Dalgalarrando & Cía.

PENSION FUNDS NEWS

During the Chile Day 2019 that took place in London few days ago, the Chilean Pension Funds Superintendent ("Superintendent") made several announcements regarding the government's proposals to transform and improve the investment system currently used by Pension Funds Administrators ("AFPs"). The most important announcements are the following:

A. Proposed regulatory changes

1) Gold Investment: Authorizing AFPs to invest in gold through the issue of asset backed certificates. The Superintendent explained that gold has been considered as an eligible asset due to its correlation with other assets, and also due to its safe haven features in times of economic and financial uncertainty. AFPs would be authorized to invest through exchange-traded funds, allowing access to this asset by means of a liquid instrument, which allows an easy operation and gives sheer exposition to the commodity.

2) Equity funds: Foreign infrastructure and real estate income investment would be excluded from the limits of equity funds in which AFPs are authorized to invest. The current situation, in which direct and indirect foreign investment in this type of assets is considered in the variable income limit, discourages investment in this type of instrument. This proposal means to recognize the hybrid nature of this type of asset, which resembles fixed income more than variable income in terms of risk / return.

3) Removal of Investment Exclusions: Currently, investments in foreign currency as a hedge are not eligible as an investment by the AFPs. It is proposed to eliminate this exclusion, thus authorizing this type of investment. With this change funds would not be forced to incur into unnecessary exchange hedging adjustments, causing inefficiency and additional costs.

4) E Type Funds: Fund E would be allowed to invest in equity instruments with certain limits. The fact that this multi-fund can invest up to 10% in debt instruments that have, in turn, investments for a maximum of 10% in restricted instruments would make it easier for AFPs to build a diversified investment portfolio, with a limited risk.

5) Limit of banking counterparty in derivatives: This limit would be modified considering the net valuation of the contracts (mark to market) after guarantees, and adjust the level

of the limit to the new criteria in order to improve the assessment of counterparty risk, thus reflecting the effective risk more accurately. Currently, a cap per counterparty of 4% of the value of each fund is applied according to the size of the contract, which would not adequately reflect the counterparty risk.

6) Hedge funds: The definition of the specific strategies and conditions to be met by hedge funds in which pension funds may be authorized to invest will be determined by a specialized team. In addition to being a type of asset widely used by international pension funds, it can grant a new option of safeguard in scenarios of falling stock markets.

7) Green Finances: Climate risk would be included into the risk matrix that is currently used in the Risk Based Supervision (SBR) process by the first semester of 2020.

8) Update of the compendium of rules for alternative asset investment: The Compendium of Pension System Rules would be updated in order to improve investment in alternative assets.

9) Investment of funds based on the risk of investment portfolios: The Superintendent pointed out the convenience of including measurement standards for AFP investment based on the overall risk of investment portfolios. This would enable a better regulatory context for a more efficient portfolio structuring.

B. Proposed amendments to Decreto Ley N° 3.500 (the "DL"):

1) Allow the AFPs' investment system to define structural limits: Currently, Article N° 45 of the DL sets forth structural limits for governmental instruments, investments abroad, restricted instruments, alternative assets, equities and exchange coverage. The Superintendent's proposal is that governmental regulation defines these limits, not the law, in order to have more flexible investment limits based on the constant evolution of AFP investments. In this regard, the structural limits that would be reviewed by the authority would be those of alternative assets and restricted securities.

2) Eliminate the obligation of minimum exchange coverage: : Currently, there is a legal obligation to set minimum limits of exchange coverage to investments in foreign currencies, equal to 50% of the total investment in foreign bonds with investment grade. The Superintendent proposes to eliminate the reference to this obligation from the law, leaving it to the governmental regulations to fix it so that investment decision making becomes more flexible.

3) Allow the governmental authorities to define the limits by issuer: The Superintendent proposed more flexible limits by issuer, proposing that these are regulated by the governmental authority, through the Technical Investment Council.

4) Use of common criteria in the definition of primary, secondary, foreign and national markets: The Superintendent proposes the use of common criteria in order to standardize the treatment and definition of primary and secondary markets and domestic and foreign markets in order to increase the efficiency in transactions for fund investments. Current definitions of such markets creat asymetrys which need to be eliminated.

5) Increase the investment limit for variable income instruments in the Unemployment Fund: The Superintendent proposes to increase the current maximum investment limit of 5% in equities for the Unemployment Fund (CIC Fund) to 10% of total assets..

If you have any questions about this article or need more information on this subject, please contact Felipe Dalgalarrando H. by email to fdalgalarrando@dryc.cl or telephone +56-2-23830000.



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