

Public Consultation on Draft Revisions to the OECD Guidelines on Corporate Governance of State-Owned Enterprises: CAF's comments

I. Proposed changes

	Current	Proposed	Rationale
Page 9	<p>Ownership entity. The ownership entity is the part of the state responsible for the ownership function, or the exercise of ownership rights in, or control over, the SOEs. "Ownership entity" can be understood to mean either a single state ownership agency, a co-ordinating agency,,or a government ministry or another public body responsible for exercising state ownership. States can moreover exercise their ownership or control through corporate structures, such as state-owned holding companies (SOHCs).</p>	<p>Ownership entity. The ownership entity is the part of the state responsible for the ownership function, or the exercise of ownership rights in, or control over, the SOEs. "Ownership entity" can be understood to mean either a single state ownership agency, a co-ordinating agency,,or a government ministry or another public body, at a central or municipal level, responsible for exercising state ownership. States can moreover exercise their ownership or control through corporate structures, such as state-owned holding companies (SOHCs).</p>	<p>This, considering that in Latin America, there are important SOEs at a Municipal Level, specially in water & sewage, electricity, public transportation as well as microfinance.</p>
Page 12 and 32	<p>Being represented at the general shareholders meetings and effectively exercising voting rights;</p>	<p>Being represented at the general shareholders meetings (if available as governing body) and effectively exercising voting rights;</p>	<p>There are many SOEs in Latin America that are 100% owned by the state (Central Government or Municipal) that have no shares and thus no General Assembly. In those cases, the Board is the maximum level of authority.</p>
Page 63	<p>Politicians who are in a position to influence materially the operating conditions of SOEs should not serve on their boards. Former such persons should be subject to predetermined cooling-off periods. Civil servants and other public officials can serve on boards under the condition that qualification and conflict of interest requirements apply to them. Moreover, Ppersons linked directly with the executive powers</p>	<p>Politicians who are in a position to influence materially the operating conditions of SOEs should not serve on their boards. Former such persons should be subject to predetermined cooling-off periods. Civil servants and other public officials can serve on boards under the condition that qualification and conflict of interest requirements apply to them. Moreover, Ppersons linked directly with the executive powers – i.e. heads of state, heads of</p>	<p>In Latin America it is not uncommon that Ministers, as well as Governors and Mayors not only serve on boards, but they do it as the</p>

	– i.e. heads of state, heads of government, and ministers, secretaries of state, heads of regulatory agencies, and their deputies – should not serve on boards as this would cast serious doubts on the independence of their judgment.	government, and ministers, secretaries of state, heads of regulatory agencies, and their deputies, and at a subnational level Governors and Mayors – should not serve on boards as this would cast serious doubts on the independence of their judgment.	Chairperson. Even though it is implicit that if they should not serve on boards, it is even less recommended to be the Chairperson, but it could be considered to make this last reference.
Pag 37	Another important case is when SOEs are used as delivery vehicles for specific public policy objectives such as the the advancement of sustainable	Another important case is when SOEs are used as delivery vehicles for specific public policy objectives such as the the advancement of sustainable	Last paragraph, a typo: double “the”
Pag 62	Mechanisms to evaluate and maintain the effectiveness of board performance and independence should be developed. These can include, for example, limits on the term of any continuous appointments, limits on the possible number of reappointments, limits on the number of board position an individual board member can hold as well as resources to enable the board to access independent information or expertise. SOEs should also engage in board and committee evaluation and training.	Mechanisms to evaluate and maintain the effectiveness of board performance and independence should be developed. These can include, for example, limits on the term of any continuous appointments, limits on the possible number of reappointments, limits on the number of board position an individual board member can hold as well as resources to enable the board to access independent information or expertise. SOEs should also engage in board and committee induction, training and evaluation.	The reference to an effective and appropriate induction program (together with the training program) is stated in page 67. It can be mentioned beforehand in this paragraph.

II. Additional Comments

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Broadly speaking, independent board members are understood to mean individuals free of any material interests (including remuneration) or relationships with the enterprise (non-executive board members), the state (neither civil servants, public officials, nor elected officials), its management, and other major shareholders, as well as with institutions and interest groups with a direct interest in the operations of the SOE that could jeopardise their exercise of objective judgement. Independent board members should be in possession of an independent mindset and sufficient competencies to carry out the board duties.

Regarding the topic of independence of board members, as a reference, CAF’s “Guidelines for Good Corporate Governance of State-Owned Enterprises”

<https://scioteca.caf.com/handle/123456789/1791> includes requirements or conditions to consider a Board Member as independent (page 55), though we are going to update it to include two additional conditions:

- Not to belong, or have belonged during the last three years, to the political party or coalition in power that has ownership the SOE; or without belonging to it, have actively participated in the political campaign of the political party or coalition or its main leaders.
- Not to have contributed resources or not to have been a supplier of goods or services to the political campaign of the political party or coalition in power, directly or indirectly (1), when the contributions or the value of goods or services provided are significant (2) to either of the parties.

(1) Indirect is understood when it is carried out through a company in which the board member is a controlling shareholder or administrator (board member or CEO/Chief Executive Officer), or when it is carried out through the spouse or a relative up to the first degree of consanguinity or affinity.

(2) It shall be presumed significant when the contributions or the value of the goods or services provided amount to more than 5% of the contributor's annual income from resources or goods or services, or the total campaign income."

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The ownership policy should also include in the ownership policy objectives such as the creation of long-term value, the provision of public services, or strategic goals such as the maintenance of certain industries under national ownership, or economic, environmental and social goals. It is the role of the state to decide the rationales for state ownership, but whatever they are, they should in any case be clearly defined for each SOE

As a reference, CAF's "Transparency in the Corporate Governance of State-Owned Enterprises in Latin America." <https://scioteca.caf.com/handle/123456789/367> In that publication we also highlight the fact that SOEs long term value could be either social or economic and, in some cases, SOEs receive conflicting demands from the owner such as maximizing social impact and obtaining the highest financial return. In this regard, it is important that **long-term objectives of SOEs should be explicitly stated in their incorporation documents** in conjunction with the strategic orientation role that should be played by the Board of Directors.

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C. The state should let SOE boards exercise their responsibilities and should respect their independence. The ownership entity should establish and maintain appropriate frameworks for communication with SOEs highest governing body, and typically through the Chair.

In CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" for a similar guideline (No. 8) we include a recommendation for staggered boards: As a way to give the Boards of Directors more stability and to reinforce the independence of their members, the state should evaluate the advisability of choosing the directors of the SOE on a phased basis, so that they are elected and/or renewed over at least two electoral periods.

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2. Establishing and safeguarding well-structured, merit-based and transparent board nomination processes in fully- or majority-owned SOEs, actively participating in the nomination of all SOEs' boards and contributing to gender and other forms of board diversity;

In line with this section, CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" (No. 38) recommends that SOEs must have a specific procedure for the proposal and selection of directors that includes, along with other things, the establishment of general requirements for being a Director and an Independent Director as well as a justified proposal for each candidate. For the search for candidates for Director, the process should include among its tools the use of databases of directors and support from headhunting firms specialized in identifying and selecting board members.

In that same Guideline it is indicated that, along with the general process of appointing Board members, the reality for SOEs is that, on many occasions, it is the legal and regulatory framework itself that unwisely determines the actual membership of the Board of Directors by associating membership on the Board with certain executive or governmental positions (for example, the respective Minister, Governor, Mayor or other Government Official). For these cases, in which because of their background as public officers they may not have prior knowledge and understanding of how the company is run or the responsibilities that carry the role of board member, a key element will be to include a series of formal induction and periodic training programs that will make it possible for these directors, to understand their role and exercise it as suitably and securely as possible.

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6. When appropriate and permitted by the legal system and the state's level of ownership, Maintaining, as appropriate, continuous dialogue with external auditors and specific state control organs;

In CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" for a similar guideline (No. 11) we include a recommendation: It is extremely important for the state, by means of government action, to ensure that the various public bodies responsible for supervision, control, and auditing (Comptrollers, Attorneys General, etc.) differentiate between the business reality of an SOE that is possibly in competition with the private sector and other public administration bodies. In those cases in which the internal control laws for state entities or their equivalent do not differentiate between the business operations of the SOEs and the institutional activity of, for example, a Ministry, the government, and the SOEs themselves, they should establish permanent contact with the corresponding public agencies in order to jointly identify possible alternatives that allow the implementation of control architecture models appropriate to an operating company.

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1. The state and SOEs should ensure that all shareholders are treated equitably.

The ownership entity should develop guidelines regarding equitable treatment of non-state shareholders. It should ensure that individual SOEs, and more particularly their boards, are fully aware of the importance of the relationship with shareholders and are active in enhancing it.

In CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" we include a guideline (No. 15) which provides a specific recommendation regarding the role and responsibility of the board: Proposals for certain operations that may affect the interests of minority shareholders (mergers, issuance of shares or convertible bonds without respecting the right to preferential subscription, spin-offs, etc.) made by the Board of Directors must necessarily be supported by an ad hoc report made by the same body. Ideally, this report should be supported by the opinion of an external advisor with recognized experience and professional solvency and made public to all shareholders.

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B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government shareholders. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are incentivise managers to act consistent within the long-term interest of the enterprise and its shareholders.

Regarding the role of the board to appoint and remove the CEO, CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" additionally include the responsibility on managing the succession of the CEO and upper management, as well as its own succession (No. 34): Although in several countries in the region the appointment of the CEO does not correspond exclusively to the Board of Directors of the SOE but to the state entity that holds the ownership of the company (President, Ministry, Mayor's Office, Specialized Ownership Agency - SOA, etc.), it would be advisable to try to apply the following recommendations both as harmoniously and in as much coordination with that representative as possible. The Board of Directors' role in the succession of upper management should be undertaken in a manner that:

- The personal and professional requirements necessary to be a valid candidate are defined.
- There is regular and periodic monitoring that the CEO is putting in place an effective succession preparation process for his own position sufficiently in advance (more than a year). Furthermore, it should be known that this process is also occurring for the rest of the upper management positions.
- The list of candidates for successor is known and monitoring is being done to ensure that their abilities are being effectively developed.
- There is provision for what to do with internal candidates who are not finally chosen.

In addition, the Board of Directors itself should play an active part in its own succession, and to do so, it should:

- Establish the profiles required within it in accordance with the approved strategic plan and the particular context of the company.
- Evaluate their own performance and dynamics to detect the main areas where specific profiles would be required.
- Maintain a fluid communication with the SOA about the requirements, profiles, and needs that would be required by the Board for them to function better.

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F. Good practice calls for the Chair to be independent with a role separate from that of the CEO. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-

ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" (No. 47) also suggest and encourage the separation of the position of Chairman of the Board from that of the CEO, in order for the Board to be able to effectively exercise its control over upper management and supervision. Nevertheless, in specific cases and when it is appropriate due to the business situation, local regulation or complexity of the company, the CEO may also be considered to be the Chairman of the Board of Directors on a temporary basis. For these cases, it would be advisable to compensate this doubling up of positions by:

- Defining a time frame in which this doubling of positions is appropriate.
- Explaining the reasons that motivate the advisability of doubling the positions.
- Effective counterbalancing measures implemented to compensate for the doubling up of positions such as the existence of an independent Vice Chairman of the Board with enhanced powers.

The above counterweights should also be understood as fully complementary to the counterweights included in the guideline referring to the Board's control function for those cases in which the CEO is directly elected by the SOA and also holds the position of Chairman of the Board.

In this same Guideline, we include the role of the Secretary of the Board, who has traditionally been linked in the region simply to the drafting and keeping of minutes. Nevertheless is a key player in strengthening the efficiency of the Board's actions as a support to the Chairman of the Board. Therefore, in this guideline it is advised to undertake an internal reinforcement of the figure of the Secretary, detailing some key duties.

In a separate topic, CAF's "Guidelines for Good Corporate Governance of State-Owned Enterprises" (No. 40) recommend that SOEs establish the causes for the dismissal of directors. The Board of Directors should be the only body that can propose a dismissal to the General Assembly of Shareholders or the proprietary body in charge of appointing the members to the Board for violation of any of the previously defined grounds. The Board may only submit a proposal to the General Assembly of Shareholders or to the SOA for the dismissal of any of its members for one or more of the grounds set forth in the Bylaws or rules and regulations since, otherwise, the positions of members of the Board of Directors could be jeopardized by political interference.