Debt Management Strategy: Debt policy goals and structure

**Debt Management Strategy:**

- **Domestic:** to develop and lengthen yield curves (nominal and real), while deepening liquidity by fostering greater participation of non-residents
  - Recent issuances have strengthened new benchmarks and have created longer tenors, extending the debt maturity profile in line with international standards

- **External:** to establish benchmarks for Chilean companies in international capital markets

- **In addition:** to promote the development of a green asset class (social/green bonds) that attracts foreign investment in support of the country’s sustainable infrastructure needs, while diversifying the investor base

- **Strong commitment with depth and liquidity**

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**Debt Composition by Currency**

<table>
<thead>
<tr>
<th>Year</th>
<th>US Dollars</th>
<th>Euros</th>
<th>Inflation Linked CLP</th>
<th>Nominal CLP</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>83%</td>
<td>0%</td>
<td>17%</td>
<td>11%</td>
<td>0%</td>
</tr>
<tr>
<td>2010</td>
<td>67.8%</td>
<td>0.5%</td>
<td>15.0%</td>
<td>38.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>2019</td>
<td>67.8%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>38.2%</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance; Public Debt Report
Liquidity agenda increasing foreign investors’ participation

Not high liquidity and low foreign participation justified a plan initiated in 2014:

- **Improving liquidity and promoting foreign investor participation**
  - Less auctions per bond and for a higher amount, instead the previous method of multiple auctions of smaller amounts
  - Continuous contact with investors in order to update about debt management operation and Chilean economy
  - Settlement adjustments in order to comply with international standard (T+2)

- **Continuous discussion with index research team in order to include Chilean bonds (nominal)**
  - Discussions with JP Morgan research team in order to be included in the GBI Emerging Market Bond Index

- **Modifications of Article 104 (exemption for capital gains)**
  - Simplification to Article 104 approved by Congress in 2016 and in force from February 1st, 2017
  - The Issuer is in charge to apply the retention, in order to simplify the mechanics

- **Liability Management executed in 2016**
  - In order to repurchase bonds that will not be used as benchmark, and replace them by tapping existing benchmarks

Source: Ministry of Finance
Modernization of the Sovereign Debt Plan and Strategy

- At the beginning of the year, the Maturity Profile showed:
  - Low liquidity
  - Absence of benchmarks
- The participation of non-resident Investor in the local currency debt was approximately 3.4%

Other adjustments

- Concentration of trading in key benchmarks, achieved by liability management operations in local currency bonds
  - Strong references both in inflation-linked and nominal curves
  - Implemented by exchanging illiquid & low outstanding bonds (“non benchmark bonds”), with “benchmark bonds” with high liquidity and larger outstanding amounts
- First domestic Euroclearable bond

Liability Management executed in 2016

Maturity Profile: Nominal Curve as of December 2016
USD billion

Maturity Profile: Inflation linked Curve (UF) as of December 2016
USD billion
• Euroclearable bonds and book building simultaneously with local and international investors
  – January 18th, 2017: first time that the Republic of Chile offered CLP 1.0 Trillion domestic bonds to international investors and book-building process:
    • International investors could hold a direct interest in the bonds through Euroclear, as a DCV-Participant
    • Payments of principal and interest to investors will be made in Chilean Pesos (CLP) via the local clearing system, DCV
  – The Republic made public its intent to offer the bonds to domestic and international investors on Thursday January 12th, a week ahead of the trade
    • The trade was marketed to international investors through a global investor call, in which the Republic explained the details of the transaction
    • More than 100 international investors accessed the recording – a clear indication of interest by the international investment community
  – Due to the successful story, it was repeated in 2017, 2018 and 2019

<table>
<thead>
<tr>
<th></th>
<th>Republic of Chile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Currency Ratings</td>
<td>Aa3 / AA / AA- (Moody’s / S&amp;P / Fitch)</td>
</tr>
</tbody>
</table>
| Distribution            | • Local registration for domestic investors
|                         | • 144A / Reg. S. for international investors(1) |
| Currency                | Chilean Peso (CLP); all payments payable in CLP |
| Size                    | CLP 1.0 Trillion (~US$1.5 Billion) |
| Maturity                | February 28, 2021 |
| Coupon                  | 4.50% per annum, accruing from September 1, 2016 |
| Yield (“TIR”)           | 3.80%(2) |
| Issue price             | 102.740%(3) |
| Foreign exchange rate   | 657.85 CLP / USD(4) |
| Interest payment dates  | March 1 and September 1 |
| Amortization            | Bullet |
| Use of Proceeds         | General government purposes |
| Denominations           | CLP 5,000,000 and integral multiples thereof |
| Settlement currency     | All international investors settle primary allocation in USD |
| Clearing                | DCV / Euroclear |
| Listing                 | Santiago Stock Exchange |
| Governing Law           | Chilean Law |

Allocation by investor % of total
- Local: 19%
- Foreign: 81%

Demand by investor % of total
- Local: 16%
- Foreign: 84%

(1) With permanent restrictions: transfers in the U.S. are only to QIBs. (Unitary ISIN under existing ISIN). No registration rights; (2) Calculated per local (“SEBRA”) conventions; (3) Plus accrued interest of CLP 2.9bn calculated pursuant to SEBRA conventions; (4) Dolar Observado published in the official gazette on the morning of the transaction – settlement to international investors in USD
Progress to improve liquidity in the local fixed income market in recent years

- **LM as a regular policy**
- **Greater weight in the GBI EM Bond index**
  - Three local Euro-clearable bonds issuances since February 2017. These have allowed for a broader inclusion of Chilean bonds in the GBI Emerging Market Bond Index.
  - Chile’s share in this index increased from 0.10% in 2016 to 3.3% by Sep-2019.
- **Recent events and stability of non-residents investment**

### Non-resident Holdings of LC Debt & GBI-EM Share

<table>
<thead>
<tr>
<th>Year</th>
<th>Holdings of local debt by non-residents (left axis)</th>
<th>Chile’s share in GBI-EM Index (right axis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>6.9%</td>
<td>0.1%</td>
</tr>
<tr>
<td>2014</td>
<td>5.2%</td>
<td>0%</td>
</tr>
<tr>
<td>2015</td>
<td>3.5%</td>
<td>0%</td>
</tr>
<tr>
<td>2016</td>
<td>3.4%</td>
<td>0%</td>
</tr>
<tr>
<td>2017</td>
<td>16.2%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2018</td>
<td>14.2%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Sep-19</td>
<td>16.2%</td>
<td>3.3%</td>
</tr>
</tbody>
</table>

Source: JP Morgan and the Ministry of Finance

![Maturity Profile: Nominal Curve as of December 2019](source)

![Maturity Profile: Inflation linked Curve (UF) as of December 2019](source)
Diagnosis and Further Steps

**Diagnosis:**

- **Pros**
  - Investor diversification
  - Good experience when locals are going abroad
  - Signals of higher liquidity

- **Cons**
  - Liquidity requires a fluid movement between locals and foreigners, which could not be the case when the FX market has constraints
  - Foreign investor prefer book building, which add certain administrative constraints and difficulties for a good timing
  - Price tension is not necessary high, because international investor are price takers, or normally want an issue premium

*Nonetheless, the Chilean experience shows that to improve foreign participation requires other complementary measures.*

- **Still, additional measures are necessary or at least worth to analyze**
  - Market Makers
  - OTC for Pension Funds
  - ETF’s