Chile

The Pension Reserve Fund and the Economic and Social Stabilization Fund
CHILE

Synopsis

Market Value

Pension Reserve Fund
$7.01 billion

Economic and Social Stabilization Fund
$15.21 billion

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.

Good Governance Fundamentals

<table>
<thead>
<tr>
<th>Good Governance Fundamentals</th>
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</thead>
<tbody>
<tr>
<td>Clear Deposit Rules</td>
<td>yes</td>
</tr>
<tr>
<td>Clear Withdrawal Rules</td>
<td>yes</td>
</tr>
<tr>
<td>Clear Investment Rules</td>
<td>yes</td>
</tr>
<tr>
<td>Transparent</td>
<td>yes</td>
</tr>
<tr>
<td>Publicly Available Audits</td>
<td>yes</td>
</tr>
<tr>
<td>Effective Oversight</td>
<td>yes</td>
</tr>
</tbody>
</table>

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)
**CHILE**

**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.
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
Operational Laws, Rules and Policies

**Structural Balance Rule**
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 Rules**

**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 2013).\(^7\)
- 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.

**Fund Withdrawal Rules**

**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

Mineral Revenues

Budget

Surplus*  Deficit

Pension Reserve Fund

Payments made into the Pension Reserve Fund at the discretion of the Minister of Finance

Economic and Social Stabilization Fund

Remaining fiscal surplus minus debt repayments and any advance payments into the Economic and Social Stabilization Fund made the previous year

Minimum annual deposit of 0.2% of the previous year’s GDP or if the fiscal surplus is greater, then up to 0.5% is deposited

Used to help finance pension and social welfare liabilities

Used to help finance fiscal deficits and make payments of public debt

*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 Fund\(^{12}\)
- 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 Fund\(^{13}\)
- 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.

Investment Allocation

Pension Reserve Fund\(^{14}\)
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 Fund\(^{15}\)
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 Fund

Allocation by Asset Class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>15%</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>20%</td>
</tr>
<tr>
<td>Inflation-Indexed Sovereign Bonds</td>
<td>17%</td>
</tr>
<tr>
<td>Sovereign and Government Related Bonds</td>
<td>48%</td>
</tr>
</tbody>
</table>

Allocation by Geographic Region

<table>
<thead>
<tr>
<th>Geographic Region</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>32%</td>
</tr>
<tr>
<td>North America</td>
<td>38%</td>
</tr>
<tr>
<td>Other</td>
<td>11%</td>
</tr>
<tr>
<td>Supranational</td>
<td>2%</td>
</tr>
<tr>
<td>Developed Asia</td>
<td>17%</td>
</tr>
</tbody>
</table>
Investment Laws, Rules and Policies

Economic and Social Stabilization Fund

Allocation by Asset Class

As of April 2013

- Money Market: 29%
- Inflation-Indexed Sovereign Bonds: 4%
- Sovereign Bonds: 67%

Allocation by Geographic Region

As of April 2013

- Developed Asia: 15%
- North America: 42%
- Europe: 43%
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.

Pension Reserve Fund and Economic and Social Stabilization Fund (JPMorgan Chase Bank serves as custodian institution)
Oversight and Safeguards

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.

The Ministry of Finance and the Financial Committee, the ministry’s advisory body, publish separate reports on fund management.
## Transparency Laws, Rules and Policies

**There is public disclosure of the following:**

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>When or how often Fund reports are published and made publicly available</td>
<td>yes</td>
</tr>
<tr>
<td>Which individuals or organizations are responsible for publishing Fund reports</td>
<td>yes</td>
</tr>
<tr>
<td>Size of the Fund(s)</td>
<td>yes</td>
</tr>
<tr>
<td>Deposit and withdrawal amounts</td>
<td>yes</td>
</tr>
<tr>
<td>Returns on investments</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – geographic location</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – asset class</td>
<td>yes</td>
</tr>
<tr>
<td>Detailed asset allocation – specific assets</td>
<td>yes</td>
</tr>
<tr>
<td>Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules</td>
<td>yes</td>
</tr>
</tbody>
</table>
Annex:
List of Applicable Laws

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