



# BOARD PRACTICES AND FINANCING FOR LATIN AMERICAN STATE-OWNED ENTERPRISES

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## ABOUT THIS REPORT

1. This report was prepared for the June 2015 meeting of the Latin American Network on Corporate Governance of State-Owned Enterprises (SOEs) to review current arrangements and trends in SOE board nomination, size and composition, evaluation, training, induction and use of committees. The report also covers the corollary issue of SOE financing and budgeting. Information and data were collected from an OECD questionnaire completed by invited experts of participating countries. The countries covered include **Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru** and **Uruguay**. This paper is divided into two parts which provide complementary analysis of these two important areas of corporate governance.

2. The first section dealing with boards builds on the Network's 2012 questionnaire survey and report, [\*Ownership Oversight and Board Practices for Latin American State-Owned Enterprises\*](#). Country practices are described with reference to the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* and other publications that set the framework for SOE boards best practices such as the OECD's *Boards of Directors of State-Owned Enterprises: An Overview of National Practices*, CAF's *Guidelines for Good Corporate Governance of SOEs* and the World Bank's *Corporate Governance of State-Owned Enterprises in Latin America* and *Toolkit on Corporate Governance of State-Owned Enterprises*.

3. The second part focuses on frameworks for commercially-oriented SOE budgeting and finance, and includes a brief comparative review of the Latin American experience compared to OECD policies and practices in this area. Country practices are described with reference to those highlighted in the OECD publication *Financing State-Owned Enterprises: An Overview of National Practices*, which benchmarks the policies and practices of 22 OECD member countries, and additional sources such as OECD *Transparency and Accountability Frameworks for Latin American State-Owned Enterprises* and OECD *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* publications.

4. This publication contains summary appendices for each participating country to complement the report explaining and comparing general practices in Latin America. The lack of a uniform trend across Latin America emphasizes the importance of analyzing each individual country's practices in light of its own frameworks for SOE boards and financing. In addition, 2015 SOE board practices are compared to those gathered from the 2012 Network report, in order to highlight changes in board practices for each participating country.

### Box 1. Main Findings

**PART 1: Overview of State-Owned Enterprise Board Practices:** The increased amount of information and evolving practices reported by respondents when compared to the 2012 Network report suggests that there is growing recognition of the importance of SOE boards as the primary tool for corporate governance improvement. This information also highlights some positive trends that support the boards' shift in responsibility from oversight bodies entrusted with compliance toward driving performance and setting strategy. However, some Latin American countries have yet to establish formal and transparent processes to help ensure that government nominations to SOE boards are primarily based on candidates' skills and qualifications. The majority of the countries do not report differing requirements for public and private sector board candidates. Two countries (Chile and Costa Rica) are explicitly working towards achieving greater gender equality.

Board size usually ranges from three to seven members and remuneration is typically reported to be below market levels, but some respondents reported attempts to adjust remuneration to be market consistent. Largely, the chair and the CEO are separate roles and the board holds the power to remove the CEO. Induction and orientation programmes for new board members and annual evaluations of board efficiency have been established only by countries with centralized ownership models (Chile, Paraguay and Peru). Board education continues to be a weak practice in the region, but those countries that have implemented pilot education programmes have reported good levels of satisfaction on the outcomes. There is also a growing trend in Latin America to establish specialized committees in SOEs. In some cases the establishment of committees is mandatory, while in other cases, it has become a common practice even if there is no legal obligation for SOEs to set them up.

**PART 2: Financing of State-Owned Enterprises:** The answers provided by the respondents showed a great variety of policies, processes and practices in relation to the ways that each country seeks to ensure that SOE financing is provided on market-consistent terms, which is key to maintaining a level playing field with private competitors as a basis for efficient and competitive markets. In determining the optimal capital structure, Latin American respondents highlighted that, in contrast to many OECD countries, final budget approval is in almost all the cases (except for Peru) the responsibility of the Ministry of Finance or National Congress, while the SOE board or AGM are usually only responsible for pre-approving the budget. Two countries, Argentina and Mexico, highlighted the possibility of developing multiannual budgets under separate requirements or processes.

The boards are responsible for making decisions that affect capital structure such as establishing a rate-of-return. However, there are no general rate-of-return requirements or guidelines in any of the countries. Likewise, according to responses, there are no overarching principles that guide decisions on dividend levels. The exceptions are Argentina and Brazil (where company law determines some elements) and Uruguay. Additionally, all respondents except for Costa Rica reported that their governments provide direct state support, but requirements and methods vary by country. These answers show various methods to determine how and when that support is warranted. Latin American countries also do not have a mechanism that ensures market-consistent equity costs, which would help to ensure competitive neutrality. Two countries, Chile and Costa Rica, reported that some SOEs benefit from advantageous financing conditions when compared with private competitors. Other country responses suggested that there is no evidence to support that statement. All countries except for Peru reported that explicit guarantees to SOEs could be provided with no existing mechanisms to compensate for potential cost advantages of such guarantees.



## INTRODUCTION

5. State-owned enterprises play a crucial role in the global economy. Not only do they include some of the world's largest companies, but are also key influencers in the economy through their investments and, in some cases through their involvement in capital markets. SOEs tend to be established in critical sectors such as oil and gas and financial services, playing a key role in economic growth.

6. SOEs also play a sizeable role in Latin American economies, and are common in all Latin American countries surveyed (see Table 1 below). For example, the aggregate budget of Colombian SOEs linked to the central government represents approximately 8 per cent of GDP and 24.5 per cent of the government budget, according to the World Bank's *Corporate Governance of State-Owned Enterprises in Latin America* (2014). Three SOEs (Ecopetrol, ISAGEN and ISA) –all listed on the national stock exchange– constitute 15 per cent of the national stock market and 50 per cent of the total value of SOEs. In Chile, SOEs employ around 49,000 workers (0.7 per cent of overall employment); their aggregate expenditures account for approximately 9.4 per cent of GDP; and the revenues generated by all SOEs amount to 12.8 per cent of GDP. At the same time, they contribute to government finances through taxes, fees, royalties, and dividends in an amount that reaches almost 2.5 per cent of the GDP or 6 per cent of total government revenue. It is important to note that CODELCO (the national copper corporation) is responsible for nearly 95 per cent of all fiscal transfers from the SOEs to the State. Brazilian SOEs employ around 500,000 people (0.7 per cent of total employment) and total investment by SOEs amounts to roughly 2.3 per cent of GDP. At the same time, they pay dividends and contribute to government finances by paying taxes and fees that amount to almost 3 per cent of the GDP or 9 per cent of total government revenue.

7. Due to SOEs' important function in both national and global economies, countries must establish clear governance models in order to allow SOEs to perform at the most efficient level with a strong commitment to accountability. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* are applicable to SOEs under any type of ownership strategy. According to the Guidelines, the state should be an informed and active owner, acting in a transparent and accountable manner, with professionalism and effectiveness. It is important to note that the ownership model applied by each country could shape the way the guiding principles are put into practice, but the general principle remains the same for all. From the information gathered as part of the 2012 OECD report and the 2014 review of Latin American SOEs by the World Bank, Latin American SOEs could be roughly classified under three main ownership models ranging from centralization of the ownership function to decentralized. Some countries may fit in between categories depending on the specific ownership arrangements:

1. The **centralised model** aims to align oversight and transparency practices for SOEs by establishing coherent policies, efficient allocation of human resources, clear lines of accountability and close fiscal supervision. Although among the OECD area, centralization of the ownership function is the prevailing model, in Latin America, only three countries have centralized ownership models: Chile, Paraguay and Peru. Chile has established the Public Enterprise System (SEP) which oversees 22 of the country's 33 SOEs. Peru ownership entity, the National Funding for the Financing of the Peruvian State's Business Activities (FONAFE) is currently responsible for 31 SOEs. Paraguay's move to a more centralized model is more recent.

2. In a **dual or hybrid model**, the responsibility is shared between a sector ministry and one or more centralized ministries. This model is effective where there is a clear division between the roles of owner and regulator, thereby strengthening checks and balances as well as providing simultaneous technical and financial oversight. On the other hand, multiple layers of oversight may provide for unclear objectives and lines of reporting; Brazil, Colombia, Ecuador and Uruguay provide examples of this type of ownership model. For example, Brazil shares ownership oversight between the Department of Co-ordination and Corporate Governance of State Enterprises (DEST) -a government entity within the Ministry of Planning Budget and Management- and two additional ministries: the Ministry of Finance and the sectorial ministry. Colombia, which had a decentralized model, is currently moving towards a hybrid model which may ultimately become a centralized model.
3. The **decentralised or sector model** relies on several ministries, with little coordination at the center, that oversee SOEs within their sectoral policy area. Governments using this model may face a greater challenge in implementing a whole-of-government ownership policy and consistent corporate governance practices. Under this model, a clear separation of ownership from sectoral ministries' respective regulatory roles is recommended in order to limit exposure to undue political intervention. Argentina, Costa Rica and Mexico provide examples of this model.

8. It is important that SOEs maintain good corporate governance practices in order to minimize risks and maintain a level playing field (competitive neutrality) in support of successful growth for the country's economy as well as for its critical sectors. The state, as part of its responsibilities, must work to ensure that SOEs follow these practices. As a benchmark for the creation and implementation of good corporate governance practices, the government should refer to private and public sector standards such as the *OECD Corporate Governance Principles* and the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (both of which have been revised and updated in 2015).



**Table 1. Number of SOEs per country (as of June 2015)**

	Argentina	Brazil	Chile	Colombia*	Costa Rica	Ecuador	Mexico	Paraguay	Peru	Uruguay
Total	137	141	33	120	69**	28	87	9	31	15
Commercial	129	123	33	106	42**	11	75	9	28	9
Non-commercial	8	18	0	14	27**	17	12	0	3	6
Listed	50	9	1***	3	0	0	16***	0	9****	0
Non-listed	87	132	32	117	69	28	71	0	22	15
Fully-owned	9	33	30	36	85%**	28	86	5	23	15
Majority-owned	67	108	33	39	n/a	5	1	4	8	0
Minority-owned <sup>1</sup> (10-50%)	70	n/a	0	25	n/a	0	0	0	n/a	0

Source: Country responses to OECD questionnaires

\* Colombia's figures for full and partial ownership of SOEs, provided to the OECD as part of their corporate governance accession review process to become an OECD member, do not add up to the total number of 120 because Colombia counts any enterprise with state ownership as an SOE, including those with less than 10% minority ownership.

\*\*Approximate numbers provided by questionnaire respondents.

\*\*\*The listed SOEs in Chile and Mexico do not trade equity but must comply with listing requirements for issuance of debt instruments.

\*\*\*\* Peru's 9 SOEs are listed for both equity shares and debt.

<sup>1</sup> While companies with minority state ownership are not defined by OECD as SOEs per se, the 10 to 50% threshold indicates a significant ownership role for the state.



## PART 1: OVERVIEW OF STATE-OWNED ENTERPRISE BOARD PRACTICES

9. The role and responsibilities of an SOE's board of directors is critical, as highlighted in the last chapter of the *OECD Guidelines*: "The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions."

### Board Nomination Practices

10. According to the *OECD Guidelines*, board member nomination and election frameworks should be the first step towards securing professionalism, independence and freedom from undue political influence, allowing board members to act in the interest of the SOE and all of its shareholders. The state role as an owner is to promote, or establish when appropriate, transparent and well-structured nomination processes and to be an active participant in the nomination process for boards, in order to support long-term thinking, business-oriented and accountable boards.

11. As pointed out in the OECD's *Boards of Directors of State-Owned Enterprises: An Overview of National Practices* report, transparency and a well-defined structure should characterize the board nomination process, and thus it is important to determine the person or body responsible for designating board members. This can help to minimize or prevent political intervention in the nomination and appointment process. Practices vary depending on the ownership structure of the country and can formally and informally involve the ownership entity, individual ministries and/or executive powers. In any case, transparency requires setting and disclosing specific qualifications for board members and clear guidelines for their nomination and appointment. Although in most OECD countries surveyed in the *OECD Board of Directors of State-Owned Enterprises* report, the formal nomination power is exercised by the relevant minister or through some form of inter-ministerial process, where feasible, board appointments should be subject to co-ordination or consensus on a whole of government basis. Although less common, it is recommended that Annual General Meetings (AGM) hold the power of appointment, even in wholly-owned SOEs, since this is an important source of transparency and would be a necessary step in companies with mixed ownership. Apart from formal nomination powers, many OECD economies have placed emphasis on the identification and selection process for board members – since this can bring objectivity and transparency to the nomination process, while ensuring that applicants are drawn from a wide pool of talent to encourage professional boards that are capable of independent judgment. Nomination committees are not common practice, yet they have been developed by some OECD countries. These committees can either exist within the company or can be responsible for all SOEs in the country. In Canada, as a prime example of aligning with the OECD Guidelines, SOE boards are required to create and manage board profiles as part of the formal nomination process.

12. In Latin America, most of the countries reported that the appointments are made either by the line ministry or the executive power. Usually SOE boards have no involvement in the nomination or appointment of candidates. The majority of the countries reported that they have established a set of rules or procedures to nominate and appoint board members; Brazil, Chile, Colombia, Mexico and Peru are examples of this. However, some Latin American countries have yet to establish formal and transparent processes to help protect against politically-motivated appointments and to ensure that nominations are primarily based on candidates' skills and qualifications. In the cases of SOEs with mixed ownership,

Argentina, Brazil, Chile and Ecuador reported that there were mechanisms in place to protect minority shareholders.

13. SOEs in **Brazil** follow the same practices that are established for private companies in the Brazilian Corporation Law (Law 6404/76). Although officially appointed at the shareholders' meeting – where the Ministry of Finance represents the federal government – board members are previously chosen by the Ministry of Planning, minority shareholders, employees and the relevant line ministry. The latter is in charge of designating the chairman. The candidates nominated by the ministries must have the prior approval of the Brazilian President, which involves an administrative process evaluating the candidates' backgrounds. The ministries identify candidates without the intervention of recruitment agencies or a pool of directors. Government representatives are usually drawn from the public sector. The company's board has no role in the nomination and appointment process. It is important to note that 15 Brazilian SOEs – representing 10 per cent of the country's public companies – do not make board appointments at shareholders' meetings. Instead, the line ministry appoints board members in accordance with the SOE's bylaws. However, DEST is promoting necessary adjustments in this area. In the case of mixed ownership, minority shareholders have the right to appoint at least one member to the board, regardless of the number of voting shares that they own.

14. In **Chile**, SEP's Council is responsible for the appointment and removal of SOE members of the board of directors included under SEP's portfolio. No other minister has veto, approval or ratification power on this issue. Each SOE board determines the combination of skills required for the board as a whole and the specific requirements for each individual member. Based on these requirements, the Council leads the search for candidates and ultimately selects the Board members. SEP considers past candidates and public sources (such as employment search engines) to identify candidates. Members of the Council may also propose candidates. Recruitment services have been used in specific cases. For less than fully owned SOEs, candidates are proposed by the SEP Council and the appointment is made at the AGM, where every shareholder has voting rights.

15. In **Colombia**, the nomination process differs both between and within the different Ministries. The Ministry of Finance and Public Credit (*Ministerio de Hacienda y Crédito Público – MHCP*) relies on the Direction of Investment Banking and the Secretary General (legal counsel) to propose a list of candidates based on their professional experience, the company's profile and the restrictions established by law. The Ministry's Asset Committee then approves the list, which is later subject to AGM approval through an electoral quotient system, a proportional voting system allowing minority shareholders to group their votes. In the case of independent directors, the same procedure is used but with prior verification of their compliance with the definition of independence. SOEs under the Defense Ministry vary greatly in practices from the ones under MHCP portfolio, mostly due to the strong military culture. Most board members appointed are either active or retired military officers.

16. Ecopetrol (Colombia's oil company) has put in place a special procedure to assure the election of independent board members. The state nominates two out of nine candidates, as proposed by the departments (regions) relevant to the hydrocarbon exploitation locations and minority shareholders. The state will also vote for those board candidates, as long as they are suitable and comply with the legal definition of independent director.

17. **Peru** has established a detailed legal framework for the nomination and appointment of SOE board members under FONAFE's authority. The nomination process starts when the ministers who are members of FONAFE's board propose candidates for the board of the SOE of their respective sectors. Additionally, the Minister of Finance and Economy must always nominate at least one director. Then an evaluation of candidates takes place, dismissing those who do not comply with the formal requirements established by the law. In addition, the nominees are evaluated according to their education and

professional background as well as the usefulness of their capacities to the board. New directors are appointed by the AGM and there is no involvement of the SOE board in the process. There are some cases when SOEs' directors are directly appointed by the line ministry and the Ministry of Finance and Economy in accordance with the law of creation of those SOEs.

18. Peru is currently in the process of appointing independent board members to SOEs that will be identified with the help of recruitment companies that will propose the names to FONAFE. The ownership entity has developed regulations outlining the process for their nomination and election, requisites, rights, duties and obligations.

19. In **Argentina**, board directors are appointed by vote in the AGM, where the state will be represented by the Ministry, decentralized institution or SOE who holds ownership. Argentina has no mandated requirements for a formal nomination process and only listed companies or those involved in capital markets require the existence of nomination committees. Positions on the board are not openly advertised and nominations are based on political decisions. Argentine SOEs do not rely on a pool of directors for finding qualified candidates. Minority shareholders are protected by the Companies Law, which is fully applicable to Argentine SOEs. This law includes the differentiation of types of shares and allows cumulative voting to be used to elect board members. Additionally, minority shareholders hold the rights of information and to call shareholders meetings.

20. Although there are no set rules for nominees' skills and experience, there is a growing trend in Argentina to appoint directors with experience in the SOE-related field and also representatives of the union related to the company's activity. Unlike other SOEs, ENERSA (the country's energy company) requires that at least one director has knowledge of capital markets (since the company is listed by virtue of public debt issuances). Restrictions to the appointment of directors throughout Argentina are limited, only stating that directors must have an Argentine address. However, SOEs may establish further restrictions in their bylaws.

21. In **Costa Rica**, each SOE has its own nomination and appointment process established in the law that creates it. In general, board members are appointed by the Government Council (the country's President and its Ministers). As an exception, some SOE boards have members appointed by private organizations such as unions. There is no formal nomination process for members appointed by the Government Council, although ministers may nominate candidates informally. Costa Rica's president must approve the final decision. In the case of SOE boards with representatives from private organizations – such as chambers of commerce, associations, unions and professional associations – each SOE bylaw outlines the process whereby representatives are elected.

22. **Ecuador** has established a unique system where SOEs' boards are composed of three members elected by the line ministry, the National Secretary for Planning and Development (*Secretaría Nacional de Planificación y Desarrollo –SENPLADES*) and the President, respectively. In the case of a mixed ownership company, the board should include appointees from both public and private owners.

23. Board appointments of statutory SOEs (created by law or presidential decree) in **Mexico** are regulated by the Federal Law of Parastatal Entities (*Ley Federal de Entidades Parastatales –LFEP*) whereas non-statutory SOEs' board appointments only use these rules as general guidelines, establishing their own processes in their by-laws. Since almost all Mexican SOEs are fully state-owned, each line ministry is responsible for appointing board members to the companies under their coordination. In general, SOEs boards include public servants from different ministries. The rule is that the majority of board members are government representatives. There is no nomination and appointment process in place. The chairman of the SOE is usually the head of the relevant ministry or the person he or she appoints.

Additionally, boards must include a representative of the Ministry of Finance. Representatives from the public and private sectors may be appointed.

24. A recent energy reform impacted on the regulation of Mexico's largest SOEs, PEMEX (the country's petroleum company) and CFE (Mexican electrical company). In these companies, the director nomination and appointment process is different than for its counterparts. For PEMEX, Mexico's President appoints all 10 board members, of which five should be independent and require Senate approval. Similarly, in CFE the country's President appoints nine out of ten board members. The remaining member is an employee representative. If the Senate rejects a presidential appointment twice, the President may appoint the independent member directly, without the Senate's approval.

25. As previously mentioned, **Paraguay** relies on an ownership entity, the National Council for Public Companies (*Consejo Nacional de Empresas Publicas – CNEP*), which makes recommendations to the President for the nomination and removal of board members. Subsequently, the President, through a presidential decree, holds the authoritative power of appointment. Board members may be nominated by the CNPE, line ministers or political parties and can also be chosen from SOE employees; there is no formal procedure for the nomination. SOEs in Paraguay do not use head hunters or other third parties and do not require the establishment of a nomination committee.

26. In **Uruguay**, article 187 of the Constitution states that SOE board members are appointed by the President in agreement with the Council of Ministers (*Consejo de Ministros*); while previous approval by three fifths of the Senate is necessary. If the Senate does not approve the appointment within 60 days of the nomination, the executive power can change the nomination or maintain the original one, which would then require an absolute majority vote by the Senate. Candidates are identified by an internal process within political parties. There are no directors' pools and there is no Nomination Committee. Additionally, the opportunity for candidates to be self-nominated does not exist. The board of directors does not play a role in the nomination and appointment process.

### **Board size and composition**

27. The *OECD Guidelines'* annotations encourage the implementation of smaller boards, although there is no "one size fits all" method. Smaller boards are considered more efficient because they enable real strategic discussions and ensure that the directors are more involved. When deciding on the size of a board, it is important to consider the inclusion of a sufficient number of non-executive members to enhance board objectivity and independence. The size of the board may also be relevant for achieving diversity objectives in cases where the state has established affirmative action targets for example for gender or other under-represented groups. As stated in the *OECD Corporate Governance of State-Owned Enterprises* report, OECD countries have been reducing their board sizes in recent years; countries such as Sweden and New Zealand have reduced their board size to 7 members. This tendency towards implementing smaller board sizes also exists in Latin America; according to the analyses made in the 2012 report on *Ownership Oversight and Board Practices for Latin American State Own Enterprises* prepared by the OECD, board size generally ranges from between three to seven members. The same tendency was found in the responses to the 2015 questionnaire. Argentina and Paraguay are the only two countries which do not establish size limits; however, Paraguay, through the implementation of regulatory changes to the CNEP, is looking to implement such limits in order to establish boards with few members as part of good corporate governance practices.

28. Board composition not only affects efficiency but also plays an important role in the overall reputation of the company. In order to ensure that board members capable of independent and objective judgment are chosen, SOEs should develop clear and transparent criteria that considers a variety of skills, competencies and experiences and helps to identify any possible conflicts of interest. Moreover, the criteria

could include topics that encourage board diversity. The criteria should be flexible enough to allow for adjustments depending on the SOEs' sector or context. OECD countries in the European jurisdiction are working towards gender equality on SOE boards. Examples of such countries include Austria, Belgium and Finland, who have implemented hard quotas for female representation of 25, 33 (one-third) and 40 per cent, respectively. In addition, it is not recommended that an excessive number of members from the state administration are appointed. It is important that state-representatives on boards have the same responsibilities and are subject to the same liability as any other board member. In this aspect, Norway has taken an interesting approach, excluding Parliament, Ministers and State Secretaries from serving on SOE boards. As stated in the Annotations to the *OECD Guidelines*, it should be clear that it is board members' duty to act in the best interests of the company as a whole and they should not act as individual representatives of the constituencies that appointed them. In line with the SOE Guidelines, many OECD countries have made it obligatory for the SOEs to have independent directors on SOE boards.

29. Most countries in Latin America have set requirements for candidates to be elected to SOEs boards. In general, academic background, experience in the sector in which the SOE operates and previous experience as a board member or manager are requested. Colombia was the only country that reported a fixed percentage of independent members to be legally established as in some sectors SOEs boards must be made up of at least 25 per cent of independent board members.

30. In **Chile** the ownership entity, SEP, has established a set of rules called "Procedure for selection and appointment of Company Directors" which defines the steps to be followed for nominating board members and the requirements the candidates must comply with for being appointed in the board of SOEs. In general, candidates are required to have professional experience as executives, directors or managers of public agencies or private corporations, suitability to the challenges of each SOE, academic background, university teaching experience in economic and corporate matters, experience in the economic sector in which the SOE operates and past experience in businesses or operations in which the company may be or is involved. Chile has set a constraint regarding maximum number of appointments stating that a board member should not be involved in more than 5 boards of private or public entities.

31. In **Mexico**, there are two kinds of board members: those who represent the Government as civil servants, and those appointed due to their experience in the private sector. Public servants appointed to SOE boards should hold a position at least three levels below the secretary of the respective ministry. The members from the private sector should have a recognized capability or experience linked with the operations or services carried out by the institution. There are also certain legal restrictions to be a board member. For example, they cannot be members of Congress nor have any other potential conflict of interest. More specific requirements may be stated in their bylaws or in the law of creation for statutory SOEs.

32. In **Peru**, the requirements that must be fulfilled by directors in order to be eligible to sit on an SOE board include professional skills and background within the relevant sector, previous experience as a board member or manager, and honesty and capability. There are no constraints with respect to gender, age or nationality. Directors can be recruited from both the public and private sectors. As stated above, FONAFE evaluates the candidates' compliance with both formal requirements and professional skills necessary to form part of an SOE board.

33. Both **Chile** and **Costa Rica** are making active attempts to increase gender equality. Recent regulatory reforms in Costa Rica require that political parties put in place mechanisms to boost female representation. According to these laws, the elected party must then ensure that a certain number of women hold public office and serve as directors in public companies. In Chile, the current government has assumed the commitment to include by 2018 at least 40 per cent of female board members in SOEs. A bill project establishing female quotas is also being supported by the President.

34. In the cases of **Brazil** and **Costa Rica** the eligibility requirements are determined by each SOE. Brazilian SOE bylaws usually state that board members must be Brazilian citizens, and although there are no limits to the number of boards a person may sit on, federal public servants attending boards can only be paid for two positions. In consequence, it has become general practice that federal public servants are not appointed to more than two seats at a time. In Costa Rica, once board members are appointed, they cannot undertake any other type of activity – public or private – that will interfere with the SOE’s activity.

35. Although no formal criteria exist, board members for SOEs in **Paraguay** must comply with certain constraints: they must be of Paraguay nationality, between 25-35 years old, not have been condemned for common crimes and have legal capacity to conduct commerce. This also includes restrictions on working for competitor companies and having been declared in bankruptcy in the past. No preference exists between directors from the public or private sector – either can be chosen. As part of the regulatory reform of CNEP, Paraguay is looking to create criteria/profiles for directors.

### **Remuneration policy**

36. In order to encourage the long-term interest of the company and attract the best qualified professionals, remuneration incentives should consider the expertise and experience required for those nominated and should not be below market levels. The *OECD Guidelines* recommend that board remuneration focuses on current market conditions so that the company can attract competent and professional directors. However, this is not generally the case in Latin America where all of the surveyed countries have remuneration levels set below market, which except for in Chile, Mexico and Uruguay (who reported a lack of clear evidence on the matter) has reportedly impacted negatively on companies’ ability to attract candidates.

37. **Argentina** follows the rules established for private companies in the Company Law (*Ley de Sociedades Comerciales*) which stipulates that remuneration, including salaries and any other payments, cannot exceed 25 per cent of an SOE’s revenue. Where no dividends are paid, the maximum amount drops to 5 per cent, which increases slowly at the same rate as the distribution until it reaches the limit when the revenues are distributed completely. In all cases, the board makes the proposal on remuneration which is then submitted to the AGM for its approval.

38. In **Brazil**, board members’ remuneration cannot be over 10 per cent of the management team medium remuneration, which must exclude any participation in profits and results, and compensations.

39. **Chilean** SOEs structured as corporations, limited liability and joint stock companies have remuneration levels set at the AGM. On the other hand, in the case of SOEs created by law, remuneration is established in the law of creation. The board has no role in determining remuneration levels. Reportedly, Chile’s ability to attract professional and experienced private sector candidates has been increasing over the last few years.

40. In **Costa Rica** and **Peru**, board members receive a payment for each session they attend. The maximum amount a Costa Rican SOE can pay per session is established by law and remuneration levels have not been updated since 2008. In Peru, remuneration is periodically fixed by FONAFE’s board. FONAFE has recently updated the remuneration levels through a national and regional benchmarking exercise, performed by external consultants, in order to align them to market conditions.

41. In **Colombia**, the President of the Republic has legal authority to set the remuneration of the state’s representatives on the boards of some SOEs. This authority is delegated to the Minister of Finance for the remuneration of directors of SOEs in which the state holds a majority stake. The President has, in



addition, delegated the power to establish the salary regime of the public employees of bodies that include non-financial SOEs linked to the MHCP and the presidents of state financial entities.

42. The MHCP has established a scale of fees based on SOEs' assets and payment capacity and, within these limits, allows shareholders' meetings to set fees as they deem appropriate. In a number of enterprises, however, directors' fees are non-existent or very low and do not adequately compensate the time and effort involved, particularly if the aim is to attract independent directors with experience in the private sector. On the other hand, public officials may not, as a general rule, receive more than one income that has its source in the National Treasury. An exception is made in the case of directors' fees, with public officials permitted to receive additional remunerations from up to two SOEs at the same time.

43. In **Ecuador**, the Organic Law of Private Enterprises (*Ley Orgánica de Empresas Públicas*) provides that each SOE board is responsible for setting the company's remuneration levels. The Ministry of Labor Relations, with the help of specialized firms, performs an *ex post* control of the remuneration levels and overall human resources policies of the SOE, which the board is later made aware of in order to make the necessary adjustments.

44. In **Mexico**, the national government must set remuneration levels according to the regulations set forth by the Ministry of Finance. The LFEP does not contain any additional requirements and the board has no role in contributing to the establishment of these policies. The Mexican response indicated that there have been no issues related to remuneration policy and the ability to attract candidates. In the case of PEMEX and CFE, a special committee made up of two representatives of the Ministry of Finance and a representative of the Ministry of Energy, is responsible for setting remuneration standards. The committee should consider current remuneration in the general job market for benchmarking purposes. The objective is to attract the necessary talent to have the best board members possible in those companies.

45. In **Paraguay**, board member remuneration is decided in the shareholder meeting. Since 2014, salaries are required to be published for SOEs. Due to the lower salaries provided by SOEs compared to private companies, potential board members have, in the past, migrated to private companies.

46. Board member remuneration is legally established in **Uruguay**, generally in the Budget Law. Remuneration tends to be lower than those provided to ministers or CEOs. The country reported that this does not necessarily affect a SOE's ability to attract candidates because of the public service culture existing in Uruguay. Moreover, the public and political exposure of the position has been reported, in some cases, to attract professional candidates with great academic and technical merit. The board has no role regarding remuneration.

## **Board Chair and CEO**

47. The *OECD Guidelines* recommend that boards be responsible for (or at least involved in) the appointment and dismissal of the CEO. It is important for CEO appointments to follow professional criteria, with clear and transparent rules. As part of its involvement, the board should also influence the CEO's salary, which must be based on the individual's performance. The *OECD Guidelines* highlight the importance of separating the CEO and Board Chair, as it promotes a balance of power, facilitates independence from management in the board decision-making process and improves accountability. To separate these positions in an effective way, the roles of each must be clearly defined in order to avoid confusion and any overlap in responsibilities. As reported in the *OECD Board of Directors of SOEs* report, Scandinavian countries as well as Austria, Germany, the Netherlands and New Zealand follow the OECD Guidelines of separating the Chair and CEO positions. In these countries, the board is responsible for appointing the CEO with the advisement of the relevant ministers. In the majority of the cases reported, the role of the CEO and Chairman are also separated in Latin American SOEs, with the exception of Costa

Rica and Paraguay. Only in Mexico and Costa Rica the government's executive power may remove the CEO at any given time, while in the rest of the countries it is a responsibility that generally falls under the board duties.

48. **Argentina, Brazil, Chile, Colombia** (in most cases), **Ecuador, Peru** and **Uruguay** reported that the board is responsible for appointing and removing the CEO. In Brazil and Peru the CEO may also be removed by the AGM.

49. **Chile** relies on a public record of recruitment firms to find appropriate candidates who can fill the CEO position for a particular SOE under SEP. In order to remove a CEO, the board of directors must adopt an agreement, which authorizes the CEO's dismissal due to incompatibilities with the SOE or his/her inability to provide the necessary expertise.

50. In **Ecuador**, the member appointed by the line ministry always chairs the meeting. This member is also responsible for nominating the candidates for CEO positions.

51. In **Brazil, Peru, Mexico, Ecuador, Colombia, Chile** and **Uruguay** SOEs' chairs are separate from CEOs. In **Argentina**, there are limited cases in which the board's chair and the CEO are the same person.

52. On the contrary, the CEO and the chair are not separate in **Costa Rica**. The Government Council has the power to both appoint and remove the CEO. Nevertheless, a CEO's resignation is usually requested at the President's discretion. Some SOEs' bylaws establish that the CEO can be removed by a majority vote of the members of the board.

53. Similarly, in the majority of **Mexican** SOEs, there is no specific process for removing the CEO but the Mexican president may do so at any given time. In PEMEX and CFE, however, the CEO can be removed by either the board of directors (by a seven of 10 majority) or the country's president.

## **Board Evaluation**

54. The *OECD Guidelines* recommend a systematic annual evaluation to assess the performance and improve the professionalism of the board and its directors. A board evaluation is a useful tool to identify board dynamics, composition, remuneration and size gaps, as well as the effectiveness of induction and training programs. It also serves as a strong incentive for directors to be dedicated and active board members. Whether the evaluation is conducted through a top-down approach or entails self-evaluation, the process must focus on the board's performance and should not simply be a "box ticking" exercise. Most OECD countries rely on either the ownership entity to perform the evaluation or the board itself. Many countries count on self-evaluations to test the board's performance. New Zealand, for example, requires boards to perform self-evaluations periodically (at least once a year); this evaluation includes the board as a whole, the chair and each individual member. It is uncommon for external facilitators to be involved in the board evaluation process. For most OECD countries, the board is able to decide whether or not they prefer to use such resources. In Latin America, reporting countries with centralized ownership models – Chile, Paraguay and Peru – have established annual evaluations which are conducted or administered by the ownership entity. The rest of the countries reported that no evaluation on board efficiency is conducted by the ownership entity, although some SOEs boards, notably in Brazil, conduct self-evaluations.

55. In **Chile**, SEP administers an annual board evaluation, providing a questionnaire to board members, which focuses on the board as a whole while also evaluating both the chair's role and its impact on board performance. The evaluation – including the gathering and analysis of the information – is carried out by Corporate Governance Centers, auditors or specialized companies. Once it has received the results, SEP reviews them, comparing them to past years. Board directors are subsequently able to review the

results of the questionnaire. To assess the board further, SEP performs its own evaluation of the members' attendance, fulfillment of goals proposed by SEP and the overall performance of the SOE.

56. In **Paraguay**, the CNEP conducts quarterly evaluations of the SOEs under its supervision. To increase the efficiency of its services or production of public goods (depending on the type of SOE), the CNEP uses instruments known as results based management contracts (*Contratos de Gestions por Resultados*) to set quarterly and annual goals for the SOE to comply with. Starting in 2015, this process will be done at the end of the fiscal year. If the SOE receives two consecutive negative evaluations, the CNEP may recommend the country's President to remove the SOE chair or CEO. Self-evaluations are not a part of this process.

57. **Peru** is in the process of establishing a formal evaluation process for SOE boards. A pilot evaluation, consisting of evaluating 16 companies in the electrical sector, has been done in 2013 with the support of international development financial institutions. It is FONAFE's objective to extend this practice to the rest of the SOEs now that the pilot was successful. This is a significant development since 2012, when no evaluation process was in place. The current system includes a self-evaluation of each member of the board (except for the Chair), an individual evaluation of the board as a whole performed by each director, and an evaluation of each board member completed by the Chair. The criteria for evaluation assess the functioning of the board as a whole and the degree of involvement of each board member. The results of the evaluations are compiled into a report presented to the shareholder (FONAFE), who can make the necessary changes to the board's composition in the case of a negative evaluation.

58. In **Uruguay**, there is an evaluation conducted by the Office of Planning and Budget (*Oficina de Planeamiento y Presupuesto – OPP*) which evaluates the board as a whole. The results are communicated monthly through the follow up of the financial program. It is also communicated annually through meetings between the board and the OPP or the country's President. Ultimately, bad evaluations can result in resignation or removal of board members.

59. **Argentina** and **Mexico** do not conduct top-down evaluations of board efficiency as there are no ownership entities to perform such evaluations on those countries. Listed SOEs are the only type of SOEs in Argentina that conduct self-evaluations. In the case of Mexico, only PEMEX and CFE have annual board evaluations that are undertaken by the Commissioner: an independent professional chosen by the Chamber of Deputies (by a two-thirds majority vote) from a list of three candidates presented by the Mexican Institute of Financial Executives. The evaluation assesses the enterprises' performance in general and of the board in particular.

60. **Brazil** has not established a top-down evaluation process for board efficiency. Each SOE board undertakes annual self-evaluations of the board and of each individual board member. It is important to note that these results are not sent to DEST.

61. Although not required under **Colombian** legislation, board evaluations are recommended by the country's corporate governance code (*Codigo Pais*), which suggests that it be carried out by the Corporate Governance Committee. The MHCP declares that this is not a common practice in Colombia, except in the case of large, listed SOEs, such as ISA, which tend to require self-evaluations. On the other hand, Ecopetrol has in the past relied on an external, specialised company to implement an external and independent evaluation, which complemented its internal annual board evaluation.

62. **Costa Rica** conducts a general evaluation of SOE efficiency in the country. However, there is no specific evaluation mechanism in place for SOE boards.

## Board Induction/Orientation

63. Directors should have clearly established roles in order to be aware of their responsibilities and liabilities. As recommended by the *OECD Guidelines*, SOEs should organize an induction program that provides directors with an idea of their duties and obligations so that they can work efficiently to complete them. Induction programs allow new board members to be more efficient when they focus not only on the needs of the board but also on the specific needs of the new member. It is important to organize these programs during the first month of appointment and before the first board meeting. It is recommended that the orientation includes existing board members so that they can share their experience and as a way to introduce themselves and the ways of working together. As highlighted in the *OECD Board of Directors of State-Owned Enterprises* report, the implementation of board induction programs is common practice among OECD countries; however they differ in structure and organisation. A position held by most countries is that induction programmes should match the needs of each board and requirements will vary, even if induction is a requirement.

64. The majority of the countries reporting in Latin America indicated that there are no formal specific board induction programs. However a number of countries report informal practices either at the level of the board or initiated at the request of ownership entities. It is important to note that three of Latin American countries that have ownership entities or co-ordination units –Brazil, Chile and Peru–provide orientation to the board members.

65. In **Brazil**, DEST is responsible for providing orientation activities for its representatives on the board (members elected by the Ministry of Planning). Usually, DEST sends standard reports such as updates on SOEs' execution of the Investment Budget and a monthly summary of DEST's technical reports for each SOE. The ownership entity is not obliged to provide orientation to representatives from the line ministry, minority shareholders or employees. It is important to note that holding companies are responsible for giving orientation to their representatives in any of their subsidiaries.

66. In **Chile**, SOEs are responsible for establishing their own formal induction programs, as stated in the SEP guidelines. These induction programs must be tailored to the SOE, highlight its overall objective as a company and provide key background knowledge. Important information provided in an SOE's induction program includes the SOE's goals, financial position, board duties and organizational structure. Additionally, SEP coordinates at least two annual seminars for discussing specific matters related to the activities developed by the different SOEs. This includes information regarding the specific obligations and duties of SOE boards under SEP and corporate governance matters, which are important to the management of companies, based on the guidelines provided to every board and director.

67. **Peru** offers induction to new directors, provided by FONAFE's Executive Director and by each SOE's General Manager. Although there is no defined format for induction, each SOE General Manager usually explains the applicable laws, the problems facing the company and the relevant aspects of the business and sector in which the company operates. During five hours of presentations, FONAFE's Executive Director describes the organization's duties and responsibilities, financial data for SOE's controlled by FONAFE, and board members' rights, obligations and prohibitions.

68. Although, there is no formal process for the induction of new directors established in **Costa Rica**'s laws, it is a common practice for each SOE to provide induction/orientation to new board members. The format varies for each company; presentations and internal board meetings are commonly used.

69. Similarly in **Uruguay**, SOEs generally have meetings before the appointment of a member even if there are no official rules to establish induction programmes in the country. These meetings rely on the participation of the country's President, the line ministry or the OPP.

## Board Education/Training

70. The OECD considers ongoing professional development to be good practice and SOEs should focus on facilitating thematic training in areas where supplementary skills are needed on an individual or board basis (for example on accounting standards, tax codes/legislation, or laws, regulations and other areas of relevance to the function of the board). In most Latin American countries, general training for boards is not a formal requirement and it is uncommon for SOEs to have a legal obligation to provide board education and training. In consequence, many countries expect board members to already have the necessary qualifications and experience to perform their duties. Those who regularly provide board training or have tried pilot education programs in the past report a good level of satisfaction with the outcomes.

71. In **Chile**, SEP organizes training programs for all board members - not differentiating among public sector, independent or employee representatives - with the assistance of Corporate Governance Centers. Such training is tailored to the many specific characteristics of SOE boards. Additionally, the organization carries out both seminars and one-on-one meetings with SOE boards, chairpersons and audit committees. SOEs may implement their own separate board training within the enterprise. No training is provided before the nomination process takes place. Training is taken into consideration during the annual evaluation process of the SOE's boards under SEP. The country's respondents reported that there is no formal accreditation linked to director education and training. Specialized training is also available through educational institutions (e.g. course on corporate governance for public companies developed by a local University - *Diplomado en Gobierno Corporativo para Directores del Sistema de Empresas Públicas*).

72. Although in **Peru** FONAFE is not legally obliged to provide training sessions, some training events have been organized in the past in order to guarantee sound governance and to improve directors' capabilities. Board members have also attended courses at business schools and taken on-line courses on corporate governance and management skills.

73. Similar to Peru, board member training in **Costa Rica** is not a legal requirement for SOEs. Still, board members might be part of informal training such as workshops and courses. The costs and expenses for these training sessions are covered by each SOE. An exceptional case is the National Institute of Insurance (*Instituto Nacional de Seguro –INS*) as its law of creation dictates that half of the institute's board must receive training at least once a year.

74. There is no formal training program provided to government representatives at SOEs in **Brazil**. DEST provides general technical guidelines for topics related to the department, through seminars and before their monthly meetings. This training is aimed at all board members, whether government, minority shareholders or employee representatives. However, other documents, such as investment reports and decisions minutes, are only provided to representatives of the Ministry of Planning. Brazilian SOEs do not offer any "off the shelf" training.

75. In **Argentina**, there are no requirements for board education and training; however, each SOE makes its own effort to keep board directors up-to-date and continue their professional development. In particular, directors that are members of an audit committee must receive training in order to ensure the sound governance of SOEs (*Resolución N° 37/2006 de la Sindicatura General de la Nación*). As reported in 2012, the National Securities Commission (CNV), the Ministry of Economy and Public Finances and the General Trustee of the Nation (*Sindicatura General de la Nación –SIGEN*) financed and implemented a program in 2011 that focused on updating director knowledge of relevant laws, such as the Company Law, Law of State Financial Administration and Internal Control Systems (*Ley de Administración Financiera y de los Sistemas de Control del Sector Público Nacional – 24,156*). The program lasted three months – with four-hour meetings twice a week – and was conference-based. This program has not been repeated. The

country's respondents believe that there is no centralized training due to the lack of a central ownership entity.

76. **Paraguay** and **Uruguay** reported that there is no form of board education or training provided.

### **Board Committees**

77. The *OECD Guidelines* recommend that when necessary, SOE boards establish specialized committees, particularly audit, risk management and remuneration committees. Committees serve to reinforce the competency of the board, while preserving independence in key board functions, such as in audit. When not required by law, the ownership entity should define criteria for when specific committees are necessary, which could vary according to SOE size, specific risks faced or competencies that should be reinforced. It is important to note that large SOEs should at least be required to have an audit committee. Non-executive directors should be responsible for chairing the committees, and these should include a significant number of independent members. This number and type of independence required should be related to the type of committee, the sensitivity generated by conflicts of interests and the sector where the SOE operates. In most OECD economies board committees are not mandatory; however, France and Finland have recently encouraged the establishment of committees. There is a growing trend in Latin America to establish specialized committees in SOEs, with some based on regulatory requirements. There is also a tendency to consider independent or at least non-executive directors as a fundamental requirement for committee composition, especially for audit committees.

78. **Argentina's** SIGEN regulates that state majority-owned companies (with the exception of SMEs, financial institutions and listed companies) should incorporate an Audit Committee with at least three members of which at least two should be independent. The definition of independence is set in the SIGEN regulation. Regulation which also determines the duties and responsibilities of the Audit Committee, which could exercise attributions related to other specific committees such as remuneration or risk if these are not created. For state minority –owned companies, SIGEN suggests that the state board representative should try to promote every policy and practice to enhance good governance.

79. In **Brazil**, listed SOEs must have a remuneration committee and many financial institutions establish separate risk and audit committees. DEST has submitted a formal proposal (not yet approved) to create Audit Committees at SOEs, which would be separate from the compliance and risk management area. The committee, designed to give support to each SOE board, would be composed of both board members and external members. These external members would include a financial specialist and a specialist relevant to the SOE's particular sector.

80. Also in **Chile**, SOEs that are under listed companies' regulation (i.e. Codelco) must establish an audit committee – with at least one independent director - if their assets exceed a certain threshold.

81. **Costa Rica, Ecuador** and **Peru** reported that the establishment of board committees has become a common practice even if there is no legal obligation for SOEs to set up such committees.

82. Issuers of publicly-traded securities in **Colombia** are required to have Audit committees formed by at least three directors, including all the independent directors. For companies that fall under the responsibility of the Financial Superintendency, audit committees must be established, which are also responsible for evaluating business risks. SOEs under the country's corporate governance code (*Codigo Pais*) are recommended to establish an audit committee, appointments and remunerations committee and a corporate governance committee. SOEs under MHCP portfolio do not have a streamlined practice on board committees. For those that fall under the Defense Ministry, SOEs tend either to establish audit committees only, or to not establish board committees.

83. In **Mexico**, board committees are only required for PEMEX, CFE and development banks. However, every SOE board is allowed to establish technical or specialised committees to help with strategic planning and supervision of management. PEMEX and CFE must have four committees (Audit; Human Resources and Remunerations; Strategy and Investment; Acquisitions, Leasing, Works and Services). In these companies, the Audit Committees must have at least three independent directors and all committees must be chaired by an independent director.

## PART 2: FUNDING AND FINANCING OF STATE-OWNED ENTERPRISES

84. The funding and financing of wholly or majority owned commercial SOEs (those that receive a majority of their income from sales and fees) is an important topic when considering good governance practices. If the conditions of SOE financing are not market-consistent, as outlined in the OECD *Financing State-Owned Enterprises*, this could undermine the objective of developing competitive markets based on a level playing field with private competitors. The OECD explains that financing for an SOE at a lower cost than its peers can serve to undercut its competitors and reduce the enterprise's incentive to boost productivity. On the other hand, higher costs of financing can have a negative effect on an SOE's financial and commercial viability. According to the *OECD Competitive Neutrality* report, these unjustified advantages – lower costs of financing- or disadvantages – higher costs of financing- generated purely as a result of their government ownership, should be avoided for both political and economic reasons. As the relevant regulator, the state should ensure that market competitors are “playing fair” while making certain that SOEs also comply with any applicable public service mandate. Any public service that SOEs are expected to undertake that go beyond normal commercial practices should be transparently funded by the state budget, and if possible, subject to separate accounting. The economic rationale for this approach is that disadvantages for some market players could exclude from competition those who produce goods and services more efficiently. This section is aimed at SOEs of a largely commercial nature and not those SOEs whose primary purpose is to fulfil public service obligations or achieve sectoral policy objectives. Having said that, respondents have shared interesting cases where countries have established special financing arrangements for the fulfilment of public service obligations by otherwise commercially-operating SOEs, or cases in which SOEs do not compete with private enterprises.

### Overall Government Review Processes for SOE Budgets

85. The overall requirements and processes established for SOEs to submit annual budgets for review and approval are different for each Latin American country analyzed in this report. Although it is difficult to establish comparative characteristics in detail, we can highlight the fact that final budget approval is in almost all cases the responsibility of government institutions such as the Ministry of Finance or National Congress. The SOE board or AGM are responsible for drafting and/or pre-approving the budget. Peru is the only country in which budget approval remains within the responsibility of the ownership entity. This practice is similar to the most common OECD model, where budgets would be submitted to the annual meeting but not necessarily require government approval except for specific investments or public service obligations that require separate financing from the regular SOE budget. Only two countries, Argentina and Mexico, highlighted the possibility of developing multiannual budgets under separate requirements or processes.

86. In **Peru**, FONAFE's board has the delegated authority to approve a consolidated budget for all SOEs under its ownership. Each SOE budget and annual work plan must be prepared by its respective Board of Directors and be aligned with the Macroeconomic Multiannual Framework, a set of guidelines established by the Ministry of Finance. Once FONAFE has consolidated and approved the budgets, each SOE must obtain AGM approval for their respective budgets.

87. Similar to Peru, in **Chile** the ownership entity is deeply involved in the process for producing SOEs' budgets; however final approval is the responsibility of the Ministry of Finance. The process starts when each SOE develops its own strategic plan to present to SEP for its review and approval. In this way, SEP must agree to a set of strategic objectives and an investment plan – both associated with key



performance indicators – with each SOE. The SOE uses this input to develop its annual budget. Each SOE subsequently submit its budget to the Ministry of Finance, which requests the SEP’s opinion regarding the consistency between the budget and the previously approved strategic plan.

88. Financing practices for **Argentina’s** federal public sector are regulated by the Financial Administration Law (*Ley de Administración Financiera y de los Sistemas de Control del Sector Público Nacional*). This law applies to all SOEs, whether they are fully owned, majority- or minority-owned by the state. The law seeks to guarantee that SOEs apply the principles of financial regularity, legality, economy and efficiency whenever obtaining and using public funds. It also develops systems that ensure that SOEs provide timely and reliable information about their financial behavior, which is useful for daily management and for evaluating the overall performance of each area.

89. The Financial Administration Law also establishes the approval procedure for SOE budgets. According to the law, the National Budget Office (*Oficina Nacional de Presupuesto*) is responsible for establishing the technical norms for SOE budget creation and evaluation, taking into consideration the general principles and guidelines regarding public sector budgeting and financing provided for in the Coordinating Body of Financial Management Systems (*Órgano Coordinador de los Sistemas de Administración Financiera*). SOEs must follow these norms or guidelines when drafting their annual budgets, which should include all expected costs and resources, providing an overview of the company’s transactions and financial results for the period. Following the board’s approval, the SOE must submit its budget to the National Budget Office, which produces a report assessing whether the budget is in line with the country’s policies, strategies and objectives for the SOE. If the company does not present its budget in a timely manner, the National Budget Office prepares its own draft to submit to the National Government. Ultimately, the National Government approves all SOE budgets.

90. Regarding multi-year budgeting, projects that will take more than a fiscal year to develop must ensure the budget includes information regarding the resources invested in previous years as well as those to be invested in the future. The budget should also outline the project’s total cost and execution schedule. The National Government’s approval of the budget implies that the project has received authorization for the project to develop. However, this authorization will expire if the project has not commenced by the end of the fiscal year.

91. In **Brazil**, each SOE budget – which must align with the company’s business plan and strategic plan – is subject to the board’s approval. The budget is then submitted to the line ministry and DEST for its evaluation. Afterwards, the budget is consolidated with both the Investment Budget (*Orçamento de Investimento* – OI) and the Global Expenditure Program (*Programa de Despesas Globais* – PDG), which must be approved by law and presidential decree, respectively. In the case of *dependent SOEs* (companies entirely funded by the state, which receive financial resources for ordinary expenses and operations) the process is similar. However, DEST has no role in the budget submission and the Secretariat of the Federal Budget performs the consolidation.

92. Regarding multi-year budgeting, each SOE prepares its own multiannual strategic plan. Most SOEs also prepare a multiannual internal budget. These documents are not approved by the government and must be in line with the OI.

93. In **Colombia**, the MHCP is responsible for the budgetary process for SOEs that have more than 90% state ownership; in particular, the ministry participates in the planning, adjustment and monitoring of the budget process. The National Public Budget Office holds budgetary control for these types of companies. For certain SOEs, the National Economic and Social Council (CONPES) has jurisdiction on budget issues.

94. SOE budgets in **Costa Rica** are not subject to the state's executive power approval. The central government establishes annual guidelines, both general and more specific regulations, which companies must follow when proposing their budgets. According to Financial Administration and Public Budget Law (*Ley de la Administración Financiera de la República y Presupuestos Públicos*), the guidelines are drafted by the Budget Authority (*Autoridad Presupuestaria*) and then approved by the President. Some SOEs are not obliged to follow the guidelines. These include the Electricity Institute of Costa Rica (ICE), the National Institute of Insurance (INS) and companies that operate in the financial sector. The National Controller (*Controlaría General de la República*) – an auxiliary entity to the legislative power – gives final approval for SOE budgets. Multiannual budgets are not permitted under Costa Rica's regulations.

95. In **Ecuador**, SOEs must present their budget proposal, including expected incomes and expenditures, to the Ministry of Finance. Together with SENPLADES and each SOE, the Ministry of Finance analyzes and adjusts the proposal. Once the Congress (*Asamblea Nacional*) approves the federal budget, the SOE modifies its budget in line with the general budget approved by the Board of Directors. Afterwards, the budget is submitted to the Ministry of Finance for its final approval.

96. In **Mexico**, SOE budgets are based on their annual work programmes and must include a description of the capital necessary for the organisation to fulfill its operations and overall objectives. The budget must follow the Ministry of Finance's general guidelines, expenditure ceiling and terms, as well as the specific guidelines provided by the Coordinating Ministry. CEOs present their budgets to the Board for approval, which is then submitted to the Ministry of Finance through the Coordinating Ministry. The budget is integrated into the country's Federal Budget, which is afterwards submitted to the Chamber of Deputies for its approval. In the case of PEMEX and CFE, they have budgetary autonomy. Then, in order to prepare their annual budget, the Ministry of Finance provides them with details of estimated variables that will affect the following fiscal year in order to allow the CEO to use this information in the preparation of the budget draft, which must be approved by the Board. If the Ministry of Finance believes that changes should be made to the budget draft, they will communicate this back to PEMEX and CFE. As a final step, Congress must approve the edited budget draft.

97. For multiannual budgets, SOEs must include the projects and contracts they will develop over the coming fiscal year and outline expenditures that are likely to span more than one financial year. For a project or contract that an SOE proposes during budget preparations, the organization must submit an assessment of costs and expected profit to the Ministry of Finance. The project is subsequently included in the investment portfolio, which is later evaluated by the Public Expenditures Commission (*Comisión Intersecretarial de Gasto Público Financiamiento y Desincorporación*) in order to decide the project's preference and inclusion in the federal budget. On the contrary, if an SOE proposes a project or contract during the budget's execution – in other words, during the fiscal year – the CEO's authorization is needed. The SOE must inform the Public Function Secretary (*Secretaría de la Función Pública*) about such projects and, in addition to quarterly reporting, must provide the Ministry of Finance with the total amount spent during the period and the project's consistency with the draft budget forecast for the following year. PEMEX and CFE have budgetary autonomy and do not require the Ministry of Finance's authorization in order to exercise their budgets. However, after their boards' approval, multiannual projects must be included in the federal budget.

98. In **Paraguay**, the Ministry of Finance issues a budgeting guidelines decree based on which the budget should be drafted. After the Ministry approves the budget draft, it is submitted to Congress. Stock corporations do not have to submit their budgets to the Ministry of Finance, but they do have to present financial information including assets and monthly budget implementation. They must also provide Congress with a budgetary annex after the closing of the fiscal year. Although stock corporations' budgets do not require the Ministry of Finance's approval, they must inform the Ministry of any changes in the budget.

99. Although SOEs in **Uruguay** have budgetary autonomy, there is government intervention in the budgeting process. Annually, each SOE presents to the executive power and Court of Auditors (*Tribunal de Cuentas*) its budget together with a report explaining its goals, objectives and investment profiles for a five-year period (i.e. the term of office of the country's President). The executive power and the Court of Auditors can make observations to the budget. Should the SOE reject the observations, Congress must solve any budgetary discordance by a two-thirds vote. If Congress does not vote within 40 days, the budget is approved, including the executive powers' observations.

## Capital Structure

100. Decisions regarding capital structure influence both the sources and cost of SOE financing (i.e. debt, equity, etc.), and SOEs' use of capital resources to create value for investors, owners and the broader public. According to the *OECD Financing State-Owned Enterprises* study, maintaining an optimal capital structure, a challenge for any company, presents additional challenges for commercially-oriented SOEs that also must address public policy concerns, as it directly affects competitive neutrality. The report also highlights that in most OECD countries, SOE boards and management are responsible for capital structure decisions and that the authorities are usually responsible for their oversight. The state's role can then range from limited participation to setting broad guidelines that ensure proper capital structure or to directing review and approval. This section focuses on the responsibilities that Latin American states and SOEs boards have in determining SOEs' capital structures.

101. In general, Latin American SOEs' capital structures are different than private companies, since SOEs usually rely on their own revenues to finance their investments and operations, and thus SOEs tend to have lower levels of debt, as is the case for Brazil, Chile, Costa Rica and Peru.

102. In **Argentina** and **Ecuador**, SOEs' capital structures are established in their laws of creation. Boards play an advisory role by assessing whether each Argentine company's capital is sufficient for its activity or if it would be necessary to obtain new resources from the owners or third parties. This information should be included in the annual report. However, it should be noted that for engaging in public credit operations – that is, acquiring debt – SOEs in Argentina must have the prior approval of the Coordinator Entity of Public Finance Administration (*Órgano Coordinador de los Sistemas de Administración Financiera*).

103. In **Brazil**, each SOE determines its own capital structure. There are no general guidelines to be followed in these decisions. However, capital increases must be linked to investment projects and are subject to DEST approval. Long-term credit operations also require the approval of DEST.

104. Similarly, in **Peru**, SOEs' boards and management make proposals regarding financial needs, as part of the budget, which must then be approved by FONAFE's board of directors. The AGM ratifies the board's decision. This defines the proposed capital structure.

105. In **Chile**, it is not common for SOEs to determine an optimal capital structure. This is largely because the Ministry of Finance makes the final decision regarding dividends, debt and capitalizations for each SOE. In recent years, the state's practice is to have SOEs to fund their investments with their own resources. In those cases where additional resources are necessary, SOEs can assume debt or, as a last option, seek capitalization from the state. Only in special cases will the Ministry of Finance allow companies to borrow in order to finance their development, and in even fewer cases will the government agree to increase their public capital.

106. Like in Chile, in **Paraguay**, the Ministry of Finance holds the responsibility of determining the capital structure of SOEs, including the country's budget. For stock companies, the board and the AGM

hold this responsibility. For fully-owned SOEs, the Public Administration Law (*Ley de Administracion Financiera*) and the Budget Law (*Ley de Presupuesto General de la Nacion*) act as guidelines for a SOE's capital structure, highlighting the necessity of financing debt through the company's own resources. Majority-owned SOEs follow the rules of the civil code as a general principle, and may set their own rules in their bylaws.

107. There are two types of SOEs in **Costa Rica**. One group includes companies whose legal frameworks have been modified and modernized in order to grant them autonomy and flexibility regarding their capital structure. For this type of SOEs, the board calculates the company's total debt, since most projects presented by management – including their funding options – require the board's approval. However, limits are established in their bylaws, particularly regarding debt, which encourages the use of their own resources in investment projects. For example, the electricity SOE ICE can negotiate and take on debt worth up to 45% of its total assets. For the other group of SOEs (i.e. those that do not have modernized legal frameworks), financing decisions are subject to technical revisions and approvals from the Central Bank, the Planning and Economic Policy Ministry or the Ministry of Finance.

108. In **Mexico**, there is technically no overarching principle that guides decision-making regarding the capital structure of SOEs. However, in general, the government seeks to provide each SOE with the resources they need in order to develop their operations, consistent with government solvency and financial stability. According to Mexican regulations, Congress is the government's highest authority for financial decisions, as it establishes the amount of debt that both the government and SOEs can assume.

### **Actions affecting SOEs' capital**

#### **Rate of return requirements**

109. The World Bank Toolkit recommends to “cover the need for a positive return to shareholders, a positive rate-of-return for commercial SOEs, and efficient operation of social SOEs”. The establishment of appropriate rate-of-return requirements is a way to secure the efficient use of capital resources to create value based on commercial activities. More efficient capital resources allocation can be achieved by measuring and monitoring market consistency between rates-of-return requirements of SOEs compared to that of private companies. Commercial SOEs that fail to ensure this consistency could face disadvantages when compared to private sector competitors. On the other hand, SOEs subject to rate-of-return requirements are also disadvantaged if these rates of return do not take into account the costs of performing non-commercial activities. The OECD Guidelines suggest that authorities can avoid market disadvantages through targeted subsidies for SOEs' non-commercial priorities and ensuring that rate-of-return requirements apply only to SOEs' commercial activities.

110. Representatives from all of the countries analyzed in this report stated that there are no general rate-of-return requirements established for their national SOEs. Many of them indicated that SOEs boards are ultimately responsible for approving the rate-of-return objectives. This contrasts with practices in OECD countries, the majority of which have established rate-of-return targets for SOEs' commercial activities, which are either elaborated by the ownership entity or by the boards in close consultation with the ownership authorities.

111. **Chile** is the only reported case whose ownership entity seeks to establish rate-of-return requirements. SEP does not require the SOEs to fulfil an annual requirement but rather requires the projects implemented by the SOEs to meet a certain rate of profitability. In particular, requirements for SOEs under SEP are based on performance metrics such as EBITDA, EBIT, ROE and ROA.

112. In **Argentina**, SOEs must define financial objectives and present them, together with their budgets, to the Ministry of Economy and Public Finance, which will afterwards submit them to Congress. Quarterly and annual evaluations are conducted and any deviation from the approved objectives must be explained. At the end of the fiscal year, each SOE presents a report to the Ministry of Economy and Public Finance and to Congress stating the main financial developments of the year (Cuenta de Ahorro, Inversión y Financiamiento).

113. In **Colombia**, the General Directorate within the National Public Budget Office, with the advice of the National Planning Department (DNP), proposes the amount of SOE profit that goes towards the National Treasury.

114. **Ecuador, Costa Rica, Mexico, Paraguay, Peru and Uruguay** have no general rule established for rate of return requirements. Usually, financial or profit targets are defined either in each SOE annual budget or financial program, and must be aligned with the country's objectives for the company. There is no legal sanction in place for when profit targets are not met.

### **Dividend payout and levels policies**

115. The countries analysed in this report do not have an overarching principle that guides decisions on dividend levels, except for Argentina, Brazil (where company law applies to SOEs and regulates some elements of dividends' policies) and Uruguay. These types of decisions are influenced by SOEs' performance, their ability to access external financing for future capital needs, and, in some cases, state budgetary needs. As highlighted in the *OECD Financing State-Owned Enterprises* report, OECD member governments typically involve themselves in the process of establishing expectations for dividend levels at some point in the process, but methods for doing so vary substantially. OECD country practices may vary between use of no dividend guidelines or targets, broad guidelines or establishing an explicit percentage of net income.

116. In **Argentina**, dividends can only be distributed from the company's net profits and after the approval of the annual financial statements. In practice, SOEs do not distribute dividends, with YPF (the country's petroleum company) being the only exception. Although it has been reported that there is no explicit dividend policy, profit reinvestment is the general practice. SOEs are more guided by the need to develop their activities than by a profit expectation.

117. In **Brazil**, at least 25 per cent of profits must be distributed as dividends and 5 per cent must be retained. The use of the remaining profits must be decided at the AGM. Even though there is no federal directive about SOEs' dividends, DEST suggests that when dividends are distributed in excess of the minimum 25 per cent set by the law, SOEs should ensure that such practice is compatible with their financial/economic situation. In addition, DEST also seeks to ensure that profit retention is linked with investment projects or credit expansion. At the AGM, the Ministry of Finance represents the federal government. However, the government casts a combined vote made by the Ministry of Finance (which prioritizes dividend payments to address the government's cash-flow needs) and the Ministry of Planning (which prioritizes the retention of profits to fulfil investments approved by Congress). The AGM must consider DEST's opinion. Some companies are used to stabilizing their dividends around a fixed historical percentage. Extraordinary dividend payments can only be made when they are established in the SOE's bylaws.

118. In **Uruguay**, there is a formal policy for dividend payouts to the executive power, which follows a specific calculation process. For commercial and industrial companies, the dividend payout is negotiated as part of the Financial Program and is a result of the profits earned in the fiscal year. In banking companies, dividends are decided by considering the results of the previous fiscal year. Additionally, each

SOE's bylaws may contain specific rules about percentages over annual profits. There has not been any prior case of extraordinary dividend payments.

119. In countries such as Chile, Ecuador and Mexico, dividends in some cases are subject to fulfill large pay-outs to the state to fulfill public uses. While common practice in many parts of the world – according to the *World Bank Toolkit* – basing dividends on unrelated public finance needs rather than primarily on the analysis of the SOE's own financial situation and investment needs --is not an optimal approach. OECD research has revealed that using dividends to fund public activities can be harmful to an SOE's commercial viability, for example when their use diverts resources from investments that may be needed for the SOE's longer-term sustainability. On the other hand, when dividends are retained and not distributed at market levels, SOEs could gain competitive advantages when compared to their private counterparts.

120. In **Chile**, the dividends policy changes each year and is not based on SOEs' capital structure. SEP enterprises are expected to distribute 100 per cent of profits as dividends to the state. However, this policy is flexible, depending on the SOE's committed investments and debt financing alternatives. SOEs' boards must propose a dividend level in their annual budget, which is subject to approval directly from the Ministry of Finance or in the case of enterprises in SEP's portfolio by SEP at the AGM.

121. In **Ecuador** the Board of Directors determines the investment and reinvestment level in order to provide for the company's operations. The remaining profits must be distributed to the government.

122. **Mexico's** SOEs should aim to cover costs and legal and fiscal obligations. Generally, most SOEs operate at a loss, which means the state does not benefit from dividend payments. Two of the largest Mexican SOEs, PEMEX and CFE, must provide the Federal Government with a detailed report about their financial situation. The Ministry of Finance then determines an appropriate dividend level, which in PEMEX's case requires the prior approval of the Technical Committee of the Mexican Petroleum Fund. Congress must approve the proposal and PEMEX must then deliver the dividend to the Federation Treasury. It should be noted that PEMEX provides one third of government revenues, according to the World Bank case studies on Latin America. For most SOEs, there is no principle regarding whether the company should reinvest or distribute their revenues. On the contrary, PEMEX and CFE are required to reinvest any earnings not distributed as dividends to the government. Extraordinary dividends are not regulated under Mexican law.

123. In **Costa Rica**, there is no overarching principle guiding dividend levels. Instead, decisions regarding dividend distribution vary depending on the sector and context in which each SOE operates. Companies offering public services must only make enough profit to cover their expenses. Other companies, should they make a profit, are obliged to distribute dividends. In some cases, SOEs are required to distribute their earnings to associations, institutions and organizations of social interest, such as hospitals, education funds or pension regimes.

124. In **Colombia**, the MHCP's Investment Bank Division is responsible for performing a technical study of the SOE's borrowing level which it uses to establish a dividend policy based on the SOE's financial capacity. CONPES looks at the state's financial needs in order to determine the amount of profits to be either paid or retained by certain SOEs.

125. For stock companies with state majority-ownership in **Paraguay**, shareholders decide on the dividend payout based on the capital structure and the expected profits of the SOE. There is currently no policy regarding the re-investment of earnings in the form of dividends. However, the CNEP is working on a policy for stock companies and SOEs under the country's general budget. The latter currently distributes

dividends to the state based on the country's budgetary needs. There have not been any situations of extraordinary dividends.

126. In **Peru**, profit reinvestments or dividend payouts are decided on a case-by-case basis. SOEs present their proposed dividend levels to FONAFE's board. If approved, the proposal is presented to the AGM for approval. To determine dividend levels, on- and off-market cash flow and financing possibilities are analysed for each SOE.

### **Direct State Support**

127. State support provided to SOEs does not necessarily result in an uneven playing field between SOEs and private competitors. In fact, when SOEs are responsible for both commercial and non-commercial activities, state support should be directed towards the latter. This can help SOEs avoid the competitive disadvantages that impact their commercial objectives when focusing on non-commercial ones. When an SOE has these types of social-public responsibilities and obligations, the *OECD Guidelines* suggest that the related costs and activities should be clearly identified and funded by the state budget in order to avoid market distortions. The majority of OECD countries surveyed in the *OECD Financing State-Owned Enterprises* report provide state support for public service obligations, which can take several forms: direct capital injections, subsidies and, although less common, reductions in the rate-of-return requirements. European Union (EU) member countries are subject to the EU state aid rules which prohibit any support that would distort competition or be against the general interest. All respondents from Latin American countries reported that their countries provide state support, with the exception of Costa Rica. Their answers showed varied methods to determine how and when that support is warranted.

128. In **Argentina**, direct contributions from the state are given to support SOEs activities that are economically unviable. The Treasury transfers funds either to cover operational costs or to compensate the company for the social services that it provides. For example, Correo Oficial de la República Argentina S.A. (the country's postal company) is compensated for maintaining its offices in places where there is no economic benefit in order to comply with a social purpose. It is important to note that SOEs cannot work in permanent deficit, as private sector regulations –which demand mandatory capital reductions— are applicable to them.

129. In **Brazil**, when public policy is translated into investments (e.g. infrastructure), the government provides financial support through direct capital contributions. According to a constitutional mandate, the government's contribution to *non-dependent companies* must always translate into an investment project.

130. In **Chile**, the Treasury contributes to financing SOEs – in order to assure the provision of public services with high externalities – through capital injections or ordinary transfers approved each year in the Budget Law. Although there is no specific process for these situations, there have been recent examples of SOEs receiving financial compensation for Chilean transport companies. For example, Chile's railway company (EFE) received funding from the Treasury for a three-year investment plan. Separately, the Metro (Santiago subway) secured funding arising from its mandatory public service.

131. While no overall policy on state support for SOEs was articulated for **Mexico**, CFE and PEMEX provide some examples of such support. CFE has an Electric Universal Service Fund – established by the Ministry of Energy – that finances activities related to energy in rural communities and marginalized urban areas. The Fund provides the resources needed for CFE to act as a distributor and supplier of basic electrical services. On the other hand, Mexico's Hydrocarbons Law states that PEMEX may be required by the government to conduct projects considered to lead to social benefits and economic development. The costs of these types of projects would be funded based on the federal budget, which is approved by Congress.

132. **Peru** provides state support to commercial SOEs that fulfill social objectives separate from their commercial targets.

133. **Paraguay** and **Uruguay** reported that they analysed direct state support on an ad-hoc basis, determining whether the project is a government priority and the degree of financial support that the state will provide.

### **Equity financing and modes of (re)capitalization**

134. The *OECD Financing State-Owned Enterprises* report highlights that a small number of OECD countries have established mechanisms to ensure market-consistent equity costs, which help to underpin competitive neutrality objectives. Australia, Estonia, Hungary, New Zealand and Sweden have implemented interesting requirements in which recapitalizations can only be provided to projects that demonstrate a minimum expected rate-of-return. Such mechanisms to support market consistency in equity financing and recapitalization tend not to be well developed in Latin American countries. A more viable way to leverage the resources of SOEs has been to utilize other forms of financing, such as joint ventures. However, this is still not common practice in the region. In countries where new SOEs have been recently created, such as in Argentina, Brazil and Ecuador, there is a common trend to establish new companies for political reasons, whether the government wants to operate in a strategic sector or the SOE will provide public services. Whether these receive or not the majority of their income from sales and fees, no economic or financial reasons were reported as the rationale for their creation.

135. As SOEs in **Brazil** adhere to private companies' regulations, the federal government as a shareholder is allowed to allocate resources for capital increases from the federal budget. This type of recapitalization must be approved at the shareholders' meeting. Minority shareholders are granted pre-emption rights. For unlisted companies, the government transfers the resources as an Advance for Future Capital Increases (Adiantamento para Futuro Aumento de Capital – AFAC), and afterwards the issue is discussed at the AGM. Conversely, listed SOEs issue new shares and offer them to every investor, after shareholders' approval. Capital increases are not common practice because of their complexity and the possibility of accessing less complicated sources of financing.

136. SOEs are also permitted to undertake joint ventures with private companies in order to finance specific projects. Nevertheless, SOEs often choose to establish a new SOE, with minority private capital, or participate in a private company. Establishing a new SOE requires DEST approval while holding a minority stake in a private company is a Board-level decision. In both cases, Congressional authorization is needed.

137. In **Chile**, recapitalization from the federal budget is always subject to approval by Congress. Metro SA and SAISPA SpA rely on regular recapitalizations to finance their investments, approved by the Budget Law. There have also been SOEs, such as CODELCO, ENAP, and BECH, which have required extraordinary recapitalizations that were implemented in special laws, allowing the companies to receive direct capital transfers. In the case of unlisted, wholly owned SOEs, equity issuance does not include procedures to ensure that the cost of capital is market consistent. For majority-owned SOEs, recapitalization decisions are made at the AGM with the participation of minority shareholders.

138. Recapitalization from the federal budget is not common practice in **Costa Rica** and local SOEs are using other mechanisms to grow their business. ICE (Costa Rica's electricity company) and RECOPE (the country's state-owned oil refining company) have both expanded through acquisitions or joint ventures. ICE acquired Cablevision in 2013 in an attempt to extend its influence in the telecommunications market. In 2008, RECOPE created a joint venture with China National Petroleum Corporation (CNPCI) for



a refinery project. However, it is important to note that joint ventures are not common practice for public companies in the country.

139. In the case of **Ecuador**, recapitalizations from the federal budget do not arise from the issuance of new equity. SOEs are legally entitled to associate with private and public companies, whether national or foreign, in order to develop new projects, access new technologies or reach productivity goals.

140. As SOEs in **Mexico** do not have shared stock structures, government recapitalization cannot occur through the issuing of new equity. Instead, the federal government makes expenditures called “contributions” to increase SOE funds. Due to the recent Energy Reform, PEMEX and CFE are now authorized to pool resources with private companies in order to undertake various projects.

141. In **Peru**, the recapitalization of SOEs is common practice. Resources from the federal budget are transferred to SOEs for the execution of some projects and then capitalized, usually by issuing common and preferred stock. In majority-owned SOEs, minority shareholders are consulted about recapitalization decisions. If unlisted SOEs are looking to issue equity to attract private investors, financial consultants conduct a study of the cost of capital, in order to determine share prices.

142. In **Uruguay**, recapitalization of SOEs can occur; however, they must be done so by law. Due to the inability of SOEs to issue shares – on account that they do not have share structures – tradable debt instruments are used for recapitalizations. In order to ensure market consistency, the issuing of tradable debt instruments is made public and also relies on the intervention of the Central Bank of Uruguay and the two Uruguay Stock Exchanges. Generally, the interest rate is aligned with the type of company and its risk of default. Joint ventures or pooling with private companies are not used in practice in Uruguay.

### **Sources and cost of debt financing**

143. Authorities must keep in mind that potential competitive advantages may not only be provided by the government, but also through market sources who assume automatic government support and therefore provide cheaper financing (due to the perception of a lower default risk). To avoid market distortions, it is important to attain debt neutrality by requiring SOEs to pay the same interest rates as private enterprises in similar circumstances. Following the *OECD Guidelines*, the state should avoid giving automatic guarantees to SOEs, as this could create incentives for creditor abuse. The SOEs of most countries surveyed in the *OECD Financing State-Owned Enterprises* report rely on commercial debt financing, which uses commercial loans as its primary form. Few countries have implemented mechanisms that balance the cost advantages that may surface from such financing, as they claim that there is no evidence pointing towards preferential financing conditions for SOEs on the commercial market. The only country to put in place mechanisms to ensure debt neutrality is Australia, where SOEs must pay a debt neutrality charge when benefitting from debt financing on the commercial market. It is not common practice for SOEs in OECD countries to benefit from a direct government guarantee on commercial debt. In Latin America, almost all respondents assert that there is no evidence of SOEs benefitting from advantageous financing conditions when compared with private competitors, with the exception of certain cases in Chile and Costa Rica. Also all respondents, except for Peru, report on the possibility of governments to provide explicit guarantees to SOEs, and while the processes and requirements vary, none of them report the existence of mechanisms to compensate for this cost advantage.

144. In **Chile**, SOEs can only rely on the market for debt sourcing, as the Chilean Constitution prohibits the issuance of loans from the Government, its agencies and other SOEs. An SOE’s source of financing depends on the amount, cost and timing of each operation as well as the purpose for such financing. For example, large SOEs such as CODELCO, ENAP, EFE and Metro have issued bonds in both international and domestic markets while other, smaller companies have received banking credits. In order

to grant a state guarantee for SOE debt, a law must be created that authorizes the President to provide such a guarantee. In particular, these types of laws allow the state to provide guarantees for a limited amount of collateral. These guarantees expire when the amount distributed reaches its limit. The criteria used to provide guarantees for debts of public enterprises is based largely on the project's social impact. The Ministry of Finance is responsible for setting the maximum amount to be provided between the various SOEs. As for financial conditions for accessing credit, there is evidence that private lenders provide preferential terms for SOEs since State ownership is considered a positive feature during their credit risk assessment. Separately, Chile has no mechanism in place to avoid distortions, based on the understanding that most SOEs develop their operations without private competitors and no compensation for the advantages received are needed. As a form of off market funding, the majority of Chilean SOEs – such as the ENAP – rely on credit from suppliers.

145. In **Costa Rica**, commercially oriented SOEs' funding only comes from financial institutions, both national and international, and from investors, providing debt financing, trusts, or other methods. In general, the source of financing chosen by a SOE depends heavily on variables such as financial cost, available resources, government politics, diversification and maturity. Most SOEs rely on commercial loans for debt financing; however, large SOEs prefer more sophisticated and diverse financial mechanisms such as bonds and trusts. In exceptional cases, a small number of Costa Rican SOEs have relied on their own resources.

146. In Costa Rica, it is possible for SOEs to benefit from government guarantees. For example, in the case of ICE, the company relies on state guarantees to access multilateral bank loans for investment projects. RECOPE once used the government's guarantee to take on a USD 12 million loan. However, the experience was not satisfactory since the loan approval process in Congress took four years. Currently, RECOPE can access commercial loans without the government's guarantee due to its close relationship with the government. This is highlighted by international rating agencies and is the reason why international lenders do not require any guarantee by the government, presumably because even without an explicit government guarantee, commercial lenders perceive an implicit state guarantee and may price their loans accordingly. Consequently, as the company manages Costa Rica's hydrocarbons monopoly, international banks perceive that there is less of a risk and therefore offer better financial conditions than those offered to private sector companies.

147. Costa Rican SOEs also use off-market funding mechanisms. For example, in certain cases, ICE has relied on supplier credits. ICE has taken this approach when the financial cost, terms and the availability of resources are aligned with the nature of the assets being financed, and when these sources include financial advantages for the company compared to other sources available on the market. Also, RECOPE often uses short-term credits from hydrocarbons suppliers.

148. In **Argentina** the approval of the Coordinating Body of Financial Management Systems (*Órgano Coordinador de los Sistemas de Administración Financiera*) is necessary for SOEs to acquire debt. Additionally, if foreign debt is to be acquired, the Central Bank's opinion is required for clearance. When authorized, SOEs are capable of obtaining credit through a variety of instruments, such as debt issuance and placement of securities, bonds, long and medium-term obligations, treasury bills and commercial loans. If the national government needs to give its guarantee for these operations, the authorization should be included in the annual budget or in a specific law. The National Office of Public Credit (*Oficina Nacional de Crédito Público*) is responsible for establishing the public credit system in order to ensure the efficient programming, use and control of the sources of financing.

149. In **Brazil**, SOEs obtain funding from either public or private institutions, without any privilege or differentiation, under the same conditions as provided to the private sector. However, *dependent SOEs* cannot assume financial debt, as only the government can fund them. Conversely, for listed SOEs, the

source of financing and the credit institution chosen is an internal company decision, which must follow the rules defined by the Board, considering the relative advantages of the available market opportunities. In all cases, DEST must monitor the debt level of SOEs. The loan amounts and conditions are disclosed in each SOE's accounting statement for transparency. The Brazilian authorities reported that there is no evidence of private lenders offering more favorable conditions to SOEs than to the private sector. Unlisted SOEs have little or no financial debt. At the end of 2014, only three SOEs in Brazil had financial debt, all at very low levels. For two of these companies, the loans were made through a public bank, a credit line also freely available to the private sector under the same conditions. Any SOE may ask for a government guarantee for its credit operation. The Ministry of Finance must give approval. SOEs can obtain government guarantees only when they have adequate and sufficient resources in order to honor the commitment in full.

150. In **Ecuador**, SOEs can obtain funding from national and international markets, through the issue of bonds, long-term obligations and commercial loans. An SOE's level of debt must be consistent with the Public Debt Committee (*Comité de Deuda Pública*) policies and the company's payment capacity. The Board of Directors must then approve the SOE's financing decisions. Regarding state guarantees, SOEs with payment capacity may benefit from such guarantees for financing investment projects. To this end, the board's approval is necessary as well as a payment capacity study prepared by the Ministry of Finance. Respondents from Ecuador did not report on the existence of preferential terms granted to SOEs by private lenders.

151. SOEs in **Mexico** can obtain financing on the domestic and foreign markets, whether from public or private institutions. No authorization is required if the SOE is seeking credit from a national bank, although the CEO must inform the Ministry of Finance. On the contrary, when the credit is to be granted by a foreign bank, both the board and the Ministry of Finance must provide approval. Unlike other SOEs, PEMEX and CFE do not need the approval of the Ministry of Finance for obtaining credit from national or foreign banks. Nevertheless, they must coordinate their funding actions with the Ministry of Finance in order to avoid any price increase either for them or for the government. The government does not grant explicit state guarantees to every SOE. For example, the government does not back up contractual obligations undertaken by PEMEX and CFE. Development banks, however, are granted those guarantees. Respondents from Mexico reported that there was no information regarding the existence of preferential terms granted to SOEs by private lenders. Nor was any information provided regarding the number of off market funding mechanisms used by Mexican SOEs.

152. SOEs in **Paraguay** obtain financing from a number of sources, including government institutions, financial institutions and multilateral financial institutions such as the World Bank, Inter-American Development Bank (IADB), International Bank for Reconstruction and Development (IBRD) and CAF. Indirectly, SOEs obtain funds from the placement of sovereign bonds in international markets. Short-term loans, which must be cancelled within the fiscal period, can be obtained from local private banks, while international banking is not currently a practice. SOEs in Paraguay do not rely on tradable debt instruments; instead, the most common practice for financing is the use of commercial loans from multilateral financial institutions. However, most SOEs finance their projects with their own resources.

153. Although all loans contracted by SOEs have state guarantees, there is no evidence of private lenders formalising preferential terms for SOEs, according to the Paraguayan authorities. To compensate for SOEs' potential ability to access cheaper financing, they are not able to obtain debts from the market on their own, or to negotiate a variety of financial instruments. The executive is responsible for authorizing the loan which must also be approved by Congress. It is typical for SOEs to rely on off-market mechanisms. In order to avoid debts between SOEs and to ensure against wrongful use such as one SOE being financed at the expense of another, the CNEP has limited this mechanism.

154. In general, **Peruvian** SOEs make use of commercial loans. However, for long-term financing, the law limits SOEs' ability to assume debt. Companies rely on their own resources, which means that government authorization is required for long-term debt financing. Off-market funding is also possible through supplier and client credits, from either the private sector or another SOE. Peru's government has not provided guarantees for SOE debt in the past and reported that there is no evidence of commercial lenders providing differential treatment to SOEs.

155. In **Uruguay**, all SOEs, excluding those that are not profitable, obtain finance in the market. Larger debt operations must be approved by the executive power and Congress. The OPP and the Central Bank perform an analysis of SOE debt financing, allowing them to ensure that the conditions follow those of the market. SOEs lean towards the use of tradable debt instruments because they provide them with better financial benefits and improve their credit performance. In general, the relative importance of financial, commercial and other mechanisms for debt financing is 60, 20 and 20%, respectively. State guarantees are usually provided for financial debts with Multilateral Credit Organizations. There is no evidence that SOEs are provided with preferential terms, according to the Uruguayan authorities, and there are no mechanisms to compensate for potential cheaper financing. In Uruguay, SOEs may rely on off-market mechanisms; the extent of their use depends on the SOE's activity. For example, for the provision of petroleum it is common to use supplier credits.

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## ANNEX 1: COUNTRY TABLES

ARGENTINA	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	137 SOEs (67 of these with ownership above 50% and remainder 10 - 50%). 129 are commercial, 9 are fully-owned and 50 are listed.	Board directors are appointed by the AGM. No formal nomination process or capability requirements exist. Positions on the board are not openly advertised and are based on political decisions. Minority shareholders are protected by the Companies Law, which allows cumulative voting to be used to elect board members.	Argentina does not establish board size limits. There are no written director requirements.	Follows the rules established for private companies in the Company Law. Remunerations cannot exceed 25% of an SOE's revenue.	Limited cases in which the positions are not separated. Board of directors is responsible for designating and removing the CEO.	Argentina does not conduct a top-down evaluation of board efficiency. Listed companies carry out self-evaluations.	No formal induction/orientation process.	No requirement for board education and training. SOEs are individually responsible for maintaining the professional development of their board members.	Majority-owned SOEs should incorporate an Audit Committee. Listed companies require the existence of a nomination committee.
2012 comparative notes	Argentina had 112 SOEs (40 commercial; 17 listed; 23 are fully-owned).	Appointment takes place in the AGM and there are no written requirements for these candidates, with the exception of Energia Argentina which requires that at least one board member have experience in capital markets. For Argentina's 17 listed SOEs, nomination committees are required. In 2012, there was a trend that union representatives be nominated. Politicians are frequently appointed as board members. Argentine SOEs do not advertise board vacancies.	No maximum limit on board size. Argentina nationality is required for nomination.	N/A	N/A	N/A	No formal induction/orientation process.	No official board training program. the National Securities Commission (CNV), the Ministry of Economy and Public Finances and the General Trustee of the Nation ( <i>SIGEN</i> ) financed and implemented a program in 2011 that focused on updating director knowledge of relevant laws. This program has not been repeated.	Certain SOEs require the creation of an Audit Committee. This committee is made up of three independent directors, a Unidades de Auditoria Interna (UAI) representative and a SIGEN representative.

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
National Budget Office is responsible for establishing the technical norms for SOE budget creation and evaluation, taking into consideration the general principles and guidelines regarding public sector budgeting and financing provided for in the Coordinating Body of Financial Management Systems. Following the board's approval, the SOE must submit its budget to the National Budget Office. Ultimately, the National Government approves all SOE budgets.	SOEs' capital structures are established in their laws of creation. Boards play an advisory role by assessing whether each company's capital is sufficient for its activity or if it would be necessary to obtain new resources from the owners or third parties. This information should be included in the annual report.	SOEs must define financial objectives and present them, together with their budgets, to the Ministry of Economy and Public Finance, which will afterwards submit them to Congress. Quarterly and annual evaluations are conducted. At the end of the fiscal year, each SOE presents a financial developments report to both the Ministry of Economy and Public Finance and to Congress.	In line with Company Law, dividends can only be distributed from the company's net profit and after annual financial statements have been approved.	SOEs receive direct state support for economically unviable activities. SOEs cannot work in permanent deficit, as private sector regulations – which demand mandatory capital reductions— are applicable to them.	There is an un-written policy regarding the creation of new SOEs. The government has expanded state participation in some strategic areas previously neglected by establishing new SOEs or retaking of control of companies privatized in the past.	SOEs must have the approval of the Coordinating Body of Management System to acquire debt. Additionally, if foreign debt is to be acquired, the Central Bank's opinion is required for clearance.



BRAZIL	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/ Orientation	Education/ Training	Board Committees
2015	141 SOEs (123 are commercial, 33 SOEs are fully-owned and 108 are majority-owned; 9 are listed).	SOEs follow the same practices that are established for private companies. Although officially appointed at the shareholders' meeting, board members are previously chosen by the Ministry of Planning, minority shareholders, employees and the relevant line ministry. The candidates nominated by the ministries must have the prior approval of the Brazilian President. The company's board has no role in the nomination and appointment process. In the case of mixed ownership, minority shareholders have the right to appoint at least one member to the board, regardless of the number of voting shares that they own.	SOEs establish their own eligibility requirements. Federal public servants attending boards can only be paid for two positions. Board size ranges between 3 and 7 members.	Board members' remuneration cannot be over 10% of the management team's median salary.	Chairs and CEOs are separated. CEO can be removed at any time by the board or the AGM.	Brazil has not established a top-down evaluation process for board efficiency. Each SOE board undertakes annual self-evaluations. These results are not sent to DEST (the SOE governance co-ordination department in the Ministry of Planning, Budget and Management).	DEST is responsible for providing orientation activities for its representatives on the board. The ownership entity is not obliged to provide orientation to representatives from the line ministry, minority shareholders or employees. Holding companies are responsible for giving orientation to their representatives in any of their subsidiaries.	There is no formal training program. DEST provides general technical guidelines for topics related to the department, through seminars and before their monthly meetings. This training is aimed at all board members. Brazilian SOEs do not offer any "off the shelf" training.	Listed SOEs must have a remuneration committee and many financial institutions establish separate risk and audit committees.
2012 comparative notes	147 SOEs (119 commercial; 38 fully-owned; 8 listed;).	The sectoral ministry takes responsibility for the board nominations, leaving one member to be appointed by the Ministry of Finance.	Regulations include 6 members with 1 from the Ministry of Finance. Additionally, Brazilian nationality is required.	Remuneration is set to 10% of manager's median salary. The Ministry of Finance, which decides remuneration, uses results from the board's self-evaluation to fix any issues in the remuneration levels.	Board chair and CEO are separate.	A resolution was recently put in place that requires all board members and managers to perform self-evaluations. These evaluations are sent to the Ministry of Finance for the process of determining any changes in remuneration.	DEST provides orientation to its own representatives that serve on SOE boards.	Holding companies are responsible for providing training to board members of its subsidiary companies. DEST implemented an orientation seminar in June 2012. The seminar encouraged the professional development of current board members.	N/A

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
SOE budget must align with the company's business plan and strategic plan and are subject to the board's approval. The budget is then evaluated by the line ministry and DEST, and eventually consolidated and approved by law and Presidential decree. DEST has no role in the budget submission and the Secretariat of the Federal Budget performs the consolidation.	Each SOE determines its own capital structure, not following any general guidelines. However, capital increases and long-term credit must be linked to investment projects and are subject to DEST approval.	No general rate-of-return requirements	At least 25% of profits must be distributed as dividends and 5% must be retained. The use of the remaining profits must be decided at the AGM. Some companies are used to stabilizing their dividends around a fixed historical percentage. Extraordinary dividend payments can only be made when they are established in the SOE's bylaws.	The government provides financial support through direct capital contributions to translate public policy into investments	SOEs adhere to private companies' regulations, the federal government as a shareholder is allowed to allocate resources for capital increases from the federal budget. This type of recapitalization must be approved at the AGM. Minority shareholders are granted pre-emption rights. For non-listed companies, the government transfers the resources as an Advance for Future Capital Increases (Adiantamento para Futuro Aumento de Capital – AFAC), and afterwards the issue is discussed at the AGM. Conversely, listed SOEs issue new shares and offer them to every investor, after shareholders' approval	SOEs obtain funding from either public or private institutions, without any privilege or differentiation, under the same conditions as provided to the private sector. Dependent SOEs cannot assume financial debt, as only the government can fund them. Conversely, for listed SOEs, the source of financing and the credit institution chosen is an internal company decision. In all cases, DEST must monitor the debt level of SOEs.

CHILE	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	33 SOEs. All are commercial and only one is listed (for bonds).	The Council of the ownership entity, SEP, is responsible for the appointment and removal of SOE members of the board of directors included under SEP's portfolio. No other minister has veto, approval or ratification power on this issue. For less than fully-owned SOEs, candidates are proposed by the SEP Council and the appointment is made at the AGM, where every shareholder has voting rights.	SEP has established a set of rules called "Procedure for selection and appointment of Company Directors" which defines the steps to be followed for nominating board members and the requirements the candidates must comply with for appointment. In general, candidates are required to have relevant experience. A board member should not be involved in more than 5 boards of private or public entities. Chile is making active attempts to increase gender equality with a 2018 target of 40% female board members. Board size must range between 3 and 7 members.	Chilean SOEs structured as corporations, limited liability and joint stock companies have remuneration levels set at the AGM. In SOEs created by law, remuneration is established in the law of creation. The board has no role in determining remuneration levels.	SOEs maintain separate board chairs and CEOs. SEP counts on headhunters and public records to find appropriate candidates for CEO. Board of directors must adopt an agreement in order to dismiss the CEO.	External analysts such as Corporate governance centers carry out board evaluations for SEP. The overall evaluation includes a questionnaire completed by board members and an assessment by SEP. The evaluation also considers the results from the board training programs.	SOEs are responsible for establishing their own formal induction programs. SEP also coordinates at least two annual seminars - carried out by experts in the field - based on their guidelines.	SEP, with the help of Corporate governance centers, organizes training programs and one-on-one meetings for all members. Some SOEs may implement their own separate board training.	Listed companies must create an audit committee with at least one independent director if their patrimony exceeds a certain amount.
2012 comparative notes	33 SOEs (all commercial; 3 listed).	SEP's board of directors is responsible for nominating and appointing board members, seeking characteristics similar to those of private sector directors	Boards have 3-7 members with at least one employee representative. Members cannot participate in more than 5 company boards. . Nominees should have economic experience in the related sector and professional experience in the private sector.	No laws for remuneration.	N/A	Corporate governance centers, specialized companies or auditors conduct annual board evaluations on SEP's behalf. These evaluations are used in the board nomination process.	The "Procedure for Selection and Appointment of Company Directors" contains information guiding specific mechanisms for board induction.	No discrepancies were made between induction training and on-going training. A formal program for board training for SOEs under the SEP is in place. SEP holds seminars and one-on-one meetings with board members, the chairman and the audit committee.	N/A

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
The ownership entity is deeply involved in the process of producing SOEs' budgets; however final approval is the responsibility of the Ministry of Finance.	Ministry of Finance makes the final decision regarding dividends, debt and capitalizations for each SOE. The state's practice is to have SOEs fund their investments with their own resources. When additional resources are necessary, SOEs can assume debt or seek capitalization from the state. Only in special cases will the Ministry of Finance allow companies to borrow in order to finance their development, and in even fewer cases will the government agree to increase their public capital.	Chile is the only reported case whose ownership entity seeks to establish rate-of-return requirements.	The dividend policy changes each year and is not based on SOEs' capital structure. SEP enterprises are expected to distribute 100% of profits as dividends to the state. However, this policy is flexible, depending on the SOE's committed investments and debt financing alternatives.	The Treasury contributes to financing SOEs through capital injections or ordinary transfers approved each year in the Budget Law. Although there is no specific process for these situations, there have been recent examples of SOEs receiving financial compensation for Chilean transport companies.	Recapitalization from the federal budget is always subject to approval by Congress. In the case of unlisted, fully-owned SOEs, equity issuance does not include procedures to ensure that the cost of capital is market consistent. For majority-owned SOEs, recapitalization decisions are made at the AGM with the participation of minority shareholders.	SOEs can only rely on the market for debt sourcing, as the Chilean Constitution prohibits the issuance of loans from the Government, its agencies and other SOEs. There is evidence that private lenders provide preferential terms for SOEs since State ownership is considered a positive feature during their credit risk assessment. Chile has no mechanism in place to avoid distortions.

COLOMBIA	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	120 enterprises with state ownership, including 36 fully owned and 39 majority-owned. 106 are considered commercial and 3 are listed.	The nomination process differs both between and within the different Ministries. The Ministry of Finance and Public Credit ( <i>Ministerio de Hacienda y Crédito Público – MHCP</i> ) relies on the Direction of Investment Banking and the Secretary General (legal counsel) to propose a list of candidates based on their professional experience, the company's profile and the restrictions established by law. The list is later subject to AGM approval through an electoral quotient system, a proportional voting system allowing minority shareholders to group their votes. SOEs under the Defense Ministry vary greatly in practices from the ones under MHCP portfolio, mostly due to the strong military culture. Most board members appointed are either active or retired military officers.	No formal criteria have been established for ensuring the qualifications of board appointees.	The President of the Republic has legal authority to settle remuneration of the state's representatives on the boards of some SOEs. This authority is delegated to the Minister of Finance for the remuneration of directors of SOEs in which the state holds a majority stake.	SOEs' chairs are separate from CEOs. The board is responsible for appointing and removing the CEO in most cases.	Although not required under Colombian legislation, board evaluations are recommended by the country's corporate governance code, which suggests that it be carried out by the Corporate Governance Committee.	No induction or orientation program established.	No education or training program established.	SOEs are typically required to have audit committees. SOEs operating under different governance bodies have varying committees-related requirements.
2012 comparative notes	105 SOEs (all commercially-oriented; 3 listed; 18 fully-owned; 51 majority owned; 36 minority-owned).	There is no uniform policy for the appointment of board members, which are either made by the President or by the responsible Ministries. In the case of listed companies with minority shareholders, minority shareholders have the same voting rights as they do in other listed companies.	No formal criteria have been established for ensuring the qualifications of board appointees.	No specific policy for remuneration but often set in relation to the size of the SOE's assets.		No evaluation system has been established.	No system for training or orientation in place. Colombia's Ministry of Finance and Public Credit reported that it was in the process of developing an induction programme for new board members in partnership with a private university.		N/A

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
The MHCP is responsible for the budgetary process of SOEs with more than 90 per cent state ownership; in particular, the ministry participates in the planning, adjustment and monitoring of the budget process		Within the National Public Budget Office, the General Directorate, with advice of the National Planning Department (DNP), proposes the amount of SOE profit that goes towards the National Treasury.	The MHCP's Investment Bank Division establishes a dividend policy based on the SOE's financial capacity. CONPES (National Council for Economic and Social Policy) looks at the state's financial needs in order to determine the amount of profits to be either paid or retained by certain SOEs.			

COSTA RICA	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/ Orientation	Education/ Training	Board Committees
2015	69 SOEs. 42 are commercial, all are non-listed and 85% are fully-owned. All numbers provided by Costa Rica are approximate.	Each SOE has its own nomination and appointment process established in the law that creates it. In general, board members are appointed by the Government Council (the country's President and its Ministers). There is no formal nomination process for members appointed by the Government Council, although ministers may nominate candidates informally. Costa Rica's president must approve the final decision.	Costa Rica allows each SOE to determine its own eligibility requirements. Costa Rica is one of few countries that is actively working towards gender equality on SOE boards, including some requirements for a certain number of women to be appointed to public companies. Boards must range between 3 and 7 members.	Board members receive a payment for each session they attend. The maximum amount an SOE can pay per session is established by law. Remuneration levels have not been updated since 2008.	The CEO and the chair are not separate in Costa Rica. The Government Council has the power to both appoint and remove the CEO. Nevertheless, a CEO's resignation is usually requested at the President's discretion. Some SOEs' bylaws establish that the CEO can be removed by a majority vote of the members of the board.	There is no specific evaluation mechanism in place for SOE boards.	There is no formal process for the induction of new directors established in Costa Rica's laws; however, it is a common practice for each SOE to provide induction/orientation to new board members.	Board member training in Costa Rica is not a legal requirement for SOEs. Still, board members might be part of informal training such as workshops and courses.	The establishment of board committees has been a common practice in Costa Rica; however, it is not a legal obligation.
2012 comparative notes	Costa Rica did not participate in the 2012 report								

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
SOE budgets in Costa Rica are not subject to the state's executive power approval. The central government establishes annual guidelines, both general and more specific regulations, which companies must follow when proposing their budgets. Some SOEs are not obliged to follow the guidelines. The National Comptroller – an auxiliary entity to the legislative power – gives final approval for SOE budgets. Multiannual budgets are not permitted under Costa Rica's regulations.	There are two types of SOEs in Costa Rica. One group includes companies whose legal frameworks have been modified and modernized in order to grant them autonomy and flexibility regarding their capital structure. For this type of SOEs, the board calculates the company's total debt, since most projects presented by management – including their funding options – require the board's approval. Other SOEs financing decisions are subject to technical revisions and approvals from the Central Bank, the Planning and Economic Policy Ministry or the Ministry of Finance.	No general rate-of-return requirements. Usually, financial or profit targets are defined either in each SOE annual budget or financial program, and must be aligned with the country's objectives for the company.	No overarching principle guiding dividend levels. Instead, decisions regarding dividend distribution vary depending on the sector and context in which each SOE operates.	Costa Rica is the only participant country that does not provide state support.	Recapitalization from the federal budget is not common practice in Costa Rica and local SOEs are using other mechanisms to grow their business. Joint ventures are not common practice for public companies in the country.	Commercially oriented SOEs' funding only comes from financial institutions, both national and international, and from investors, providing debt financing, trusts, or other methods. Most SOEs rely on commercial loans for debt financing; however, large SOEs prefer more sophisticated and diverse financial mechanisms such as bonds and trusts. In exceptional cases, a small number of Costa Rican SOEs have relied on their own resources. It is possible for SOEs to benefit from government guarantees. Costa Rican SOEs also use off market funding mechanisms. Costa Rica is one of two countries to report evidence of SOEs benefitting from advantageous financing conditions when compared with private companies.



ECUADOR	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	28 SOEs. 11 are commercial. All 28 are both non-listed and fully-owned.	Ecuador has established a unique system where SOE boards are composed of three members elected by the line ministry, the National Secretary for Planning and Development (SENPLADES) and the President, respectively.	Board sizes in Ecuador are usually 3 members with the exception of SOEs under control of the Armed Forces, which have 7 members.	Each SOE board is responsible for setting the company's remuneration levels. The Ministry of Labor Relations, with the help of specialized firms, performs an ex post control of the remuneration levels.	The board chair and CEO are separate. The member appointed by the line ministry always chairs the meeting. This member is also responsible for nominating the candidates for CEO positions. The board has the power to appoint and remove the CEO.	No evaluation on board efficiency is conducted.	No formal, specific board induction program.	General training is not a formal requirement and is not common practice for SOEs in Ecuador.	The establishment of board committees has become a common practice although it is not legally obligated.
2012 comparative notes	24 SOEs (21 fully-owned; all non-listed).	The coordinating entity, National Secretary for Planning and Development (SENPLADES), appoints one member to each SOE. The remaining board members are appointed by the country's President and the sector minister, which each appoint one member.	All but four of Ecuador's 24 SOEs have 3 board members. Four SOEs under the responsibility of the Ministry of Defense are an exception with five board members, and SOE subsidiaries may have up to seven members.	N/A	N/A	SOE boards, in general, are evaluated by the country's President as well as the related ministers and other structures of state control who take both efficiency and social benefits into account.	There is no formal induction process.	There is no formal training process in place.	N/A

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
SOEs must present their budget proposal, including expected income and expenditure, to the Ministry of Finance. The National Secretary for Planning and Development and the Ministry of Finance analyze and adjust the proposal. Once the Congress approves the federal budget, the SOE modifies its budget in line with the general budget approved by the Board of Directors. Afterwards, the budget is submitted to the Ministry of Finance for its final approval.	Capital structures are outlined in each SOE's law of creation. The Board is responsible for authorizing any contract loans.	No formal rate-of-return requirements.	The Board of Directors determines the investment and reinvestment level in order to provide for the company's operations. The remaining profits must be distributed to the government. In some cases, dividends are subject to fulfill large pay-outs to the state for public uses.	No information available.	When new SOEs have been recently created, there is a common trend to establish such SOEs for political reasons. Recapitalizations from the federal budget do not arise from the issuance of new equity. SOEs are legally entitled to associate with private and public companies, whether national or foreign, in order to develop new projects, access new technologies or reach productivity goals.	SOEs can obtain funding from national and international markets, through the issuance of bonds, long-term obligations and commercial loans. The Board of Directors must approve the SOE's financing decisions. SOEs with payment capacity may benefit from state guarantees for financing investment projects. Respondents from Ecuador did not report on the existence of preferential terms granted to SOEs by private lenders.

MEXICO	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	87 SOEs. 75 are commercial, approximately, 86 are fully-owned and one is majority-owned. 16 are listed (for debt instruments).	Mexico has established set rules for board nomination and appointment. Since almost all Mexican SOEs are fully-owned, each line ministry is responsible for appointing board members to the companies under their coordination. There is no nomination and appointment process in place. The chairman of the SOE is usually the head of the relevant ministry or the person he or she appoints. Additionally, boards must include a representative of the Ministry of Finance. Representatives from the public and private sectors may be appointed.	There are two kinds of board members: those who represent the Government as civil servants, and those appointed due to their experience in the private sector. Public servants appointed to SOE boards should hold a position at least three levels below the secretary of the respective ministry. The members from the private sector should have a recognized capability or experience linked with the operations or services carried out by the institution. More specific requirements may be stated in their bylaws or in the law of creation for statutory SOEs.	The national government must set remuneration levels according to the regulations set forth by the Ministry of Finance.	In all Mexican SOEs, the board chair and CEO positions are separated. In the majority of SOEs, there is no specific process for removing the CEO but the Mexican President may do so at any given time.	There is no evaluation process for Mexican SOE boards, as there is no ownership entity to perform such evaluations.	No formal board induction program.	No formal board training program.	Board committees are only required for PEMEX, CFE and Development Banks. However, every SOE board is allowed to establish technical or specialized committees to help with strategic planning and supervision of management.
2012 comparative notes	110 SOEs (90 commercial; none listed).	Board members are directly appointed by the head of each Ministry.	The chair position is generally occupied by the head of each ministry. The board also consists of a representative from the Secretariat of Finance and Public Credit who is responsible for the regulation of the SOE as well as representatives from the private and public sectors that must have experience in the related field. Private sector members make up the minority and members of Congress are prohibited from being board members.	Civil servants who serve as board members do not receive remuneration.	N/A	Due to the lack of formal requirements, board evaluations are performed on an ad-hoc basis by the internal auditing body.	No formal programs for board orientation.	No formal programs are in place for board education and training.	N/A

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return requirements	Dividend payout and levels policies	Direct state support		
The budget must follow the Ministry of Finance's general guidelines, expenditure ceiling and terms, as well as the specific guidelines provided by the Coordinating Ministry. CEOs present their budgets to the Board for approval, which is then submitted to the Ministry of Finance through the Coordinating Ministry. The budget is integrated into the country's Federal Budget, which is afterwards submitted to the Chamber of Deputies for its approval.	There is technically no overarching principle that guides decision-making regarding the capital structure of SOEs. However, in general, the government seeks to provide each SOE with the resources they need in order to develop their operations.	No formal rate-of-return requirements.	Generally, most SOEs operate at a loss, which means the state does not benefit from dividend payments. Two of the largest Mexican SOEs, PEMEX and CFE, must provide the federal government with a detailed report about their financial situation. The Ministry of Finance then determines an appropriate dividend level. For most SOEs, there is no principle regarding whether the company should reinvest or distribute their revenues. Extraordinary dividends are not regulated under Mexican law.	While no overall policy on state support for SOEs was articulated for Mexico, CFE and PEMEX provide some examples of such support. The costs are funded based on the federal budget, which is approved by Congress.	Federal legislation establishes that the main factor to consider when establishing a new SOE is the company's public purpose. As SOEs in Mexico do not have shared stock structures, government recapitalization cannot occur through the issuing of new equity. Instead, the federal government makes expenditures called "contributions" to increase SOE funds.	SOEs in Mexico can obtain financing on the domestic and foreign markets, from public or private institutions. When the credit is to be granted by a foreign bank, both the board and the Ministry of Finance must provide approval. The government granted explicit state guarantees to some SOEs (e.g. d Respondents from Mexico reported that there was no information regarding the existence of preferential terms granted to SOEs by private lenders.

PARAGUAY	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/Orientation	Education/Training	Board Committees
2015	9 SOEs in total, all of which are commercial. 5 are fully-owned and 4 are majority-owned.	National Council for Public Companies (CNEP) makes recommendations to the President for the nomination and removal of board members. The President holds the authoritative power of appointment. There is no formal procedure for nomination. SOEs in Paraguay do not use head hunters or other third parties and do not require the establishment of a nomination committee.	Although no formal criteria exist, board members for SOEs must respect certain constraints.	Board member remuneration is decided in the shareholder meeting.	No information available.	The CNEP conducts quarterly evaluations of the SOEs under its supervision. Self-evaluations are not a part of this process.	No information available.	Paraguay reported that there is no form of board education or training provided.	No board committees.
2012 comparative notes	Paraguay did not participate in the 2012 report								

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
	Government intervention of capital structure	Rate of return req.	Dividend payout and levels policies	Direct state support		
<p>The Ministry of Finance issues a budgeting guidelines decree to guide budget drafts. After the Ministry approves the budget draft, it is submitted to Congress. Stock corporations do not have to submit their budgets to the Ministry of Finance; however, they do have to present other financial info. Stock corporations' budgets do not need the Ministry of Finance's approval, but must inform the Ministry of budget changes.</p>	<p>The Ministry of Finance determines the capital structure of SOEs including the country's budget. For stock companies, the board and the AGM hold this responsibility. For fully-owned SOEs, the Public Administration Law and the Budget Law act as guidelines for a SOE's capital structure, highlighting the necessity of financing debt through the company's own resources. Majority-owned SOEs follow the rules of the civil code as a general principle, and may set their own rules in their bylaws.</p>	<p>Paraguay has no general rule established for rate of return requirements. There is no legal sanction in place for when profit targets are not met.</p>	<p>For stock companies with state majority-ownership in Paraguay, shareholders decide on the dividend payout based on the capital structure and the expected profits of the SOE. There is currently no policy regarding the re-investment of earnings in the form of dividends. There have not been any situations of extraordinary dividends.</p>	<p>Paraguay reported that they analyze direct state support on an ad-hoc basis, determining whether the project is a government priority and the degree of financial support that the state will provide.</p>	<p>No information available.</p>	<p>SOEs in Paraguay are financed through various sources; including government institutions, financial institutions and multilateral financial institutions such as the World Bank, Inter-American Development Bank (IADB), International Bank for Reconstruction and Development (IBRD) and CAF. Indirectly, SOEs obtain funds from the placement of sovereign bonds in international markets. SOEs in Paraguay do not rely on tradable debt instruments; instead, the most common practice for financing is the use of commercial loans from multilateral financial institutions. However, most SOEs finance their projects with their own resources.</p>

PERU	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/ Orientation	Education/ Training	Board Committees
2015	31 SOEs. 28 are commercial, 23 are fully-owned and 8 are majority-owned. 9 are listed.	Peru has established a detailed legal framework for the nomination and appointment of SOE board members under FONAFE's authority. Members of FONAFE's board propose candidates for the board of the SOE of their respective sectors. The Minister of Finance and Economy must always nominate at least one director. Then an evaluation of candidates takes place, dismissing those who do not comply with the formal requirements established by the law. New directors are appointed by the AGM and there is no involvement of the SOE board in the process. Peru is currently in the process of appointing independent board members to SOEs.	Directors must have sector-related professional skills and background, previous experience as a board member or manager, and honesty and capability to be eligible to sit on an SOE board. Board sizes must range between 3 and 7 members.	Remuneration is established by session attendance and is periodically fixed by FONAFE's board. Remuneration falls below market standards. FONAFE has recently updated the remunerations levels in order to align them to market conditions.	Chair and CEOs are separate in Peruvian SOEs.	Peru is in the process of establishing a formal evaluation process for SOE boards. A pilot evaluation, consisting of evaluating 16 companies in the electrical sector, has been done in 2013 with the support of international development financial institutions.	Induction is provided by FONAFE's Executive Director and by each SOE's General Manager. There is no defined format for induction.	FONAFE is not legally obliged to provide training sessions, but some training events have been organized, and some board members take relevant business courses.	Although not a legal obligation, the establishment of board committees has become common practice in Peru.
2012 comparative notes	FONAFE is responsible for 31 SOEs, of which 9 are listed.	FONAFE's Board of Directors is responsible for board nominations. The Minister of Finance and Economy is responsible for nominating at least one member, who serves as the board's chair. Nominees are reviewed and must sign an affidavit confirming that they meet the required criteria. FONAFE is working on developing a framework for the appointment of independent directors.	FONAFE seeks professional experience, additional training, and overall personal attributes when appointing a board member. The board member must also have no criminal history or have been previously removed from a board.	Remunerations are determined by FONAFE's board.	N/A	No formal evaluation process exists.	SOE General Managers usually implement induction. For FONAFE, the executive director provides induction through presentations about director responsibilities and obligations.	Peru does not provide training for board directors since it is a prerequisite for appointment.	N/A

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FONAFE's board approves consolidated budgets for all SOEs under its ownership; Peru is the only participating country where this exists. Each SOE budget and annual work plan must be aligned with guidelines established by the Ministry of Finance. SOEs must also obtain AGM approval for their respective budgets.	SOEs propose capital structures, which must then be approved by FONAFE's board of directors. The AGM ratifies the board's decision. Peruvian SOEs generally rely on their own resources for financing investment and operations, which leads to a lower level of debt than private companies.	No formal rate-of-return requirements.	Profit reinvestments or dividends payouts are decided on a case-by-case basis. SOEs present their proposed dividend levels to FONAFE's board. If approved, the proposal is presented to the AGM for approval.	Peru provides state support to commercial SOEs that fulfill social objectives separate from their commercial targets.	The recapitalization of SOEs is common practice. Resources from the federal budget are transferred to SOEs for the execution of some projects and then capitalized, usually by issuing common and preferred stock. In majority-owned SOEs, minority shareholders are consulted about recapitalization decisions.	In general, Peruvian SOEs make use of commercial loans. However, for long-term financing, the law limits SOEs' ability to assume debt. Companies rely on their own resources, which means that government authorization is required for long-term debt financing. Off-market funding is also possible.



URUGUAY	Number of SOEs	Board Nomination Practices	Board Size and Composition	Remuneration Policy	Board Chair and CEO	Board Evaluation	Induction/ Orientation	Education/ Training	Board Committees
2015	15 SOEs in total, 9 of which are commercial and 6 of which are non-commercial. All 15 are fully-owned.	SOE board members are appointed by the President in agreement with the Council of Ministers; previous approval by three fifths of the Senate is necessary. Candidates are identified by an internal process within political parties. There are no directors' pools and there is no Nomination Committee. The opportunity for candidates to be self-nominated does not exist. The board of directors does not play a role in the nomination and appointment process.	No information available.	Board member remuneration is legally established, generally in the Budget Law. Remuneration tends to be lower than those provided to ministers or even CEOs. The board has no role regarding remunerations.	SOEs' chairs are separate from CEOs.	There is an evaluation conducted by the Office of Planning and Budget (OPP) which evaluates the board as a whole. The results are communicated monthly through the follow-up of the financial program. It is also communicated annually through meetings between the board and the OPP or the country's President. Ultimately, bad evaluations can result in resignation or removal of board members.	SOEs generally have meetings before the appointment of a member even if there are no official rules of programs set up in the country. These meetings rely on the participation of the country's President, the line ministry or the OPP.	Uruguay reported that there is no form of board education or training provided.	No information available.
2012 comparative notes	Uruguay did not participate in the 2012 report.								

Overall government review processes for SOE budgets	Capital Structure	Actions affecting SOEs' capital			Equity financing and modes of (re)capitalization	Sources and costs of debt financing
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<p>Although SOEs in Uruguay have budgetary autonomy, there is government intervention in the budgeting process. Annually, each SOE presents its budget and other materials to the executive power and Court of Auditors (<i>Tribunal de Cuentas</i>). The executive power and the Court of Auditors can make observations to the budget.</p>	No information available.	No general rule established for rate of return requirements.	<p>There is a formal policy for dividend payouts to the executive power, which follows a specific calculation process. Each SOE's bylaws may contain specific rules about percentages over annual profits. There has not been any prior case of extraordinary dividend payments.</p>	<p>Direct state support is analyzed on an ad-hoc basis, determining whether the project is a government priority and the degree of financial support that the state will provide.</p>	<p>Recapitalization of SOEs can occur; however, they must be done so by law. Due to the inability of SOEs to issue shares, tradable debt instruments are used for recapitalizations. The issuing of tradable debt instruments is made public and also relies on the Central Bank of Uruguay and the two Uruguay Stock Exchanges. Joint ventures or pooling with private companies are not used in practice in Uruguay.</p>	<p>All SOEs, excluding those that are not profitable, obtain finance in the market. Larger debt operations must be approved by the executive power and Congress. SOEs lean towards the use of tradable debt instruments. State guarantees are usually provided for financial debts with Multilateral Credit Organizations. No evidence was reported of SOEs being provided with preferential terms, and there are no mechanisms to compensate for potential cheaper financing. SOEs may rely on off-market mechanisms; the extent of their use depends on the SOE's activity.</p>