Chile

The Pension Reserve Fund and the Economic and Social Stabilization Fund
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.
**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.

**TIMELINE**

- **1985**: The Copper Compensation Fund is established as a stabilization fund.
- **1987**: The Copper Compensation Fund is activated.
- **2001**: Chile implements a structural balance rule to smooth spending from year to year and deposit surpluses in a fund.
- **2006**: Fiscal Responsibility Law No. 20.128 authorizes the creation of the Pension Reserve Fund and the Economic and Social Stabilization Fund. The Pension Reserve Fund is established first with an initial contribution of $600 million from the preceding year’s fiscal surplus.
- **2007**: The Economic and Social Stabilization Fund replaces the Copper Compensation Fund. The initial endowment of $6 billion includes the $2.6 billion in remaining assets of the now defunct Copper Compensation Fund. A Financial Committee is also created to advise the Finance Minister on the two new Funds.
- **2008**: The Santiago Principles are agreed on by members of the International Working Group of Sovereign Wealth Funds in Santiago, Chile.

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² 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.
³ The Santiago Principles are agreed on by members of the International Working Group of Sovereign Wealth Funds in Santiago, Chile.
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Good Governance Standards and Gaps in Regulation

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

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Good Governance Standards Met

Operations
- Objectives are Clear
- Rule for How Much Can beWithdrawn in Any Given Year
- Rule for Which Revenues Must be Deposited and When
- Exceptions to Rules are Clarified

Investment
- Use of Resource Revenues as Collateral
- Domestic Investment is Explicitly Prohibited
- Investment Risk Limitations
- Publication of Specific Investments

Management
- Penalties for Misconduct by Fund Managers & Staff
- Ethical & Conflict of Interests Standards for Managers & Staff
- The Detailed Responsibilities of Fund Managers & Staff
- The Role of Government Agencies in Fund Management

Transparency and Oversight
- Public Disclosure of Independent External Audits
- Public Disclosure of Internal Audit Results
- Formalized Oversight Mechanism
- Public Disclosure of Regularly Compiled Fund Reports

Legend:
- Presence of Regulation
- Absence of Regulation
Operational Laws, Rules and Policies

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 2013).⁸
- 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 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.

The two Funds’ different deposit and withdrawal rules reflect their different objectives.
**Operational Laws, Rules and Policies**

**Flow of Funds**

1. **Mineral Revenues**
   - **Budget**
     - **Surplus**
     - **Deficit**
   - 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

2. **Pension Reserve Fund**
   - Payments made into the Pension Reserve Fund at the discretion of the Minister of Finance
   - Remaining fiscal surplus minus debt repayments and any advance payments into the Economic and Social Stabilization Fund made the previous year
   - 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 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 Fund

Allocation by Asset Class

As of May 2013

- Equity: 15%
- Corporate Bonds: 20%
- Inflation-Indexed Sovereign Bonds: 17%
- Sovereign and Government Related Bonds: 48%
- Other: 11%

Allocation by Geographic Region

As of May 2013

- Europe: 32%
- North America: 38%
- Developed Asia: 17%
- Supranational: 2%
- Other: 11%
Investment Laws, Rules and Policies

Economic and Social Stabilization Fund

Allocation by Asset Class
- Money Market: 29%
- Inflation-Indexed Sovereign Bonds: 4%
- Sovereign Bonds: 67%

Allocation by Geographic Region
- Developed Asia: 15%
- North America: 42%
- Europe: 43%

As of April 2013
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>
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<tr>
<td>Which individuals or organizations are responsible for publishing Fund reports</td>
<td>yes</td>
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<tr>
<td>Size of the Fund(s)</td>
<td>yes</td>
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<tr>
<td>Deposit and withdrawal amounts</td>
<td>yes</td>
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<tr>
<td>Returns on investments</td>
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<tr>
<td>Detailed asset allocation – geographic location</td>
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<tr>
<td>Detailed asset allocation – asset class</td>
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<tr>
<td>Detailed asset allocation – specific assets</td>
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<tr>
<td>Natural resource prices and other fiscal assumptions used to calculate deposit and withdrawal amounts allowed under fiscal rules</td>
<td>yes</td>
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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 Nº 888 (Designa miembro y acepta renuncia de miembro del Comité Financiero)
Decreto Nº 917 (Designa miembros Comité Financiero)
Decreto Nº 811 Designa 3 miembros del Comité Financiero periodo 08-2010 a 08-2012
Decreto Nº 637 (Establece bases de política fiscal)
Modifica Decreto Nº 637/2010 (Modifica bases de la política fiscal)
Decreto Nº 1.181 (Designa miembros del Comité Financiero)

All of the above can be found at:
http://www.hacienda.cl/fondos-soberanos/legislacion.html
Endnotes