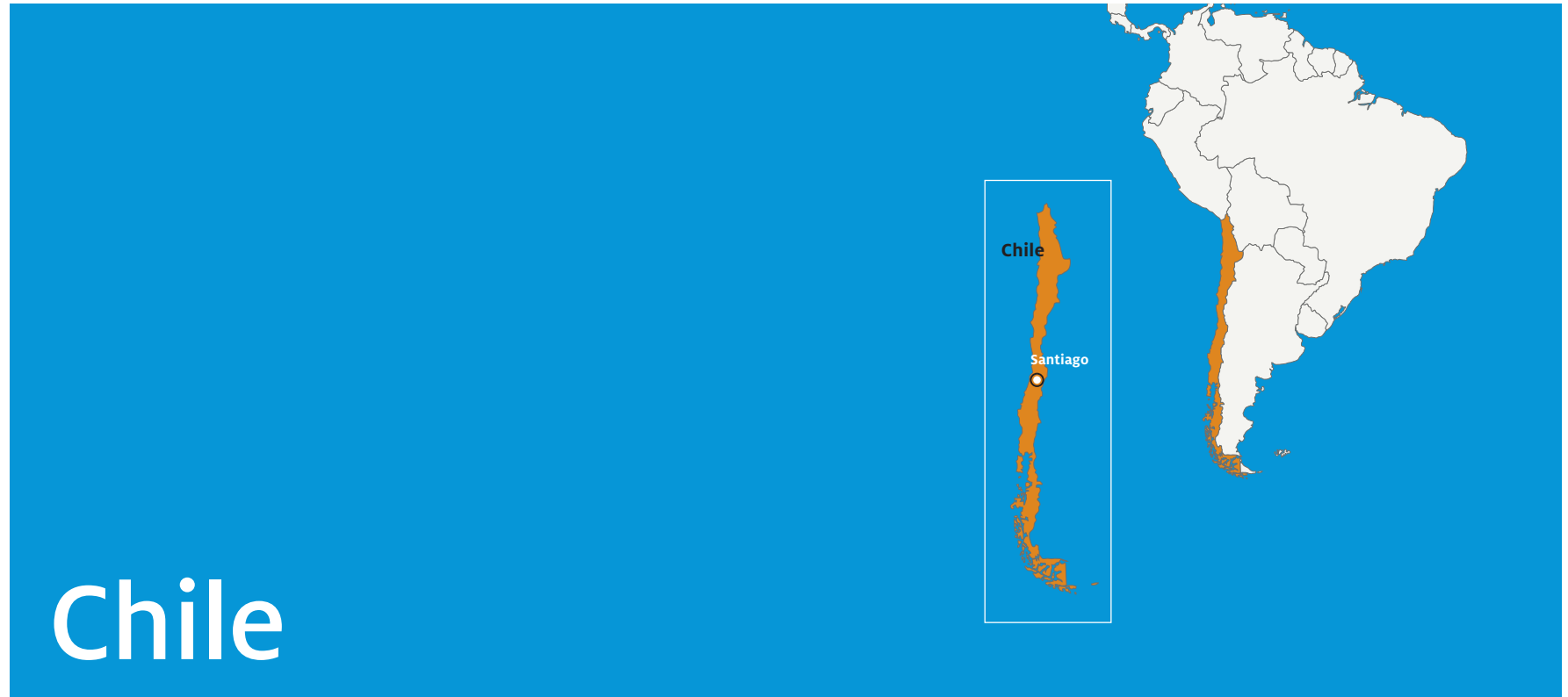


Natural Resource Funds



The Pension Reserve Fund
and the Economic and
Social Stabilization Fund



Market Value

Pension Reserve Fund
\$7.01 billion

Economic and Social Stabilization Fund
\$15.21 billion

Santiago
Compliance
Index

85 / 100

Resource
Governance Index
Natural Resource
Fund Score

87 / 100

Truman Sovereign
Wealth Fund
Scoreboard

91 / 100 (Economic and
Social Stabilization Fund)

85 / 100
(Pension Reserve Fund)

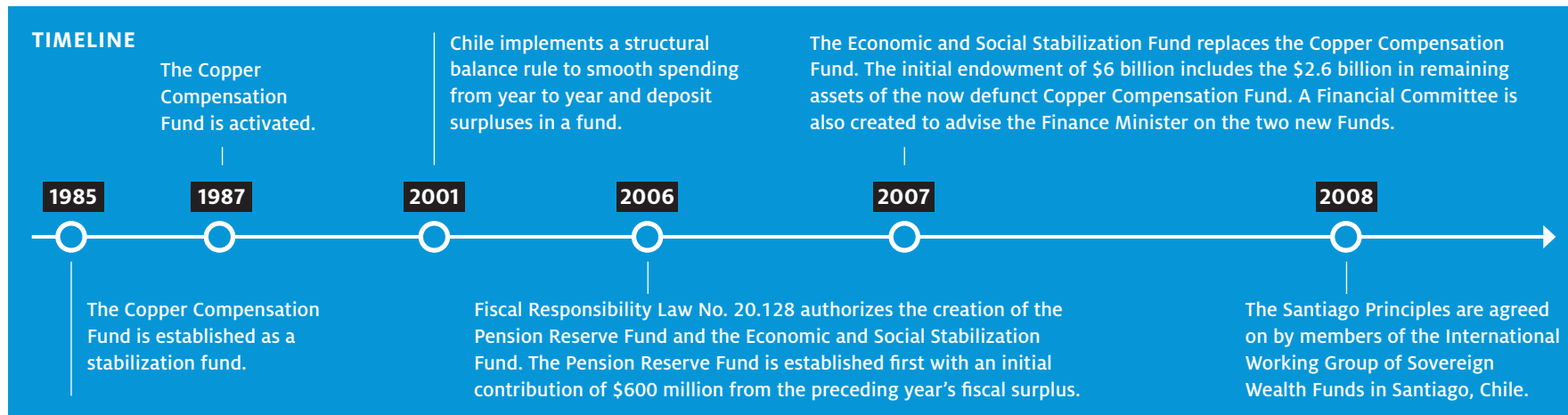
Good Governance Fundamentals	
Clear Deposit Rules	yes
Clear Withdrawal Rules	yes
Clear Investment Rules	yes
Transparent	yes
Publicly Available Audits	yes
Effective Oversight	yes

Fund Highlights

- Chile established two funds in 2006, the Pension Reserve Fund to help finance pension and social welfare spending and the Economic and Social Stabilization Fund to help overcome fiscal deficits when copper revenues decline unexpectedly.
- The Funds are governed by a strong set of deposit and withdrawal rules underpinned by a fiscal rule that smooths spending over time.

- The two Funds' respective investment rules are designed to reflect their different objectives, avoid conflicts of interest and prevent excessive risk-taking.
- While external audits are made public, compliance with the rules is not assessed by a formal oversight body like a multistakeholder committee or independent fiscal council.
- The Funds are very transparent. Information on fund managers, returns on specific investments and even how deposits and withdrawals are calculated is all publicly available.

Timeline and Fund Objectives



Fund Inception

- The Pension Reserve Fund and the Economic and Social Stabilization Fund were authorized by **Fiscal Responsibility Law No. 20.128** in 2006.¹
- The Economic and Social Stabilization Fund was officially created via the **Ministry of Finance Statutory Decree No. 1** to replace the now abolished Copper Compensation Fund.²

Fund Objectives³

- The Pension Reserve Fund is a savings fund for pension and social welfare obligations. The Fund specifically finances state guaranteed solidarity pension benefits and contributions for the elderly and disabled.
- The Economic and Social Stabilization Fund is a stabilization fund and countercyclical tool that aims to smooth out government expenditures, allowing the government to finance fiscal deficits in times of low growth and/or low copper prices and to pay down public debt when necessary.

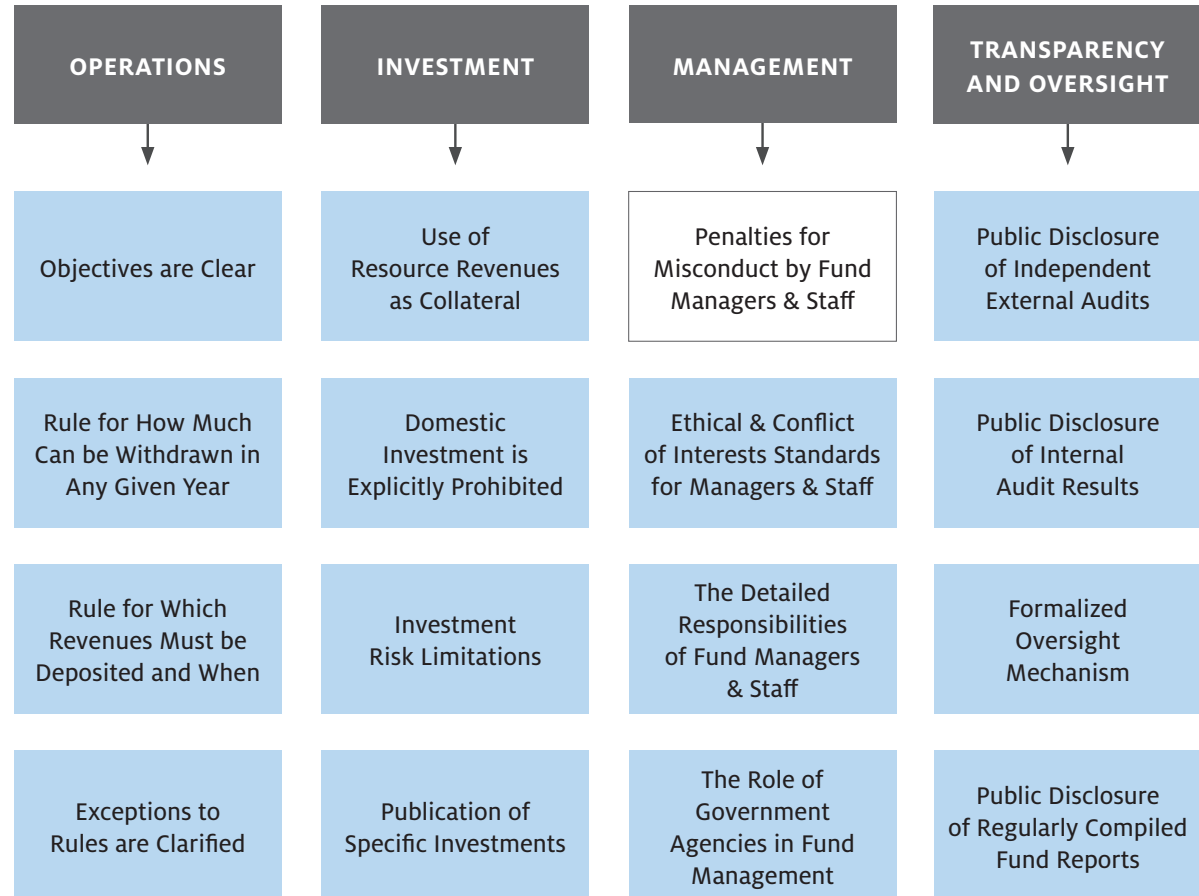
CHILE


Each box represents a regulatory standard essential for promoting consistent use of and safeguarding resource revenues. White boxes highlight regulatory gaps in fund governance.


15/16

Good Governance Standards Met

Good Governance Standards and Gaps in Regulation



 Presence of Regulation

 Absence of Regulation

Operational Laws, Rules and Policies

The two Funds' different deposit and withdrawal rules reflect their different objectives.

Structural Balance Rule⁴

Fiscal surpluses are deposited into Chile's funds to smooth spending from year to year. Advisory Committees of the Ministry of Finance calculate trend GDP growth and forecast copper prices, which are then used to estimate fiscal revenues for budget planning. For 2014, the Ministry of Finance has calculated the target structural balance to be a 1 percent deficit indicating the need for withdrawals from the Economic and Social Stabilization Fund rather than deposits.^{5,6}

Fund Deposit Rules⁷

Pension Reserve Fund

- A minimum of 0.2 percent of the previous year's GDP must be deposited into the Pension Reserve Fund annually. If the effective fiscal surplus exceeds this amount, the deposit amount can rise to a maximum of 0.5 percent of the previous year's GDP. The Fund is capped at 900 million Unidades de Fomento (approximately \$41 billion as of July 2013⁸).
- Deposits can be financed with funds from the Economic and Social Stabilization Fund at the discretion of the Minister of Finance.

Economic and Social Stabilization Fund

- Any remaining fiscal surplus after deposits to the Pension Reserve Fund are made, minus any funds used for public debt repayments or advance payments into the Economic and Social Stabilization Fund made the previous year, are deposited into the Economic and Social Stabilization Fund.

- In 2021, if withdrawals from the Pension Reserve Fund are not greater than 5 percent of pension spending that year, the Pension Reserve Fund will cease to exist and its remaining funds will be transferred to the Economic and Social Stabilization Fund.

Fund Withdrawal Rules⁹

Pension Reserve Fund

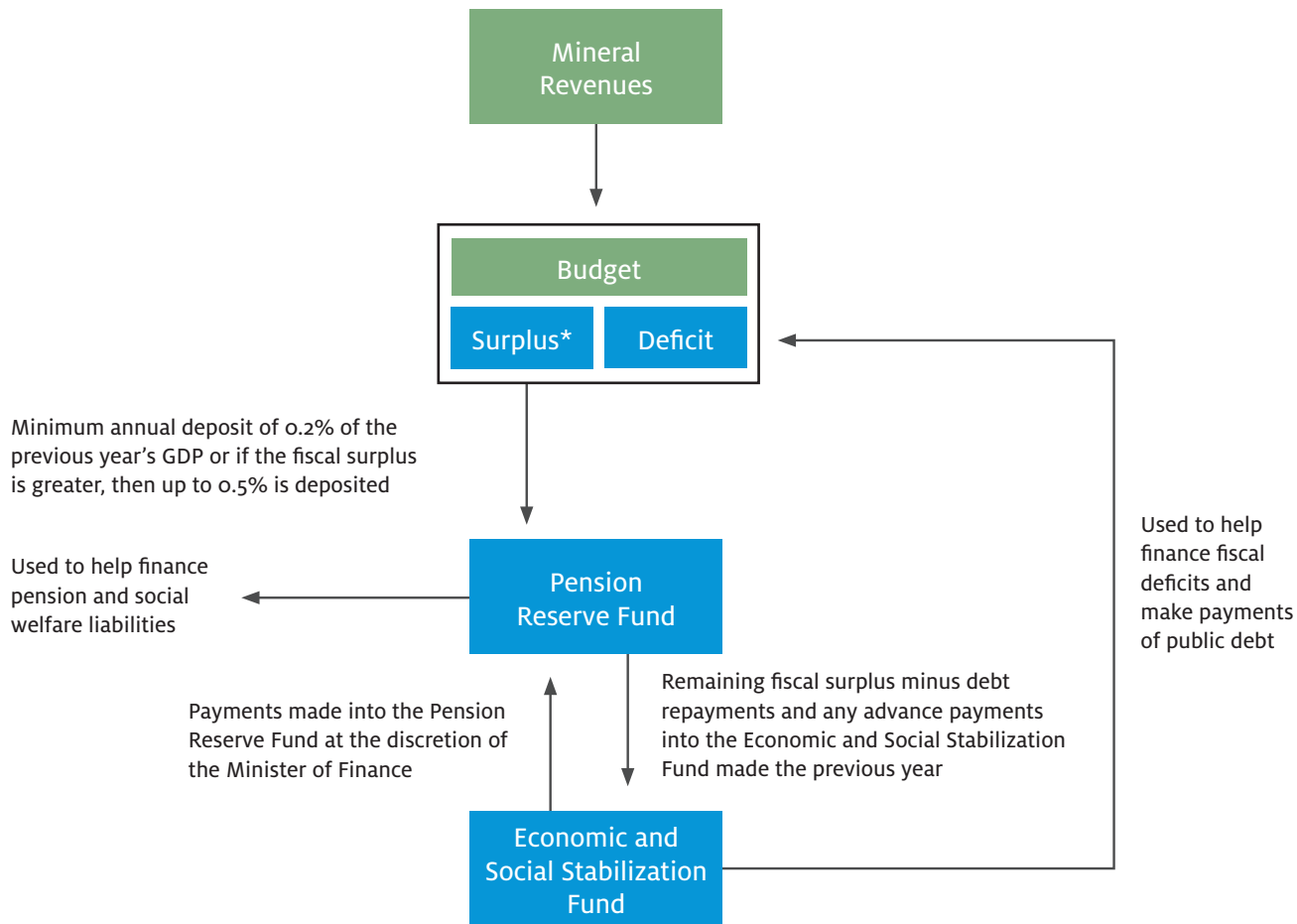
- Funds from the Pension Reserve Fund can only be used to pay for pension and social welfare liabilities.
- Until 2016, the previous year's return on the Pension Fund may be withdrawn.
- From 2016 onward, annual withdrawals from the Pension Reserve Fund cannot be greater than a third of the difference between the current year's pension-related expenditures and 2008 pension-related expenditures, adjusted for inflation.

Economic and Social Stabilization Fund

- Chile's Structural Balance Rule allows for estimating fiscal revenues for budget planning and therefore, whether withdrawals are needed.
- Funds can be withdrawn from the Economic and Social Stabilization Fund at any time in order to fill budget gaps in public expenditure and to pay down public debt. However, withdrawals are subject to the structural balance rule.
- Funds can be withdrawn, at the discretion of the Minister of Finance, to finance annual contributions to the Pension Reserve Fund.

Operational Laws, Rules and Policies

Flow of Funds



*See Structural Balance Rule on page 5.

Investment Laws, Rules and Policies

Investment Objectives

Pension Reserve Fund

The Pension Reserve Fund generates returns to help finance pension liabilities. To serve this objective, the Fund's investment goal is to maximize expected return while mitigating risk. The Fund must be managed such that, in any given year, there is a 95% probability that the Fund will not suffer a loss of more than 10% of its value in U.S. dollars.¹⁰

Economic and Social Stabilization Fund

The Economic and Social Stabilization Fund's investment policy is to maximize the Fund's value in order to partially cover cyclical reductions in fiscal revenues while maintaining a low level of risk.¹¹

Investment Strategy

Pension Reserve Fund¹²

- The Pension Reserve Fund has a medium to long-term investment horizon.
- Under the new investment policy, the Central Bank of Chile manages sovereign bond investments, but delegates management of equity and corporate bond investments to external fund managers.

Economic and Social Stabilization Fund¹³

- Funds are invested in portfolios with a high level of liquidity and low credit risk and volatility in order to ensure that resources are available to cover fiscal deficits and avoid significant losses in the Fund's value.

- Funds are invested in fixed-income assets in reserve currencies that typically do well in financial crises.
- Sovereign investments are made exclusively in United States, German and Japanese government bonds.
- The Fund has adopted a passive management investment policy since May 2011.

Investment Allocation

Pension Reserve Fund¹⁴

Prior to 2012, funds were allocated similarly to the strategic asset allocation of the Economic and Social Stabilization Fund. The Pension Reserve Fund is now allocated according to the following strategic asset allocation:

- 48% Sovereign bonds
- 17% Inflation-indexed bonds
- 15% Equities
- 20% Corporate bonds

Economic and Social Stabilization Fund¹⁵

Funds are allocated according to the following strategic asset allocation:

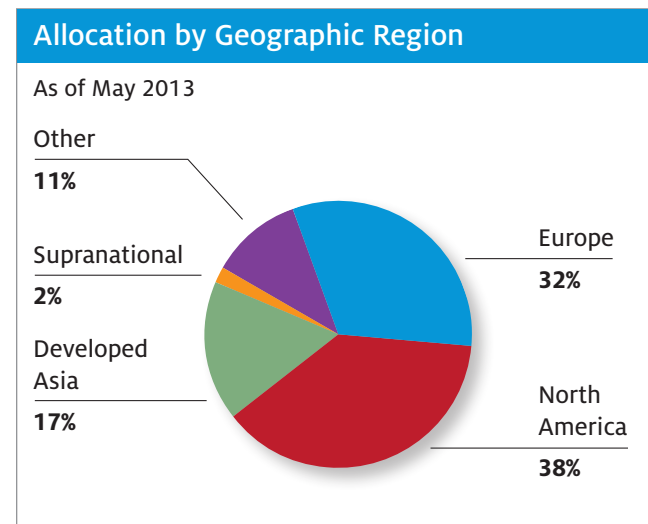
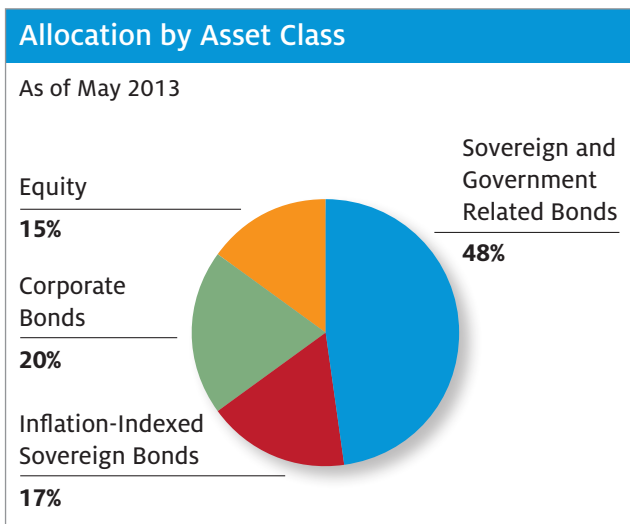
- 30% Money market instruments
- 66.5% Sovereign bonds
- 3.5% Inflation-indexed sovereign bonds

Policy on In-State Investments:

Fund assets may not be invested in Chile.¹⁶

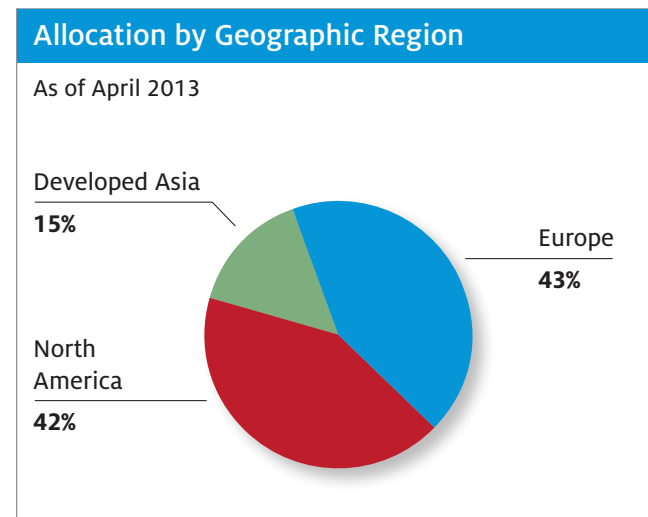
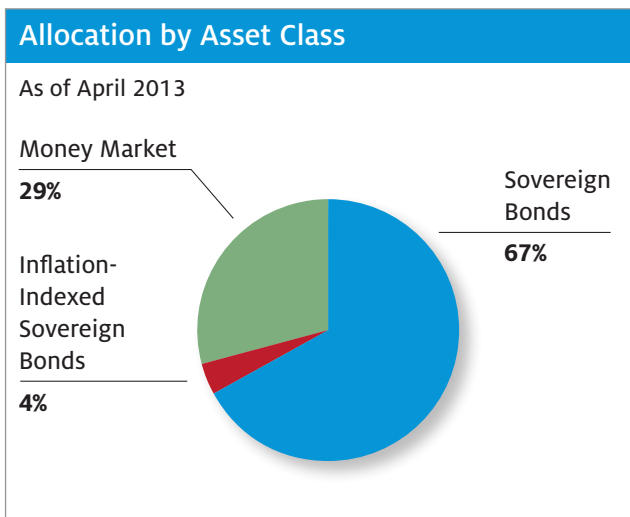
Investment Laws, Rules and Policies

Pension Reserve Fund¹⁷



Investment Laws, Rules and Policies

Economic and Social Stabilization Fund¹⁸



Management and Accountability

Management and internal accountability

External accountability

The Chilean Congress passed the legislation authorizing the Funds and receives monthly, quarterly and annual reports from the Ministry of Finance.

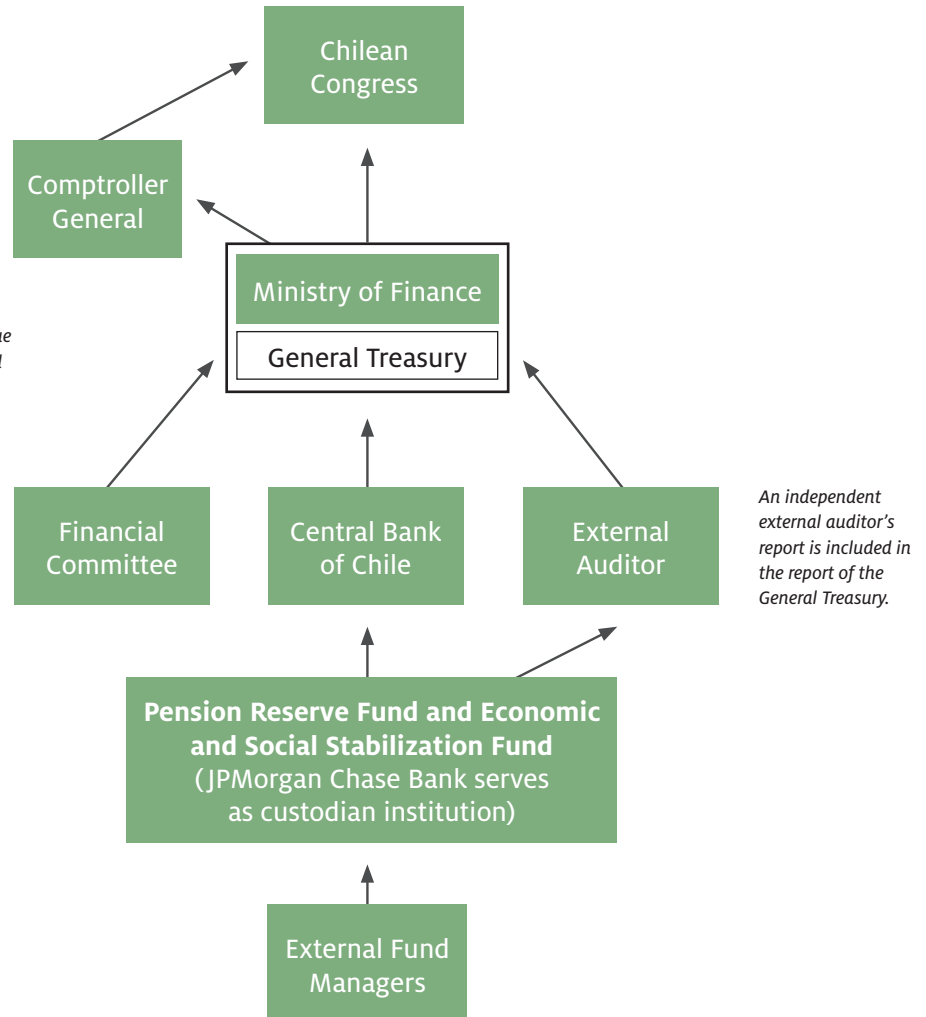
The Comptroller General performs an audit and reports to the Congress and the government.

The Ministry of Finance decides investment and management policy while the General Treasury, Chile's revenue service, is responsible for accounting and preparing audited reports on the Funds.

The Financial Committee is appointed by the Ministry of Finance to advise on the Funds' management and investment policies. It releases its own annual reports separate from those of the Ministry of Finance.

The Central Bank of Chile manages the Funds with a portion delegated to external fund managers. It also monitors the performance of external fund managers and the custodian institution.

35% of the Pension Reserve Fund is managed externally with the remainder managed by the Central Bank of Chile.



An independent external auditor's report is included in the report of the General Treasury.

Oversight and Safeguards

The Ministry of Finance and the Financial Committee, the ministry's advisory body, publish separate reports on fund management.

Oversight Mechanisms

- Finances are subject to regular and comprehensive internal audits.
- The Funds' finances are subject to regular and independent external audits that meet international standards.
- Funds are managed separately from the country's international reserves.
- International oversight institutions, such as the World Bank or the International Monetary Fund provide technical assistance on issues related to the Funds.

Common Oversight Mechanisms or Safeguards Not Present in Chile

- The Funds are not subject to formal oversight by a multistakeholder committee or independent fiscal council to assess compliance with the rules.

Transparency Laws, Rules and Policies

There is public disclosure of the following:

When or how often Fund reports are published and made publicly available	yes	
Which individuals or organizations are responsible for publishing Fund reports	yes	
Size of the Fund(s)	yes	
Deposit and withdrawal amounts	yes	
Returns on investments	yes	
Detailed asset allocation – geographic location	yes	
Detailed asset allocation – asset class	yes	
Detailed asset allocation – specific assets	yes	
Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules	yes	

Annex:

List of Applicable Laws

Fiscal Responsibility Law Number 20.128 (2006)

Decreto 1.383 (Designa al Banco Central como agente fiscal) Aceptación de Agencia Fiscal

Decreto 1.259 (Establece bases de política fiscal)

DFL 1 (Crea FEES)

Decreto 1.382 (Regula inversiones de recursos del FRP)

Decreto 1.649 (Amplía límites de inversión del FRP)

Decreto 1.028 (Designa miembros del Comité Financiero)

Decreto N° 888 (Designa miembro y acepta renuncia de miembro del Comité Financiero)

Decreto N° 917 (Designa miembros Comité Financiero)

Decreto N° 811 Designa 3 miembros del Comité Financiero periodo 08-2010 a 08-2012

Decreto N° 637 (Establece bases de política fiscal)

Modifica Decreto N° 637/2010 (Modifica bases de la política fiscal)

Decreto N° 1.181 (Designa miembros del Comité Financiero)

All of the above can be found at:

<http://www.hacienda.cl/fondos-soberanos/legislacion.html>

Endnotes

1. Annual Report Sovereign Wealth Funds, Ministry of Finance 2011 p. 11. Available at: <http://www.hacienda.cl/english/sovereign-wealth-funds/annual-report/annual-report-sovereign-wealth-funds-483.html>
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12. Annual Report Sovereign Wealth Funds, Ministry of Finance 2011 p. 45. Available at: <http://www.hacienda.cl/english/sovereign-wealth-funds/annual-report/annual-report-sovereign-wealth-funds-483.html>
13. Annual Report Sovereign Wealth Funds, Ministry of Finance 2011 p. 35. Available at: <http://www.hacienda.cl/english/sovereign-wealth-funds/annual-report/annual-report-sovereign-wealth-funds-483.html>
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