OECD Guidelines on Corporate Governance of State-Owned Enterprises

2015 EDITION

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Foreword

The OECD Guidelines on Corporate Governance of State-Owned Enterprises *(the Guidelines) are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. The Guidelines were first developed in 2005 as a complement to the* OECD Principles of Corporate Governance[1] *(the Principles). They have been updated in 2015 to reflect a decade of experience with their implementation and address new issues that have arisen concerning SOEs in the domestic and international context.*

In carrying out their ownership responsibilities, governments can also benefit from following recommendations that are applicable to the private sector, notably the G20/OECD Principles of Corporate Governance. *The Guidelines are intended as a complement to the Principles, with which they are fully compatible. Other relevant OECD instruments include the* OECD Guidelines for Multinational Enterprises. *Auxiliary guidance may also be sought from other sources, such as the* OECD Policy Framework for Investment *and the* OECD Competition Assessment Toolkit. *The Guidelines provide advice on how governments can ensure that SOEs are at least as accountable to the general public as a listed company should be to its shareholders.*

The updated Guidelines were adopted by the OECD Council, the governing body of the Organisation, in July 2015, as part of a Recommendation of the Council to promote their use by the international community.

1. These Principles have been renamed the *G20/OECD Principles of Corporate Governance* following their revision in 2015 and their endorsement by the G20 Finance Ministers and Central Bank Governors at their meeting of 4-5 September 2015.

Acknowledgements

The Guidelines were revised by OECD countries in co-operation with a very large circle of partners and stakeholders. Colombia, Latvia and the Russian Federation have participated in the review of the Guidelines as Associates (on an equal footing with OECD countries) and have associated themselves with the outcome of the review. The World Bank Group participates as an Observer to the Working Party on State Ownership and Privatisation Practices. Argentina, Brazil, People's Republic of China, Costa Rica, Kazakhstan, Lithuania, Peru, the Philippines, South Africa and Ukraine participated directly in the Working Party's discussions of the revision. Extensive consultations outside of the Working Party's regular meetings were organised during the revision of the Guidelines. Comments were received from the authorities in the following countries: Cabo Verde, Ecuador, Egypt, India, Indonesia, Iraq, Lao People's Democratic Republic, Malaysia, Mauritania, Morocco, Myanmar, Paraguay, Suriname, Thailand, Uruguay and Viet Nam.

The revision process further benefited from the inputs of OECD's institutional consultation partners, the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC), as well as the Argentine Institute for Governance of Organisations (IAGO), the Asian Development Bank, the Baltic Institute of Corporate Governance, the Brazilian Association of Capital Market Investors, the Brazilian Institute of Corporate Directors, Guberna, the Inter-American Development Bank, the International Corporate Governance Network, the Latin American Development Bank, the Malaysian Directors Academy, the Myanmar Development Resource Institute – Centre for Economic and Social Development, the Myanmar Institute of Certified Public Accountants, the Pakistan Institute of Corporate Governance, the Philippine Institute of Certified Public Accountants, the Philippine Institute of Corporate Directors, the Singapore Institute of Directors, the Union of Myanmar Federation of Chambers of Commerce and Industry and the United Nations Economic Commission for Africa.

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Preface

Good governance of state-owned enterprises (SOEs) is essential for efficient and open markets at both the domestic and international level. In many countries SOEs are the main providers of key public services, including public utilities. This means that their operations have an impact on citizens' everyday life and on the competitiveness of the rest of the economy. SOEs are increasingly prominent actors in international markets. Ensuring that they operate in a sound competitive and regulatory environment is crucial to maintaining an open trade and investment environment that underpins economic growth.

The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (the *Guidelines*) are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. The *Guidelines* were first developed in 2005 as a complement to the *OECD Principles of Corporate Governance*. They have been updated in 2015 to reflect a decade of experience with their implementation and address new issues concerning SOEs in the domestic and international context.

The *Guidelines* have been changed considerably and their policy relevance greatly enhanced. The updated and upgraded instrument provides greater clarity regarding how policy makers should incorporate public institutions and ensure implementation of the agreed good practices. Recommendations regarding the rationale for state ownership of enterprises have been developed, which will help decide whether, and subject to what accountability requirements, governments may want to step into the corporate sector. Recommendations for maintaining a level playing field between SOEs and private enterprises provide guidance for SOEs that are active in the domestic and international marketplace.

These revised *Guidelines* are being issued at a critical juncture. With many countries experiencing lower economic growth and finding their fiscal space diminished, governments face growing challenges to ensure well-functioning SOE sectors, and this document provides them with relevant guidance. Many economies have large SOE sectors, and experience shows that the state-owned sector may either promote or hamper economic and social development depending on whether it operates according to commonly agreed good practices. At the same time a number of countries are paying increasing attention to the foreign SOEs that operate in their jurisdictions – including in the context of trade and investment agreements – with a view to gauging their commercial orientations and likely impacts on the competitive landscape.

I am confident that the *Guidelines* will continue to grow in importance as a resource for governments. They provide a powerful tool for contributing to fairer and more competitive markets, value creation, growth and development, and for improving the provision of essential services to all members of society. I thus invite governments in both OECD and partner countries to make active use of the *Guidelines*.

Angel Gurría

OECD Secretary-General

Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises

8 July 2015

THE COUNCIL,

Having regard to Article 5(b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;

Having regard to the Recommendation of the Council on Principles of Corporate Governance for which this Recommendation sets the complementary guidelines for state-owned enterprises;

Having regard to the Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises (hereafter the “Guidelines”), which this Recommendation replaces;

Having regard to the Guidelines for Multinational Enterprises, which form an integral part of the Declaration on International Investment and Multinational Enterprises; the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; the Recommendation of the Council on Principles for Private Sector Participation in Infrastructure; the Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships; and the Recommendation of the Council on Gender Equality in Education, Employment and Entrepreneurship;

Considering the revision of the Guidelines following years of growing attention by governments embarking on reform of their state-owned sectors;

Recognising the important role that state-owned enterprises play in many economies and their increasing participation in international markets and the large benefits resulting from good corporate governance in state-owned enterprises;

Recognising that state-owned enterprises face some distinct governance challenges arising from the fact that their ownership is exercised by government officials on behalf of the general public;

On the proposal of the Corporate Governance Committee:

I. Recommends that Members and non-Members having adhered to this Recommendation (hereafter the "Adherents") take due account of the Guidelines which are set out in the Appendix to this Recommendation and form an integral part thereof as commonly agreed good practices in organising their state-owned enterprise sectors;

II. Recommends that Adherents actively promote the implementation of the Guidelines in establishing their ownership practices and defining a framework for corporate governance of state-owned enterprises;

III. Invites the Secretary-General to disseminate this Recommendation;

IV. Invites Adherents to disseminate this Recommendation;

V. Invites non-Adherents to take due account of this Recommendation and, where appropriate, adhere to it subject to a review by the Working Party on State Ownership and Privatisation Practices;

VI. Instructs the Corporate Governance Committee, through the Working Party on State Ownership and Privatisation Practices, to follow up on the implementation of this Recommendation and to report to Council no later than five years following its adoption and as appropriate thereafter.

About the Guidelines

Most industrialised economies are characterised by open and competitive markets firmly rooted in the rule of law, with private enterprises as the predominant economic actors. However, in some other countries, including many emerging economies, state-owned enterprises (SOEs) represent a not insubstantial part of GDP, employment and market capitalisation. Even in countries where SOEs play only a minor role in the economy, they are often prevalent in utilities and infrastructure industries, such as energy, transport, telecommunications and in some cases also hydrocarbons and finance, whose performance is of great importance to broad segments of the population and to other parts of the business sector. Consequently, good governance of SOEs is critical to ensure their positive contribution to economic efficiency and competitiveness. Experience shows that market-led development is the most effective model for efficient allocation of resources. A number of countries are in the process of reforming the way in which they organise and manage their SOEs and have in many cases taken international best practices such as the present Guidelines as points of departure or even benchmarks. The Guidelines aim to: (i) professionalise the state as an owner; (ii) make SOEs operate with similar efficiency, transparency and accountability as good practice private enterprises; and (iii) ensure that competition between SOEs and private enterprises, where such occurs, is conducted on a level playing field. The Guidelines do not address whether certain activities are best placed in public or in private ownership. However, if a government decides to divest SOEs then good corporate governance is an important prerequisite for economically effective privatisation, enhancing SOE valuation and hence bolstering the fiscal proceeds from the privatisation process.

The rationale for state ownership of enterprises varies among countries and industries. It can typically be said to comprise a mix of social, economic and strategic interests. Examples include industrial policy, regional development, the supply of public goods, as well as the existence of so called “natural” monopolies where competition is not deemed feasible. Over the last few decades however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have led to readjustment and restructuring of the state-owned sector in many countries. Moreover, SOE participation in international trade and investment has grown significantly.

While SOEs were once principally engaged in providing basic infrastructure or other public services within their domestic markets, SOEs are increasingly becoming important actors outside their territories. In tandem with this development is the proliferation of state-owned investment vehicles, which adds complexity to the relationship between governments and the enterprises they own. These developments are surveyed in a number of OECD reports that have served as input to these Guidelines[2].

SOEs face some distinct governance challenges. On the one hand, SOEs may suffer from undue hands-on and politically motivated ownership interference, leading to unclear lines of responsibility, a lack of accountability and efficiency losses in the corporate operations. On the other hand, a lack of any oversight due to totally passive or distant ownership by the state can weaken the incentives of SOEs and their staff to perform in the best interest of the enterprise and the general public who constitute its ultimate shareholders, and raise the likelihood of self-serving behaviour by corporate insiders. SOEs' management may also be protected from two disciplining factors that are considered essential for policing management in private sector corporations, i.e. the possibility of takeover and the possibility of bankruptcy. At the level of the state, the enforcement of commercial laws and regulations against SOEs can create unique challenges because of intra-governmental friction resulting from regulators bringing enforcement actions against entities controlled by the government. Additional governance issues arise when SOEs have the dual goals of carrying out economic activities and fulfilling a public policy role.

More fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, the government and the legislature), without clearly and easily identifiable, or with remote, principals; parties have intrinsic conflicts of interest that could motivate decisions based on criteria other than the best interests of the enterprise and the general public who constitute its shareholders. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge and requires profound attention to the same three principles that are paramount for an attractive investment environment; transparency, evaluation and policy coherence.

The *Guidelines on Corporate Governance of State-Owned Enterprises* were first developed to address these challenges in 2005. In 2014, the OECD Corporate

2. *Accountability and Transparency: A Guide for State Ownership*, OECD, 2011; *Competitive Neutrality: Maintaining a Level Playing Field Between Public and Private Business*, OECD, 2012; *Boards of Directors of State-Owned Enterprises*, OECD, 2013; *Financing State-Owned Enterprises: An Overview of National Practices*, OECD, 2014; and *State-Owned Enterprise Governance: A Stocktaking of Rationales for State Ownership*, OECD, 2015.

Governance Committee asked its subsidiary Working Party on State Ownership and Privatisation Practices to review and revise this instrument in the light of almost a decade of experiences with its implementation. A report had previously taken stock of changes in corporate governance and state ownership arrangements in OECD countries since 2005 and concluded that national reform efforts had, with few exceptions, been consistent with the Guidelines[3]. Based on this the Working Party concluded that the Guidelines should continue to set high levels of aspiration for governments and serve as a guidepost for reforms to the SOE sector.

In carrying out its ownership responsibilities governments can also benefit from following recommendations that are applicable to the private sector, notably the *OECD Principles of Corporate Governance* (the *Principles*)[4]. The Guidelines are intended as a complement to the Principles, with which they are fully compatible. Other relevant OECD legal instruments include the *OECD Declaration on International Investment and Multinational Enterprises*, of which the *Guidelines for Multinational Enterprises* form an integral part. Auxiliary guidance may also be sought from other sources, such as the *OECD Policy Framework for Investment* and the *OECD Competition Assessment Toolkit*. The Guidelines provide advice on how governments can ensure that SOEs are at least as accountable to the general public as a listed company should be to its shareholders.

The remainder of the document is divided into two main parts. The Guidelines presented in the first part cover the following areas: I) Rationales for State Ownership; II) The State's Role as an Owner; III) State-Owned Enterprises in the Marketplace; IV) Equitable Treatment of Shareholders and Other Investors; V) Stakeholder Relations and Responsible Business; VI) Disclosure and Transparency; and VII) The Responsibilities of the Boards of State-Owned Enterprises. Each of the sections is headed by a single Guideline that appears in bold italics and is followed by a number of supporting sub-Guidelines. In the second part, the Guidelines are supplemented by annotations that contain commentary on the Guidelines and are intended to help readers understand their rationale. The annotations may also contain descriptions of dominant trends and offer a range of implementation methods and examples that may be useful in making the Guidelines operational.

3. *Corporate Governance of State-Owned Enterprises: Change and Reform in OECD Countries since 2005*, OECD, 2010.
4. These Principles have been renamed the *G20/OECD Principles of Corporate Governance* following their revision in 2015 and their endorsement by the G20 Finance Ministers and Central Bank Governors at their meeting of 4-5 September 2015.

Applicability and definitions

The Guidelines are addressed to those government officials that are charged with the ownership of enterprises and also provide useful guidance for SOE boards and management. They provide recommendations regarding the governance of individual SOEs, as well as regarding state ownership practices and the regulatory and legal environment in which SOEs operate. The Guidelines are generally applicable to SOEs, whether they operate domestically or internationally.

It must be recognised that no one size fits all and different legal and administrative traditions may call for different arrangements. The Guidelines are therefore outcomes-based, meaning that it is the role of governments to decide how to achieve the outcomes that they recommend. This section reviews some of the questions and issues that the owners of enterprises need to address in order to decide on the applicability of the Guidelines.

Defining an SOE. Countries differ with respect to the range of institutions that they consider as state-owned enterprises. For the purpose of the Guidelines, any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership, should be considered as an SOE. This includes joint stock companies, limited liability companies and partnerships limited by shares. Moreover statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature.

Ownership and control. The Guidelines apply to enterprises that are under the control of the state, either by the state being the ultimate beneficiary owner of the majority of voting shares or otherwise exercising an equivalent degree of control. Examples of an equivalent degree of control would include, for instance, cases where legal stipulations or corporate articles of association ensure continued state control over an enterprise or its board of directors in which it holds a minority stake. Some borderline cases need to be addressed on a case-by-case basis. For example whether a "golden share" amounts to control depends on the extent of the powers it confers on the state. Also, minority ownership by the state can be considered as covered by the Guidelines if corporate or shareholding structures confer effective controlling influence on the state (e.g. through shareholders' agreements). Conversely, state influence over corporate decisions exercised via *bona fide* regulation would normally not be considered as control. Entities in which the government holds equity stakes of less than ten percent that do not confer control and do not necessarily imply a long-term interest in the target company, held indirectly via independent asset managers such as pension funds, would also not be considered as SOEs. For the purpose of these Guidelines, entities which are owned or controlled by a government for a limited duration arising out of bankruptcy, liquidation, conservatorship or receivership, would normally not be considered as SOEs. Different modes of exercising state control will also give rise to different governance issues. Throughout the Guidelines, the term “ownership” is understood to imply control.

Economic activities. For the purpose of these Guidelines, an economic activity is one that involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator in order to make profits. The market structure (e.g. whether or not it is characterised by competition, oligopoly or monopoly) is not decisive for determining whether an activity is economic. Mandatory user fees imposed by the government should normally not be considered as a sale of goods and services in the marketplace. Economic activities mostly take place in markets where competition with other enterprises already occurs or where competition given existent laws and regulations could occur.

Public policy objectives. For the purpose of this document, public policy objectives are those benefitting the general public within the SOE’s own jurisdiction. They are implemented as specific performance requirements imposed on SOEs and/or private enterprises other than the maximisation of profits and shareholder value. These could include the delivery of public services, such as postal services, as well as other special obligations undertaken in the public interest. In many cases, public policy objectives might otherwise be achieved via government agencies, but have been assigned to an SOE for efficiency or other reasons. *Ad-hoc* interventions by governments in the actions of SOEs should normally not be considered as part of an enterprise’s public policy objectives. Public policy objectives can either be pursued separately from, or in combination with, economic activities.

The governing bodies of SOEs. Some SOEs have two-tier boards that separate the supervisory and management function into different bodies. Others only have one-tier boards, which may or may not include executive (managing) directors. In the context of this document “board” refers to the corporate body charged with the functions of governing the enterprise and monitoring management. Many governments include “independent” members in the boards of SOEs, but the scope and definition of independence varies considerably according to national legal context and codes of corporate governance. A CEO is the enterprise’s highest ranking executive officer, responsible for managing its operations and implementing corporate strategy. The CEO is accountable to the board.

Listed SOEs. Some parts of the Guidelines are specifically oriented towards "listed SOEs". For the purpose of this document, "listed SOEs" refers to SOEs whose shares are publicly traded. In some jurisdictions SOEs that have issued preference shares, exchange-traded debt securities and/or similar financial instruments may also be considered as listed.

Ownership entity. The ownership entity is the part of the state responsible for the ownership function, or the exercise of ownership rights in SOEs. "Ownership entity" can be understood to mean either a single state ownership agency, a co-ordinating agency or a government ministry responsible for exercising state ownership. Throughout the Guidelines and Annotations, the term "ownership entity" is used without prejudice to the choice of ownership model. Not all adherents to the Guidelines have necessarily assigned a government institution to play a predominant ownership role, and this needs not affect the implementation of the remainder of the recommendations.

Applicability. The Guidelines are applicable to all SOEs pursuing economic activities, either exclusively or together with the pursuit of public policy objectives or the exercise of governmental authority or a governmental function. Whether other units of government should adhere to the Guidelines depends in part on the extent to which they undertake economic activities. The Guidelines are generally not intended to apply to entities or activities whose primary purpose is to carry out a public policy function, even if the entities concerned have the legal form of an enterprise. As a guiding principle, those entities responsible for the ownership functions of enterprises held at subnational levels of government should seek to implement as many of the recommendations in the Guidelines as applicable.

I. Rationales for state ownership

The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

A. The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.

B. The government should develop an ownership policy. The policy should *inter alia* define the overall rationales for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.

C. The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.

D. The state should define the rationales for owning individual SOEs and subject these to recurrent review. Any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly mandated by the relevant authorities and disclosed.

II. The state's role as an owner

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

A. Governments should simplify and standardise the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms.

B. The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management. The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner.

C. The state should let SOE boards exercise their responsibilities and should respect their independence.

D. The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralised in a single ownership entity, or, if this is not possible, carried out by a co-ordinating body. This "ownership entity" should have the capacity and competencies to effectively carry out its duties.

E. The ownership entity should be held accountable to the relevant representative bodies and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and effectively exercising voting rights;
2. Establishing well-structured, merit-based and transparent board nomination processes in fully- or majority-owned SOEs, actively participating in the nomination of all SOEs' boards and contributing to board diversity;
3. Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;

4. Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;
5. Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;
6. When appropriate and permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;
7. Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

III. State-owned enterprises in the marketplace

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

B. Stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.

C. Where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained, allowing for an attribution to main activity areas.

D. Costs related to public policy objectives should be funded by the state and disclosed.

E. As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs' legal form should allow creditors to press their claims and to initiate insolvency procedures.

F. SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance. In particular:

1. SOEs' relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds.
2. SOEs' economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs' economic activities should not receive inputs (such as energy, water or land) at prices or conditions more favourable than those available to private competitors.

3. SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

IV. Equitable treatment of shareholders and other investors

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

A. The state should strive toward full implementation of the *OECD Principles of Corporate Governance* when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

1. The state and SOEs should ensure that all shareholders are treated equitably.
2. SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.
5. Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

V. Stakeholder relations and responsible business

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements.

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.

C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.

D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.

E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.

VI. Disclosure and transparency

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. With due regard to enterprise capacity and size, examples of such information include:

1. A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);
2. Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;
3. The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;
4. The remuneration of board members and key executives;
5. Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;
6. Any material foreseeable risk factors and measures taken to manage such risks;
7. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;
8. Any material transactions with the state and other related entities;
9. Any relevant issues relating to employees and other stakeholders.

B. SOEs' annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

C. The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

VII. The responsibilities of the boards of state-owned enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.

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

C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

D. Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their exercise of objective judgement.

E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

F. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

H. SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

I. SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

Annotations to Chapter I: Rationales for state ownership

The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

The members of the public whose government exercises the ownership rights are the ultimate owners of SOEs. This implies that those who exercise ownership rights over SOEs owe duties toward the public that are not unlike the fiduciary duties of a board toward the shareholders, and should act as trustees of the public interest. High standards of transparency and accountability are needed to allow the public to assure itself that the state exercises its powers in accordance with the public's best interest.

In OECD countries, the rationales for establishing or maintaining state enterprise ownership typically include one or more of the following: (1) the delivery of public goods or services where state ownership is deemed more efficient or reliable than contracting out to private operators; (2) the operation of natural monopolies where market regulation is deemed infeasible or inefficient; and (3) support for broader economic and strategic goals in the national interest, such as maintaining certain sectors under national ownership, or shoring up failing companies of systemic importance[1].

A. The ultimate purpose of state ownership of enterprises should be to maximise value for society, through an efficient allocation of resources.

The roles that are assigned to SOEs, and the rationales underpinning state enterprise ownership, differ radically across jurisdictions. However, good practice calls for governments to consider and articulate how any given enterprise shall be adding value to the members of the public that are its ultimate owners, through an efficient allocation of resources. To inform the decision to establish or maintain an enterprise in state ownership, governments should consider whether a more efficient allocation of resources to benefit the public could be achieved through an alternative ownership or taxation structure.

1. *State-Owned Enterprise Governance: A Stocktaking of Rationales for State Ownership*, OECD, 2015.

Where SOEs are expected to provide public services then a number of efficiency considerations impose themselves. The public is best served if services are delivered in an efficient and transparent manner, and when no alternative use of the same fiscal resources could have resulted in better services. Such considerations should guide policy makers' choices in relying on SOEs as delivery-vehicles for public policy objectives. Where SOEs are engaged in competitive economic activities then they serve the public best by maximising long-term value and generating an adequate revenue stream for the national treasury.

B. The government should develop an ownership policy. The policy should *inter alia* define the overall rationales for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.

Multiple and contradictory rationales for state ownership can lead to either a very passive conduct of ownership functions, or conversely result in the state's excessive intervention in matters or decisions which should be left to the enterprise and its governance organs. In order for the state to clearly position itself as an owner, it should clarify and prioritise its rationales for state ownership by developing a clear and explicit ownership policy. This will provide SOEs, the market and the general public with predictability and a clear understanding of the state's overall objectives as an owner.

The ownership policy should ideally take the form of a concise, high level policy document that outlines the overall rationales for state enterprise ownership. It may be considered good practice to include in the ownership policy objectives such as the creation of value, the provision of public services, or strategic goals such as the maintenance of certain industries under national ownership. It is the role of the state to decide the rationales for state ownership, but whatever they are, they should be clearly communicated to the public, and to all parts of the government that exercise ownership rights or are otherwise involved in the implementation of the state's ownership policy.

In addition, the ownership policy should include more detailed information on how ownership rights are exercised within the state administration, including the ownership entity's mandate and main functions and the roles and responsibilities of all government entities that exercise state ownership. It should also reference and synthesise the main elements of any policies, laws and regulations applicable to SOEs, as well as any additional guidelines that inform the exercise of ownership rights by the state. Where relevant, the state should also include information on its policy and plans regarding the privatisation of SOEs. A high level of transparency is important to prevent preferential treatment, and therefore maximise proceeds.

C. The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.

In developing and updating the state's ownership policy, governments should make appropriate use of public consultation. The mechanisms and scope of public consultation vary across countries, but they should involve notifying and soliciting input from the general public or their representatives. They should also involve consulting broadly with private sector representatives, including investors and market service providers, and with trade union representatives. Effective and early use of public consultation can be instrumental in facilitating acceptance of the ownership policy by market participants and key stakeholders. The development of the ownership policy can also involve consultations with all concerned government entities, for example relevant legislative or parliamentary committees, the state audit institution, as well as relevant ministries and regulators.

The ownership policy should be accessible to the general public and widely circulated amongst the relevant ministries, agencies, SOE boards, management, and the legislature. The political commitment can be further strengthened by relying on proper accountability mechanisms such as regular legislative approval.

The state should strive to be consistent in its ownership policy and avoid modifying the overall rationales for state ownership too often. However, rationales and objectives may evolve over time, in which case the ownership policy needs to be updated accordingly. Dependent on national context the best way to do this may include reviews of SOE ownership as part of the state budgetary processes, medium-term fiscal plans or in accordance with the electoral cycle.

D. The state should define the rationales for owning individual SOEs and subject these to recurrent review. Any public policy objectives that individual SOEs, or groups of SOEs, are required to achieve should be clearly mandated by the relevant authorities and disclosed.

The rationales for owning individual enterprises – or as the case may be, classes of enterprises – can vary. For example, sometimes certain groups of enterprises are state-owned because they fulfil important public policy functions, while other groups with predominantly economic activities remain state-owned for strategic reasons, or because they operate in sectors with natural monopoly characteristics. Natural monopolies are sectors where it is most effective for production to be undertaken by a single firm. In such cases, the state may deem it more cost efficient to own such enterprises directly rather than to regulate privately-owned monopolies. To clarify the respective policy rationales underpinning their maintenance in state ownership, it can sometimes be useful to classify those SOEs into separate categories and define their rationales accordingly. All elements in the chain of agents involved in the governance of SOEs should be made aware of the government's commitment to the present Guidelines.

SOEs are sometimes expected to fulfil special responsibilities and obligations for social and public policy purposes. In some countries this includes a regulation of the prices at which SOEs have to sell their products and services. These special responsibilities and obligations should be clearly mandated and motivated by laws and regulations. They could also be incorporated into corporate bylaws. The market and the general public should be clearly informed about the nature and extent of these obligations, as well as about their overall impact on the SOEs' resources and economic performance.

Countries differ in respect of the authorities that are mandated to communicate specific obligations to SOEs. In some cases only the government has this power. In others, the legislature can establish such obligations through the legislative process. In the latter case it is important that proper mechanisms for consultation be established between the legislature and the state bodies responsible for SOE ownership, to ensure adequate co-ordination and avoid undermining the autonomy of the ownership entity.

Annotations to Chapter II: The state's role as an owner

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

In order to carry out its ownership functions, the government should refer to private and public sector governance standards, notably the *OECD Principles of Corporate Governance*, which are also applicable to SOEs. In addition, there are specific aspects of SOE governance that either merit special attention or should be documented in more detail in order to guide SOE board members, management and the state ownership entity in effectively performing their respective roles.

A. Governments should simplify and standardise the legal forms under which SOEs operate. Their operational practices should follow commonly accepted corporate norms.

SOEs may have different legal forms from other companies. This may reflect specific objectives or societal considerations as well as special protection granted to certain stakeholders. This particularly concerns employees whose remuneration may be fixed by regulatory acts/bodies and who benefit from specific pension rights and protection against redundancies equivalent to those provided to civil servants. In a number of cases, SOEs are also to a large extent protected from insolvency or bankruptcy procedures by their specific legal status.

Where this occurs, a number of other elements of the Guidelines have often not been properly implemented. For instance, the SOEs may then differ from private limited liability companies through: (i) the respective authority and power of the board, management and ministries; (ii) the composition and structure of these boards; (iii) the extent to which they grant consultation or decision making rights to some stakeholders, more particularly, employees; (iv) disclosure requirements; and (v) the extent to which they are subjected to insolvency and bankruptcy procedures. The legal form of SOEs also often includes a strict definition of the activity of the SOEs concerned, preventing them from diversifying or extending their activities in new sectors and/or overseas. Such limits aim to prevent misuse of public funds, stop overly ambitious growth strategies or prevent SOEs from exporting sensitive technologies. Care must be taken to ensure that such legal limits do not hamper the necessary autonomy of the board in carrying out its duties.

When standardising the legal form of SOEs, governments should base themselves as much as possible on corporate law that is equally applicable to privately owned companies and avoid creating a specific legal form, or granting SOEs a privileged status or special protection, when this is not absolutely necessary for achieving the public policy objectives imposed on the enterprise. Standardising of the legal form of SOEs enhances transparency and facilitates oversight through benchmarking. The standardising should particularly target SOEs engaged in economic activities. It should focus on making those means and instruments usually available to private owners, also available to the state as an owner. Standardising should therefore primarily concern the role and authority of the enterprise's governance organs as well as transparency and disclosure obligations.

B. The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management. The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner.

The prime means for an active and informed ownership by the state are a clear and consistent ownership policy, the development of broad mandates and objectives for SOEs, a structured board nomination process and an effective exercise of established ownership rights. The state's broad mandates and objectives for SOEs should be revised only in cases where there has been a fundamental change of mission. While it may sometimes be necessary to review and subsequently modify an SOE's objectives, the state should refrain from modifying them too often and should ensure that the procedures involved are transparent.

This does not imply that the government should not act as an active owner. It means that the ownership entity's authority to give direction to the SOE or its board should be limited to strategic issues and public policy objectives. The state should not be involved in operational decision-making, such as directing the SOE's hiring decisions. The state should publicly disclose and specify in which areas and types of decisions the ownership entity is competent to give instructions.

C. The state should let SOE boards exercise their responsibilities and should respect their independence.

In the nomination and election of board members, the ownership entity should focus on the need for SOE boards to exercise their responsibilities in a professional and independent manner. It is important that when carrying out their duties individual board members do not act as representatives of different constituencies. Independence requires that all board members carry out their duties in an even-handed manner with respect to all shareholders.

When the state is a controlling owner, it is in a unique position to nominate and elect the board without the consent of other shareholders. This legitimate right comes with a high degree of responsibility for identifying, nominating and electing board members. In this process, and in order to minimise possible conflicts of interest, the ownership entity should avoid electing an excessive number of board members from the state administration. This is particularly relevant for SOEs engaged in economic activities, where limiting board membership by representatives of the ownership entity or by other state officials can increase professionalism, help prevent excessive government intervention in SOE management and it may help limit the state's responsibility for decisions taken by SOE boards.

Employees of the ownership entity or professionals from other parts of the administration should only be elected to SOE boards if they meet the required competence level for all board members and if they do not act as a conduit for political influence that extends beyond the ownership role. They should have the same duties and responsibilities as the other board members and act in the interest of the SOE and all its shareholders. Disqualification conditions and situations of conflict of interest should be carefully evaluated and guidance provided about how to handle and resolve them. The professionals concerned should have neither excessive inherent nor perceived conflicts of interest. In particular this implies that they should neither take part in regulatory decisions concerning the same SOE nor have any specific obligations or restrictions that would prevent them from acting in the enterprise's interest. More generally, all potential conflicts of interests concerning any member of the board should be reported to the board which should then disclose these together with information on how they are being managed.

It is important to clarify the respective personal and state liability when state officials are on SOE boards. The state officials concerned may have to disclose any personal ownership they have in the SOE and follow the relevant insider trading regulation. Guidelines or codes of ethics for members of the ownership entity and other state officials serving as SOE board members could be developed by the ownership entity. Such guidelines or codes of ethics should indicate how information passed on to the state from these board members should be handled. Direction in terms of broader policy objectives should be channelled through the ownership entity and enunciated as enterprise objectives rather than imposed directly through board participation.

D. The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralised in a single ownership entity, or, if this is not possible, carried

out by a co-ordinating body. This "ownership entity" should have the capacity and competencies to effectively carry out its duties.

It is critical for the ownership function within the state administration to be clearly identified, whether it is located in a central ministry such as the finance or economics ministries, in a separate administrative entity, or within a specific sector ministry.

To achieve a clear identification of the ownership function, it can be centralised in a single entity, which is independent or under the authority of one minister. This approach helps in clarifying the ownership policy and its orientation, and also helps ensure its more consistent implementation. Centralisation of the ownership function also allows for reinforcing and bringing together relevant competencies by organising "pools" of experts on key matters, such as financial reporting or board nomination. In this way, centralisation can be a major force in the development of aggregate reporting on state ownership. Finally, centralisation is also an effective way to clearly separate the exercise of the ownership function from other potentially conflicting activities performed by the state, particularly market regulation and industrial policy, as mentioned in Guideline III.A below.

The ownership entity should have the requisite capacities and competencies to effectively carry out its duties, and be supported by formal regulations and procedures consistent with those applicable to the companies in which it exercises the state's ownership rights.

If the ownership function is not centralised, a minimum requirement is to establish a strong co-ordinating entity among the different administrative departments involved. This will help to ensure that each SOE has a clear mandate and receives a coherent message in terms of strategic guidance or reporting requirements. The co-ordinating entity would harmonise and co-ordinate the actions and policies undertaken by different ownership departments in various ministries, and help ensure that decisions regarding enterprise ownership are taken on a whole-of-government basis. The co-ordinating entity should also be in charge of establishing an overall ownership policy, developing specific guidelines and unifying practices among the various ministries. The establishment of a co-ordinating entity can also facilitate the centralisation of some key functions, in order to make use of specific expertise and ensure independence from individual sector ministries. For example, it can be useful for the co-ordinating entity to undertake the function of board nomination.

E. The ownership entity should be held accountable to the relevant representative bodies and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

The relationship of the ownership entity with other government bodies should be clearly defined. A number of state bodies, ministries or administrations may have different roles *vis-à-vis* the same SOEs. In order to increase public confidence in the way the state manages ownership of SOEs, it is important that these different roles be clearly identified and explained to the general public. For instance, the ownership entity should maintain co-operation and continuous dialogue with the state supreme audit institutions responsible for auditing the SOEs. It should support the work of the state audit institution and take appropriate measures in response to audit findings.

The ownership entity should be held clearly accountable for the way it carries out state ownership. Its accountability should be, directly or indirectly, to bodies representing the interests of the general public, such as the legislature. Its accountability to the legislature should be clearly defined, as should the accountability of SOEs themselves, which should not be diluted by virtue of the intermediary reporting relationship.

Accountability should go beyond ensuring that the exercise of ownership does not interfere with the legislature's prerogative as regards budget policy. The ownership entity should report on its own performance in exercising state ownership and in achieving the state's objectives in this regard. It should provide quantitative and reliable information to the public and its representatives on how the SOEs are managed in the interests of their owners. In the case of legislative hearings, confidentiality issues should be dealt with through specific procedures such as confidential or closed meetings. While generally accepted as a useful procedure, the form, frequency and content of this dialogue may differ according to the constitutional law and the different legislative traditions and roles.

Accountability requirements should not unduly restrict the autonomy of the ownership entity in fulfilling its responsibilities. For example, cases where the ownership entity needs to obtain the legislature's *ex ante* approval should be limited and relate to significant changes to the overall ownership policy, significant changes in the size of the state sector and significant transactions (investments or disinvestment). More generally, the ownership entity should enjoy a certain degree of flexibility *vis-à-vis* its responsible ministry, where applicable, in the way it organises itself and takes decisions with regards to procedures and processes. The ownership entity could also enjoy a certain degree of budgetary autonomy that can allow flexibility in recruiting, remunerating and retaining the necessary expertise, for instance through fixed-term contracts or secondments from the private sector.

F. The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise.

To avoid either undue political interference or lack of oversight due to passive state ownership that results in negative performance, it is important for the ownership entity to focus on the effective exercise of ownership rights. The state as an owner should typically conduct itself as any major shareholder when it is in a position to significantly influence the enterprise and be an informed and active shareholder when holding a minority post. The state needs to exercise its rights in order to protect its ownership and optimise its value.

Among the basic shareholder rights are: (i) to participate and vote in shareholder meetings; (ii) to obtain relevant and sufficient information on the corporation on a timely and regular basis; (iii) to elect and remove members of the board; (iv) to approve extraordinary transactions; and (v) to vote on dividend distribution and enterprise dissolution. The ownership entity should exercise these rights fully and judiciously, as this would allow the necessary influence on SOEs without infringing on their day-to-day management. The effectiveness and credibility of SOE governance and oversight will, to a large extent, depend on the ability of the ownership entity to make an informed use of its shareholder rights and effectively exercise its ownership functions in SOEs.

An ownership entity needs unique competencies and should have professionals with legal, financial, economic and management skills that are experienced in carrying out fiduciary responsibilities. Such professionals must also clearly understand their roles and responsibilities as civil servants with respect to the SOEs. In addition, the ownership entity should include competencies related to the specific obligations that some SOEs under their supervision are required to undertake in terms of public service provisions. The ownership entity should also have the possibility to have recourse to outside advice and to contract out some aspects of the ownership function, in order to exercise the state's ownership rights in a better manner. It could, for example, make use of specialists for carrying out evaluation, active monitoring, or proxy voting on its behalf where deemed necessary and appropriate. The use of short-term contracts and secondments can be useful in this regard.

Its prime responsibilities include:

1. **Being represented at the general shareholders meetings and effectively exercising voting rights;**

The state as an owner should fulfil its fiduciary duty by exercising its voting rights, or at least explain if it does not do so. The state should not find itself in the position of not having reacted to propositions put before the SOEs' general shareholder meetings. It is important to establish appropriate procedures for state representation in general shareholders meetings. This is achieved by clearly identifying the ownership entity as representing the state's shares.

For the state to be able to express its views on issues submitted for approval at shareholders' meetings, it is further necessary that the ownership entity organises itself to be able to present an informed view on these issues and articulate it to SOE boards via the general shareholders meeting.

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

The ownership entity should ensure that SOEs have efficient and well-functioning professional boards, with the required mix of competencies to fulfil their responsibilities. This will involve establishing a structured nomination process and playing an active role in this process. This will be facilitated if the ownership entity is given sole responsibility for organising the state's participation in the nomination process.

The nomination of SOE boards should be transparent, clearly structured and based on an appraisal of the variety of skills, competencies and experiences required. Competence and experience requirements should derive from an evaluation of the incumbent board and needs related to the enterprise's long term strategy. These evaluations should also take into consideration the role played by employee board representation when this is required by law or mutual agreements. To base nominations on such explicit competence requirements and evaluations will likely lead to more professional, accountable and business-oriented boards.

SOE boards should also be able to make recommendations to the ownership entity concerning the approved board member profiles, skill requirements and board member evaluations. Setting up nomination committees may be useful, helping to focus the search for good candidates and in structuring further the nomination process. In some countries, it is also considered good practice to establish a specialised commission or "public board" to oversee nominations in SOE boards. Even though such commissions or public boards might have only recommendation powers, they could have a strong influence in practice on increasing the independence and professionalism of SOE boards. Proposed nominations should be disclosed in advance of the general shareholders meeting, with adequate information about the professional background and expertise of the respective candidates.

It could also be useful for the ownership entity to maintain a database of qualified candidates, developed through an open competitive process. The use of professional staffing agencies or international advertisements is another means to enhance the quality of the search process. These practices can help to enlarge the pool of qualified candidates for SOE boards, particularly in terms of private sector expertise and international experience. The process may also favour greater board diversity, including gender diversity.

The ownership entity should consider the *OECD Recommendation on Gender Equality in Education, Employment and Entrepreneurship*. It recommends that jurisdictions encourage measures such as voluntary targets, disclosure requirements and private initiatives that enhance gender diversity on boards and in senior management of listed companies and consider the costs and benefits of other approaches such as boardroom quotas. Where SOEs provide public services, the recommendations regarding gender equality in the public sector are also pertinent. According to these, the authorities should take measures including introducing mechanisms to improve the gender balance in leadership positions in the public sector, such as disclosure requirements, target setting or quotas for women in senior management positions.

3. **Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;**

The state as an active owner should, as mentioned above, define and communicate broad mandates and objectives for fully state-owned SOEs. Where the state is not the sole owner of an SOE, it is generally not in a position to formally "mandate" the fulfilment of specific objectives, but should rather communicate its expectations via the standard channels as a significant shareholder.

SOE mandates are concise documents that give a brief overview of an SOE's high-level long-term objectives, in line with the established rationale for state ownership in the enterprise. A mandate will usually define the predominant activities of an SOE and give some indications regarding its main economic and, where relevant, public policy objectives. For example, the state might define the mandate of its state-owned postal services operator as follows: "To operate the national postal service on a self-sustaining basis and to maintain universal service at affordable prices to meet the needs of the national population". Clearly defined mandates help ensure appropriate levels of accountability at the enterprise level, and can help limit unpredictable changes to an SOE's operations, such as non-recurring special obligations imposed by the state that might threaten an SOE's commercial viability. They also provide a framework to help the state define and subsequently monitor the fulfilment of an SOE's more immediate-term objectives and targets.

In addition to defining the broad mandates of SOEs, the ownership entity should also communicate more specific financial, operational and non-financial performance objectives to SOEs, and regularly monitor their implementation. This will help in avoiding the situation where SOEs are given excessive autonomy in setting their own objectives or in defining the nature and extent of their public service obligations. The objectives may include avoiding market distortion and pursuing profitability, expressed in the form of specific targets, such as rate-of-return targets, dividend policy and guidelines for assessing capital structure appropriateness. Setting objectives may include trade-offs, for example between shareholder value, long term investment capacity, public service obligations and even job security. The state should therefore go further than defining its main objectives as an owner; it should also indicate its priorities and clarify how inherent trade-offs shall be handled. In doing so, the state should avoid interfering in operational matters, and thereby respect the independence of the board.

4. **Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;**

In order for the ownership entity to make informed decisions on key corporate matters, it should ensure that it receives all necessary and relevant information in a timely manner. The ownership entity should also establish means that make it possible to monitor SOEs' activity and performance on a continuous basis. The ownership entity should ensure that adequate external reporting systems are in place for all SOEs. The reporting systems should give the ownership entity a true picture of the SOE's performance or financial situation, enabling it to react on time and to be selective in its intervention.

The ownership entity should develop the appropriate devices and select proper valuation methods to monitor SOEs' performance based on their established objectives. It could be helped in this regard by developing systematic benchmarking of SOE performance, with private or public sector entities, both domestically and abroad. For SOEs with no comparable entity against which to benchmark overall performance, comparisons can be made concerning certain elements of their operations and performance. This benchmarking should cover productivity and the efficient use of labour, assets and capital. This benchmarking is particularly important for SOEs operating in sectors where they do not face competition. It allows the SOEs, the ownership entity and the general public to better assess SOE performance and reflect on their development.

Effective monitoring of SOE performance can be facilitated by having adequate accounting and audit competencies within the ownership entity to ensure appropriate communication with relevant counterparts, both with SOEs' financial services, its internal audit function and specific state controllers. The ownership entity should also require that SOE boards establish adequate internal controls, ethics and compliance measures for detecting and preventing violations of the law.

5. **Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;**

In order to ensure adequate accountability by SOEs to shareholders, reporting bodies and the broader public, the state as an owner should develop and communicate a coherent transparency and disclosure policy for the enterprises it owns. The disclosure policy should emphasise the need for SOEs to report material information. The development of the disclosure policy should build on an extensive review of existing legal and regulatory requirements applicable to SOEs, as well as the identification of any gaps in requirements and practices as compared with good practice and national listing requirements. Based on this review process, the state might consider a number of measures to improve the existing transparency and disclosure framework, such as proposing amendments to the legal and regulatory framework, or elaborating specific guidelines, principles or codes to improve practices at the enterprise level. The process should involve structured consultations with SOE boards and management, as well as with regulators, members of the legislature and other relevant stakeholders.

The ownership entity should communicate widely and effectively about the transparency and disclosure framework for SOEs, and also encourage implementation and ensure quality of information at the enterprise level. Examples of such mechanisms include: the development of guidance manuals and training seminars for SOEs; special initiatives such as performance awards that recognise individual SOEs for high quality disclosure practices; and mechanisms to measure, assess and report on implementation of disclosure requirements by SOEs.

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

National legislation differs concerning the communication with external auditors. In some jurisdictions, this is the prerogative of the board of directors. In others, in the case of wholly-state owned enterprises, the ownership function as the sole representative of the annual general meeting is expected to communicate with the external auditors. In this case the ownership entity will need the requisite capacity, including detailed knowledge of financial accountancy, to fill this function. Depending on the legislation, the ownership entity may be entitled, through the annual shareholders' meeting, to nominate and even appoint the external auditors. Regarding wholly-owned SOEs, the ownership entity should maintain a continuous dialogue with external auditors, as well as with the specific state controllers when the latter exist. This continuous dialogue could take the form of regular exchange of information, meetings or discussions when specific problems occur. External auditors will provide the ownership entity with an external, independent and qualified view on the SOE performance and financial situation. However, continuous dialogue of the ownership entity with external auditors and state controllers should not be at the expense of the board's responsibility.

When SOEs are publicly traded or partially-owned, the ownership entity must respect the rights and fair treatment of minority shareholders. The dialogue with external auditors should not give the ownership entity any privileged information and should respect regulation regarding privileged and confidential information.

7. **Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.**

There is a strong case for aligning the remuneration of board members of SOEs with private sector practices. For SOEs with predominantly economic objectives operating in a competitive environment, board remuneration levels should reflect market conditions insofar as this is necessary to attract and retain highly qualified board members. However, care should also be taken to effectively manage any potential backlash against SOEs and the ownership entity due to negative public perception triggered by excessive board remuneration levels. This can pose a challenge for attracting top talent to SOE boards, although other factors such as reputational benefits, prestige and access to networking are sometimes considered to represent non-negligible aspects of board remuneration.

Annotations to Chapter III: State-owned enterprises in the marketplace

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

When SOEs engage in economic activities then it is commonly agreed that those activities must be carried out without any undue advantages or disadvantages relative to other SOEs or private enterprises. There is less consensus about how a level playing field is to be obtained in practice – particularly where SOEs combine their economic activities with non-trivial public policy objectives. In addition to specific challenges such as ensuring equal financial, regulatory and tax treatment come some more overarching issues, including identifying the cost of public service activities and, where feasible, separation of economic activities and public policy objectives. The publication OECD (2012) *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business*, which provides best practices from OECD member countries, should serve as a point of inspiration for regulators and policy makers.

A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

When the state plays a dual role of market regulator and owner of SOEs with economic operations (e.g.in newly deregulated and often partially privatised network industries) the state becomes at the same time a major market player and an arbitrator. This can create conflicts of interest that are neither in the interest of the enterprise, the state or the public. Full administrative and legal separation of responsibilities for ownership and market regulation is a fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition. Such separation is also advocated by the *OECD Principles of Regulatory Reform*.

Another important case is when SOEs are used as delivery vehicles for specific public policy goals, such as the implementation of industrial policy. In such cases, the lack of separation between the ownership and policy formulation functions is problematic for a number of reasons highlighted throughout the Guidelines, and it can easily result in goals confusion and conflicts of interest between branches of the state. A separation of industrial policy and ownership need not prevent necessary co-ordination between the relevant bodies, and it will enhance the identification of the state as an owner and will favour transparency in defining objectives and monitoring performance.

In order to prevent conflicts of interest, it is also necessary to separate clearly the ownership function from any entities within the state administration which might be clients or main suppliers to SOEs. Legal as well as non-legal barriers to fair procurement should be removed. In implementing effective separation between the different state roles with regard to SOEs, both perceived and real conflicts of interest should be taken into account.

B. Stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.

SOEs as well as the state as a shareholder should not be protected from challenge via the courts in case they are accused of infringing the law or disrespecting contractual obligations. Stakeholders should be able to challenge SOEs and the state as an owner in courts and/or tribunals and be treated fairly and equitably in such cases by the judicial system. They should be able to do so without having to fear an adverse reaction from the state powers exercising ownership over the SOE that is subject to the dispute.

C. Where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained, allowing for an attribution to main activity areas.

Where SOEs combine economic activities and public policy objectives, structural separation of those activities, when feasible and efficient, can facilitate the process of identifying, costing and funding public policy objectives. Structural separation implies the division of a formerly integrated entity into economic activities and parts tasked with carrying out public policy objectives. There are different degrees of separation ranging from accounting, functional or corporate separation. However, it must be recognised that depending on individual SOEs' production factors, including technology, capital equipment and human capital, separation is not always feasible and, where feasible, is sometimes not economically efficient.

Economic activities of entities which remain integrated with other parts of the government sector typically share costs and/or assets and liabilities. Ensuring a level playing field then requires, first, a high level of transparency and disclosure regarding the cost structure. This point is further accentuated where the public policy objectives of an SOE are subject to government subsidies or other preferential treatment. Secondly, a separation of costs and assets between accounts corresponding to economic activities and public policy objectives should be undertaken. Such efforts have been the object of international rulemaking. The separation of economic activities and public policy objectives also helps avoid market-distorting cross-subsidisation between the two types of activities.

D. Costs related to public policy objectives should be funded by the state and disclosed.

In order to maintain a level playing field with private competitors, SOEs need to be adequately compensated for the fulfilment of public policy objectives, with measures taken to avoid both over compensation and under compensation. On the one hand, if SOEs are over compensated for their public policy activities, this can amount to an effective subsidy on their competitive activities, thus distorting the level playing field with private competitors. On the other hand, under compensation for public policy activities can jeopardise the viability of the enterprise.

It is therefore important that any costs related to the fulfilment of public policy objectives be clearly identified, disclosed and adequately compensated by the state on the basis of specific legal provisions and/or through contractual mechanisms, such as management or service contracts. Related funding arrangements should also be disclosed. Compensation should be structured in a way that avoids market distortion. This is particularly the case if the enterprises concerned are pursuing public policy objectives in addition to economic activities. Where SOEs are profitable the compensation can take the form of foregone dividend revenues by the state, having the equivalent effect of a subsidy, but regardless of forms the compensation should be identified and accounted for. It is important that compensation provided to SOEs be calibrated to the actual costs of fulfilling well-defined public policy objectives and not be used to offset any financial or operational inefficiencies. The funding and fulfilment of public policy objectives should also be monitored and evaluated through the overall performance monitoring system.

E. As a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations. Laws and regulations should not unduly discriminate between SOEs and their market competitors. SOEs' legal form should allow creditors to press their claims and to initiate insolvency procedures.

Although in some countries SOEs are exempt from certain laws and regulations (e.g. tax, competition and bankruptcy laws as well as zoning regulations and building codes), such exemptions should generally be avoided; where they exist, they should be limited and transparent, and SOEs, to the extent possible, should adhere to the policies underpinning those laws and regulations. Any exemptions from the application of general laws or regulations that result in favourable treatment for SOEs, or affect public safety, should be disclosed, either by the state ownership entity or by individual SOEs.

SOEs and their private competitors should generally be treated equally, including under national treatment and market access rules. This includes the application of the *OECD Declaration on International Investment and Multinational Enterprises* and the *OECD Codes of Liberalisation,* where applicable.

F. SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance.

Whether financing for an SOE's economic activities comes from the state budget or the commercial marketplace, measures should be implemented to ensure that the terms of both debt and equity financing are market consistent.

In particular:

1. SOEs' relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds.

Creditors sometimes seem to assume that there is an implicit state guarantee on SOEs' debts. This situation has in many instances led to artificially low funding costs disrupting the competitive landscape. Moreover, in those countries where state-owned financial institutions tend to be among the main creditors of SOEs involved in economic activities, there is great scope for conflicts of interest. Reliance on state-owned financial institutions may shelter SOEs from a crucial source of market monitoring and pressure, thereby distorting their incentive structure and leading to excessive indebtedness, wasted resources and market distortions.

A clear distinction is necessary between the state's and SOEs' respective responsibilities in relation to creditors. Mechanisms should be developed to manage conflicts of interests and ensure that SOEs develop relations with state-owned banks, other financial institutions as well as other SOEs based on purely commercial grounds. State-owned banks should grant credit to SOEs on the same terms and conditions as for private companies. These mechanisms could also include limits on, and careful scrutiny of, SOEs' board members sitting on the boards of state-owned banks.

Where the state extends guarantees to SOEs effectively to compensate for its inability to provide them with equity capital additional problems may arise. As a general principle, the state should not give an automatic guarantee in respect of SOE liabilities. Fair practices with regard to the disclosure and remuneration of state guarantees should also be developed and SOEs should be encouraged to seek financing from capital markets. With regard to commercial lenders, the state should make clear to all market participants its lack of backing of SOE-incurred debts. It should also consider mechanisms of imposing compensatory payments to the national treasury from SOEs benefiting from lower funding costs than private companies in like circumstances.

2. **SOEs' economic activities should not benefit from any indirect financial support that confers an advantage over private competitors, such as preferential financing, tax arrears or preferential trade credits from other SOEs. SOEs' economic activities should not receive inputs (such as energy, water or land) at prices or conditions more favourable than those available to private competitors.**

To maintain a level playing field, SOEs should be subject to an equal or equivalent tax treatment as private competitors in like circumstances. In addition to the points raised above, there should also be no expectation that SOEs may benefit from their government-near status to run up tax arrears or be subject to lenient enforcement of tax rules.

SOEs also should generally not benefit from "off market" funding arrangements from other SOEs, such as trade credits. Such arrangements, unless they are fully consistent with normal corporate practices, amount to preferential lending. The state should implement measures to ensure that inter-SOE transactions take place on purely commercial terms.

3. **SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.**

SOEs' economic activities should be expected to earn rates of return comparable, in the long run, to those of the competing companies. Rates-of-return (RoR) need to be considered over a long time span, given that even among private companies operating in highly competitive environments RoRs can differ considerably in the short and medium term. Moreover any equity financing provided by the state budget should be subject to a required minimum expected RoR that is consistent with private sector companies in like circumstances. A number of governments allow lower RoR to compensate for balance sheet anomalies such as temporary needs for high capital spending. This is not uncommon in other parts of the corporate sector and, if carefully calibrated, this does not imply a departure from practices consistent with maintaining a level playing field. Conversely, some governments also tend to lower RoR requirements to compensate SOEs for such public policy objectives as they are charged with. This is not a good practice since this kind of objective, as discussed elsewhere in the Guidelines, should be compensated separately and be more closely linked to the actual cost of the public policy objectives.

G. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

The participation of SOEs in public procurement processes has been an area of concern for governments committed to a level playing field. Designing bidding regimes that in principle do not favour any category of bidder is uncomplicated, and indeed is embedded in the legislation of a growing number of jurisdictions. Implementation may, however, in practice be complicated. Whether or not such rules are limited to procurement by the general government or are also extended to procurement by SOEs differs between countries. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be transparent, competitive, non-discriminatory and safeguarded by appropriate standards of transparency. Generally, the activities of SOEs can be divided into two parts: activities that are for commercial sale or resale; and activities to fulfil a governmental purpose. In cases where an SOE is fulfilling a governmental purpose, or to the extent that a particular activity allows an SOE to fulfil such a purpose, the SOE should adopt government procurement guidelines that ensure a level playing field for all competitors, state-owned or otherwise. State-owned monopolies should follow the same procurement rules applicable to the general government sector.

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Annotations to Chapter IV: Equitable treatment of shareholders and other investors

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

It is in the state's interest to ensure that, in all enterprises where it has a stake, all shareholders are treated equitably. The state's reputation in this respect will influence SOEs' capacity to attract outside funding and the valuation of the enterprise. It should therefore ensure that other shareholders do not perceive the state as an opaque, unpredictable and unfair owner. The state should on the contrary establish itself as exemplary and follow best practices regarding the treatment of shareholders.

A. The state should strive toward full implementation of the *OECD Principles of Corporate Governance* when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:

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

Whenever a part of an SOE's capital is held by private shareholders, institutional or individual, the state should recognise their rights. Non-state shareholders should in particular be protected against abusive action by the state as an owner, and should have efficient means of redress. Insider trading and abusive self-dealing should be prohibited. Pre-emptive rights and qualified majorities for certain shareholder decisions can also be a useful *ex-ante* means of ensuring minority shareholder protection. Specific care should be taken to ensure the protection of shareholders in cases of partial privatisation of SOEs.

As a dominant shareholder, the state is in many cases able to make decisions in general shareholders meetings without the agreement of any other shareholders. It is usually in a position to decide on the composition of the board of directors. While such decision making power is a legitimate right that follows with ownership, it is important that the state doesn't abuse its role as a dominant shareholder, for example by pursuing objectives that are not in the interest of the enterprise and are thereby to the detriment of other shareholders. Abuse can occur through inappropriate related party transactions, biased business decisions or changes in the capital structure favouring controlling shareholders.

The ownership entity should develop guidelines regarding equitable treatment of non-state shareholders. It should ensure that individual SOEs, and more particularly their boards, are fully aware of the importance of the relationship with shareholders and are active in enhancing it. When the state is able to exercise a degree of control that exceeds its shareholding, then there is a potential for abuse. The use of golden shares should be limited to cases where they are strictly necessary to protect certain essential public interests such as those relating to the protection of public security and proportionate to the pursuit of these objectives. Further, governments should disclose the existence of any shareholders' agreements and capital structures that allow a shareholder to exercise a degree of control over the corporation disproportionate to the shareholders' equity ownership in the enterprise.

2. **SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.**

A crucial condition for protecting shareholders is to ensure a high degree of transparency. As a general rule, material information should be reported to all shareholders simultaneously to ensure their equitable treatment. Moreover, any shareholder agreements, including information agreements covering board members, should be disclosed.

Minority and other shareholders should have access to all the necessary information to be able to make informed investment decisions. Meanwhile, significant shareholders, including the ownership entity, should not make any abusive use of the information they might obtain as controlling shareholders or board members. For non-listed SOEs, other shareholders are usually well identified and often have privileged access to information, through board seats for example. However, whatever the quality and completeness of the legal and regulatory framework concerning disclosure of information, the ownership entity should ensure that all enterprises where the state has shares put mechanisms and procedures in place to guarantee easy and equitable access to information by all shareholders. Particular care should be taken to ensure that when SOEs are partially privatised, the state as shareholder should have no greater involvement in corporate decisions, or access to information, than what its shareholding provides as a right.

3. SOEs should develop an active policy of communication and consultation with all shareholders.

SOEs, including any enterprise in which the state is a minority shareholder, should identify their shareholders and keep them duly informed in a timely and systematic fashion about material events and forthcoming shareholder meetings. They should also provide them with sufficient background information on issues that will be subject to decision. It is the responsibility of SOE boards to make sure that the enterprise fulfils its obligations in terms of information to the shareholders. In doing so, SOEs should not only apply the existing legal and regulatory framework, but are encouraged to go beyond it when relevant in order to build credibility and confidence, with due regard to avoiding overly burdensome requirements. Where possible, active consultation with minority shareholders will help in improving the decision making process and the acceptance of key decisions.

4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.

Minority shareholders may be concerned about actual decisions being made outside the SOE's shareholder meetings or board meetings. This is a legitimate concern for listed companies with a significant or controlling shareholder, but it can also be an issue in companies where the state is the dominant shareholder. It might be appropriate for the state as an owner to reassure minority shareholders that their interests are taken into consideration. In situations where there may be a conflict between the interest of the state and those of minority shareholders, such as related party transactions, the involvement of minority shareholders in the approval process of such transactions should be considered.

The right to participate in general shareholder meetings is a fundamental shareholder right. To encourage minority shareholders to actively participate in SOEs' general shareholder meetings and to facilitate the exercise of their rights, specific mechanisms could be adopted by SOEs. These could include qualified majorities for certain shareholder decisions and, when deemed useful by the circumstances, the possibility to use special election rules, such as cumulative voting. Additional measures should include facilitating voting *in absentia* or developing the use of electronic means as a way to reduce participation costs. Moreover, employee-shareholder participation in general shareholders meetings could be facilitated by, for example, the collection of proxy votes from employee-shareholders.

It is important that any special mechanism for minority protection is carefully balanced. It should favour all minority shareholders and in no respect contradict the concept of equitable treatment. It should neither prevent the state as a majority shareholder from exercising its legitimate influence on the decisions nor should it allow minority shareholders to unduly hold up the decision-making process.

5. **Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.**

To ensure equitable treatment of all shareholders, transactions between the state and SOEs should take place on the same terms as those between any other market participants. This is conceptually related to the issue of abusive related party transactions, but it differs insofar as "related parties" are more weakly defined in the case of state ownership. The government is advised to ensure the market consistency of all transactions by SOEs with the state and state-controlled entities and, as appropriate, test them for probity. The issue is further linked to the board obligations treated elsewhere in these Guidelines, because the protection of all shareholders is a clearly articulated duty of loyalty by board members to the enterprise and its shareholders.

B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.

Most countries have corporate governance codes for stock-market listed enterprises. However, their implementation mechanisms differ significantly, with some being merely advisory, others being implemented (by stock markets or securities regulators) on a comply-or-explain basis, and yet others being mandatory. It is a basic premise of the Guidelines that SOEs should be subject to best practice governance standards of listed enterprises. This implies that both listed and unlisted SOEs should always comply with the national corporate governance code, irrespectively of how "binding" they are.

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

As part of its commitment to ensure a high degree of transparency with all shareholders, the state should ensure that material information on any public policy objectives an SOE is expected to fulfil is disclosed to non-state shareholders. The relevant information should be disclosed to all shareholders at the time of investment and be made continually available throughout the duration of the investment.

D. When SOEs engage in co-operative projects such as joint ventures and public-private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner.

When SOEs engage in co-operative projects with private partners, care should be taken to uphold the contractual rights of all parties and to ensure effective redress and/or dispute resolution mechanisms. Relevant other OECD recommendations should be observed, in particular the *OECD Principles for Public Governance of Public-Private Partnerships* as well as, in the relevant sectors, the *OECD Principles for Private Sector Participation in Infrastructure*. One of the key recommendations from these instruments is that care should be taken to monitor and manage any implicit or explicit fiscal risks for the government resulting from public-private partnerships or other arrangements that the SOE enters into.

Moreover, formal agreements between the state and private partners, or between the SOE and private partners, should clearly specify the respective responsibilities of project partners in the case of unforeseen events, while at the same time there should be sufficient flexibility for contract renegotiation in case of need. Dispute resolution mechanisms need to ensure that any disputes occurring throughout the duration of the project are addressed in a fair and timely manner, without prejudice to other judicial remedies.

Annotations to Chapter V: Stakeholder relations and responsible business

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

In some OECD countries, legal status, regulations or mutual agreements/ contracts grant certain stakeholders specific rights in SOEs. Some SOEs might even be characterised by distinct governance structures regarding the rights granted to stakeholders, principally employee board level representation, or other consultation/decision making rights to employees' representatives and consumer organisations, for example through advisory councils.

SOEs should acknowledge the importance of stakeholder relations for building sustainable and financially sound enterprises. Stakeholder relations are particularly important for SOEs as they may be critical for the fulfilment of public service obligations whenever these exist and as SOEs may have, in some infrastructure sectors, a vital impact on the macroeconomic development potential and on the communities in which they are active. Moreover, some investors increasingly consider stakeholder related issues in their investment decisions and appreciate potential litigation risks linked to stakeholder issues. It is therefore important that the ownership entity and SOEs recognise the impact that an active stakeholder policy may have on the enterprise's long term strategic goals and reputation. SOEs should thus, in consultation with the ownership entity, develop and adequately disclose clear stakeholder policies.

However, the government should not use SOEs to further goals which differ from those which apply to the private sector, unless compensated in some form. Any specific rights granted to stakeholders or influence on the decision making process should be explicit. Whatever rights granted to stakeholders by the law or special obligations that have to be fulfilled by the SOE in this regard, the company organs, principally the general shareholders meeting and the board, should retain their decision making powers.

A. Governments, the state ownership entities and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements.

As a dominant shareholder, the state may control corporate decision making and be in a position to take decisions to the detriment of stakeholders. It is therefore important to establish mechanisms and procedures to protect stakeholder rights. The ownership entity should have a clear policy in this regard. SOEs should fully respect the rights of stakeholders, as established by law, regulations and mutual agreements. They should act in the same way as private sector listed companies.

To encourage active and wealth-creating co-operation with stakeholders, SOEs should ensure that stakeholders have access to relevant, sufficient and reliable information on a timely and regular basis to be able to exercise their rights. Stakeholders should have access to effective redress in the event their rights are violated. Employees should also be able to freely communicate their *bona fide* concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this. SOEs should establish clear policies and processes in this regard, for example whistleblowing policies. In the absence of timely remedial action or in the face of a reasonable risk of negative employment action to a complaint regarding contravention of the law, employees are encouraged to report their *bona fide* complaint to the competent authorities. Many countries also provide for the possibility to bring cases of violations of the *OECD Guidelines for Multinational Enterprises* to a National Contact Point.

Mechanisms for employee participation should be encouraged to develop when considered relevant with regard to the importance of stakeholder relations for some SOEs. However, when deciding on the relevance and desired development of such mechanisms, the state should give careful consideration to the inherent difficulties in transforming entitlement legacies into effective performance enhancing mechanisms. Examples of mechanisms for employee participation include employee representatives on boards and governance processes such as trade union representation and works councils that consider employee viewpoints in certain key decisions. International conventions and norms also recognise the rights of employees to information, consultation and negotiation.

B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.

Good practice requires listed companies to report on stakeholder issues. By doing so, SOEs will demonstrate their willingness to operate more transparently and their commitment to co-operation with stakeholders. This will in turn foster trust and improve their reputation. Consequently, listed or large SOEs should communicate with investors, stakeholders and the public at large on their stakeholder policies and provide information on their effective implementation. This should also be the case for any SOE pursuing important public policy objectives or having general services obligations, with due care to the costs involved related to their size. Reports on stakeholder relations should refer to best practice and follow existing guidelines on social and environmental responsibility disclosure. It is also advisable that SOEs have their stakeholder reports independently scrutinised in order to strengthen their credibility.

C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.

SOE boards, like private company boards, should apply high ethical standards. This is in the long term interest of any enterprise as a means to make it credible and trustworthy in day-to-day operations and with respect to its longer term commitments. SOEs may be subject to particular pressures given the interaction of business considerations with political and public policy ones. Moreover, as SOEs can play an important role in setting the business tone of the country, it is also important for them to maintain high ethical standards.

SOEs and their officers should conduct themselves according to high ethical standards. SOEs should develop internal controls, ethics and compliance programmes and measures, committing themselves to comply with country norms and in conformity with broader codes of behaviour. This should include a commitment to comply with the *OECD Anti-Bribery Convention* and to implement the recommendations of the *OECD Good Practice Guidance on Internal Controls, Ethics and Compliance.*

Codes of ethics should apply to the SOEs as a whole and to their subsidiaries. They should give clear and detailed guidance as to the expected conduct of all employees and compliance programmes and measures should be established. It is considered good practice for these codes to be developed in a participatory way in order to involve all the employees and stakeholders concerned. These codes should benefit from visible support and commitment by the boards and senior management. SOEs' compliance with codes of ethics should be periodically monitored by their boards.

Codes of ethics should include guidance on procurement processes, as well as specific mechanisms protecting and encouraging stakeholders, and particularly employees, to report on illegal or unethical conduct by corporate officers. In this regard, the ownership entities should ensure that SOEs under their responsibility effectively put in place safe-harbours for complaints for employees, either personally or through their representative bodies, or for others outside the SOE. SOE boards could grant employees or their representatives a confidential direct access to someone independent on the board, or to an ombudsman within the enterprise. The codes of ethics should also comprise disciplinary measures, should the allegations be found to be without merit and not made in good faith, frivolous or vexatious in nature.

D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.

Like private companies, SOEs have a commercial interest in minimising reputational risks and being perceived as "good corporate citizens". SOEs should observe high standards of responsible business conduct, including with regards to the environment, employees, public health and safety, and human rights. Their actions should be guided by relevant international standards, including: the *OECD Guidelines for Multinational Enterprises*, which have been adopted by all OECD member countries and reflect all four principles contained in the *ILO Declaration on Fundamental Principles and Rights at Work*; and the *UN Guiding Principles on Business and Human Rights*. The ownership entity can communicate its expectations in this regard and require SOEs to report on related performance. SOE boards and management should ensure that they are integrated into the corporate governance of SOEs, supported by incentives and subject to appropriate reporting and performance monitoring.

SOEs should not be required to engage in charitable acts or to provide public services that would more appropriately be carried out by the relevant public authorities. The state's expectations regarding the responsible business conduct of SOEs should be disclosed in a clear and transparent manner.

E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.

SOEs should not under any circumstances be used as sources of capital to finance political campaigns or activities. Where SOEs have been used in the past for party financing this has not necessarily taken the form of direct disbursements. In some cases, the use of transactions between SOEs and corporations controlled by political interests, through which the SOEs were effectively put at a loss, have been alleged.

Moreover, although it is in some countries a common practice for private companies to make political campaign contributions for commercial reasons, SOEs should abstain from doing so. The ultimate control, including through regulation, over SOEs is the responsibility of politicians who belong to political parties that benefit from the largesse of corporate sponsors. Thus, the risk of conflicts of interest – already present in private sector companies – is greatly amplified in the case of SOEs.

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Annotations to Chapter VI: Disclosure and transparency

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

Transparency regarding the financial and non-financial performance of SOEs is key for strengthening the accountability of SOE boards and management and for enabling the state to act as an informed owner. When deciding on the reporting and disclosure requirements for SOEs, some consideration should be given to enterprise size and commercial orientation. For example, for SOEs of a small size not engaged in public policy activities, disclosure requirements should not be so high as to effectively confer a competitive disadvantage. Conversely, where SOEs are large or where state ownership is motivated primarily by public policy objectives, the enterprises concerned should implement particularly high standards of transparency and disclosure.

A. SOEs should report material financial and non-financial information on the enterprise in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest.

All SOEs should disclose financial and non-financial information, and large and listed ones should do so according to high quality internationally recognised standards. This implies that SOE board members sign financial reports and that CEOs and CFOs certify that these reports in all material respects appropriately and fairly present the operations and financial condition of the SOE.

To the extent possible, the relevant authorities should carry out a cost-benefit analysis to determine which SOEs should be submitted to high quality internationally recognised standards. This analysis should consider that demanding disclosure requirements are both an incentive and a means for the board and management to perform their duties professionally.

A high level of disclosure is also valuable for SOEs pursuing important public policy objectives. It is particularly important when they have a significant impact on the state budget, on the risks carried by the state, or when they have a more global societal impact. In the EU, for example, companies that are entitled to state subsidies for carrying out services of general economic interest are required to keep separate accounts for these activities.

SOEs should face at least the same disclosure requirements as listed companies. Disclosure requirements should not compromise essential corporate confidentiality and should not put SOEs at a disadvantage in relation to private competitors. SOEs should report on their financial and operating results, non-financial information, remuneration policies, related party transactions, governance structures and governance policies. SOEs should disclose whether they follow any code of corporate governance and, if so, indicate which one. In the disclosure of financial and non-financial performance, it is considered good practice to adhere to internationally accepted reporting standards.

Regarding disclosure of remuneration of board members and key executives, it is viewed as good practice to carry this out on an individual basis. The information should include termination and retirement provisions, as well as any specific benefits or in kind remuneration provided to board members.

With due regard to enterprise capacity and size, examples of such information include:

1. **A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership entity);**

It is important that each SOE is clear about its overall objectives. Regardless of the existing performance monitoring system, a limited set of basic overall objectives should be identified together with information about how the enterprise is dealing with trade-offs between objectives that could be conflicting.

When the state is a majority shareholder or effectively controls the SOE, enterprise objectives should be made clear to all other investors, the market and the general public. Such disclosure obligations will encourage SOE officials to clarify the objectives to themselves, and could also increase management's commitment to fulfilling these objectives. It will provide a reference point for all shareholders, the market and the general public for considering the strategy adopted and decisions taken by the management.

SOEs should report on how they fulfilled their objectives by disclosing key financial and non-financial performance indicators. When the SOE is also used for public policy objectives, it should also report on how these are being achieved.

2. **Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives;**

Like private corporations, SOEs should disclose information on their financial, operational and non-financial performance. In addition, when SOEs are expected to fulfil specific public policy objectives, information on the costs of related activities, and how they are funded, should be disclosed. At the same time, care should be taken by the ownership entity to ensure that the additional reporting obligations placed on SOEs, beyond those placed on private enterprises, do not create an undue burden on their economic activities.

3. **The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes;**

It is important that the ownership and voting structures of SOEs are transparent so that all shareholders have a clear understanding of their share of cash-flow and voting rights. It should also be clear who retains legal ownership of the state's shares and where the responsibility for exercising the state's ownership rights are located. Any special rights or agreements that diverge from generally applicable corporate governance rules, and that may distort the ownership or control structure of the SOE, such as golden shares and power of veto, should be disclosed. The existence of shareholder agreements should be disclosed, whereas some of their contents may be subject to conditions of confidentiality.

4. **The remuneration of board members and key executives;**

It is important that SOEs ensure high levels of transparency regarding the remuneration of board members and key executives. Failure to provide adequate information to the public could result in negative perceptions and fuel risks of a backlash against the ownership entity and individual SOEs. Information should relate to actual remuneration levels and the policies that underpin them.

5. **Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board;**

Full transparency surrounding board member qualifications is especially important for SOEs. SOE board member nomination is often the direct responsibility of the government and as such, there is a risk that board members be perceived as acting on behalf of the state or specific political constituencies, rather than in the long term interest of the enterprise and its shareholders. Requiring high levels of transparency on board member qualifications and nomination processes can play a part in increasing the professionalism of SOE boards. It also allows investors to evaluate board member qualifications and identify any potential conflicts of interest.

6. Any material foreseeable risk factors and measures taken to manage such risks;

Severe difficulties arise when SOEs undertake ambitious strategies without clearly identifying, assessing or duly reporting on the related risks. Disclosure of material risk factors is particularly important when SOEs operate in newly de-regulated and increasingly internationalised industries where they are facing a series of new risks, such as political, operational, or exchange rate risks. Without adequate reporting of material risk factors, SOEs may give a false representation of their financial situation and overall performance. This in turn may lead to inappropriate strategic decisions and unexpected financial losses. Material risk factors should be reported in a timely fashion and with sufficient frequency.

Appropriate disclosure by SOEs of the nature and extent of risk incurred in their operations requires the establishment of sound internal risk management systems to identify, manage, control and report on risks. SOEs should report according to new and evolving standards and disclose all off-balance-sheet assets and liabilities. When appropriate, such reporting could cover risk management strategies as well as systems put in place to implement them. This should apply to financial and operational risks, but also where relevant and material to the SOE, human rights, labour, environment and tax-related risks. Companies in extractive industries should disclose their reserves according to best practices in this regard, as this may be a key element of their value and risk profile.

7. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships;

To give a fair and complete picture of an SOE's financial situation, it is necessary that mutual obligations, financial assistance or risk sharing mechanisms between the state and SOEs are appropriately disclosed. Disclosure should include details on any state grant or subsidy received by the SOE, any guarantee granted by the state to the SOE for its operations, as well as any commitment that the state undertakes on behalf of an SOE. Disclosure standards should be in line with existing legal obligations, for example those governing state aid. Disclosure of guarantees could be done by SOEs themselves or by the state. It is considered good practice that the legislature monitors state guarantees in order to respect budgetary procedures.

Public-private partnerships should also be adequately disclosed. Such ventures are often characterised by transfers of risks, resources and rewards between public and private partners for the provision of public services or public infrastructure and may consequently induce new and specific material risks.

8. Any material transactions with the state and other related entities;

Material transactions between SOEs and related entities, such as an equity investment of one SOE in another, might be a source of potential abuse and should be disclosed. Reporting on transactions with related entities should provide all information that is necessary for assessing the fairness and appropriateness of these transactions. It is also considered good practice, even in the absence of material transactions, to clearly identify SOEs' organisational and corporate links with other related entities.

9. Any relevant issues relating to employees and other stakeholders.

SOEs should provide information on key issues relevant to employees and other stakeholders that may materially affect the financial and non-financial performance of the enterprise, or have significant impacts on stakeholders. Disclosure may include management/employee relations, including remuneration, collective bargaining coverage, and mechanisms for employee representation, as well as relations with other stakeholders such as creditors, suppliers and local communities. It may also include any material information on environmental, social, human rights and anti-corruption measures.

Some countries require extensive disclosure of information on human resources. Relevant policies, such as programmes for human resource development and training, retention rates of employees and employee share ownership plans, can communicate important information on the competitive strengths of companies to market participants and other stakeholders.

B. SOEs' annual financial statements should be subject to an independent external audit based on high-quality standards. Specific state control procedures do not substitute for an independent external audit.

In the interest of the general public, SOEs should be as transparent as publicly traded corporations. Regardless of their legal status and even if they are not listed, all SOEs should report according to best practice accounting and auditing standards.

In practice, SOEs are not necessarily required to be audited by external, independent auditors. This is often due to specific state audit and control systems that are sometimes considered sufficient to ensure the quality and comprehensiveness of accounting information. These financial controls are typically performed by specialised state or "supreme" audit entities, which may inspect both SOEs and the ownership entity. In many cases they also attend board meetings and are often reporting directly to the legislature on the performance of SOEs. However, these specific controls are designed to monitor the use of public funds and budget resources, rather than the operations of the SOE as a whole.

To reinforce trust in the information provided, the state should require that, in addition to special state audits, at least all large SOEs be subject to external audits that are carried out in accordance with internationally recognised standards. Adequate procedures should be developed for the selection of external auditors and it is crucial that they are independent from the management as well as large shareholders, i.e. the state in the case of SOEs. Moreover, external auditors should be subject to the same criteria of independence as for private sector companies. This requires the close attention of the audit committee or the board of directors and generally involves limiting the provision of non-audit services to the audited SOE as well as periodic rotation of audit partners or tendering of the external audit assignment.

C. The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

The ownership entity should develop aggregate reporting that covers all SOEs and make it a key disclosure tool directed to the general public, the legislature and the media. This reporting should be developed in a way that allows all readers to obtain a clear view of the overall performance and evolution of the SOEs. In addition, aggregate reporting is also instrumental for the ownership entity in deepening its understanding of SOE performance and in clarifying its own policy.

The aggregate reporting should result in an annual aggregate report issued by the state. This aggregate report should primarily focus on financial performance and the value of the SOEs, but should also include information on performance related to key non-financial indicators. It should at least provide an indication of the total value of the state's portfolio. It should also include a general statement on the state's ownership policy and information on how the state has implemented this policy. Information on the organisation of the ownership function should also be provided, as well as an overview of the evolution of SOEs, aggregate financial information and reporting on changes in SOEs' boards. The aggregate report should provide key financial indicators including turnover, profit, cash flow from operating activities, gross investment, return on equity, equity/asset ratio and dividends. The ownership entity should strengthen disclosure on stakeholder relations by having both a clear policy and developing aggregate disclosure to the general public.

Information should also be provided on the methods used to aggregate data. The aggregate report could also include individual reporting on the most significant SOEs. It is important to underline that aggregate reporting should not duplicate but should complement existing reporting requirements, for example, annual reports to the legislature. Some ownership entities could aim at publishing only "partial" aggregate reports, i.e. covering SOEs active in comparable sectors.

The ownership entity should consider developing a website, which allows the general public easy access to information. Such websites can provide information both on the organisation of the ownership function and the general ownership policy, as well as information about the size, evolution, performance and value of the state sector.

Annotations to Chapter VII: The responsibilities of the boards of state-owned enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

Empowering and improving the quality and effectiveness of SOE boards is a fundamental step in ensuring a high-quality corporate governance of SOEs. It is important that SOEs have strong boards that can act in the interest of the enterprise and its owners, effectively monitor management and protect management from interference in day-to-day operations. To this end, it is necessary to ensure the competency of SOE boards, enhance their independence and improve the way they function. It is also necessary to give them explicit and full responsibility for carrying out their functions and ensure that they act with integrity.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably.

The responsibilities of SOE boards should be articulated in relevant legislation, regulations, the government ownership policy and the corporate charters. It is essential and should be emphasised that all board members have the legal obligation to act in the best interest of the enterprise and to treat all shareholders equitably. The collective and individual liability of board members should be clearly stated. There should not be any difference between the liabilities of different board members, whether they are nominated by the state or any other shareholders or stakeholders. Training should be required in order to inform SOE board members of their responsibilities and liabilities.

To encourage board responsibility and in order for boards to function effectively, the boards of directors should be consistent with best practices developed for the private sector. They should be limited in size, comprising only the number of directors necessary to ensure their effective functioning.

Experience further indicates that smaller boards allow for real strategic discussion and are less prone to become rubberstamping entities. A Directors' Report should be provided along with the annual statements and submitted to the external auditors. The Directors' Report should give information and comment on the organisation, financial performance, material risk factors, significant events, relations with stakeholders, and the effects of directions from the ownership entity.

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

In order to carry out their role, SOE boards should actively (i) formulate or approve, monitor and review corporate strategy, within the framework of the overall corporate objectives; (ii) establish appropriate performance indicators and identify key risks; (iii) develop and oversee effective risk management policies and procedures with respect to financial and operational risks, but also with respect to human rights, labour, environmental and tax-related issues; (iv) monitor disclosure and communication processes, ensuring that the financial statements fairly present the affairs of the SOE and reflect the risks incurred; (v) assess and monitor management performance; and (vi) decide on CEO remuneration and develop effective succession plans for key executives.

One key function of SOE boards should be the appointment and dismissal of CEOs. Without this authority it is difficult for SOE boards to fully exercise their monitoring function and assume responsibility for SOEs' performance. In some cases, this might be done in concurrence or consultation with the ownership entity.

Some countries deviate from this good practice and in the case of fully-state owned SOEs allow the state to appoint directly a CEO. To ensure that the integrity of the board is maintained, good practice would at least require consultations with the board. Regardless of the procedure, appointments should be based on professional criteria and a competitive selection procedure. Particularly for large SOEs engaged in economic activities, the use of independent experts to manage the selection procedure is considered a good practice. Rules and procedures for nominating and appointing the CEO should be transparent and respect the line of accountability between the CEO, the board and the ownership entity. Any shareholder agreements with respect to CEO nomination should be disclosed.

It follows from their obligation to assess and monitor management performance that SOE boards should decide, subject to applicable rules established by the state, on the compensation of the CEO. They should ensure that the CEO's remuneration is tied to performance and duly disclosed. Compensation packages for senior executives should be competitive, but care should be taken not to incentivise management in a way inconsistent with the long term interest of the enterprise and its owners. The introduction of malus and claw-back provisions is considered good practice. They grant the enterprise the right to withhold and recover compensation from executives in cases of managerial fraud and other circumstances, for example when the enterprise is required to restate its financial statements due to material noncompliance with financial reporting requirements. A number of governments have put in place limits on SOE executive remuneration, graduated according to enterprise size and sector of operation.

C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

A central prerequisite in empowering SOE boards is to structure them so that they can effectively exercise objective and independent judgement, be in a position to monitor senior management and take strategic decisions. All board members should be nominated through a transparent process and it should be clear that it is their duty to act in the best interests of the enterprise as a whole. They should not act as individual representatives of the constituencies that appointed them. SOE boards should also be protected from political interference that could prevent them from focusing on achieving the objectives agreed on with the government and the ownership entity. Any state representatives nominated to serve on SOE boards should have equivalent legal responsibilities as other board members. For instance, they should not enjoy *de jure* or *de facto* exemptions from individual responsibility.

It is considered good practice to strive toward diversity in board composition including with regards to gender, age, geographical, professional and educational background. Persons linked directly with the executive powers – i.e. heads of state, heads of government and ministers – should not serve on boards as this would cast serious doubts on the independence of their judgment. For SOEs engaged in economic activities, it is recommended that board members have sufficient commercial, financial and sectoral expertise to effectively carry out their duties. In this respect, private sector experience can be useful.

Mechanisms to evaluate and maintain the effectiveness of board performance and independence should be developed. These include, for example, limits on the possible number of reappointments, as well as resources to enable the board to access independent information or expertise.

D. Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their exercise of objective judgement.

To enhance the objectivity of SOE boards a certain minimum number of independent board members on SOE boards should be required. Some countries require that SOEs apply the same rules for independent board members that apply to listed companies. What is understood by "independence" varies significantly across countries. Independent board members should be free of any material interests or relationships with the enterprise, its management or its ownership that could jeopardise the exercise of objective judgement. It is also considered good practice to exclude persons based on marital, family or other personal relationships with the enterprise's executives or controlling shareholders.

Independent board members should have the relevant competence and experience to enhance the effectiveness of SOE boards. In SOEs engaged in economic activities it is advisable that they be recruited from the private sector, which can help make boards more business-oriented. Their expertise could also include qualifications related to the SOE's specific obligations and policy objectives.

E. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

Since all SOE board members may become subject to conflicts of interest, measures should also be implemented to address conflicts of interest if they do arise. All board members should disclose any conflicts of interest to the board which must decide how they should be managed. Particular measures should be implemented to prevent political interference on the boards of SOEs. In SOEs carrying out important public service obligations a case can be made for a certain political oversight. Conversely, in SOEs engaged in economic activities without public policy objectives it is good practice to avoid board representation by the highest levels of political power including from within the government and the legislature. This does not imply that civil servants and other public officials should not serve on boards.

F. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.

The Chair has a crucial role to play in promoting board efficiency and effectiveness. It is the Chair's task to build an effective team out of a group of individuals. This requires specific skills, including leadership, the capacity to motivate teams, the ability to understand different perspectives and approaches, the capacity to diffuse conflicts as well as personal effectiveness and competence. The Chair of the board should act as the primary point of contact between the enterprise and the ownership entity. The Chair can also play an essential role in board nomination procedures by assisting the ownership entity, with input from the board's annual self-assessments, to identify skills gaps in the composition of the current board.

It is regarded as good practice that the Chair is separate from the CEO. Separation of the two roles helps to ensure a suitable balance of power, improves accountability and reinforces the board's ability to make objective decisions without undue influence from management. An adequate and clear definition of the functions of the board and of its Chair helps prevent situations where the separation might give rise to inefficient opposition between the two enterprise officers. It is similarly considered good practice that the head of the management board (where applicable) does not become the Chair of the supervisory board upon retirement.

Separation of the Chair from the CEO is particularly important in SOEs, where it is usually considered necessary to empower the board's independence from management. The Chair has a key role in guiding the board, ensuring its efficient running and encouraging the active involvement of individual board members in the strategic guidance of the SOE. When the Chair and the CEO are separate, the Chair should also have a role in agreeing with the ownership entity on the skills and experience that the board should contain for its effective operation.

G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

The purpose of employee representation on SOE boards is to strengthen accountability towards employees as stakeholders and to facilitate information sharing between employees and the board. Employee representation can help enrich board discussions and facilitate the implementation of board decisions within the enterprise. When employee representation on SOE boards is mandated by the law or collective agreements, it should be applied so that it contributes to the SOE boards' independence, competence and information. Employee representatives should have the same duties and responsibilities as all other board members, should act in the best interests of the enterprise and should treat all shareholders equitably. Employee representation on SOE boards should not in itself be considered as a threat to board independence.

Procedures should be established to facilitate access to information, training and expertise, and the independence of employee board members from the CEO and management. These procedures should also include adequate, transparent and democratic appointment procedures, rights to report to employees on a regular basis – provided that board confidentiality requirements are duly respected – training, and clear procedures for managing conflicts of interest. A positive contribution to the board's work will also require acceptance and constructive collaboration by other members of the board as well as by management.

H. SOE boards should consider setting up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

The establishment of board committees can be instrumental in enhancing the efficiency of SOE boards, reinforcing their competency and underpinning their critical responsibility. They may also be effective in changing the board culture and reinforcing its independence and legitimacy in areas where there is a potential for conflicts of interests, such as with regards to procurement, related party transactions and remuneration issues. The use of specialised board committees, especially in large SOEs, in line with practices in the private sector is considered a good practice. Special committees that may add value to boards include those in the fields of: audit, remuneration, strategy, ethics, risk, and procurement.

In the absence of specialised board committees, the ownership entity may develop guidelines to define in which cases SOE boards should consider establishing specialised board committees. These guidelines should be based on a combination of criteria, including the size of the SOE and specific risks faced or competencies which should be reinforced within SOE boards. Large SOEs should at least be required to have an audit committee or equivalent body with powers to meet with any officer of the enterprise.

It is essential that specialised board committees be chaired by a non-executive and include a sufficient number of independent members. The proportion of independent members as well as the type of independence required (e.g. from management or from the main owner) will depend on the type of committee, the sensitivity of the issue to conflicts of interests, and the SOE sector. The audit committee, for example, should be composed of only independent and financially literate board members. To ensure efficiency, the composition of board committees should include qualified and competent members with adequate technical expertise.

The existence of specialised board committees should not excuse the board from its collective responsibility for all matters. Specialised board committees should have written terms of reference that define their duties, authority and composition. Specialised board committees should report to the full board and the minutes of their meetings should be circulated to all board members.

I. SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

A systematic evaluation process is a necessary tool in enhancing SOE board professionalism, since it highlights the responsibilities of the board and the duties of its members. It is also instrumental in identifying necessary competencies and board member profiles. It is also a useful incentive for individual board members to devote sufficient time and effort to their duties as board members. The evaluation should focus on the performance of the board as an entity. It could also include the effectiveness and contribution of individual board members. However, the evaluation of individual board members should not impede the desired and necessary collegiality of board work.

Board evaluation should be carried out under the responsibility of the Chair and according to evolving best practices. External or independent expertise should be called upon as necessary. The board evaluation should provide input to the review of issues such as board size, composition and remuneration of board members. The evaluations could also be instrumental in developing effective and appropriate induction and training programmes for new and existing SOE board members. In carrying out the evaluation, SOE boards could seek advice from external and independent experts as well as the ownership entity.

The outcomes of board evaluations can also serve as a helpful source of information for future board nomination processes. However, a balance needs to be struck: board evaluations may be used to alert the ownership entity to a need to recruit future board members with specific skills that are needed in a given SOE board. But they should generally not be used as a tool for "deselecting" individual existent directors which could discourage them from playing an active, and perhaps critical, role in the board's discussions.

J. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

As in large listed companies, it is necessary for large SOEs to put in place an internal audit system. Internal auditing provides independent and objective evaluations to help SOEs improve risk management, control and governance.. Internal auditors are important to ensure an efficient and robust disclosure process and proper internal controls in the broad sense. They should define procedures to collect, compile and present sufficiently detailed information. They should also ensure that SOE procedures are adequately implemented.

To increase their independence and authority, the internal auditors should work on behalf of, and report directly to, the board and its audit committee, or the audit boards when these exist. Internal auditors should have unrestricted access to the Chair and members of the entire board and its audit committee. Their reporting is important for the board's ability to evaluate actual company operations and performance. Consultation between external and internal auditors should be encouraged. Finally, it is also recommended as good practice that an internal control report is included in the financial statements, describing the internal control structure and procedures for financial reporting. Material findings from the internal audit should be reported to the board and, where applicable, its audit committee.

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