GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

DRAFT TEXT

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Draft OECD Guidelines on the Corporate Governance of State-Owned Enterprises

Preamble

1. During the 1980's and 1990's, OECD countries underwent extensive privatisation programmes. The OECD Privatisation Network and its outreach pillar, the Advisory Group on Privatisation (AGP) studied and extensively discussed various policy issues linked to privatisation. The Privatisation Network's 1998 publication, "State-Owned Enterprises, Privatisation and Corporate Governance", concluded that, despite extensive privatisation activity, state-owned enterprises are likely to remain important in many OECD countries, and that their governance will be a critical element in ensuring their positive contribution to the overall economic efficiency and competitiveness of the economies concerned. More recent experience is summarised in the publication issued under the responsibility of the Working Group on Privatisation, "Privatising State-Owned Enterprise, An Overview of Policies and Practices in OECD Countries", 2003. It concluded that privatisation is only effective in terms of economic performance if adequate corporate governance practices and an appropriate institutional framework are put in place.

2. It is against this backdrop that the OECD Steering Group on Corporate Governance in June 2002 gave a mandate to the Working Group on Privatisation and Corporate Governance of State-Owned Assets to develop a set of non-binding guidelines and best practices on corporate governance of state-owned enterprises. The Working Group launched this work in June 2003, with the aim of presenting the Guidelines on Corporate Governance of State-Owned Enterprises for endorsement by the OECD in early 2005.

3. The rationale for state ownership of commercial enterprises has varied depending on countries and industries. In many OECD countries, large waves of nationalisation occurred after the Second World War, and in some cases ownership was also a product of the 1930's economic crisis and the associated rescue of banks. It was often the presence of significant social, economic and strategic interests that provided the motivation for state ownership in sectors providing public services such as public transport, post and telecommunications, electricity and water supply. The monopolistic and network nature of these sectors and/or public good aspects argued at that time in favour of state ownership. In some other cases, it was also the lack of private initiative or resources to develop a specific sector, including network industries, and large operations to explore and exploit specific natural resources that triggered state investment. State enterprises were also used to achieve regional policy goals in countries with significant development inequalities among regions.

4. Despite considerable privatisation activity in the 1980's and 1990's, the state remains a large owner of commercial enterprises in both OECD and non-OECD countries. Even if their importance has declined significantly, SOEs may still represent in some OECD countries up to 20 % of GDP, around 10% of the employment, and as much as 40% of market capitalisation. State ownership is apparent in various sectors, though it is usually most prevalent in utilities and infrastructure, with energy, transport and telecommunication being the most important industries. A number of non-OECD countries also have very significant state sectors and in some cases they are a dominant feature of the economy. These countries are in many cases reforming the way they organise and manage their state owned enterprises and are looking towards the OECD experience to guide their own reforms.

5. The sheer scale of state ownership of commercial enterprises makes good governance of these enterprises an important determinant for overall economic performance. Moreover, the globalisation of

markets, technological changes and liberalisation of monopolistic markets have made readjustment and/or restructuring of the state-owned sector often necessary. In particular, in order to create a "level playing field", there has been a demand to separate market regulation and supervision from ownership and control, though these latter have often remained poorly defined. A mixed record in some cases, including poor financial results and a consequently heavier budgetary burden and indebtedness, have led in some countries to a demand for reorganising the exercise of ownership rights (ownership function) within the state administration. A number of OECD governments have consequently undertaken significant reforms in the way they fulfil their ownership function *vis-à-vis* SOEs.

6. Regardless of the policy envisaged *vis-à-vis* further privatisation, improving the governance of state-owned enterprises is thus an important public policy objective as it should greatly improve their efficiency. By appropriately exercising its ownership rights and responsibilities, the state can play an important role in monitoring corporate performance and in establishing good corporate governance practices to the benefit of the corporations and society. For the SOEs, good corporate governance practices open the way to efficiency gains, better performance and the ability to compete with private competitors. It also enhances valuation of their assets. At a more macro level, improvements in the governance of state-owned enterprises are intended to promote growth through improved economic performance and increased productivity. By facilitating access to capital (both debt and equity), it should lead to a more efficient and transparent allocation of resources and enhance investment and job creation. It may also contribute to fiscal sustainability through a decrease in the budgetary burden and in the level of public debt. In addition, state-owned enterprises should not be granted an excessive autonomy in defining by themselves the nature and the extent of their public services objectives or their internal and international strategy. Finally, better corporate governance of state-owned assets will promote competition and improve overall public governance through greater transparency.

7. In order to carry out its ownership responsibilities, the state can benefit from using tools that are applicable to the private sector, including the OECD Principles of Corporate Governance. This is especially true for listed SOEs. However, SOEs face a specific set of governance challenges that are distinctive from those faced by purely private corporations. Governance challenges derive from a set of characteristics that may be more or less acute depending on countries' administrative traditions, the recent history of state sector reforms and the degree of liberalisation of the economies concerned. SOEs tend to suffer both from passive ownership by the State, or to the contrary, from undue political interference. There may be a dilution of accountability, deriving from a soft budget constraint. SOEs are often protected from two major threats that are essential for policing management in private sector corporations, i.e. takeover and bankruptcy. More fundamentally, corporate governance difficulties derive from the fact that there is a complex chain of agents, without clearly and easily identifiable, or remote, principals. SOEs have multiple principals, involving Ministries, the Parliament, the population or interest groups, and the SOE itself. To structure this complex chain of accountability in order to encourage SOE management to make efficient decisions and to ensure their accountability is a challenge.

8. The Guidelines should thus be seen as complementary to the OECD Principles of Corporate Governance and oriented to the range of specific governance issues related to SOEs. They accordingly adopt the perspective of the state as an owner, focusing on the characteristics and components of its policy which would ensure good corporate governance. These Guidelines deal with the way in which the ownership function should be organised within the state administration, how boards should be appointed and vested with responsibilities and how transparency should be ensured. It should be understood that these Guidelines only seek to amplify or add specificity to the OECD Principles of Corporate Governance in certain areas, and do not supersede nor conflict with them.

9. As these Guidelines are intended to assist governments in improving the performances of SOEs, the companies on which they could be profitably applied should be decided on pragmatic basis. These

Guidelines are primarily oriented to state-owned enterprises using a distinct legal form (i.e. separate from the public administration) and having a commercial activity (i.e. with the bulk of their income coming from sales and fees), whether or not they pursue a public policy objective as well. These SOEs may be in competitive or in non-competitive sectors of the economy. When necessary, these Guidelines distinguish between listed and non-listed SOEs, or between wholly owned, majority and minority owned SOEs since the ownership issues are somewhat different in each case. The Guidelines can also be used to cover the subsidiaries of these aforementioned entities, whether listed or not.

10. Although the Guidelines are intended to cover enterprises under both central government and federal state ownership, the authorities could also promote their use by enterprises owned by sub-national levels of governments. Finally, these Guidelines could also be useful for non-commercial SOEs fulfilling essentially special public policy purposes, whether or not in a corporate form. It is in the governments and the public's interest that all these categories of SOEs are professionally run and with good governance practices.

11. While the development of an effective state ownership policy in some instances may require changes in underlying legislation, it can, to a great extent, be carried out within the boundaries of existing rules and regulations, such as company law and securities regulation. Taking such laws and regulations as given, the Guidelines cover additional steps that can be taken to improve the exercise of state ownership rights.

12. For reasons of convenience, enterprises where the state has a significant control, whether with a full, a majority, or a significant minority ownership, are referred to as "*SOEs*" throughout the Guidelines. However, many of the Guidelines are also useful in cases where the state retains a small shareholding in a company, but should nevertheless act as a responsible and informed shareholder. In the same vein, "*ownership entity*" is intended to refer to the state entity responsible for executing the ownership rights of the State, whether it is a specific Department within a Ministry, an Autonomous Agency or other.

Chapter I: Ensuring an Effective Legal and Regulatory Framework for SOEs

The legal and regulatory framework for state-owned enterprises should be developed in order to ensure a level-playing field for SOEs and the private sector in areas where they compete and with the view to promote good corporate governance practices, following in this regard the OECD Principles of Corporate Governance.

A. There should be a clear separation between the ownership function and the state's other roles that may influence the conditions for state-owned enterprises' activity, particularly in regulation and industrial policy.

B. Governments should strive to simplify and streamline the legal form under which SOEs operate as well as their operational practices.

C. Any specific obligations that an SOE is required to undertake in terms of public service provisions or special responsibilities above the generally accepted norm should be clearly identified by laws and regulations, disclosed to the general public, and provision made to cover related costs in a transparent manner.

D. SOEs should not be exempt from the application of general laws. Other shareholders and stakeholders, including competitors, should have access to efficient redress mechanisms in case their rights are violated.

II. The State Acting as an Owner

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

A. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the government's role in the corporate governance of SOEs, and how it will implement its ownership policy.

B. The exercise of ownership rights should be clearly identified within the government administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralisation in a single entity of the ownership function.

C. To perform their duties in a more efficient way, the co-ordinating or ownership entity should have a certain flexibility in the way it organises itself and takes decisions**.**

D. The co-ordinating or ownership entity should have clearly defined relationships with the other relevant government bodies, and be accountable to the representative bodies such as the Parliament.

E. The co-ordinating or ownership entity should establish well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participate in the nomination of all SOEs' boards.

F. The state should let SOE boards carry out their responsibilities and limit its direct participation in these boards.

G. The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.

H. The co-ordinating or ownership entity should represent the state as an active owner and exercise its ownership rights within the legal structure of each company. It has a primary responsibility in:

1. Participating in general shareholders meetings and voting the state shares;

2. Setting up reporting systems allowing regular monitoring and assessment of SOE performance;

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

4. Setting remuneration schemes for SOE board members that take into consideration the long term interest of the company and are competitive enough to attract and retain qualified professionals.

III. Equitable Treatment of Shareholders

The State and SOEs should recognise the rights of all shareholders and ensure their equitable treatment and equal access to corporate information, referring to the OECD Principles of Corporate Governances in this regard.

A. The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally and have access to effective redress mechanisms.

B. SOEs should observe a high degree of transparency towards all shareholders.

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

D. Minority shareholders' access to the decision-making process could be facilitated through specific mechanisms regarding board election or facilitating participation in AGMs.

IV. Relations with Stakeholders

The State should ensure SOEs fulfil their responsibilities towards stakeholders and report adequately on stakeholder matters.

A. Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles on Corporate Governance in this regard.

B. Listed or large SOEs should report on stakeholder relations, as well as SOEs performing an important public policy role or objective(s).

C. The board of SOEs should be required to develop, communicate and put in place compliance programmes related to internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to SOEs and their subsidiaries.

D. SOEs should face competitive conditions regarding access to finance. They should establish arm's length relationships with state-owned banks, other state-owned financial institutions as well as any other SOEs. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.

V. Transparency and Disclosure

SOEs should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

A. The co-ordinating or ownership entities should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.

B. SOEs should develop efficient internal audit procedures and function, under the control of and reporting to the board or to the audit committee.

C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

D. SOEs should be subject to the same high quality accounting and financial disclosure standards as listed companies. Large or listed SOEs should disclose financial and non financial information according to international best practices, as well as SOEs performing an important public policy role or objective(s).

E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.

1. A clear statement of the company objectives should be provided to the general public, as well as a report on the fulfilment of these objectives.
2. The ownership and voting structure of SOEs should be transparent.
3. Specific attention should be given to adequate disclosure of material risk factors.
4. Reporting should detail any financial assistance, including guarantees, received from the State and commitments made by the State on SOEs' behalf.

VI. The Responsibilities of SOE Boards

SOE boards should have adequate authority, the necessary competencies and sufficient objectivity to carry out their function of strategic guidance and monitoring of management. The board should act with integrity and be accountable for its actions.

A. SOE boards should be assigned a clear mandate and ultimate responsibility for SOE performance. They should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.

B. SOE boards should exercise objective and independent judgement. They should consist of members with relevant competence and experience and include a sufficient number of non-executive and independent members. The number of members from the administration should be limited and all board members should be nominated through a transparent nomination process.

C. Where employee representation on the board is mandated, mechanisms should be developed in order to guarantee that this voice is exercised effectively and contributes to the enhancement of the board skills, information and independence.

D. The Chairpersons of SOE boards should have the relevant competencies to fulfil their crucial role. Good practice calls for the post to be separate from the CEO.

E. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

F. When necessary, SOE boards could set up specialised committees to support the full board in performing its most essential functions. These committees could be set up in particular with respect to audit, risk, remuneration, nomination and ethics.

G. SOE boards should carry out an annual evaluation to appraise their performance.

Annotation to Chapter I: Ensuring an Effective Legal and Regulatory Framework for SOEs

13. ***The legal and regulatory framework for state-owned enterprises should be developed in order to ensure a level-playing field for SOEs and the private sector in areas where they compete a*****nd*** ***with the view to promoting good corporate governance practices, following in this regard the OECD Principles of Corporate Governance.***

14. The legal and regulatory framework within which SOEs operate is often extremely complex. It can introduce significant market distortions and undermine accountability by management to the owners and by the state as an owner to the public. An unclear division of responsibilities among multiple authorities has led in cases to a lack of coherence and consistency of the institutional framework. Reduced complexity, clear division of responsibilities and normalisation of SOE status should favour the strengthening of SOE corporate governance. This could be facilitated by a clear reference to the OECD Principles of Corporate Governance and to these complementary Guidelines.

15. A. There should be a clear separation between the ownership function and the state's other roles that may influence the conditions for state-owned enterprises' activity, particularly in regulation and industrial policy.

16. In implementing effective separation between the different state roles with regard SOEs, both perceived and real conflicts of interest should be taken into account.

17. SOEs have often been used as the main instrument for industrial policy and, consequently, in many cases, have been put under the responsibility of branch or sector ministries. This has sometimes resulted in confusion and conflicts of interest between industrial policy and the ownership functions of the State. This confusion in turn may lead to the undermining of the ownership function. In this case, SOEs tend to be perceived only as key instruments for the state industrial policy and not also as assets whose value should be protected and enhanced by its owner, the State. A clear separation of these two functions, industrial policy and ownership, will enhance the identification of the State as an owner and will favour clarity in defining objectives and monitoring performance. However, this separation does not prevent coordination between the two functions of ownership and industrial policy and does not limit, *per se*, the latter.

18. The State often plays a dual role of regulator and owner *vis-à-vis* SOEs, especially those which are in competitive sectors of the economy. In these sectors, and particularly in the newly deregulated and often partially privatised network industries, the State is at the same time a main player and an arbitrator. Therefore a clear separation of ownership and regulation is now regarded as good practice. This separation is a necessary pre-condition for SOEs and private sector companies to be on a level playing field and for avoiding distortion of competition. It is advocated by the OECD Principles of Regulatory Reform.

19. In order to prevent conflicts of interest, it is also necessary to clearly separate the ownership function from the other departments within the state administration which might be clients or main suppliers of SOEs. General procurement rules should apply to SOEs as well as to any other companies. Legal as well as non legal barriers to fair procurement should be removed.

20. B. Governments should strive to simplify and streamline the legal form under which SOEs operate as well as their operational practices.

21. SOEs may have a specific, and in certain cases, a quite different legal status than other companies. Where this occurs, the SOEs often differ from the 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 the extent to which they are subjected to insolvency and bankruptcy procedures, etc.

22. A specific legal status can also reflect specific objectives or social/societal considerations as well as special protection granted to certain stakeholders. They often include, for example, specific provisions regarding employees, allowing their remuneration to be fixed by regulatory acts/bodies, giving them specific pension rights, and protection against redundancies in the same manner as for civil servants. This treatment is often for historical reasons and, as such, established rights are clearly protected.

23. Status 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. These limits have been legitimately set to prevent misuse of public funds, stop overly ambitious growth strategy or prevent SOEs from exporting sensitive technologies. However, these limits are in some cases perceived as depriving SOEs of the necessary flexibility to compete efficiently in an increasingly competitive and liberalised environment.

24. In some countries, SOEs' specific legal status have evolved significantly in recent years in response to the deregulation and liberalisation of markets; especially in EU countries with the increased scrutiny of state aid and cross subsidisation. Limitations on the type of activities have been relaxed. Debates have focused on relaxing the limits and obligations regarding the definition of SOEs' activities and on the protection of employees, more particularly, safeguarding employees' (retirement) pension rights. In some countries, changes in the legal form have been accompanied by the State taking on these commitments, with new employees not benefiting from the same conditions.

25. Governments should try to streamline the legal status of SOEs. In doing so, they should base themselves as much as possible on corporate law and at least avoid creating a specific status when not absolutely necessary to the objectives of the enterprise. Harmonisation of the legal status of SOEs would enhance transparency and facilitate oversight through benchmarking. It would also level the playing field with private competitors in increasingly liberalised and competitive sectors, allowing greater flexibility to compete efficiently and in the redistribution of control in some sectors. The harmonisation should concern primarily SOEs having a commercial activity and active in competitive or contestable sectors of the economy. It should also focus more particularly on areas allowing the State to use the means and instruments usually available to private owners. Harmonisation should thus concern primarily the role and authority of the company's governance organs as well as transparency and disclosure obligations. It should favour, *inter alia*, greater transparency *vis-à-vis* specific obligations of general service provisions SOEs may be required to fulfil by law. This greater transparency does not prejudice the existence or content of these specific obligations.

26. Given the inherent difficulties and length of legislative processes, harmonisation may be difficult to achieve through legislative amendments. An easier option could be to make some regulations more inclusive, extending their validity or coverage to SOEs with specific status. Governments could in this case focus on amending specific provisions or regulations concerning, for example, disclosure requirements. However, the overall streamlining or harmonisation process should determine a common level playing field for SOEs and private companies active in competitive sectors.

27. C. Any specific obligations that an SOE is required to undertake in terms of public service provision or special responsibilities above the generally accepted norm should be clearly identified

by laws and regulations, disclosed to the general public, and provision made to cover related costs in a transparent manner.

28. It might be decided by legislative means that SOEs should fulfil special responsibilities and obligations for social and public policy purposes. These special responsibilities and obligations may go above the generally accepted norm, i.e. what is usually expected from an ordinary privately owned enterprise. Such specific requirements need to be adequately compensated by the State budget on the basis of specific legal provisions and/or through contractual mechanisms, such as management contracts. This is particularly the case if the concerned enterprises are in competitive sectors of the economy. The market and the general public should be clearly informed about the nature and extent of these obligations. It is also important that related costs be clearly identified and disclosed.

29. D. SOEs should not be exempt from the application of general laws. Other shareholders and stakeholders, including competitors, should have access to efficient redress mechanisms in case their rights are violated.

30. In many countries SOEs are exempt from competition and from a number of other laws and regulations. They are often not covered by bankruptcy law and creditors sometimes have difficulties in enforcing their contracts and in obtaining payments. Exemptions from the general legal provisions should be avoided to the fullest extent possible so that to avoid market distortions and underpinning the accountability of management. SOEs as well as the state as a shareholder should not be protected from challenge via the courts, in case they infringe the law.

Annotation to Chapter II: The State Acting as an Owner

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

31. 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. Most aspects of the OECD Principles are relevant for SOEs and can be profitably applied. However, some specific aspects of SOE governance either merit special attention or should be documented in more detail in order to guide SOE board members, management and the state entity responsible for executing the ownership rights of the State in effectively performing their respective roles.

32. A. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the government's role in the corporate governance of SOEs, and how it will implement its ownership policy.

33. It is often the multiplicity and contradictory nature of the objectives of state ownership that underlines either the passive conduct of the state as an owner, or conversely results in its excessive intervention in matters or decisions which should be made by the company and its governance organs. This confusion often derives, at least partially, from the lack of clear identification of the ownership role within the state administration as well as from the lack of clear separation from other state functions in relation to SOEs, such as regulation.

34. In order for the State to clearly position itself as an owner, it should clarify and prioritise its main objectives. These main objectives may include in many cases to pursue profitability and avoid distortion of markets. However, these objectives may also present difficult trade-offs, such as creating value, improving public service quality or even ensuring job stability in the state sector. The State should thus go further than broadly defining its main objectives as an owner, but should also give indications about how it intends to achieve these objectives and clarify how it will resolve the inherent trade-offs.

35. Moreover, the State should strive to be consistent in its ownership policy and avoid modifying its objectives too often. A clear, consistent and explicit ownership policy will provide SOEs, the market and the general public with predictability and a clear understanding of the State's objectives as an owner as well as its long term commitments.

36. In developing and updating the state's ownership policy, it is recommended for the government to make appropriate use of public consultation. The ownership policy and associated objectives should be public documents, be made accessible to the general public and widely circulated amongst ministries concerned, SOE boards, management, and the legislature. It is also important that relevant civil servants, SOE board members and senior management endorse in one way or another and support the ownership policy and the corporate objectives statements. This would be instrumental in clarifying their respective role *vis-à-vis* the state as an owner.

37. B. The exercise of ownership rights should be clearly identified within the government administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralisation in a single entity of the ownership function.

38. It is critical for the ownership function within the State administration to be clearly identified, wherever it is located, at a central ministry such as the Finance or Economics Ministries, in another administrative entity, or within different sector ministries.

39. In order to strengthen and clearly identify the ownership function within the state administration, it is at least necessary 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 hears a single voice 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. The co-ordinating entity should also be in charge of elaborating an overall policy, developing specific guidelines and unifying practices among the various ministries.

40. A stronger option to facilitate a clear identification of the ownership function might be to centralise it in a single entity, independent or under the authority of one main Ministry. It would help in clarifying the ownership policy and its orientation, and would also ensure its more consistent implementation. Centralisation could also allow for reinforcing and bringing together relevant competencies by organising "pools" of experts in critical matters, such as financial reporting or board nomination. In this way, centralisation can be a major force in the elaboration of aggregated and global reporting on state ownership. Finally, centralisation is also an effective way to clearly separate the exercise of ownership rights from other activities performed by the State, such as industrial policy or regulation.

41. Centralisation of the ownership function in a single entity is probably most relevant for SOEs in competitive sectors. It does not apply to all SOEs mainly fulfilling public policy purposes. These type of SOEs are not the primary target of these Guidelines, and in their case sector ministries may remain the most relevant and competent entities to exercise ownership rights which might be indistinguishable from policy objectives.

42. Centralisation, where considered, needs to avoid giving rise to a new and overly powerful bureaucratic layer, due to the size of the state sector or administrative practices and traditions. However, the exercise of ownership rights by sector or branch ministries gives rise to strong concerns regarding SOEs operational autonomy, as this is a primary and frequent source of undue interference with their conduct. The clear separation of the ownership function from other state functions is much more difficult to achieve in such a decentralised scheme.

43. Finally, in case the centralisation of the ownership function in a single entity is not feasible or desirable, some critical aspects of the ownership function could nevertheless be centralised. This may more particularly be the case for the nomination of SOEs' board members. Partial centralisation may thus be instrumental in reinforcing expertise in one key element of the ownership function, as well as enhancing independence from branch ministries in this regard.

44. This centralisation may be carried out whatever the level of government under which the responsibility of SOEs is located. This may imply centralisation at the national or Federal level, at the State level or at a regional level. In this sense, this guideline does not give direction regarding which should be the appropriate level of SOE management within a state or a federation. It just indicates that at any given level of authority, the ownership function would better be centralised in a single entity. Moreover, if there are different administrative levels of ownership, harmonisation of ownership practices should be looked for. Finally, centralisation of the ownership function does not imply the centralisation of the legal ownership.

45. C. To perform their duties in a more efficient way, the co-ordinating or ownership entity should have a certain flexibility in the way it organises itself and takes decisions.

46. The designated ownership entity, be it a single centralised entity or a co-ordinating entity, should enjoy a relative degree of flexibility *vis-à-vis* its responsible Ministry with regards to procedures and processes. The co-ordinating or ownership entity could also enjoy budgetary autonomy. This would allow, for example, sufficient flexibility in bringing together expertise, including from the private sector, and in determining adequate remuneration to attract and retain such expertise. This would also facilitate the clear separation from other functions where the co-ordinating or ownership entity is located in a sector Ministry.

47. Furthermore, mechanisms could also be put in place to allow a certain degree of flexibility in the management of SOE capital structures. In conjunction with SOE boards, the entity should be able to facilitate a change in the capital structure of an SOE, consistent with the state ownership objective and the SOE's specific circumstances. For example, such mechanisms would facilitate, within a certain limit, the indirect transfer of capital from one SOE to another (such as through some redistribution of dividends received), or the raise of capital on a competitive basis with non state-owned companies. However, as such mechanisms would *de facto* reduce budget making powers of the Parliament, they should be limited and subject to careful *ex post* oversight in order to avoid any form of cross-subsidisation via capital transfers.

48. D. The co-ordinating or ownership entity should have clearly defined relationships with the other relevant government bodies, and be accountable to representative bodies such as the Parliament.

49. The relationship of the co-ordinating or ownership entity with other government bodies should be clearly defined. A number of state bodies, Ministries or administrations have different roles *vis-à-vis* the same SOEs. In order to increase the public confidence in the way the State handles ownership of SOEs, it is important that these different roles are clarified and explained to the general public.

50. The co-ordinating or ownership entity should also be directly or indirectly accountable to representative bodies, such as the Parliament, and through it to the ultimate owners of SOEs, i.e. the citizens. Its accountability to the legislature should be clearly defined, as well as the accountability of SOEs themselves. The co-ordinating or ownership entity is accountable with respect to its delegated responsibility in the governance framework, while the accountability of SOEs to Parliament is through the ownership entity. However, the accountability of SOEs should not be diluted by virtue of the intermediary reporting relationship.

51. The accountability mechanisms should, on the one hand, not restrict unduly the autonomy of the co-ordinating or ownership entity in fulfilling their main responsibilities. For example, cases where the co-ordinating or ownership entity needs to obtain the legislature's *ex ante* approval should be limited. These cases could include only significant changes in the overall ownership policy, or also significant changes in the size of the state sector, as well as significant transactions (investments or disinvestment). On the other hand, accountability should go beyond ensuring that the exercise of ownership does not interfere with the legislature's prerogative as regards budget policy. Specific mechanisms such as *ad hoc* or permanent commissions could be set up to maintain the dialogue between the co-ordinating or ownership entity and the legislature. In the case of Parliament hearings, confidentiality issues should be dealt with through specific procedures such as confidential or closed meetings. But the form, frequency and content of this dialogue will differ according to the constitutional law and the different parliamentary traditions and roles.

52. E. The co-ordinating or ownership entity should establish well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participate in the nomination of all SOEs' boards.

53. The co-ordinating or ownership entity should ensure that SOEs have efficient and well-run professional boards, with the required mix of competencies to fulfil their mandate. This will involve establishing a structured nomination process, thereby influencing SOE board structure and composition.

54. The nomination of SOE boards should be transparent, avoiding the possibility that too many different Ministries or other government organs get involved with a complex round of negotiations. In some countries state "representatives" are nominated by decrees, at Prime Minister or Ministerial level, or even with the direct involvement of the Head of State.

55. The nomination process of board members should be clearly structured and based on an appraisal of the variety of skills, competencies and experiences required. These requirements should derive from specific evaluation of the current board and the strategic evolution envisaged for the company. These evaluations should also take into consideration the role played by employee representatives when these are required by law or mutual agreements. A structured approach has proven effective in leading to more professional, accountable and business oriented boards. It would also be instrumental in putting more emphasis on specialisation and moving away from excessively generalist boards.

56. Where the state is not the sole owner, the co-ordinating or ownership entity should consult with other shareholders ahead of the AGM. SOE boards should also be able to make recommendations to the ownership entity based on the approved board member profiles, skill requirements and board member evaluations. Setting up nomination committees within SOEs boards may be a useful instrument in this regard, helping to focus the search for good candidates and in formalising further the nomination process. It is also considered to be a good practice in some countries to set up 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 published in advance of the AGM, with adequate information on the professional background and expertise of the respective candidates.

57. Ownership entities could also maintain a database of qualified candidates, developed through an open competitive process. The use of professional staffing agencies or international advertisements could also enhance the quality of the nomination process. These practices would help in enlarging the pool of qualified candidates for SOE boards, particularly for bringing in more private sector expertise and, in cases, foreign experience, which could lead to more professional SOE boards. The process may also favour greater board diversity, including gender diversity.

58. F. The state should let SOE boards carry out their responsibilities and limit its direct participation in these boards.

59. The state and the government should not impede on SOE boards' work and authority, and allow these boards to carry out their responsibilities. One useful way of both articulating the owner's strategy and to communicate with SOE boards, while maintaining their full autonomy and authority, is for the co-ordinating or ownership entity to nominate member of its staff on SOE boards. When staffs of the ownership entity or other persons with similar duties are appointed to SOE boards, 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.

60. This state participation in SOE boards should, however, be limited in order to promote their exercise of independent judgement. Staff of the ownership entity or civil servants from other parts of the administration should thus sit on SOE boards only if they meet the required competence level for all board members and if they not act as tools for undue political influence. There should neither be excessive

inherent or perceived conflicts of interest. Finally, their presence should not be perceived by other board members as resulting in a decrease of their own responsibility. State "representatives" might indeed be viewed as "super directors" who represent the Minister's point of view and this could be disruptive to the proper dynamics of the board. The board might in this case consider that the State itself monitors directly the company. This is particularly relevant for SOEs having other shareholders than the State or for SOEs in competitive sectors and where the policy purposes are not dominant.

61. Co-ordination among different board members from the state is a key issue where they are numerous, and especially when they are nominated by different ministries or government departments. This may give rise to disputes about mandates and rivalries between differing state organs concerned and may serve to impair strategic guidance from the State. Experience indicates that such rivalries can also lead to board members remaining silent or passive, or to believing that their mandate is to support the CEO, especially when this latter is nominated directly by the state or the government.

62. It is particularly necessary to clarify the respective personal and state liability when civil servants are on SOE boards, as this might be related both to their administrative status as civil servants and to the company legislation. The concerned civil servants should not have any specific obligations or restrictions that would prevent them from acting in the company's benefit. They should not take part in regulatory decisions concerning the same SOE in order to avoid conflicts of interests nor receive any detailed unilateral instructions from their Ministries. They could nevertheless solicit instructions or receive ones from the ownership entity. Moreover, the concerned civil servants might have to disclose any personal ownership they have in the SOE and refrain from trading its shares, in accordance with guidelines or code of ethics to be adopted by the ownership entity. Disqualification conditions and situations of conflict of interest should be carefully evaluated and guidance provided about how to handle and resolve them. Guidelines or code of ethics for members of the ownership entity and other civil servants serving as SOE board members could be developed by the co-ordinating or ownership entity in this regard. These Guidelines or code of ethics should also cover what confidential information can be passed on the state from these directors.

63. Some countries have decided to avoid nominating or electing any persons from the ownership entity or other civil servants on SOE boards. This aims at limiting conflicts of interests that might arise and at depriving very clearly the government from the possibility to directly intervene in the SOE's business or management. This could also avoid the state or the government to be wrongly perceived as directly responsible if things go wrong. In this case, it is even more important that the co-ordinating or ownership entity participates actively in the nomination of board members.

64. G. The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.

65. The clear definition of the ownership strategy, its consistent implementation by the ownership or co-ordinating entity, structured board nomination processes as well as a focus on the effective exercise of ownership rights *per se* should allow the State to be an active owner without undue interference with the management of SOEs.

66. In this respect, the ownership or co-ordinating entity's ability to issue direction to the SOE or its board should be limited to strategic issues and policies. Any direction given by the ownership or co-ordinating entity should be publicly disclosed and clear limits should be specified regarding which areas, types of decision and/or significance of transactions for which the ownership or co-ordinating entity is competent to give instructions or comments, or request information. They should also define the required procedures and media for such intervention.

67. H. The co-ordinating or ownership entity should represent the state as an active owner and exercise its ownership rights within the legal structure of each company.

68. To avoid undue political interference or passive state ownership, it is important for the co-ordinating or ownership entity to focus on and limit itself to effectively exercising ownership rights. The State as an owner should in many cases conduct itself as any major shareholder when it is in a position to significantly influence the company, or as an informed and active minority shareholder as appropriate. It would be well advised to exercise its rights in order to protect its ownership and optimise its value.

69. As defined by the OECD Principles of Corporate Governance, four of these basic 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; and (iv) to approve extraordinary transactions. These are four basic rights that the co-ordinating or ownership entity should exercise fully and judiciously, as this would allow it 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.

70. An ownership entity has to include other competencies than the ones normally available in the civil service. To be able to fulfil its function, the co-ordinating or ownership entity should thus include professionals with experience in carrying out fiduciary responsibilities and relevant competencies in law, finance, economics and general management. Such professionals must also clearly understand their roles and responsibilities as civil servants as well as with respect to 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 co-ordinating or 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 more efficient, expert and informed manner. They could, for example, resort to specialised service providers for carrying out evaluation, active monitoring, or proxy voting on its behalf if it deems this necessary and appropriate.

71. The co-ordinating or ownership entity has a primary responsibility in:

72. 1. Participating in general shareholders meetings and voting the state shares;

73. 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 and effectively influenced major decisions taken by SOEs, depending on its stake as a shareholder.

74. For the state to be able to express its view on issues submitted for approval at shareholders' meetings, it is necessary that the co-ordinating or ownership entity organises itself to be able to present an informed view on these issues and articulate it to SOE boards *via* the AGM.

75. It is important to establish appropriate procedures for the state to be represented in AGMs, such as ensuring that it is the co-ordinating or ownership entity that formally represents the state. The AGM is not an appropriate forum for solving inter-governmental issues.

76. 2. Setting up reporting systems allowing regular monitoring and assessment of SOE performance;

77. In order for the co-ordinating or ownership entity to influence the corporation as an owner, they should ensure they receive all the necessary and relevant information to make appropriate decisions when required, and that they are able to monitor SOEs' activity and performance on a continual basis.

78. The co-ordinating or ownership entity should ensure that adequate external reporting systems are in place for all SOEs. The reporting systems should give the co-ordinating or ownership entity a true picture of the SOE's performance or financial situation, enabling them to react on time and to be selective in their intervention.

79. The co-ordinating or ownership entity should develop the appropriate devices and select proper valuation methods to monitor SOEs' performance in respect of 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. This benchmarking should cover productivity and the efficient use of labour, assets and capital. This benchmarking is particularly important for SOEs in non-competitive sectors. It would allow the SOEs, the co-ordinating or ownership entity and the general public to better assess SOE performance and reflect on their development.

80. Effective monitoring of SOE performance can be facilitated by having adequate accounting and audit competencies within the co-ordinating or ownership entity to ensure appropriate communication with relevant counterparts, both with SOEs' financial services, external auditors and specific state controllers.

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

82. Depending on the legislation, the co-ordinating or ownership entity may be entitled to nominate and even appoint the external auditors. Regarding wholly-owned SOEs, the co-ordinating or ownership entity should maintain a continuous dialogue with external auditors, as well as with the specific state controllers when these latter exist. This continuous dialogue could take the form of regular exchange of information, meetings or *ad hoc* discussions when specific problems occur. External auditors will provide the co-ordinating or ownership entity with an external, independent and qualified view on the SOE performance and financial situation. It will allow for a complementary information feedback. Continuous dialogue with external auditors and state controllers will help in avoiding situations where the main owner is the last informed on necessary decisions or remedial action to be taken.

83. However, in the case of listed and other partially-owned SOEs, the co-ordinating or ownership entity should be very careful to respect fair treatment of minority shareholders. The dialogue with external auditors should not give the co-ordinating or ownership entity any preferential information and should respect regulation regarding inside and confidential information.

84. 4. Setting remuneration schemes for SOE board members that take into consideration the long term interest of the company and are competitive enough to attract and retain qualified professionals.

85. There is a strong trend to re-evaluate SOE board remuneration in order to bring it closer to private sector practices. However, in a majority of OECD countries, this remuneration is still far below market levels, for the competencies and experience required, as well as for responsibilities involved.

86. In order to enhance board professionalism and improve the business perspective, the co-ordinating or ownership entity should establish remuneration schemes which attract and retain professional board members with the required expertise and experience, provided that these are selected on a merit basis. Remuneration schemes have to take into consideration both rates paid in the private sector and the long term interest of the company.

Annotation to Chapter III: Equitable Treatment of Shareholders

87. The State and SOEs should recognise the rights of all shareholders and ensure their equitable treatment and equal access to corporate information, referring to the OECD Principles of Corporate Governance in this regard.

88. As soon as part of a SOEs' capital is held by private shareholders, institutional or individual, the State should recognise their rights and these should be clearly reflected in the SOE charters. It is in the interest of the co-ordinating or ownership entity and SOEs themselves to refer to the OECD Principles of Corporate Governance with regard to minority shareholders' rights. The Principles state that "*Minority shareholders should be protected from abusive action, by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress*". The Principles also forbid insider trading and abusive self-dealing. Finally, the annotations call for pre-emptive rights and qualified majorities for certain shareholder decisions as an *ex-ante* right which might be useful in some circumstances, particularly in case of related party transactions.

89. On the one hand, as a dominant shareholder, the State may be in a position to abuse minority shareholders' rights. It is indeed in many cases able to make decisions in AGMs without any other shareholder's approval, and is usually in a position to legitimately control the board's composition. Moreover, the State may in cases pursue political ends that are not in the interest of minority shareholders. The State may also be in the position of minority shareholder but yet still able to exercise disproportionate control over the company. On the other hand, the state as a minority shareholder should be treated equally by other shareholders.

90. It is in the State's own interest to ensure that, in all enterprises where it has a stake, minority shareholders are treated equally and the OECD Principles of Corporate Governance in this regard are implemented. Having other shareholders introduces market pressures and may become an important means of monitoring and motivating SOE management. In case the state is a minority shareholder, it will prevent the State from being abused and preserve the value of state shares. In case the State has a significant or dominant stake, it will ensure that other shareholders do not perceive it as an opaque, unpredictable and/or unfair owner. The state's track record in terms of respecting minority rights will have a significant impact on the value of the company and on its future capacity to sell further shares on the market. The State should thus be exemplary in its behaviour and follow best practices regarding equal treatment of minority shareholders.

91. A. The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally and have access to effective redress mechanisms.

92. The co-ordinating or ownership entity and SOEs themselves should "tie their own hands" and take clear measures that will prevent the dominant shareholders (the State or other shareholders), from abusing minority shareholders. These abuses can occur through inappropriate related party transactions, biased business decisions or changes in the capital structure favouring controlling shareholders. The measures which can be taken include better disclosure, a duty of loyalty of board members, as well as qualified majorities for certain shareholder decisions.

93. The co-ordinating or ownership entity should develop guidelines in this regard and make sure that individual SOEs, and more particularly their boards, are fully aware of the importance of this relationship and are active in enhancing them.

94. As stated in the OECD Principles of Corporate Governance, "*the potential for abuse is marked when the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owners through exploiting legal devices to separate ownership from control*". Governments should thus limit as much as possible the use of Golden Shares or other devices, such as dual class shares, that allow a distortion between ownership and control.

95. Finally, adequate redress mechanisms should be available to all SOE shareholders in case their rights are violated. Private individual as well as institutional shareholders should be able to challenge the state as an owner in the courts and be treated fairly and equally in such case by the judicial system.

96. B. SOEs should observe a high degree of transparency towards all shareholders.

97. A crucial condition for protecting minority and other shareholders is to guarantee a high degree of transparency. The OECD Principles of Corporate Governance "*support simultaneous reporting of information to all shareholders in order to ensure their equitable treatment. In maintaining close relations with investors and market participants, companies must be careful not to violate this fundamental principle of equitable treatment*".

98. 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 co-ordinating or ownership entity, should not make any abusive use of the information they might obtain as controlling shareholders and follow relevant provisions of the Company Law, Commercial Law and securities laws and regulations in this regard. Listed SOEs should also apply listing requirements and regulations in the spirit of the OECD Principles of Corporate Governance. For non-listed SOEs, other shareholders are usually well identified and often have specific 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 co-ordinating or 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.

99. Any shareholder agreements, including information agreements covering directors, should be disclosed.

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

101. SOEs, including any enterprise in which the state is a minority shareholder, should identify their minority and other shareholders and keep them duly informed in a timely and systematic fashion about material events or forthcoming AGMs. They should also provide them with sufficient background information on decisions to be made. It is the responsibility of SOEs' boards to ensure that the shareholders are sufficiently informed. In doing so, SOEs should not only apply the existing legal and regulatory framework, but also go beyond it when relevant in order to build credibility and confidence. When possible, active consultation with minority shareholders will help avoid decisions that would be unwelcome or badly perceived, and minimize the risk that decisions may be challenged in courts.

102. D. Minority shareholders' access to the decision-making process could be facilitated through specific mechanisms regarding board election or facilitating participation in AGMs.

103. Minority shareholders may be concerned about actual decisions being made outside of the company's AGM or board, or prior to their meetings, the former becoming mere rubber stamp entities. This is true for listed companies with a significant or controlling shareholder, but there is an even stronger

rationale for reassuring minority shareholders in case the State is a dominant shareholder. To grant minority shareholders an input in the decision making process may be a good instrument to empower the company's organs. It will reassure minority shareholders that their views will be taken into consideration and enhance the State's credibility *vis-à-vis* minority shareholders in general.

104. To grant minority shareholders an input in the decision making process could imply putting in place mechanisms which could go beyond that already adopted by other companies. This could imply primarily making sure that significant decisions are effectively reported or decided in a transparent manner in the AGM, particularly regarding board election. This could also imply, when deemed useful by the circumstances, giving minority shareholders some disproportionate influence on board elections through a specific electoral system. Cumulative voting, for example, allows minority shareholders to focus their voting rights on the same directors and may help in rebalancing the dominant shareholders' position by a stronger influence of minority shareholders. These specific mechanisms should however be carefully balanced and favour all minority shareholders. They should neither be too disproportionate nor entail the creation of circumstances of special privileges, thereby contradicting the very idea of equitable treatment.

105. As underlined in the OECD Principles of Corporate Governance, 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, in the same vein as those recommended for listed companies in the OECD Principles. These include facilitating voting *in absentia* or developing the use of electronic means as a way to reduce participation costs.

106. In the case of SOEs, these mechanisms could also include facilitating independent employee-shareholder participation such as a system facilitating the transparent collection of proxy votes from employee-shareholders. Employees in many countries are the most numerous individual shareholders, especially in partially privatised enterprises. The relevance and desirability of such mechanisms should be evaluated based on the specific context and the importance of retaining human capital by the enterprise concerned. Such mechanisms should also follow recommendations given by the OECD Principles of Corporate Governance regarding proxy voting: "*The corporate governance framework should ensure that proxies are voted in accordance with the direction of the proxy holder and that disclosure is provided in relation to how undirected proxies will be voted. […] Where proxies are held by the board or management for company pension funds or for employee stock ownership plans, the directions for voting should be disclosed"*.

Elements of Annotations to Chapter IV: Relations with Stakeholders

107. The State should ensure SOEs fulfil their responsibilities towards stakeholders and report adequately on stakeholder matters.

108. In some OECD countries, legal status, regulations or mutual agreements/contracts grant certain stakeholders specific rights in SOEs. In some countries, SOEs are even characterised by particular governance structures differing from the usual limited liability company, as regard 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.

109. SOEs should acknowledge the importance of stakeholder relations *per se* for building sustainable and financially sound enterprises. This is particularly important, as stakeholder relations may be critical for the fulfilment of general service obligations whenever these exist. In some sectors, such as in infrastructure sectors, SOE have a vital impact on the economic development potential and on the communities in which they are active. The ownership entities and SOEs should thus recognise the impact that an active stakeholder policy may have on the company's long term strategic goal and reputation. They should also take into account that 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 co-ordinating or ownership entity and SOEs have clear stakeholder policies, and that these policies be adequately disclosed.

110. 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 AGM and the board, should retain their decision making powers.

111. A. Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and protect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.

112. As a dominant shareholder, the State may control corporate decision making and be in a position to take decisions to the detriment of stakeholders. Moreover, in their capacity as law makers or regulators, governments have also an effect, direct or indirect, on the profitability of SOEs as well as on the way in which various stakeholders receive a share in SOEs' added value.

113. It is therefore important to establish mechanisms and procedures to protect stakeholder rights. The co-ordinating or ownership entity should have a clear policy along this line and make sure that the rights of stakeholders, as established by law, regulations and mutual agreements are fully respected. SOEs should act like private sector listed companies regarding stakeholders, and use the OECD Principles of Corporate Governance as a useful basis in this regard.

114. Implementation of the OECD Principles of Corporate Governance implies full recognition of the contribution of various stakeholders and encourages active and wealth-creating co-operation with them. To this end, 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 legal redress in the event their rights are violated. Employees should also be able to freely communicate their

concerns about illegal or unethical practices to the board and their rights should not be compromised for doing that.

115. Performance enhancing mechanisms for employee participation should be permitted to develop when deemed relevant with regard to the importance of stakeholder relations for some SOEs. However, in 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.

116. B. Listed or large SOEs should report on stakeholder relations, as well as SOEs performing an important public policy role or objective(s).

117. Good practice increasingly requires listed companies to report on stakeholder issues. Moreover, stakeholder relations may be even more important for SOEs as they are critical for the fulfilment of general service obligations, whenever these exist. Consequently, whenever SOES are listed or large, they 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 "policy-oriented" SOE, i.e when its main function is to fulfil policy objectives and/or general services obligations. Report on stakeholder relations should include information on social and environmental policies, whenever SOEs have specific objectives in this regard. 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. To this end, they could refer to best practice and follow guidelines on social and environmental responsibility disclosure, which have been developed in the past few years.

118. It is also advisable that SOEs have their stakeholder reports independently scrutinised in order to strengthen their credibility. This will also provide useful information on the effective implementation of the stakeholder policy and suggestions for improvements in this regard.

119. The co-ordinating or ownership entity could in turn strengthen disclosure on stakeholder matters by having both a clear policy and possibly developing aggregate disclosure in this regard to the general public.

120. C. The board of SOEs should be required to develop, communicate and put in place compliance programmes related to internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to SOEs and their subsidiaries.

121. The OECD Principles of Corporate Governance recommend that boards apply high ethical standards. This is in the long term interest of any company as a means to make it credible and trustworthy in day-to-day operations and with respect to longer term commitments. In the case of SOEs, there may be more pressures to deviate from high ethical standards given the interaction of business considerations with political and public policy ones. Moreover, as SOEs might play an important role in setting the business tone of the country, it is also important for them to maintain high ethical standards.

122. SOEs and their officers should conduct themselves according to high ethical standards. SOEs should develop internal codes of ethics, committing themselves to comply with country norms and in conformity with broader codes of behaviour. This might include a voluntary commitment to comply with *the OECD Guidelines for Multinational Enterprises*, which reflects all four principles contained in the *ILO Declaration on Fundamental Principles and Rights at Work*, and *the OECD Anti-Bribery convention*. The ethical code should apply to the SOEs as a whole and to their subsidiaries.

123. The ethical code should give clear and detailed guidance as to the expected conduct of all employees. It is also considered as a 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 also be fully supported and implemented by the boards and senior management. Compliance programs should also be established.

124. The code of ethics should include guidance on procurement processes, as well as develop 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 company. SOE boards could grant employees or their representatives "a confidential direct access to someone independent on the board", or to an ombudsman within the company. However, the codes of ethics and such mechanisms should also comprise disciplinary measures, should the allegations be found to be without merit, frivolous or vexatious in nature.

125. D. SOEs should face competitive conditions regarding access to finance. They should establish arm's length relationships with state-owned banks, other state-owned financial institutions as well as any other SOEs. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.

126. In a number of cases, SOEs are to a large extent protected from insolvency or bankruptcy procedures by their specific legal status. This is sometimes due to the necessity to ensure continuity in the provision of public services. Moreover, creditors and the board often assume that there is an implicit state guarantee on SOEs' debts. This situation has in many instances led to excessive indebtedness and wasted resources. This is detrimental to both creditors and to the ultimate owners, the taxpayers, and can also serve to distort the markets.

127. A clear distinction between the state and SOEs' respective responsibilities in relation to creditors is necessary. The State often grants guarantees to SOEs to compensate for its inability to provide them with equity capital, but this facility is often widely abused. 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.

128. Conversely, SOEs creditors should also be in a position to protect their rights by pressing their claims. In some countries, state-owned banks and other financial institutions tend to be the most significant if not the main creditor of SOEs. This environment leaves great scope for conflicts of interest. It may lead to bad loans by state-owned banks as the enterprise might feel itself under no obligation to repay the loan. This may shelter SOEs from a crucial source of market monitoring and pressure, thereby distort the incentive structure they face.

129. Mechanisms should be developed to manage these conflicts of interests and ensure that SOEs develop arm's length relationships with state-owned banks, other financial institutions as well as other SOEs. State-owned banks should grant credit to SOEs on the same terms and conditions as for private companies. These mechanisms could also include limits and careful scrutiny on SOEs' board members sitting on the board of state-owned banks.

Annotations to Chapter V: Transparency and Disclosure

130. SOEs should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

131. A. The co-ordinating or ownership entities should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.

132. Co-ordinating or centralised ownership entities should develop aggregate reporting on SOEs as this is a key disclosure tool directed primarily to the general public, but also to the Parliament and the media. Aggregate reporting is instrumental for the co-ordinating or ownership entity in improving their knowledge of SOEs and in clarifying their own policy. Moreover, it would allow the co-ordinating or centralised ownership entity, the government and the general public to obtain a clear view of the overall performance and evolution of SOEs.

133. The publication by the state of an annual aggregate report is the main output of aggregate reporting. This aggregate report should focus primarily on the evolution of the profitability and value of state-owned enterprises, giving at least 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 effectively implemented this policy. Information on the organisation of the ownership function should also be provided, as well as an overview of the evolution of state-owned enterprises, aggregate financial information, and reporting on changes in SOEs' boards. The aggregate report should provide main indicators including turnover, profit, shareholder's equity, cash flow from operating activities, gross investment, return on equity, equity/asset ratio and dividends. Information should also be provided on the methods used to aggregate data. The aggregate report could also provide individual reporting on the most significant SOEs. However, aggregate reporting should not duplicate but complement existing reporting requirements, for example, annual reports to Parliaments. Some ownership entities could aim at publishing only "partial" aggregate reports, i.e. covering SOEs active in comparable sectors. Finally, publishing bi-yearly aggregate reports would improve further transparency on state ownership.

134. It has proven useful in some countries for the co-ordinating or ownership entity to develop a website allowing easier access to information by the general public. This website could provide information both on the organisation of the ownership function and the general ownership policy, as well as significant information on the size, evolution, performance and value of the state sector.

135. B. SOEs should develop efficient internal audit procedures and function, under the control of and reporting to the board or to the audit committee.

136. As in large public companies, it is necessary for large SOEs to put in place an internal audit system that will bring a systematic and disciplined approach to improve risk management, financial control and governance processes. Internal auditors are important to ensure an efficient and robust disclosure process. They should define procedures to collect, compile and present sufficiently detailed information. They should also ensure that company procedures are adequately implemented and be able to guarantee the quality of the information disclosed by the company. Internal auditors should also report to management since they are important for the CEO to gauge how the company is effectively operating and performing.

137. To increase their independence and authority, the internal auditors should be under the control of and report directly to the board and its audit committee in one tier systems, to the supervisory board in two-tier systems, or to the audit boards where these exist. Internal auditors should have unrestricted access

to the Chair and members of the entire board and its audit committee. As is now becoming increasingly common, consultation between external and internal auditors should be encouraged.

138. C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

139. SOEs are not necessarily required to be audited by external, independent auditors. This is often due to specific financial control systems that are sometimes considered sufficient to guarantee the quality and comprehensiveness of accounting information. These financial controls are performed by specialised state audit entities, which may inspect both SOEs and the co-ordinating or ownership entity. In many cases they also attend board meetings and are often in charge of reporting directly to the Parliament on SOEs' performance. However, the existence of these specific controls does not always make the overall picture more transparent and support monitoring by the State since they are focused specifically on the use of public money and budget resources, rather than on the operations of the SOE as a whole. Moreover, while these specific controls may be in some countries very effective, they are in others countries considered as intrusive, burdensome and cost ineffective.

140. To reinforce trust in the information provided by SOEs, the state should consider requiring SOEs to submit, in addition to state special audits, to external audits according to international standards. This is particularly valid for large SOEs. It is crucial that the external auditors are independent from the management as well as large shareholders, i.e. the state in the case of SOEs. They should thus be subject to the same criteria of independence as for private sector companies. This includes limits on providing consulting or other non-audit services to the SOE concerned, as well as rotation of audit partners or audit firms.

141. D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non financial information according to international best practices, as well as SOEs performing an important public policy role or objective(s).

142. As the general public is the ultimate owner, SOEs should be at least as transparent as publicly traded corporations. Regardless of their legal status and even if they are not listed, all SOEs should report according to the highest accounting and auditing standards.

143. To the extent possible, a cost-benefit analysis should be carried out to determine which SOEs should be submitted to high disclosure standards. This analysis should consider that demanding disclosure requirements are also both an incentive and a means for the board and management to perform their duties professionally. It should also consider that high quality disclosure is essential in building public confidence in the way the state manages SOEs. SOEs under a certain threshold in terms of size could be excluded, provided that they do not perform an important public policy role. The size threshold could only be decided on a pragmatic basis and will vary according to different countries, industrial sectors and size of the overall state sector.

144. For SOEs performing an important public policy role or objectives, a high level of disclosure on their part is still valuable. It is even necessary whenever they have a significant impact on the state budget or the risks carried on by the state, or when they might have a more global societal impact. In the EU, for example, SOEs entitled to State subsidies for carrying out services of general interests are required to maintain separate accounts.

145. **E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.**

146. The OECD Principles of Corporate Governance describe what the main elements of disclosure for a public company should be. SOEs should at least comply with these requirements, including financial and operating results, remuneration policies for board members and key executives, related party transactions and governance structures and policies. In this regard, SOEs should disclose if they follow a code of corporate governance and, if so, which one. Moreover, SOEs should be more vigilant particularly when addressing the following issues which tend to be problematic or lacking transparency.

147. 1. A clear statement of the company objectives should be provided to the general public, as well as a report on the fulfilment of these objectives.

148. It is important that each SOE be 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.

149. When the state is a majority shareholder or effectively controls the SOE, company objectives should be made clear to all other investors, the market and the general public. The disclosure obligation may force the company to clarify the objectives themselves, and could also increase management's commitment in pursuing these objectives. It will provide a reference point for all shareholders, the market and the general public for considering the strategy adopted or decisions taken by the management.

150. SOEs should report on how they fulfilled their objectives through disclosing key performance indicators. When the SOE is also used for policy purposes, such as general services obligations, it should also report on how these are being achieved.

151. 2. The ownership and voting structure of SOEs should be transparent.

152. It is important that the ownership and voting structure of SOEs be transparent, so that private individual or institutional shareholders have a clear idea of their share in ownership and control. It should also be clear what are the different public entities or administrations which retain the legal ownership and voting rights, as well as the state entities charged with exercising these ownership and voting rights. Special rights of the state such as golden shares and veto powers should also be declared.

153. 3. Specific attention should be given to adequate disclosure of material risk factors.

154. A number of difficulties have arisen in some OECD countries as large SOEs have undertaken risky strategies without clearly identifying, or at least duly reporting on the related risks.. Risk disclosure is even more relevant as a number of large SOEs are in newly liberalised sectors and increasingly internationalised. Consequently, 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, as well as unexpected and major financial difficulties.

155. 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. Their reporting could cover, when appropriate, risk management strategies as well as systems put in place to implement them. Finally, resources companies should disclose their

reserves according to best practices in this regard, as this may be a key element of their value and risk profile.

156. Public Private Partnerships should also be adequately disclosed. Such emerging cooperative ventures, characterised by transfers of risks, resources and rewards between public and private partners for the provision of public services or public infrastructure, may entail new and specific risks.

157. 4. Reporting should detail any financial assistance, including guarantees, received from the State and commitments made by the State on SOEs' behalf.

158. To give a fair and complete picture of an SOE's financial situation, it is also necessary that mutual obligations, financial assistance or risk sharing mechanisms between the State and the SOEs be appropriately disclosed. Disclosure should include 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 of guarantees could be done by SOEs themselves or by the government. It is considered good practice that Parliaments monitor government guarantees in order to underpin budgetary procedures.

Annotations for Chapter VI: The Responsibilities of SOE Boards

159. SOE boards should have adequate authority, the necessary competencies and sufficient objectivity to carry out their function of strategic guidance and monitoring of management. The board should act with integrity and be accountable for its actions.

160. In a number of countries, SOE boards are too large, lacking business perspective and often independence of judgment. They may also include numerous members coming from the government or state administration. SOE boards are thus considered in some countries as weak and, moreover, might not be entrusted with the usual board responsibilities. They might not be in a position to fulfil their most critical functions where they are by-passed both by SOE senior management and by the ownership entities themselves. Moreover, their function may also be duplicated by specific State regulatory bodies in some areas.

161. Empowering and improving the quality of SOE boards is a high priority to improve the corporate governance of SOEs. It is important that SOEs have strong boards in order to effectively monitor management and protect against undue political interference. To this end, it will be necessary to ensure the competency of SOE boards, enhance their independence and finally improve the way they function. It is also necessary to allow them clear and full responsibility for their functions and ensure that they act with integrity at all times and deal with conflicts of interest.

162. A. SOE boards should be assigned a clear mandate and ultimate responsibility for SOE performance. They should be fully accountable to the owners, act in the best interests of the company and treat all shareholders equitably.

163. SOE boards should have in principle the same level of responsibility and liability as the boards of companies under normal corporate law. However, in practice, board members may, *de facto*, perceive a reduced liability, particularly the ones nominated by the state**.** The responsibilities of SOE boards should be articulated in relevant legislation, regulations, the government ownership policy and the company charters.

164. It is essential and should be emphasised that all board members have the legal obligation to act in the best interests of the company, 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, any specific shareholders or stakeholders.

165. To encourage board responsibility and in order for them to function effectively, they should be limited in size, following best practice in the private sector. Experience indicates that smaller boards allow for lively strategic discussion and are less prone to become rubberstamping entities.

166. To underline the board's responsibilities, 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 co-ordinating or ownership entity.

167. B. SOE boards exercise objective and independent judgement. They should consist of members with relevant competence and experience and include a sufficient number of non-executive

and independent members. The number of members from the administration should be limited and all board members should be nominated through a transparent nomination process.

168. A central prerequisite in empowering SOE boards is to structure them so that they can effectively exercise objective and independent judgement, be in position to monitor senior management and provide value adding strategic guidance. As underlined in the Principles, "*in order to exercise its duties of monitoring managerial performance, preventing conflicts of interest and balancing competing demands on the corporation, it is essential that the board is able to exercise objective judgement*" (Annotation Principle VI.E.). SOE boards should therefore be protected from undue and direct political interference that could detract them from focusing on achieving the objectives agreed on with the government and the ownership entity.

169. A first requirement to enhance the independence of SOE boards' is to bring in a sufficient number of outside non-executive directors free of conflicts of interests. These would normally be recruited from the private sector and should have the relevant competence and experience. It will help in making boards more business-oriented, particularly for SOEs that have to face competition. This expertise could also include qualifications related to the SOE's specific obligations and policy objectives.

170. A second factor to enhance SOE boards' independence is to limit the number of board members who come directly from the state administration.

171. To limit direct and undue political interference in the decision making of SOEs, it is also recommended to explicitly exclude from SOE boards Members of the Parliament, Ministers or State Secretaries. In the same vain, political representation following party lines should be avoided. Requests for political representation should be dealt with strictly in nominating and appointment process for SOE board members. Broader political objectives should instead be channelled through the co-ordinating or ownership entity and enunciated as enterprise objectives rather than imposed directly. SOE boards should not respond to policy signals until they are authorised by the Parliament or approved by specific procedures.

172. However, "*in carrying out its duty, the board should not be viewed, or act, as an assembly of individual representatives for various constituencies. While specific board members may indeed be nominated or elected by certain shareholders (and sometimes contested by others) it is an important feature of the board's work that board members when they assume their responsibilities carry out their duties in an even-handed manner with respect to all shareholders*" (Annotation Principle VI.B.).

173. Mechanisms to evaluate and maintain the effectiveness of board independence should be developed. These include, for example, limits on the possible number of reappointments and means granted to the board to have access to independent information or to resources to carry out independent expertise.

174. C. Where employee representation on the board is mandated, mechanisms should be developed in order to guarantee that this voice is exercised effectively and contributes to the enhancement of the board skills, information and independence.

175. When employee representation on SOE boards is mandated by the law or collective agreements, it should be structured so as to contribute to increasing the SOE boards' independence, skills and information. Employee representatives should have the same duties and responsibilities as all other non-executive board members, should act in the best interests of the company and treat all shareholders equitably. The employee representative function should not be considered *per se* as a threat to board independence.

176. To make sure that, when board level employee representation does exist, employee members are contributing positively to the decision making process, mechanisms should be developed to ensure that they have a real "independence of mind", that they respect their duty of confidentiality, and that they invest the necessary time and effort to fulfil their board duties. These mechanisms should include adequate transparent and democratic election procedures, extensive training and measures to soften the potential conflicts of interest. A positive contribution to the board's work will also require acceptance and collaboration by other members of the board as well as by the SOE management.

177. D. The Chairpersons of SOE boards should have the relevant competencies to fulfil their crucial role. Good practice calls for the post to be separate from the CEO.

178. The Chairperson has a key role in guiding the board and ensuring its efficient running. They must ensure that relevant matters are put on the agenda and that board members have unrestricted access to all necessary information in order to exercise an objective and informed judgement. Finally they should oversee the active involvement of individual board members in the strategic guidance of the SOE.

179. For enhancing board independence, the OECD Principles of Corporate Governance consider as a good practice that the Chair person is separated from the CEO in single board structures. In the case of two-tier board systems, it is similarly considered as a good practice to avoid that the head of the lower board becoming the Chairman of the Supervisory Board on retirement. These good practices help in "*achieving an appropriate balance of power, increasing accountability and improving the board's capacity for decision making independent of management*". In the case of SOEs, this is even more desirable as it is necessary to empower their boards and make them more independent from management. Such separation should be considered as a fundamental step in establishing strong SOE boards.

180. It is also advisable for the Chair not to come from the SOE itself or from the administration, in order both to bring in more business-oriented leadership and experience, and to help SOE boards to exercise independent judgment.

181. E. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

182. In many instances, SOE boards are not granted full responsibility and powers required for strategic guidance, the monitoring of management and the control over disclosure. They may be deprived of certain critical functions and also in some cases of the power and authority to carry out these functions. SOE boards may see their roles and responsibilities encroached from both ends; by the ownership entities and by management.

183. SOE boards may be deprived of some of their responsibility for overseeing the strategy of the SOE. The co-ordinating or ownership entity, if not the government itself, may be tempted to become too involved in strategic issues, although it is their responsibility to define the overall objectives of the company. Frequently the line is, however, narrow between defining objectives and setting strategies. SOE boards may also encounter difficulties in exercising control over management as they do not always have the legitimacy, or even the authority, to do so. Furthermore, in some countries, there is a strong link between the management and the ownership function or directly with the government, resulting from the appointment process. In this case, SOE senior management tends to report to the ownership function or the government directly, by-passing the board. SOE boards may also feel partially deprived from their responsibility regarding reporting, as decisions about disclosure may be partially duplicated by specific state control bodies.

184. In order to carry out their role, SOE boards should be informed and active in (i) formulating, monitoring and reviewing corporate strategy, within the framework of the overall objectives defined by the government and the ownership entity; (ii) ensuring key risk areas are identified and appropriate performance indicators are established; (iii) monitoring the disclosure and communication processes, ensuring that the financial statements fairly present the affairs of the SOE and reflect the risks incurred; (iv) assessing and following management performance. SOE boards should also ensure that effective succession plans for all directors and key executives are in place.

185. In some countries SOE boards do not fulfil what should be one of their key functions, the appointment and dismissal of CEOs. The board may be officially in charge of nominating or even appointing the CEO but *de facto* there is a strong interaction, in the form of consultation with the government or even approval from the Ministry in charge or directly by the Head of State. Without the crucial role of appointing and, in case of poor performance, dismissing the CEO, it is difficult for the board to fully exercise its monitoring function and feel responsible for the company's performance. It should therefore be considered good practice for SOE boards to be able to appoint and remove the CEO. In some cases, this might be done in concurrence or consultation with the ownership entity, as this is usually the case with major investors in limited liability companies. In any cases, 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.

186. SOE boards should also be in a position to have a major influence over the CEO's remuneration. They should ensure that the CEO's remuneration is tied to its performance and duly disclosed.

187. F. When necessary, SOE boards could set up specialised committees to support the full board in performing its most essential functions. These committees could be set up in particular with respect to audit, risk, remuneration, nomination and ethics.

188. The establishment of specialised committees within the board have recently increased, in line with standard practice in the private sector. These committees are not usually mandatory. The most frequent committees are the audit and remuneration committees. Strategic and ethics committees are less frequent. In rare cases, risk or procurement committees are also established. However, some recent events and failures have emphasised the necessity to reinforce SOE boards with regard to audit and risk management, as well as to ethics in general and in many cases procurement.

189. The setting up of specialised committees could be instrumental in reinforcing the competency of SOE boards and in underpinning their critical responsibility in matters such as risk management and audit. They may be also 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.

190. The co-ordinating or ownership entity should develop a policy to define in which cases specialised committees should be mandatory. This policy 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.

191. It is essential for specialised committees within the boards to be chaired by a non-executive and to 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 should, for example, comprise only non-executive directors.

192. The existence of specialised committees should not excuse the board from collective responsibility for all matters. Specialised committees should have written terms of reference, fully describing their duties, authority and membership. Committees should report to the full board and the minutes of their meetings should be circulated to all the board members.

193. SOE boards could also set up nomination committees to co-operate with the ownership entity with regard to the board nomination process. It is important to involve the board in thinking about its own composition and succession planning, through their involvement in the search process and with the possibility to make recommendations to the ownership entity. This may be critical in making sure that the nomination process really focuses on competencies and in providing for continuity of practice in this matter. In some countries it is the practice that nomination committees can also be set up outside the board structure, particularly including main owners.

194. G. SOE boards should carry out an annual evaluation to appraise their performance.

195. The systematic evaluation of board performance remains rare in SOEs, as is also the case in many limited liability companies. An evaluation process is a necessary tool in enhancing SOE board professionalism. It underlies the responsibilities of the board and clarifies its main functions. It may also be instrumental in advocating more business experience and in diversifying board member profiles. Finally, it is a useful incentive for individual board members to devote sufficient time and effort in carrying out their critical functions.

196. SOE boards should carry out self evaluation. They may be helped in doing so by external and independent experts as well as by the ownership entity. Such evaluations should scrutinise both the overall board performance and the effectiveness and contribution of individual directors. However, this individual board member evaluation should not impede the desired and necessary collegiality of board work. In any case, an individual evaluation of the Chair’s performance seems necessary.

197. Board evaluation should be carried out under the responsibility of the Chairperson and according to evolving best practices. Individual evaluations could use as a benchmark performance contracts signed between the board members and the government where they exist. Based on these individual and collective evaluations, the boards’ size and composition, as well as remuneration, could be reviewed. These evaluations could also be instrumental in developing effective and appropriate induction and training programmes for new and existing SOE board members.