Fund (hereinafter called the “Fund” or “ESSF”) was created through Law N° 20,128, issued by the Ministry of Finance of Chile on 30 September 2006, which combined into a single fund the additional fiscal revenue stabilization resources stipulated in Decree Law N° 3,653 of 1981 and the Copper Revenue Compensation Fund established under loan agreement BIRF N° 2,625 CH, as specified in Decree with Force of Law N° 1 of 11 December 2006.

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

- a) Decree N° 1,383 of 2006, which authorizes the Central Bank of Chile 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 2012, which informs the fiscal agent of the new performance guidelines for managing the Economic and Social Stabilization Fund.
- c) General Comptroller Official Letter N° 71,390 of 2009, which provides instructions on the Fund’s valuation criteria.
- d) Decree N° 1,636 of 2011, which regulates the coordination and functioning of advisory activities, management support and auditing of the Public Treasury’s financial assets and liabilities, in particular the Economic and Social Stabilization Fund.

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

- To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.

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

The information for the accounting of the sovereign wealth funds is provided by the 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.

- e) Ministry of Finance Official Letter N° 1,267 of 2013, which establishes the new investment guidelines for the Economic and Social Stabilization Fund.
- f) Ministry of Finance Official Letter N° 1,926 of 2013, which establishes the new custodian guidelines.
- g) Ministry of Finance Decree N° 1,618 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.
- h) Ministry of Finance Decree N° 892 of 2014, which establishes fiscal policy in accordance with the provisions of Article 1 of Law N° 20,128.

Qualitative characteristics of the Fund's financial statements

- i. The Principle of Relevance, as a category of the Fund's financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.
- ii. The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.
- iii. The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.
- iv. The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

On 4 June 2013 the Ministry of Finance issued Official Letter N° 1,267, which contains the new investment guidelines for the Economic and Social Stabilization Fund. These guidelines, which entered into force on 5 August 2013, replace and rescind the investment guidelines contained in Official Letter N° 433, issued by the Finance Ministry in 2011.

2. MAIN ACCOUNTING CRITERIA USED

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

a. Basis of preparation and presentation of the financial statements—The Fund financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Additionally, the Fund opted for the early application of IFRS 9: Financial Instruments (issued in November 2009 and modified in October 2011), with the initial application dating to 1 January 2009. IFRS 9 introduces new requirements for classifying and measuring financial assets under the scope of IAS 39: Financial Instruments. Specifically, IFRS 9 requires that all financial assets be classified and later measured either at amortized cost or fair value based on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets.

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

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

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

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

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

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

b. Period covered – The financial statements cover the years between 1 January and 31 December 2014 and 2013, respectively.

c. Functional and presentation currency – The entries included in the Fund'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 Fund 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 identifiable financial investments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Derivatives are also classified at fair value through profit or loss. The Fund has adopted the policy of not using hedge accounting.

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

Financial instruments at fair value through profit or loss:

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

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

Financial assets at amortized cost:

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

On the closing date of each statement of financial position, the Fund assesses whether there is objective evidence of impairment of a financial asset or a group of financial assets, comparing the book value of the asset with any loss events that could have an impact on the expected future cash flows of the financial asset or group of assets, which can be reliably estimated.

Financial liabilities:

Financial liabilities at amortized cost will be classified as Other Liabilities.

Recognition, reduction and measurement:

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

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

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

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

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

Dividend income from financial assets at fair value through profit or loss is recognized on 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 Fund’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 management of the Fund.

f. Funds under management—These are securities delivered to the Central Bank of Chile, acting as fiscal agent for the management of Fund’s resources. The securities can be totally or partially employed in the performance of the assigned duties.

g. Funds in custody—These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for Fund’s 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 Decree with Force of Law N° 1 of 11 of September 2006, the Fund will be established and increased with the following resources:

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

In addition, it also states that:

- a) with all deposits in accounts held by the Funds identified in Article 1, as of the date that the Decree with Force of Law enters into force;
- b) with all resources deriving from the application of Transitory Article 2 of Law N° 19,030;
- c) with 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) with 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 Decree with Force of Law 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 Fund'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 purpose of preparing the Statement of Cash Flows, the sovereign wealth funds use the following definitions:

- Cash and cash equivalents: Includes cash on hand, time deposits in financial 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. Reclassification—The financial statements for 31 December 2013 have been reclassified relative to the financial statements presented last year. This reclassification does not have a significant impact on the financial statements of this year and is solely for the purpose of comparability.

I. New accounting rules

i) The following new rules and amendments have been adopted in these financial statements.

IFRS amendments	Compulsory application date
IAS 32: <i>Financial instruments: Presentation – Clarification of the rules on offsetting financial assets and financial liabilities</i>	Annual periods beginning on or after 1 January 2014
Investment entities: Amendments to IFRS 10: <i>Consolidated financial statements</i> ; IFRS 12: <i>Disclosure of interest in other entities</i> ; and IAS 27: <i>Separate financial statements</i>	Annual periods beginning on or after 1 January 2014
IAS 36: <i>Impairment of assets: Recoverable amounts disclosures for nonfinancial assets</i>	Annual periods beginning on or after 1 January 2014
IAS 39: <i>Financial instruments: Recognition and measurement—Novation of derivatives and continuation of hedge accounting</i>	Annual periods beginning on or after 1 January 2014
IAS 19: <i>Employee benefits: Defined benefits plan—Employee contributions</i>	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2010–2012: Amendments to six IFRS	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2011–2013: Amendments to four IFRS	Annual periods beginning on or after 1 July 2014
New interpretations	
IFRIC 21: <i>Levies</i>	Annual periods beginning on or after 1 January 2014

The application of the amendments and interpretations of the International Financial Reporting Standards described above has not had a significant impact on the Fund's accounting policies or on the amounts reported in these financial statements, although they could affect the accounting of future transactions or agreements.

ii) The following new amendments and interpretations have been issued, but they have not yet entered into force:

New IFRSs	Compulsory application date
IFRS 14: <i>Regulatory deferral accounts</i>	Annual periods beginning on or after 1 January 2016
IFRS 15: <i>Revenue from contracts with customers</i>	Annual periods beginning on or after 1 January 2017
IFRS amendments	Compulsory application date
Accounting for acquisitions of interests in joint operations (amendments to IFRS 11)	Annual periods beginning on or after 1 January 2016
Clarification of acceptable methods of depreciation and amortization (amendments to IAS 16 and IAS 38)	Annual periods beginning on or after 1 January 2016
Agriculture: bearer plants (amendments to IAS 16 and IAS 41)	Annual periods beginning on or after 1 January 2016
Equity method in separate financial statements (amendments to IAS 27)	Annual periods beginning on or after 1 January 2016
Sale or contribution of assets between an investor and its associate or joint venture (amendments to IFRS 10 and IAS 28)	Annual periods beginning on or after 1 January 2016
Disclosure initiative (amendments to IAS 1)	Annual periods beginning on or after 1 January 2016
Investment entities: applying the consolidation exception (amendments to IFRS 10, IFRS 12 and IAS 28)	Annual periods beginning on or after 1 January 2016
Annual improvements cycle 2012–2014: Amendments to four IFRSs	Annual periods beginning on or after 1 July 2016

The Fund's management deems that the future adoption of the Standards and Amendments described above will not have a significant impact on the Fund's financial statements.

3. FUND'S INVESTMENT POLICY

The ESSF management objective is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, in both the Article 4 portfolio and the externally managed portfolio. To this end, an investment portfolio (IP) will be established from the sum of the two portfolios mentioned above. The specific guidelines, parameters and rules are contained in the following sections.

For the ESSF Article 4 portfolio, the fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in the following section. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

3.1. Guidelines and parameters

3.1.1. Asset classes

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

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

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

The asset classes Banking; Treasury Bills and Sovereign Bonds; and Inflation-Indexed Sovereign Bonds, purchased directly by the Central Bank of Chile and managed directly by the Fiscal Agent, make up the Article 4 portfolio. Stocks and other assets, acquired directly by the external managers, will be managed by external managers and make up the externally managed portfolio.

3.1.2. Benchmarks

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

Table 2: Benchmarks

Benchmark	Percent of IP
Merrill Lynch LIBID 3-Month Average USD	5.0%
Merrill Lynch LIBID 3-Month Average EUR	6.0%
Merrill Lynch LIBID 3-Month Average JPY	4.0%
Banking	15.0%
Merrill Lynch Treasury Bills Index USD	6.0%
Merrill Lynch Treasury Bills Index EUR	7.0%
Merrill Lynch Treasury Bills Index JPY	6.0%
Treasury bills	19.0%
Barclays Capital Global Treasury: U.S. 7-10 Yrs.	26.5%
Barclays Capital Global Treasury: Germany 7-10 Yrs.	11.0%
Barclays Capital Global Treasury: Japan 7-10 Yrs.	10.0%
Barclays Capital Global Treasury: Switzerland 7-10 Yrs.	7.5%
Sovereign bonds	55.0%
Treasury Bills and Sovereign Bonds	74.0%
Barclays Capital Global Inflation-Linked: U.S. TIPS 1–10 yrs.	2.5%
Barclays Capital Global Inflation-Linked: Germany 1–10 yrs.	1.0%
Inflation-indexed sovereign bonds	3.5%
Stocks: MSCI All Country World Index * (unhedged with reinvested dividends)	7.5%
Total	100%

*Excluding Chile.

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

3.1.3. Article 4 portfolio

3.1.3.1. Risk budget

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

3.1.3.2. Eligible banks

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

- a) Selection criteria: The institution's long-term rating must be A– or higher from at least two international credit rating agencies (Fitch, Moody's and Standard & Poor's).
- b) Investment limits by issuer: The investment limits for each eligible rating category (AAA to A–) are listed in Table 3. They are calculated every quarter and in the event of contributions, based on the closing value of the IP in the previous quarter or the value on the day prior to the contribution plus the amount of the contribution.

Table 3: Bank exposure limits

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

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

3.1.3.3. Eligible sovereign issuers

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

3.1.3.4. Eligible currencies

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

3.1.3.5. Eligible instruments

- a) **Banking:** The only eligible bank instruments are bank transactional account balances, overnight and weekend deposits, time deposits and certificates of deposits, as well as transactional account balances, overnight deposits and time deposits held in central banks in eligible countries.

b) Sovereign: Only instruments included in the benchmark are eligible for investment.

3.1.3.6. Currency forwards

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

- a) Forwards or swaps can only be arranged between eligible currencies.
- b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of AA– or higher from at least two international credit rating agencies (Fitch, Moody's and Standard & Poor's).
- c) Currency forward or swap contracts can specify cash delivery or net settlement.
- d) 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 in Note 3.1.3.2.
- e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their 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 in Note 3.1.3.2. 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.
- f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.
- g) The notional value of forwards contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio.

3.1.4. Externally managed portfolio

3.1.4.1. Risk budget

The equity portfolio has ex ante tracking error of 60 basis points.

3.1.4.2. Eligible issuers and currencies

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

3.1.4.3. Eligible instruments

The types of instruments that are included in the benchmark are eligible for investment, as are the following instruments:

- a) The Finance Ministry will generate, maintain and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds (ETFs), which the fiscal agent must, in turn, report to the custodian(s).
- b) Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of stocks included in the stock benchmark, provided that they do not require the use of tax agents in the issuing country of the underlying asset.
- c) Exchange-traded futures on stock indexes, used for hedging purposes to minimize differences relative to the applicable stock benchmark (see Table 2) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in an eligible instrument (Note 3.1.4.4).
- d) If the external portfolio managers receive an ineligible instrument as the result of corporate events affecting the stocks in which the portfolio is invested, the situation must be reported to the Finance Ministry through the fiscal agent up to 31 December 2013 and, after that date, directly by the external portfolio manager, so that the Ministry can evaluate the situation and stipulate the steps to be taken.

3.1.4.4. Eligible instruments for cash in foreign currency

The external portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the average monthly value of the portfolio of each external manager. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of that manager's total portfolio returns.

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

For the externally managed portfolio, each portfolio manager can invest up to US\$ 20 million U.S. dollars in a given bank.

3.1.4.5. Limits on forwards or swaps

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

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section 3.1.3.6, letters (a) to (e).

3.1.5. Limits on spot currency transactions

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

3.1.6. Special restrictions

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

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

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

3.1.7. Rebalancing policy

During the transition period established in the Agency Decree, through 31 December 2013, in the event that deviations by asset class deriving from changes in the price or market valuation of the instruments should exceed, at the close of any given day, the deviation ranges established in Table 5, the fiscal agent must implement or, as the case may be, instruct the external manager to implement convergence to the benchmark established in Table 2. The fiscal agent will have 10 bank business days to achieve this convergence, during which the fiscal agent and external managers will be granted a waiver of compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and 3.1.4.1. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

Table 5: Deviation range for rebalancing

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

In addition, in the event of any contributions made during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent must converge to the benchmark established in Table 2. In this case, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and 3.1.4.1.

The custodian will report the relative share of each asset class in the IP. Based on this information, the fiscal agent will carry out the rebalancing of asset classes, as required, during the transition period established in the Agency Decree, through 31 December 2013.

Starting on 1 January 2014, the Finance Ministry will monitor compliance with the target ranges and, at least once a year, will instruct the amounts to be rebalanced between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 2. In addition, in the event of any contributions, the Finance Ministry will instruct the amounts to be transferred to and/or between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 2. In the event of any withdrawals, the Finance Ministry will instruct the amounts to be withdrawn from the externally managed portfolios and the Article 4 portfolio. During each rebalancing episode, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of sections 3.1.3, 3.1.3.1, 3.1.4 and 3.1.4.1. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

3.1.8. Intermediaries.

The following entities are eligible to provide intermediation services:

- i. Entities that are authorized to buy in the primary market; that is, that are classified as primary dealers in the United States of America, the United Kingdom or France.
- ii. Banks that are eligible for investment and that directly provide intermediation services; or affiliates of these banks, provided that the corresponding parent bank(s) certify at least 90% ownership.
- iii. Investment banks that have the same long-term credit rating required for banks that are eligible for investment; or their affiliates provided that the corresponding investment bank(s) certify at least 90% ownership.

3.2. Valuation criteria

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

3.3. Securities lending program

3.3.1. Article 4 portfolio

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

3.3.2. Externally managed portfolio

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

3.4. Other

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

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

In the event of noncompliance with any of the instructions described in this report, at any time, due to fluctuations in market prices, abnormal market conditions or any other reason beyond the control of the fiscal agent or the external portfolio managers, in their respective mandates, the situation will not be considered noncompliance with the guidelines, provided that the necessary measures are taken to ensure compliance within seven days of detecting the situation. This period can be extended by the Finance Ministry at the request of the fiscal agent or its delegate, when justified. Should such an event arise in the externally managed portfolios during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent will report its opinion on submitting the request.

Starting on 1 January 2014, the external portfolio managers will make this request directly to the Finance Ministry.

3.5. Entry into force and transfer to external managers

The provisions of section 3.1. will enter into force on 5 August 2013, taking into account the waivers outlined below. Until that date, the portfolios will continue to be subject to the provisions of section II of the investment guidelines contained in Finance Ministry Official Letter N° 433 of 2011.

3.5.1. IP benchmark

The stipulations of Table 1 “Benchmark allocation of the investment portfolio (IP)” in section 3.1.1. will enter into force no later than 30 August 2013 with regard to the 7.5% share of stocks, taking into account the provisions of section 3.5.2. below. This date can be postponed at the request of the fiscal agent.

3.5.2. Externally managed portfolio

The stock benchmark identified in Table 2 in section 3.1.2. will enter into force no later than 30 August 2013, taking into account the waivers outlined below and at all times with due observance of the guidelines and parameters established in sections 3.1.4.2., 3.1.4.3., 3.1.4.4., 3.1.4.5., 3.1.5. and 3.1.6.

In 2013, the fiscal agent transferred the resources in question to the external portfolio managers. The transfers were made in U.S. dollars. The first transfer of US\$300 million to Mellon Equity took place on 21 August, with an additional US\$300 million to BlackRock Equity on 22 August. The second transfer of US\$269 million to Mellon Equity and US\$267 million to BlackRock Equity took place on 02 October.

3.5.3. Article 4 portfolio

The fiscal agent must achieve the benchmark allocation for the Article 4 portfolio (shown in Table 2 of these guidelines) no later than five business days from the date of each transfer of resources to the external portfolio managers. Thus, between the date that the guidelines enter into force and five business days after the date of the first transfer of resources and for five days after the second, the fiscal agent will have a waiver of compliance with the requirements of section 3.1.3.1. However, during that period the fiscal agent cannot invest in any instruments that are not authorized under either the previous guidelines or the new guidelines.

Thus, the resources corresponding to the 7.5% that will be invested in stocks will continue to be part of the Article 4 portfolio until they have been transferred to the external portfolio managers. To prepare for the delivery of these funds, the fiscal agent will choose a transition strategy for generating the necessary liquidity to be able to deliver the resources to the external portfolio managers.

3.6. Appointment of external managers for the externally managed portfolio

The fiscal agent is expressly authorized to contract, on this one occasion only and with no prior selection process, the management services for the externally managed portfolio, which will be provided by the companies that are currently contracted to manage the stock portfolio for the Pension Reserve Fund: namely, Mellon Capital Management Corporation and BlackRock Institutional Trust Company, N.A.

In December 2013, the fiscal agent reported to the Finance Minister (with a copy to the International Finance Coordinator and the Head of the Sovereign Wealth Funds Unit, both within the Ministry of Finance) on the contracts and/or the changes to the contracts held with Mellon Capital Management Corporation and BlackRock Institutional Trust Company, N.A., as applicable, in compliance with the provisions of the above paragraph, and submitted a copy of the documents in question. These documents expressly state that as of 1 January 2014, the contractual relationship established under these contracts will be managed directly by the Finance Ministry in representation of the Fisco of the Republic of Chile, upon completion of the transition period established in the Agency Decree on 31 December and the fulfillment of the additional responsibilities of the fiscal agent specified in Article 2 of Finance Ministry Decree N° 1,618 of 2012.

3.7. Other provisions related to the external managers during the transition period established in the Agency Decree, through 31 December 2013

In the event that during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent exercises the early termination of the contract for the external management of fiscal resources held by one of the external portfolio managers, where the cause of early termination is problems of solvency, capacity, severe or recurrent noncompliance with instructions, fraud or any other serious situation, the fiscal agent is expressly authorized to transfer all or part of the fiscal resources managed under that contract to any other external portfolio manager with a current contract.

In the event that the fiscal agent cannot transfer the fiscal resources managed under the external portfolio management contract subject to early termination for the reasons outlined in the above paragraph, the fiscal agent can, with the prior approval of the Finance Minister, authorize or exercise the management or conservation functions that it deems necessary, during the transition period established in the Agency Decree, through 31 December 2013, until a new selection process can be initiated for choosing and contracting an external portfolio manager.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1 Critical accounting estimates

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

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

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

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

The determination of what constitutes “observable” represents a critical judgment by the Fund’s management. 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 and operational risk. Most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the Fund’s investment policy. This section describes the risks in greater detail, together with the mechanisms established to mitigate them.

5.1 Market risk:

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

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

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

Credit spread risk: The market value of the fixed-income instruments in the ESSF portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is minimal in the ESSF, because the fixed-income portfolio includes only sovereign issues from the United States, Germany, Japan and Switzerland, among which the lowest rating is AA–.

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

5.2 Credit risk:

The issuer of a fixed-income instrument could enter into a default situation if it becomes unable to meet its financial obligations due to a lack of liquidity or capital. Thus, the fund's credit risk exposure increases to the extent that the default probability of a destination institution or government rises. The ESSF limits exposure to this type of risk differently depending on whether it is sovereign or bank risk. For sovereign exposure, investment is confined to the United States, Germany, Japan and Switzerland, all of which have a sovereign rating of over AA–. Bank investment, in turn, is subject to minimum credit ratings and maximum investments by institution (see Table 6).

Table 6

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

^(a) IP: Investment portfolio.

Source: Ministry of Finance.

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

5.3 Liquidity risk:

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

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

5.4 Operational risk

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

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

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

6. ACCOUNTING CHANGES

As of 31 December 2014, there were no accounting changes relative to the previous year.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were US\$ 14,282,828,122 on 31 December 2014 and US\$15,413,587,754 on 31 December 2013.

a) The breakdown of investments carried at fair value on 31 December 2014 and 2013 is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy level	2014 US\$	2013 US\$
Stocks	1	1,117,875,671	1,223,124,745
Other capitalization instruments	1	20,947,313	17,965,114
Government bonds	1	8,099,281,868	8,524,084,599
Indexed bonds	1	512,287,180	541,570,158
Treasury bills	1	1,161,515,449	2,384,983,014
Derivatives	1	547,841	14,436
Subtotal		<u>10,912,455,322</u>	<u>12,691,742,066</u>
Custodian investments, Central Bank of Chile	Fair value hierarchy level	2014 US\$	2013 US\$
Time deposits	1	<u>3,370,372,800</u>	<u>2,721,845,688</u>
Subtotal		<u>3,370,372,800</u>	<u>2,721,845,688</u>
Total		<u>14,282,828,122</u>	<u>15,413,587,754</u>

b) The breakdown of investments by investment currency on 31 December 2014 and 2013 is as follows:

	Fair value instruments, J.P. Morgan			
	2014		2013	
Local Currency	US\$	% del	US\$	% del
U.S. Dollar	5,723,581,483	52.45%	5,802,176,478	45.72%
Euro	1,855,064,821	17.00%	3,006,074,831	23.69%
Yen	1,943,199,875	17.81%	2,383,263,551	18.78%
Other	1,390,609,143	12.74%	1,500,227,206	11.81%
Subtotal	<u>10,912,455,322</u>	<u>100.00%</u>	<u>12,691,742,066</u>	<u>100.00%</u>

	Fair value instruments, Central Bank of Chile			
	2014		2013	
Local Currency	US\$	% del	US\$	% del
U.S. Dollar	1,280,497,917	37.99%	975,974,832	35.86%
Euro	1,867,118,558	55.40%	998,868,252	36.70%
Yen	222,756,325	6.61%	747,002,604	27.44%
Subtotal	<u>3,370,372,800</u>	<u>100.00%</u>	<u>2,721,845,688</u>	<u>100.00%</u>
Total	<u>14,282,828,122</u>		<u>15,413,587,754</u>	

c) The total value of assets by risk segment on 31 December 2014 and 2013 is as follows:

Risk segment	2014		2013	
	Market value US\$	Market value %	Market value US\$	Market value %
Capitalization instruments	1,138,822,984	7.75%	1,241,089,859	8.05%
Banking (*)	3,791,173,882	25.78%	2,727,421,882	17.69%
Sovereign bonds	9,773,084,497	66.47%	11,450,637,771	74.26%
Total	14,703,081,363	100.00%	15,419,149,512	100.00%

Asset class	2014		2013	
	Market value US\$	Market value %	Market value US\$	Market value %
Capitalization instruments	1,138,822,984	7.75%	1,241,089,859	8.05%
Money market (*)	4,952,689,331	33.68%	5,112,404,896	33.16%
Sovereign bonds	8,099,281,868	55.09%	8,524,084,599	55.28%
Inflation-indexed bonds	512,287,180	3.48%	541,570,158	3.51%
TOTAL	14,703,081,363	100.00%	15,419,149,512	100.00%

(*) Includes cash and cash equivalents.

8. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US\$14,260,395 on 31 December 2014 and US\$23,679 on 31 December 2013.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2014 US\$	2013 US\$
Derivatives	1	14,260,395	23,679
Total investments		14,260,395	23,679

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

Local Currency	Fair value instruments, J.P. Morgan			
	2014		2013	
	US\$	% of IP	US\$	% of IP
U.S. Dollar	5,545,709	38.89%	-	0.00%
Euro	2,376,732	16.67%	11,840	50.00%
Yen	5,545,709	38.89%		
Other	792,245	5.55%	11,839	50.00%
Total	<u>14,260,395</u>	<u>99.99%</u>	<u>23,679</u>	<u>100.00%</u>

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

Risk segment	2014		2013	
	Market value	Market value	Market value	Market value
	US\$	%	US\$	%
Banking	<u>14,260,395</u>	<u>100.00%</u>	<u>23,679</u>	<u>100.00%</u>

Liability class	2014		2013	
	Market value	Market value	Market value	Market value
	US\$	%	US\$	%
Money market	<u>14,260,395</u>	<u>100.00%</u>	<u>-</u>	<u>100.00%</u>

9. CONSTITUTION OF THE FUND

The Fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2014 and 2013:

2014						2013				
	Contributions	Withdrawals	Commissions	Custodian	Other		Contributions	Withdrawals	Commissions	Custodian
	US\$	US\$	US\$	fees	expenses		US\$	US\$	US\$	fees
				US\$	US\$					US\$
January	-	-	-	-	-	January	-	-	-	-
February	-	-	(333,441)	-	-	February	-	-	-	(312,612)
March	-	-	(200,643)	(69,392)	-	March	-	-	(197,320)	-
April	-	-	-	(101,123)	(5)	April	-	-	-	-
May	-	-	-	(300,613)	-	May	603,385,350	-	-	(126,127)
June	-	(498,934,816)	(200,643)	-	-	June	-	-	(197,319)	(188,745)
July	-	-	(63,588)	(107,523)	-	July	-	-	-	-
August	-	-	(88,535)	-	-	August	-	-	-	-
September	-	-	(268,166)	(368,147)	-	September	-	-	(197,319)	(189,738)
October	-	-	(71,123)	-	-	October	-	-	-	-
November	-	-	(66,480)	(82,841)	-	November	-	-	-	-
December	-	-	(265,985)	(98,025)	-	December	-	-	(197,319)	(562,198)
Total	-	(498,934,816)	(1,558,603)	(1,127,662)	(5)	Total	603,385,350	-	(789,277)	(1,379,420)

10. INTEREST EARNED

The breakdown of interest income earned on investments in debt securities carried at fair value through profit or loss as of 31 December 2014 and 2013 is as follows:

	2014 US\$	2013 US\$
Interest earned, Central Bank of Chile	4,878,003	2,724,711
Interest earned, J.P. Morgan	<u>156,090,282</u>	<u>174,907,576</u>
Total	<u><u>160,968,285</u></u>	<u><u>177,632,287</u></u>

11. DIVIDEND INCOME

The breakdown of dividends received from equity investments as of 31 December 2014 and 2013 is as follows:

Dividends from investments managed by	31-Dec-14 US\$	31-Dec-13 US\$
Mellon Capital Management Corporation	13,605,773	3,287,242
BlackRock Institutional Trust Company, N.A.	<u>13,707,786</u>	<u>3,182,086</u>
Total	<u><u>27,313,559</u></u>	<u><u>6,469,328</u></u>

12. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2014 and 2013 breaks down as follows:

Cash in custodian and externally managed accounts	2014 US\$	2013 US\$
J.P. Morgan	416,570,320	820,472
Mellon Capital Management Corporation	1,634,959	3,135,014
BlackRock Institutional Trust Company, N.A.	<u>2,047,962</u>	<u>1,606,272</u>
Total	<u><u>420,253,241</u></u>	<u><u>5,561,758</u></u>

13. FUND'S RETURNS

The breakdown of the Fund's returns as of 31 December 2014 and 2013 is as follows:

Type of return	Accumulated return		
	Current period	Last 12 months	Last 24 months
Nominal	(1.07%)	(1.67%)	(0,64%)

14. FAIR VALUE

The Fund applies IRFS 13 to determine the fair value of its financial assets and financial liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB), as of 1 January 2013. The application is prospective according to the IRFS rule, but the Fund has opted to apply it retrospectively for purposes of comparability.

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

		31-Dec-14		31-Dec-13		
	Level	Net book value	Fair value	Level	Net book value	Fair value
		US\$	US\$		US\$	US\$
Financial assets						
Cash and cash equivalents	1	420,253,241	420,253,241	1	5,561,758	5,561,758
Stocks	1	1,117,875,671	1,117,875,671	1	1,223,124,745	1,223,124,745
Other capitalization instruments	1	20,947,313	20,947,313	1	17,965,114	17,965,114
Time deposits	1	3,370,372,800	3,370,372,800	1	2,721,845,688	2,721,845,688
Government bonds	1	8,099,281,868	8,099,281,868	1	8,524,084,599	8,524,084,599
Indexed bonds	1	512,287,180	512,287,180	1	541,570,158	541,570,158
Treasury bills	1	1,161,515,449	1,161,515,449	1	2,384,983,014	2,384,983,014
Derivatives	1	547,841	547,841	1	14,436	14,436
Financial liabilities						
Derivative financial instruments	1	14,260,395	14,260,395	1	23,679	23,679

In 2014 and 2013, all the assets and liabilities in the Fund were measured according to the prices quoted in the stock market. That is, the valuation technique is based on Level 1 inputs, such that the Fund has not made any changes in fair value hierarchies to date.

15. LIENS AND RESTRICTIONS

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

On 31 December 2014 and 2013, the Fund owned the following instruments under the item Securities lending:

2014

Location	Notional value	Market value US\$
Europe	335,115,000	450,181,775
United States of America	<u>2,997,741,000</u>	<u>3,024,780,810</u>
Total	<u><u>3,332,856,000</u></u>	<u><u>3,474,962,585</u></u>

2013

Location	Notional value	Market value US\$
Europe	181,800,000	253,848,594
United States of America	<u>2,215,900,000</u>	<u>2,135,582,142</u>
Total	<u><u>2,397,700,000</u></u>	<u><u>2,389,430,736</u></u>

16. SECURITIES CUSTODY

As of 31 December 2014, securities custody is as follows:

Entity	Securities custody					
	National custody			Foreign custody		
	Amount in custody US\$	% of total investments in instruments issued by national issuers	% of total ESSF assets	Amount in custody US\$	% of total investments in instruments issued by foreign issuers	% of total ESSF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	14,268,567,727	100%	97.045%
Total investment portfolio in custody				14,268,567,727	100%	97.045%

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

As of 31 December 2013, securities custody is as follows:

Entity	Securities custody					
	National custody			Foreign custody		
	Amount in custody US\$	% of total investments in instruments issued by national issuers	% of total ESSF assets	Amount in custody US\$	% of total investments in instruments issued by foreign issuers	% of total ESSF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	15,413,564,075	100%	99.964%
Total investment portfolio in custody				15,413,564,075	100%	99.964%

17. RELEVANT EVENTS

Ministry of Finance Decree N° 1,492 was passed on 26 September 2014, which regulates the coordination and performance of consulting activities, management support and the oversight of the General Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund, and which replaces Decree N° 1,636 of 2009.

18. SUBSEQUENT EVENTS

Ministry of Finance Decree N° 1,492 was published in the *Official Gazette* on 6 March 2015. The new decree regulates the coordination and performance of consulting activities, management support and the oversight of the General Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund, and which replaces Decree N° 1,636 of 2009.

Between 1 January 2015 and the date of issue of these financial statements (2 April 2015), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

Hernán Frigolett Córdova
General Treasurer of Chile

Cristián Palma Arancibia
Director of Public Finances
Treasury of Chile

Hernán Nobizelli Reyes
Director of Government Accounting
Treasury of Chile

* * * * *

Financial Statements: Pension Reserve Fund

Financial statements for the years ended on 31 December 2014 and 2013 and the independent auditors' report³⁴

³³ The financial statements of the Pension Reserve Fund for the years ended on 31 December 2014 and 2013 were prepared by the General Treasury and audited by Deloitte. This chapter presents a translation of the financial statements that were audited in Spanish. The original financial statements and the letter of the auditor are available in the annual report in Spanish at www.hacienda.cl/fondos-soberanos/informe-anual.html.

INFORME DE LOS AUDITORES INDEPENDIENTES

A los señores Tesorería General de la República
Fondo de Reserva de Pensiones

Hemos efectuado una auditoría a los estados financieros adjuntos de Fondo de Reserva de Pensiones (en adelante el "Fondo"), que comprenden los estados de situación financiera al 31 de diciembre de 2014 y 2013 y los correspondientes estados de resultados, de resultados integrales, de cambios en el patrimonio neto y de flujos de efectivo por los años terminados en esas fechas y las correspondientes notas a los estados financieros.

Responsabilidad de la Administración por los estados financieros

Tesorería General de la República, es responsable por la preparación y presentación razonable de estos estados financieros de acuerdo con Normas Internacionales de Información Financiera. Esta responsabilidad incluye el diseño, implementación y mantención de un control interno pertinente para la preparación y presentación razonable de los estados financieros, para que éstos estén exentos de representaciones incorrectas significativas, ya sea debido a fraude o error.

Responsabilidad del auditor

Nuestra responsabilidad consiste en expresar una opinión sobre estos estados financieros a base de nuestras auditorías. Efectuamos nuestras auditorías de acuerdo con normas de auditoría generalmente aceptadas en Chile. Tales normas requieren que planifiquemos y realicemos nuestro trabajo con el objeto de lograr un razonable grado de seguridad de que los estados financieros están exentos de representaciones incorrectas significativas.

Una auditoría comprende efectuar procedimientos para obtener evidencia de auditoría sobre los montos y revelaciones en los estados financieros. Los procedimientos seleccionados dependen del juicio del auditor, incluyendo la evaluación de los riesgos de representaciones incorrectas significativas de los estados financieros, ya sea debido a fraude o error. Al efectuar estas evaluaciones de los riesgos, el auditor considera el control interno pertinente para la preparación y presentación razonable de los estados financieros del Fondo con el objeto de diseñar procedimientos de auditoría que sean apropiados en las circunstancias, pero sin el propósito de expresar una opinión sobre la efectividad del control interno del Fondo. En consecuencia, no expresamos tal tipo de opinión. Una auditoría incluye, también, evaluar lo apropiadas que son las políticas de contabilidad utilizadas y la razonabilidad de las estimaciones contables significativas efectuadas por la administración del Fondo, así como una evaluación de la presentación general de los estados financieros.

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

Opinión

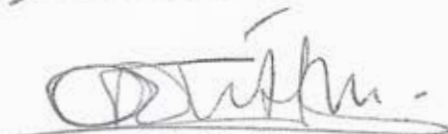
En nuestra opinión, los mencionados estados financieros presentan razonablemente, en todos sus aspectos significativos, la situación financiera de Fondo de Reserva de Pensiones al 31 de diciembre de 2014 y 2013 y los resultados de sus operaciones y los flujos de efectivo por los años terminados en esas fechas, de acuerdo con Normas Internacionales de Información Financiera.

Otros Asuntos

Como se indica en Nota 1, el Fondo de Reserva de Pensiones está destinado a completar el financiamiento de obligaciones fiscales derivadas de la garantía estatal de pensiones mínimas de vejez, invalidez y sobrevivencia regulada en el Decreto Ley N°3.500 de 1980 y de las pensiones asistenciales reguladas en el Decreto Ley N°869 de 1975.

Deloitte.

Abril 2, 2015



Jorge Ortiz Martínez
12.070.100-2

PENSION RESERVE FUND

STATEMENT OF FINANCIAL POSITION

31 DECEMBER 2014 AND 2013

Figures in U.S. dollars - US\$)

	Notes	2014 US\$	2013 US\$
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	12	20,011,585	19,560,358
FINANCIAL ASSETS AFFECTING INCOME			
Stocks		1,184,328,783	1,193,788,399
Other capitalization instruments		22,346,962	17,512,332
Corporate bonds		1,595,317,934	1,416,294,791
Time deposits		338,913	8,751,703
Government bonds		4,114,111,471	3,699,548,640
Indexed bonds		1,009,807,895	979,372,236
Derivatives		2	373,370
TOTAL INVESTMENTS	7	<u>7,926,251,960</u>	<u>7,315,641,471</u>
TOTAL ASSETS		<u><u>7,946,263,545</u></u>	<u><u>7,335,201,829</u></u>
LIABILITIES			
Derivative financial instruments	8	<u>2,564,141</u>	<u>87,324</u>
NET EQUITY			
Fisco resources		6,449,368,454	5,072,618,668
Contributions by the Fisco	9	498,934,816	1,376,749,786
Accumulated results		885,746,051	810,635,597
Income in the year		<u>109,650,083</u>	<u>75,110,454</u>
NET EQUITY		<u>7,943,699,404</u>	<u>7,335,114,505</u>
TOTAL LIABILITIES AND NET EQUITY		<u><u>7,946,263,545</u></u>	<u><u>7,335,201,829</u></u>

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

PENSION RESERVE FUND

STATEMENT OF INCOME FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013 (Cifras en dólares estadounidenses - US\$)

	Notes	2014 US\$	2013 US\$
OPERATING INCOME			
Interest earned	10	162,947,098	148,191,596
Income from dividends	11	27,230,580	25,872,663
Net unrealized gains from price changes on financial instruments		<u>-</u>	<u>24,580,106</u>
Total net operating income		<u>190,177,678</u>	<u>198,644,365</u>
OPERATING LOSSES			
Net loss from the sale of financial instruments		(31,170,529)	(119,182,487)
Net unrealized loss from price changes on financial instruments		<u>(44,727,830)</u>	<u>-</u>
Total net operating loss		<u>(75,898,359)</u>	<u>(119,182,487)</u>
Net operating income		<u>114,279,319</u>	<u>79,461,878</u>
MANAGEMENT EXPENSES			
Fiscal agent's fees (Central Bank of Chile)	9	(1,516,514)	(1,032,599)
Custodian's fees and external portfolio managers' fees	9	<u>(3,112,722)</u>	<u>(3,318,825)</u>
INCOME IN THE YEAR		<u>109,650,083</u>	<u>75,110,454</u>

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

PENSION RESERVE FUND

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013 (Cifras en dólares estadounidenses - US\$)

	2014 US\$	2013 US\$
INCOME IN THE YEAR	<u>109,650,083</u>	<u>75,110,454</u>
OTHER COMPREHENSIVE INCOME RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	<u>-</u>	<u>-</u>
OTHER COMPREHENSIVE INCOME NOT RECLASSIFIED TO INCOME IN SUBSEQUENT YEARS	<u>-</u>	<u>-</u>
TOTAL OTHER COMPREHENSIVE INCOME	<u>-</u>	<u>-</u>
COMPREHENSIVE INCOME IN THE YEAR	<u><u>109,650,083</u></u>	<u><u>75,110,454</u></u>

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

PENSION RESERVE FUND

STATEMENT OF CHANGES IN NET EQUITY

31 DECEMBER 2014 AND 2013

Figures in U.S. dollars - US\$)

	Notes	Fisco resources US\$	Accumulated results US\$	Income for the year US\$	Total US\$
Opening balance, 1 January 2014		6,449,368,454	810,635,597	75,110,454	7,335,114,505
Distribution of income from previous year		-	75,110,454	(75,110,454)	-
Contributions by the Fisco	9	498,934,816	-	-	498,934,816
Income for the year		-	-	109,650,083	109,650,083
Closing balance, 31 December 2014		6,948,303,270	885,746,051	109,650,083	7,943,699,404
Opening balance, 1 January 2013		5,072,618,668	530,345,677	280,289,920	5,883,254,265
Distribution of income from previous year		-	280,289,920	(280,289,920)	-
Contributions by the Fisco	9	1,376,749,786	-	-	1,376,749,786
Income for the year		-	-	75,110,454	75,110,454
Closing balance, 31 December 2013		6,449,368,454	810,635,597	75,110,454	7,335,114,505

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

PENSION RESERVE FUND**STATEMENT OF CASH FLOW—INDIRECT METHOD
FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013
(Cifras en dólares estadounidenses - US\$)**

	Notes	2014 US\$	2013 US\$
CASH FLOWS FROM OPERATING ACTIVITIES			
Income in the year		109,650,083	75,110,454
Net unrealized losses		44,727,830	(24,580,106)
Changes in fund management and custody		<u>(652,861,502)</u>	<u>(1,439,890,196)</u>
Net cash flows from operating activities		<u>(498,483,589)</u>	<u>(1,389,359,848)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase from capital contributions	9	<u>498,934,816</u>	<u>1,376,749,786</u>
Net cash flows from financing activities		<u>498,934,816</u>	<u>1,376,749,786</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		<u>451,227</u>	<u>(12,610,062)</u>
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		<u>19,560,358</u>	<u>32,170,420</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12	<u><u>20,011,585</u></u>	<u><u>19,560,358</u></u>

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

PENSION RESERVE FUND

NOTES TO THE FINANCIAL STATEMENTS

As of 31 DECEMBER 2014 and 2013

(Figures in U.S. dollars—US\$)

1. GENERAL INFORMATION

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

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

- a) Decree N° 1,383 of 2006, which authorizes the Central Bank of Chile 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 Fund’s resources.
- c) Decree N° 1,649 de 2007, which modifies the Fund's investment limits.
- d) Ministry of Finance Official Letter N° 1,673 of 2011, which informs the fiscal agent of the new performance guidelines for managing the Fund’s resources.
- e) General Comptroller Official Letter N° 71,390 of 2009, which provides instructions on the Fund’s valuation criteria.
- f) Decree N° 1,636 of 2010, which regulates the coordination and functioning of advisory activities, management support and auditing of the Public Treasury’s financial assets and liabilities, in particular the Pension Reserve Fund.

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

- To record sovereign wealth fund investments, as well as debt operations, in accordance with the accounting and budgetary standards established by the General Comptroller and/or the Budget Office, as applicable.

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

The information for the accounting of the Fund 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.

- g) Ministry of Finance Official Letter N° 1,925 of 2013, which establishes the new investment guidelines for the Pension Reserve Fund.
- h) Ministry of Finance Official Letter N° 1,926 of 2013, which establishes the new custodian guidelines.
- i) Ministry of Finance Decree N° 1,618 of 2013, which redefines the activities performed by the Central Bank of Chile in its role as fiscal agent.
- j) Ministry of Finance Decree N° 892 of 2014, which establishes fiscal policy in accordance with the provisions of Article 1 of Law N° 20,128.

Qualitative characteristics of the Fund's financial statements:

- i. The Principle of Relevance, as a category of the Fund's financial statements, infers the Principle of Materiality and Relative Importance, which in turn implies that in the accounting, the correct application of principles and standards includes being practical, provided that it does not in any way distort the general picture of the information.
- ii. The Principle of Reliability encompasses the following reporting principles: the Principle of Faithful Representation, the Principle of Substance over Form, the Principle of Neutrality, the Principle of Prudence and the Principle of Full Disclosure, within an internal audit system based fundamentally on the Central Bank of Chile's responsibility, as fiscal agent, to verify the information prepared by the custodian.
- iii. The Principle of Comparability constitutes one of the objectives behind conforming to international financial standards in the accounting of the sovereign wealth funds, so as to be consistent with international accounting practices.
- iv. The Principle of Understandability aims to generate financial statements for the sovereign wealth funds that are prepared with the aim of being generally informative.

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

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

On 13 August 2013, the Finance Ministry issued the new investment guidelines for the Pension Reserve Fund. These guidelines, which entered into force on 16 August 2013, replace and rescind the investment guidelines contained in Official Letter N° 1,637, issued by the Finance Ministry in 2011.

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

On 31 January 2014, a team of expert consultants commissioned by the Finance Ministry issued an Actuarial Study Report on the sustainability of the Pension Reserve Fund. The study measured the expected evolution of the Pension Reserve Fund under different scenarios, to provide the basis for a sustainability analysis of the Fund over the next 20 years. The report finds that the Pension Reserve Fund demonstrates sustainability in every one of the scenarios tested.

2. MAIN ACCOUNTING CRITERIA USED

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

a. Basis of preparation and presentation of the financial statements—The Fund's financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

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

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

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

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

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

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

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

b. Period covered—The financial statements cover the years between 1 January and 31 December 2014 and 2013, respectively.

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

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

Financial assets and liabilities:

Classification:

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

Financial assets at fair value through profit or loss:

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

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

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

Stocks and other capitalization instruments are carried at fair value and any changes in value are recognized directly through profit or loss on the comprehensive income statement.

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

Financial assets at amortized cost:

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

On the closing date of each statement of financial position, the Fund assesses whether there is objective evidence of impairment of a financial asset or a group of financial assets, comparing the book value of the asset with any loss events that could have an impact on the expected future cash flows of the financial asset or group of assets, which can be reliably estimated.

Financial liabilities:

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

Recognition, reduction and measurement

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

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

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

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

Dividend income from financial assets at fair value through profit or loss is recognized on 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 Fund’s financial statements, a distinction is made between cash held in the current account maintained for the Funds by the Treasury and cash held by the custodian as a result of operations undertaken in management of the Fund.

f. Funds under management—These are securities delivered to the Central Bank of Chile, acting as fiscal agent for the management of Fund’s resources. The securities can be totally or partially employed in the performance of the assigned duties.

g. Funds in custody—These are securities delivered by the Central Bank of Chile, as fiscal agent, to the custodian J.P. Morgan Chase & Co., which provides general custody services for Fund's securities and instruments.

h. Net equity—The net equity of the Fund 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 Pension Reserve Fund 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 Pension Reserve Fund 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 Pension Reserve Fund assets is to complement the payment of the liabilities laid out in the Fund 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 financial 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

i) The following new rules and amendments have been adopted in these financial statements.

IFRS amendments	Compulsory application date
IAS 32: <i>Financial instruments: Presentation – Clarification of the rules on offsetting financial assets and financial liabilities</i>	Annual periods beginning on or after 1 January 2014
Investment entities: Amendments to IFRS 10: <i>Consolidated financial statements</i> ; IFRS 12: <i>Disclosure of interest in other entities</i> ; and IAS 27: <i>Separate financial statements</i>	Annual periods beginning on or after 1 January 2014
IAS 36: <i>Impairment of assets: Recoverable amounts disclosures for nonfinancial assets</i>	Annual periods beginning on or after 1 January 2014
IAS 39: <i>Financial instruments: Recognition and measurement— Novation of derivatives and continuation of hedge accounting</i>	Annual periods beginning on or after 1 January 2014
IAS 19: <i>Employee benefits: Defined benefits plan— Employee contributions</i>	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2010–2012: Amendments to six IFRSs	Annual periods beginning on or after 1 July 2014
Annual improvements cycle 2011–2013: Amendments to four IFRSs	Annual periods beginning on or after 1 July 2014
New interpretations	
IFRIC 21: <i>Levies</i>	Annual periods beginning on or after 1 January 2014

The application of the amendments and interpretations of the International Financial Reporting Standards described above has not had a significant impact on the Fund's accounting policies or on the amounts reported in these financial statements, although they could affect the accounting of future transactions or agreements.

ii) The following new amendments and interpretations have been issued, but they have not yet entered into force:

New IFRSs	Compulsory application date
IFRS 14: <i>Regulatory deferral accounts</i>	Annual periods beginning on or after 1 January 2016
IFRS 15: <i>Revenue from contracts with customers</i>	Annual periods beginning on or after 1 January 2017
IFRS amendments	Compulsory application date
Accounting for acquisitions of interests in joint operations (amendments to IFRS 11)	Annual periods beginning on or after 1 January 2016
Clarification of acceptable methods of depreciation and amortization (amendments to IAS 16 and IAS 38)	Annual periods beginning on or after 1 January 2016
Agriculture: bearer plants (amendments to IAS 16 and IAS 41)	Annual periods beginning on or after 1 January 2016
Equity method in separate financial statements (amendments to IAS 27)	Annual periods beginning on or after 1 January 2016
Sale or contribution of assets between an investor and its associate or joint venture (amendments to IFRS 10 and IAS 28)	Annual periods beginning on or after 1 January 2016
Disclosure initiative (amendments to IAS 1)	Annual periods beginning on or after 1 January 2016
Investment entities: applying the consolidation exception (amendments to IFRS 10, IFRS 12 and IAS 28)	Annual periods beginning on or after 1 January 2016
Annual improvements cycle 2012–2014: Amendments to four IFRSs	Annual periods beginning on or after 1 July 2016

The Fund management deems that the future adoption of the Standards and Amendments described above will not have a significant impact on the Fund's financial statements.

3. FUND'S INVESTMENT POLICY

The PRF management objective is to obtain monthly returns in line with the benchmarks, based on a passive management strategy, in both the Article 4 portfolio and the externally managed portfolio. To this end, an investment portfolio (IP) will be established from the sum of the two portfolios mentioned above. The specific guidelines, parameters and rules are contained in the following sections.

For the PRF Article 4 portfolio, the fiscal agent will choose an investment strategy capable of achieving this objective, within the risk standards specified in the relevant guidelines and parameters, as outlined in the following section. The eligible strategies include the possibility of selecting a limited number of instruments or replicating the full index, among other alternatives.

3.1. Guidelines and parameters

3.1.1. Asset classes and benchmarks

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

Table 1: Asset allocation and Benchmark

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

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

² Excluding Chile.

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

The asset classes Sovereign and government-related bonds and inflation-indexed sovereign bonds, purchased directly by the Central Bank of Chile and managed directly by the Fiscal Agent, make up the Article 4 portfolio. The asset classes corporate bonds, stocks, and other assets, acquired directly by the external managers, will be managed by external managers and make up the externally managed portfolio.

3.1.2 Article 4 portfolio

3.1.2.1 Risk budget

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

3.1.2.2 Eligible issuers and currencies

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

3.1.2.3 Eligible instruments

3.1.2.3.1 Eligible instruments for sovereign and government-related bonds

Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of seven business days to sell the instrument.

3.1.2.3.2 Eligible instruments for inflation-indexed sovereign bonds

Instruments that are included in the corresponding benchmark are eligible for investment, as well as instruments that meet the benchmark's eligibility criteria and thus should be incorporated into the benchmark at the close of the respective month. In the event that an instrument is not incorporated into the benchmark as expected, for whatever reason, the fiscal agent will have a period of seven business days to sell the instrument.

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

The fiscal agent can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the average monthly value of the Article 4 portfolio. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of the Article 4 portfolio returns.

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

For the Article 4 portfolio, a maximum amount equivalent to US\$ 20 million U.S. dollars can be invested in a given bank. However, whenever a contribution is made to the Article 4 portfolio, a maximum amount equivalent to US\$ 80 million U.S. dollars can be invested in a given bank during the waiver period established in section 3.1.6.

3.1.2.5 Currency forwards or swaps

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

- a) Forwards or swaps can only be arranged between eligible currencies.
- b) Currency forward or swap contracts can only be written or held with eligible counterparties that have a credit rating of AA– or higher from at least two international credit rating agencies (Fitch, Moody's and Standard & Poor's).
- c) Currency forward or swap contracts can specify cash delivery or net settlement.
- d) 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 associated counterparty risk must be taken into account for the purposes of complying with the limits established for credit risk (Note 3.1.2.4).
- e) The counterparty risk associated with each net settlement contract that includes a close-out netting clause in the case of counterparty default or insolvency will equal 15% of the notional value of the forward and 30% of the notional value of the swap, both in their 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 3.1.2.4). 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.

- f) The notional amount of open forward or swap contracts will not exceed a sum total of 4% of the Article 4 portfolio.
- g) The notional value of forwards contracted by the fiscal agent with an eligible counterparty cannot exceed 1% of the market value of the Article 4 portfolio.

3.1.2.6 Limits on sovereign and government-related bonds

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

Table 2: Investment limits by credit rating for sovereign and government-related bonds

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

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

3.1.3 Externally managed portfolio

3.1.3.1 Risk budget

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

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

3.1.3.2 Eligible issuers and currencies

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

3.1.3.3 Eligible instruments

3.1.3.3.1 Eligible instruments for corporate bonds

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

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

3.1.3.3.2 Eligible instruments for stocks

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

- ✓ The Finance Ministry will generate, maintain and communicate to the fiscal agent a list of eligible mutual funds and exchange-traded funds (ETFs), which the fiscal agent must, in turn, report to the custodian.
- ✓ Exchange-traded American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of stocks included in the stock benchmark, provided that they do not require the use of tax agents in the issuing country of the underlying asset.
- ✓ Exchange-traded futures on stock indexes, used for hedging purposes to minimize differences relative to the applicable stock benchmark (see Table 1) or to gain exposure to part of the benchmark. No leveraging is allowed at the start of each derivative transaction. That is, the notional amount involved in each derivative operation cannot exceed the market value of the share of underlying assets. If the underlying asset is cash, it must be held in the instruments eligible for cash in foreign currency in the externally managed portfolio.

- ✓ If the external portfolio managers receive an ineligible instrument as the result of corporate events affecting the stocks in which the portfolio is invested, the situation must be reported to the Finance Ministry through the fiscal agent up to 31 December 2013 and, after that date, directly by the external portfolio manager, so that the Ministry can evaluate the situation and stipulate the steps to be taken.

3.1.3.4 Eligible instruments for cash in foreign currency in the externally managed portfolio

The external portfolio managers can hold cash in foreign currency in the instruments stipulated below, for a maximum amount equivalent to 5% of the average monthly value of the portfolio of each external manager. The return on cash in foreign currency earned by each manager will be incorporated in the calculation of that manager's total portfolio returns.

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

For the externally managed portfolio, each portfolio manager can invest up to US\$ 20 million U.S. dollars in a given bank. However, whenever a contribution is made to the externally managed portfolios, a maximum amount equivalent to US\$ 80 million U.S. dollars can be invested in a given bank during the waiver period established in section 3.1.6.

3.1.3.5 Limits on forwards or swaps

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

The notional value of forwards or swaps contracted by an external manager with an eligible counterparty cannot exceed 1% of the market value of the portfolio under management. The methodology for calculating this 1% is described in section 3.1.2.5. However, the associated counterparty risk must be taken into account for the purpose of compliance with the limits established in section 3.1.3.4.

3.1.3.6 Limits by issuer of corporate bonds

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

Table 3: Limits by issuer's credit quality for corporate bonds.

Credit rating	Limit by issuer
AAA	15%
AA+	10%
AA	10%
AA–	10%
A+	5%
A	5%
A–	5%
BBB+	5%
BBB	5%
BBB–	5%

3.1.3.7 Limits by credit rating of corporate bonds

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

Table 4: Limits by credit rating of corporate bonds

Credit rating	Maximum % of the externally managed portfolio
AAA	100%
AA+	
AA	
AA–	
A+	60%
A	
A–	
BBB+	45%
BBB	
BBB–	

During the transition period established in the Agency Decree, the fiscal agent is responsible for monitoring the investment limits by issuer and by credit rating in the corporate bond asset class; starting on 1 January 2014, this responsibility will be transferred to the Ministry of Finance. For the purpose of monitoring said limits, the median credit rating on long-term instruments from the three international rating agencies (Standard & Poor's, Moody's and Fitch) is used. If only two ratings are available, the lower of the two is taken. If there is only one, that rating is taken.

3.1.4 Limits on currency spot transactions

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

3.1.5 Special restrictions

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

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

For the externally managed portfolio, the external managers can contract currency futures, forwards or swaps, where the aggregate notional amount cannot exceed 10% of the portfolio under their management.

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

External managers cannot invest in their own stocks or in corporate bonds issued by their own companies.

3.1.6 Rebalancing

During the transition period established in the Agency Decree, through 31 December 2013, in the event that deviations by asset class deriving from changes in the price or market valuation of the instruments should exceed, at the close of any given day, the deviation ranges established in Table 5, the fiscal agent must implement or, as the case may be, instruct the external manager to implement convergence to the benchmark established in Table 1. The fiscal agent will have 10 bank business days to achieve this convergence, during which the fiscal agent and external managers will be granted a waiver of compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio and instruments eligible for cash in foreign currency applicable to the Article 4 portfolio. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

Table 5: Deviation range for rebalancing

Strategic Asset Allocation		Deviation range
Asset class	Percent of IP	(percent of IP)
Sovereign and government-related bonds	48%	45%–51%
Inflation-indexed sovereign bonds (real)	17%	14%–20%
Corporate bonds	20%	17%–23%
Stocks	15%	12%–18%

In addition, in the event of any contributions made during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent must converge to the benchmark established in Table 1. In this case, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio, instruments eligible for cash in foreign currency applicable to the Article 4 portfolio, the risk budget for the externally managed portfolio and instruments eligible for cash in foreign currency applicable to the externally managed portfolio.

The custodian will report the relative share of each asset class in the investment portfolio. Based on this information, the fiscal agent will carry out the rebalancing of asset classes, as required, during the transition period established in the Agency Decree, through 31 December 2013.

Starting on 1 January 2014, the Finance Ministry will monitor compliance with the target ranges and, at least once a year, will instruct the amounts to be rebalanced between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 1, as needed. In addition, in the event of any contributions, the Finance Ministry will instruct the amounts to be transferred to and/or between the externally managed portfolios and the Article 4 portfolio in order to converge to the benchmarks established in Table 1. In the event of any withdrawals, the Finance Ministry will instruct the amounts to be withdrawn from the externally managed portfolios and/or the Article 4 portfolio. During each rebalancing episode, the fiscal agent and external managers will be granted a waiver of 10 bank business days with regard to compliance with the requirements of the sections governing the Article 4 portfolio, the externally managed portfolio, the risk budget for the Article 4 portfolio, instruments eligible for cash in foreign currency applicable to the Article 4 portfolio, the risk budget for the externally managed portfolio and instruments eligible for cash in foreign currency applicable to the externally managed portfolio. This period can be extended by the Finance Ministry at the request of the fiscal agent, when justified.

3.2 Valuation criteria

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

3.3 Securities lending program

3.3.1 Article 4 portfolio

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

3.3.2 Externally managed portfolio

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

3.4 Other

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

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

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

During the transition period established in the Agency Decree, the Ministry of Finance can extend the waiver period at the request of the fiscal agent or its delegate, when justified. Should such an event arise in the externally managed portfolios during the transition period, the fiscal agent will report its opinion on submitting the request. Starting on 1 January 2014, the Ministry of Finance can extend the waiver period applicable to the Article 4 portfolio at the request of the fiscal agent or its delegate, when justified; and can extend the waiver period applicable to the externally managed portfolio at the direct request of the external managers, when justified.

3.5 Entry into force

The provisions of section 3.1. will enter into force on 16 August 2013. Until that date, the portfolios will continue to be subject to the provisions of section II of the previous investment guidelines.

3.6 Other provisions related to the external managers during the transition period established in the Agency Decree, through 31 December 2013

In the event that during the transition period established in the Agency Decree, through 31 December 2013, the fiscal agent exercises the early termination of the contract for the external management of fiscal resources held by one of the external portfolio managers, where the cause of early termination is problems of solvency, capacity, severe or recurrent noncompliance with instructions, fraud or any other serious situation, the fiscal agent is expressly authorized to transfer all or part of the fiscal resources managed under that contract to any other external portfolio manager with a current contract.

In the event that the fiscal agent cannot transfer the fiscal resources managed under the external portfolio management contract subject to early termination for the reasons outlined in the above paragraph, the fiscal agent can, with the prior approval of the Finance Minister, authorize or exercise the management or conservation functions that it deems necessary, during the transition period established in the Agency Decree, through 31 December 2013, until a new selection process can be initiated for choosing and contracting an external portfolio manager.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

4.1 Critical accounting estimates

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

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

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

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

The determination of what constitutes “observable” represents a critical judgment by the Fund’s management. 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 PRF is exposed to many of the same risks as the ESSF. However, credit risk is higher in the PRF due to the investments in a larger number of countries and in corporate bonds. As in the case of the ESSF, most of these risks directly depend on the asset and currency allocation and the chosen benchmarks, especially given the passive management strategy stipulated in the investment policy.

5.1 Market risk:

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

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

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

Credit spread risk: The market value of the fixed-income instruments in the PRF portfolio is exposed to changes in the market's perception of the solvency of the issuers of those instruments. In general, if an issuer's solvency worsens, the credit spread on the instruments issued by that entity widens, and the market value of the instruments drops. This risk is higher in the PRF than in the ESSF because the fixed-income portfolio includes investments in a large number of issuers from around the world. For example, the Fund invests in instruments issued by the governments of developed and developing countries, public and semi-public agencies, multi-lateral financial institutions, corporations and so on. This risk is mitigated by having a well-diversified portfolio and investing only in investment-grade instruments (with a rating of BBB– or higher).

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

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

5.2 Credit risk

In the PRF bond portfolio, credit risk exposure is controlled primarily by having a well-diversified portfolio and investing only in issuers included in the benchmark. In the case of bank deposits, credit risk is minimal, given that the time deposits are very short term and are mainly used to invest the cash on hand that is necessary for managing the portfolio. There is also a minimum credit rating for eligible banks and limits on the amount that can be deposited in any given bank. The credit risk associated with forwards and swaps is controlled through minimum credit rating requirements for eligible counterparties and limits on exposure to any given counterparty (see table 7). In addition, forwards and swaps cannot exceed a stipulated percentage of each manager's portfolio. For the portfolio managed by the CBC, forwards and swaps cannot exceed 4% of the portfolio. In the case of the external managers, the use of futures is also allowed so as to limit the total use of derivatives. Thus, forwards, swaps and futures cannot exceed 10% of each external manager's portfolio.

Table 7. Credit limits on bank deposits and forwards
(millions of U.S. dollars, unless otherwise indicated)

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

^(a) Percent of each manager's portfolio.

Source: Ministry of Finance.

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

5.3 Liquidity risk:

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

5.4 Operational risk:

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

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

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

6. ACCOUNTING CHANGES

As of 31 December 2014, there were no accounting changes relative to the previous year.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Investments carried at fair value were on US\$7,926,251,960 on 31 December 2014 and US\$7,315,641,471 on 31 December 2013.

a) The breakdown of investments carried at fair value on 31 December 2014 and 2013 is as follows:

Custodian investments, J.P. Morgan	Fair value hierarchy	2014 US\$	2013 US\$
Stocks	1	1,184,328,783	1,193,788,399
Other capitalization instruments	1	22,346,962	17,512,332
Corporate bonds	1	1,595,317,934	1,416,294,791
Government bonds	1	4,114,111,471	3,699,548,640
Indexed bonds	1	1,009,807,895	979,372,236
Derivatives	1	2	373,370
Subtotal		<u>7,925,913,047</u>	<u>7,306,889,768</u>
 Custodian investments, Central Bank of Chile	 Fair value hierarchy	 2014 US\$	 2013 US\$
Time deposits	1	<u>338,913</u>	<u>8,751,703</u>
Subtotal		<u>338,913</u>	<u>8,751,703</u>
 Total		 <u>7,926,251,960</u>	 <u>7,315,641,471</u>

b) The breakdown of investments by investment currency on 31 December 2014 and 2013 is as follows:

Local Currency	Fair value instruments, J.P. Morgan			
	2014		2013	
	US\$	% of IP	US\$	% of IP
U.S. Dollar	3,433,226,952	43.32%	3,034,390,393	41.53%
Euro	1,923,174,379	24.26%	1,796,451,425	24.59%
Yen	914,850,886	11.54%	976,996,626	13.37%
Other	1,654,660,830	20.88%	1,499,051,324	20.51%
Subtotal	7,925,913,047	100.00%	7,306,889,768	100.00%

Local Currency	Fair value instruments, Central Bank of Chile			
	2014		2013	
	US\$	% of IP	US\$	% of IP
Other	338,913	100.00%	8,751,703	100.00%
Subtotal	338,913	100.00%	8,751,703	100.00%
Total	7,926,251,960		7,315,641,471	

c) The total value of assets by risk segment on 31 December 2014 and 2013 is as follows:

Risk segment	2014		2013	
	Market value	Market value	Market value	Market value
	US\$	%	US\$	%
Stocks	1,206,675,747	15.19%	1,211,674,101	16.51%
Banking (*)	20,350,498	0.25%	28,312,061	0.39%
Bonds	6,719,237,300	84.56%	6,095,215,667	83.10%
Total	7,946,263,545	99.99%	7,335,201,829	100.00%

Asset class	2014		2013	
	Market value	Market value	Market value	Market value
	US\$	%	US\$	%
Stocks	1,206,675,747	15.19%	1,211,674,101	16.51%
Banking (*)	20,350,498	0.25%	28,312,061	0.39%
Corporate bonds	1,595,317,934	21.09%	1,416,294,791	19.31%
Sovereign bonds	4,114,111,471	51.71%	3,699,548,640	50.44%
Inflation-indexed bonds	1,009,807,895	11.76%	979,372,236	13.35%
Total	7,946,263,545	100.00%	7,335,201,829	100.00%

(*) Includes cash and cash equivalents.

8. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Derivative financial liabilities carried at fair value were US\$2,564,141 on 31 December 2014 and US\$87,324 on 31 December 2013.

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

Custodian investments, J.P. Morgan	Fair value hierarchy level	2014 US\$	2013 US\$
Derivatives	1	<u>2,564,141</u>	<u>87,324</u>
Total		<u><u>2,564,141</u></u>	<u><u>87,324</u></u>

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

Local Currency	Fair value instruments, J.P. Morgan			
	2014		2013	
	US\$	% of IP	US\$	% of IP
AUD	150,832	5.88%	8,732	10.00%
CAD	75,416	2.94%	-	0.00%
CHF	75,416	2.94%	8,732	10.00%
EUR	150,832	5.88%	8,732	10.00%
GBP	75,416	2.95%	8,732	10.00%
JPY	527,911	20.59%	-	0.00%
MXN	150,832	5.88%	-	0.00%
SGD	75,415	2.94%	8,732	10.00%
USD	<u>1,282,071</u>	<u>50.00%</u>	<u>43,664</u>	<u>50.00%</u>
Total	<u><u>2,564,141</u></u>	<u><u>100.01%</u></u>	<u><u>87,324</u></u>	<u><u>100.00%</u></u>

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

Risk segment	2014		2013	
	Market value US\$	Market value %	Market value US\$	Market value %
Banking	<u>2,564,141</u>	<u>100.00%</u>	<u>87,324</u>	<u>100.00%</u>

Liability class	2014		2013	
	Market value US\$	Market value %	Market value US\$	Market value %
Money market	<u>2,564,141</u>	<u>100.00%</u>	<u>87,324</u>	<u>100.00%</u>

9. CONSTITUTION OF THE FUND

The Fund entrusted to the Central Bank of Chile for management, in the role of fiscal agent, was created in March 2007. The following movements were recorded in 2014 and 2013:

	2014				2013			
	Contributions	Withdrawals	Commissions	Custodian fees	Contributions	Withdrawals	Commissions	Custodian fees
	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$
January	-	-	-	(358,402)	-	-	-	-
February	-	-	-	(950,101)	-	-	-	(314,065)
March	-	-	(181,029)	(242,547)	-	-	(258,149)	-
April	-	-	-	(232,043)	-	-	-	(1,166,662)
May	-	-	-	(392,965)	1,376,749,786	-	-	(469,461)
June	498,934,816	-	(181,029)	-	-	-	(258,150)	(467,175)
July	-	-	(176,570)	(120,344)	-	-	-	(221,550)
August	-	-	(225,142)	-	-	-	-	-
September	-	-	(371,336)	(410,760)	-	-	(258,150)	(355,881)
October	-	-	(68,764)	-	-	-	-	(117,810)
November	-	-	-	(87,854)	-	-	-	-
December	-	-	(312,644)	(317,705)	-	-	(258,150)	(206,221)
TOTAL	498,934,816	-	(1,516,514)	(3,112,722)	1,376,749,786	-	(1,032,599)	(3,318,825)

10. INTEREST EARNED

The breakdown of income from interest earned on investments in debt securities carried at fair value through profit or loss on 31 December 2014 and 2013 is as follows:

	2014	2013
	US\$	US\$
Interest earned, Central Bank of Chile	16,063,460	16,282,512
Interest earned, J.P. Morgan	<u>146,883,638</u>	<u>131,909,084</u>
Total	<u><u>162,947,098</u></u>	<u><u>148,191,596</u></u>

11. DIVIDEND INCOME

The breakdown of dividends received from equity investments as of 31 December 2014 and 2013 is as follows:

Dividends from investments managed by	31-Dec-14	31-Dec-13
	US\$	US\$
Mellon Capital Management Corporation	13,611,557	12,943,388
BlackRock Institutional Trust Company, N.A.	<u>13,619,023</u>	<u>12,929,275</u>
Total	<u><u>27,230,580</u></u>	<u><u>25,872,663</u></u>

12. CASH AND CASH EQUIVALENTS

The balance in Cash and cash equivalents on 31 December 2014 and 2013 breaks down as follows:

Cash in custodian and externally managed accounts	2014	2013
	US\$	US\$
J.P. Morgan	1,489,208	1,846,998
Mellon Capital Management Corporation	2,336,197	3,928,701
Rogge Global Partners	6,386,993	8,398,402
BlackRock Institutional Trust Company, N.A.	<u>9,799,187</u>	<u>5,386,257</u>
Total	<u><u>20,011,585</u></u>	<u><u>19,560,358</u></u>

13. FUND'S RETURNS

The breakdown of the Fund's returns as of 31 December 2014 and 2013 is as follows:

Type of return	Current period	Accumulated return	
		Last 12 months	Last 24 months
Nominal	(0,89)%	1.75%	2.53%

14. FAIR VALUE

The PRF has applied IRFS 13 to determine the fair value of its financial assets and financial liabilities, in accordance with the requirements of the International Accounting Standards Board (IASB) as of 1 January 2013. The application is prospective according to the IRFS rule, but the PRF has opted to apply it retrospectively for purposes of comparability.

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

31-Dec-14				31-Dec-13			
Level	Net book value		Fair value	Level	Net book value		Fair value
	US\$		US\$		US\$		US\$
FINANCIAL ASSETS							
Cash and cash equivalents	1	20,011,585	20,011,585	1	19,560,358	19,560,358	
Stocks	1	1,184,328,783	1,184,328,783	1	1,193,788,399	1,193,788,399	
Other capitalization instruments	1	22,346,962	22,346,962	1	17,512,332	17,512,332	
Corporate bonds	1	1,595,317,934	1,595,317,934	1	1,416,294,791	1,416,294,791	
Time deposits	1	338,913	338,913	1	8,751,703	8,751,703	
Government bonds	1	4,114,111,471	4,114,111,471	1	3,699,548,640	3,699,548,640	
Indexed bonds	1	1,009,807,895	1,009,807,895	1	979,372,236	979,372,236	
Derivatives	1	2	2	1	373,370	373,370	
FINANCIAL LIABILITIES							
Derivative financial instruments		2,564,141	2,564,141	1	87,324	87,324	

In 2014 and 2013, all the assets and liabilities in the Fund were measured according to the prices quoted in the stock market. That is, the valuation technique is based on Level 1 inputs, such that the Fund has not made any changes in fair value hierarchies to date.

15. LIENS AND RESTRICTIONS

In accordance with Ministry of Finance Official Letter N°1,925 of 13 August 2013, Section II N°5, the fiscal agent for the Article 4 portfolio can enter into agreements with the Fund's custodian(s) to participate in securities lending, provided that the custodians comply with the operating criteria established in the Fund's Custodian Guidelines, in particular the obligation to return the respective securities or, in the absence thereof, to pay the corresponding market value. The resources earned or disbursed are to be recorded on the sovereign wealth funds financial statements as income in the year.

On 31 December 2014 and 2013, the Fund owned the following instruments under the item Securities lending:

2014

Location	Nominal value	Market value US\$
Europe	32,800,000	51,850,655
United States of America	<u>280,378,000</u>	<u>284,096,456</u>
Total	<u><u>313,178,000</u></u>	<u><u>335,947,111</u></u>

2013

Location	Nominal value	Market value (US\$)
Europe	40,950,000	62,341,161
United States of America	<u>387,615,000</u>	<u>391,474,976</u>
Total	<u><u>428,565,000</u></u>	<u><u>453,816,137</u></u>

16. SECURITIES CUSTODY

As of 31 December 2014, securities custody is as follows:

Entity	Securities custody, 2014					
	National custody			Foreign custody		
	Amount in custody US\$	% of total investments in instruments issued by national issuers	% of total PRF assets	Amount in custody US\$	% of total investments in instruments issued by foreign issuers	% of total PRF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	7,923,687,819	100%	99.72%
Total investment portfolio in custody	-	-	-	7,923,687,819	100%	99.72%

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

As of 31 December 2013, securities custody was as follows:

Entity	Securities custody, 2013					
	National custody			Foreign custody		
	Amount in custody US\$	% of total investments in instruments issued by national issuers	% of total PRF assets	Amount in custody US\$	% of total investments in instruments issued by foreign issuers	% of total PRF assets
Securities depositories	-	-	-	-	-	-
Other entities (*)	-	-	-	7,315,554,147	100%	99.73%
Total investment portfolio in custody	-	-	-	7,315,554,147	100%	99.73%

17. RELEVANT EVENTS

Ministry of Finance Decree N° 1,492 was passed on 26 September 2014, which regulates the coordination and performance of consulting activities, management support and the oversight of the General Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund, and which replaces Decree N° 1,636 of 2009.

18. SUBSEQUENT EVENTS

Ministry of Finance Decree N° 1,492 was published in the *Official Gazette* on 6 March 2015. The new decree regulates the coordination and performance of consulting activities, management support and the oversight of the General Treasury's financial assets and liabilities, in particular the Economic and Social Stabilization Fund and the Pension Reserve Fund, and which replaces Decree N° 1,636 of 2009.

Between 1 January 2015 and the date of issue of these financial statements (2 April 2015), there have not been any other subsequent events that could materially affect the balances or interpretation of these financial statements.

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Appendix 1

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Appendix 2

Glossary of Terms

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

ADR — American Depositary Receipt.

Alternative investments — Investments in instruments other than traditional securities (such as stocks and fixed-income instruments), in particular private equity, hedge funds, commodities and real estate.

Asset class — A specific investment category, such as stocks, corporate bonds, sovereign bonds and money market instruments. The assets in a given class generally have similar risk characteristics, react similarly in the market and are subject to the same regulations.

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

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

Cash — Cash on hand and bank demand deposits.

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

Credit default swaps (CDS) — Financial instruments used by investors to protect against default on bond payments. They can also be used to take speculative positions on the bond covered by the CDS.

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

Duration — A parameter that measures a bond's sensitivity to interest rate movements. The longer the bond's duration, the greater its exposure to loss in response to an interest rate hike.

Exchange rate return — The share of the return deriving from fluctuations in the exchange rate between the dollar and the other currencies in which investments are made.

Exchange traded funds (ETFs) — Financial instruments traded on the stock exchange, which typically replicate a market index. They have traditionally been used to obtain passive exposure to 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.

GDR — Global Depositary Receipt.

Inflation-indexed bond — A bond that is adjusted based on a specified inflation index. In the case of the United States, these bonds are called Treasury Inflation-Protected Securities (TIPS).

Internal rate of return (IRR) — The effective rate of return on investments, calculated by setting the present value of all net cash flows to zero.

Investment policy — A set of criteria, principles and guidelines that regulate the amount, structure and dynamics of a portfolio's investments.

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

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

Liquidity — The facility with which an investment or instrument can be sold without significant loss of value.

Money market instruments — Short-term instruments with a maturity of less than one year, which are easily converted into cash and are less volatile than other asset classes.

Mutual funds (MFs) — An investment vehicle managed by an entity that pools capital from different investors in order to achieve exposure in different asset classes. Unlike ETFs, MFs are not traded on an exchange.

Passive management — An investment strategy aimed at replicating the returns of a representative index or indexes of a given asset class.

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 Chilean Institute for Pension Normalization on account of contributions made by workers to the former pay-as-you-go pension system prior to joining the current AFP system.

Return in local currency — A financial instrument's return in the denomination currency. Corresponds to the share of the return deriving from the interest rate level, interest rate movements, changes in credit quality and other factors.

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

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

Sovereign bond — A bond issued by a government.

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 equity 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 local currency and the return from exchange rate movements.

Tracking error (ex post or ex ante) — An indicator used to measure how closely a portfolio tracks its benchmark. The ex post tracking error is calculated with historical data; the ex ante tracking error is a prediction of future performance.

Value-at-Risk (VaR) — A measure of the potential loss in a portfolio over a given period of time and with a given probability.

Variable-income instruments — Stocks.

Volatility — A measure of a financial asset's risk, based on the variability or dispersion of the asset's price over a period of time.

Appendix 3

Abbreviations

ADR	American Depositary Receipt
AUD	Australian dollar
bp	Basis points
CAD	Canadian dollar
CBC	Central Bank of Chile
CBJ	Central Bank of Japan
CDS	Credit Default Swaps
CHF	Swiss franc
ECB	European Central Bank
ETF	Exchange-Traded Fund
EUR	Euro
FC	Financial Committee
FED	U.S. Federal Reserve
ESSF	Economic and Social Stabilization Fund
GAAP	Generally accepted accounting principles
GBP	Pound sterling
GDP	Gross domestic product
GDR	Global Depositary Receipt
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IIR	Internal rate of return
JPM	J.P. Morgan
JPY	Japanese yen
LIBID	London interbank bid rate
LIBOR	London interbank offered rate
M US\$	Thousands of U.S. dollars
MM US\$	Millions of U.S. dollars
MBS	Mortgage-backed securities
PRF	Pension Reserve Fund
TE	Tracking error
TWR	Time-weighted rate of return
UF	Unidad de Fomento (an inflation-indexed unit of account)
USA	United States of America
USD	U.S. dollar
US\$	U.S. dollar
VaR	Value at risk

