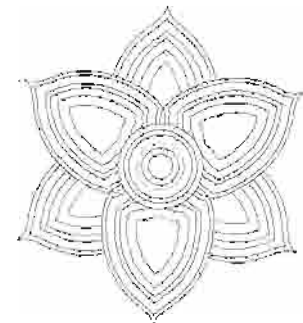




An **Report**
nu **2010**
a l
CENTRAL BANK OF CHILE



**An
nu
a l** Report
2010
CENTRAL BANK OF CHILE



OUR NEW FAMILY OF BANKNOTES

On 18 August 2009, the Central Bank of Chile announced a program for implementing the biggest change in banknotes in 30 years. That day, the design of the new \$5,000 bill was revealed. This was the first in the new family of banknotes to be released, and it entered into circulation in September. This marked the start of an unparalleled process of modernizing the means of payment in our country.

The \$10,000, \$20,000, and \$2,000 banknotes were put into circulation in 2010, while the \$1,000 bill was scheduled to be released next year.

The Central Bank is very proud of the way this initiative has unfolded. Despite the enormous complexity of the logistics, which involved the gradual replacement of millions of paper notes without disrupting the fluidity or credibility of the means of payment, these new banknotes have been quickly accepted by the public, which has had no problem incorporating the bills into their daily transactions.

The new banknotes incorporate high technological standards to facilitate their recognition and are all based on a common design featuring images of historical figures, landscapes, animals, and symbols that are part of the Chilean national identity. Never before has our country had a family of banknotes with so many common features among the different denominations.

Two types of substrate or material are used in the different denominations. The \$2,000 and \$5,000 bills, as well as the forthcoming \$1,000, are made of polymer (or plastic) material, while the \$10,000 and \$20,000 are cotton paper. The banknotes are also different sizes: the length of each denomination varies by seven millimeters, with the \$20,000 measuring 148 millimeters and the \$1,000 measuring 120 millimeters. The height is the same for all the bills, at 70 millimeters.

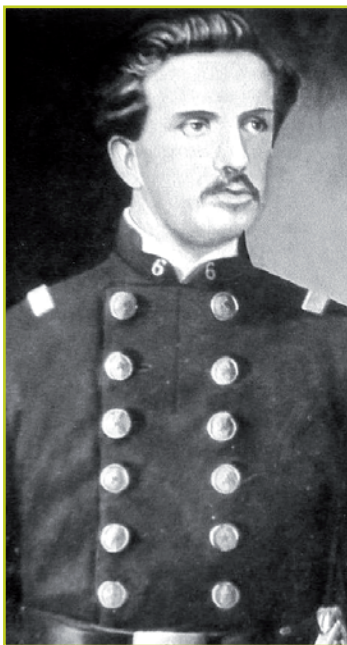
The polymer banknotes have similar recognizable security features: namely, more pronounced embossing on the front face and a clear window in which the image of the historical figure and the denomination are repeated. All three banknotes include an image of the antú (a Mapuche symbol representing the sun giving life to the earth), which changes from the color of the bill to gold when tilted.

The security features on the cotton paper banknotes include a 3D strip in which the image of the antú moves when the bill is tilted, as well as embossing for easy recognition by touch. On the back side, the denomination number changes colors when the bill is tilted.

All the banknotes have a partial motif of the denomination that is completed when backlit.



1,000 pesos



Ignacio Carrera Pinto

This banknote, scheduled to enter into circulation in May 2011, will replace the current bill, first issued in 1978. It retains the picture of Ignacio Carrera Pinto, a national hero from *La Concepción*. The picture on the front face is based on a portrait painted by Juan Manuel Huidobro in 1982, which is part of the Military School's collection.

On the back side are pictures of the *Torres del Paine* National Park, located in the *Magallanes* Region, and the *guanaco*, a ruminant native to the Andes mountains between Peru and Tierra del Fuego.

When the new bill will be issued in May 2011, this denomination will account for around 24 percent of all banknotes held by the public, with around 140 million units in circulation.



2,000 pesos

The \$2,000 banknote entered into circulation in November 2010. The front face retains the portrait of one of the leaders of the independence movement, Manuel Rodríguez, which is based on an engraving by Narciso Desmadryl, dated 1854.

The back side features a picture of the *Nalcas* National Reserve, located in the *Araucanía* Region and home of the *Lonquimay* and *Tolhuaca* volcanoes. Our native fauna is represented by the *choroy* parakeet, which is found exclusively in Chile and mainly inhabits large tracts of forest from Aconcagua to Chiloé.

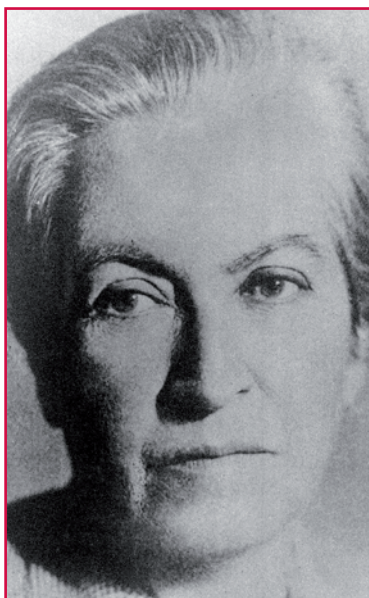
This banknote has been made of polymer substrate since September 2004, when a test program was launched to assess the performance of the material and its reception by the public. The denomination was first issued in December 1997, on cotton paper substrate.

When the new banknote was issued, there were 43 million units in circulation.



Manuel Rodríguez

5,000 pesos



Gabriela Mistral

This was the first of the new family to enter into circulation, in September 2009. The front face features an updated picture of the poet Gabriela Mistral, winner of the Nobel Prize for Literature. The portrait is based on a photograph in the archives of the University of Chile.

The back side shows a picture of the *La Campana* National Park, located in the coastal mountain range of the *Valparaíso* Region, on the southern edge of the *Aconcagua* Valley. The featured fauna is the *tucúquere*, a bird of prey found in forests, scrublands, and foothills from Tarapacá to Tierra del Fuego.

When the new banknote was issued, there were 68 million units in circulation..



10,000 pesos

This banknote was put into circulation in late March 2010. The front face has a picture of Arturo Prat, a national hero of the Pacific War. The portrait is based on a painting by Manuel Antonio Caro, which is part of the Chilean Navy's collection.

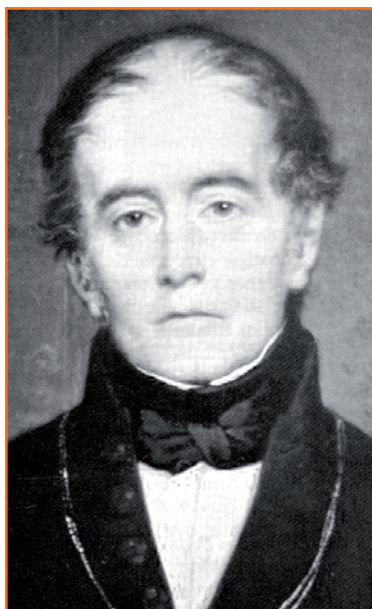
The back side has pictures of the Alberto de Agostini National Park in the *Magallanes* Region and the national bird, the condor, which is native to the Andes Mountains and the Pacific coast of South America.

This denomination has the largest number of bills in circulation (43%). It was first issued in 1989, and there were 250 million units in circulation when the new banknote was launched.



Arturo Prat

20,000 pesos



Andrés Bello

The \$20,000 bill was issued in July 2010, and it is the only one in the series that was given a complete change of color. The front face features a new portrait of Andrés Bello, based on a painting by the French artist Raymond Monvoisin which belongs to the University of Chile.

The back side has a picture of the *Surire* salt flat, located in the extreme north of Chile in the *Arica y Parinacota* Region. It also features the Chilean flamingo, which inhabits shallow freshwater and saltwater wetlands all along the national territory.

This denomination was first issued on the market in 1998. When the new banknote was issued, there were 61 million in circulation.



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SENIOR AUTHORITES OF THE CENTRAL BANK OF CHILE

31 DECEMBER 2010



José De Gregorio Rebeco
Governor



Manuel Marfán Lewis
Deputy Governor



Enrique Marshall Rivera
Board Member



Sebastián Claro Edwards
Board Member



Rodrigo Vergara Montes
Board Member

EMPLOYEE PROFILE

31 DECEMBER 2010 (*)

TOTAL STAFF	615
<hr/>	
BY GENDER	
WOMEN	200
MEN	415
<hr/>	
BY AGE (YEARS)	
UNDER 25	17
26 TO 35	196
36 TO 45	145
46 TO 55	156
56 TO 65	97
OVER 65	4
<hr/>	
BY EDUCATION LEVEL	
PhD.	36
PROFESSIONAL	394
ADMINISTRATIVE	185
AVERAGE YEARS OF SERVICE	13
ANNUAL TURNOVER	10.18%

(*) Excluding Board Members.



GENERAL MANAGER

ALEJANDRO ZURBUCHEN SILVA

GENERAL COUNSEL

MIGUEL ÁNGEL NACRUR GAZALI

GENERAL AUDITOR

SILVIA QUINTARD FLEHAN

DIVISION DIRECTORSKEVIN COWAN LOGAN
Financial PolicyBELTRÁN DE RAMÓN ACEVEDO
Financial OperationsLUIS GONZÁLEZ BANNURA
Corporate Management and ServicesLUIS ÓSCAR HERRERA BARRIGA
ResearchRICARDO VICUÑA POBLETE
Statistics**MANAGERS**LUIS ÁLVAREZ VALLEJOS
Communications AdvisorGABRIEL APARICI CARDOZO
Infraestructure and Financial RegulationsMATÍAS BERNIER BÓRQUEZ
Domestic MarketsLUIS FELIPE CÉSPEDES CIFUENTES
Economic ResearchRODRIGO CIFUENTES SANTANDER
Financial ResearchCECILIA FELIÚ CARRIZO
Human ResourcesMARIELA ITURRIAGA VALENZUELA
Financial ServicesLEONARDO EUGENIO JADUE JADUE
InformaticsJUAN ESTEBAN LAVAL ZALDÍVAR
Chief Counsel of Corporate Legal ServicesSERGIO LEHMANN BERESI
International AnalysisPABLO MATTAR OYARZÚN
Chief Counsel of Normative Legal ServicesIVÁN MONTOYA LARA
TreasuryLUIS OPAZO ROCO
Financial StabilityENRIQUE ORELLANA CIFUENTES
Monetary Policy Strategy and CommunicationGLORIA PEÑA TAPIA
Statistical InformationÁLVARO ROJAS OLMEDO
International RelationsFRANCISCO RUIZ ABURTO
Macroeconomic StatisticsCRISTIÁN SALINAS CERDA
International MarketsCLAUDIO SOTO GAMBOA
Macroeconomic AnalysisMARIO ULLOA LÓPEZ
Strategic and Risk ManagementMARÍA INÉS URBINA DE LUIGGI
Logistical ServicesCLAUDIA VARELA LERTORA
Institutional AffairsJORGE ZÚÑIGA MAYORGA
Security



BANCO CENTRAL
DE CHILE

Santiago, 25 April 2011

Mr. Felipe Larraín B.
Minister of Finance
Santiago

Pursuant to Sections 78 and 79 of the Basic Constitutional Act of the Central Bank of Chile, contained in Article One of Law 18,840, I hereby submit this institution's *Annual Report, 2010*.

Sincerely,

A handwritten signature in black ink, appearing to read "José De Gregorio R.", written over a horizontal line.

José De Gregorio R.
Governor



BANCO CENTRAL
DE CHILE

Santiago, 25 April 2011

Mr. Guido Girardi L.
President of the Senate
Valparaíso

Pursuant to Sections 78 and 79 of the Basic Constitutional Act of the Central Bank of Chile, contained in Article One of Law 18,840, I hereby submit to the Senate this institution's *Annual Report*, 2010.

Sincerely,

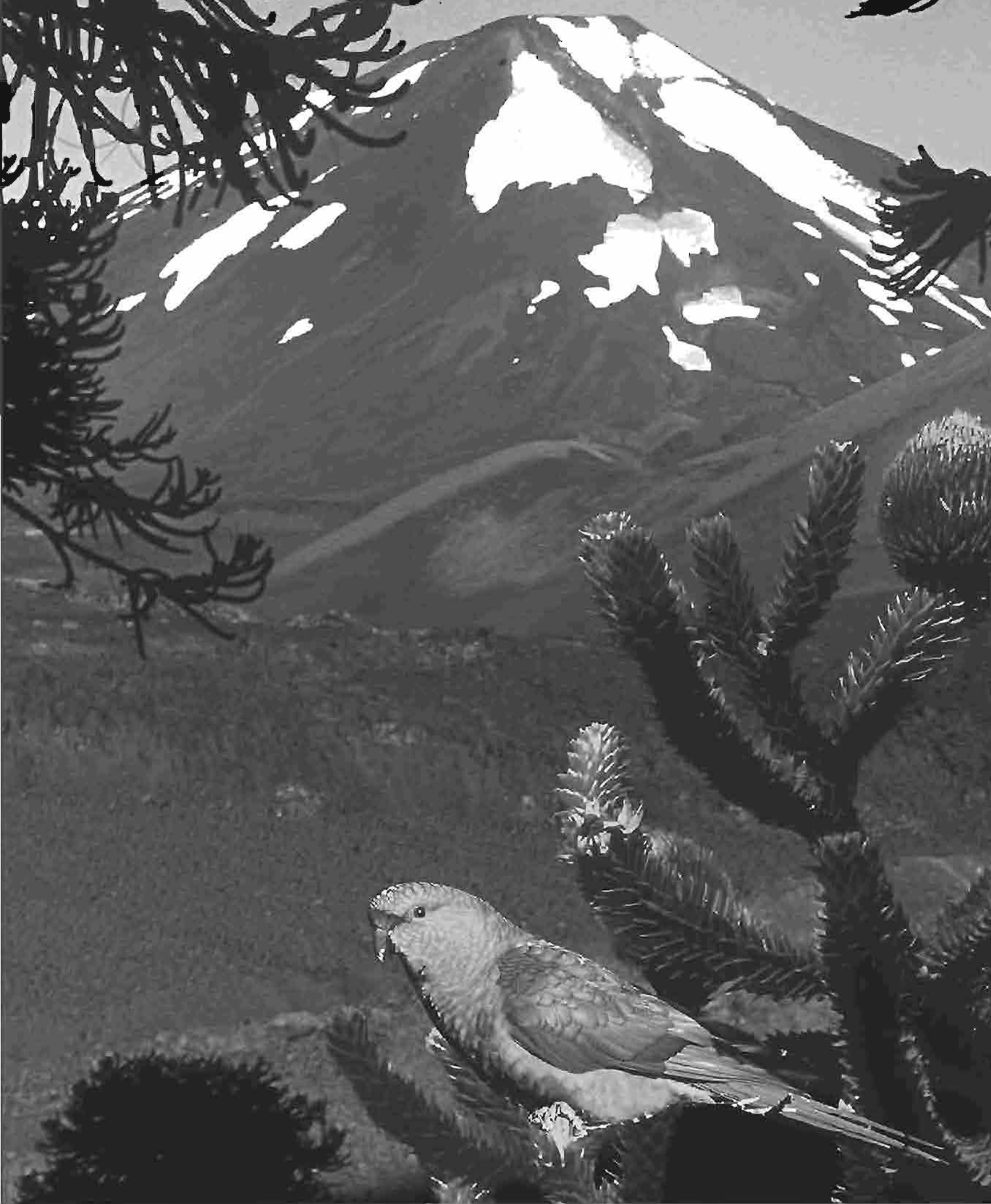
A handwritten signature in black ink, appearing to read "J. De Gregorio R.", written over a horizontal line.

José De Gregorio R.
Governor





I. Financial Management and Policies of the Central Bank of Chile in 2010



A. Economic overview

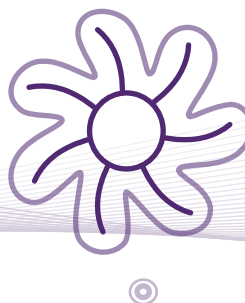
In 2010, the world economy continued the process of recovering from the deep recession that hit in 2009. The aggressive fiscal and monetary stimulus measures adopted in countries around the world began to yield results. However, the recovery unfolded at an uneven rate in the different economies, which thus played different roles in the process. While the emerging economies began to grow above trend, quickly closing the output gap, the developed economies recorded a slower recovery of output and were characterized by a lukewarm recovery in the labor market and a persistent output gap.

Over the course of the year, it became evident that some of the peripheral economies of Europe had a fragile fiscal position, which generated episodes of stress in the international financial markets. In the second quarter, doubts arose about the recovery of output in the developed economies, as well as the effects that this slower recovery would have on the performance of the emerging economies. Uncertainty about the future of these economies diminished in the second half of the year, and although new situations developed in other European peripheral economies, their impact on the global financial markets was fairly limited.

The different recovery rates, especially the dynamic activity in emerging Asia, caused a new upsurge in commodity prices. Several emerging

economies presented a scenario of growing inflationary pressures stemming from the hike in commodity prices and buoyant domestic demand. Together with the disparity in the closing of the output gap, this led to a divergence in the policy responses of developed and emerging economies. In the former, policies remained strongly stimulative, and expectations of when the normalization process would start were put off, whereas the latter began to withdraw the monetary stimulus—or to send signals in this direction—toward the second half of the year. The divergence in recovery rates also favored capital flows out of the developed economies and into the emerging markets, in a context in which the dollar was depreciating in international markets vis-à-vis a generalized appreciation in emerging currencies, including the Chilean peso.

In Chile, the evolution of output and inflation in 2010 were marked not only by the effects of external developments, but also by the earthquake and tsunami that hit the southern central region of the country in late February (27-F). In late 2009 and the first two months of 2010, local output was recovering from the 2009 world recession faster than projected. The recovery of private demand was initially driven by the recovery of inventories, but later consumption and gross fixed capital formation also became more dynamic. Several indicators available in late February showed that the observed trends in consumption and output in the second half of 2009—when output grew at an annualized rate of almost 6%—were being consolidated.



The 27-F disaster generated a sharp output contraction as firms were paralyzed in March and part of April, mainly in the manufacturing sector and in the most strongly affected areas. The disruption in production was short-lived, however, and by the second quarter of the year, the output level exceeded the level prior to 27-F. The economy's growth rate increased as a result of very dynamic private consumption and investment, which in part reflected the replacement of damages caused by 27-F, the build-up of inventories that had been drawn down during the 2009 crisis, and the continuation of an expansive monetary policy.

Thus, the year saw a gradual closing of the output gap left by the crisis, following not only the destruction of the capital stock on 27-F and the consequent reduction in the trend output level, but also the fast recovery of GDP. As a result, inflation, which started 2010 in negative territory, ended the year at 3%. Although the recovery of inflation was slower than expected, this reflected both specific factors and the lower inflation of imported goods. In addition, inflation risks were growing toward the end of the year, in part because of rising international food prices.

B. Monetary policy

In 2009 the Board cut the monetary policy rate (MPR) to its lower limit (0.5%) and also took unconventional measures, implementing the short-term liquidity facility (known locally by its Spanish acronym, *Flap*). This facility initially ensured the provision of funds for a period of six months at a rate equal to the MPR. The goal of these initiatives was to give the national economy a sufficient monetary stimulus to deal with the effects of the world crisis and prevent inflation from falling below the 3% target in a two-year horizon.

At the start of 2010, the national economy showed clear signs of recovery, as the output gap began to close and a lower monetary stimulus was needed, which was consistent with beginning to gradually increase the MPR. However, the earthquake and tsunami on 27 February (27-F) put this recovery process in doubt. In response to the immediate disruptions caused by 27-F, the process of withdrawing the monetary stimulus was postponed until the impact could be carefully evaluated. Following the rapid recovery of the economy, the withdrawal of the

monetary stimulus began mid-year, when the MPR was increased by 50 basis points in June. The process of increasing the MPR then continued steadily through the end of the year, bringing the rate to 3.25% in December. The Board further considered that it would be necessary to continue gradually reducing the monetary stimulus.

C. Foreign exchange policy

Since September 1999, the Central Bank of Chile has applied a floating exchange rate regime, in which the exchange rate is determined by the market. This regime allows for the conduct of an independent monetary policy, facilitates the economy's adjustment to shocks, and prevents sharp exchange rate misalignments, which in turn avoids more costly adjustments in terms of output variability and, in principle, attenuates the flow of speculative capital. Under this floating exchange rate regimen, the Bank reserves the right to intervene in exceptional circumstances, in the event of an overreaction of the exchange rate that could potentially cause adverse effects. The exchange rate is said to overreact when, without much variation in its fundamentals, it rises or falls sharply within a short period, possibly followed by movements in the opposite direction. The adverse effects of this fluctuation include a loss of confidence among economic agents, stemming from inflationary effects requiring monetary policy measures that are inadequate given the economic cycle, an increase in the volatility in the financial markets, and misleading price signals that may interfere with the efficient allocation of resources.

No such exceptional situations occurred in 2009, and the floating exchange rate regime operated normally. However, on 3 January 2011, the Board decided to initiate a foreign exchange purchase program to strengthen its international liquidity position. The objective of this initiative was to bring foreign exchange reserves to a level consistent with values seen in other economies similar to Chile. The intervention would also soften the effects of the exchange rate adjustment underway in the Chilean economy. To implement this program, the Bank will accumulate additional foreign exchange reserves for an amount of US\$12 billion in 2011, through periodic foreign exchange purchases starting on 5 January and continuing through the end of December 2011. This program will bring the Central Bank's international liquidity

position to the equivalent of 17% of GDP. The monetary effects of the measure will be offset with the goal of maintaining the provision of liquidity in pesos in the market, consistent with current monetary policy ^{1/}.

D. Financial regulations

In accordance with the new regulatory framework in force for the settlement and clearing of derivatives instruments (Law 20,345), the Board issued its prior favorable report on the operating regulations approved by the Superintendence of Securities and Insurance. These regulations will govern the participants in the first management company that will operate as a clearing house for the financial brokerage and fixed-income markets and as a central counterparty for the variable-income market^{2/}. The Bank introduced changes to the regulations applicable to its real time gross settlement (RTGS) system to incorporate management companies constituted as central counterparty entities or financial clearing houses. The latter does not, under any circumstances, represent a commitment on the part of the Bank to provide financing or refinancing facilities or any guarantee.

In November, the Board raised the upper limit on total overseas investment by the pension funds from 60 to 80%, as well as the upper limit on overseas investment by type of fund; the increase is to be implemented gradually starting on 1 December 2010. This modification was designed within the framework of coordination between the Ministry of Finance and the Central Bank, and it is consistent with the general orientation of the government's economic policy. The objective is to contribute to optimizing the profitability and security of pension savings. The decision took into account the behavior of the financial markets, to ensure that possible investment portfolio adjustments by the pension funds would not affect the normal functioning of internal and external payments or the implementation of monetary policy.

^{1/} For more details on the measure, see <http://www.bcentral.cl/prensa/comunicados-consejo/otros-temas/03012011.pdf>.

^{2/} CCLV, *Contraparte Central S.A.*, is an affiliate of the Santiago Stock Exchange; it opened for operations on 30 August 2010.

E. Financial management

E.1 Monetary management

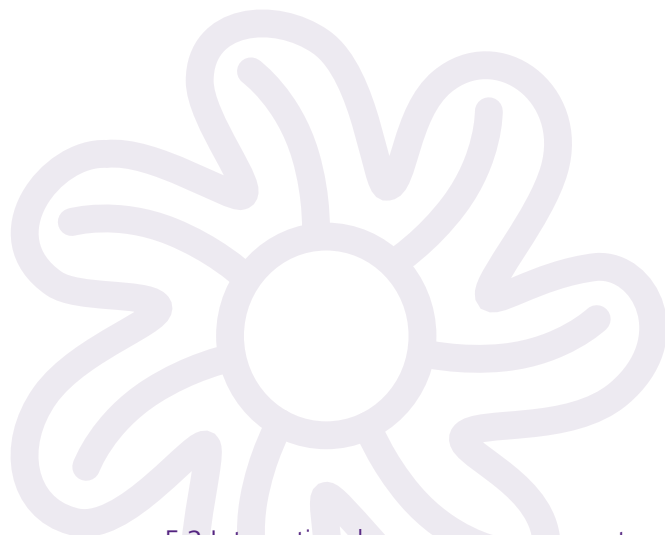
To support the implementation of monetary policy, the Bank monitors market liquidity and employs the mechanisms and instruments at its disposal to ensure that the interbank interest rate remains around the MPR.

This is achieved through the monthly liquidity management schedule, which specifies the auction of Central Bank discount promissory notes (PDBC) and bonds, as well as other open market operations and standing facilities. In addition, market liquidity forecasts are revised daily and, when necessary, monetary adjustment operations are carried out to facilitate the convergence of the interbank rate to the MPR.

In 2010, the Bank conducted its monetary management in the context of the scheduled withdrawal of the liquidity support measures initiated in October 2008 (foreign currency swaps and 28-day repos) and the unconventional monetary policy measures initiated in July 2009 (*Flap*).

On 8 February, the temporary regulations loosening compliance with foreign currency reserve requirements expired. There was no demand for the foreign currency swap program in 2010. Access to the *Flap* was offered for the last time on 17 May, and its final operations matured on 14 June. The last 28-day repos from the 2008 program were offered on 29 June, maturing on 27 July.

With all of these instruments, the market demanded an average additional liquidity of Ch\$1.5 trillion. The deviation between the interbank interest rate and the MPR averaged 5 basis points.



E.2 International reserve management

The purpose of international reserve management is to provide efficient and secure access to international liquidity and to safeguard the financial equity of the Bank. Reserve management is based on the legal framework defined in the Basic Constitutional Act of the Central Bank, which governs its operation, and on a series of internal policies and practices in line with recommendations from international organizations.

In 2010, the Bank held sufficient international reserves to face potential and predictable foreign currency liquidity needs. As of 31 December, the investment portfolio, which includes short- and long-term assets to be used for dealing with unforeseen contingencies and long-term requirements, stood at US\$23.61 billion. The liquidity portfolio, which includes short-term assets earmarked for covering foreseeable requirements in the near future, totaled US\$2.84 billion. At the aggregate level, including other assets such as monetary gold and special drawing rights (SDRs) issued by the International Monetary Fund (IMF), total international reserves closed the year at US\$27.86 billion.

In 2010, international reserves grew US\$2.49 billion relative to the close of 2009. This increase is mainly explained by the maturing of foreign exchange swaps carried out in 2009 (US\$745 million) and an increase in the liquidity portfolio (US\$1.69 billion).

Reserve liquidity was secured by investing in a short-term deposit portfolio in international commercial banks and in fixed-income instruments traded in highly liquid secondary markets. On 31 December 2010, current account and time deposits represented 21.5% of total reserves; short-term papers, 36.6%; bonds 36.4%; and other assets, 5.5%.

To safeguard Central Bank equity, investment resources are administered according to policies and controls approved by the Board and designed to limit operating and financial risks. Credit risk was controlled through restrictions on issuers, instruments, intermediaries, and custodians. As of 31 December, 79.9% of reserves were invested in AAA-rated instruments issued by banks, sovereigns, foreign financial institutions, or supnationals. The remaining 20.1% was invested in

instruments rated A to AA+, mainly from the banking sector. Market risk was controlled by diversifying investment currencies, instruments, and maturities and by taking into consideration the impact of decisions regarding these parameters on the Bank's balance sheet. At year-end, 53.1% of reserves were held in U.S.dollar-denominated instruments, 33.3% in euro-denominated instruments, and 15.1% in instruments denominated in other currencies. Portfolio duration averaged around 17 months. Operating risk was managed by separating duties and responsibilities and applying internal and external control mechanisms.

In 2010, two independent administrators continued to perform the long-term general mandate for the external management of part of the Bank's international reserves. They each managed a portfolio of around US\$315 million. The risk evaluation method also continued to be based on a risk budget, whereby administrators were authorized to take a maximum risk of 100 basis points of tracking error against the respective benchmark. The special mandate for mortgage-backed securities (MBS) managed a portfolio of approximately US\$450 million.

The external management programs were modified on 30 November, ending the special MBS mandate, modifying the benchmark structure of the long-term general mandate, and terminating the contractual relationship with one of the independent administrators of the general mandate. The resources from both the MBS mandate and the terminated general mandate were transferred to internal management. With regard to the general mandate, MBSs were incorporated into the program's benchmark structure. As a result of these changes, the investment policy of the remaining administrator will be modified in 2011 and a selection process will be carried out to contract a new independent portfolio administrator.

Total returns from international reserve management were 0.36% measured in foreign currencies (a reference basket of currencies in the investment portfolio) and -0.15% measured in dollars. The differential return relative to the benchmark that is used to guide and assess investment performance was -8.9 basis points. The total operating costs of managing the Bank's international reserves for this fiscal year were 3.5 basis points of the total reserves under management. Income from the securities lending program was around 0.9 basis points of international reserves.

In accordance with institutional policy on the provision of information, appendix IV presents a more detailed report on the international reserve management described in this section.

E.3 Debt management

The Bank's debt management policy aims to minimize financing costs, within specified limits on financial risk, and to promote the development of local capital markets.

The Bank's 2010 debt plan was announced in late 2009. The debt plan included peso-denominated Central Bank securities with two- and five-year maturities (BCP-2 and BCP-5), for a monthly amount of Ch\$41.7 billion and Ch\$62.5 billion, respectively.

In January, on request from the Treasury of Chile, the Central Bank accepted the role of fiscal agent in the placement of Treasury bonds in the local capital market in the first half of the year. This involved four issues of UF-denominated Treasury bonds with maturities of 5, 10, 20, and 30 years (BTU-5, BTU-10, BTU-20, and BTU-30), and one issue of ten-year peso-denominated Treasury bonds (BTP-10).

Mid-year, the Bank accepted a new fiscal agency role for placements in the second half. This included the reopening of three issues carried out in the first half (BTU-10, BTU-20, and BTU-30) and the issue of a new seven-year UF-denominated Treasury bond (BTU-7).

In the fourth quarter, to promote the depth of benchmark bonds in the local market, the Bank offered to replace inflation-indexed coupon promissory notes (PRC) with UF-denominated bonds (BCU). The program, which totaled US\$300 million, contemplated the issue of a new five-year BCU series, with the corresponding purchase of an equivalent amount in PRCs. The operation was successfully completed in December 2010.

Both the Central Bank and Treasury bonds were issued in accordance with the specifications of Article 104 of the Income Tax Law.

E.4 Provision of large-value payment services

The Bank is responsible for safeguarding the normal operation of the payment systems. To this end, it is vested with legal authority in the areas of regulation and supervision of these systems. It also operates the real time gross settlement (RTGS) system, which is the heart of

the payment system in Chile. The RTGS system orchestrates the use of Central Bank money to clear large-value transactions, monetary policy operations, transactions in other settlement and payment systems, such as check clearing, the large-value payment clearing house, and, more recently, the securities clearing house. The stability of the financial system depends on the payment settlement and clearing infrastructure being able to handle the demands placed on it, allowing payments to be made and cleared even in times of stress.

The securities payment and clearing systems were only mildly affected by 27-F. Since the earthquake occurred in the early morning on a Saturday, there was a window of time for taking corrective actions before the resumption of operations on Monday, 1 March.

Despite problems in the telephone networks, the Bank's internal call tree—which includes on-site responsibilities in the event of possible problems in the communication networks—and the escalation levels of the potential difficulties proved highly useful for the coordination of the first assessment activities in the field. The identification of the people responsible, contact lists, and methods of communication in the case of systemically important events had already been addressed in Communication and Coordination Protocols, developed in conjunction with the participants in the securities and payments market infrastructure. With the exception of the most devastated areas, the financial system could operate almost normally on the next business day. To further improve its response system, the Bank initiated a project to explicitly consider disaster scenarios and the failure of key suppliers in its activities, in order to ensure its ability to generate adequate operational responses and thus to refine its business continuity plans.

In 2010, the RTGS system cleared an average of Ch\$2.24 trillion (up 21% in annual terms). The average number of payments per day was 814 (down 3% in annual terms). The latter reflects a reduction in interbank payments, which only began to recover in the second half. The settlement of individual payments maintained a high level of certainty and stability, with no indication of problems in the settlement process. The rejection rate (measured through the amount of payment instructions received) was 0.20%. The aggregate accumulated extension of operating hours by system participants was 150 minutes. Transactions involving the Bank, which recorded a higher average daily amount settled in the fiscal year, corresponded to the use of the standing deposit facility (Ch\$1.03 trillion) and the intraday liquidity facility (Ch\$685 billion).

The new securities clearing house, which operates under a scheme of gross real time settlement with Central Bank money, opened without negative consequences—despite the additional liquidity requirements generated—and with a daily close of operations within the business hours established in its internal operating regulations.

Appendix V presents more detail on the provision of high-value payment services.

E.5 Administration of fiscal funds (ESSF and PRF)

In early 2007, in accordance with Law 20,128 on Fiscal Accountability, the Ministry of Finance requested, through Executive Decree 1383 (agency decree), that the Central Bank act as its fiscal agent in the administration of all or part of the fiscal resources held in the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF).

After analyzing the regulatory framework provided by the Basic Constitutional Act and considering the economies of scale and scope that the Central Bank could contribute in managing such fiscal resources, the Board accepted the request and empowered the Director of the Financial Operations Division to institute the internal procedures necessary to perform the task entrusted to the Bank as fiscal agent to manage these resources, as established in Article 4 of the agency decree and in the related performance guidelines.

In 2010, the Bank's objective in administering these resources was the accumulation of value relative to a benchmark comparator, while complying with the risk standards defined by Ministry of Finance in its performance guidelines and accepted by the Bank.

At the same time, the Bank applied the same standards to the administration of these resources as to its own reserve management, ensuring the preservation of the managed capital and adequate liquidity protection.

The Bank continued to hire the services of a general custodian, which also measured the performance, risk, and compliance of the administration of the resources entrusted to the Bank in accordance with the standards and parameters outlined in the performance guidelines.

In 2010, the PRF resources increased US\$337.29 million, of which US\$150 million were financed with ESSF recourses. On 31 December, the PRF had a market value of US\$3.84 billion. The ESSF received contributions of US\$1.36 billion, reaching a market value of US\$12.72 billion at year-end. Since the Bank accepted the fiscal agent assignment, the Treasury has made contributions to the two funds of US\$21.91 billion and withdrawals of US\$8.44 billion.

Credit risk was controlled through restrictions on issuers, instruments, intermediaries, and custodians, as defined in the aforementioned performance guidelines. As of 31 December, 72.20% of these resources were invested in AAA-rated instruments and 27.80% in instruments rated A– to AA+. Market risk was controlled through the diversification of investment instruments, currencies, and maturities. At year-end, 79.34% of the funds were invested in sovereign bonds and 20.66% in bank securities. In terms of currency composition, 49.23% was held in instruments denominated in U.S. dollars, 40.49% in euros, and 10.29% in yen. Portfolio duration averaged 29.45 months.

In 2010, the ESSF resources administered by the Bank earned an absolute return of 1.84% measured in dollars, which implies a yield differential of 15 basis points below the benchmark, both measured using the time-weighted rate of return (TWRR) methodology^{3/}. Using the same methodology, the PRF resources earned an absolute return of 1.81% measured in dollars, or 18 basis points below the benchmark.

With regard to agency fees, the costs of administering the funds were charged to the Treasury. In 2010 annual charges were 0.43 basis point of the total resources under administration.

Since the Bank accepted the fiscal agent assignment, it has provided daily, monthly, and quarterly reports to the Finance Minister and the Treasurer, including measures of performance, risk, and compliance with the relevant benchmarks.

In accordance with institutional policy on the provision of information and with specifications in the agency decree, appendix V presents a more detailed report on the administration of fiscal resources.

^{3/} The TWRR methodology yields a rate of return that has been adjusted for the impact of possible contributions (capital contributions or contributions generated through the securities lending program) and withdrawals (capital withdrawals or payments to third parties), which allows the analyst to isolate the effect of exogenous changes in the size of the portfolio on the funds' performance and to compare the portfolio administrator's performance with a reference benchmark.

F. Miscellaneous

F.1 Commission on Price Distortions

The National Commission on Price Distortions is in charge of investigating the existence of price distortions on imported goods. It is a technical body composed of representatives from public institutions in the economic sector. Its task is to advise the President of Chile on the application of antidumping measures, countervailing duties, and safeguard measures. The Commission operates independently from the Bank, although by law the Technical Secretariat resides within the Bank. Its functions include gathering background information for investigations, preparing technical reports, channeling communications among the parties involved, and carrying out pertinent notifications.

In 2010, the Commission held fourteen meetings and opened one investigation. A definitive antidumping duty on wheat flour imports from Argentina was in force at the end of the year.

F.2 Chilean Copper Commission (*Cochilco*)

On 14 October 2010, the Board of the Central Bank of Chile appointed Pablo Pincheira Brown to represent the Bank on the Board of the Chilean Copper Commission. This appointment, which replaces Matías Bernier Bórquez, is for a period of two years beginning on 23 October 2010. At the same time, the appointment of Eduardo López Escobedo to the Copper Commission Board was renewed for the same period.

F.3 Competition Tribunal

By virtue of Resolution 1539E-01 of 19 May 2010, the Board appointed Teodoro Wigodski Sirebrenik to the position of Alternate Judge / Economist on the Competition Tribunal (*Tribunal de Defensa de la Libre Competencia*, or TDLC). This appointment, made following the resignation of María Soledad Arellano Schmidt, is through 12 May 2012.

By virtue of Resolution 1555-01 of 5 August 2010, the Board appointed Javier Eduardo Velozo Alcaide to the position of Judge / Legal Counsel on the Competition Tribunal. This appointment, made following the resignation of Tomás Menchaca Olivares, is through 12 May 2012.

The aforementioned appointments were made in accordance with

Articles 6, 7, and 12 of Decree Law 211 of 1973, which established guidelines for the protection of competition.

G. The balance sheet of the Central Bank of Chile

G.1 Balance sheet levels and structure

The behavior of the economy and the policies adopted by the Central Bank of Chile are reflected in the Bank's balance sheet, whether in the total amount or in the composition of assets and liabilities, which in turn affects the trend in earnings and losses. Thus, the considerable debt in the form of Central Bank promissory notes on the liability side is largely explained by the need to finance the rescue of the financial system following the crisis in the first half of the 1980s and by the accumulation of international reserves in the 1990s. The balance sheet also reflects the Bank's ongoing commitment to price stability and its concern for keeping the interest rate structure compatible with existing benchmarks and with the conduct of monetary policy based on inflation targets.

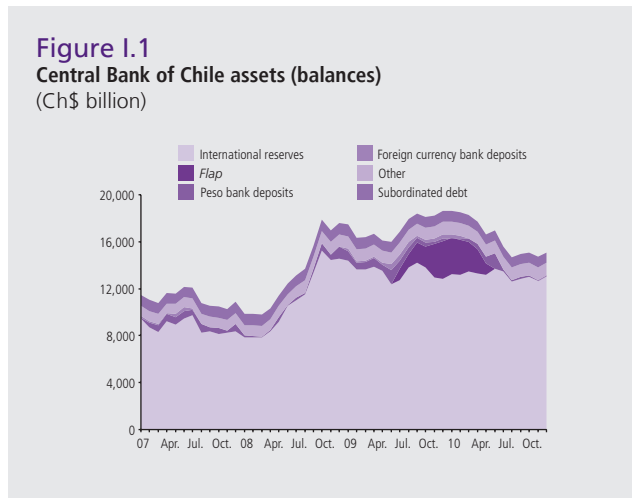
The evolution of the balance sheet in 2010 was marked by a reduction in the size of assets and liabilities. This reflected the end of the expansive quantitative policies of 2009. On the asset side, the domestic credit balance shrank considerably, after growing strongly in 2009. On the liability side, the Central Bank's debit balance contracted. In equity terms, 2010 closed with a larger deficit, mainly due to exchange rate losses from the appreciation of the peso against the dollar. Another factor was the negative earnings (assets minus liabilities) recorded in 2010.

G.2 Size and composition of the balance sheet

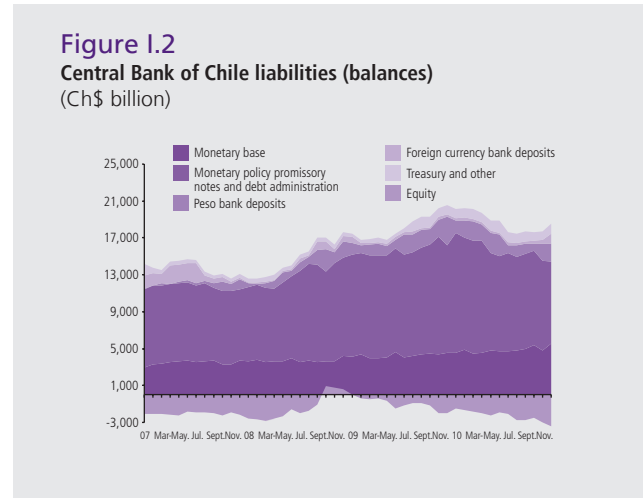
The size of the balance sheet (total assets or liabilities), as a share of GDP, shrank around 6% between the close of 2009 and the close of 2010. This was largely due to the withdrawal of the monetary stimulus applied by the Central Bank in 2009.

On the asset side, the largest reduction was in the balance of monetary policy instruments (mainly repos and the *Flap*), which fell to nearly

zero. This implied a reduction in assets of 4.1 percentage points of GDP (figure I.1 and table A.1). International reserves recorded mixed movements. Foreign exchange losses caused a reduction in value in pesos, while the termination of swap operations and the larger reserve balance in dollars increased that currency's influence on the reserves. On aggregate, the latter effect dominated, resulting in a slight increase in the reserve balance in 2010. As a share of GDP, however, reserves fell 1.7 percentage points. At the close of 2010, assets were around 14.5% of GDP.



On the liability side, Central Bank debt (monetary policy promissory notes) contracted 4.2 percentage points of GDP (figure I.2). This is consistent with the withdrawal of the monetary stimulus, and it represents the counterpart of the lower balances in monetary policy instruments. The monetary base increased 0.2 percentage point of GDP. The remainder of the drop in liabilities is mostly explained by changes in equity. The 2010 fiscal year produced losses, primarily due to the appreciation of the peso. This caused an increase in the equity deficit, relative to 2009, of 1.1 percentage point of GDP.



G.3 Return on assets, cost of liabilities, and changes in equity

Period earnings can be broken down into profit and losses from the following: (a) return on assets (interest earned) and cost of liabilities; and (b) flows associated with (adjustable) accounts indexed to either inflation (generally bonds) or the exchange rate (mainly reserves).

With regard to earnings and losses associated with returns and costs, the differential between external and internal interest rates was negative in 2010, as in 2009. This implied that the return on assets was lower than the cost of liabilities. The average return on assets, mainly reserves, is similar to the external interest rate. The cost of liabilities is associated with the MPR, which affects the Bank's promissory notes.

Externally, the majority of the developed economies continued to apply a strong monetary stimulus. The average interest rate earned on international reserves fell from 1.7% in 2009 to 1.3% in 2010. In Chile, the Central Bank gradually adjusted the MPR in 2010, increasing the rate 185 basis points over the value at the close of the 2009 accounting period. Despite the increase in the local rate, the (average) rate on monetary policy promissory notes remained at levels similar to 2009 (3.8%). The differential between the average interest rate on assets and liabilities was -0.5%, and earnings from interest therefore recorded losses in 2010.

Flows associated with indexed (adjustable) accounts recorded accounting losses in 2010. This was mainly due to gains/losses on assets stemming from exchange rate fluctuations and to the cost of UF-indexed liabilities (debt). In terms of the rates implicit in changes in the (adjustable) value of indexed assets and liabilities, fluctuations in the exchange rate and the UF (*unidad de fomento*, an inflation-indexed unit of account) translated into a negative differential of 7.2% (12.0% in 2009).

As is usually the case, exchange rate fluctuations had the strongest impact on accounting earnings in 2010. Between year-end 2009 and year-end 2010, the peso-dollar exchange rate fell 7.5%. The value of reserves in pesos fell 9.4% due to the exchange rate effect alone. The value of the net balance of all foreign currency assets minus all

foreign currency liabilities on the balance sheet (the foreign currency position) fell 8.4% (table I.2a). The differences between these last two rates and the peso-dollar exchange rate fluctuation is explained by the appreciation of the other currencies that make up the Bank's basket of foreign currencies. For example, the peso-euro exchange rate fell 14.7%.

In sum, the Bank's 2010 income statement posts accounting losses of Ch\$3.45 trillion (table I.1), which breaks down as follows: losses of Ch\$1.26 trillion due to changes in the value of assets and liabilities; losses of Ch\$140 billion in interest; and losses of Ch\$86 billion in nonfinancial costs. The Treasury did not make capital contributions in 2010. The net accounting loss of Ch\$1.49 trillion is explained by a real change in equity from its initial revalued amount of -\$1.96 billion to its closing value of -\$3.45 trillion.



Tolhuaca volcano

TABLE I.1
CENTRAL BANK BALANCE SHEET

(Balances in Ch\$ billion, and percent of GDP, as of 31 December of each year)

	2009		2010		Rates of return (2) (%)			
	Balance	% GDP	Balance	% GDP	2009		2010	
					Interest	ΔValue	Interest	ΔValue
Assets (1)	18,612	20.6	15,091	14.5	1.8	-14.1	1.6	-7.1
Net international reserves	12,849	14.2	13,051	12.6	1.7	-17.6	1.3	-9.4
Treasury promissory notes	0	0.0	0	0.0				
Other public sector assets	883	1.0	938	0.9	2.5	-1.3	4.8	1.3
Subordinated debt	914	1.0	877	0.8	4.8	-2.3	5.0	2.3
Monetary policy instruments (3)	3,727	4.1	0	0.0	0.6	-1.3	0.5	0.6
Other	238	0.3	226	0.2	1.6	-24.4	3.7	-4.5
Liabilities (1)	20,572	22.8	18,540	17.9	2.4	-2.1	2.1	0.1
Monetary base	4,582	5.1	5,525	5.3	0.2	0.0	0.2	0.0
Monetary policy promissory notes (4)	11,579	12.8	8,916	8.6	3.8	-1.7	3.8	1.2
Other monetary policy liabilities (5)	3,117	3.5	2,603	2.5	0.7	-0.6	0.5	-0.2
Current accounts and reserve requirements								
in foreign currency	248	0.3	423	0.4	0.0	-22.9	0.0	-7.1
Treasury and other public sector deposits	303	0.3	378	0.4	0.8	-11.4	1.2	-3.2
Other	744	0.8	695	0.7	0.2	-20.7	0.3	-8.5
Equity (1)	-1,960	-2.2	-3,449	-3.3				
Revalued initial capital	599		-1,963					
Nominal initial capital	618		-1,960					
Revaluation of equity	-19		-3					
Net result	-2,753		-1,486					
Nonfinancial results (6)	-67		-86					
Net interest (6)	-123		-140					
Changes in value (7)	-2,582		-1,264					
Less: Revaluation of equity	19		3					
Capital contributions	0		0					
Application of IFRS guidelines	193							

(1) Assessed equity is equivalent to the accounting measure; however, total assets and liabilities differ, mainly because of differences in the treatment of provisions, temporary assets, and temporary liabilities.

(2) Implicit rates are calculated based on estimates of average balances and losses/profits due to interest or changes in value. The resulting rates may be distorted if the end-of-month balances used to estimate the average balances are not representative.

(3) Includes credit to banks guaranteed with foreign currency deposits (foreign currency swaps) or risk-free securities (repos) and liquidity lines in domestic and foreign currency.

(4) Includes PDBC, BCP, PRC, CERO UF, BCU, and PRD.

(5) Short-term remunerated bank deposits in domestic and foreign currency. Foreign currency deposits, except daily deposits, guarantee credits in domestic currency (note 3).

(6) The foreign currency component of these items is converted to pesos using average exchange rates.

(7) Includes indexation in domestic currency and the effect of foreign exchange rate fluctuations on assets and liabilities in foreign currency.

Source: Central Bank of Chile.

TABLE I.2A
CENTRAL BANK BALANCE SHEET POSITIONS

(Balances as of 31 December of each year and annual flows in Ch\$ billion)

	Balance 2009	2010 flows (4)		Balance 2010
		Exchanges (5)	△ Earnings and capital (6)	
Denominated and payable in pesos (1)	-14,137	-11	-462	-14,609
Monetary base (2)	-4,582	-931	-12	-5,525
Central Bank promissory notes	-11,579	3,170	-507	-8,916
Banks	299	-2,150	-1	-1,852
Other	1,726	-100	58	1,683
Denominated in foreign currency and payable in pesos (1)	0	0	0	0
Denominated and payable in foreign currency (1)	12,176	11	-1,027	11,160
EQUITY (1)	-1,960	0	-1,489	-3,449

TABLE I.2B
FOREIGN CURRENCY POSITIONS ON THE CENTRAL BANK BALANCE SHEET

(Balances as of 31 December of each year and annual flows in US\$ million)

	Balance 2009	2010 flows (4)		Balance 2010
		Exchanges (5)	△ Earnings and capital (6)	
Denominated in foreign currency and payable in pesos	0	0	0	0
Denominated and payable in foreign currency	24,044	22	-238	23,828
International reserves (3)	25,373	2,692	-201	27,864
Central government (net)	-453	-76	0	-529
Banks (net)	256	-2,637	6	-2,375
Central Bank bonds and promissory notes	0	0	0	0
Other (net)	-1,132	43	-43	-1,132
TOTAL	24,044	22	-238	23,828

(1) The positions are defined as assets minus liabilities, so the difference is equivalent to equity. Because assets are added and liabilities are subtracted, the resulting signs of both balances and flows must be incorporated, with the same sign, as positive or negative contributions to equity.

(2) Because the monetary base is a negative component of the position denominated and payable in domestic currency, its negative flows (due to exchanges or net profits) correspond to increases in the position, while positive flows correspond to decreases. Exchange flows of other entries are the balancing entry or its increase or decrease due to exchanges.

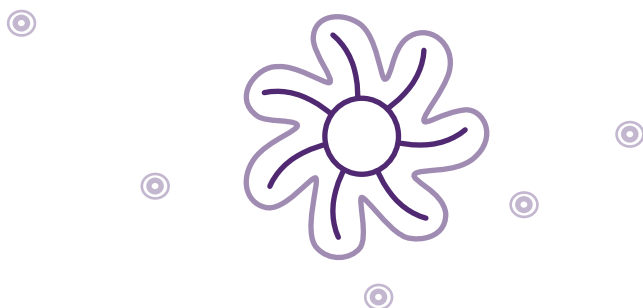
(3) Because international reserves are a positive component of the position denominated and payable in foreign currency, its flows reflect the direction of its variations (with the same sign). Exchange flows of other entries with the opposite sign are the balancing entry of its increase or decrease due to exchanges.

(4) Flows are, in general, the result of operations or imputations that translate into changes in balances.

(5) Exchange flows are produced whenever an asset or liability is modified as a consequence of the opposite variation of another asset or liability. In aggregate terms, exchanges alone do not change the equity level.

(6) Includes interests, price-level restatements, and other changes in value, profits minus nonfinancial losses, and capital contributions.

Source: Central Bank of Chile.



G.4 Balance sheet positions

The currency positions on the balance sheet can be used to assess equity exposure to foreign exchange risk. Furthermore, by clarifying the nature of the flows that determine changes in the balance—separating out changes stemming from transactions per se (exchanges) versus changes due to interest and fluctuations in value—it is possible to track the Bank's policies more closely.

The Bank's position denominated and payable in foreign currency increased US\$22 million (table I.2b). This increase was explained by greater international reserves of US\$2.69 billion, the growth of government funds of US\$76 million, a drop in net credit to banks of US\$2.64 billion (due to the termination of the expansive quantitative policy), and a contraction in the net credit balance of other transactions of US\$43 million.

These assets and liabilities recorded additional changes through associated interest and fluctuations in value, as well as payment (or receipt) of nonfinancial costs (income). The US\$2.49 billion increase in reserves includes a drop of US\$201 million in accrued interest and changes in value in dollars. The latter reflects the fact that other currencies in the reserve basket—such as the euro—depreciated against the dollar, generating losses in reserves measured in dollars. In addition, the Bank stopped supplying liquidity in foreign currency to the banking system through dollar swaps, which largely explains the increase in reserves. This was offset by an increase of US\$1.89 billion in the commercial banks' foreign exchange deposits in the Bank, in both current accounts and liquid dollar deposits.

The expansion of the Bank's foreign exchange position (denominated and payable in foreign currency) due to operating flows was Ch\$11 billion, with an equivalent reduction in the position payable in domestic currency (table I.2a). The reduction of Ch\$11 billion in the position denominated and payable in domestic currency can be broken down into flows that expanded the monetary base by Ch\$931 billion, reduced the debt from promissory notes by Ch\$3.17 trillion, increased the net debt with banks by Ch\$2.15 trillion, and decreased the net balance of other assets held by the Bank by Ch\$100 billion. All these assets and liabilities registered additional reductions of Ch\$462 billion through interest, nonfinancial readjustments, and nonfinancial costs incurred during the year.

The increase in the monetary base, taking into account the interest paid for technical reserves (MPR less 100 basis points ^{4/}), was Ch\$931

billion, implying a higher real growth than GDP. The monetary base increased its share in liabilities (excluding equity) from 22 to 30% between year-end 2009 and year-end 2010.

The Ch\$2.15 trillion increase in net liabilities with the banks includes a Ch\$3.36 trillion drop in monetary policy assets and a Ch\$845 billion drop in liquidity deposits by the banks. The former reflects the impact of the discontinuation of the extraordinary measures implemented in 2009. The reduction in the net balance of other assets (Ch\$100 billion) mainly includes subordinated debt service paid to the Bank by bank shareholders (Ch\$102 billion), an increase in fiscal deposits (Ch\$53 billion), and a net expansion of Ch\$52 billion mainly from the Bank's nonfinancial income in domestic currency.

G.5 Capitalization of the Central Bank of Chile

Law 20,128 on Fiscal Accountability, published in the *Official Gazette* on 30 September 2006, authorizes the Treasury (through the Ministry of Finance) to make annual capital contributions to the Central Bank of Chile. Each contribution can be up to 0.5% of the previous year's GDP.

In accordance with this law, the Treasury did not make any contributions in 2009 and 2010, following the guidelines governing these specific contributions as established in Article 11 of the legal text. This authority is granted to the Minister of Finance for a period of five years from the date of publication of the law, and it requires the fulfillment of budgetary stipulations with regard to the existence of an effective surplus vis-à-vis one year previous to the date the contribution is made, after deducting the contribution to the Pension Reserve Fund established in the same law.

The Bank has already received three annual capital contributions. The remaining are contingent on an economic-financial study to be carried out by the Ministry of Finance to evaluate the impact of past contributions on the Bank's projected balance sheet for a period of twenty years.

These past three contributions were added to the Bank's international reserves, as established by the Board through Resolution 1289-02 of 31 August 2006. The value of these contributions was Ch\$323 billion in 2006 (US\$606 million); Ch\$387 billion in 2007 (US\$736 million); and Ch\$428 billion in 2008 (US\$730.7 million).

^{4/}When the MPR is below 100 basis points, the technical reserve remuneration is zero.





II. Institutional management and governance



A. Organization and operation

A.1 The Board

The Board has five Members, one of whom acts as chair and also serves as the Central Bank's Governor. The Board is responsible for the senior governance and management of the Bank, in its quality as an autonomous, technical public institution with constitutional authority. Board Members are appointed by the President of Chile by means of an Executive Decree issued by the Ministry of Finance, with prior approval from the Senate. Members hold office for a renewable period of ten years, and the Board is reconstituted on a partial basis every two years, when one Member is changed at a time^{1/}.

The Bank's Governor is appointed by the President of Chile from among the Board Members. The Governor holds office for five years or until his appointment as Board Member expires, whichever comes first, and may be reappointed for new periods. Along with chairing the Board, the Governor is responsible for representing the Central Bank

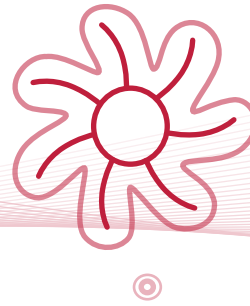
on extrajudicial matters and directing institutional relations with public authorities, financial institutions, and international bodies. Mr. José De Gregorio Rebeco was appointed Governor on 7 December 2007 to hold office until his term as Board Member expires on 9 December 2011.

The Deputy Governor is appointed by the Board, which also specifies the applicable term of office. The Deputy Governor stands in for the Governor when necessary and performs all other tasks entrusted to him. Mr. Manuel Marfán Lewis, who was appointed Board Member in December 2003, was appointed Deputy Governor for the period from 7 January 2010 to 9 December 2011.

The remaining Board Members are Mr. Enrique Marshall Rivera (appointed in December 2005), Mr. Sebastián Claro Edwards (December 2007), and Mr. Rodrigo Vergara Montes (December 2009). All three were appointed for a ten-year term.

Generally, the Board is responsible for exercising the authority and fulfilling the tasks entrusted to the Central Bank by law to comply with its mission: to ensure monetary stability and the normal operation of domestic and external payments. The Board therefore determines the general policies of the Central Bank, issues regulations governing its operation, and supervises the upper levels of the Central Bank. To this end, it also conducts ongoing assessments of compliance with the general rules and policies it has established and the development of institutional activities.

^{1/} Title II of the Central Bank's Basic Constitutional Act, in accordance with Articles 108 and 109 of the Chilean Constitution, includes the regulations governing the Board and the specific laws applicable to Board Members in terms of their appointment, compensation, incompatibilities, conflicts of interest, causes for termination of office, and other legal obligations inherent to the fulfillment of their duties. The last amendment to that title was Article 7 of Law 20,088 on Equity Affidavit.



Rules governing Board sessions and resolutions

The Central Bank operates essentially through agreements and other resolutions passed by the Board in accordance with the organizational statutes governing the Bank.

The Board must hold ordinary sessions at least once a week and special meetings when called by the Governor, either of his own volition or in response to a written request by two or more Board Members. Any resolutions adopted at the meeting must be recorded in the minutes. Board resolutions must be adopted by a quorum of three Members and must have the favorable vote of the majority of those present, except in cases in which the law requires a special quorum for specific resolutions, by reason of their importance or relevance^{2/}.

The Board Member chairing the session will cast the deciding vote in case of a tie. The Board generally holds its meetings at its offices in Santiago, but it is empowered to meet and vote on legal resolutions, regulations, or other rulings anywhere within the territory of Chile.

A.2 Coordination and transparency mechanisms within the institutional structure of the Bank

The Central Bank's Basic Constitutional Act establishes the relationships that allow the Bank to adequately fulfill its duties in coordination with the Executive Branch and other government bodies, thereby ensuring suitable control of its actions. Provisions in this area include the following:

(i) Section 6, paragraph 2, of the Basic Constitutional Act, which defines the coordination between the Board and the government, states that on adopting resolutions, the Board shall take into account the general orientation of the government's economic policy.

(ii) Before 30 April of each year, the Bank must submit to the Minister of Finance and the Senate a report on its activities in the previous year, including information on the policies and programs implemented in the period. This *Annual Report* must include the financial statements with their respective notes and the external auditors' opinion.

^{2/}A special quorum is required, for example, to approve internal regulations governing Board and Central Bank operations; to override the Finance Minister's veto or suspension of a resolution; to adopt, renew, or suspend foreign exchange restrictions; to receive deposits from the General Treasury or other governmental bodies; and to waive immunity from the enforcement of international contracts entered into by the Central Bank on economic and financial matters.

(iii) With regard to information on the Bank's policies and annual programs, the Basic Constitutional Act further requires that the Central Bank provide a second report to both the Minister of Finance and the Senate no later than 30 September each year.

(iv) It is the Bank's duty to report to the President of Chile and the Senate regarding the general rules and policies it approves in exercising its powers and to advise the Executive Branch, when requested, on all matters associated with the Bank's functions.

(v) The Minister of Finance can attend Board meetings and is accorded the right to speak and to propose the adoption of certain resolutions. The Minister must therefore be given written advance notice of all calls to Board meetings and the scheduled agenda items.

(vi) The Minister of Finance can suspend any Board agreement or resolution for up to 15 days, unless all Board Members unanimously vote to override the suspension, in which case the suspension will not take effect.

(vii) The Minister of Finance has the right to veto Board resolutions that impose, terminate, or modify foreign exchange restrictions covered under Section 49 of the Basic Constitutional Act. In the event of a veto, the resolution in question can only be adopted through a unanimous vote by the Board Members.

The last two items aim to promote dialogue with the Executive Branch before the adoption of highly important resolutions, so as to avoid the disruption caused by a suspension or veto. This gives the two bodies the opportunity to overcome differences in opinion with regard to economic measures, although deference is always given to the Bank's autonomy and technical expertise.

In addition to these legal regulations, the Board has established several regulatory provisions aimed at maintaining ongoing communication with the President of Chile, the Senate, and the general public about any measures adopted. This ensures the transparency of its actions and recognizes that the timely dissemination of the Board's decisions plays a crucial role not only in the general public's and the market's perception of the Bank's policies, but also in their impact on the economy.



Consistent with this principle, the Bank continuously incorporates international best practices with the goal of enhancing the transparency of its decisions.

These measures include the provision of advance notice of the dates of the monetary policy meetings and the prompt publication of the meeting minutes, as well as the dissemination of information on resolutions affecting monetary, credit, financial, and foreign exchange regulations. In particular, Board Resolution 1289-01, which was adopted on 31 August 2006, addresses institutional policy on the disclosure of information. This statute was modified via Resolution 1495-01-090820 to establish a systematic schedule and format for the *Monetary Policy Reports* and the *Financial Stability Reports*, which are released to the appropriate authorities and the public. This contributes to the efficient dissemination of regular, timely information on the measures adopted by the Central Bank in the areas of monetary and foreign exchange policy and capital market regulation, as well as the foundations on which these policies are based.

Thus, as outlined in the modifications to Resolution 1495 cited above, the *Monetary Policy Report* is published and presented to the Senate quarterly, in March, June, September, and December of each year. The *Financial Stability Report* is published half-yearly in June and December, in conjunction with the *Monetary Policy Report*. The resolution also provides for the dissemination of information on international reserve management, which is contained in this *Annual Report* and in the *Report on the Balance Sheet* included in the *Monthly Bulletin*.

A.3 Board regulations

The current operating regulations for the Central Bank's Board outlines the general rules for Board meetings, including guidelines on notification, the agenda, participation and debate, the preparation of minutes, and the public release of information on the issues discussed, through the respective minutes. They also include special rules on monetary policy meetings, mainly with regard to their frequency, participants, the agenda and debate, minutes, summary of discussions, and the dissemination of resolutions through a public press release issued after the meeting.

Given their importance and to make them as widely available as possible, these regulations were published in the *Official Gazette* and may be accessed directly on the Bank's website at www.bcentral.cl.

A.4 General management, general counsel, and auditing

Sections 24, 25, and 26 of the Basic Constitutional Act stipulate that the General Manager is responsible for managing and supervising the Central Bank, with the instructions and powers granted by the Board. The General Counsel, in turn, has the sole task of safeguarding the Bank's legal structures and monitoring the legal risks associated with the Bank's actions. The General Auditor is responsible for inspecting and auditing the Bank's accounts, operations, and administrative standards.

Mr. Alejandro Zurbuchen Silva has served as General Manager since 7 August 2006. Mr. Miguel Ángel Nacur Gazali has served as General Counsel and Certifying Officer of the Bank since 1 March 1997. Ms. Silvia Quintard Flehan has served as General Auditor since 1 January 2007.

A.5 Audit and Compliance Committee

Through Resolution 1330-01-070419 the Board created the Audit and Compliance Committee and approved the organizational statutes governing it. As an advisory body to the Board, this Committee reports on the effectiveness of internal monitoring systems and procedures; assesses and reports on the implications for the Bank's equity and reputation of complying with its obligations; assesses the reliability, integrity, and timeliness of the information included in the financial statements; coordinates with the Bank's General Auditor in terms of the responsibilities assigned by the Basic Constitutional Act; and proposes the hiring of external auditors. In June 2010, through Resolution 1542-01-100603, the Board renewed the appointment of the members of the Audit and Compliance Committee and established the renewal of their appointments as institutional policy.

In 2010 the Committee met seven times to execute the provisions in its governing statutes. The issues addressed at these meetings included assessing the services provided by the independent auditing firm; reviewing the annual auditing plan and final report; learning the activities of the internal auditing division; and reviewing the risk management, internal monitoring, and information systems.



Alejandro Zurbuchen
General Manager

B. Internal administration

B.1 Strategic planning

The Central Bank of Chile's vision is to be widely recognized as an autonomous, technical, leading institution, known for its institutional values and the effectiveness with which it achieves price stability and the normal functioning of the payment system. Its mission is to contribute to the smooth functioning of the economy and the well-being of the community, safeguarding the stability of the currency and the normal operation of the internal and external payment systems.

The Bank's strategic planning plays an important role in the achievement of its vision and mission. The planning horizon is medium term and is tied to the term of office of the Bank's Governor, with a one-year lag. The current medium-term strategic plan was in its second year in 2010; it extends through 2012. The strategic focal points for the four-year period are as follows:



- Leadership in essential areas: to return inflation to the target range and to preserve financial stability, handling the global crisis successfully and at the lowest possible cost.
- Efficient management in a friendly working environment: to achieve strategic and operational leadership at the regional level.
- Modernity and tradition: a new family of banknotes and coins.

Based on these strategic definitions and the budget set by the Board, the different units worked on their strategic plans and initiatives, giving emphasis and priority to areas aligned with the focal points mentioned above so as to achieve the defined objectives.

The main achievements and advances in 2010 were the following:

- Normalization of the monetary policy rate. The process of normalizing the monetary policy rate was initiated in 2010.
- Important advances and innovation in administrative areas. In 2010, the risk assessment of all high and serious risk processes was concluded. A project was initiated to implement an enterprise resource planning (ERP) system. New technological tools were incorporated, which have facilitated the organization's work. The IFRS accounting criteria were applied to the Bank's financial statements. The Financial Operations Division was restructured, with the creation of new units within the division.
- Operational continuity. The operational continuity plan was put to the test by the earthquake on 27 February, when the Bank maintained continuity of its critical operations without affecting the market. The plan also worked during the general power cut on 14 March. In September, the new alternate operations site began operating in the Country Club.
- A new family of banknotes. The new \$10,000 bill entered into circulation in March, following the launch of the \$5,000 bill in 2009. The \$20,000 and \$2,000 banknotes were issued in July and November 2010, respectively.

B.2 Internal organization, restructuring, and appointment of executives

In March, the Board created the International Relations Management, which reports to the Office of the Governor and whose main role is to strengthen international ties with the financial community, other central

banks, and multilateral institutions. Also in March, the Board created the Financial Research Management, which reports to the Financial Policy Division. The objective of this restructuring was to adequately and efficiently separate the main processes of the Division and to improve the coordination between the respective managements.

In August, the Board established the Financial Services Management, which reports to the Financial Operations Division, and the Payments Department and the Operations Control and Registration Department, which both report to the new Management and which replace the Payments and Securities and International Treasury departments. The objective of this restructuring was to reduce the Division's operating risks by clearly separating the different functions, to increase process efficiency, and to generate operating synergies by establishing areas of specialization and separating functions within the Division.

The Board also changed the name of the International Investment Management to the International Markets Management, while the National Financial Markets Management was renamed the Domestic Markets Management. The Board further created the Fiscal Agency Department, which reports to the International Markets Management, and the Domestic Markets Department, which reports to the Domestic Markets Management.

In terms of executive appointments, the following appointments were made in 2010. In January, the Board appointed Mr. Manuel Marfán Lewis to the position of Deputy Governor of the Board and of the Central Bank of Chile, through 9 December 2011. In March, Mr. Rodrigo Cifuentes Santander was named Manager of Financial Research, and Mr. Luis Opazo Roco was designated Manager of Financial Stability. In June, Mr. Álvaro Rojas Olmedo was named Manager of International Relations. In August, Mr. Luis Óscar Herrera was appointed Director of the Research Division. In September, Mr. Gabriel Aparici Cardozo was selected as Manager of Financial Regulation and Infrastructure, Mr. Juan Carlos Piantini Cardoso as Head of the Fiscal Agency Department, and Ms. Claudia Sotz Pantoja as Head of the Domestic Markets Department. In November, Ms. Mariela Iturriaga Valenzuela was appointed Manager of Financial Services. In December, Mr. Andrés Vargas Poblete was named Head of the Payments Department, and Mr. Cristián González Quijada was designated Head of the Operations Control and Registration Department.

B.3 Human resources management

Skills-based management model

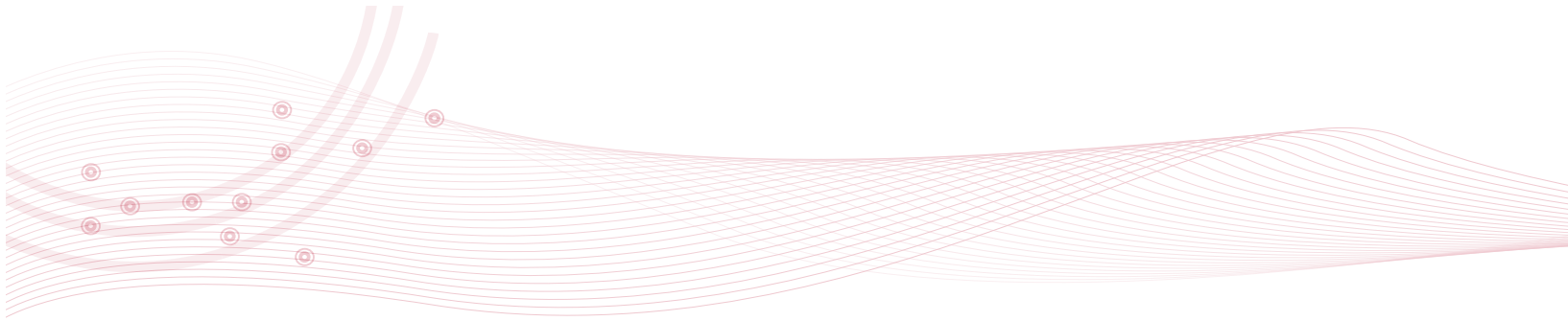
In 2010, the Bank continued working with its program to close the skills gap in upper management through the development of individual coaching programs and group workshops for managers and department heads. A skills assessment was conducted for the next level of heads, who interact more directly with the work teams. This reinforces the core principle of the methodology by encouraging the leadership styles and management practices defined by the Administration to filter down to all levels of the organization.

This completes another step toward achieving the program goals—namely, that the positions responsible for managing work teams develop a common approach and standards of conduct that are in line with the Institution's ideals and consistent with the definitions in the Skills Dictionary, which has recently been edited and simplified.

The skills-based management model used by the Bank is a key element in the selection process for management positions, as well as in the formulation of development plans for people in management positions.

Career development

In 2010, advances were made in terms of defining critical positions, formulating development plans for their designated replacements, and designing professional development programs for staff with an excellent performance record. In late 2009, the division directors identified the critical positions within their units, based on two main components: replacement cost and operational continuity. These critical positions were officially recognized in 2010, and a replacement was designated. The official recognition was conducted by the development committee, made up of the General Manager, the Human Resources Manager, and the corresponding Division Director. Once a position was recognized as critical, a professional development program was put underway, starting with the design and implementation of a measure of potential in late 2010. In 2011, work on the development plan will continue with the identification of the existing skills gap for each of the professionals identified as a replacement for a critical position.



With regard to the recruitment, retention, and development of high-performing professionals in economics and finance, a work plan was drawn up in 2010 focusing on recent graduates in economics and business administration and new Ph.D. recipients from prestigious universities around the world.

To this end, a series of activities was undertaken with both internal staff and university departments, to determine the Bank's capacity to attract young university graduates. These activities revealed that young graduates continue to see the Bank as an attractive employer, due to its strong positioning in terms of careers in economics and business administration. The next challenge for this project, to be implemented in 2011, is to take concrete actions for the professional development of staff within the Bank who show potential for entering the pool of replacement officers for the main managements within the Bank.

Over the course of the year, the groundwork was laid for the Bank to participate for the first time as a recruiting employer at the American Economic Association job fair for graduates of Ph.D. programs from universities around the world. Participation in this annual job fair, which is held early in the year, represents a special opportunity for introducing the Bank into the academic arena. It will facilitate the recruiting and contracting of highly qualified professionals for the main economic and financial areas within the Bank.

In 2010, the Bank continued its Visiting Student Program, which was initiated in 2009. The program is directed toward Chilean citizens (who do not receive financing from the Bank) who are in doctorate programs related to the Bank's main functions. Over the course of the year, the Bank received seven students from a range of doctorate programs in economics and finance at prestigious universities in the United States and Europe. The students worked with teams of Bank professionals on projects of interest in the Research Division, the Financial Policy Division, and the Board.

This program has been very well received. It has allowed Bank staff to get to know professionals with interests that dovetail the Bank's

work, as well as to spread information on jobs and projects being developed within the Institution. It provides a very interesting vehicle for both sides to get to know each other, with an eye to contracting future professionals with post-graduate studies.

B.4 The Comptroller

The Comptroller's activities focus on helping the Board and the Administration fulfill their duties, through an independent, objective, and systematic evaluation of the design and effectiveness of risk management, internal monitoring, and corporate governance. It also carries out consulting duties that, combined with the above, add value and contribute to the achievement of institutional objectives.

In 2010, the main challenges were in the following areas: implementing an audit plan based on international practices; supporting and responding to the needs of the Audit and Compliance Committee; and maintaining the certification of the quality of the audit process by the Institute of Internal Auditors (IIA). The IIA Quality Assurance Review verifies that the activities of the Bank's Comptroller "comply with international standards for the professional exercise of internal auditing." It is evidence of the Comptroller's commitment to continuously improving the quality of its performance and its use of best practices. In addition, the Internal Auditing Service of the Central Bank of Chile maintained its certification under ISO 9001:2008 standards.

B.5 Main contracts for the provision of goods and services

The Bank is subject to the provisions in its Basic Constitutional Act governing the periodic release of information on the fulfillment of its public duties. In this context, this report discloses the main contracts signed by the Bank for an amount greater than Ch\$100 million, which are related to the supply of goods and services that allow the institution to operate normally (tables II.1 and II.2). With regard to the issue of banknotes and coins, section E.3 provides general information on the contracts signed by the Bank in connection with the 2010 issue program.

TABLE II.1
CONTRACTS SIGNED IN 2010.
 (Over Ch\$ 100 million during the life of the contract)

Supplier	Contract purpose	Effective	Ending
Tech one Group S.A. (4)	Information and technological services	01.Jan.10	31.Dec.12
América XXI Consultores Informáticos Internacionales Limitada (4)	Information and technological services	18.Jan.10	17.Jan.13
Ingeniería de Servicios, Electricidad, Computación, Asesorías y Proyectos Limitada	Infrastructure services	01.Apr.10	09.Jul.10
Browse Ingeniería de Software S.A.	Information and technological services	24.Mar.10	30.May.10
Adexus S.A. (4)	Information and technological services	01.Apr.10	31.Mar.13
Novared Chile S.A.	Information and technological services	16.Mar.10	12.Sept.10
Claudio Hernán Alvarez Lazcano	Infrastructure maintenance services	28.Apr.10	18.Dec.10
Constructora Antillanca Limitada (6)	Infrastructure maintenance services	26.May.10	15.Mar.11
Proyectos, Montajes, Ingeniería y Servicios en Telecomunicaciones y Obras Civiles Limitada (4)	General services	05.Jul.10	04.Jul.13
Servicios Generales de Apoyo Empresarial Limitada (5)	Recreational services	01.Jul.10	30.Jun.15
Aquiles Gómez y Compañía Limitada (4)	Servicios de actividades deportivas estadio	16.Jul.10	15.Jul.13
Empresa Nacional de Telecomunicaciones S.A. (2)	Information and technological services	01.Sept.10	31.Aug.15
Indra Sistema Chile S.A.	Information and technological services	04.Oct.10	04.Jul.11
S&A Consultores Asociados Chile Limitada (4)	Information and technological services	01.Oct.10	30.Sept.13
Empresa Nacional de Telecomunicaciones S.A.	Information and technological services	29.Oct.10	05.May.11
Telmex Servicios Empresariales S.A. (4)	Communication services	01.Nov.10	31.Oct.13
Novared Chile S.A. (4)	Information and technological services	10.Dec.10	09.Dec.13
Instituto Nacional de Estadísticas (3)	Statistical products	02.Jan.10	01.Jan.12
Central de Restaurantes Aramark Limitada (4)	Food services	04.Jan.10	03.Jan.13
Productora Gráfica Andros Limitada (4)	Printing services	01.Jan.10	31.Dec.12
Casa de Moneda de Chile S.A. (1)	Custodian services	08.Apr.10	07.Apr.14

(1) Three-year contract, which is automatically renewable for an additional one-year period.

(2) Three-year contract, which is automatically renewable for up to two additional one-year periods.

(3) One-year contract, which is automatically renewable for an additional one-year period.

(4) One-year contract, which is automatically renewable for up to two additional one-year periods.

(5) One-year contract, which is automatically renewable for up to four additional one-year periods.

(6) Contract for the duration of the work (90 calendar days). On 15 December 2010, an addendum to the contract was signed for additional works, which extended the contract for additional 90 calendar days.

Source: Central Bank of Chile.

TABLE II.2
EXPENDITURES IN CONSULTING, SURVEYS, STUDIES, AND SEMINARS
 (2010 Ch\$ million) (*)

	2006	2007	2008	2009	2010
Consulting, surveys, studies and seminars	952.2	2,261.7	1,966.1	1,685.8	1,514.9
Consulting	522.8	1,711.4	1,330.5	764.7	904.3
Surveys and studies	279.0	313.7	430.1	706.9	409.4
Seminars	150.4	236.6	205.5	214.2	201.2

(*) The average CPI was used to update older figures to 2010 pesos.

Source: Central Bank of Chile.

TABLE II.3
PERSONNEL, ADMINISTRATION, AND OTHER EXPENSES
 (2010 Ch\$ million) (*)

	2006	2007	2008	2009	2010
Personnel and administrative expenses					
Personnel expenses	19,862.5	21,946.4	21,615.7	22,886.3	24,145.6
Administrative expenses	8,684.9	10,509.2	11,350.5	10,800.3	12,456.2
Provisions for severance pay	1,209.1	998.8	6,650.0	2,119.5	1,862.9
Total	29,756.5	33,454.4	39,616.2	35,806.1	38,464.7
Other expenses					
Depreciation and amortization	1,664.3	2,373.7	2,641.0	2,096.4	1,478.5
Taxes and contributions	539.1	479.3	448.8	568.5	474.4
Total	2,203.4	2,853.0	3,089.8	2,664.9	1,952.9
Total personnel, administrative, and other expenses	31,959.9	36,307.4	42,706.0	38,471.0	40,417.6
A. Personnel expenses					
Wages and other employer contributions	16,835.9	18,888.7	18,540.4	19,635.4	21,071.4
Employee wellbeing	2,308.0	2,354.6	2,488.7	2,576.0	2,565.8
Training	718.6	703.1	586.6	674.9	508.4
Total	19,862.5	21,946.4	21,615.7	22,886.3	24,145.6
B. Administrative expenses					
Utilities	710.7	825.4	928.5	1,019.0	950.7
General services	3,220.4	3,372.9	3,407.9	4,057.5	4,334.1
Maintenance of fixed assets	985.9	763.0	1,207.4	639.7	1,477.8
Informatics and technological development expenses	2,815.7	3,286.2	3,840.6	3,398.3	4,178.7
Consulting, surveys, studies, and seminars	952.2	2,261.7	1,966.1	1,685.8	1,514.9
Total	8,684.9	10,509.2	11,350.5	10,800.3	12,456.2

(*) The average CPI was used to update older figures to 2010 pesos.

Source: Central Bank of Chile.

C. Personnel, administration, and other expenses

These expenses include personnel compensation and benefits, the use and consumption of goods and services, and other expenses necessary for carrying out the Bank's activities (table II.3). On the income statement, they are broken down as follows: (i) personnel and administration; and (ii) other expenses. Of the total personnel and administrative expenses, personnel represents 63%; administrative expenses, 32%; and retirement benefits, 5%.

Personnel expenses

Personnel expenditures rose 21.6% in real terms between 2006 and 2010, from Ch\$ 19.68 billion to Ch\$ 24.15 billion. Salaries represent an important component of personnel expenditures, and the fixed share of salaries has been steadily coming up to market rates over the course of this period, so as to guarantee the incorporation and retention

of highly qualified professionals in the Bank. This largely explains personnel expenses in the last five-year period, together with the evolution of the personnel structure—characterized by a trend toward the professionalization of the Bank and a decline in administrative, secretarial, and service personnel.

From December 2006 to December 2010, the size of the staff grew 2%, from 601 to 615 employees. Professionals, executives, and senior managers accounted for 64% of the total in 2006, versus 70% in December 2010. This trend toward a larger share of professionals is expected to continue in the future.

Retirement benefit costs

To comply with International Financial Reporting Standards (IFRS), in 2008, 2009, and 2010 the benefits calculation incorporated accounting criteria that include financial parameters and demo figures. The biggest effect is seen in 2008, when the IFRS criteria were first applied.



Publications by the Central Bank of Chile

The 54.1% real increase in retirement benefit costs between 2006 and 2010 is essentially explained by the application of the benefits accounting criteria and by severance pay for years of service paid out to personnel on the retirement plan started in 2008. The amount of the severance payments and the net increase in benefits in 2010 was Ch\$1.86 billion.

Administrative costs

Administrative costs recorded a real increase of 43.4% between 2006 and 2010, from Ch\$8.69 billion to Ch\$12.46 billion. This mainly reflects higher disbursements for maintenance of fixed assets, computer and technological development expenses, and consulting, surveys, research, and seminars.

Between 2009 and 2010, administrative expenses increased 15.3% in real terms, mainly due to increased expenditures on office and/or building remodeling and on software purchases for the central computer network.

D. Communication and diffusion

D.1 Main publications by the Central Bank of Chile in 2010

The main objectives of the Central Bank's publication policy is to increase transparency in the delivery and communication of economic information, improve its timeline, and provide the public with information on key economic issues.

The main publications through which the Bank communicates its policies are the *Monetary Policy Report* and the *Financial Stability Report*. The former, which is published in March, June, September and December, presents the Board's assessment of the recent and expected evolution of inflation, its implications for monetary policy in the medium term, and the information necessary for agents to adequately formulate their price and economic growth estimates.

The *Financial Stability Report*, which is published half-yearly (in June and December of each year), reports on recent macroeconomic and financial developments that could affect the financial stability of the Chilean economy. The report also presents the policies and measures

that support the normal functioning of the internal and external payment systems, with the goal of promoting knowledge and debate on the Bank's actions in carrying out its functions.

In the field of economic research, in 2010 the Bank published volume 14 of the series, *Central Banking, Economic Policy, and Analysis*, entitled *The Central Bank of Chile, 1925–1964: An Institutional History*. The work was researched and written by a former general manager of the Bank, Camilo Carrasco. The book describes the circumstances that led to the creation of the Bank in 1925, its objectives and development in the first forty years of its history, the main actions taken in that period, and their results. The book was launched on 12 January 2010, with a discussion by former Central Bank Governor, Mr. Andrés Bianchi.

The Bank's economic research is also reflected in the journal *Economía Chilena*, which is published three times a year (in April, August, and December). The ten papers and seven research notes published in 2010 mainly address issues affecting the Chilean economy, with a strong empirical focus and an emphasis on issues relevant for the conduct of economic policy.

Over the course of 2010, five new papers were published in the *Economic Policy Papers* series. This series discloses the opinion of Bank authorities on relevant economic and monetary policy topics. The subjects discussed were related to the challenges faced by the emerging economies as a result of the capital inflows of the past few years; the role of central banks in the wake of the financial crisis of 2008–09; the debate on macroprudential regulation, financial stability, and capital flows stemming from the crisis; some reflections on post-crisis monetary policy objectives and instruments; and the importance of China in the global economy and its impact on the economic performance of Latin America.

In addition, 48 *Working Papers* were published in 2010. This series has become one of the most important series internationally in the field of specialized economics, based on the number of Internet visits. Its purpose is primarily to facilitate the exchange of ideas and to release preliminary economic research results for discussion and commentary.

The Bank also published three new papers in the *Studies in Economic Statistics* series. The purpose of this series is mainly to release research papers in economic statistics, with a strong empirical and factual

content. The papers include a study of the financial debt of Chilean households in the last decade; a descriptive analysis of the evolution of the economic expectations survey conducted by the Central Bank since 2000; and a measure and description of the nonfinancial private business sector in Chile, based on data used by the Bank in the national accounts.

Finally, in accordance with the provisions of Section 53 of its Basic Constitutional Act, the Bank continued its annual program of periodical publications, aimed at disseminating information on the main national macroeconomic statistics. This year's publications included the following: *Informativo Diario* (Daily Report), *Boletín Mensual* (Monthly Bulletin), *Indicadores de Comercio Exterior* (Foreign Trade Indicators), and *Indicadores Macroeconomicos y de Coyuntura* (Macroeconomic Indicators and Current Indicators). The following yearbooks were also published: *Cuentas Nacionales* (National Accounts), *Balanza de Pagos* (Balance of Payments), *Deuda Externa de Chile* (Chilean External Debt), *Síntesis Monetaria and Financiera* (Monetary and Financial Synthesis), and *Síntesis Estadística de Chile* (Statistical Synthesis of Chile).

D.2 Visits to the Senate

In 2010, the *Monetary Policy Report* was presented to the Senate Finance Committee in April (the March *Report*), June, and December; the September *Monetary Policy Report* was submitted to the full Senate. In June and December, the *Monetary Policy Report* was presented jointly with the *Financial Stability Report* for the first and second half of the year, respectively.

The Governor of the Central Bank, José De Gregorio, attended two special sessions of Congress analyzing the exchange rate situation. Specifically, he spoke at a session of the House of Representatives in October and at a session of the Senate in December.

D.3 Seminars and conferences

The Fifth High-Level Seminar of the Eurosystem and Latin American Central Banks was held on 24–25 June. The event was organized by the Economic Research Division, as part of a joint initiative between the Central Bank of Chile and the European Central Bank. Participants included the Bank's Deputy Governor, Manuel Marfán, Board Member Rodrigo Vergara, and other senior economists not only from the



Presentation of the Monetary Policy Report to the Senate

Central Bank of Chile and the European Central Bank, but also from the central banks of Brazil, Colombia, Germany, Greece, Italy, Mexico, the Netherlands, Peru, and Spain.

The last workshop in a series organized by the Bank's Statistical Survey professional team was held on 5 July. The series, which began in 2009, comprised a total of seven workshops in Santiago and three in Antofagasta, Valparaíso, and Puerto Montt. These workshops are directed at businesses that provide the Bank with information on their operations.

As part of the ongoing training program coordinated by the Human Resources Management, a broad range of academic activities was organized in the Bank in 2010, including internal seminars not only for the Bank's economists, but also for professionals from public institutions and graduate students from the main economic schools in the country.

On 3–5 August, the bank hosted a course on Financial Frictions, Aggregate Economic Activity, and Public Policies, led by Nobuhiro Kiyotaki, Professor of Economics at the University of Princeton. The course was attended by professionals from the economic and financial areas of the Bank and graduate students from the main economic schools in the country.

During the same visit, on 6 August the Economic Research Management held a Workshop on Financial Markets and Monetary Policy. The workshop was attended by a number of foreign researchers, led by Professor Kiyotaki.

On 9 September, the Financial Research Management organized a seminar to present the Household Financial Survey to the academic community and others interested in public policies in Chile and abroad. This event featured the participation of Orazio Attanasio, Professor of Economics at University College London.

On 21–23 September, the Statistical Information Services Department coordinated a consultant workshop led by Antonio Casado of the Bank of Spain. The workshop centered on the Bank's experience with FAME/SIE7E, in terms of strategic, technical, and user issues. Mr. Casado provided his expert opinion and reported on experiences in Spain and the rest of Europe.

On 22–24 September, the Central Bank of Chile hosted the Third Seminar on Strategic Planning in Latin American Central Banks, organized in conjunction with the Latin American Studies Center (Cemla). The event featured the participation of representatives of the main central banks in the region, as well as special guests from

Cemla meeting on "Financial and Monetary Statistics"



European banks, including the Netherlands and Sweden, and the U.S. Federal Reserve Bank.

Between July and December 2010, a series of training workshops for journalists was held for the second consecutive year, organized by the Central Bank and the Inter-American Association of Economic and Finance Journalists (Aipef Chile). The objective of the workshops was to promote the development and improvement of economic reporting among both general and specialized journalists. The series consisted of eight workshops, led by the Governor of the Central Bank, José De Gregorio, together with managers and staff economists. The following subjects were discussed: monetary policy and the inflation target, exchange rate policy, monetary aggregates, international reserve management, reading the Central Bank's balance sheet and equity, unobservable variables in macroeconomics, and the derivatives market. A total of 54 journalists attended the workshops, with an average of 24 per presentation. Participants represented a range of media, including newspapers, information agencies, magazines, radios, Internet sites, communications agencies, institutions, Aipef members, and others.

From 4 to 15 October, representatives from seven countries and staff members from the Superintendence of Securities and Insurance and the Central Bank of Chile attended a course on "Monetary and Financial Statistics," organized by Cemla and the Central Bank. The course

included theoretical classes, applied exercises, and case studies from the countries of the foreign participants.

On 21–22 October, the Bank held its Fourteenth Annual Conference, titled "Fiscal Policy and Macroeconomic Performance," which was attended by representatives from central banks around the world. The event was inaugurated by the Governor of the Bank, followed by keynote speaker Olivier Blanchard, Chief Economist of the International Monetary Fund. The central topic of discussion was the adoption and results of the aggressive fiscal stimulus packages implemented in numerous economies in response to the global crisis of 2008. The main conclusions of the meeting will be published in the next volume of the book series on *Central Banking, Analysis, and Economic Policies*.

A workshop on "The Objectives of International Reserves" was held on 25–26 October, organized by the Financial Operations Division and the International Relations Management. The workshop focused on reviewing the economic and financial objectives of central bank international reserves, and it included presentations by staff members of the central banks of Brazil, South Africa, Finland, and Canada. The viewpoint of the private sector was represented by two guest participants from important firms in the financial sector and one multilateral organization.



Students participating in the contest, "Economics Close up"

On 19 November, the Economic Research Management coordinated the Workshop on Macroeconomic Fluctuations and Labor Markets. The seminar featured the presentation of seven research projects on subjects related to labor market dynamics and policy implementation. The papers will be published in a special issue of the journal *Economía Chilena*.

On 23–25 November, a seminar on financial stability was organized by Cemla, the Financial Stability Institute of the Bank for International Settlements (BIS), and the Central Bank of Chile. The event featured presentations by staff members from the BIS, the European Central Bank, the Riksbank (Sweden), and the Bank of Spain. The seminar ended with a round-table discussion on the analysis of financial stability in the region. It was attended by representatives from central banks in more than ten Latin American countries.

D.4 "Economics for the Majority" program

As part of its community outreach program "Economics for the Majority," which is mainly aimed at high school and university students, the Central Bank continued to develop its guided tour program, which consists of a visit to the main premises of the Bank. In 2010, 3,834

people visited the Bank. The tour includes a walk through the main premises of the Bank, an informational video, and, in the case of university students and students with a particular interest in economics, a talk explaining the Bank's role, objectives, and monetary policy, depending on their level of understanding.

Another activity coordinated by the community outreach program was the sixth annual contest "Economics close up," in which third- and fourth-year high school students from all over the country use their daily lives as the basis for researching and analyzing economic issues that tie into the Bank's role and objectives. For this year's contest, which was sponsored by the Ministry of Education, 1,562 students from 328 educational establishments created 420 team projects. This exceeded expectations, considering that the start of the school year was postponed due to the earthquake.

A team of Bank economists reviewed the projects and selected ten finalists, which were then evaluated by a panel of judges composed of the Governor of the Central Bank, Board Member Rodrigo Vergara, the Minister of Education, the Minister of Finance, and distinguished education specialists. The panel selected three team finalists, who were asked to present their projects to the judges.

Governor José De Gregorio on a regional visit



This year, the *Liceo Alonso de Ercilla y Zúñiga de Cañete* won two awards: first place for the project "The rate of intrigue" and third place for "History corroborates the autonomy of the Central Bank of Chile." Second place went to the group from the *Colegio Nuevo Milenio de Villa Alemana*, for the project "To improve there must be change: Perfection is built from small changes."

In 2010, the Bank continued to offer training activities for high school teachers, to motivate them to participate in the contest and provide information and guidance for supporting their students as they develop their projects. Six workshops were held in January, April, and July 2010 and were attended by 90 teachers.

In addition to the above activities, Bank economists conducted five presentations in schools in the Greater Santiago area. These were attended by 560 third- and fourth-year high school students. Additional presentations were given in Nueva Imperial, Punta Arenas, and Antofagasta, with 350 students in attendance.

D.5 Regional visits

In 2010, the Bank continued to present its main reports, the *Monetary Policy Report* and *Financial Stability Report*, at the regional meetings.

These meetings are intended to promote the public's learning and becoming familiar with the Bank's objectives, policies, instruments, and projections; to facilitate a better understanding of the Bank's actions; and to improve the effectiveness of its policies. These meetings coincide with the quarterly publication of the *Monetary Policy Report*, and the presentation of this *Report* and the *Financial Stability Report* are complemented with other presentations on the Central Bank's policies and instruments and with a panel on the development prospects of the visited region.

The Bank organizes these meetings in association with a regional university or business group. This offers a valuable opportunity to get closer to the community, business people, and regional authorities, thereby promoting direct dialogue and greater mutual awareness between the Bank and different economic sectors in each region of the country.

The following meetings were held in 2010. In April, the meeting in Punta Arenas was organized by the Central Bank in conjunction with the Confederation of Production and Trade (CPC) and was led by the Governor of the Bank, José De Gregorio; and the Copiapó meeting was led by Board Member Enrique Marshall and organized by the Corporation for the Development of the Atacama Region (*Corproa*).

In June, the Antofagasta meeting was coordinated by the Catholic University of the North and featured Deputy Governor Manuel Marfán; and the Concepción meeting was held at the Catholic University of Concepción, with the Governor of the Bank presiding. In September, the Puerto Montt meeting was held at the San Sebastián University and was led by Board Member Enrique Marshall; and the Valparaíso meeting was held at the Federico Santa María Technical University, led by Board Member Rodrigo Vergara. Attendance ranged from 80 to 250 people at each meeting.

Board Members and other senior executives also made several presentations outside Santiago, in response to invitations from academic institutions, union associations, and the media. This year, presentations were given by Board Member Rodrigo Vergara in La Serena in April; by Board Member Enrique Marshall in Temuco in June; by Board Member Sebastián Claro in Iquique in September; and by Board Member Enrique Marshall in Valdivia in December.

D.6 Cultural outreach

As part of the inauguration of the new family of banknotes, three exhibits were organized in the main hall of the Central Bank in 2010. This program, which aims to increase knowledge on the historical figures featured on the banknotes, began in September 2009 with the presentation of "Gabriela: A universal perspective." A second installation, "Prat: Facets of a hero," opened on 31 March. Thanks to the collaboration of the Navy and the National Historical Museum, this exhibit brought together valuable pieces and numerous of the hero's belongings, as well as a selection of documents, letters, and images from his life. These were complemented by a succession of biographical texts developed by the curator, Juan Manuel Martínez, an art historian specializing in allegorical representations of our history.

The exhibit "Andrés Bello: Humanist of the Republic" was inaugurated in early August, one week after the \$20,000 bill entered into circulation. This installation included original manuscripts edited by Bello and first editions of his works, which were generously loaned by the National Institute and the University of Chile's Andrés Bello Central Archive. The latter also collaborated through the loan of the portrait by R. Monvoisin, on which the image of Bello on the new banknote is based. The textual components of the exhibit were developed by historian Iván Jaksic, who is a specialist on this Venezuelan-born intellectual. The showing featured an actor playing the role of Andrés Bello; the actor and another



Diffusion of the new family of banknotes



National Heritage Day

guide worked to create an engaging script that was presented to over a thousand students who came to see the exhibit.

Finally, the exhibit "Manuel Rodríguez: Beyond the legend" opened on 17 November. The objective was to promote a broader understanding of Rodríguez beyond the leader's mythic image. To this end, a full series of texts was prepared based on original historical sources, with the assistance of consultant researcher Ernesto Guajardo. The exhibit incorporated audiovisual elements, guides, and an actor portraying Manuel Rodríguez. It was very well received by the general public and by over a thousand students participating in the school visits program.

For the seventh consecutive year, the Bank participated in Chile's National Heritage Day, which was held on Sunday, 30 May. The event is organized by the government's Monument Committee, and for the day more than 50 cultural heritage buildings open their doors to the public.

This year, the Governor and other senior authorities hosted 2,081 people and discussed the Central Bank's most important functions. The tour started with the showing of a new institutional video recorded in March and April 2010. The visitors then toured the most interesting areas of the building, including the Governor's Office, the Board Room, and the exhibit "Money in Chile: Memoir of a nation." The exhibit features a selection of 68 representative pieces and 7 gold ingots from the Bank's numismatic collection. The tour ended with the Arturo Prat exhibit.

In addition, as part of the bicentennial celebration, a second National Heritage Day was held on 5 September. The Bank received 1,643 visitors. The tour featured the same highlights as in May, but ending with the Andrés Bello exhibit.

E. Miscellaneous

E.1 Technological changes

The earthquake on 27 February and the general power outage on 14 March put to the test the outcome of recent projects aimed at fortifying the technological contingency mechanisms and infrastructure that support the Bank's critical business processes. Both contingencies were overcome without major disruptions in the operational continuity of the Bank's technological platform and, therefore, in the provision of services.

To continue improving and strengthening the operational continuity of its services, the Bank established an alternate operations site in 2010. In the case of a major contingency that impedes access to the corporate offices, staff members can continue to perform their main functions at this location.

In the area of data security, notable achievements include the technological renovation of the security measures associated with network connection and access, the updating of security mechanisms for the protection and secure handling of sensitive information, and the implementation of new technologies for reinforcing the security and supervision of the use of privileged passwords for platform management.

With regard to site infrastructure, in 2010 a series of improvements were made in the technical and spatial conditions of the main processing site. Highlights include the implementation of an integral structured fiber cabling solution and the installation of an independent technical room to house the climate control and electrical support systems. A project was also carried out to select, contract, and set up of a new external processing site, in accordance with the Bank's business needs. The equipment is expected to be moved out of the current external site in the first half of 2011.

Finally, in 2010 the Informatics Management participated actively in a series of technological projects for other areas of the Bank. In particular, implementation began on a business intelligence solution for monetary programming and climate for the Domestic Markets Management, a solution was identified for improving document management and the

administration of the Bank's institutional content, and the technical requirements were defined for the selection of a corporate enterprise resource planning (ERP) solution.

E.2 Appointment of independent auditors

The second paragraph of Section 76 of the Basic Constitutional Act stipulates that the Central Bank's financial statements must include an independent auditors' opinion and that the Board is to appoint the auditors from among those registered with the Superintendence of Banks and Financial Institutions. After issuing a call for tenders to contract financial statement auditing services for an initial period of three years, and based on a report by the Audit and Compliance Committee, the Board appointed *KPMG Auditores y Consultores Ltda.* to provide professional auditing services for the period 2008–10, through Resolution 1406-01-080424.

E.3 Banknotes and coins

In 2010, the Bank continued the gradual process of replacing the old peso bills with the new family of banknotes, to provide a modern means of payment based on the latest technology available today. The new \$10,000 banknote entered into circulation on 31 March 2010, the \$20,000 on 28 June, and the \$2,000 on 17 November. The process will be completed in 2011 with the issue of the new \$1,000 bill, thereby meeting the two-year schedule for replacing all the denominations.

The three issues in 2010 were accompanied by a countrywide educational and informational campaign incorporating audiovisual, written, and digital media. The campaign objective was to inform the public about the new bills and their security recognition features.

As of December 2010, there were 600.71 million individual banknotes in circulation, an increase of 10.2% relative to year-end 2009 (545.25 million). The total number of coins grew 7.7% in the year, to 9.73 billion.

To meet growing public demand, in 2010, the Bank contracted the minting of 192 million new coins: specifically, 20 million \$500 coins; 110 million \$10 coins; 28 million \$5 coins, and 34 million \$1 coins. The banknotes and coins issued in 2010 were produced in Sweden, Australia, and Chile.



Presentation by Professor Raghuram Rajan

The Bank continued its training program to help the community become familiar with the banknotes in circulation and their security recognition features. Over the course of the year, the Bank trained 2,784 people, including 1,012 commercial bank tellers and 1,772 retail cashiers in Santiago and other regions of the country. About 33,000 leaflets and 15,000 posters were distributed to banks, stores, and public institutions, including the local police (*carabineros*) and the investigative police.

E.5 International relations activities

In 2010, the Central Bank continued to undertake its regular international activities. These included the participation of authorities and executives in the bimonthly and annual meetings of the Bank for International Settlements (BIS); the spring meetings of the Institute of International Finance (IIF) and the International Monetary Fund (IMF); the annual meetings of the Inter-American Development Bank (IDB) and the IIF; the annual joint meeting of the IMF and the World Bank; the meetings of central bank governors of Mercosur and associated countries; the Cemla governor meetings; and visits to other central banks.

Highlights include the IMF mission that took place from 19 to 30 July and the Mercosur meetings of central bank governors held in Buenos Aires (April) and Asunción (August).

As a result of Chile's incorporation into the Organization for Economic Cooperation and Development (OECD), in 2010, the Bank participated in meetings of OECD economists, namely, the Economic Policy Committee (EPC) and the Working Group on Short-Term Economic Projections (STEP), which are held twice a year at OECD headquarters in Paris.

In 2010, the Bank also participated in special international meetings held in Santiago, international seminars and presentations, courses taught by foreign experts, and visits from technical staff from other central banks. These activities included a special presentation on the financial crisis by Raghuram Rajan, Professor of Finance at the University of Chicago's Booth School of Business (June); and the presentation in Chile of the World Economic Outlook (WEO) by Olivier Blanchard, Chief Economist of the International Monetary Fund (October). As part of the IMF Article IV mission, the Bank held a seminar in July to discuss papers submitted for the purpose.

In addition, two special missions were received, one by the OECD (September) and one by the World Bank and the IMF (December). The latter was associated with preparations for the next Financial Sector Assessment Program (FSAP) Update, to take place in March and April 2011.

Official visits were also made by the Governor of the Central Bank of Finland, who was accompanied by a group of members of parliament (January), and by the Minister of Finance of the Regional Government of Hong Kong (December).

This year's visits from technical staff from other central banks included staff from the Central Bank of Nigeria (January); the Central Bank of Costa Rica (March); the Central Bank of Guatemala (May); the Central Bank of Bolivia (July); the Central Bank of Brazil (October); the Central Bank of Egypt (November); and the Central Bank of Paraguay (December).

E.6 Transparency Law

As of 31 December 2010, the Bank had received a total of 58 applications for access to information, of which two remained pending. All the applications were addressed in less time than stipulated in Law 20,285 on Access to Public Information (which allows 20 business days to respond to a request). Only one case required an extension of this period for a response, as a result of the volume and complexity of the information required (table II.4).

TABLE II.4
TRANSPARENCY LAW

Month	N° of applications received	Web	Physical
January	7	6	1
February	2	2	
March	2	1	1
April	2	2	
May	3	2	1
June	5	5	
July	3	2	1
August	8	3	5
September	3	1	2
October	5	3	2
November	12	4	8
December	6	2	4
Total	58	33	25

Responses sent	N°
Applications with responses processed	50
Applications with response pending	2
Applications that do not comply with Article 12	1
Applications forwarded to other organizations	4
Applications waived	1
Total	58

Responses processed pursuant to the Transparency Law	N°	%
Responses providing the requested information	33	57
Responses denying the requested information	2	3
Responses providing some of the requested information	6	10
Responses in which the requested information is not in the Bank's domain	8	14
Responses in which the requested information is not available	7	13
Responses pending	2	3
Total	58	100

Source: Central Bank of Chile.





Appendices



Appendix I

Press releases on monetary policy meetings, 2010

14 January

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to hold the monetary policy interest rate at 0.50% in annual terms.

Internationally, recent data confirm the outlook for global output this year, which has contributed to a progressive stabilization of the financial markets. Copper and oil prices have started to increase again.

Domestically, the available data suggest that output and demand are growing. The unemployment rate has continued to fall. Credit conditions have loosened.

In December, the CPI and several core measures decreased. Wage dynamics continue to be in line with the historical trend. Annual inflation is expected to be low in the coming quarters, while medium-term inflation expectations have been stable.

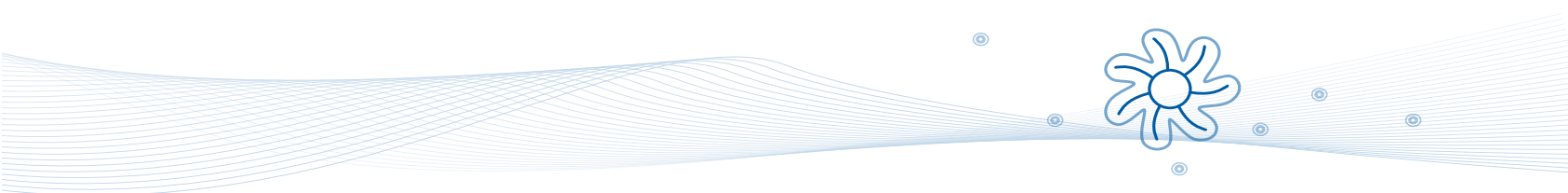
The Board considers that the macroeconomic environment is consistent with holding the MPR at its lower limit of 0.50% at least until the second quarter of this year. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

11 February

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to hold the monetary policy interest rate at 0.50% in annual terms.

Internationally, financial market volatility has increased as a result of turbulence in some European economies. Copper and oil prices have fallen, but the outlook for the global recovery for this year had not changed.

Domestically, the available data suggest that output continues to expand, and demand is growing somewhat faster than projected in the December *Monetary Policy Report*. The unemployment rate has continued to shrink, and credit conditions are normalizing.



In January, the CPI increased due to some specific items. The different core measures continue to record only slight changes. Medium-term inflation expectations remain stable. The real exchange rate has risen.

The Board considers that the macroeconomic environment is consistent with holding the MPR at its lower limit of 0.50% at least until the second quarter of this year. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

18 March

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to hold the monetary policy interest rate at 0.50% in annual terms.

Before the earthquake and tsunami on 27 February, the local context pointed to a scenario characterized by a narrowing output gap and more dynamic demand and output than projected in the last *Monetary Policy Report*. This was confirmed with the publication of the 2009 National Accounts. In February, the CPI increased in line with private expectations, and core inflation was higher than in previous months. Internationally, the financial markets had become less volatile, commodity prices had increased significantly, and the outlook for the global recovery for this year had not changed.

The earthquake and tsunami have macroeconomic consequences. The immediate disruptive effects of the disaster can be expected to cause lower output levels and higher inflation in the very short term. In the medium run, the macroeconomic scenario will be determined by the evolution of productive capacity and the magnitude, timing, and financing mechanisms of the reconstruction efforts. It is still too early to quantify these factors.

The Board considers that given the current situation, in particular the uncertainty associated with the effects of the disaster, holding the MPR at its lower limit of 0.50% at least until the second quarter of this year is consistent with an inflation forecast of 3% in the policy horizon.

15 April

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to hold the monetary policy interest rate at 0.50% in annual terms.

Internationally, financial market volatility has eased despite the turbulence in some European economies. Copper and oil prices remain high. The outlook for the global recovery this year continues to be favorable.

Domestically, the available output data do not diverge from the last *Monetary Policy Report*. In March, the CPI increased less than market forecasts, but private inflation expectations consider this a temporary trend. At longer terms, expectations are consistent with the baseline scenario of the *Monetary Policy Report*. A precise statistical reading of the data continues to be complicated at the shortest term due to the disruptions caused by the earthquake.

The Board considers that the macroeconomic environment and private expectations are consistent with the normalization of monetary policy as described in the last *Report*. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

13 May

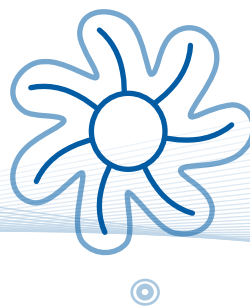
At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to hold the monetary policy interest rate at 0.50% in annual terms.

Internationally, market volatility was mitigated by announcements of fiscal measures and financial support in Europe. The outlook for global growth continues to be favorable, but the impact of the recent financial turbulence on world output is still uncertain. Copper and oil prices have fallen, but they remain at historically high levels.

Domestically, the available output data suggest that the immediate effects of the earthquake were greater than projected. Demand indicators, in turn, are more dynamic than considered in the March *Report*. Credit conditions have continued to normalize, and unemployment continues to fall.

In April, the CPI increased somewhat less than market forecasts, and longer-term private inflation expectations are consistent with the baseline scenario in the *Monetary Policy Report*.

The Board considers that the time is approaching to start the process of normalizing monetary policy. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.



15 June

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 50 basis points, to 1.00% in annual terms.

Internationally, financial market volatility remains high as a result of the economic situation in Europe. In the most likely scenario, the turbulence is expected to have a limited effect on world output, although the situation is still uncertain. Copper and oil prices have fallen, but they remain at historically high levels.

Domestically, the available output data show that the immediate effects of the earthquake dissipated quickly, and the economy is on the path to recovery. Demand indicators are very dynamic, and unemployment continues to fall.

In May, the CPI increased in line with market expectations. Core inflation continues to record only slight changes. Longer-term private expectations are consistent with annual inflation levels around 3% in the policy horizon.

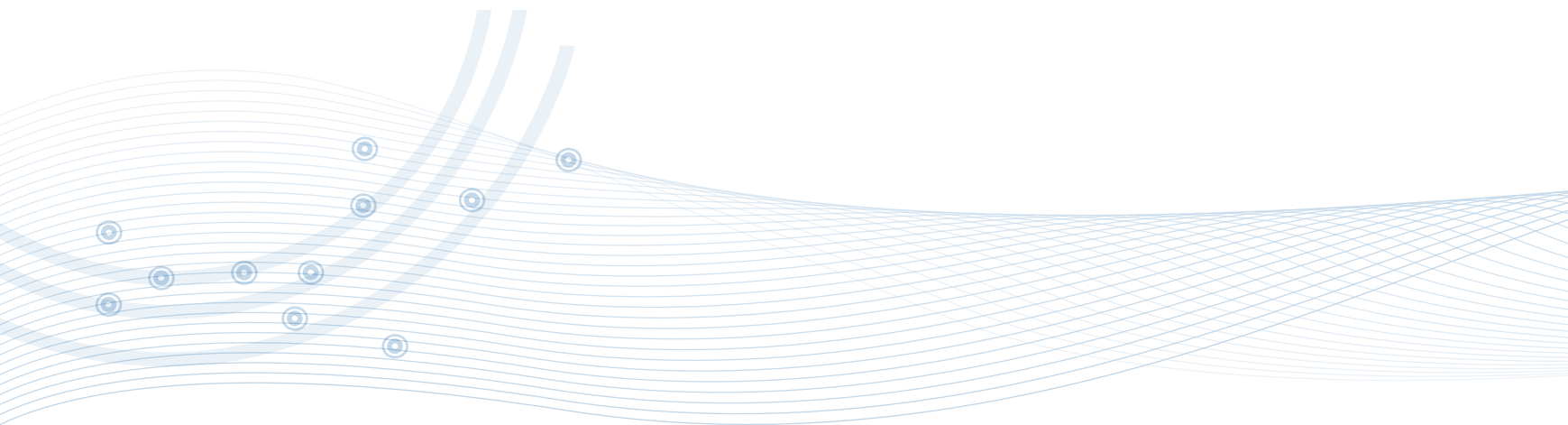
The Board considers that the time is right to start withdrawing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

15 July

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 50 basis points, to 1.50% in annual terms.

Internationally, financial market volatility remains high as a result of the economic situation in Europe, and there is ongoing uncertainty about the effect of the turbulence on the world growth outlook. Copper and oil prices remain high, and the external environment facing the Chilean economy is favorable.

Domestically, the available data point to very dynamic output and demand, within the ranges forecast in the last *Monetary Policy Report*.



The CPI recorded no change in June, which is slightly below market expectations, while the different core inflation measures were positive. Private expectations toward the end of the policy horizon are consistent with annual inflation levels around 3%.

The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

12 August

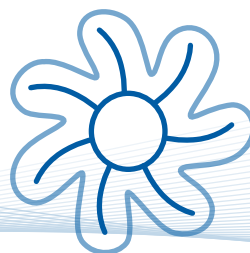
At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 50 basis points, to 2.00% in annual terms.

Internationally, uncertainty about the rate of the global recovery has increased, and financial market volatility remains high. Commodity prices remain high, and the external environment facing the Chilean economy is favorable.

Domestically, the available output and demand data are more dynamic than forecast in the last *Monetary Policy Report*. Unemployment has fallen.

In July, the monthly change in the CPI was mainly explained by temporary trends, while the different core inflation measures remained low. Private expectations place annual inflation above the target in the short term, but toward the end of the policy horizon, expectations are consistent with levels around 3%.

The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.



16 September

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 50 basis points, to 2.50% in annual terms.

Internationally, the financial markets remain volatile, and there is ongoing uncertainty about the rate of the global recovery. Commodity prices remain high.

Domestically, the output and demand data have not changed since the September *Monetary Policy Report*. In August, the CPI grew somewhat less than market forecasts, while the different core inflation measures remained low. Private expectations place annual inflation at around 3% toward the end of the policy horizon. The peso has appreciated.

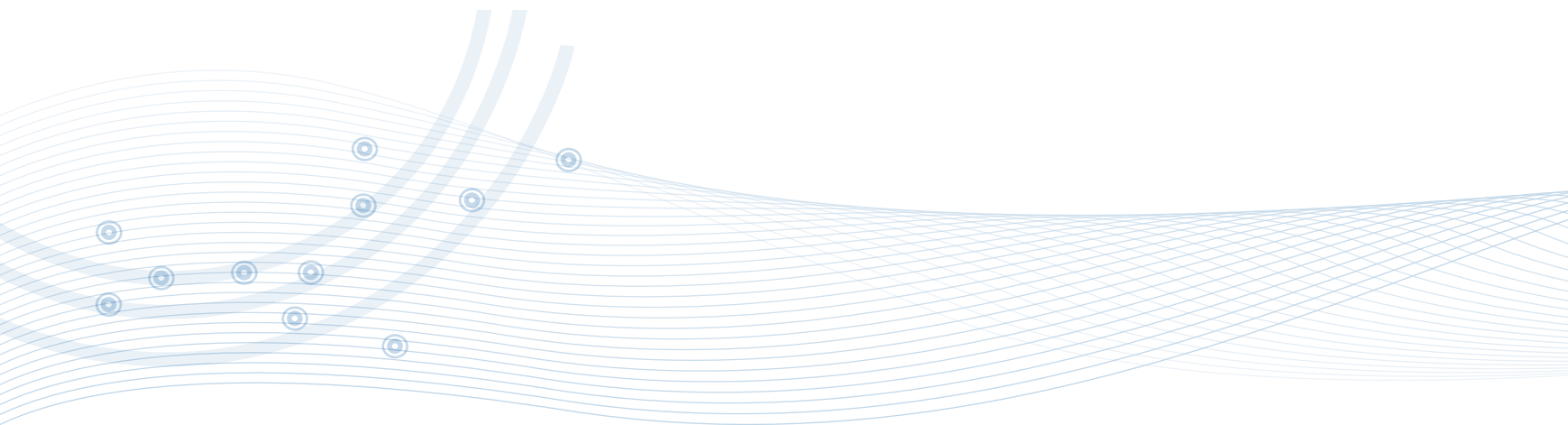
The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

14 October

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 25 basis points, to 2.75% in annual terms.

Internationally, growth has been moderate in the developed economies, in contrast to the dynamic performance of the emerging economies. In this context, long-term interest rates have generally fallen in the main economies, the dollar has depreciated in the international markets, and commodity prices have turned upward in recent weeks. A slower-than-expected recovery in the developed economies is an important risk factor for the emerging economies.

Domestically, output data indicate that the economy is growing robustly, in line with the forecast scenario in the September *Monetary Policy Report*. Inflation is somewhat lower than projected. Private inflation expectations show a slight reduction in the short and medium term, from the upper half of the target range to values centered around 3% in annual terms. The peso has continued to appreciate against the U.S. dollar.



The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

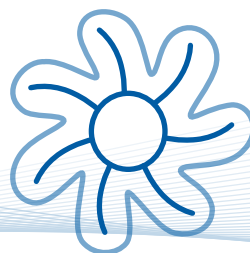
16 November

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 25 basis points, to 3.00% in annual terms.

Internationally, the developed economies continue to post moderate growth, in contrast to the dynamic performance of the emerging economies. In the international financial markets, concern about the risk of some European economies has heightened in recent weeks, which has contributed to increased financial volatility. The slow recovery of the developed countries is still an important risk factor for the emerging economies. In addition, there are signs of higher inflation in emerging economies, and some countries in Asia have adopted measures to reduce the monetary stimulus.

Domestically, output data indicate that the economy is growing robustly, in line with the forecast scenario in the September *Monetary Policy Report*. Inflation has been somewhat lower than projected due to lower tradable goods inflation, but private expectations remain aligned around 3% within the relevant monetary policy horizon. The peso-dollar exchange rate is at a similar level to the last meeting.

The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.



16 December

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to increase the monetary policy interest rate by 25 basis points, to 3.25% in annual terms.

Internationally, signs continue to point to moderate growth in the developed economies, in contrast to the dynamic performance of the emerging economies. In the international financial markets, concern about the risk of some European economies has remained high in recent weeks. The slow recovery of the developed countries is still an important risk factor for the emerging economies. The increase in international commodity prices, including food and energy, has sharpened, which is having an impact on inflation in some economies.

Domestically, the output, demand, and unemployment data continue to evolve positively. Inflation has been somewhat lower than projected due to lower imported goods inflation, but private expectations remain aligned around 3% within the monetary policy horizon. The peso has appreciated against the U.S. dollar since the last meeting.

The Board will continue reducing the strong monetary stimulus, although the rate of withdrawal will depend on the evolution of internal and external macroeconomic conditions. At the same time, it will continue to be flexible in its use of policy in order to keep forecast inflation at 3% in the policy horizon.

Appendix II

Press releases on foreign exchange and financial measures in 2010

27 August

Yesterday the Central Bank tendered an exceptional issue of seven-day nominal promissory notes (PDBC), which is a shorter maturity than the usual 30 days.

The objective of this operation, which was carried out under the current regulations on these issues, was to enable the adjustment of credit market rates at maturities of under 90 days for amounts over 5,000 UF.

This action was motivated by the lag between current interest rates in force as calculated by the SBIF and the banking system's deposit rates, in a context of rising market rates.

4 October

At its meeting on Thursday, 30 September, the Board of the Central Bank of Chile approved operations to replace PRCs with BCU bonds, via the sale of tendered BCU bonds that are paid for through the purchase of PRCs.

The objectives of this measure are to standardize the portfolio of credit instruments issued by the Central Bank of Chile and to promote the depth of benchmark bonds in the local fixed-income market.

This program will be carried out in the fourth quarter of 2010. It includes the issue of a new series of five-year BCU bonds, totaling US\$300 million. This series is subject to the provisions of Article 104 of the Income Tax Law, as well as Chapter IV.E.1 of the *Compendium of Financial Regulations*.

The conditions for the valuation of the PRCs will be announced by the Central Bank of Chile in advance of each tender.

This program may be subject to modifications in the case of significant changes in market conditions. Any such modifications will be announced in a timely fashion.



4 November

In a meeting held today, the Board of the Central Bank of Chile decided to raise the upper limit on total overseas investment by the pension funds from 60% to 80%, in accordance with the authority granted in Law 20,255, published in the *Official Gazette* on 17 March 2008, which modified DL 3500 of 1980.

At the same time, the Board raised the upper limit on overseas investment by type of fund, to 100% for type A funds, 90% for type B funds, 75% for type C funds, 45% for type D funds, and 35% for type E funds.

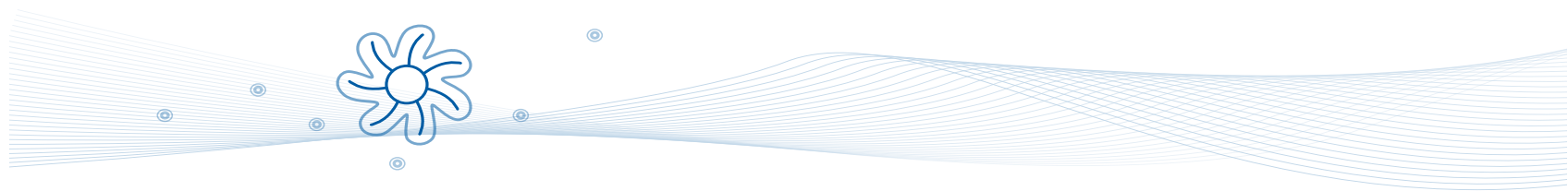
The Board meeting was attended by the Minister of Finance.

As in the case of previous decisions on these matters, the increases in overseas investment limits will be implemented gradually, according to the following schedule, where the upper limit on total overseas investment corresponds to the sum of Type A, B, C, D, and E pension funds for a given Pension Fund Administrator:

1 December 2010:	65%
1 March 2011:	70%
1 June 2011:	75%
1 September 2011:	80%

UPPER LIMIT ON OVERSEAS INVESTMENT BY TYPE OF FUND (percent)

	Type of fund				
	A	B	C	D	E
1 December 2010	85	75	65	35	30
1 March 2011	90	80	70	40	35
1 June 2011	95	85	75	45	35
1 September 2011	100	90	75	45	35



The resolution adopted by the Board, in accordance with its legal authority, to expand the diversification options of the pension funds will contribute to optimizing the profitability and security of pension savings. The change is consistent with general orientation of the Government's economic policy.

As in the case of previous decisions on these matters, and with consideration for compliance with its legal mandate, the Central Bank of Chile has taken financial market developments into account, to ensure that possible investment portfolio adjustments by the pension funds can be carried out without affecting the normal functioning of the internal and external payment systems or the implementation of monetary policy.

The new regulatory guidelines will be published tomorrow in the *Official Gazette* and enter into effect on 1 December of this year.

Appendix III

Main measures taken by the Central Bank of Chile in 2010

January

7

By Resolution 1517E-01-100107, the Board appointed Mr. Manuel Marfán Lewis to the position of Deputy Governor of the Board and of the Central Bank of Chile through 9 December 2011.

By Resolution 1518-01-100107, the Board appointed Mr. Juan Eduardo Chackiel Torres to succeed Ms. Gloria Peña Tapia as representative of the Central Bank of Chile on the National Commission on Price Distortions on Imported Goods, established by Article 11 of Law 18,525.

14

By Board Resolution 1519-03-100114, chapters IVE.1 and IVE.2 of the Central Bank's *Compendium of Financial Regulations* were modified to establish the general conditions applicable to bonds issued by the Central Bank of Chile in accordance with these regulations and subject to the tax treatment specified in Article 104 of the Income Tax Law, which exempts proceeds from the sale of public debt securities from the capital gains tax defined in the Income Tax Law, in accordance with provisions in that Article.

With regard to bonds issued in accordance with Article 104 of the Income Tax Law, the general conditions of issue establish that the Central Bank of Chile will deduct 4% of the interest earned by the bonds at the time the payment of a given coupon is remitted in each half-yearly period, with the understanding that the coupon has then been paid in full and on time by the Central Bank of Chile in its role as issuer of the bonds.

The Central Bank of Chile applies the deduction indicated above in compliance with the withholding obligations specified in Article 74 N° 7 of the Income Tax Law, whose annual declaration and payment must be made by the issuer in accordance with Article 79 of the same legislation. The legislation also establishes the mechanism through which the Central Bank of Chile will notify investors of the aforementioned withholding tax, in the case of investors who request notification and who are not classified as taxpayers for the purposes of the Income Tax Law, which must be determined with regard to the 4% of the interest earned by the bonds in accordance with the Income Tax Law, for the period in which the bonds were the property of the investor.

By Board Resolution 1519-04-100114, the Central Bank of Chile the Central Bank accepted the role of fiscal agent granted by Ministry of Finance Executive Decree 1686, published in the *Official Gazette* on 12 January 2010, to represent and act in the name and on the

account of the Treasurer in the placement and administration of the bonds specified in the Decree. Specifically, five new Treasury bonds (BTU-05, BTU-10, BTU-20, BTU-30, and BTP-10) are to be placed in the local capital market in the first half of 2010, issued by the Treasury in accordance with Executive Decree 1686. The directive includes the service of the bonds at maturity.

At its monthly monetary policy meeting, the Board of the Central Bank decided to keep the monetary policy interest rate at 0.50% in annual terms.

28

By Board Resolution 1521-04-100128, chapters IV.D.1, IV.D.1.1, and IV.D.1.2 of the Central Bank's *Compendium of Financial Regulations* were modified to incorporate special regulations on the tendering of foreign currency swap operations by the Central Bank of Chile to banking firms, when the invited institutions use electronic communication and connection systems to participate in the auction in question.

February

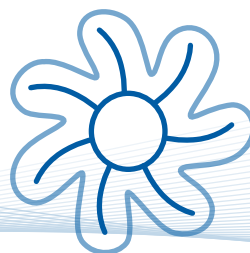
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At its monthly monetary policy meeting, the Board of the Central Bank decided to keep the monetary policy interest rate at 0.50% in annual terms.

19

Through Administrative Directive (*Carta Circular*) 527 addressed to banking firms, the Central Bank of Chile specified the characteristics of banknotes stained with ink via an anti-theft device, with regard to the established procedures for replacing the bills at the Central Bank, in its role as issuer of legal currency, following an analysis by officers of the Chilean Investigative Police in accordance with the investigative order decreed by the Public Prosecutor's Office.

Banking firms can present banknotes without these characteristics to the Central Bank for replacement, in accordance with the established procedure for unfit banknotes, should it be deemed necessary.



These instructions were issued in response to a number of enquiries by banking firms and the general public, to specifically clarify previous communications by the Central Bank on this matter and to avoid confusion with regard to other banknotes that have some kind of mark or stain.

22

The Central Bank of Chile announced that starting on Wednesday, 24 February 2010, the results of the Financial Brokers Survey (FBS) will be published twice a month. The FBS is a survey of the main local and foreign financial brokers with dealings in Chile, who also participate in the existing Economic Expectations Survey (EES).

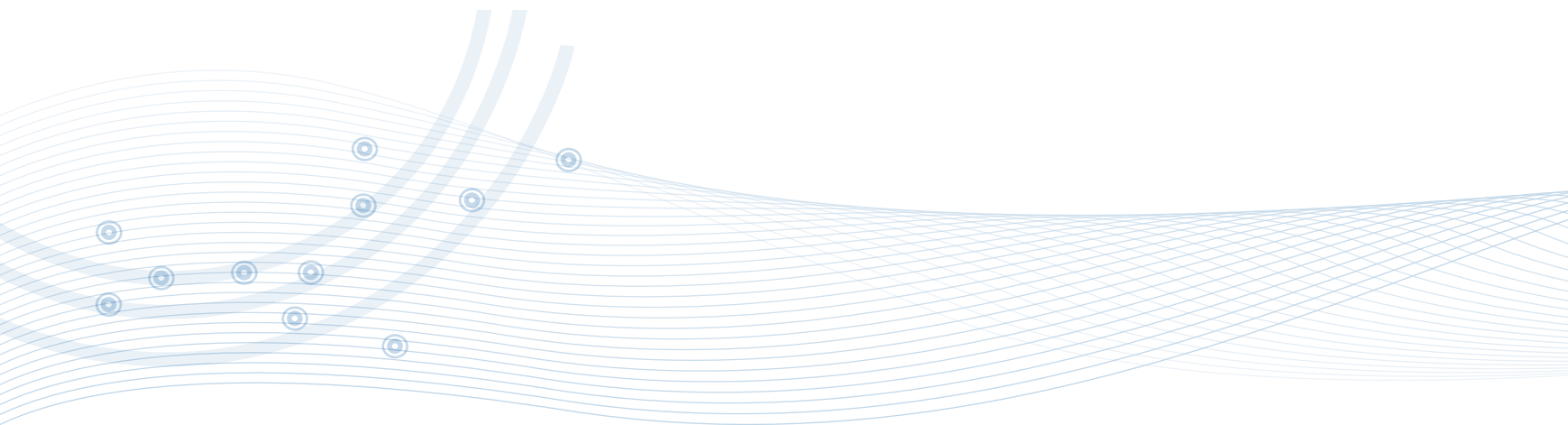
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By Resolution 1526-03-100225, the Board of the Central Bank of Chile accepted the changes to the performance guidelines, submitted by the Minister of Finance, for its role as fiscal agent as established in the Law on Fiscal Accountability, in relation to the administration of the resources in the Pension Reserve Fund and the Economic and Social Stabilization Fund, as well as to the annual compensation to which the Bank is entitled for these services.

March

18

By Board Resolution 1529-01-100318, and in conformance with the provisions of Articles 6, 7, and 12 of Decree Law 211 of 1973 establishing the regulations for the Competition Tribunal, the Board of the Central Bank of Chile issued the Public Announcement and approved the application requirements in relation to the public call for applications as required by the legislation. The process was initiated to appoint a replacement for the position of Alternate Judge / Economist on the Competition Tribunal, following the voluntary resignation of Ms. María Soledad Arellano Schmidt. The appointment is for the remainder of Ms. Arellano Schmidt's appointment, that is, through 12 May 2012.



18

At its monthly monetary policy meeting, the Board of the Central Bank decided to keep the monetary policy interest rate at 0.50% in annual terms.

31

By Resolution 1522-01-100204 of 4 February 2010, the Board of the Central Bank of Chile issued the technical specifications of the new \$10,000 banknote, which entered into circulation on 31 March. This measure falls within the ambit of the new family of Chilean banknotes, issued in conjunction with the bicentennial of the Independence of the Republic of Chile, and aims to provide Chilean society with modern, trustworthy, and safe means of payment.

The release of the new bill, which was originally scheduled for 3 March, was postponed following the earthquake and tsunami that affected a vast area of the country.

April

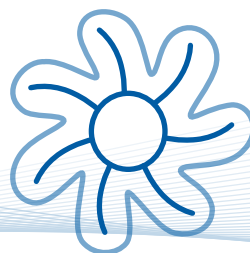
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At its monthly monetary policy meeting, the Board of the Central Bank decided to keep the monetary policy interest rate at 0.50% in annual terms.

May

13

At its monthly monetary policy meeting, the Board of the Central Bank decided to keep the monetary policy interest rate at 0.50% in annual terms.



19

The Central Bank of Chile reported to the Minister of Economy, Development, and Reconstruction on the appointment of Mr. Teodoro Wigodski Sirebrenik to replace the outgoing Alternate Judge / Economist on the Competition Tribunal. The appointment was made following a public call for applications initiated through Board Resolution 1529-01-100318, and it was formalized in Board Resolution 1539E-01-100519.

20

By Board Resolution 1540-01-100520, and in conformance with the provisions of Articles 6, 7, and 12 of Decree Law 211 of 1973 establishing the regulations for the Competition Tribunal, the Board of the Central Bank of Chile issued the Public Announcement and approved the application requirements in relation to the public call for applications as required by the legislation. The process was initiated to appoint a replacement for the position of Judge / Legal Counsel on the Competition Tribunal, following the voluntary resignation of Mr. Tomás Menchaca Olivares. The appointment is for the remainder of Mr. Menchaca Olivares's appointment, that is, through 12 May 2012.

June

3

By Resolution 1542-01-100603, the Board chose to renew the appointment of Mr. Vivian Clarke Levi as member of the Central Bank of Chile's Audit and Compliance Committee for a period of three years, starting on 16 June 2010.

At the same time, the Board set institutional policy on the renewal of the appointment of Audit and Compliance Committee members, authorizing up to one renewal of the appointed position, for a new period of three years. Thus, the maximum term of office in this position will be up to six years.

The new policy does not preclude consideration of the specific situation of the Committee Chairman, Mr. Luis Bates Hidalgo, who was initially appointed to a term of office of one year, which was then renewed for a period of three years ending on 16 June 2011.



At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 50 basis points, to 1.00% in annual terms.

July

1

By Board Resolution 1548-01-100701, the Central Bank of Chile accepted the role of fiscal agent granted by Ministry of Finance Executive Decree 554, published in the *Official Gazette* on 25 June 2010, to represent and act in the name and on the account of the Treasurer in the placement and administration of the bonds specified in the Decree, in conformance with the terms and conditions established therein. The issue includes the reopening of three issues placed in the first half of 2010 (BTU-10, BTU-20, and BTU-30) and the issue of a new series (BTU-07). These instruments are to be placed in the market in the second half of 2010.

15

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 50 basis points, to 1.50% in annual terms.

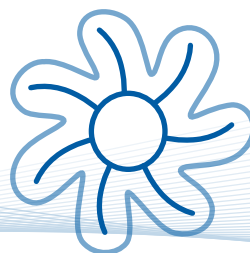
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By Resolution 1550-02-100715 of 15 July 2010, the Board of the Central Bank of Chile issued the technical specifications of the new \$20,000 banknote, which entered into circulation on 27 July. This was the third bill in the new family of Chilean banknotes to be issued.

August

5

The Central Bank of Chile reported to the Minister of Economy, Development, and Reconstruction on the appointment of Mr. Javier Eduardo



Veloza Alcaide to replace the outgoing Judge / Legal Counsel on the Competition Tribunal. The appointment was made following a public call for applications initiated through Board Resolution 1540-01-100520, and it was formalized in Board Resolution 1555-01-100805.

By Board Resolution 1555-04-100805, the general conditions outlined in Board Resolution 1103-01-031223, on bank transaction accounts opened by the Central Bank of Chile, were modified to establish the text of bank transaction account contracts signed with Management Companies operating in the financial payment and clearing systems governed by Law 20,345 (on Managing Societies). The sole objective of these accounts is to allow the companies to settle the sums of money specified in Article 3 of that law, corresponding to the credit and debit balances resulting from the clearing of payment orders received through the systems.

In this case, the indicated settlements can be made by the respective Management Companies, in their role as the account holder of an open transaction account with the Central Bank, through a payment system that is regulated or authorized by the Central Bank of Chile, subject to the regulations issued by the Bank.

By Board Resolution 1555-05-100805, Chapter III.H.4 of the Central Bank of Chile's *Compendium of Financial Regulations* was modified to authorize access to the Central Bank of Chile's real time gross settlement (RTGS) system by Management Companies that have opened a transactional account in national currency with the Central Bank of Chile, in accordance with the legislation on the subject (Law 20,345), to the extent that the company has presented a request for participation and complies with the established requirements and conditions.

Resolutions 1555-04 and 1555-05 clarify that the sole objective of granting the authorization to participate in the RTGS system and opening the transaction accounts for the Management Companies is to comply with the relevant legislation. As such, the measures in question do not, under any circumstance, involve the provision of financing or refinancing facilities to the Management Companies or in any way represent a guarantee on the part of the Central Bank of Chile with regard to the transactions settled.

11

Through Administrative Directive (*Carta Circular*) 3013-671, the Central Bank announced the general conditions contract for transactional accounts opened by Management Companies, the contract terms for the companies to join the RTGS system, and changes to the operating regulations governing the RTGS system, contained in Chapter III.H.4.1 of the *Compendium of Financial Regulations*, in relation to Resolution 1555-05.



12

By Resolution 1556-02-100812, the Board of the Central Bank of Chile, in conformance with the provisions of Article 10 of Law 20,345, gave its prior favorable report on the operating regulations for the financial payment and clearing systems to be managed by *Sociedad CCLV Contraparte Central S.A.* in its role as Management Company. This favorable report is a legal prerequisite for the approval of the regulations by the Superintendence of Securities and Insurance, as per Exempt Resolution 481 of 13 August 2010.

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 50 basis points, to 2.00% in annual terms.

September

16

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 50 basis points, to 2.50% in annual terms.

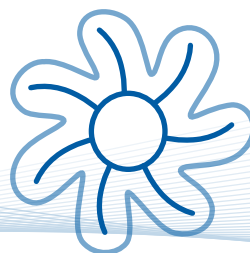
30

By Board Resolution 1566-01-100930, the Board approved operations to replace Central Bank indexed promissory notes payable in coupons (PRC) with five-year UF-denominated Central Bank bonds (BCU-5), via the sale of the tendered BCU bonds that are paid for through the purchase of PRCs. The objectives of this program are to standardize the portfolio of credit instruments issued by the Central Bank of Chile and to promote the depth of benchmark bonds in the local fixed-income market.

October

12

By Board Resolution 1569-01-101014, Pablo Pincheira Brown and Eduardo López Escobedo were named to represent the Central Bank of Chile on the Board of the Chilean Copper Commission (*Cochilco*), for a period of two years starting on 23 October 2010.



14

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 25 basis points, to 2.75% in annual terms.

28

In an Administrative Directive addressed to Banks, Pension Fund Administrators, Insurance Companies, Mutual Fund Administrators, Stock Brokers, and Securities Agents, the Central Bank of Chile established the documentation required to certify the period in which bonds issued under Article 104 of the Income Tax Law have been in the possession of investors who are not classified as taxpayers for the purposes of tax withholding as established in the law.

November

4

By Board Resolution 1573-02-101104, Chapter III.F.4, "Pension fund investments," of the *Compendium of Financial Regulations* was modified to raise the upper limit on total overseas investment by the pension funds from 60% to 80%. This increase will be implemented gradually, according to the following schedule:

1 December 2010:	65%
1 March 2011:	70%
1 June 2011:	75%
1 September 2011:	80%

At the same time, the upper limit on overseas investment by type of fund was raised to 100% for type A funds, 90% for type B funds, 75% for type C funds, 45% for type D funds, and 35% for type E funds. This increase will be implemented gradually, according to the following schedule:



	Type of fund (percent)				
	A	B	C	D	E
1 December 2010	85	75	65	35	30
1 March 2011	90	80	70	40	35
1 June 2011	95	85	75	45	35
1 September 2011	100	90	75	45	35

16

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 25 basis points, to 3.00% in annual terms.

17

By Resolution 1574-01-101111 of 11 November 2010, the Board of the Central Bank of Chile issued the technical specifications of the new \$2,000 banknote, which entered into circulation on 17 November. This was the fourth bill in the new family of Chilean banknotes to be issued.

December

16

At its monthly monetary policy meeting, the Board of the Central Bank decided to raise the monetary policy interest rate by 25 basis points, to 3.25% in annual terms.

Appendix IV

International reserve management

A. Introduction

International reserves are liquid foreign exchange assets held by the Central Bank of Chile to support its monetary and foreign exchange policies. They are one of the instruments available to the Bank to meet its permanent objective of safeguarding the stability of the currency and the normal operation of the internal and external payment systems.

Consistent with the purpose, benefits, and costs of international reserves, their administration aims to guarantee secure, efficient access to international liquidity and safeguard the financial equity of the Bank. To achieve this, the Bank acts according to the legal framework stipulated in Section 38 of its Basic Constitutional Act, which specifically grants it the authority to manage, maintain, and dispose of its international reserves abroad.

The current system of a floating exchange rate regime, inflation targeting, solid fiscal policies, prudent financial regulation and supervision, and full financial integration together provide a consistent framework for maintaining essential macroeconomic balances and facing the different shocks that affect the economy, thereby reducing their impact. Nevertheless, the Bank reserves the right to intervene in the foreign exchange market under certain exceptional circumstances.

In line with its transparency policies, the Bank must report on annual international reserve management in 2010^{1/}. The next section reports on the investment policies and benchmark structure used in managing reserves. The third section reports on external administrators. The fourth section summarizes the risk management policies and the results of the international reserve management.

B. Investment policies and benchmark structure

The reserve investment policy encompasses liquid financial assets that meet the legal requirements established for their management. This policy was designed in terms of its impact on the bank's financial balance sheet results and risks, and the characteristics of the potential needs for foreign exchange liquidity. The primary objective is to preserve principal in view of possible market fluctuations.

B.1 Investment portfolio and liquidity portfolio

In 2010, international reserve investment was grouped in two main portfolios: the investment portfolio and the liquidity portfolio.

^{1/} Board Resolution 1289-01-060831 of 29 August 2006.



The investment portfolio included short- and long-term foreign exchange assets. The short-term component acted as a buffer to deal with shifts in foreign currency liquidity needs. Investments in this subportfolio were held in bank deposits and money market instruments maturing in up to one year. The long-term subportfolio included investments in nominal and indexed bonds^{2/}, mostly maturing in one to ten years. In 2010, the main source of movements in the investment portfolio funds was the foreign currency swap program carried out by the Bank over the course of 2009, of which US\$750 million matured in 2010.

A share of the investment portfolio was managed by external administrators, who were vested with the authority to manage a long-term global portfolio and an MBS portfolio^{3/}, as detailed in section C of this appendix.

At the close of 2010, the investment portfolio totaled US\$23.48 billion, of which US\$23.17 billion was managed internally and US\$314 million was handled by external administrators. The internally managed portion was invested as follows: 13.9% in bank deposits, 10.2% in external financial institutions, and 75.9% in sovereign and supranational risk. The last item included investments in the United States (33%) and Germany (34%), with the remaining 33% divided among France, the United Kingdom, Spain, Canada, Belgium, Italy, Austria, Australia, the Netherlands, Denmark, Finland, Cyprus, Portugal, and supranationals. Investment in deposits fell US\$1.92 billion due to the reduction of this risk in the benchmark structure. Investment in securities grew US\$2.70 billion.

The liquidity portfolio is designed to cover the foreseeable need for funds in the short term. It was the preferred source for dealing with the daily fund requirements deriving from withdrawals from foreign currency accounts held at the Bank by commercial banks and the public sector. This portfolio is made up of bank deposits (overnight, weekend, and time), which totaled US\$2.84 billion at the close of 2010.

As of 31 December 2010, 52.1% of total reserves were invested in U.S. dollars, 33.3% in euros, and 14.6% in other currencies (table 1). In 2010, international reserves increased US\$2.49 billion relative to 2009, mainly due to the maturing of foreign exchange swaps carried out by the Bank in 2009 (US\$745 million) and an increase in the liquidity portfolio (US\$1.69 billion).

B.2 Investment portfolio benchmark structure

The investment portfolio benchmark structure establishes the basic parameters that guide currency composition, duration, distribution of credit risk by type of risk and instrument, and the respective reference benchmarks.

^{2/} The indexed bonds are U.S. dollar bonds (Treasury Inflation-Protected Securities, or TIPS) and euro bonds (Euro Linkers).

^{3/} Mortgage-backed securities, or debt securities backed by mortgages.

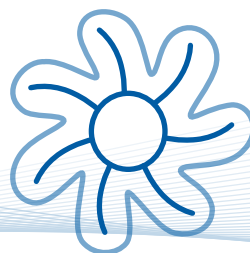


TABLE 1
COMPOSITION OF INTERNATIONAL RESERVES

Type of portfolio	Currency	2009		2010	
		December	Percent	December	Percent
Investment portfolio		22,695.7	89.4	23,479.4	84.3
Currencies and deposits	Dollar	2,846.4	11.2	1,130.8	4.1
	Euro	2,183.0	8.6	1,272.8	4.6
	Other	39.8	0.2	747.1	2.7
Securities	Dollar	10,896.5	42.9	10,505.7	37.7
	Euro	6,539.9	25.8	8,016.6	28.8
	Other	190.1	0.7	1,806.3	6.5
Total	Dollar	13,742.9	54.2	11,636.6	41.8
	Euro	8,722.9	34.4	9,289.4	33.3
	Other	229.9	0.9	2,553.4	9.2
Liquidity portfolio		1,153.6	4.5	2,838.4	10.2
Currencies and deposits	Dollar	1,141.4	4.5	2,838.4	10.2
	Euro	12.2	0.0	0.0	0.0
	Other	0.0	0.0	0.0	0.0
Securities	Dollar		0.0		0.0
Total	Dollar	1,141.4	4.5	2,838.4	10.2
	Euro	12.2	0.0	0.0	0.0
Other currencies		0.0	0.0	0.0	0.0
Other assets		1,523.2	6.0	1,545.9	5.5
Monetary gold	Other	8.8	0.0	11.2	0.0
IMF SDRs	Other	1,143.4	4.5	1,217.3	4.4
IMF reserve position	Other	286.1	1.1	282.1	1.0
Reciprocal lending agreements	Dollar	84.9	0.3	35.3	0.1
Total		25,372.5	100.0	27,863.7	100.0
	Dollar	14,969.2	59.0	14,510.3	52.1
	Euro	8,735.1	34.4	9,289.4	33.3
	Other	1,668.2	6.6	4,064.0	14.6

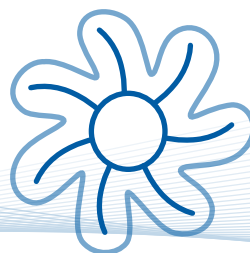
Source: Central Bank of Chile.

The investment policy was revised in 2010 to update the reference benchmarks and portfolio duration, to better address the volatility of the international financial markets and protect the Bank's balance sheet. The currency composition of the investment portfolio was adjusted in January, reducing the share of U.S. dollars (USD) from 60 to 50%, holding the euro (EUR) at 40% and incorporating the Australian dollar (3.5%), the Canadian dollar (3.5%), and the pound sterling (3.0%). The reference benchmarks used for these new economies were Merrill Lynch three-month Libid indices, average six-month FixBis for short-term sovereign risk, and J.P. Morgan one- to ten-year bond indices for long-term sovereign risk. Bank risk was reduced from 20 to 10%, while the maximum allowed for this type of risk was lowered from 25 to 15%. In addition, the reference benchmark for USD and EUR deposits was changed from the average six-month Merrill Lynch Libid indices to the average three-month Merrill Lynch Libid indices (table 2).

TABLE 2
BENCHMARK STRUCTURE OF THE INTERNALLY MANAGED INVESTMENT PORTFOLIO, BY RISK AND REFERENCE BENCHMARK

Structure	Credit risk	Current share (%)	Reference benchmark
Short-term portfolio	Bank	10	Merrill Lynch indices: 3-mth Libid, ave. of last 3 mths. (USD, EUR, AUD, CAD, and GBP)
	Sovereign, Agency, and Supranational	50	Merrill Lynch indices: US Treasury Bills (USD); German Gov. Bill Index (EUR); 6-mth FixBis, ave. of last 6 mths. (AUD, CAD, and GBP)
Long-term portfolio	Sovereign, Agency, Supranational, and Bank	34	J.P. Morgan bond index for 1- to 10-year segments in the U.S. and Germany; for Australia, Canada, and the United Kingdom, 1–10 global segment
	Inflation-indexed bonds	6	Barclays bond index for 1- to 10-year segments in the U.S. and Europe.
Total portfolio		100	

Source: Central Bank of Chile.



With regard to the duration of the internally managed investment portfolio, the benchmark duration of the long-term portfolio was 37.4 months, with a permissible range of zero to eight months over the overall portfolio duration. For the short-term investment portfolio, the benchmark duration was 3.0 months. On aggregate, the investment portfolio had an average duration of 16.8 months, with an accepted minimum duration of zero months and a maximum deviation of six months over the benchmark. The duration did not change relative to December 2009 (table 3).

TABLE 3
CURRENCY, MATURITY, AND DURATION STRUCTURE OF INTERNALLY MANAGED BENCHMARK PORTFOLIO

	U.S. dollar		Euro		Australian dollar		Canadian dollar		Pound sterling		Total	
	Share (%)	Duration (months)	Share (%)	Duration (months)	Share (%)	Duration (months)	Share (%)	Duration (months)	Share (%)	Duration (months)	Share (%)	Duration (months)
Short-term portfolio												
Bank	5.0	1.5	4.0	1.5	0.4	1.5	0.4	1.5	0.3	1.5		
Sovereign, Agency, and Supranational	25.0	2.7	20.0	4.3	1.8	3.0	1.8	3.0	1.5	3.0		
Short-term subtotal	30.0	2.5	24.0	3.8	2.1	2.8	2.1	2.8	1.8	2.8	60	3.0
Long-term portfolio												
Nominal bonds												
Maturity segment												
1-3 years	9.3	22.3	7.5	21.4								
3-5 years	4.0	45.2	3.2	42.7								
5-7 years	1.7	64.8	1.3	60.0								
7-10 years	1.7	87.0	1.3	85.0								
1-10 years					1.4	45.4	1.4	44.0	1.2	53.8		
Subtotal	16.7	38.5	13.3	36.7	1.4	45.4	1.4	44.0	1.2	53.8	34	38.9
Indexed bonds												
Maturity segment												
1-10 years	3.3	28.5	2.7	30.5								
Subtotal	3.3	28.5	2.7	30.5							6.0	29.4
Long-term subtotal	20.0	36.8	16.0	35.7	1.4	45.4	1.4	44.0	1.2	53.8	40	37.4
Total portfolio	50.0	16.2	40.0	16.6	3.5	19.8	3.5	19.2	3.0	23.2	100	16.8

Source: Central Bank of Chile.

B.3 Liquidity portfolio benchmark structure

The investments in this portfolio match the projected disbursements on the Bank's balance sheet in terms of currency composition and maturity. The liquidity portfolio's currency benchmark structure was defined as a function of the real currency composition of the projected disbursements and of the deposits and withdrawals made by commercial banks and the public sector. The benchmark for investments in this portfolio was calculated on the basis of the overnight, weekend, and time rates of the currencies that make up this portfolio, as a function of characteristics of the projected disbursements.

C. External management program

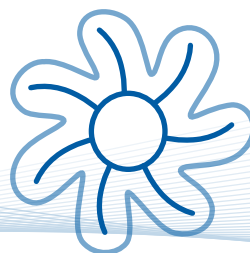
C.1 External portfolio management programs

In 2010, the Bank changed the external portfolio management mandates, terminating the contractual relationship with one of the general mandate administrators and eliminating the exclusive mortgage-backed securities (MBS) program.

Until 30 November 2010, the Bank had two external portfolio management programs, which administered a total of US\$1.08 billion through that date. The first was a long-term general mandate, for which the administrators were selected in 2006 and began operating in January 2007. This mandate focuses on a portfolio similar to the internally managed long-term investment portfolio, except that the external administrators are allowed to invest in mortgage-backed securities (MBSs). The program continued to pursue three objectives: to add value to the foreign currency portfolio; to obtain transfers of know-how and technologies, and to act as an active benchmark for the Central Bank portfolio. This program had two external administrators through the end of November, each with a portfolio of approximately US\$315 million. The risk assessment methodology was based on a risk budget, whereby the administrators are allowed to take risk up to a maximum of a 100-basis-point tracking error (deviation from the benchmark).

The second program involved an MBS-specific mandate. The primary objectives were to add value to the portfolio and transfer know-how through dialogue between the administrators and the staff of the Central Bank. This program had one external administrator, which managed a portfolio valued at approximately US\$450 million on 30 November.

The measurement of performance, risk assessment, and benchmark compliance for both programs continued to be outsourced through the custodian bank.



D. Risk management and results of international reserve management

D.1 Risk management within international reserve management

International reserve management takes into account criteria for limiting liquidity, credit, market, and operating risk.

To reduce liquidity risk, the Bank managed a portfolio made up exclusively of short-term deposits in international commercial banks (diversified by maturity) and fixed-income instruments traded in deep, highly liquid secondary markets. Credit risk was managed through limits on bank risk, sovereign risk, supranational risk, and risk from external financial institutions, as well as the counterparties used (table 4).

TABLE 4
COMPOSITION OF INTERNATIONAL RESERVES BY CREDIT RISK (1) (2) (3)
 (percent as of 31 December 2010)

Type of credit risk	Credit rating						Total
	AAA	AA+	AA	AA-	A+	A	
External financial institutions	10.2	0.0	0.0	0.0	0.0	0.0	10.2
Bank	0.1	0.0	2.7	6.3	2.4	2.4	13.9
Sovereign	65.2	4.4	0.0	1.8	0.1	0.0	71.5
Supranational	4.4	0.0	0.0	0.0	0.0	0.0	4.4
Total	79.9	4.4	2.7	8.1	2.5	2.4	100.0

(1) Banking risk is related to investment in banks' financial instruments (deposits, foreign exchange spot/forward, Pfandbriefe). Sovereign risk is related to investment in instruments from sovereign states (deposits, bills, floating-rate notes, nominal and indexed bonds). Agency risk is associated with investment in instruments of U.S. government agencies (bills, nominal bonds). Supranational risk is associated with investment in instruments from a multilateral official issuer (deposits, bills, floating-rate notes, nominal bonds).

(2) The risk rating corresponds to the average of the Fitch, Moody's, and Standard and Poor's ratings.

(3) Excluding investments in externally managed portfolios and the liquidity portfolio, gold holdings, and IMF positions.

Source: Central Bank of Chile.

Market risk was managed by diversifying investment currencies, instruments, and maturities and by measuring and monitoring the limits on exposure to currency and maturity risks, as noted above.

The average daily VaR^{4/} of the internally managed investment portfolio was 4.84% in 2010 (5.59% in 2009). The tracking error^{5/} was 11.3 basis points.

With regard to operating risk, a clear separation of responsibilities and functions was maintained at the institutional and hierarchical levels, and efficient controls were used to mitigate this risk in the area of reserve management. The Bank also employs IT systems that enable operating under market quality standards. Additional initiatives to improve operational continuity standards include the development of lines of succession for critical positions and the maintenance of an active contingency unit to guarantee the operational continuity of both international reserves and fiscal resources in the event of problems with the Bank's physical or technological infrastructure. This, combined with internal and external audits, has ensured that the decision-making process and management assessment within the Bank remain clearly defined.

In September 2010, the Financial Operations Division was restructured to allow the business areas to focus on their main duties and to transfer operations support to service areas. With regard to international reserve management, front office and back office functions were separated, creating the International Markets Management (which replaced the International Investments Management) and the new Financial Services Management. The former is responsible for front office duties and other tasks, while the latter focuses on back office and associated services.

D.2 Returns on international reserve management

The total return from international reserve management in 2010 was 0.36% measured in foreign currency, that is, in terms of the reference basket of currencies of the investment portfolio. Measured in dollars, it was -0.15%. The differential return obtained against the benchmark structure was -8.9 basis points. For the 2000-10 period, the average annual return measured in foreign currency was 3.66%, with a differential return against the benchmark structure of 22 basis points (table 5).

^{4/} The VaR is based on a parametric model with a daily horizon, a 95% confidence level, and a decay factor of 0.94.

^{5/} The tracking error is based on a parametric model with an annual horizon, an 84% confidence level, and a decay factor of 0.94.

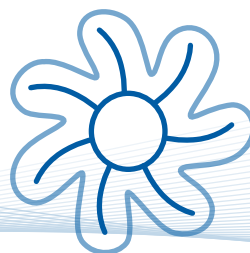


TABLE 5
ABSOLUTE RETURNS ON INTERNATIONAL RESERVES AND BENCHMARK
 (percent)

Period	In foreign currencies		In U.S. dollars		Differential
	International reserves	Benchmark	International reserves	Benchmark	
2010	0.36	0.45	-0.15	-0.06	-0.09
2009	2.15	1.65	3.34	2.84	0.50
2008	5.70	5.37	4.14	3.81	0.33
2007	4.81	4.78	8.86	8.83	0.03
2006	2.45	2.39	6.84	6.78	0.06
2005	2.90	2.85	-1.72	-1.77	0.05
2004	1.84	1.95	4.08	4.20	-0.11
2003	2.31	1.78	6.64	6.12	0.53
2002	5.25	4.69	9.34	8.78	0.57
2001	5.57	5.27	3.90	3.60	0.30
2000	6.88	6.65	4.84	4.61	0.22

Source: Central Bank of Chile.

D.3 Operating costs and the securities lending program

In 2010, total operating costs involved in the administration of the Bank's international reserves represented around 3.5 basis points of the total managed portfolio (table 6).

During the period, the Bank continued its securities lending program with the custodians for international reserves. This program consists in lending securities owned by the Bank to primary dealers, who are required to set up a guarantee deposit equivalent to 102% of the value of the instrument being lent. The contractual relationship with the loan agent—that is, the custodian—also includes a clause stipulating that in the event of the debtor's default, the custodian is liable for the full amount of the positions lent, thereby transferring the risk from the debtor to the custodian. The custodian bank must keep the Bank's position in separate accounts, so that there is no credit risk for the lender. In 2010, the income generated for the Bank by this program was 0.9 basis point of international reserves.

TABLE 6
NET SUMMARY OF RESERVE MANAGEMENT IN 2010

	Return (%)	Differential return (bp)	Administrative costs (bp)	Income from securities lending (pb)	Net differential return (pb)	Net return (%)
Total international reserves	-0.15	-8.9	3.5	0.9	-11.5	-0.18

Source: Central Bank of Chile.

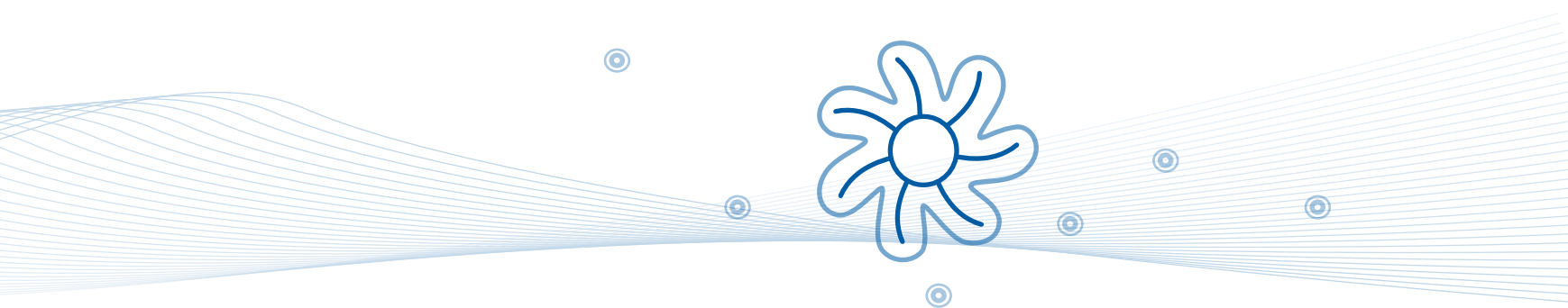


TABLE 7

Financial institutions with outstanding deposits as of 31 December 2010

AA-, AA, AA+, AAA	Australia & New Zealand Banking Group Limited Banco Bilbao Vizcaya Argentaria SA Banco Santander SA Bank of Scotland plc Barclays Bank PLC BNP Paribas SA Canadian Imperial Bank of Commerce Crédit Agricole Corporate and Investment Bank Crédit Industriel et Commercial Intesa Sanpaolo SpA Lloyds TSB Bank PLC Svenska Handelsbanken The Royal Bank of Scotland PLC Westpac Banking Corporation	
	Minimum	10
	Maximum	388
	Category average	150
A+, A	Bayerische Landesbank Muenchen DZ Bank AG Deutsche Zentral-Genossenschaftsbank Erste Bank der Oesterreichischen Sparkassen AG KBC Bank NV Landesbank Baden Wurttemberg Nordeutsche Landesbank Girozentrale Raiffeisen Zentralbank Österreich AG UniCredit Bank AG Unicredito Italiano SpA	
	Minimum	16
	Maximum	179
	Category average	116

Source: Central Bank of Chile.

TABLE 8
ELIGIBLE BANKS AND PERMISSABLE LIMITS AS OF 31 DECEMBER 2010
(Value in US\$ million, and months)

Country	Bank	Amount	Term (months)
Germany	UniCredit Bank AG	180	3
Germany	Bayerische Landesbank	180	3
Germany	Commerzbank AG	180	3
Germany	DekaBank Deutsche Girozentrale	90	3
Germany	Deutsche Bank AG	432	9
Germany	DZ BANK AG Deutsche Zentral-Genossenschaftsbank	180	3
Germany	Landesbank Baden-Württemberg	180	3
Germany	Landesbank Hessen-Thüringen Girozentrale	90	3
Germany	Norddeutsche Landesbank Girozentrale	180	3
Germany	NRW.BANK	432	12
Australia	Australia & New Zealand Banking Group Limited	432	12
Australia	Commonwealth Bank of Australia	432	12
Australia	National Australia Bank Limited	432	12
Australia	Westpac Banking Corporation	432	12
Austria	Erste Group Bank AG	180	3
Austria	Raiffeisen Zentralbank Österreich AG (RZB)	180	3
Belgium	Dexia Bank Belgium S.A.	180	3
Belgium	Fortis Bank SA/NV	180	3
Belgium	ING Belgium SA/NV	180	3
Belgium	KBC Bank NV	180	3
Canada	Bank of Montreal	432	9
Canada	Canadian Imperial Bank of Commerce	432	9
Canada	National Bank of Canada	180	3
Canada	Royal Bank of Canada	432	12
Canada	The Bank of Nova Scotia	432	9
Canada	The Toronto-Dominion Bank	432	9
Denmark	Danske Bank Aktieselskab	180	3
Denmark	Nordea Bank Danmark A/S	432	9
Spain	Banco Bilbao Vizcaya Argentaria S.A.	432	12
Spain	Banco Santander Central Hispano S.A.	432	12
Spain	Caja de Ahorros y Pensiones de Barcelona	432	9
Spain	Caja de Ahorros y Monte de Piedad de Madrid	180	3
Finland	Nordea Bank Finland Plc	432	9
France	BNP Paribas S.A.	432	12
France	Credit Agricole Corporate and Investment Bank	432	9
France	HSBC France	432	12
France	Credit Agricole S.A.	432	9
France	Crédit Industriel et Commercial (CIC)	324	9
France	Natixis	180	3
France	Société Générale	180	3
Netherlands	ABN AMRO Bank NV	180	3
Netherlands	The Royal Bank of Scotland NV	180	3
Netherlands	ING Bank NV	180	3

TABLE 8
ELIGIBLE BANKS AND PERMISSABLE LIMITS AS OF 31 DECEMBER 2010

(Value in US\$ million, and months)

continued

Country	Bank	Amount	Term (months)
Netherlands	NV Bank Nederlandse Gemeenten	585	12
Netherlands	Rabobank Nederland	702	12
Italy	Intesa Sanpaolo SpA	432	9
Italy	Unicredit SpA	180	3
Japan	Mizuho Corporate Bank Ltd.	180	3
Japan	Sumitomo Mitsui Banking Corporation	180	3
Japan	The Bank of Tokyo-Mitsubishi UFJ. Ltd.	180	3
Japan	The Norinchukin Bank	180	3
Japan	The Shizuoka Bank Ltd.	432	9
Japan	The Sumitomo Trust & Banking Co. Ltd.	180	3
Norway	DnB NOR Bank ASA	180	3
Norway	Nordea Bank Norge ASA	432	9
Portugal	Caixa Geral de Depositos S.A.	180	3
Sweden	Skandinaviska Enskilda Banken AB (Publ) (SEB)	180	3
Sweden	Svenska Handelsbanken AB (publ)	432	9
Switzerland	Credit Suisse	432	9
Switzerland	UBS AG	180	3
Switzerland	Zürcher Kantonalbank	702	12
United Kingdom	Bank of Scotland Plc	432	9
United Kingdom	Barclays Bank Plc	432	9
United Kingdom	HSBC Bank Plc	432	12
United Kingdom	LloydsTSB Bank Plc	432	9
United Kingdom	National Westminster Bank Plc	432	9
United Kingdom	Standard Chartered Bank	180	3
United Kingdom	The Royal Bank of Scotland Plc	432	9
United States	The Bank of New York Mellon	432	12
United States	Bank of America NA	180	3
United States	Citibank. NA	180	3
United States	Comerica Bank	180	3
United States	Deutsche Bank Trust Company Americas	432	9
United States	Goldman Sachs Bank USA	180	3
United States	HSBC Bank USA N.A.	432	12
United States	J.P. Morgan Chase Bank	432	9
United States	BNY Mellon Bank National Association	324	12
United States	PNC Bank NA	180	3
United States	State Street Bank & Trust Company	432	9
United States	The Northern Trust Company	432	9
United States	U.S. Bank N.A.	432	9
United States	Wells Fargo Bank. NA	432	12

Source: Central Bank of Chile.



TABLE 9

Intermediaries used in 2010

ANZ Securities, USA	ANZ SECURITIES INC., USA
Banca IMI Securities Corp., USA	BANCA IMI SECURITIES CORP., USA
Bank for International Settlements, Basle	BANK FOR INTERNATIONAL SETTLEMENTS, BASLE
Bank of America Securities LLC, USA	BANK OF AMERICA SECURITIES LLC., USA
Barclays Capital Inc., USA	BARCLAYS CAPITAL INC., USA
Barclays Capital, UK	BARCLAYS CAPITAL, U. KINGDOM
BNP Paribas Securities Corp., USA	BNP PARIBAS SECURITIRS CORP., USA
BNP Paribas, France	BNP PARIBAS, FRANCE
Citigroup Global Markets Inc., USA	CITIGROUP GLOBAL MARKETS INC., USA
Citigroup Global Markets Ltd., UK	CITIGROUP GLOBAL MARKETS LTD., U. KINGDOM
Commerzbank AG, Frankfurt	COMMERZBANK AG, FRANKFURT
Commonwealth Bank of Australia, Sydney	COMMONWEALTH BANK OF AUSTRALIA, SYDNEY
Crédit Agricole Corporate and Investment Bank, USA	CREDIT AGRICOLE CORPORATE AND INVESTMENT BANK, USA
Credit Suisse Securities (Europe) Limited, UK	CREDIT SUISSE SECURITIES (EUROPE) LIMITED, U. KINGDOM
Credit Suisse Securities (USA) Llc, USA	CREDIT SUISSE SECURITIES (USA) LLC., USA
Deutsche Bank AG (London Branch) UK	DEUTSCHE BANK AG (LONDON BRANCH), U. KINGDOM
Deutsche Bank AG, Frankfurt	DEUTSCHE BANK AG, FRANKFURT
Deutsche Bank Securities Inc., USA	DEUTSCHE BANK SECURITIES INC., USA
DZ Bank AG Deutsche Zentral-Genossenschafts, Frankfurt	DZ BANK AG DEUTSCHE ZENTRAL-GENOSSENSCHAFTS, FRANKFURT
Goldman. Sachs & Co., USA	GOLDMAN, SACHS & CO., USA
HSBC Bank Plc., UK	HSBC BANK PLC, U. KINGDOM
HSBC Bank USA N.A., New York	HSBC BANK USA N.A., NEW YORK
HSBC Securities (USA) Inc., USA	HSBC SECURITIES (USA) INC., USA
JP Morgan Sec. Ltd., UK	J.P. MORGAN SEC. LTD., U. KINGDOM
JP Morgan Securities Inc., USA	J.P.MORGAN SECURITIES INC., USA
Jefferies & Company. Inc., USA	JEFFERIES & COMPANY. INC., USA
Jefferies International Limited., UK	JEFFERIES INTERNATIONAL LIMITED., U. KINGDOM
Merrill Lynch Gov. Sec. Inc., USA	MERRILL LYNCH GOV. SEC. INC., USA
Merrill Lynch. Pierce. Fenner & Smith Inc., USA	MERRILL LYNCH. PIERCE. FENNER & SMITH INC., USA
Mizuho Securities USA Inc., USA	MIZUHO SECURITIES USA INC., USA
Morgan Stanley & Co. Inc., USA	MORGAN STANLEY & CO. INC., USA
Morgan Stanley & Co. International Plc., UK	MORGAN STANLEY & CO. INTERNATIONAL PLC., U. KINGDOM
Natixis, Paris	NATIXIS, PARIS
Nomura Securities International, Inc., USA	NOMURA SECURITIES INTERNATIONAL, INC., USA
Nordea Bank Finland Plc., Helsinki	NORDEA BANK FINLAND PLC., HELSINKI
RBC Capital Markets. Llc., USA	RBC CAPITAL MARKETS, LLC., USA
RBS Securities Inc., USA	RBS SECURITIES INC., USA
Royal Bank of Scotland, UK	ROYAL BANK OF SCOTLAND, UNITED KINGDOM
Société Générale, France	SOCIÉTÉ GÉNÉRALE, FRANCE
The Royal Bank of Scotland Plc., London	THE ROYAL BANK OF SCOTLAND PLC., LONDON
UBS Limited, UK	UBS LIMITED, U. KINGDOM
UBS Securities Llc., USA	UBS SECURITIES LLC., USA
Unicredit Bank AG, Germany	UNICREDIT BANK AG, GERMANY

Source: Central Bank of Chile.

Appendix V

Real time gross settlement (RTGS/CAS) system

A. Introduction

Payment systems are the means through which banks transfer funds to other banks, and they are a key component of the economic and financial infrastructure. Their safe and efficient operation is critical for the good performance of the economy, effective monetary policy, and the maintenance and promotion of financial stability.

The Central Bank of Chile is responsible for safeguarding the normal operation of the payment systems. To this end, it has been vested with the power to regulate and supervise these systems. The adoption of the “Basic Principles”^{1/} recommended by the Committee on Payment and Settlement Systems of the Bank for International Settlements (BIS) is an essential requirement in the design and operation of systemically important payment facilities, which are capable of triggering or transmitting disturbances across the financial system.

In Chile, the large-value payment system (LVPS) comprises the real time gross settlement (RTGS) system, which is owned and operated by the Central Bank, and the deferred netting system of the large-value payment clearing house (LVPCH), operated by *ComBanc S.A.*, a banking support corporation. The RTGS system settles individual gross payments. In the LVPCH, participants settle their net position resulting from payments made and received during the day once the business cycle is completed in the RTGS system. Both systems process interbank, client account, and delivery versus payment (DVP) transactions. The DVP method for settling transactions involving securities is based on the implementation of DVP models 1 and 2—as defined by the BIS Committee on Payment and Settlement Systems (CPSS)^{2/}—to ensure that securities are transferred if, and only if, the corresponding payment is received.

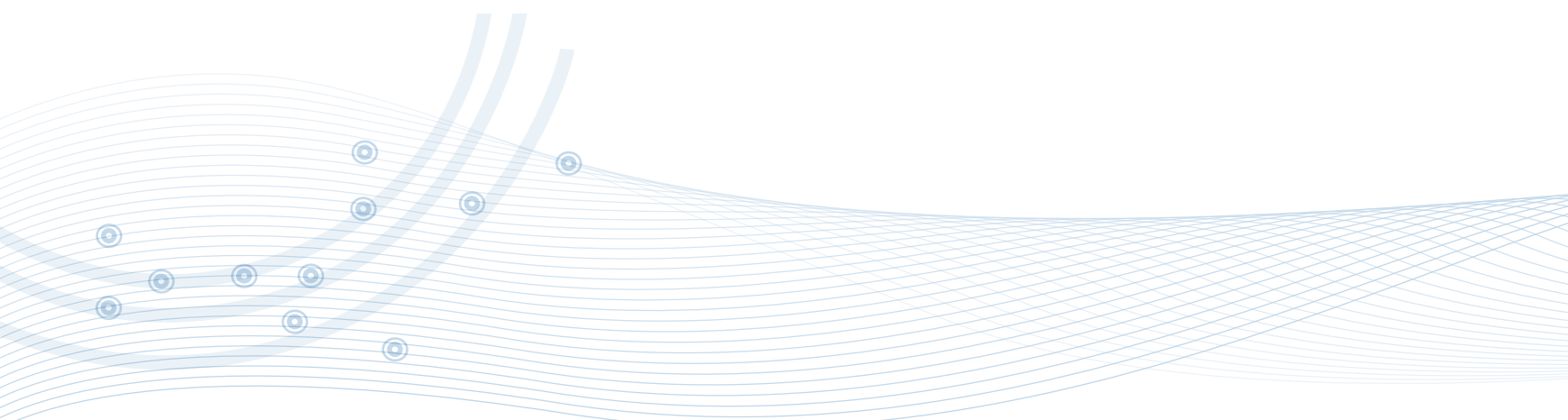
B. The RTGS system

The RTGS/CAS system is the real time gross settlement system used in Chile. In the RTGS system, individual payments are processed and settled continuously and irrevocably in real time. The RTGS system was implemented in April 2004 to reduce the settlement risk associated with the deferred settlement of large-value interbank payments and to promote the efficiency and security of the large-value payment system.

The system provides settlement services for system participants, and all participants keep a single settlement account with the Central Bank. As of December 2010, the system had 25 direct participants, including all banking firms and the securities clearing house (*Sociedad CCLV*). There is no indirect participation in the RTGS system.

^{1/} “Core Principles for Systemically Important Payment Systems,” Committee on Payment and Settlement Systems (CPSS), Bank for International Settlements, January 2001.

^{2/} “Delivery versus Payment in Securities Settlement Systems,” Committee on Payment and Settlement Systems (CPSS), Bank for International Settlements, September 1992.

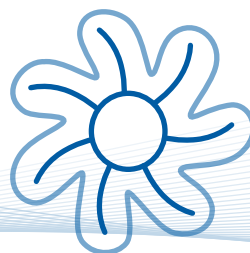


The Central Bank's acting as a clearing agent reduces systemic risk for two reasons. First, payments are settled with "central bank money," which eliminates the credit risk from the clearing agent. Second, if a participant bank's liquidity is insufficient to settle its payments, the Bank can provide additional liquidity against the provision of collateral. The RTGS system operates and settles payments using central bank money, debiting the Central Bank settlement account held by the delivering participant and simultaneously crediting the settlement account of the receiving participant. Since there is no credit or liquidity risk for participants in terms of the clearing agent and the assets used for settlement, the RTGS system complies with BIS basic principle VI for systemically important payment systems.

A payment is entered directly by the participant. The RTGS system verifies that there are sufficient funds in the delivering participant's account and then makes the payment; all payments are final and irrevocable. In the event that there are insufficient funds in the delivering participant's account, the payment is placed in a centralized queue until there are sufficient funds. As additional funds are made available, payments are settled on a first-in, first-out (FIFO) basis.

The processed transactions include payments in local currency entered directly by the delivering participants between 9:00 a.m. and 5:30 p.m., as well as the netting from the different clearing houses (checks, automatic teller machines, and large value). The Bank's direct charges and deposits resulting, for example, from open market transactions, standing deposit and credit facilities, and treasury operations (currency deposits and withdrawals) close at 6:15 p.m.

Participants can be given access to intraday credit from the Central Bank (the intraday liquidity facility), after first signing a contract and providing proof of connection. Intraday credit is provided interest free against the delivery of collateral via repo operations, using the Soma electronic platform. If, at the close of the day, the delivering participant does not have sufficient funds, the Bank retains control of the securities for the uncovered balance, while the participant is given an overnight loan from the standing liquidity facility (with interest).



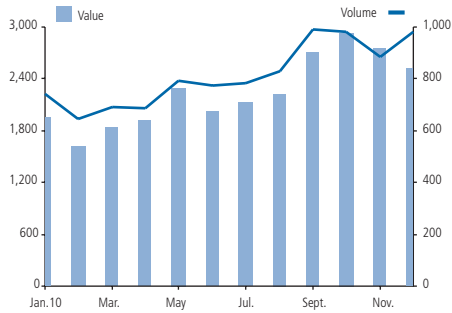
C. Main initiatives

The promulgation of the law on financial payment and clearing systems (Law 20,345) established a period of 15 months for companies involved in securities payment and clearing to adapt their operations to the legislation. Within this framework, the Bank authorized the incorporation of the securities clearing house (*Sociedad CCLV*) as a participant in the RTGS system, to execute money transfers to settle payment instructions in this system. The clearing house began operating in September, following the completion of a test program.

In early 2010, the Bank launched an assessment program to identify risk-management procedures in the unsynchronized delivery of transactions involving more than one currency. This led to a series of improvements and the adoption of the payment versus payment (PVP) settlement option. Under this standard, the settlement of two transactions in different currencies is subject to the condition that they can be settled simultaneously, which will contribute to the future automation of transactions involving more than one currency.

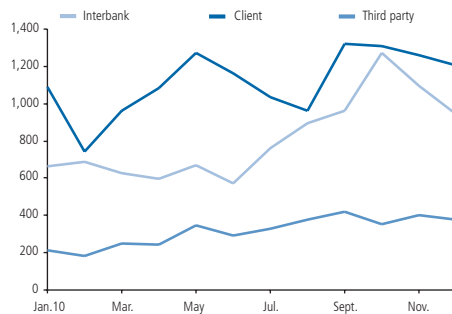
Finally, the Bank started preparations to bring the new version of the RTGS system on line in 2011. This system migration will improve operational continuity and change the mechanisms for integrating the RTGS system with the Bank's internal systems. The changeover will require close coordination with participating financial institutions for the testing process and the startup of operations.

FIGURE 1
FTIs SETTLED IN THE RTGS SYSTEM (*)
(Ch\$ billion, number of transactions)



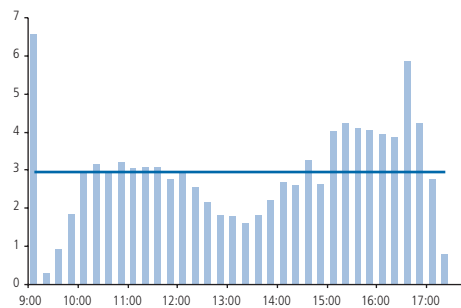
(*) Monthly daily average.
Source: Central Bank of Chile.

FIGURE 2
FTIs SETTLED IN THE RTGS SYSTEM BY TYPE (*)
(Ch\$ billion)



(*) Monthly daily average.
Source: Central Bank of Chile.

FIGURE 3
INTRADAY PATTERN OF FTIs SETTLED (*)
(percent, every 15 minutes)



(*) Daily average in 2010.
Source: Central Bank of Chile.

D. Statistical report

The RTGS system operated without disturbances in 2010, with the continuous and timely settlement of payments. Participants sent 203,620 payments or fund transfer instructions (FTIs), averaging 814 a day, for a total of Ch\$559.93 trillion (an average of \$2.24 trillion). The number of transactions fell 3% relative to 2009, although the value settled grew 21%. This is consistent with the upward trend in the average value of each payment settled in the RTGS system. This is particularly the case for payments associated with securities settlement, where participants have achieved efficiency gains by “packaging” the settlement of several transactions in the delivery a single payment (figure 1).

The downward trend in the amounts settled, beginning in the second half of 2009, coincided with the establishment of the short-term liquidity facility (known locally by its Spanish acronym, *Flap*), which caused a drop in the volumes traded on the interbank market. Use of the *Flap* peaked at Ch\$3.22 trillion in early 2010, at which point the facility was gradually withdrawn and activity resumed in the interbank market. The opening of the securities clearing house (*Sociedad CCLV*) gave an additional boost to payment activity, particularly in the client payment segment. This is because its operational design is based on the settlement of securities transactions with Central Bank money, whereas the previous scheme settled payments using commercial bank accounts (figure 2).

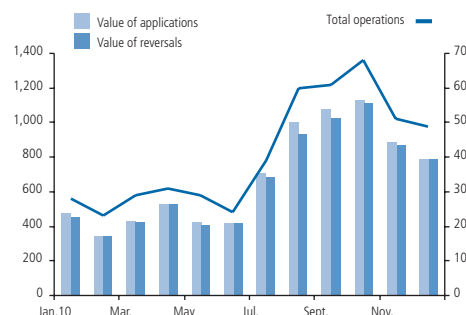
The intraday pattern in the value of settlements continued to be highly concentrated in the hour right after opening, although the relative share of this time slot fell for two reasons. First, the amount settled mainly reflects the posting of guarantees in the Central Bank by participants in the large-value payment clearing house (LVPCH). Since this amount is very stable, its relative weight has shrunk as the general level of settlements has grown. Second, the operating regulations of the securities clearing house (*Sociedad CCLV*) establish very specific times for settling payments, so when it began operating, it displaced activity toward the 3:00 to 4:00 p.m. time slot. By next year, the value of payments settled in this time slot is expected to exceed the opening of the day (figure 3).

As indicated, the operation of the *Flap* affected the use of the intraday liquidity facility for the intraday financing of operations. Thus, in the second half both the amount requested and the number of operations were almost double their levels in the first half. This more intensive use led to a small increase in amounts left unsettled (or not bought back) toward the end of the day, which were converted into an overnight loan from the standing liquidity facility (with the corresponding interest charges). In 2010, the repurchase percentage was almost 98% of the total requested (figure 4).

In 2010, the large-value payment systems (LVPS) cleared an average of Ch\$10.13 trillion per day, with a daily average of 5,175 operations. This represents an increase of 7% in terms of value and 5% in volume in annual terms. The amount settled in the RTGS system as a share of the LVPS continued to follow an upward trend, reaching nearly 71% in 2010. Transactions in which the Bank was one of the counterparties averaged around 49% of the total value settled daily in the LVPS—most notably operations with the standing deposit facility to adjust liquidity at the close of the day and the use of the intraday liquidity facility. The remaining 51% is explained by payments between participants. In terms of the distribution of the daily volume settled, the share of the RTGS system declined to 21% of the total (figure 5).

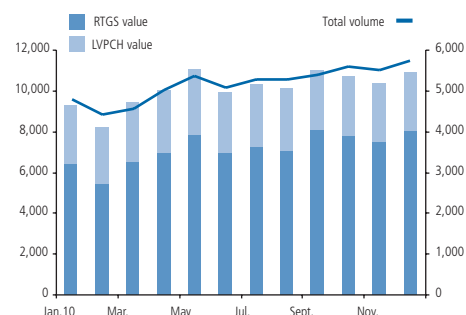
Interbank obligations arising from the clearing of retail payment instruments, as well as the close of the LVPCH business cycle, are settled on a multilateral net basis in the RTGS system. The multilateral net settlement positions of each participant for each netting flow (that is, checks, ATMs, and large value) are settled daily at a set time in the daily operating cycle of the RTGS system. Each participant is informed of its net position with enough lead time to arrange funds in the case of insufficient funds. Over the course of the year, the daily settlement of net multilateral positions averaged Ch\$607 billion. Of this amount, 17% was checks, 3% ATMs, and the remaining 80% the LVPCH (figure 6).

FIGURE 4
INTRADAY LIQUIDITY FACILITY OPERATIONS (FLI) (*)
(Ch\$ billion, number of operations)



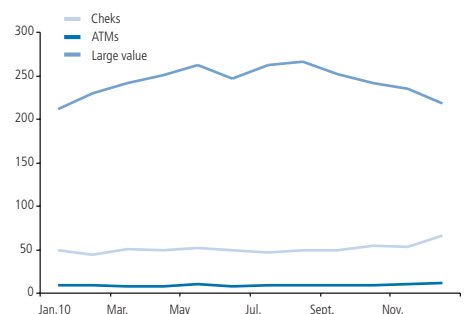
(*) Monthly daily average.
Source: Central Bank of Chile.

FIGURE 5
PAYMENTS SETTLED IN THE LARGE-VALUE PAYMENT SYSTEM (*)
(Ch\$ billion, number of operations)



(*) Monthly daily average.
Sources: Central Bank of Chile and ComBanc.

FIGURE 6
AMOUNT SETTLED THROUGH CLEARING HOUSES (*)
(Ch\$ billion)



(*) Monthly daily average.
Source: Central Bank of Chile.

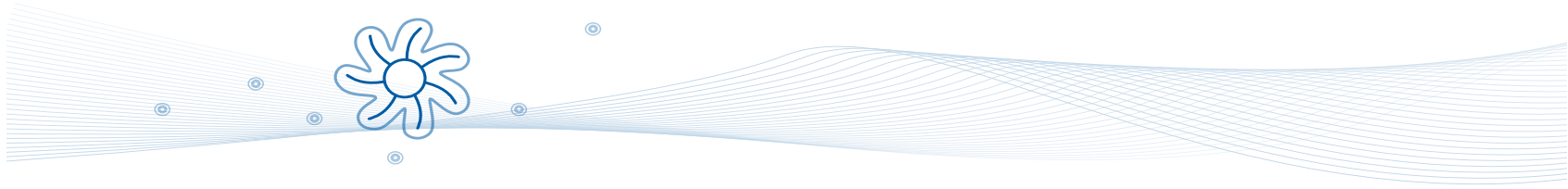
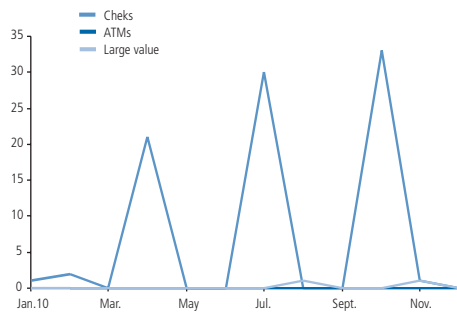


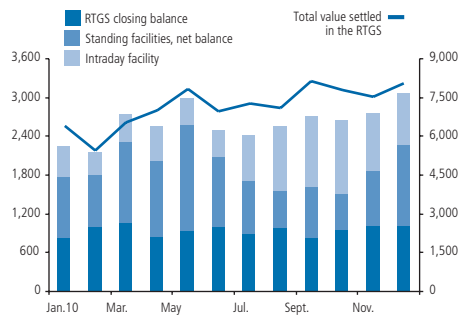
FIGURE 7
ACCUMULATED DELAY IN CLEARING HOUSE SETTLEMENTS (*)
(minutes)



(*) Monthly.

Source: Central Bank of Chile.

FIGURE 8
LIQUIDITY IN THE RTGS SYSTEM (*)
(Ch\$ billion)



(*) Monthly daily average.

Source: Central Bank of Chile.

In 2010, participant-caused delays in the settlement of obligations by the clearing houses were marginally lower than in 2009. Operating incidents caused only minor effects, which were handled under the contingency plans. Lack of sufficient funds in the accounts of participants with a final net debit position at the time of clearing continued to be the main cause of delays (figure 7).

Liquidity rotation in the RTGS system—that is, the average number of times that each peso of liquidity is used to settle payments—was 2.7 times in 2010. This value, which is similar to last year, probably reflects a low opportunity cost for liquidity as a result of the adequate range of securities that the Bank accepts in exchange for liquidity in the RTGS system. It also reflects the initial expansion of liquidity due to *Flap* operations, which generated an increase in the use of the standing deposit facility, especially in the first half (figure 8).

Appendix VI

Management of fiscal funds (ESSF and PRF)

A. Introduction

As fiscal agent, the Central Bank of Chile manages resources in the name and on the account of the Treasury. These resources are part of the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF).

The following sections describe the institutional context in which this fiscal agency operates. They also report on the investment policy, the fund structure, the reporting system, the administration results, and the costs of managing the resources.

B. Institutional framework

In September 2006, Law 20,128 on Fiscal Accountability created the ESSF and the PRF. Under this law, the Ministry of Finance issued Executive Decree 1383, whereby the Central Bank is vested with the representation of the Treasury for investing all or part of the ESSF and PRF resources, once the Bank has formally accepted the assignment in accordance with its Basic Constitutional Act.

Through Board Resolution 1321-01, issued on 22 February 2007, the Bank accepted the role of representation, together with the performance guidelines governing the actions of the fiscal agent.

These guidelines were in effect throughout 2008 and part of 2009. The Board then accepted new performance guidelines that went into effect in September 2009.

The Board Resolution authorized the Director of the Financial Operations Division (FOD) to establish the internal procedures necessary to regulate the fulfillment of these tasks, in accordance with the Decree and the performance guidelines.

The operational management of this fiscal agency is centered in the International Markets Management, which reports to the FOD. All of the procedures used in international reserve management were considered and applied to the administration of the fiscal resources. This has ensured equivalent quality standards in portfolio management and in the processes for controlling financial and operating risk.

C. Investment objectives and policy

The investment policy objectives for each fund (fiscal portfolios) and the risk-return profile associated with each of them reflect decisions made by the Ministry of Finance. The Central Bank must manage the fiscal resources in accordance with the relevant decrees and the accepted performance guidelines.

The performance guidelines contain the investment criteria, which define a reference benchmark and place restrictions on fiscal portfolio management. The benchmark structure implicitly incorporates risk-return objectives established by the Ministry of Finance. The fiscal agent's performance is assessed against this benchmark portfolio.

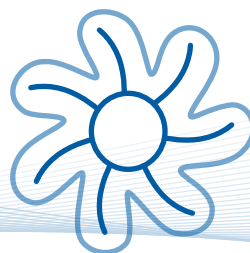
The investment guidelines determine and restrict the different risks to which the fiscal portfolios are exposed, such as foreign exchange, interest rate, and credit risk. To limit foreign exchange risk, the benchmark requires that funds be distributed as follows: 50% in U.S. dollars, 40% in euros, and 10% in yen, with a maximum deviation of $\pm 5\%$ from the central values defined for each currency. Nine additional currencies are also eligible under the guidelines^{1/}. However, investment in these secondary currencies is conditional on the existence of an underlying asset and hedging in one of the main currencies.

With regard to interest rate risk, the investment guidelines stipulate that the duration of the benchmark portfolio is near 30 months and the minimum duration of the fiscal portfolios can reach zero months, with a maximum deviation of five months over the duration of the benchmark portfolio.

Exposure to credit risk is controlled through restrictions on the issuers in which funds can be invested. The guidelines allow investment in sovereign risk (up to 100% of the portfolio), supranational risk (up to 60%), bank risk (up to 50%), and U.S. agency risk (up to 30%). The universe of eligible instruments further includes balances held in transaction accounts, overnight deposits, time deposits, certificates of deposit, bank acceptances, commercial papers, bills, notes, discount notes, nominal bonds, inflation-indexed bonds, and floating-rate notes.

The investment guidelines establish additional criteria and restrictions as complementary measures to minimize credit risk, including eligibility criteria by issuer, maximum exposure by risk type, eligible operations, treatment of derivatives, and eligible intermediaries.

^{1/} Pound sterling, Canadian dollar, Norwegian krone, Australian dollar, Swedish krona, Danish krone, Swiss franc, New Zealand dollar, and Singapore dollar.



The benchmark portfolio specified in the investment guidelines is made up of a short-term portfolio (30%) and a long-term portfolio (70%). The bank-risk benchmark for the short-term portion is made up of London interbank bid (Libid) rates obtained from a reference deposit portfolio with a residual maturity of between 1 and 180 days. The short-term portion corresponding to sovereign risk is benchmarked against a government bond portfolio, with an average maturity of approximately three months. The indices used as reference benchmarks for the short-term portfolios are provided by Merrill Lynch.

The nominal long-term portion and the long-term portion composed of Treasury Inflation-Protected Securities (TIPS) are benchmarked against Barclays Capital's total return index, which includes investments in government bonds maturing in up to ten years.

D. Structure of fiscal portfolios

The administration mandate began in March 2007. Since that date, the ESSF and the PRF have received net contributions of US\$10.04 billion and US\$3.43 billion, respectively.

At the request of the Ministry of Finance, the Bank delivered ESSF resources of US\$150 million in 2010, which were used to comply with part of the annual contribution to the PRF.

As of 31 December, the market value of the resources managed by the Bank was US\$16.56 billion. Of this amount, US\$12.72 billion corresponded to the ESSF and US\$3.84 billion to the PRF. This implies an increase in the market value of the net resources delivered for management of US\$3.09 billion (table 1).

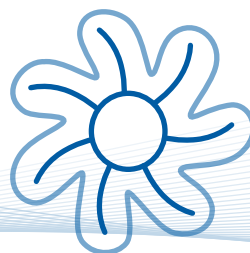
TABLE 1
ESSF AND PRF
 (as of 31 December 2010; US\$ million)

Sector	PRF	Market value ESSF	Total	Percent of market value
Agency	0.0	0.0	0.0	0.0
DOLLAR	0.0	0.0	0.0	
Bank risk	812.1	2,607.9	3,419.9	20.7
DOLLAR	372.1	1,198.5	1,570.6	
EURO	342.7	1,088.7	1,431.4	
YEN	97.3	320.7	418.0	
Sovereign risk	3,024.6	10,112.2	13,136.9	79.3
DOLLAR	1,516.8	5,062.9	6,579.7	
EURO	1,210.9	4,061.0	5,271.9	
YEN	296.9	988.3	1,285.2	
Total	3,836.7	12,720.1	16,556.8	100.0

Sector	PRF	Market value ESSF	Total	Percent of market value
DOLLAR	1,888.9	6,261.4	8,150.3	49.2
EURO	1,553.6	5,149.7	6,703.3	40.5
YEN	394.2	1,309.0	1,703.2	10.3
Total	3,836.7	12,720.1	16,556.8	100.0

Currency	Duration (years)	
	PRF	ESSF
DOLLAR	2.46	2.48
EURO	2.36	2.37
YEN	2.67	2.65
Total	2.44	2.46

Source: J.P. Morgan N.A.



E. Reports

Decree 1383 and the performance guidelines define the content and frequency of the reports that the Bank must deliver to the Minister of Finance and the General Treasurer of Chile. As a general rule, the custodian bank, in its middle office role, must provide the relevant information that is needed to prepare reports, and the fiscal agent must report daily, monthly, quarterly, and annually on the status of the resources under administration.

Daily reports provide information on the market value and duration of each portfolio, under items sorted by currency and risk type. Monthly, quarterly, and annual reports contain more detailed information on the portfolios. These reports describe changes in financial markets, discuss compliance with investment caps, provide details on the changes in the market value of each fund, and report on the absolute returns and differentials obtained.

In addition to measuring the custodian bank's performance and compliance with the investment guidelines, the Central Bank monitors and assesses the information provided by the custodian. To this end, it uses its own calculation methods based on systematically recorded information.

The fiscal agent must also report annually to the Minister of Finance and the General Treasurer on the custodian bank's performance.

F. Management results

In 2010, the ESSF and PRF resources obtained positive absolute returns. The ESSF resources being administered by the Bank generated an average return of 1.84% measured in dollars^{2/}. This implied a differential return of 15 basis points below the benchmark performance, both measured using the time weighted rate of return (TWRR)^{3/}. Using the same methodology, the PRF resources managed by the Bank generated an absolute return of 1.81% measured in dollars^{4/}. This meant a differential return of 18 basis points below the benchmark performance (table 2).

^{2/} This return is consistent with a 1.91% IRR measured in dollars (J.P. Morgan N.A.).

^{3/} The TWRR methodology yields a rate of return that has been adjusted for the impact of possible contributions (capital contributions or contributions generated through the securities lending program) and withdrawals (capital withdrawals or payments to third parties), which allows the analyst to isolate the effect of exogenous changes in the size of the portfolio on the funds' performance. This methodology also supports the comparison of the portfolio administrator's performance with a reference benchmark.

^{4/} This return is consistent with a 2.19% IRR measured in dollars (J.P. Morgan N.A.).

TABLE 2
TIME-WEIGHTED RATE OF RETURN (TWRR) 2010
 (percent)

	Currencies (*)	Dollar
ESSF	2.98	1.84
PRF	2.95	1.81

(*) Reference basket of currencies for the portfolio (50% USD, 40% EUR, and 10% JPY).

Source: J.P. Morgan N.A.

G. Compensation of the fiscal agent

According to the stipulations of Article 9, letter (a), of Decree 1383, the fiscal agent is entitled to charge an annual fee for the direct expenses and costs incurred in carrying out its assigned functions. For 2010, the Ministry of Finance set the annual fee of US\$660,000. This amount is consistent with the Central Bank's Basic Constitutional Act, which stipulates that the Bank shall not finance the Treasury. This fee corresponds to 0.43 basis point of the total resources managed in the year.

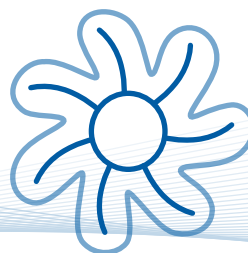


TABLE 3
FINANCIAL INSTITUTIONS WITH OUTSTANDING DEPOSITS

(as of 31 December 2010)

Institution
Banco Bilbao Vizcaya Argentaria SA
Banco Santander S.A.
Bank of Scotland Plc.
Barclays Bank Plc.
Bayerische Landesbank
BNP Paribas S.A.
Crédit Industriel et Commercial (CIC)
Erste Group Bank AG
ING Bank NV
Intesa Sanpaolo SPA
Landesbank Baden-Württemberg
Lloyds TSB Bank Plc
Norddeutsche Landesbank Girozentrale
Raiffeisen Bank International AG (RBI)
Svenska Handelsbanken AB (Publ)
The Royal Bank of Scotland Plc
Unicredit Bank AG
Unicredit SPA
Zurcher Kantonalbank

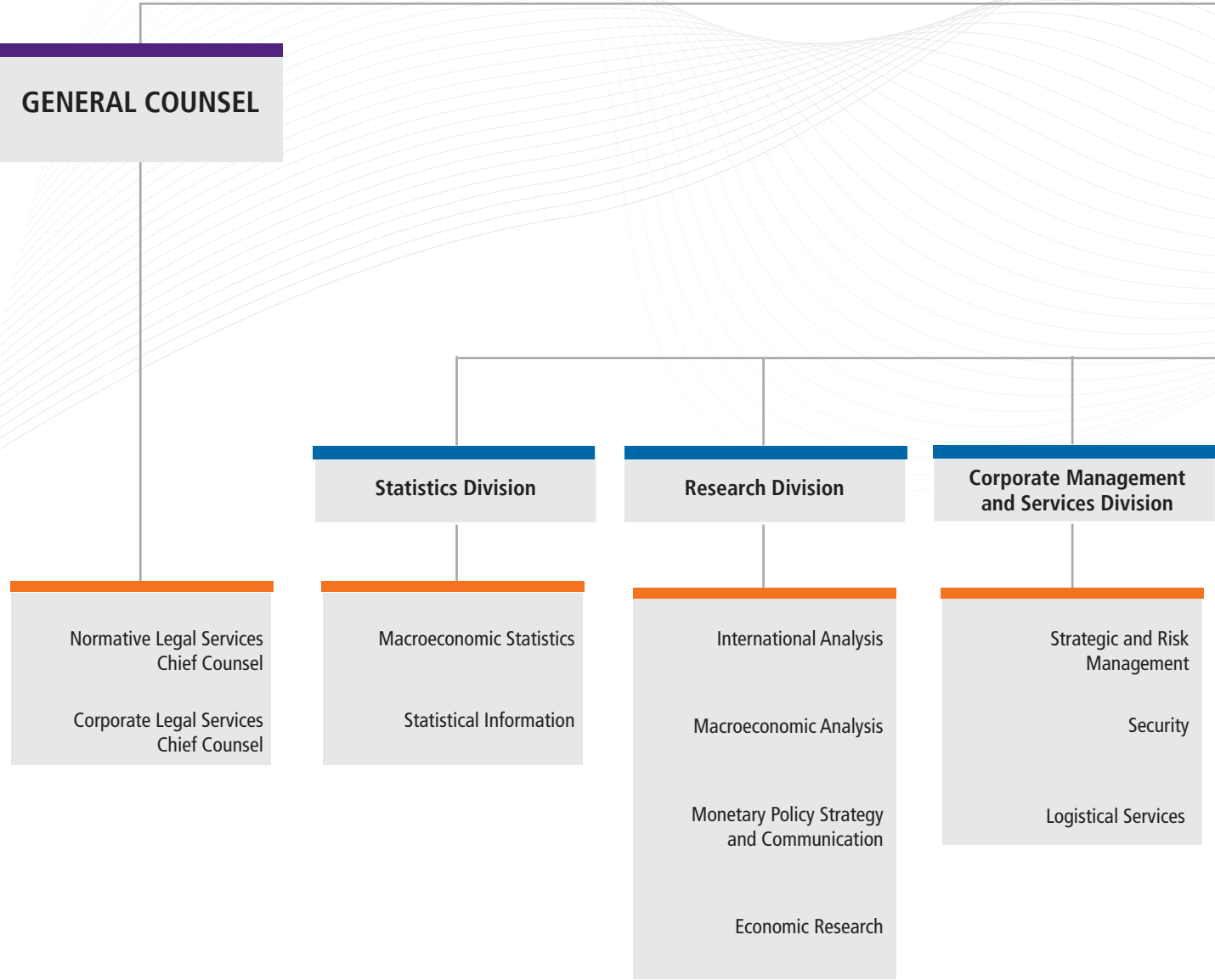
source: J.P. Morgan N.A.

TABLE 4
INTERMEDIARIES USED IN 2010

Intermediaries
Bank of America Sec. Llc., USA
Bank of America Intl. Ltd., London
Bank of America Merrill Lynch
Barclays Capital Inc., USA
Barclays Capital, UK
BNP Paribas S.A., Paris
BNP Paribas Securities Corp., USA
Citigroup Global Markets Inc., New York
Citigroup Global Mk. Ltd., UK
Commerzbank AG, Frankfurt
Crédit Agricole CIB (I) NY
Credit Suisse Securities (USA) Llc., New York
Credit Suisse Securities, UK
Deutsche Bank AG (London Branch). UK
Deutsche Bank AG, Frankfurt
Deutsche Bank Securities Inc., USA
DZ Bank AG Deutsche Zentral-Genoss., Frankfurt
Goldman, Sachs & Co., USA
HSBC Bank Plc., London
HSBC Bank Plc., UK
HSBC Securities (USA) Inc., USA
J.P. Morgan Sec. Ltd., UK
J.P.Morgan Securities. Inc., USA
Jefferies & Company. Inc., USA
Jefferies International Ltd., UK
Merrill Lynch Intl., UK
Merrill Lynch. Pierce. Fenner & Smith Incorporated
Mizuho Securities USA Inc., USA
Morgan Stanley & Co., Intl. Plc., UK
Morgan Stanley & Co. Inc., New York
Nomura Sec. Intl., Inc., USA
RBS Securities Inc.
Société Générale, Paris
The Royal Bank of Scotland Plc., London
UBS Limited, UK
UBS Securities Llc., USA
Unicredit Bank AG, Munich

Source: Central Bank of Chile.

ORGANIZATIONAL CHART





BOARD

GENERAL MANAGER

GENERAL AUDITOR

**Financial Operations
Division**

International Markets
Domestic Markets
Financial Services

**Financial Policy
Division**

Financial Stability
Financial Regulation
and Infrastructure
Financial Research

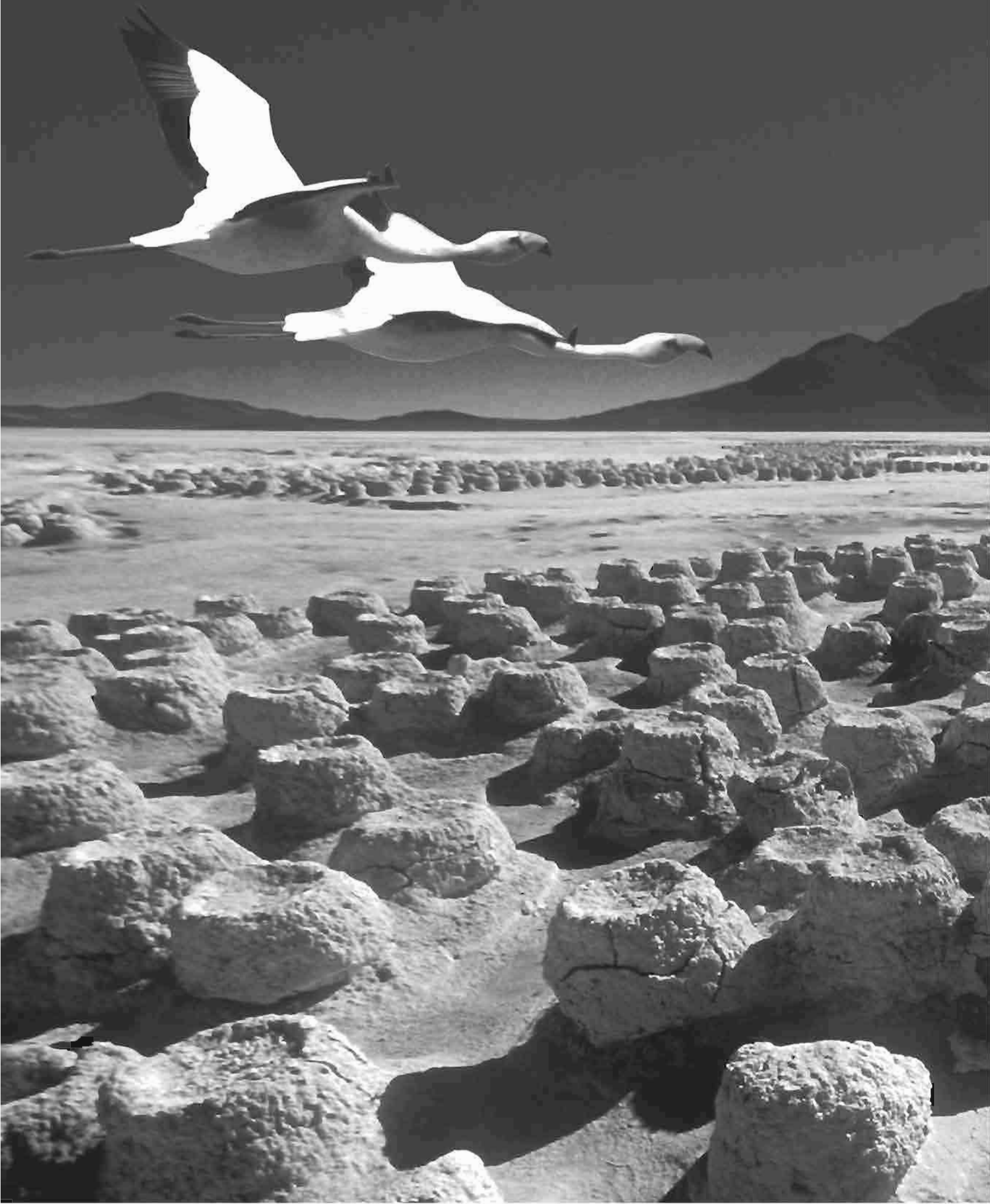
Communications
Advisory
Institutional Affairs
Informatics
Human Resources
Treasury

International Relations





III. Financial statements of Central Bank of Chile



BALANCE SHEETS 31 DECEMBER, 2010 AND 2009
(Ch\$ million)

ASSETS	NOTE	31. DEC.10	31. DEC. 09
Foreign assets		13,167,098.33	12,975,910.6
Reserve assets	11 and 12	<u>13,050,537.0</u>	<u>12,849,409.6</u>
Monetary gold		5,252.4	4,446.9
Special drawing rights (SDR)		570,139.9	579,052.2
Reserve position in the IMF		132,138.3	144,891.5
Correspondent banks abroad		26,498.2	9,656.5
Investments in foreign currency:		<u>12,299,510.2</u>	<u>12,068,153.6</u>
Instruments at fair value with effect on net income		8,475,295.5	7,055,273.7
Available-for-sale securities		1,046,029.2	1,871,316.7
Held-to-maturity securities		2,778,185.5	3,141,563.2
Reciprocal loan agreements		16,540.3	43,014.6
Other assets		457.7	194.3
Other foreign assets		<u>116,561.3</u>	<u>126,501.0</u>
Shares of and contributions to the Inter-American Development Bank (IDB)		86,227.7	93,234.6
Shares of Bank for International Settlements (BIS)		30,333.6	33,266.4
Domestic assets		1,872,028.7	5,209,790.4
Domestic loans	13	<u>1,770.4</u>	<u>3,359,585.3</u>
Loans to banks and financial institutions		1,770.4	3,359,585.3
Operations under Specific Legal Regulation	14	<u>1,870,258.3</u>	<u>1,850,205.1</u>
General Treasury transfers (Laws 18,267 and 18,401)		244,249.6	238,413.4
Loan for subordinated liabilities of financial institutions (Laws 18,401 and 19,396)		876,663.7	914,374.2
<i>Sinap</i> Liquidation Law 18,900		749,345.0	696,385.9
Securities receivable from <i>Corfo</i> Law 18,401		-	1,031.6
Other assets		<u>51,917.1</u>	<u>426,386.5</u>
Premises and equipment	15	45,433.3	44,404.9
Other securities		6,346.7	4,598.1
Other current assets		137.1	93.1
Repurchase agreements		-	377,290.4
Total Assets		<u>15,091,044.1</u>	<u>18,612,087.5</u>

Accompanying notes from 1 to 29 are an integral part of these financial statements.

BALANCE SHEETS 31 DECEMBER, 2010 AND 2009

(Ch\$ million)

(Continued)

LIABILITIES	NOTE	31. DEC. 10	31. DEC. 09
Foreign liabilities	16	658,950.5	721,461.3
Reciprocal loan agreements		1,342.4	1,865.9
Accounts with international organizations		68,025.0	73,138.8
Special drawing rights (SDR) allocations		589,583.1	646,456.6
Domestic liabilities		<u>17,866,565.1</u>	<u>19,463,646.1</u>
Monetary base	17	5,525,006.6	4,582,203.6
Banknotes and coins in circulation		4,748,482.9	4,189,634.9
Deposits from financial institutions (in Chilean pesos)		776,523.7	392,568.7
Deposits and obligations	18	3,425,860.6	3,302,270.7
Deposits and obligations with the General Treasury		377,333.2	302,719.7
Other deposits and obligations		3,048,527.4	2,999,551.0
Documents issued by Central Bank of Chile	19	8,915,697.9	11,579,171.8
Central Bank bonds in UF (BCU)		4,102,284.2	4,782,123.6
Central Bank bonds in Chilean pesos (BCP)		2,329,696.0	1,939,862.4
Central Bank discountable promissory notes (PDBC)		1,665,410.8	3,603,398.4
Optional indexed coupons (CERO) in UF		418,756.8	480,565.2
Indexed-promissory notes payable in coupons (PRC)		399,529.0	773,201.1
Other		21.1	21.1
Other liabilities	20	14,669.5	387,193.1
Provisions		14,394.3	13,737.7
Other securities		275.2	451.7
Repurchase agreements		-	373,003.7
Net equity	21	(3,449,141.0)	(1,960,213.0)
Capital		(1,961,259.2)	803,434.1
Valuation accounts		1,360.4	3,126.8
Deficit for the year		(1,489,242.2)	(2,766,773.9)
Total Liabilities and Equity		<u>15,091,044.1</u>	<u>18,612,087.5</u>

Accompanying notes from 1 to 29 are an integral part of these financial statements.

STATEMENTS OF INCOME, YEARS ENDED 31 DECEMBER, 2010 AND 2009
(Ch\$ million)

	NOTE	31. DEC. 10	31. DEC. 09
Net income for international reserves	7	<u>212,590.8</u>	<u>231,735.7</u>
Income		<u>378,470.6</u>	<u>532,375.0</u>
Interest income		156,159.0	212,335.2
Gain on sale of instruments at fair value with effect on net income		190,491.2	314,160.6
Gain on sale of available-for-sale securities		6,711.8	4,437.9
Adjustments at fair value		23,033.9	-
Other		2,074.7	1,441.3
Expenses		<u>(165,879.8)</u>	<u>(300,639.3)</u>
Interest expenses		(1.4)	(38.3)
Loss on sale of instruments at fair value with effect on net income		(131,818.7)	(181,552.0)
Loss on sale of available-for-sale securities		(85.3)	-
Adjustments at fair value		(33,974.4)	(119,049.0)
(Loss) net income for other foreign operations		(1,398.0)	10,656.2
Income		870.5	12,156.9
Other income		870.5	12,156.9
Expenses		<u>(2,268.5)</u>	<u>(1,500.7)</u>
Interest expenses		(1,718.3)	(899.9)
Other expenses		(550.2)	(600.8)
Net loss for domestic operations	8	<u>(401,328.7)</u>	<u>(184,947.0)</u>
Income		137,440.9	86,240.0
Interest income and adjustments		134,394.7	51,373.9
Other income		3,046.2	34,866.1
Expenses		<u>(538,769.6)</u>	<u>(271,187.0)</u>
Interest expenses and adjustments		(537,535.7)	(268,364.9)
Other expenses		(1,233.9)	(2,822.1)
Net (loss) gain on foreign exchange transactions	9	<u>(1,211,623.5)</u>	<u>(2,776,156.6)</u>
Gain on foreign exchange transactions		143,084.7	71,532.7
Loss on foreign exchange transactions		(1,354,708.2)	(2,847,689.3)
Issuance and distribution costs	10	<u>(47,065.2)</u>	<u>(28,478.8)</u>
Banknotes		(26,016.2)	(10,019.5)
Coins		(20,010.1)	(17,902.2)
Distribution		(1,038.9)	(557.1)
Personnel and administrative expenses		<u>(38,464.7)</u>	<u>(35,311.7)</u>
Personnel expenses		(24,145.6)	(22,570.3)
Administrative expenses		(12,456.2)	(10,651.2)
Provision for post-employment benefits		(1,862.9)	(2,090.2)
Other expenses		<u>(1,952.9)</u>	<u>(2,628.2)</u>
Depreciation and amortization		(1,478.5)	(2,067.5)
Taxes and contributions		(474.4)	(560.7)
Operating income		(1,489,242.2)	(2,785,130.4)
Price-level adjustment	2(e)	-	18,356.5
(Deficit) for the year		(1,489,242.2)	(2,766,773.9)

Accompanying notes from 1 to 29 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS AS OF 31 DECEMBER, 2010 AND 2009

Note 1

Description of business

Central Bank of Chile was established on 21 August, 1925, by Decree Law 486. The Bank is an autonomous entity of technical nature, full legal capacity, its own assets and indefinite duration, created in accordance with Articles 108 and 109 of the Political Constitution of Chile and ruled by the Basic Constitutional Act contained in Article One of Law 18,840 and its modifications.

The Bank's objective is to look after the stability of both the Chilean currency and the normal functioning of domestic and foreign payments.

In order to meet its objectives, the Bank regulates the amount of money and credit in circulation and executes credit operations and international exchange, such as, dictating regulations on monetary credit, and financial and international exchange matters.

Additionally, the Bank is exclusively empowered to issue banknotes and to mint coins.

The Bank is domiciled in *Santiago de Chile*, and its main office is located in Agustinas 1180.

Note 2

Summary of Significant Accounting Policies

(a) Basis of Preparation of the Financial Statements

These financial statements have been prepared in conformity with the "Policies of presentation and preparation of financial reports of Central Bank of Chile" approved by the Bank's Board, pursuant to Resolution 1456-01 dated 15 January, 2009 and 1519-01 dated 14 January, 2010, having a favorable report by the Superintendence of Banks and Financial Institutions, pursuant to Section 75 of the Bank's Basic Constitutional Act. The policies approved by the Board are consistent with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), in all areas in which the application of these international accounting standards does not affect legally specified provisions that govern the Bank or the compliance with its public duties. Should there be any disagreement; the standards issued by the Board of the Bank shall prevail, as in the case of:

- a.i The credits related to the liquidation of the *Sinap* governed by Law 18,900, stated in the caption "Operations Under Specific Legal Regulation" and explained in notes 2(k) and 14(b), are valued at amortized cost with effect on net income. The Bank's Board has decided to maintain the accounting treatment this asset had at the original accounting date, as it corresponds to operations arising from specific legal clauses inherent to the Bank's institutional duties.

- a.ii Accounting treatment of premises and equipment in 2009 and prior year. Measurement at acquisition cost plus price-level adjustment based on the variation of the CPI less accumulated depreciation. As from 2010, the Bank suspended the application of price-level adjustment over premises and equipment; see note 2(l).
- a.iii Application of comprehensive price-level adjustment in 2009 and prior year. In 2010, comprehensive price-level adjustment was suspended as described in note 2 (e).
- a.iv Provisions, assets and contingent liabilities. The Board decided to adopt the criterion of the international standards, however, it will be able to use the power granted by the Bank's Basic Constitutional Act to record global or individual provisions based upon the risk that may be estimated for certain investing or credit operations. During 2010 and 2009, no provisions were recorded in this regard.
- a.v The statement of changes in equity is not presented. Instead, note 21 Capital and reserves is included; containing the capital movements during 2010 and 2009.
- a.vi A statement of cash flows is not presented as defined by the international standard, instead, as part of the notes to the financial statements, a statement of variations in monetary base and a statement of variations in international reserves is presented in note 22.
- a.vii The statements of comprehensive income are not presented, instead, the statements of income for 2010 and 2009 are presented.

The presentation of these financial statements is framed within an economic and accounting framework that fairly reflects the financial position of the Bank, and at the same time, contributes to the economic analysis of the Bank's operations by clearly identifying whether they are undertaken by domestic or foreign agents. From this information it is possible to determine the Bank's share in the domestic supply of monetary assets and credit and the related effects on the Bank's foreign

creditor position. For this reason, the economic concepts of international reserves and currency issuance are shown under the captions reserve assets and monetary base liabilities, respectively.

The financial statements have been prepared on the historical cost basis. The abovementioned excludes operations corresponding to foreign investments in financial instruments that are reported at their fair value (including the corresponding effect on net income) and available-for-sale securities, which basis of measurement has been performed taking the fair value as reference.

The methods used to measure fair values are presented in note 3.

The English translation of this financial statement is provided as a free translation from the Spanish version (official and binding version). This translation has been performed solely for the convenience of non-Spanish readers.

(b) Functional and presentation currency

As the Bank's main objective is to look after the stability of the Chilean currency, which implies that open-market operations play a significant role in the development of the monetary policy, accordingly, its main activity is the issuance of banknotes and coins, in Chilean peso, which has been defined as the financial statement's functional and presentation currency. The figures of such statements are stated in millions of Chilean pesos, while the figures of these notes are stated in millions of Chilean pesos or U.S. dollars, as applicable.

(c) Transactions in foreign currency and foreign currency translation

The Bank's functional currency is the Chilean peso. Consequently, all balances and transactions denominated in currencies other than the Chilean peso are considered as denominated in "foreign currency". The balances of the financial statements expressed in this currency are translated into Chilean pesos as follows:

- c.i U.S. dollars are translated into Chilean pesos at the "observed U.S. dollar" exchange rate pursuant to Section 44 of the Basic Constitutional Act, that governs the Bank, referred to under No.6 of Chapter I in the "General Provisions" of the Compendium of Foreign Exchange Regulations (*Compendio de Normas de Cambios Internacionales*).
- c.ii Assets and liabilities stated in Chilean minted gold, are valued at the average London morning quotation of the "Gold Fixing" rate (U.S. dollars per fine troy ounce), for all business days.
- c.iii Translation of foreign currencies other than U.S. dollars is made at the exchange rates published daily by Central Bank of Chile in the *Official Gazette*, which are always based upon the "observed U.S. dollar" rate.
- c.iv Special Drawing Rights (SDR) are adjusted at the exchange rates for each of the business days of the month, reported by Central Bank of Chile, except for the last business day of the month in which the exchange rate reported by the International Monetary Fund (IMF) is considered.

The results from the purchase and sale of foreign currency, as well as the differences arisen from the update of the belongings in foreign currency, as a result of the variation of the exchange rates of such foreign currencies compared to the Chilean peso, are recorded as profits or losses for the year.

The main exchange rates to the Chilean peso used as of each year-end are as follows:

	2010 Ch\$	2009 Ch\$
United States dollar (observed exchange rate)	468.37	506.43
Pound Sterling	726.04	806.03
Euro	619.87	727.21
Special Drawing Rights (SDR)	721.30	791.04

(d) General principles used in the preparation of the financial statements

The financial statements have been prepared using as base the recognition of assets, liabilities and results when the flow of future economic benefits is probable from or towards the Bank and it is possible to determine a cost reliably, considering for such purpose, the following accounting principles:

- d.i Accrual basis
The determination of operating results and the financial position must take into account all the resources and obligations of the period, whether or not they are received or paid, in order for costs and expenses to be properly matched to the revenues they generate. In this regard, the effects of the transactions must be recognized to the extent they generate the right to receive revenues or the obligation to pay for a cost or disbursement rather than when the payment is made or received.
- d.ii Going concern
The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or significantly curtail the scale of its operations.
- d.iii Materiality
The relevance of information is affected by its nature and relative importance. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Of course, there is not a boundary line setting the limits of what is significant or not, and the best criterion should be applied to resolve the issues in each case according to the circumstances, taking into account factors such as the relative effects on assets, liabilities, equity, or on earnings for the year.
- d.iv Substance over form
If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

d.v Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

(e) Price-level adjustment

Comprehensive price-level adjustment is no longer applied beginning in 2010. The Board decided, upon the favorable report of the Superintendence of Banks and Financial Institutions, to cease the application of price-level adjustment as from 2010 in order to adopt the Bank's financial statements to IFRS, with the condition to protect the application in relation to its equity, from the specific legal regime governing the Bank as a public law entity, as well as regarding the payment of paid-in capital and the distribution of the annual surplus to the General Treasury covered by Sections 5, 75, 77, and transitory Section 2 of the Basic Constitutional Act.

Likewise, in 2010, revenues and expenses in local currency have not been adjusted. The effect of variations in the exchange rates for assets and liabilities in foreign currencies and indexation on loans and liabilities is included within profit or loss.

In addition, with the purpose of applying the legal regime related to the incorporation of the Bank's paid-in capital and distribution of surpluses to Tax Authorities as dealt with in Section 5 of the abovementioned legislation, in relation to Sections 75, 77 and transitory Section 2 of the same legislation, the Bank decided to record price-level adjustment on paid-in capital for 2010 in memorandum accounts, on the basis of CPI variation for 2010, which was 2.5 %.

During 2009, the Board decided to apply comprehensive price-level adjustment to equity and premises and equipment on the basis of CPI variation for that year which was -2.3%. The effect of the application of price-level adjustment was net credit to net income of Ch\$ 18,356.5 million.

(f) Interest income and expenses, adjustments and commissions

Interest income and expenses, adjustments and commissions are recognized as net income for the year when earned. Interests are recognized based on their effective rate.

(g) International reserve measurement criteria

International reserves are liquid assets in foreign currency held by Central Bank of Chile. They are instruments supporting monetary and foreign exchange policies, in order to meet the Bank's objective of safeguarding currency stability and the normal functioning of internal and external payment systems. Reserve assets comprise those external assets under the control of the monetary authority, which can dispose of them immediately in order to fund the imbalances of the balance of payments and to indirectly regulate the magnitude of those imbalances.

Investments in foreign financial instruments are measured and classified in accordance with IFRS, in the following categories and composition:

- g.i Investments at fair value with effect on net income
Includes bonds issued by foreign governments, institutions and banks, mid-term bonds issued by Bank for International Settlements (BIS), treasury bills, discount notes, notes payable in coupons, indexed bonds, secured bonds from public institutions issued by German banks, agency prepayable bonds, agency notes, agency discount notes.

The principle considerations used to classify instruments focus on their high liquidity. They are recorded at fair value and their changes are recognized directly in earnings. The methods used to measure fair values are described in note 3.

- g.ii Available-for-sale securities
Includes floating-rate notes, certificates of deposits, floating-rate certificates, commercial papers, bank acceptances, discount term-deposits issued by BIS, negotiable with BIS, term-deposits at interest rates issued by BIS, negotiable with BIS, and BIS floating-rate notes.

They are investments in financial assets that under some market considerations may become effective before their maturity, they are recorded at fair value and the changes in value are recognized directly in equity until the investment is sold or determined to be other-than temporarily impaired, whereupon, the cumulative gains and losses previously recognized in equity are recognized in earnings. The methods used to measure fair values are described in note 3.

g.iii Held-to-maturity securities

Includes mostly term and over night deposits and are investments in financial assets that the entity has the positive intent and ability to hold until maturity; they are valued at amortized cost using the effective interest method. These financial assets are not affected by transaction costs.

g.iv Other financial assets:

g.iv.i Reserve position in the IMF: represents the net difference between the assets (installments paid to the IMF for subscription and the net of purchases and repurchases of SDR) and liabilities (deposits made by the IMF) and is classified as a held-to-maturity investment, measured at the cost indexed to Special Drawing Rights (SDR).

g.iv.ii Reciprocal loan agreements: represent the amount owed to Central Bank of Chile by the central banks comprising Aladi's Agreement on Reciprocal Payments and Credits for the exports made by Chilean entities. Their classification corresponds to non-derivative held-to-maturity financial instruments, measured at amortized cost.

(h) Shares and contributions to the Inter-American Development Bank (IDB) and contributions to the International Monetary Fund (IMF)

Shares issued by and contributions made to the IDB, and to the IMF, on behalf of the Chilean General Treasury, are stated at acquisition or contribution cost plus adjustments, where applicable.

The accounting treatment of the previously mentioned shares and contributions conformity with Article 3 of DL 2943 dated 1979,

published in the *Official Gazette* on 16 November of the same year, according to which such shares and contributions as well as the documents evidencing them, must be recorded for the Bank's accounting purposes as investments with a charge to its own resources.

Shares and contributions to IDB are shown under "Other foreign assets". Contributions to the IMF are recorded under "Reserve position in the IMF" in "Foreign reserve assets".

(i) Bank for International Settlements (BIS) Shares

During 2003, Board Resolutions 1073-04 dated 10 July, 2003 and 1084-02 dated 16 September, 2003, authorized the incorporation of Central Bank of Chile as a member of the Bank for International Settlements (BIS). On 26 September, 2003, in accordance with these resolutions, Central Bank of Chile acquired 3,000 shares of the BIS for SDR42,054,000 which are valued at acquisition cost and are shown under "Other Foreign Assets". During 2010 dividends were received in the amount of US\$3.1 million (US\$1.2 million in 2009).

(j) Domestic loans

Domestic loans are non-derivative financial assets that correspond to loans granted in the country, classified as held-to-maturity securities, stated with interests and adjustments accrued at year-end and measured at amortized cost pursuant to the effective interest rate method, and are not affected by transaction costs.

Non-adjustable loans are shown at original value or at their latest renewal value and adjustable balances or denominated in foreign currency include the accrued exchange rate and adjustments at the balance date.

(k) Operations under specific legal regulation

Correspond to non-derivative financial assets subject to specific regulatory and legal restrictions such as the loans related to the *Sinap* Liquidation governed by Law 18,900 and Receivables from *Corfo* in conformity with Law 18,401 of General Treasury Transfer covered in

Article 13 of such law, they are classified as held-to-maturity securities and are measured at amortized cost pursuant to the effective interest rate method, and are not affected by transaction costs.

(l) Premises and equipment

Premises and equipment are measured at acquisition cost, net of accumulated depreciation. The goods that have met their useful life are stated at their residual value considering market reference prices. Depreciation is calculated using the straight-line method.

Depreciation for 2010 and 2009 is recognized as expense and has been calculated considering the following estimated useful lives:

	YEARS	
	2010	2009
Buildings	80	100
Furniture and office equipment	10	10
Computer equipment	5	5
Vehicles	5	3

The change in useful lives did not represent material effects on net income.

(m) Monetary base

Mostly include liabilities of Central Bank of Chile that are part of money, or other financial instruments contribute including freely-circulating banknotes and coins, plus deposits made by the financial system in Central Bank of Chile and the banknotes and coins held on cash by banks. It is recorded at its nominal value.

(n) Deposits and obligations

Deposits and obligations are financial liabilities for deposits and other operations made with the General Treasury and financial institutions, initially measured at fair value, and which are not affected by transaction costs. Subsequently, they are measured at amortized cost pursuant to the effective interest rate method with an effect in earnings. Unadjustable balances are stated at nominal value. Adjustable

balances or those denominated in foreign currency include the effect of the accrued exchange rate and adjustments at the balance date.

(o) Documents issued by Central Bank of Chile

The documents issued by Central Bank of Chile are financial liabilities issued in order to adopt the decisions of monetary policy, initially measured at fair value, and are not affected by transaction costs. Subsequently, they are measured at amortized cost pursuant to the effective interest rate method with effect in earning. Unadjustable balances are stated at nominal value. Adjustable balances or those denominated in foreign currency include the effect of the accrued exchange rate and adjustments at the reporting date.

The following is the detail of held-to-maturity securities: Central Bank bonds in UF (BCU), Central Bank bonds in Chilean pesos (BCP), Central Bank discountable promissory notes (PDBC), Indexed-promissory notes payable in coupons (PRC), Optional indexed coupons (CERO) in UF.

(p) Impairment of financial assets at amortized costs

Regardless of the classification or reclassification of the instruments, in the event it is determined that the recoverable value (fair value) is lower than the earning value recorded in accounting, their impairment shall be recognized with a debit to earning. Pursuant to this policy, during 2010 and 2009, the Bank has not recognized any impairment of these financial assets.

(q) Employee benefits

- q.i Post-employment benefits
Post-employment benefits are employee benefits which are payable after the completion of employment in the Bank, as stipulated in: collective contract between Central Bank of Chile and the Labor Union of Central Bank of Chile, signed on 29 June, 2007; for special resolutions approved by the Board and for special benefits delivered to retired employees of the Former Association of Retired Employees and Beneficiaries of Pensions of Public Officials of Central Bank of Chile. These benefits include:

severance indemnities, special indemnity Resolution 1414-01 dated 5 June, 2008 special benefits to retired employees of the Former Association of Retired Employees and Beneficiaries of Pensions of Public Officials of Central Bank of Chile.

This recognition is made through an actuarial calculation that considers in both cases demographic and financial variables. It is measured at the current value of all future payments using an annual discount effective interest rate, affected by the expected employment duration and expected lives of beneficiaries, in conformity with note 2(t) and note 2(u).

q.ii Accrued vacations

The annual cost of employee vacations is recognized in the financial statements on an accrual basis.

(r) Provisions and contingent liabilities

Provisions are liabilities of uncertain timing or amount. These are recognized in the balance sheet when the following requirements are met:

- is a present obligation arising from past events and,
- to the date of the financial statements it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made.

A contingent liability is an obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the Bank.

(s) Financial derivative instruments

Financial derivative contracts corresponding to forward exchange contracts and currency swaps are initially recognized in the balance sheet at cost and subsequently measured at fair value. Derivative contracts are reported as an asset when their fair value is positive and as a liability when is negative and are included in the captions "Other securities" and "Other deposits and obligations", respectively, in the

case of forward exchange contracts and in the case of currency swaps are included in "Purchase of U.S. dollars with agreements to resale" and "Creditors for the purchase of U.S. dollars with agreements to repurchase", respectively.

When signing a derivative contract, this is designated by the Bank as a derivative security held for trading, as it is not used for hedge accounting purposes.

(t) Use of estimates and judgments

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis by the Bank's senior management in order to quantify some assets, liabilities, income, expenses and uncertainties. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are described in the following notes:

- Note 2(l) Premises and equipment, determination of useful life, depreciation and residual value.
- Note 3 Methodology applied for the measurement of international reserve fair values.
- Note 20(a) Provisions, including severance indemnity and post-employment benefits.

(u) Changes in the accounting estimates

During 2010 the following changes were made to the accounting estimates:

- Useful lives of goods were reviewed, adjusting the corresponding buildings and vehicles. See note 2(l).

- The formula used to determine the Change in Market Value was improved. See note 3.
- The estimate of severance indemnity was made based on the actuarial calculation, considering the following assumptions:
 - Mortality rate: In 2010, Mortality chart M-95 was used to determine survival probabilities in the calculation of severance indemnity payments, and mortality chart RV-2009, for the calculation of survival probabilities of post-employment benefits related to the healthcare plan of the retirement plan and the benefits of the Former Association of Retired Employees and Beneficiaries of Pensions of Public Officials of Central Bank of Chile (in 2009, mortality chart M-95 was used for severance indemnity and chart RV-2004 for post-employment benefits).
 - Labor turnover: In 2010, the Bank created its own charts, using ranges of seniority, to calculate the probabilities of permanence of employees (in 2009, Chart ESA -77 was used).
 - Discount rate: The annual average of the nominal rate of BCP-10 year securities was used. For 2010 the discount rate was 6.27% (6.35% in 2009).
 - Salary growth rate: The annual average of the salary growth rate was calculated in a period of five years. For 2010 the growth rate was 5.24% (4.76% in 2009).

The effects of these changes were recognized in net income for 2010. There are also prospective effects that will be recognized as earned as set forth by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

(v) Issued but not yet effective IFRSs

As of the date of these financial statements, there are standards issued by the International Accounting Standards Board (IASB) but they are not effective yet nor is their application mandatory. The following standard and amendments will have an effect on these financial statements when becoming effective:

IFRS 9 Financial Instruments: Classification and measurement, will replace sections classification and valuation in IAS 39. This standard will be applicable to financial statements of Central Bank of Chile as from 1 January, 2013 and it shows significant differences when compared

to the current standard, including the adoption of a new classification model based on two single categories: amortized cost and fair value; the elimination of current classifications of "Investments held to maturity" and "Available for sale financial assets", and impairment analysis only of assets stated at amortized cost.

Additionally, there are other standards issued but not yet effective which address matters that do not significantly affect or will not significantly affect the Bank's operations.

Note 3

Methodology applied for the measurement of fair values

The methodology for the calculation of fair values is applied to financial instruments held as foreign investments, classified as securities at fair value with effect on net income or available-for-sale securities with value changes through equity.

The management of international reserves is performed through a world class computer system that includes a methodology for the calculation of fair value. The methodology distinguishes two types of calculation to establish the fair value: priced and non-priced securities.

(a) Priced securities (source: Bloomberg)

The system uses the prices obtained from Bloomberg at the closing of the markets of the current day. The price corresponds to $PX \text{ Mid} = (PX \text{ Bid} + PX \text{ Last})/2$.

Where:

- PX Mid: Average price.
- PX Bid: The last purchase price available for an issuance in a particular day.
- PX Last: The last price at which an issuance has been measured in a particular day.

On the other hand, the system calculates the gains and losses from investments on a daily basis using the following formula:

2010

IR Profit/Loss = Total Gain Loss - Accrued Interest – FX Gain/Loss

2009

IR Profit/Loss = Total Gain Loss - Accrued Interest – Accrued IR Profit/Loss – FX Gain/Loss

Where:

- IR Profit/Loss: Interest gain/loss due to price and reference rate changes.
- Total Gain Loss: Total gains and losses.
- Accrued Interest: Portion over the next coupon payment accrued from the last coupon until the calculation date.
- Accrued IR Profit/Loss: Portion over the reward/discount accrued from the beginning of the transaction until the calculation date.
- FX Gain/Loss: Gain/Loss due to the effects of foreign currency exchange differences.

(b) Non-priced securities (reference rate)

In regards to the purposes of compliance control, the change in the market value of those securities that do not have any reference prices, it will only have to reflect the straight-line accrual of the reward/discount over the life of the transaction.

The abovementioned, completely removes the effect in the measurement resulting from the changes in the rates (Libid or Libor) and the effect is similar to what it happens with the treatment of deposits.

The fair value of international reserve securities is classified per level as shown in note 11:

- Level 1, quoted market value
- Level 2, measurement with market price
- Level 3, measurement without reference to market price.

Note 4

Segment reporting

In order to meet its objectives, Central Bank of Chile has a number of operating functions and attributions related to the regulation of the money and credits in circulation, the regulation of the financial system and the capital market, the attributions to look after the stability of the financial system, the issuance of banknotes and coins, the functions as fiscal agent, the attributions on international matters and related to operations of international changes and statistic functions.

The Bank's primary function is the implementation of the monetary policy in Chile. Over 95% of the reserve assets of Central Bank of Chile are managed by the Bank's Financial Operations Division. Additional information on the composition of international reserve assets is presented in note 5.

Note 5

Financial instrument risks

The assets of Central Bank of Chile are mainly comprised of financial instruments from international reserves that are traded and kept in custody abroad such as bonds and government notes, bank deposits, among others. The liabilities are comprised of financial instruments related to the management of debt and open-market operations made by the Bank with institutions of the local market through the issuance of notes and time deposits received, among others.

(a) International reserves

International reserves are liquid assets in foreign currency held by Central Bank of Chile to support its monetary and exchange policies. They constitute one of the instruments that the Bank has in order to be able to meet the permanent objective of looking after the stability of the currency and normal functioning of domestic and foreign payments.

Consistent with the function of international reserves, as well as with its benefits and costs, the objective of its management aims

to provide efficiently a secure access to international liquidity and look after the financial equity of the Bank. To achieve this, it acts in conformity with the institutional framework set out in Section 38 of its Basic Constitutional Act, where it is explicitly empowered to manage, maintain and dispose of its international reserves.

a.i Investment policy and referential structure

The investment policy of international reserves considers liquid financial assets meeting the legal requirements established for its administration. It is designed based on its impact on the earnings and risks of the Bank's financial balance sheet and on the characteristics of the potential foreign currency liquidity

needs searching for the preservation of capital in case of possible market fluctuations.

International reserves are grouped in two main portfolios: the investment and liquidity portfolio.

The Investment Portfolio includes short- and long-term assets in foreign currency that are held to face unforeseen contingencies and long-term requirements. The referential structure of this portfolio considers 50% of U.S. dollars, 40% of euros, 3.5% of Australian dollars, 3.5% Canadian dollars and 3.0% of pounds sterling and an average maturity of 16.8 months.

CURRENCY STRUCTURE, PERIOD TERMS AND MATURITY OF THE REFERENTIAL PORTFOLIOS													
2010		USD		EUR		AUD		CAD		GBP		TOTAL	
		SHARE (%)	MATURITY (MONTHS)	SHARE (%)	MATURITY (MONTHS)	SHARE (%)	MATURITY (MONTHS)	SHARE (%)	MATURITY (MONTHS)	SHARE (%)	MATURITY (MONTHS)	SHARE (%)	MATURITY (MONTHS)
Short-term portfolio	Banking	5.0	1.5	4.0	1.5	0.3	1.5	0.3	1.5	0.3	1.5		
	Sovereign, Agency, Supranational	25.0	2.7	20.0	4.3	1.8	3.0	1.8	3.0	1.5	3.0		
	Subtotal (short term)	30.0	2.5	24.0	3.8	2.1	2.8	2.1	2.8	1.8	2.8	60.0	3.1
Long-term portfolio	Nominal bonds												
	Maturity tiers												
	1-3 years	9.3	22.3	7.5	21.4								
	3-5 years	4.0	45.2	3.2	42.7								
	5-7 years	1.7	64.8	1.3	60.0								
	7-10 years	1.7	87.0	1.3	85.0								
	1-10 years					1.4	45.4	1.4	44.0	1.2	53.8		
	Subtotal	16.7	38.5	13.3	36.7	1.4	45.4	1.4	44.0	1.2	53.8	34.0	38.9
Indexed bonds													
Maturity tier													
1-10 years	3.3	28.5	2.7	30.5									
Subtotal	3.3	28.5	2.7	30.5							6.0	29.4	
Subtotal (long term)	20.0	36.8	16.0	35.7	1.4	45.4	1.4	44.0	1.2	53.8	40.0	37.4	
Total portfolio	50.0	16.2	40.0	16.6	3.5	19.8	3.5	19.2	3.0	23.2	100.0	16.8	

CURRENCY STRUCTURE, PERIOD TERMS AND MATURITY OF THE REFERENTIAL PORTFOLIOS							
2009		USD		EURO		TOTAL	
		SHARE	MATURITY	SHARE	MATURITY	SHARE	MATURITY
		(%)	(MONTHS)	(%)	(MONTHS)	(%)	(MONTHS)
Short-term portfolio	Banking	12.00	3.0	8.00	3.0		
	Sovereign, Agency, Supranational	24.00	3.5	16.00	4.8	60	3.7
	Subtotal (short term)	36.00	3.3	24.00	4.2		
Long-term portfolio	Nominal bonds						
		1 – 3 years	11.42	22.4	7.62	21.3	
	Maturity tiers	3 – 5 years	4.90	46.8	3.26	42.8	
		5 – 7 years	2.04	64.3	1.36	63.6	
		7 – 10 years	2.04	84.8	1.36	84.5	
	Subtotal		20.40	38.7	13.60	37.0	
	Indexed bonds					40	36.5
Maturity tier	1 – 10 years	3.60	28.6	2.40	26.4		
Subtotal (long term)		3.60	28.6	2.40	26.4		
Total portfolio		60.00	16.9	40.00	16.7	100	16.8

BENCHMARK – 2010 INVESTMENT POLICY			
STRUCTURE	CREDIT RISK	CURRENT SHARE (%)	BENCHMARK
Short-term portfolio	Banking	10.0	Merrill Lynch indices: Libid at 3 months average last 3 months (USD, EUR, AUD, CAD and GBP)
	Sovereign, Agency and Supranational	50.0	Merrill Lynch indices: US Treasury Bills (USD) German Gov. Bill Index (EUR) Fixbis at 6 months average last 6 months (AUD, CAD and GBP)
Long-term portfolio	Sovereign, Agency, Supranational and Banking	34.0	JP Morgan bond indices for different tiers between 1-10 years in the U.S. and Germany. For Australia, Canada and United Kingdom, tier 1-10 global.
	Inflation indexed bonds	6.0	Barclays bond indices for tiers 1-10 in the U.S. and Europe.
	Total portfolio	100.0	

BENCHMARK – 2009 INVESTMENT POLICY		
STRUCTURE	CREDIT RISK	BENCHMARK (%)
Short-term portfolio	Banking risk Sovereign, Agency and y Supranational	Libid at 6 months average Merrill Lynch Government Bills Merrill Lynch
Long-term portfolio	Total return	
	1 – 3 years	56
	Maturity tiers 3 – 5 years	24
	for JP Morgan bonds 5 – 7 years	10
	7 – 10 years	10
	Total return	
	Maturity tiers Indexed bonds incepted by Barclays Capital	
	1 – 10 years	

The Liquidity Portfolio is intended to cover the forecasted requirements of funds in the short-term. The referential structure of this portfolio is matched in currencies and terms in respect to the forecasted disbursements. The referential structure of the currencies of the liquidity portfolio is defined according to the effective composition of the currencies and the forecasted disbursements and the deposits and withdrawals made by commercial or public sector banks.

a.ii Risk policy and management

The risk management policy defines a number of admissible deviations in respect of the referential structure in terms of maturity, periods, currency and limits over the different types of investment. This policy delimits liquidity, market and credit risks. The operational risk is controlled through the segregation of duties and responsibilities, the application of controls, and internal and external audit exercises over permanent and regular basis. The Departments of International Desk and International Treasury of the Management of International Investments are responsible for the investments and its enhancement, respectively,

while the Department of Management and Risk Evaluation which reports to the General Management measures the performance and risks and verifies the compliance with investment limits.

a.iii Management of liquidity risk

To reduce liquidity risk, a portfolio is structured comprising only short-term deposits in international commercial banks, with different due dates and by fixed income securities traded in secondary markets of high liquidity and depth.

a.iv Management of market risk

Market risk implies possible losses due to variations in the price of investments. The investment policy limits the market risk arising from variations on interest rates and parities by establishing maturity and composition margins of currencies around referential parameters of the portfolios and through the diversification of currencies, securities and investment periods. Market risk is monitored through the daily measurement of the maturity and composition of currencies, and by the follow-up of VaR and Tracking Error. The international reserve management

monthly report, prepared by the Department of Management and Risk Evaluation, includes the measurements of performance and risk in an absolute manner and as compared to a benchmark, and presents an evaluation of the implemented investment strategy.

a.v Management of credit risk

The policies on credit risk refer, on one hand, to the level of diversification allowed among the types of risk, and on the other,

to the standards setting the transactions that can be performed by the Bank and the way to perform them. The current policy defines the securities, issuers and counterparties, among other eligible, over which international reserves can be invested. The table below shows that the sovereign, supranational and agency risks are concentrated in risk rating category AAA, while the securities issued by bank institutions are concentrated in the AA- category.

COMPOSITION OF INTERNATIONAL RESERVES AS PER CREDIT RISK (1) (2) (3)
(percentage as of December 31, 2010)

CREDIT RISK	CREDIT RATING						TOTAL
	AAA	AA+	AA	AA-	A+	A	
Agency	10.2	0.0	0.0	0.0	0.0	0.0	10.2
Banking	0.1	0.0	2.7	6.3	2.4	2.4	13.9
Sovereign	65.2	4.4	0.0	1.8	0.1	0.0	71.5
Supranational	4.4	0.0	0.0	0.0	0.0	0.0	4.4
Total	79.9	4.4	2.7	8.1	2.5	2.4	100.0

(1) Banking risk is related to the investment in bank financial instruments (deposits, arbitrations and future arbitrations, secured bonds from public institutions issued by German banks). Sovereign risk consists of the investment in securities from sovereign states (deposits, bills, floating rate notes, nominal and indexed bonds).

Agency risk is related to the investment in securities from U.S., French and German government agencies (bills, nominal bonds, mortgage-backed securities).

Supranational risk is related to the investment in multilateral official issuer securities (deposits, bills, floating rate notes and nominal bonds).

(2) Credit rating corresponds to the average of the ratings obtained from the agencies Fitch, Moody's and Standard and Poor's.

(3) Excludes investments in portfolios of external administrators and liquidity, gold possessions and positions in IMF.

COMPOSITION OF INTERNATIONAL RESERVES AS PER CREDIT RISK (1) (2) (3) (percentage as of December 31, 2009)

CREDIT RISK	CREDIT RATING							TOTAL
	AAA	AA+	AA	AA-	A+	A	BBB+(4)	
Agency	2.2	0.0	0.0	0.0	0.0	0.0	0.0	2.2
Banking	0.6	0.0	1.9	11.3	4.4	4.6	0.0	22.8
Sovereign	64.5	1.0	4.2	2.4	0.0	0.0	0.6	72.7
Supranational	2.3	0.0	0.0	0.0	0.0	0.0	0.0	2.3
Total	69.6	1.0	6.1	13.7	4.4	4.6	0.6	100.0

(1) Banking risk is related to the investment in bank financial instruments (deposits, arbitrations and future arbitrations, secured bonds from public institutions issued by German banks).

Sovereign risk consists of the investment in securities from sovereign states (deposits, bills, floating rate notes, nominal and indexed bonds).

Agency risk is related to the investment in securities from U.S. government agencies (bills, nominal bonds, mortgage-backed securities).

Supranational risk is related to the investment in multilateral official issuer securities (deposits, bills, floating rate notes and nominal bonds).

(2) Credit rating corresponds to the average of the ratings obtained from the agencies Fitch, Moody's and Standard and Poor's.

(3) Excludes investments in portfolios of external administrators and liquidity, gold possessions and positions in IMF.

(4) On 16 December 2009, the average classification of Greece went down from A- to BBB+, thus becoming a counterparty not eligible for investments by the international reserves of Central Bank of Chile as it has a credit rating below the one requested.

Credit risk implies possible losses due to the noncompliance with financial operations by the issuers and/or counterparties of the Bank.

The investment policy limits the exposures to credit risk of countries, counterparties and issuers, setting amounts and maximum investment maturities that rely on risk ratings reported by rating agencies Moody's, Standard & Poor's and Fitch, and of other criteria such as equity and debt, among others. Similar with market risk, the Department of Management and Risk Evaluation monitors the credit risk on a daily basis by measuring the exposures to different countries, counterparties and issuers and updating regularly risk ratings and other criteria that determine the limits and investment margins.

a.vi Settlement of operations

The Department of International Treasury is in charge of this process and corresponds to the stage at which the transactions of

financial instruments are executed. They also provide instructions for the transfer of funds from and to other checking accounts of Central Bank of Chile hold abroad.

a.vii Compliance control

The compliance control function is carried out by the Department of Management and Risk Evaluation and consists of verifying the compliance with the limits established in the investment policy. The aspects monitored include: composition of currencies, duration and exposure to credit risk, among others.

a.viii Custody of securities

The Bank operates with the custodians of the following institutions that qualify in accordance with the policies established by the Board of: JP Morgan Chase, State Street Bank and Bank for International Settlement (BIS).

a.ix External administrators

During 2010, the Bank has three external administrators to manage international reserves: BlackRock Securities (BlackRock), Pimco and Wellington Management Company (Wellington). Their purpose is to add value to the foreign portfolio, obtain knowledge transfer and technology and constitute an active comparison benchmark for the Bank's portfolio.

On 30 November, 2010, the Board decided to modify the external administration program and to end existing relationships with Wellington and BlackRock, keeping Pimco. Also, the Board decided to perform a new process for selecting an external administrator to replace Wellington. Such process shall be performed in accordance with standards regularly used by the Central Bank of Chile for this purpose. The financial institution JP Morgan Chase, was engaged to perform financial risk monitoring of the outsourced portfolio and compliance control functions.

(b) Open-market operations

Central Bank of Chile implements its monetary policy through the definition of an objective level for the nominal inter-bank interest rate, known as the Monetary Policy Rate (*Tasa de Política Monetaria, TPM* in Spanish). In order for the inter-bank rate to be determined at this level, Central Bank of Chile must regulate the liquidity (or reserves) of the financial system through the use of several instruments: open-market operations, permanent liquidity and deposit facilities. Cash positions over time deposits are also included in the tools of the Bank, although Central Bank of Chile does not use them as an active instrument of monetary policy. Open-market operations are mainly performed through periodical biddings of promissory notes issued by Central Bank of Chile, forward purchase and sale contracts for promissory notes and bonds, purchases of debt securities from banks with agreements to resale (Repo), liquidity deposits and foreign currency swaps. In these biddings or auctions the following institutions can participate: banks and financial institutions, pension fund administrators, insurance companies, mutual funds, brokers and security agents, which operate through the Open-market Operation System (*Soma* in Spanish).

The injection of liquidity is generally performed through purchases of overnight repurchase agreements (Repo). In the opposite situation, where there is excess of liquidity and the inter-bank rate falls below the objective rate, the transitory excess is withdrawn through the opening of the liquidity deposit window. Other instruments used by Central Bank of Chile correspond to the line of credit for liquidity in local currency for secured banks and to the line of credit for liquidity used in special situations.

In order to adequately regulate the liquidity of the financial system, Central Bank of Chile prepares a cash program detailing the cash position requirement covering the period of measurement.

b.i Management of credit risk

To reduce the risk of open-market operations performed by Central Bank of Chile with financial institutions, there is a payment system called Real Time Gross Settlement System (*Sistema de Liquidación Bruta en Tiempo Real - LBTR* in Spanish), which eliminates the risk of settlement, when processing the payments only to the extent that there are sufficient funds in the corresponding account, placing them in a waiting queue in case of any insufficiency of funds. Additionally, open-market operations are performed under the principles of delivery versus payment (DVP), eliminating the main risk. When financial institutions do not have sufficient funds, Central Bank of Chile maintains an inter-day credit facility, through which banks can apply for inter-day credits without interests in exchange of the delivery of collaterals, such as debt securities issued by Central Bank of Chile, letters of credit and time deposits, which can be converted into a permanent liquidity option that bears interests.

b.ii Management of operational risk

The management of operational risk is a key activity in the Bank, which is controlled through the identification of operational risk scenarios and their impact on resources and support for each activity seen as critical, including the definition of recovery activities. Additionally, there are contingency plans to provide operational continuity to the services that have an impact on the *LBTR* and *Soma* systems, which are tested on a regular basis.

Note 6

Changes in accounting policies

As stated in the Bank's Basic Constitutional Act, title VI, the Board shall, with a prior favorable report from the Superintendence of Banks and Financial Institutions, issue the regulations containing the requirements and general conditions to which the financial statements of the Bank shall conform, to be prepared for periods of one year ending on 31 December of each year.

Through Resolution 1519-01, dated 14 January 2010, the Board approved new policies for the presentation and preparation of the Bank's financial statements, which have also been approved by ordinary office 5100 of 28 December, 2009 of the Superintendence of Banks and Financial Institutions pursuant to Section 75 of the Bank's Basic Constitutional Act which states that starting in 2010, price-level adjustment will no longer be included in the Balance sheet or Statement of Income, but will be reflected in memorandum accounts as described in note 2(e).

The Board, in accordance with Resolution 1456-01 dated 15 January, 2009 and upon the favorable report of the Superintendence of Banks and Financial Institutions, approved the "Policies for the presentation and preparation of financial reports of the Central Bank of Chile". These policies consider the adoption of IFRS during 2010 and 2009 in everything in which the application of these international accounting standards does not affect legal specific provisions that govern the Bank or the compliance of its public duties. Should there be any disagreement, the standards issued by the Board of the Bank shall prevail.

Note 7

Net income for international reserves

For the years ended 31 December, 2010 and 2009, this caption is composed of the following:

	(Ch\$ MILLION)	
	2010	2009
(a) Net interests and commissions on:		
Securities at fair value with effect on income	133,278.7	162,636.0
Held-to-maturity securities	21,548.6	49,215.0
Available-for-sale securities	1,234.3	443.6
Foreign correspondents	96.0	2.3
Subtotal for net interests and commissions	<u>156,157.6</u>	<u>212,296.9</u>
(b) Sales of securities:		
At fair value with effect on income	58,672.5	132,608.6
Available-for-sale	6,626.5	4,437.9
Subtotal for sales of securities	<u>65,299.0</u>	<u>137,046.5</u>
(c) (Loss) on adjustments at fair value	(10,940.5)	(119,049.0)
(d) On other income	<u>2,074.7</u>	<u>1,441.3</u>
Total income for international reserves	<u>212,590.8</u>	<u>231,735.7</u>

Note 8

Net income for domestic operations

For the years ended 31 December, 2010 and 2009, this caption is composed of the following:

	(Ch\$ MILLION)	
	2010	2009
(a) Income for domestic loan		
Interests	8,589.9	16,366.0
Adjustments	50.1	(84.0)
Other	<u>3,114.7</u>	<u>2,248.3</u>
Total income for domestic loan	<u>11,754.7</u>	<u>18,530.3</u>
(b) Income for operations under specific legal regulations		
Interests	86,378.0	66,733.7
Adjustments	<u>32,186.1</u>	<u>(34,249.2)</u>
Total income for operations under specific legal regulations	<u>118,564.1</u>	<u>32,484.5</u>
(c) Income for deposits and obligations held by Central Bank of Chile		
Interests	(26,261.5)	(24,929.2)
Other	<u>1,340.4</u>	<u>31,165.2</u>
Total income for deposits and obligations held by Central Bank of Chile	<u>(24,921.1)</u>	<u>6,236.0</u>
(d) Income for documents issued by Central Bank of Chile		
Interests	(380,524.2)	(416,561.0)
Adjustments	<u>(126,202.2)</u>	<u>174,363.2</u>
Total income for documents issued by Central Bank of Chile	<u>(506,726.4)</u>	<u>(242,197.8)</u>
Total net income for domestic operations	<u>(401,328.7)</u>	<u>(184,947.0)</u>

Note 9

Net Gain (Loss) on Foreign Exchange Operations

For the years ended 31 December, 2010 and 2009, this caption is composed of the following:

	(Ch\$ MILLION)	
	2010	2009
Gain on foreign exchange operations	143,084.7	71,532.7
Loss on foreign exchange operations	<u>(1,354,708.2)</u>	<u>(2,847,689.3)</u>
Total	<u>(1,211,623.5)</u>	<u>(2,776,156.6)</u>

Net gain (loss) on foreign exchange operations for each year ended, resulting mainly from the effect of exchange rate differences on foreign currency assets, as follows:

	(Ch\$ MILLION)	
	2010	2009
U.S. dollar	(449,265.4)	(1,762,331.2)
Euro	(706,723.9)	(1,014,662.1)
DEG	(14,844.5)	(27,862.6)
Pound sterling	(32,694.9)	328.8
Other currency	<u>(4,589.9)</u>	<u>(17,163.3)</u>
Subtotal net loss on foreign exchange operations	(1,208,118.6)	(2,821,690.4)
Arbitrage and other	<u>(3,504.9)</u>	<u>45,533.8</u>
Total net loss on foreign exchange operations	<u>(1,211,623.5)</u>	<u>(2,776,156.6)</u>

Note 10

Issuance and distribution costs

For the years ended 31 December, 2010 and 2009, this caption is composed of the following:

(Ch\$ MILLION)		
	2010	2009
Banknotes	(26,016.2)	(10,019.5)
Coins	(20,010.1)	(17,902.2)
Distribution	(1,038.9)	(557.1)
Totals	(47,065.2)	(28,478.8)

The increase in currency issuance and distribution costs during 2010 is due to the continuance of the new "family of banknotes" program started in 2009. The detail of banknotes is provided in note 17(a).

Note 11

Reserve assets

This caption includes international reserves held by Central Bank of Chile and is detailed as follows:

(US\$ MILLION)		
	2010	2009
Monetary gold	11.2	8.8
Special drawing rights (SDR)	1,217.3	1,143.4
Reserve position in the IMF	282.1	286.1
Correspondent banks abroad	56.6	19.1
Investments in foreign currency:	26,260.2	23,829.9
Instruments at fair value with effect on net income	18,095.3	13,931.3
Level 1 market value	18,095.3	13,604.8
Level 2 measurement with market price	-	326.5
Level 3 measurement without reference to market price	-	-
Available-for-sale securities	2,233.3	3,695.1
Level 1 market value	-	352.1
Level 2 measurement with market price	-	-
Level 3 measurement without reference to market price	2,233.3	3,343.0
Held-to-maturity securities	5,931.6	6,203.5
Reciprocal loan agreements	35.3	84.9
Other assets	1.0	0.3
Total reserve assets	27,863.7	25,372.5

As of 31 December, 2010, monetary gold amounted to US\$11.2 million (US\$8.8 million in 2009) equivalent to 7,940 fine gold troy ounces valued at US\$1,413 per ounce (US\$1,106 in 2009). There was no change in the amount of troy ounces compared to 2009.

Special drawing rights (SDR) correspond to reserve assets, equivalent to foreign currencies, assigned by the International Monetary Fund (IMF) to the member countries proportionally to the installment paid and valued in Chilean pesos considering the current parity reported by the International Monetary Fund.

Reciprocal Loan Agreements (debits) represent the amount payable to Central Bank of Chile from the central banks comprising Aladi's Agreements on Reciprocal Payments and Credits for the exports performed. Its classification corresponds to non derivative held-to-maturity securities, valued at amortized cost at effective rate.

The increase observed in reserve assets for the year ended 31 December, 2010 in the amount of US\$2,491.2 million, compared to 2009, is mainly explained by an increase in fair value securities of US\$4,490.5 million, offset by a decrease of US\$1,461.8 million in available-for-sale securities and US\$271.9 million in held-to-maturity securities.

Investments in foreign currencies at each year-end are detailed as follows:

(US\$ MILLION)		
	2010	2009
U.S. dollar	14,510.3	14,969.1
Euro	9,289.4	8,735.1
Other currencies	4,064.0	1,668.3
Total	27,863.7	25,372.5

Note 12

Reserve Position in the International Monetary Fund (IMF)

The reserve position balance in the IMF at each year-end is detailed as follows:

(Ch\$ MILLION)		
	2010	2009
Subscription installment, contribution	617,510.3	677,208.8
Loan, account No.1	61.4	44.3
Deposits	(485,433.4)	(532,361.6)
Total position in the IMF	132,138.3	144,891.5

Note 13

Loans to banks and financial institutions

This caption includes the following operations, which are defined as non-derivative financial instruments held-to-maturity, valued at amortized cost through the effective rate:

(Ch\$ MILLION)		
	2010	2009
Secured liquidity line of credit	-	64,765.2
Line of credit on debt restructuring	1,770.4	2,667.9
Central Bank repurchase agreements (Repo)	-	3,292,152.2
Total	1,770.4	3,359,585.3

At the end of the 2010, the line of credit had no balance. While the secured liquidity line of credit was in use during 2010, the interest rate was 0.50% (0.96% in 2009). The average discount rate for Central Bank repurchase agreements (Repo) was 0.83% in 2010 (1.69% in 2009).

Note 14

Operations under specific legal regulations

This caption mainly includes the following operations from specific laws that are defined as non-derivative financial instruments held-to-maturity, valued at amortized cost recognized in net income through the effective rate and which have not been subject to any impairment tests.

(a) Accounts Receivable from *Corporación de Fomento de la Producción (Corfo)*

Balances receivable from *Corfo*, in accordance with Law 18,401 dated 1985 and its modifications, and Law 18,577 dated 1986, relate to loans granted to financial institutions that were sold by Central Bank of Chile to *Corfo* in order to finance the acquisition, on behalf of third parties, of shares of these financial institutions.

Corfo amortized its debt by transferring securities that it recovered from shareholders, by transferring shares back to the corresponding financial institutions.

In accordance with Article 13 of Law 18,401, differences produced in the recovery, as a result of discounts granted to shareholders of up to UF15 million, will be covered by the General Treasury through future taxes which as of 31 December, 2010 amount to Ch\$244,249.6 million, equivalent to approximately UF11.4 million (Ch\$238,413.4 million in 2009, equivalent to UF11.4 million). Based on the available information, the maximum transfer amount established by law is deemed adequate to absorb the discounts.

In conformity with this law, General Treasury transfers will be completed in a period not exceeding 30 years, with a 10-year grace period, beginning on the date of final determination of the total amount. During 2010, the Bank requested the payment of the tax transfer referred to in Article 13 of Law 18,401, under the terms of the procedure established

to obtain it. Executive Decree 1526 of the Ministry of Finance, dated 14 December, 2010, established the form and timeliness in which the total amount of UF11,383,983.4695 will be completed for that General Treasury transfer.

In the case of former *Banco de Santiago*, currently *Banco Santander Chile*, there is a difference not covered by the mentioned tax guarantee of UF48,419.2617 at 31 December, 2010, equivalent to Ch\$1,038.7 million; this difference has been reclassified to Other securities within Other assets. As of the date of approval of these financial statements this situation has been resolved at the Bank's full satisfaction. As of 31 December, 2009 the balance receivable from *Corfo* amounted to Ch\$1,031.6 million.

(b) *Caja Central de Ahorros y Préstamos and Asociación Nacional de Ahorro y Préstamo*

In accordance with Law 18,900 dated 16 January, 1990, *Caja Central de Ahorros y Préstamos* (CCAP) and *Asociación Nacional de Ahorro y Préstamo* (*Anap*) ceased to exist and a procedure was established through which the respective equity would be liquidated and used to pay shareholders and the obligations of the institutions.

Article 3 of the law establishes that *Caja Central de Ahorros y Préstamos* shall cease its operations and with consideration of existing commitment, whether it has settled the liquidations required by the law or not, and shall include an inventory of all its rights, obligations and equity and those of the *Asociación de Ahorro y Préstamo*. This account will be submitted to the review of the President of the Republic through the Ministry of Finance. This Article also stipulates the President of the Republic will approve such account through executive decree issued by the Ministry of Finance published in the *Official Gazette*.

Article 5 of the aforementioned law establishes that the General Treasury shall be responsible for any obligations of the CCAP and the *Anap* that are not covered upon liquidating shareholders' equity, the funds for which should be requested from the national budget, in conformity with Article 21 of Decree Law 1263 dated 1975.

This loan arises from the grant of refinancing credit lines by Central Bank of Chile to the *Sinap* which had express legal recognition prior to the *Sinap* liquidation set out by Law 18,900 and as included in the operations as of the closing of business on the day before the Bank's Basic Constitutional Act was enforced, as established in the transitory Section 2 of the law. Consequently, such operations are the opening capital of Central Bank of Chile referred to in Article 5 of such law. The Board has determined to continue applying the accounting treatment this asset had at the date of its initial recognition, as these operations arise from legal specific provisions.

As of 31 December, 2010, the amount payable to the Bank from the liquidation of these institutions, including accrued interest as of such date, was Ch\$749,345.0 million (this amount includes interest accrued for Ch\$483,347.6 million to that date), of which Ch\$688,839.1 million relate to direct loans granted by the Bank and Ch\$60,505.9 million with credit lines for international organizations programs (Ch\$696,385.9 million in 2009, of which Ch\$640,398.0 million relate to direct credits granted by Central Bank of Chile and Ch\$55,987.9 million to credit lines for international bodies programs).

The recovery of such amounts depends on the determination of a specific date for the payment of that loan, from the General Treasury of the Bank. For this reason it is not possible to determine the specific date or other conditions on which such payment will be made.

(c) General Treasury transfers

"General Treasury transfers" included within Operations under specific legal regulations, are the following:

	(Ch\$ MILLION)	
	2010	2009
General Treasury transfer Law 18,401	244,249.6	238,413.4

The balance of this account relates to discounts provided to the purchases of the shares of up to UF15 million, as indicated in Article 13 of Law 18,401.

(d) Loan for subordinated liability

The balances as of each year-end represent a subordinated liability of *Banco de Chile* with Central Bank of Chile as established in the agreement amending payment terms dated 8 November, 1996, in accordance with the provisions of Law 19,396.

On that date, the parent company *Sociedad Matriz del Banco de Chile*, previously referred to as *Banco de Chile*, agreed to transfer the liability to SAOS S.A. (*Sociedad Administradora de la Obligación Subordinada*), based on paragraphs three and five of the aforementioned law. Consequently, the liability must be paid in 40 annual, consecutive and equal installments beginning in April 1997.

During 2010 *Sociedad Administradora de la Obligación Subordinada* SAOS S.A. paid UF4,848,537.3713 to Central Bank of Chile, of which UF2,140,215.0172 were allocated to the payment of interests of the debt and UF2,708,322.3541 to the credit amortization for subordinated liability (in 2009 UF4,678,656.6013, of which UF2,262,691.0487 corresponded to interest and UF2,415,965.5526 to amortization).

As of 31 December, 2010 the balance amounts to Ch\$876,663.7 million (Ch\$914,374.2 million in 2009).

Note 15

Premises and equipment

For the years ended 31 December, 2010 and 2009, this caption is composed of the following:

(Ch\$ MILLION)					
	BALANCES AS				BALANCES AS
	OF 31 DEC.09	ACQUISITIONS	DISPOSALS	DEPRECIATION	OF 31. DEC.10
Real estate and facilities	34,262.9	193.1	(16.8)	(324.2)	34,115.0
Furniture and equipment	5,597.2	2,022.7	(167.2)	(1.135.8)	6,316.9
Transport material	188.6	70.9	(5.5)	(18.5)	235.5
Collection of banknotes and coins	2,690.8	409.7 (*)	-	-	3,100.5
Works of art	1,652.0	-	-	-	1,652.0
Other	13.4	-	-	-	13.4
Premises and equipment, net	44,404.9	2,696.4	(189.5)	(1,478.5)	45,433.3

(*) This figure includes Ch\$409.5 million due to variations in foreign currency exchange of gold pesos.

As of 31 December, 2010 and 2009, the caption depreciation and amortization include Ch\$1,478.5 million and Ch\$2,067.5 million, respectively.

Note 16

Foreign liabilities

This caption includes the following operations

(Ch\$ MILLION)		
	2010	2009
Reciprocal loan agreements	1,342.4	1,865.9
Accounts with international bodies	68,025.0	73,138.8
Special drawing rights (SDR) allocations	<u>589,583.1</u>	<u>646,456.6</u>
Total foreign liabilities	658,950.5	721,461.3

Reciprocal Loan Agreements (credits) represent the amount owed by Central Bank of Chile to the central banks comprising Aladi's Agreements on Reciprocal Payments and Credits for the imports performed. Its classification corresponds to non derivative held-to-maturity securities, valued at amortized cost at effective rate.

Accounts with international bodies correspond to resources held in local currency by such organizations for its drawing and to obligations of Central Bank of Chile acting as a fiscal agent, with IDB, for promissory notes subscribed in foreign currency in payment of the subscription of shares and capital increases. They do not bear interests, but they do maintain value for the variations of SDR (IMF) and U.S. dollar by other agencies.

This caption is composed of the following:

	(Ch\$ MILLION)	
	2010	2009
Promissory note obligations with IDB	40,197.6	45,574.5
International Bank for Reconstruction and Development (IBRD)	20,933.2	20,921.5
Inter-American Development Bank (IDB)	5,960.2	5,708.7
International Development Association (AID)	901.1	901.1
Multilateral Investment Guarantee Agency (MIGA)	<u>32.9</u>	<u>33.0</u>
Total accounts with international organizations	68,025.0	73,138.8

During 2010, the Bank recorded in amortization Ch\$2,080.6 million of the promissory note liability with IDB, which was financed by the General Treasury in accordance with Section 38 N°.2 of the Bank's Basic Constitutional Act, affecting the Bank's equity in conformity with the provisions of Article 3 of Decree Law 2943 dated 1979; this debt also decreased by Ch\$3,266.5 million due to a decrease in the exchange rate for the U.S. dollar. See note 21.

The assignments of Special Drawing Rights (SDRs) correspond to SDR816,891,579 assigned to Chile through Central Bank of Chile, by the International Monetary Fund, which are subject to possible restitution; they accrue interests based on a rate determined by the IMF on a weekly basis.

Note 17

Monetary base

This caption is composed of the following:

	(Ch\$ MILLION)	
	2010	2009
Banknotes and coins in circulation	4,748,482.9	4,189,634.9
Deposits from financial institutions	<u>776,523.7</u>	<u>392,568.7</u>
Total monetary base	5,525,006.6	4,582,203.6

(a) Banknotes and coins in circulation

Includes the amount of banknotes and coins of legal tender issued by Central Bank of Chile held by third parties, resulting from the total banknotes and coins received from our suppliers and recorded as liabilities at their face value, less the banknotes and coins that are in the Cash of Central Bank of Chile and in its vault.

Banknotes and coins in circulation are recorded at face value. The costs of printing and coining are recorded as expense in the caption Issuance and distribution costs.

The distribution of banknotes and coins in circulation as of 31 December of each year is as follows:

DENOMINATION	(Ch\$ MILLION)	
	2010	2009
\$ 20,000	1,211,001.5	1,027,388.4
\$ 10,000	2,701,214.3	2,391,585.3
\$ 5,000	368,395.6	341,895.3
\$ 2,000	94,220.7	95,311.3
\$ 1,000	139,732.3	129,139.7
\$ 500	4,760.4	4,772.5
Other	251.4	251.4
Coins	<u>228,906.7</u>	<u>199,291.0</u>
Total	4,748,482.9	4,189,634.9

(b) Deposits from financial institutions

Deposits from financial institutions reflect the movements in drafts and deposits in local currency resulting from the operations performed by financial institutions with Central Bank of Chile. Their balance represents the funds or resources in favor of financial institutions and is useful for the constitution of cash positions.

Note 18**Deposits and obligations**

Deposits and obligations correspond to financial liabilities, classified as held to maturity for deposits held in Central Bank of Chile, by the General Treasury, as well as by financial institutions and are composed of the following:

	(Ch\$ MILLION)	
	2010	2009
Deposits and obligations with the General Treasury	377,333.2	302,719.7
Other deposits and obligations	<u>3,048,527.4</u>	<u>2,999,551.0</u>
Total	<u>3,425,860.6</u>	<u>3,302,270.7</u>

(a) "Deposits and obligations with the General Treasury" include:

	(Ch\$ MILLION)	
	2010	2009
General Treasury current accounts	129,833.1	143,526.8
Other	<u>247,500.1</u>	<u>159,192.9</u>
Total	<u>377,333.2</u>	<u>302,719.7</u>

(b) Other Deposits and Obligations" include:

	(Ch\$ MILLION)	
	2010	2009
Liquidity deposits of financial institutions	1,913,500.0	2,743,819.1
Current accounts in foreign currency	422,761.8	247,577.0
Other	<u>712,265.6</u>	<u>8,154.9</u>
Total	<u>3,048,527.4</u>	<u>2,999,551.0</u>

Note 19**Documents issued by Central Bank of Chile**

The issuance of documents of Central Bank of Chile constitutes the main supporting element for the implementation of the monetary policy in order to provide liquidity to the market in an efficient manner. These financial liabilities are classified as held to maturity and are valued at amortized cost through the effective interest method.

Maturities of these instruments as of 31 December, 2010 and 2009 are as follows:

(Ch\$ MILLION)							
	UP TO 90 DAYS	91 TO 180 DAYS	181 DAYS TO 1 YEAR	OVER 1 YEAR TO 3 YEARS	OVER 3 YEARS	TOTAL 2010	TOTAL 2009
Central Bank bonds in UF (BCU)	-	-	221,362.1	2,063,043.4	1,817,878.7	4,102,284.2	4,782,123.6
Central Bank bonds in Chilean pesos (BCP)	-	66,922.7	178,013.8	953,161.8	1,131,597.7	2,329,696.0	1,939,862.4
Central Bank discountable promissory notes (PDBC)	1,191,812.0	225,278.8	248,320.0	-	-	1,665,410.8	3,603,398.4
Indexed promissory notes payable in coupons (PRC)	9,977.2	10,487.8	20,286.7	107,627.0	251,150.3	399,529.0	773,201.1
Optional Indexed coupons (CERO) in UF	36,265.3	33,282.9	63,877.2	135,746.8	149,584.6	418,756.8	480,565.2
Other	21.1	-	-	-	-	21.1	21.1
Total as of 31 December	1,238,075.6	335,972.2	731,859.8	3,259,579.0	3,350,211.3	8,915,697.9	11,579,171.8

Balances include interest and adjustments accrued as of 31 December, 2010 and 2009.

As of 31 December, 2010, the decrease of Ch\$2,663,473.9 million in these liabilities compared to 2009, is explained mainly by a decrease in the issuance of PDBC by Ch\$1,937,987.6 million, BCU by Ch\$679,839.4 million and PRC by Ch\$373,672.1 million, offset by an increase in the issuance of BCP by Ch\$389,833.6 million.

The decrease of PDBC is due to the monetary policy implemented in late 2009, which consisted in an injection of liquidity to the market through term liquidity facilities; likewise and in order to drain this liquidity, a higher number of PDBC was issued that year. During 2010 and due to a change in the policy, term liquidity facilities were no longer used and, therefore, it was not necessary to continue issuing these notes.

The decrease in BCU and PRC in 2010 is due to maturities that have not been renewed. The debt structure for 2010 considered only the issuance of BCP, due to the maturity of BCP, BCU and PRC to be performed during 2010 were renewed only for new issuances of BCP.

Note 20 Other liability accounts

This caption is composed of the following:

(Ch\$ MILLION)		
	2010	2009
Provisions	14,394.3	13,737.7
Other securities	275.2	451.7
Repurchase agreements	-	373,003.7
Total	14,669.5	387,193.1

(a) Provisions

Central Bank of Chile has recorded provisions for severance indemnity, a benefit established in the Collective Labor Agreement in force for the period 2007-2011 accounted for in accordance with the actuarial method of projected cost. At the same time, the benefits granted to the former Association of Retired Employees and Beneficiaries of Pensions of Public Officials of Central Bank of Chile and healthcare benefits for retirement plans are also included and detailed as follows:

	(Ch\$ MILLION)	
	2010	2009
Balance at the beginning of the year	12,328.0	11,795.2
Provision for the year:		
- Severance indemnity	327.9	103.5
-Special indemnity Resolution 1414-01-080605 and agreed deposit for retirement plan	1,404.5	-
- Benefits to the former Association of Retired Employees and Beneficiaries of Pensions of Public Officials of Central Bank of Chile	(1,244.4)	420.0
- Healthcare benefits for retirement plans	(1.9)	9.3
Post-employment benefit provision balance	12,814.1	12,328.0
Pending accrued vacations of personnel	1,576.6	1,405.3
Special indemnity Resolution 572-05-961226	3.6	4.4
Balance at the end of the year	14,394.3	13,737.7

(b) Other securities

This item corresponds mainly to insignificant amounts related to the Bank's Country Club and Seaside Resort operations.

(c) Foreign Currency Repurchase Agreement

At 31 December, 2010 there were no balances in this caption. As of 31 December, 2009, Central Bank of Chile maintained the rights to repurchase US\$745.0 million, as it has been established in Chapter IV D 1.2 of the *Compendium of Financial Regulations*, equivalent to Ch\$377,290.4 million. The obligation of Ch\$373,003.7 million in 2009 arising from these operations is shown in liabilities. The abovementioned values are shown under "Repurchase agreements", in assets as well as in liabilities. At the end of 2009, these contracts were valued according to the U.S. observed dollar exchange rate. They are settled using the agreed exchange rate at liquidation.

Note 21

Capital and reserves

(a) Capital and reserves

Changes in capital and reserves during 2010 and 2009 were as follows:

	(Ch\$ MILLION)			
	CAPITAL	VALUATION ACCOUNTS	NET INCOME (LOSS)	TOTAL
Balances as of 1 January, 2009	(1,919,905.7)	-	2,742,253.8	822,348.1
Distribution of 2008 surplus	2,742,253.8	-	(2,742,253.8)	-
Price-level adjustment	(18,914.0)	-	-	(18,914.0)
Valuation accounts	-	3,126.8	-	3,126.8
Deficit for the year	-	-	(2,766,773.9)	(2,766,773.9)
Balances as of 31 December, 2009	<u>803,434.1</u>	<u>3,126.8</u>	<u>(2,766,773.9)</u>	<u>(1,960,213.0)</u>
Balances as of 1 January, 2010	803,434.1	3,126.8	(2,766,773.9)	(1,960,213.0)
Deficit distribution as of 2009	(2,766,773.9)	-	2,766,773.9	-
Capital increase (*)	2,080.6	-	-	2,080.6
Valuation accounts	-	(1,766.4)	-	(1,766.4)
Deficit for the year	-	-	(1,489,242.2)	(1,489,242.2)
Balances as of 31 December, 2010	<u>(1,961,259.2)</u>	<u>1,360.4</u>	<u>(1,489,242.2)</u>	<u>(3,449,141.0)</u>

(*) During 2010, the General Treasury granted the Bank Ch\$2,080.6 million to pay liabilities with IDB which are recorded in the Bank's records as the Fiscal Agent in accordance with the Ordinary Official Letter 1405 dated 27 August, 2010. Recognition of this balance implied recording a capital increase in the same amount. See note 16.

Section 5 of the Basic Constitutional Act of Central Bank of Chile established a paid-in capital for the Bank at Ch\$500,000 million, which at 31 December, 2010 corresponds to Ch\$1,984,546.2 million adjusted to the Consumer Price Index as of that date, which has to be paid according to transitory Section 2 of the Basic Constitutional Act.

In accordance with Section 77 of the Basic Constitutional Act of Central Bank of Chile, the deficit produced in any year will be absorbed with a debit to constituted reserves.

When there are no reserves or they are insufficient, the deficit produced in any period will be absorbed with a debit to paid-in capital.

As of 31 December, 2010, the Bank presents a negative equity of Ch\$3,449,141.0 million (negative equity of Ch\$1,960,213.0 million as of December 31, 2009), which is mainly originated from the decrease in exchange rate variations of assets in foreign currencies.

Article 11 of Law 20,128 published in the *Official Gazette* dated 30 September, 2006 stated that the General Treasury may make capital contributions to the Bank through the Ministry of Finance, under the conditions established in such law. During 2010 and 2009, the General Treasury did not make any contributions to the Bank equity in relation to this Law.

(b) Price-level adjusted capital

The Board decided no longer to apply comprehensive price-level adjustment to financial statements beginning in 2010, and therefore price-level adjustment on capital is no longer presented in the Balance sheet nor in the Statement of Income, however in order to comply the provisions of Article 5 of the Basic Constitutional Act of Central Bank of Chile, paragraph 2, which states "The capital may be increased by decision of the majority of the Board Members, through capitalization of reserves and adjusted by means of price-level adjustment", as well as stated in Title VI of the same legislation, regarding the distribution of the Bank's surpluses included in Section 77, and the payment of the initial capital referred to in transitory Section 2. Once the initial capital, properly adjusted as stated in the terms of Section 5 is paid, the resulting surplus for each year, will be determined and calculated for the purposes of surplus distribution to the General Treasury as contained in Section 77, considering the annual adjustment to the equity recorded in order accounts.

As of 31 December, 2010 the negative capital price level-adjustment recognized in order accounts amounted to Ch\$ (49,083.5) million, and the adjusted capital amounted to Ch\$ (2,010,342.7) million.

	CAPITAL AS OF 31. DEC. 2010	PRICE-LEVEL ADJUSTMENT IN ORDER ACCOUNTS	PRICE-LEVEL ADJUSTED TOTAL CAPITAL AS OF 31. DEC. 2010
Balances as of 31 December, 2010	(1.961.259.2)	(49.083.5)	(2.010.342.7)

Note 22**Variations in the monetary base and international reserves**

According to note 2.a.vi and in consideration of the Bank's unique operations, beginning in 2001, instead of preparing a statement of cash flows, the Bank discloses a statement of variations in monetary base and a statement of variations in international reserves, further defined as follows:

Monetary Base: Bank liabilities that form part of money, or otherwise contribute to the formation of monetary aggregates including freely circulating banknotes, coins and checks issued by the Bank, plus deposits made by the financial system in the Bank.

International Reserves: Foreign assets that are readily available and controlled by monetary authorities for directly financing unbalances, indirectly regulating such unbalances through exchange market intervention and/or for other purposes.

VARIATIONS IN THE MONETARY BASE	(Ch\$ MILLION)	
	2010	2009
Initial balance of monetary base	4,582,203.6	4,132,501.7
Increase		
Foreign exchange operations	10,900.8	15,634.7
Interest and indexation paid	639,332.5	740,246.9
Domestic loans	-	2,316,836.4
Operating support expenses	35,123.5	28,051.2
Deposits and obligations	1,892,930.7	-
Securities issued	1,459,846.2	-
Operations with international bodies	-	4,677.4
Other minor foreign exchange changes	68.3	-
Accounts receivable for future currency sales	373,258.2	225,477.5
Other liabilities	-	48.2
Other assets	<u>2,093.0</u>	<u>31,183.4</u>
Total increase	<u>4,413,553.2</u>	<u>3,362,155.7</u>
Decrease		
Deposits and obligations	-	(686,990.9)
Interest and indexation received for domestic operations	(181,240.0)	(123,179.7)
Operations with international bodies	(163.3)	-
Domestic loans	(3,287,194.2)	-
Securities issued	-	(2,196,097.4)
Other minor foreign exchange changes	-	(3,470.6)
Redemption of IDB promissory notes	(2,080.6)	-
Other liabilities	(72.1)	-
Total decrease	<u>(3,470,750.2)</u>	<u>(3,009,738.6)</u>
Variation of monetary base for the year	942,803.0	352,417.1
Effect of inflation on the initial balance of monetary base	-	<u>97,284.8</u>
Final balance of monetary base	5,525,006.6	4,582,203.6

VARIATIONS IN INTERNATIONAL RESERVE ASSETS	(US\$ MILLION)	
	2010	2009
Initial reserve balance	25,372.5	23,464.3
Increase		
Foreign exchange operations	21.8	30.2
Deposits and obligations	1,975.3	-
U.S. dollars sale with agreement to repurchase	176.1	221.9
Operations with international bodies	-	963.4
Other assets	1.6	-
Other liabilities	-	66.0
Interests received for deposits and other investment instruments abroad	<u>1,626.7</u>	<u>1,095.4</u>
Total increase	3,801.5	2,376.9
Decrease		
Other liabilities	(5.2)	-
Deposits and obligations	-	(271.2)
Other assets	-	(46.0)
Interest paid for foreign liabilities	(1,323.2)	(486.0)
Total decrease	(1,328.4)	(803.2)
Variation in reserves for the year	2,473.1	1,573.7
Effect of exchange rate	18.1	334.5
Final balance	<u>27,863.7</u>	<u>25,372.5</u>

Note 23 Foreign currency balances

The balance sheets include assets and liabilities payable in foreign currencies, which balances as of 31 December, 2010 and 2009 are as follows:

	(US\$ MILLION)	
	2010	2009
Assets		
Foreign assets	28,112.6	25,622.3
Reserves	27,863.7	25,372.5
Other foreign assets	248.9	249.8
Other asset accounts	5.7	749.5
Total assets	28,118.3	26,371.8
Liabilities		
Foreign liabilities	1,347.5	1,370.2
Other foreign liabilities	88.7	93.7
Special drawing rights (SDR) allocations	1,258.8	1,276.5
Domestic liabilities	2,929.9	946.6
Deposits and General		
Treasury liabilities	528.9	453.2
Other deposits and obligations	2,401.0	493.4
Other liability accounts	-	745.5
Total liabilities	4,277.4	3,062.3
Net assets	23,840.9	23,309.5

Note 24

Contingencies and commitments

There are lawsuits currently in process against Central Bank of Chile, whose outcomes according to the Bank's legal department are not expected to have a material effect on equity.

Note 25

Income taxes

Pursuant to Article 7 of Decree Law 3345 dated 1980, the Bank is exempt from income taxes.

Note 26

Fiscal Agency

Law 20,128 related to General Treasury Liability published in the *Official Gazette* as of 30 September, 2006, created the "Economic and Social Stabilization Fund" (FEES) and the "Pension Reserve Fund" (FRP). In conformity with the provisions of the aforementioned law, the Minister of Finance through Executive Decree 1383, dated 11 December, 2006, appointed Central Bank of Chile as Fiscal Agent for the administration of resources referred to such funds, in conformity with the procedures, conditions, methods and other standards established in the aforementioned Executive Decree.

In accordance with Article 5 of the abovementioned Executive Decree 1383, investments of public resources managed by the Bank, as Fiscal Agent, have been carried out in accordance with the guidelines established for these effects by the Minister of Finance. These investments have been recorded in off balance sheet accounts.

Through Resolution 1406 of the Board, dated 24 April, 2008, *KPMG Auditores y Consultores Ltda.* was assigned as the auditor of the "Economic and Social Stabilization Fund" (FEES) and the "Pension Reserve Fund" (FRP) for 2010 and 2009.

Note 27

Transactions with related parties

(a) Central Bank of Chile does not have related companies.

(b) Remunerations of the Board and key executives:

According to the Bank's Basic Constitutional Act, the remunerations of the Board are set by the President of the Republic for periods not exceeding two years, following a proposal made by a commission formed by former governors and deputy governors of the entity, appointed by the President of the Republic. In order to propose the remunerations, the act requires them to be based on those remunerations paid to the highest-ranked executive positions in bank institutions within the private sector.

The remunerations corresponding to the General Manager, the General Counsel and General Auditor of Central Bank of Chile, are at level 1 of the remuneration structure, as they are positions established in Sections 24 through 26 of the Basic Constitutional Act.

The total gross remunerations paid to the Board and key executives during 2010 amounted to Ch\$1,193.5 million (Ch\$1,156.4 million in 2009).

Note 28

Relevant events

Through Resolution 1519-01, dated 14 January, 2010, the Board approved new policies for the presentation and preparation of the Bank's financial statements, which have also been approved by the Superintendence of Banks and Financial Institutions pursuant to Section 75 of the Bank's Basic Constitutional Act.

Through Resolution 1517E-01, dated 7 January, 2010, the Bank's Board decided to designate Mr. Manuel Marfán Lewis as Deputy Governor of the Bank effective since 7 January, 2010 through 9 December, 2011, included. Such Resolution was published in the *Official Gazette* on 9 January, 2010.

Note 29

Subsequent events

In the opinion of Management, between 31 December, 2010 and the date of issuance of these financial statements the following subsequent events which could significantly affect on the amounts presented in the financial statements have occurred:

(a) Foreign currency purchase program

The Bank's Board decided to start a foreign currency purchase program in order to strengthen its international liquidity position. The objective of this initiative is to bring international reserves to a level that is compatible with values observed in economies similar to the Chilean economy. Similarly, this intervention should mitigate the effects of the foreign currency translation adjustment to which the Chilean economy has been exposed.

To implement this program, Central Bank of Chile may accumulate additional international reserves up to an amount of US\$12,000 million during 2011, through the periodical purchase of currencies from 5 January to late December 2011. This program will bring the Bank's international liquidity position to an equivalent of 17% of the GDP.

The exchange rate for the U.S. dollar as of 25 January, 2011 was Ch\$493.14, representing an increase of Ch\$24.77 compared to the rate prevailing as of 31 December, 2010. This represents an increase in the Bank's equity by Ch\$284,853.4 million, considering the exchange rate of Ch\$493.14 = US\$1.

(b) Change in euro

The value of euro as of 25 January, 2011 was Ch\$672.95, representing an increase of Ch\$53.08, compared to the rate prevailing as of 31 December, 2010. This represents an increase in the Bank's equity by Ch\$365,601.1 million, considering the exchange rate of Ch\$672.95 = €1.

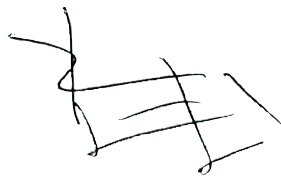
Consequently, the total increase in equity, described in (a) and (b) above, amounts to Ch\$650,454.5 million.

(c) Approval of financial statements

The financial statements for the year ended 31 December, 2010 were presented by the General Manager to the Board on 25 January, 2011 and were approved for issuance in Session 1588.

(d) Other

There are no other subsequent events that may have a significant effect neither on the figures presented herein nor in the Bank's economic and financial position.



ALEJANDRO ZURBUCHEN SILVA

General Manager



SERGIO VALLEJOS FUENTEALBA

General Accountant (S)



SILVIA QUINTARD FLEHAN

General Auditor

INDEPENDENT AUDITORS' REPORT

The Governor and Board Members of
Central Bank of Chile:

We have audited the accompanying balance sheets of Central Bank of Chile ("the Bank") as of 31 December, 2010 and 2009 and the related statements of income for the years then ended. The preparation of these financial statements (including their notes) is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Chile. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 2 to the financial statements, the Bank prepares its financial statements in accordance with standards issued by the Bank's Board, as approved by the Chilean Superintendence of Banks and Financial Institutions, as established in Section 75 of the Bank's Basic Constitutional Act. These standards are consistent with International Financial Reporting Standards (IFRS). Should there be any discrepancy, the standards issued by the Bank's Board shall prevail, including those discussed in note 2(a) to the financial statements in relation to the following matters: a) Accounting treatment of the *Sinap* Liquidation Account Law 18,900 dated 16 January, 1990, which is presented within the caption Operations Under Specific Legal Regulation and explained in note 14(b) to the financial statements; b) Accounting treatment of premises and equipment in the year 2009; c) Application of comprehensive price-level adjustment in the year 2009, as discussed in note 2(e) to the financial statements; and d) Replacement of the Statements of Changes in Equity, Cash Flows and Comprehensive Income with the notes Capital and Reserves, Variations in Monetary Base and International Reserve Assets, and Statements of Income, respectively.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Bank of Chile as of 31 December, 2010 and 2009 and the results of its operations for the years then ended, in conformity with the accounting principles described in note 2 to the financial statements.

As discussed in note 6 to the financial statements, in accordance with Resolution 1519-01 dated 14 January, 2010 and having a favorable report by the Superintendence of Banks and Financial Institutions, as required by Section 75 of the Bank's Basic Constitutional Act, the Bank's Board specifically modified the policies for the preparation and presentation of the Bank's financial statements to discontinue the application of price-level adjustment as from 2010. In accordance with Resolution 1456-01, dated 15 January, 2009, the Bank's Board approved new policies for the presentation and preparation of the Bank's financial statements, which also have been approved by the Superintendence of Banks and Financial Institutions. The purpose of these new policies is for the preparation and presentation of the Bank's financial statements to comply with the requirements established by IFRS as applicable to the Bank, as well as the guidelines prepared by the technical organizations in Chile and the Bank's Board own policies.

As discussed in note 21 to the financial statements, as of 31 December, 2010, Central Bank of Chile has a net equity deficit in the amount of Ch\$3,449,141.0 million (Ch\$1,960,213.0 million in 2009), which is explained mainly by decreases resulting from variations in the exchange rates of assets denominated in foreign currency.

The above translation of the auditors' report is provided as a free translation from the Spanish language original, which is the official and binding version. Such translation has been made solely for the convenience of non-Spanish readers.

Alejandro Cerda G.
Santiago, 25 January, 2011

KPMG Ltda.

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