EFFECTIVENESS AND STRUCTURE OF BOARDS OF DIRECTORS AT STATE-OWNED ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN
Effectiveness and Structure of Boards of Directors at State-owned Enterprises in Latin America and the Caribbean.

Public Policy and Productive Transformation consists of a series of documents aimed at disseminating successful experiences and cases in Latin America as a tool for producing knowledge for the implementation of best practices in the field of business development and productive transformation.

Gustavo Ardila
Vicepresident of Productive and financial sectors

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Productive transformation has been one of the areas that CAF, as the development bank of Latin America, has fostered as a necessary condition for reaching a high and sustainable development in the region.

The experience and expertise generated in each project during the last decades have made the Institution a Latin American point of reference in areas such as competitiveness, Corporate Governance, local and business development, and productive inclusion.

The public policies necessary to drive productive transformation are based on the development of those capabilities aimed at the implementation of good practices and specific supports for improving business management and productivity. Thus, CAF makes its knowledge and expertise available and offers efficient support to a variety of sectors while, at the same, it creates documentation and does research on success stories that are relevant for the region.

“Public Policy and Productive Transformation” consists of a series of documents aimed at disseminating those experiences and success stories in Latin America as an instrument for spreading the knowledge that CAF makes available to the countries in the region so that better practices with respect to business development and productive transformation practices can be implemented.

L. Enrique García
Executive President
EXECUTIVE SUMMARY

Understanding the dynamics and governance of Boards of Directors within the framework of State-Owned Enterprises (SOEs) is fundamental in order to identify opportunities for improvement and to establish directing bodies that are more professional, strategic, effective and value-creating for the company, the State as owner and the rest of shareholders. This is the reason why we applied a survey on the structure and effectiveness of Boards of Directors at 50 SOEs in Latin America and the Caribbean. We found that the main strengths are associated to a greater involvement on the part of Boards in strategic decision making, meeting planning, the absence of substitute members, the creation of Auditing Committees and the acknowledgement of incentives for directors; whereas staggered Board renewal and evaluation by peers are identified as the main challenges faced by Boards of Directors. Based on the results obtained, we put forward recommendations on public policy that require a joint effort whereby the companies and the State as owner work together to strengthen the Boards of Directors at SOEs in countries across the region.

Keywords: Corporate Governance, State-Owned Enterprises, Latin America and the Caribbean, Board of Directors, Performance, State as Owner.
INTRODUCTION

The Board of Directors is a key governing body for all types of enterprises, due mainly to the fact that it provides a toehold on the alignment of the management process.

The importance of understanding the dynamics of the Boards of Directors at State-Owned Enterprises (SOEs), and proposing specific practices aimed at their strengthening, lies in the need to establish directing bodies that are more professional and effective. A Board of Directors that works well is one that is able to draw up strategies, create value and act as a collegiate entity with shared responsibilities.

Building strong effective Boards of Directors at SOEs is no easy task. Previous failures of high-profile companies’ Boards, the competition with the private sector, the boom of new technologies, as well as citizens who are increasingly better informed and demand sound management of public resources, are only some of the reasons why good practices by Boards of Directors are important to any public company.

The best Boards of Directors are those that go beyond legal compliance to take on a more active role in the creation of value (“conformance role” versus “performance role”).

This paper constitutes a first attempt to understand and gain insight into how the governance models used by Boards of Directors at SOEs are working in Latin America and the Caribbean, as well as to identify related opportunities for improvement.

The great challenges faced by SOE Boards in countries across the region largely depend on the interest and commitment shown by the owner – the State as the owner. There are, however, a series of practices which can be promoted and implemented autonomously by SOEs or their Boards that turn out to be fundamental.
This paper addresses the issue from a theoretical-practical perspective as it presents and analyzes the best practices in the field of corporate governance so as to strengthen the role and governance of SOE Boards, based on the results obtained from the survey on Effectiveness and Structure of Boards of Directors at 50 State-Owned Enterprises in Latin America and the Caribbean (see Annex 1).

As complementary information, this paper uses individual reports that have been prepared confidentially for each company that took part in the survey. The individual reports provide a comparative baseline between the results obtained by the company, the consolidated result for the 50 companies, and the best practice in terms of corporate governance.

Based on this study it is hoped that joint, complementary work in the field of corporate governance will be carried out together with international peers aiming at enhancing the efficiency of Boards of Directors at SOEs in Latin America, as well as the contribution to value that they make.

This report is made up of four chapters. The first chapter analyzes the role Boards of Directors play in the corporate governance of State-owned enterprises; the second chapter describes the scope of the study and the methodology used to collect information, and provides a general characterization of the participating companies; the third chapter presents the results obtained in the study, as well as an analysis and recommendations on the best corporate governance practices and standards for SOE Boards; finally, some conclusions and recommendations on public policy are provided with the purpose of strengthening Board-level processes at SOEs in countries across the region.
CHAPTER 1
THE ROLE OF THE BOARD OF DIRECTORS IN CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

The aim of this chapter is to identify the characteristics, challenges and risks inherent to the Boards of Directors of State-Owned Enterprises (SOEs) from a corporate governance perspective, as well as to determine and analyze the key, non-delegable duties that Boards perform within the context of companies owned by the State.

The Board of Directors as Main Governing Body
The Board of Directors constitutes the core and main governing body of any company, due mainly to its role as mediator between the Ownership, represented in the case of SOEs by the State as sole owner or controlling shareholder, and the Senior Management, represented by the Executive President.

In general terms, the Board of Directors is the body responsible for controlling the Senior Management’s performance, overseeing the business and, above all, guiding the definition of the strategy. Therefore, the Board of Directors is the setting in which fundamentally strategic decisions are debated and made in favor of long-term benefits for the company.

The role of SOE Boards largely depends on the categorization of the enterprise, i.e. on the economic, political and social objectives that the State aims to achieve as owner through the companies within its scope.

The following is a basic classification of state-owned enterprises according to the models commonly present in countries across Latin America:

- SOE created with the purpose of achieving public policy objectives. In this context, the Boards of Directors are particularly relevant as they have been incorporated into
public administration in order to improve coordination between the ministries or agencies that are responsible for designing public policies and the companies as the entities which are responsible for their execution (Bernal, Samboní; 2015).

- SOE responsible for providing utility services (e.g., water, electricity, gas, etc.)
- SOE created exclusively for the provision of goods or services required by the State (e.g., military suppliers).
- SOE responsible for producing revenue for the State by competing with the private sector under equal conditions.

In the case of SOEs, the State as owner must establish and communicate to its companies and their Boards of Directors the economic expectations, the expected results and the approach to be taken regarding corporate governance of its enterprises. Depending on the categorization of each SOE, the role of the Board of Directors is defined: from Boards with a focus on public policy execution to Boards focused on generating revenue.

SOE Boards possess certain distinctive characteristics that expose them to specific risks. Some challenges include a process of composing Boards that ensures the suitability of its members, the fulfillment of duties by the directors and independence in the decision-making process, as well as their continuity.

In this case, it is crucial to understand the following question: In what way has corporate governance become a useful tool to mitigate the risks and challenges faced by the Boards of SOEs?

In general terms and from the view of good corporate governance, mechanisms should be created to protect SOEs from inappropriate political influence on the part of the State which may affect the mandate upon which they were created or their sustainability in the long term, and to enable directors to carry out their duties and responsibilities in a professional and independent manner whilst keeping away from political interests when fulfilling their obligations so as to act in favor of the company’s overall purpose, be it social or economic.

The following are the risks and challenges faced by Boards of Directors at SOEs, as well as the mechanisms which have been designed from a sound corporate governance perspective to mitigate them:
1. Composition of the Boards of Directors: Suitability of their members

The Boards of SOEs in countries across Latin America have been composed predominantly of civil servants belonging to the current administration, where discretionary political appointments – the so-called “positions of trust” – are still frequent.

According to Bernal, Oneto, Penfold, Schneider and Wilcox, “Corporate boards are predominantly composed of public officials. Executive members and independent directors are not common practice yet in the region. About one third of Latin American SOEs require specific profiles to appoint Board members.” (P.19, 2012)

Through various studies carried out by CAF – Development Bank of Latin America, including this one, it has been able to be determined that, although a significant number of Latin American public companies have defined specific profiles for appointing directors in recent years, appointments based on the position occupied as a civil servant still prevail over any professional profile. In many cases, the director is a civil servant who does not necessarily have the suitable profile in order to fulfill the duties corresponding to the position. Thus, the appointment of directors under strict suitability criteria applies predominantly to independent members.

The presence of independent members on Boards of Directors at SOEs, besides bestowing greater objectivity and independence to the decision-making process, looks to minimize possible conflicts of interest on the part of civil servants who represent the State as owner. In this case, the State – or otherwise the entity responsible for exercising the State’s ownership rights¹ - should avoid appointing directors coming from the public administration in order to limit possible excessive interference by the State in the SOE’s management and in the making of decisions arising within the context of Board meetings.

Overall, the processes for composing Boards of Directors at SOEs are expected to be based on criteria that ensure the transparency, independence and suitability of their members.

2. Stable Boards of Directors

The Boards of Directors of SOEs are more often exposed to changes caused by the dynamics and political interference of the State. When exercising its ownership rights, the State – be it as absolute owner or controlling shareholder – chooses and removes the members of the Board at its companies. This fact, though connatural and legitimate, is affected precisely by a political cycle which makes the periods served by the directors shorter compared to those of companies with other ownership structures. Therefore, this generates a challenge for the directing bodies of state-owned companies: to ensure the continuity of the company’s leadership, regardless of the changes in the political/electoral system.

One of the existing corporate governance mechanisms – and maybe the most effective one – to safeguard SOE Boards against the changing political dynamics, and thus guarantee profitability and sustainability of the company as a strategic asset of the State, is structuring a staggered appointment process for directors.

This good practice, though less advisable for other entrepreneurial structures, applies only to those directors appointed by the State, and aims to make the election processes for Board members independent – in terms of time and mutual influence – from the political/electoral processes.

¹ The entities responsible for exercising the State’s ownership rights are organisms created by the State – be it independently or as part of its organic structure – to carry out and coordinate its ownership function and, consequently, exercise its ownership rights, directing and controlling the companies falling under its scope of application in an orderly and legitimate fashion. Such entities arise as a mechanism to counteract one of the greatest challenges the State faces in its role as shareholder, namely the orderly, clearly-identified exercise of the ownership function.
By means of staggered Boards of Directors, SOEs look to ensure that their direction and governance structure is inclined to the long term and is not limited exclusively to meeting the current interests of the appointed political actor. Furthermore, it allows companies to preserve the level of knowledge and experience gained by directors from previous government periods, generate a natural process for the transmission of expertise among members of the Board –both former ones and new ones – regarding their responsibilities and main challenges to the business, and progressively link directors with new competencies and skills according to strategic moments and entrepreneurial performance.

3. Duties of the Board of Directors in the decision-making process

Boards that have a significant number of members who come from the public administration (over 50 percent), as well as a lack of administrative autonomy at SOEs, may end up conditioning the decision-making process for the directors appointed by the State. In this scenario, directors are more prone to favor the State’s interests and be less oriented towards the company’s strategic vision and competitiveness.

Generally, companies’ Boards are expected to make decisions by exercising objective, independent judgment and to comply with their fiduciary duties of diligence and loyalty to the company. This entails their acting in favor of the company’s general interest and treating all owners/shareholders equally, regardless of the particular interest of the owner/shareholder that might have appointed them.

There are several corporate governance practices aimed at ensuring that the Boards of Directors carry out their duties in an objective and independent manner. Limiting the number of the directors’ mandates and allocating resources to the Boards so they have access to independent information, or so they can conduct an independent evaluation, are some of such practices (OECD, 2011). However, there are two corporate governance practices directly related to their structure and composition which turn out to be important when attempting to understand the Boards’ role and functions.

As mentioned above, the first practice is the presence of independent members on the Boards of SOEs to counterbalance the significant influence that civil servants may exert. The second practice is the separation of positions between the Chairman of the Board and the Executive President (General Manager, CEO), which is considered a fundamental measure to establish efficient Boards of Directors at State-owned companies.

According to the Organization for Economic Co-operation and Development (OECD), “It is regarded as good practices that the Chair is separate from the CEO. Separation of the two roles helps to ensure a suitable balance of power, improves accountability and reinforces the board’s ability to make objective decisions without undue influence from management. Separation of the Chair from the CEO is particularly important in SOEs, where it is usually considered necessary to empower the board’s independence from management.” (P.73, 2015).

In addition, this separation of positions ensures the independence of roles between the Board of Directors as the exclusive body responsible for strategic steering, controlling the Senior Management and overseeing the company; and the role
of the Executive President as the one responsible for the regular course of business.

**Functions of the Boards of Directors**

The functions of the Boards of Directors have evolved significantly over recent years. From being considered a body almost exclusively controlled by the Senior Management, the Board of Directors went on to become a body that plays a key role in defining the strategic orientation of the company (CAF, 2013).

Even though there is no single model for the Board’s functions, from a good corporate governance perspective, SOE Boards should fulfill – at least – the following four key, non-delegable functions:

- **Defining strategic orientation.** Strategic steering is undoubtedly the Board of Directors’ main role. In order to fulfill this function, the Board should "formulate or approve, monitor and review corporate strategy, within the framework of the overall corporate objectives" (OECD, P.70, 2015) set by the State as owner or controlling shareholder.

- **Controlling day-to-day management.** As the Board delegates the day-to-day management or regular course of business to the Senior Management, it is responsible for monitoring, controlling and evaluating the managerial performance in order to achieve an appropriate yield for the owners, as well as to avoid conflicts and balance interests among the parties.

As part of their function of controlling management, SOE Boards should be responsible for appointing and dismissing the Executive President (General Manager, CEO) so they are able to fully carry out their overseeing function and feel empowered with regard to the public company’s performance.

In some countries of the region, this function cannot be assumed directly by the Board of Directors because of existing legal provisions that confer the appointment of the Executive Presidents of SOEs upon the incumbent authorities. In these cases, it is expected that the Boards be consulted and the appointment processes be conducted under coordination and agreement relations with the representative of the ownership.

Regardless of which the procedure may be, the appointment of the Executive President – as in the case of the members of the Board – should be based on professional and suitability criteria. The standards and procedures to nominate and appoint the Executive President of SOEs should be transparent and should respect the line of command and accountability between the Executive President, the Board of Directors and the Ownership (OECD, 2011).

Within the scope of the function of controlling the Senior Management, SOE Boards should evaluate management by the Executive President and decide on this individual’s remuneration. In this case, the Boards of Directors should make sure that the Executive President’s remuneration is linked to the results obtained in the performance evaluation processes and that it is competitive for the position carried out.

- **Supervising the company.** Within its supervising function, the Board of Directors should be knowledgeable of all matters relating to the company’s purpose so it can periodically oversee and closely monitor such affairs. Therefore, it is up to the Board to establish key performance and risk indicators that enable it to properly carry out
its supervising role, closely monitoring the quality and disclosure of financial and non-financial information, managing human resources, setting up plans for the succession of officers, and overseeing entrepreneurial ethics, conflicts of interest, transactions between related parties and the architecture of entrepreneurial control5.

• **Governing the company.** The Board’s governing function is based on its role as liaison body between the ownership and the day-to-day management. SOE Boards therefore need to materialize a governance model that is in keeping with the guidelines set by the State as owner and that will, in every case, tend to generate a system of checks and balances among the different bodies and structures of entrepreneurial governance.

The importance of clearly defining the role and functions of Boards of Directors lies in the need not only to define clear rules and action frameworks for the governing body per se, but also to establish a clear separation of functions between ownership, direction and management.

**Action frameworks between ownership, direction and management**

The Boards of Directors of SOEs face an additional challenge in regard to formally defining and effectively implementing their functions, as they might come to overstep their boundaries of action or appear blurred by the other two governing roles: by the State as owner or controlling shareholder and by the Senior Management.

Firstly, the State or the representative of the ownership may get excessively involved in the definition of the company’s strategy. Although the State is acknowledged to be entitled – as owner or controlling shareholder – to define the company’s overall objectives and action framework, it is the Board of Directors that is responsible for orienting the entrepreneurial strategy based on the guidelines set by the State.

Secondly, the State may be absent in granting the Boards full responsibility and authority to strategically steer the enterprise, control the Senior Management and oversee key issues of the company. In this case, improper action on the part of the State may diminish the Board’s scope of action or independence.

**Regarding the Ownership – Direction relationship:** In this relationship, two situations may occur that can invalidate the Board’s role.

1. The State or the representative of the ownership may get excessively involved in the definition of the company’s strategy. Although the State is acknowledged to be entitled – as owner or controlling shareholder – to define the company’s overall objectives and action framework, it is the Board of Directors that is responsible for orienting the entrepreneurial strategy based on the guidelines set by the State.

2. The State may be absent in granting the Boards full responsibility and authority to strategically steer the enterprise, control the Senior Management and oversee key issues of the company. In this case, improper action on the part of the State may diminish the Board’s scope of action or independence.

**Regarding the Direction – Senior Management relationship:** In the same line of the practice that establishes independence of positions between the Chairman of the Board and the Executive President, the definition of the Board’s functions seeks, on the one hand, to prevent the directing body from assuming operational functions and tending towards co-management, thus invading aspects which pertain to the Senior Management; and, on the other hand, for it to have enough empowerment and legitimacy so as to exercise control and oversee the Senior Management.

In some countries of Latin America, there is a strong link between the management and the ownership function – or directly with the government – favored largely by the legal power granted to the incumbent authorities to directly appoint the Executive Presidents of SOEs. In these cases, the Executive President of the SOE tends to report directly to the representative of the ownership or to the government, thus “invalidating” the role of the Board of Directors (OECD, 2011).
Other Considerations on Boards of Directors

So far, reference has been made to the challenges and characteristics distinctive to the Boards of Directors at SOEs. There are, nonetheless, other dimensions of analysis for Boards that corporate governance addresses, which allow these bodies to be strengthened and ensure that they perform their role effectively. Likewise, such good practices apply to the case of state-owned companies. The aspects mentioned below will be developed in detailed as part of the findings and conclusions of this paper.

- **The dynamics of Board meetings.** Where a series of naturally complex activities and roles must be aligned, such as: efficiency in managing time at the meetings, guaranteeing the levels and quality of the information that the directors receive before the meetings, and the fulfillment of the members’ duties and responsibilities.
- **The creation of committees** to act as supporting bodies in the fulfillment of the Board’s functions, as well as their models of operation and harmonization with the Board.
- **The execution of processes covering induction, training and evaluation** of directors, as the main mechanisms to enhance their capacities and performance as a work team; and
- **The definition of competitive remuneration criteria** for the members of the Board.

Juggling the challenges and characteristics of SOE Boards is most definitively the main concern to achieve good corporate governance at State-owned companies. Therefore, the recommendations or practices put forward from a corporate governance view for SOE Boards aim to promote a professional, committed, informed and independent directing body.
CHAPTER 2

ABOUT THIS STUDY

This document is structured based on the consolidated results of the survey on "Effectiveness and Structure of the Boards of Directors at State-Owned Enterprises (SOEs), Latin America and the Caribbean 2016," the objective of which is to analyze the effectiveness and structure of SOE Boards in countries across Latin America and the Caribbean which are members of CAF, with the aim of generating recommendations on public policy, as well as identifying the best practices to then be replicated in other SOEs.

Methodology

A 45-question survey was designed as the instrument to collect information, addressing the following areas of analysis:

i. Characterization of the company
ii. Board composition and size
iii. Directors' profile
iv. Fulfillment of the Board's role and participation in decision making
v. Supporting Committees of the Board
vi. Operational aspects of Board meetings
vii. The roles of the Chairman and of the Secretary of the Board
viii. Appointment process for directors
ix. Board induction and training
x. Remuneration of directors
xi. Board evaluation process
xii. Management of conflicts of interest at the Board
**Work Team**

The study was conducted by CAF – Development Bank of Latin America, with the support from corporate governance consulting firm Governance Consultants S.A. - www.governanceconsultants.com.

**Participating Companies’ Profile**

The survey was taken by 50 public companies that voluntarily completed the questionnaire between April and September, 2016. These companies are representative of Latin America and the Caribbean and are located in 13 countries where CAF is present: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Panama, Paraguay, Peru, Trinidad & Tobago, and Uruguay.

The following is a general characterization of the companies that took part in this study:

### Table 1. Participating companies

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<td>ISA - Interconexión Eléctrica S.A. E.S.P</td>
<td>Electricity</td>
<td>Colombia</td>
</tr>
<tr>
<td>Company</td>
<td>Sector</td>
<td>Country</td>
</tr>
<tr>
<td>-----------------------------------------------------------</td>
<td>----------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Aeropuertos y Servicios Auxiliares S.A. de CV (ASA)</td>
<td>Others</td>
<td>México</td>
</tr>
<tr>
<td>Banco Unión S.A.</td>
<td>Finance/Insurance</td>
<td>Bolivia</td>
</tr>
<tr>
<td>Comisión Federal De Electricidad</td>
<td>Electricity</td>
<td>México</td>
</tr>
<tr>
<td>Instituto Nacional de Seguros</td>
<td>Finance/Insurance</td>
<td>Costa Rica</td>
</tr>
<tr>
<td>BB Gestão De Recursos DTVM S.A.</td>
<td>Finance/Insurance</td>
<td>Brasil</td>
</tr>
<tr>
<td>BB Seguridade Participações S.A.</td>
<td>Finance/Insurance</td>
<td>Brasil</td>
</tr>
<tr>
<td>Companhia Energética De Minas Gerais - CEMIG</td>
<td>Electricity</td>
<td>Brasil</td>
</tr>
<tr>
<td>Refinadora Costarricense de Petróleo S.A</td>
<td>Oil/Gas</td>
<td>Costa Rica</td>
</tr>
<tr>
<td>Administración Nacional De Navegación y Puertos</td>
<td>Industrial</td>
<td>Paraguay</td>
</tr>
<tr>
<td>COPACO (Compañía Paraguaya de Comunicaciones)</td>
<td>Telecommunications</td>
<td>Paraguay</td>
</tr>
<tr>
<td>Instituto Costarricense de Electricidad</td>
<td>Electricity</td>
<td>Costa Rica</td>
</tr>
<tr>
<td>Banco Nacional do Desenvolvimento Econômico e Social -</td>
<td>Finance/Insurance</td>
<td>Brasil</td>
</tr>
<tr>
<td>BNDES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trinidad &amp; Tobago Securities &amp; Exchange Commission</td>
<td>Finance/Insurance</td>
<td>Trinidad</td>
</tr>
<tr>
<td>Aeropuerto Internacional de Tocumen S.A</td>
<td>Transport/Logistics</td>
<td>Panamá</td>
</tr>
<tr>
<td>Point Lisas Industrial Port Development Corporation Limited</td>
<td>Others</td>
<td>Trinidad &amp; Tobago</td>
</tr>
<tr>
<td>First Citizens Bank Limited</td>
<td>Finance/Insurance</td>
<td>Trinidad &amp; Tobago</td>
</tr>
<tr>
<td>Subterrâneos de Buenos Aires S.E.</td>
<td>Utilities</td>
<td>Argentina</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors
Peru, Colombia and Argentina – in that order – have the highest representation in the study as per the number of participating companies; therefore, for some of the topics developed in this paper, explicit reference will be made to the results obtained in these countries.

Most public companies participating in the study belong to the finance & insurance sector (30%), the electricity sector (18%) and other sectors (16%).

The companies belonging to the airline sector (2%) and to the oil & gas sector (4%) are the least represented in the study.
Of the companies surveyed, 65% have the State as sole owner, whereas in 35% of the cases, the State acts as the controlling shareholder and, thus, shares ownership with other shareholders and investors.

Most public companies (90%) operate at a national level, while 6% are State-owned at a sub-national level (department or province), and the remaining 4% operate in a city or municipality.

It is not very common for the public companies taking part in this study to have a presence in the stock market. Only 35% of the companies are listed on stock exchange markets: 31% on the stock exchanges in their countries of origin and 4% on international stock exchanges.

Of those companies listed, the majority belong to the finance & insurance sector (44%), followed by the electricity sector (31%), and then the utilities, oil & gas, transport & logistics and other sectors (6% in each case).

In addition, there are enterprises that correspond to local development banks.
CONSOLIDATED RESULTS OF THE STUDY: ANALYSIS BY TOPIC

Building Boards of Directors that are professional, effective and able to establish strategies and create value is the great challenge SOEs face. The best Boards of Directors do not limit themselves exclusively to fulfilling fiduciary responsibilities – diligence and loyalty – but take on a more active role in the collective construction and in providing information on a wider range of matters. This perspective has been called the "performance" approach by OECD (2013).

Even though there is no one standard or benchmark for effectiveness of SOE Boards from a corporate governance point of view, it is acknowledged that factors such as work team dynamics, workload, remuneration, Board size and structure, performance of committees, the role played by the Board and its Chairman, among others, may determine not only the Board’s effectiveness but also its contribution in terms of value.

An analysis on Board team dynamics is presented below. Each one of the factors and areas of analysis that determine the effectiveness of Boards will be developed in more detail throughout this paper.

Team dynamics

Considered individually, each director’s behavior and culture significantly influence the efficiency of the Board as a collegiate body, as it is the directors who, through their grouping or team dynamics, create a certain work environment in which they carry out their duties.

According to OECD (2013), the Boards of Directors of SOEs can be classified into four categories based on their team dynamics (Table 2):
Table 2. SOE Board classification as per team dynamics

<table>
<thead>
<tr>
<th>Type/function</th>
<th>The conduit board</th>
<th>The subjugated board</th>
<th>The effective board</th>
<th>The symbolic board simbólico</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision-making power</td>
<td>Board functions as an extension of a governmental department</td>
<td>Approves without contest or consideration Does not consider alternatives</td>
<td>Board makes performance-related decisions</td>
<td>Circumvented and powerless Not consulted on decisions by either management or owners</td>
</tr>
<tr>
<td>State vs. Company orientation</td>
<td>Focus on state expectations versus needs of the SOE</td>
<td>Limited strategic focus Relies on information fed by executives</td>
<td>Strategic focus</td>
<td>Unable to influence orientation</td>
</tr>
<tr>
<td>Relationship with executive management</td>
<td>Limited role of non-executive board members Relays directions given by Ministers</td>
<td>Limited role of non-executive board members Dominated by executives</td>
<td>Board is actively overseeing management Significant role for non-executive directors</td>
<td>Not privy to key discussions between owners and management with all decisions taken by owners</td>
</tr>
<tr>
<td>Value adding</td>
<td>Compliance / conformance checking</td>
<td>Does not see its role as adding value</td>
<td>Value adding with visible board influence and presence</td>
<td>Lack of recognition, influence and impact</td>
</tr>
</tbody>
</table>

Taken from “Boards of Directors of State-Owned Enterprises: An Overview of National Practices, 2013”
i. The conduit Board, which runs the SOE as an extension of a
government area or department and passes on instructions
received from the representatives of the ownership
function;
ii. The subjugated Board, which is dominated by a powerful
Executive President and has a limited strategic focus;
iii. The effective Board, which makes decisions related to the
SOE’s performance and is focused on strategic matters; and
iv. The symbolic Board, which is not involved and has no
capacity to influence the SOE’s strategic orientation.

The following analysis on the structure, effectiveness and
governance of SOE Boards in Latin America and the Caribbean,
as well as the reference to corporate governance practices and
recommendations, is made from the perspective of “Effective
Boards” – i.e. strategic, non-executive Boards with a great
capacity to add value to the SOE and its stakeholders.

Topic 1. Composition of the Board of Directors

One traditional characteristic of SOE Boards has always been
the greater presence of direct representatives of the State (civil
servants) acting as directors (in some countries by legal or
regulatory mandate).

The problems that arise around the appointment of a
considerable number of civil servants as directors of SOEs lie in
the possibility that they may receive direct instructions from the
political circles, thus eluding the opportunity for decisions to be
made by means of discussions within the Board and causing
significant weakening of corporate governance and public
management. Therefore, the appointment of “directors for
the State” who act as custodians of the government should be
avoided as much as possible, so that decisions are made by,
and communicated to, the Board of Directors as a whole acting
as a collegiate body.

In terms of Board composition, the challenge SOEs face is how
to balance the presence of civil servants and representatives
of other sectors through independent members and,
consequently, how to mitigate the SOE’s dependence upon the
ownership function exercised by the State.

According to OECD (2013), there is a significant dependence
on the ownership function when the Board is made up
exclusively of State representatives, whereas Boards composed
of independent directors are considered less linked to the
ownership function (non-State). Figure 2 presents how the
Board composition determines its level of dependence on the
ownership function.
There are intermediate levels for the composition of SOE Boards, where the following participate:

- Other State directors, who by law or statutes are appointed to represent the governmental interest. These directors can be chosen from the private sector or from the academic world, or can even be civil servants, and are appointed to act in the interest of the State.
- Directors chosen discretionally by the ownership function or by the State, but who are not specifically commissioned to represent the State.

According to the results of the study, 74% of the surveyed companies state that they have external members on their Boards, i.e. people who are not officers or employees of the company. External directors are individuals who, due to their personal or professional circumstances, cannot be qualified as independent – in other words, they may be civil servants or contractors of the shareholding government. However, in
certain countries, the law sets forth that only a civil servant can be a Board member. This, for example, is the case of Argentina.  

50% of the Boards at SOEs report that they include independent members in their composition. Independent members are considered to be those individuals with recognized professional prestige who can contribute from their experience and knowledge to the running of the company and whose relationship with the company, its shareholders or owner, directors and members of the Senior Management is circumscribed exclusively to their condition as members of the Board.

According to CAF’s Guidelines for a Latin American Code of Corporate Government (2013), although the definition of independent director may vary from country to country, there are a few general criteria or requisites that must be met in order to be considered independent, and they apply to any definition:

i. Not to have any work or business relationship with the SOE or with other SOEs under the State’s scope.
ii. Not to have any work or business relationship with the other shareholders of the SOE or of other SOEs under the State’s scope.
iii. Not to have a kinship relationship with the shareholders, members of the Board and the Senior Management of the SOE or of other SOEs under the State’s scope.
iv. Not to have a kinship relationship with executives or officers at any level of the State as owner.
v. Not to receive from the SOE, from other SOEs, or from the State as owner, a remuneration other than that earned as a member of the Board.
vi. Not to be, or to have been, an External Auditor of the SOE or of other SOEs under the State’s scope.

On average, the percentage of independent members per Board of Directors is 53%.

In 11 of the 13 countries considered in the sample there is, at least, one enterprise with independent members on its Board of Directors. The participating companies in Uruguay and Ecuador have not included this category within their composition.

Based on the sample, Peru, Colombia and Mexico are the countries with the largest number of companies with independent members on their Boards. In the case of Peru and Colombia, this result is directly proportional to the participation of their companies in the study (see Graph 1. Participation by country). In Mexico, all the participating companies have, at least, one independent member on their Board of Directors.

The companies belonging to the telecommunications, electricity and transport & logistics sectors are the ones that show the most compliance with this practice. All the companies belonging to the telecommunications sector that took part in the study have independent members on their Boards, while 78% of the participating companies belonging to the electricity sector and 67% of those in the transport & logistics sector have independent members on their Boards. The utilities sector, on the other hand, is the one which has least implemented this practice, as only 17% of the participating companies in this sector have independent members on their Boards.

Only 32% of SOEs have executive members on their Board of Directors, i.e. individuals who at the same time are officers of the company. The presence of executive members on the Boards of companies that are 100% owned by the State is higher (65%) than on Boards of SOEs where the State acts as majority shareholder and thus shares ownership with other shareholders (29%).

7 6% of SOEs gave no answer.
From the point of view of good corporate governance practices, and in line with the standards put forward by CAF, SOEs must consider the existence of different categories of directors in their directing bodies. SOEs should avoid appointing executive directors linked to the company’s day-to-day management and incorporate a larger number of independent directors, with the purpose of enhancing independence and accountability in the decision-making processes, as well as increasing the company’s experience in competitive markets given the growing wave of incursions by public companies into these markets.

A greater presence of independent members on the Boards of SOEs is founded on some guidelines given by OECD (2011) on the need to compose Boards of Directors in such a way that they are able to exercising objective, independent judgment and that they are protected against improper, direct political interference.

Even the countries belonging to OECD have come to consider as a good practice that the directors of public companies should not be directly linked to the executive power (Ministers, Secretaries of Office and their close associates).

The existence of independent members on the Board of Directors is one of the corporate governance practices with the greatest local and international visibility. Such independent members emerge in an international context to represent diffuse shareholders and contribute to higher levels of independence regarding management and the ownership function, as well as to ensure the representation and protection of other stakeholders. The definition of independent directors has progressively been included in corporate and stock market legislation around the world as an instrument to safeguard listed companies from criticism by stakeholders with regard to their administration and management, and to lean towards decision-making processes which are based on the shareholders’ general interest. This is especially relevant in the context of SOE Boards (Bernal, Samboní; 2015).

It is expected that, with the presence of Independent members on the Boards of Directors, the Boards’ levels of experience and expertise in the entrepreneurial field will be enhanced, the SOEs’ long-term vision as executors of public policy will be consolidated, and the companies will be managed in an efficient manner.

What the experience of SOEs in OECD countries shows – as well as the experience of Latin American SOEs – is that it is currently uncommon to have Boards of Directors mostly composed of executive directors or representatives of the public sector.

Regardless of the origin of the members on the Board (civil servants or independent members), the State should choose as directors individuals who meet the appropriate level of competency to carry out their duties.

Therefore, directors coming from the public administration must have the same obligations and responsibilities as the rest of the Board members, and act in the interest of the public company and of all its shareholders.

Likewise, as in the case of private capital companies, the composition of SOE Boards must ensure symmetry with its capital structure and respect the rights both of the State as owner and of the other shareholders regarding the election and removal of directors. In terms of Board composition, the results obtained in the study are mostly well aligned with the corporate governance practices recommended in this regard.
The existence of independent members and the scarce presence of executive directors at some of the surveyed SOEs is proof of a greater awareness and commitment – on the part not only of the companies but also of the State acting as owner – to achieve higher levels of objectivity, autonomy and independence in the entrepreneurial decision-making processes that devolve upon the Board of Directors. This, in turn, allows for the mitigation of political- and/or electoral-related risks inherent to State companies, which often materialize through improper or excessive interference of the State in the direction and management of the companies.

Nevertheless, SOEs across the region should continue with a transformation process whereby the presence of independent members on the Board of Directors is strengthened. For SOEs that do not as yet have independent directors, it is hoped that they will represent, at least, one third of their members; and for companies that currently do have independent members on their Boards, it is hoped that their participation over the next few years will surpass 40% of their members.

Most SOE Boards are made up of between 3 and 5 members (56%). Boards of Directors with a large number of members, i.e. over 13 members, are hardly represented in the sample. On average, Boards of SOEs are composed of 7 members, ranging from 3 to 15 directors. The countries with the highest average number of members on their Boards are Mexico and...
Panama; whereas Uruguay has the smallest Boards within the sample, with 3 directors on average.

The Boards of companies operating in the electricity and oil & gas sectors are typically composed of the highest average number of members, namely 8 in each case.

Determining the right size for the Board of Directors is another key factor to its efficiency. There is no exact number of members for SOE Boards, nor is it appropriate to recommend such a number. However, it is important to point out that Boards that are too large (with over 11 members) may hinder the deliberation and decision-making processes and lack a clear direction, while Boards that are too small (with fewer than 5 members) may complicate the very exercise of corporate governance.

According to OECD (2013), smaller Boards of Directors allow for true strategic discussion and are less prone to becoming paper bodies.

Table 3 shows the composition of Boards of Directors at SOEs in 26 countries belonging to OECD. According to the results in the table, a significant number of countries (50%) consider that the optimal size for the Board of Directors is between 5 and 8 members.

### Table 3. Maximum Board size in OECD countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Maximum size</th>
<th>Minimum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>20</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>-</td>
<td>12</td>
</tr>
<tr>
<td>Brazil</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Canada</td>
<td>12 (maximum)</td>
<td>9</td>
</tr>
<tr>
<td>Chile</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Denmark</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Finland</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>France</td>
<td>18</td>
<td>9</td>
</tr>
<tr>
<td>Germany</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Greece</td>
<td>7</td>
<td>-</td>
</tr>
<tr>
<td>Hungary</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Israel</td>
<td>12</td>
<td>-</td>
</tr>
<tr>
<td>Italy</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Korea</td>
<td>15 (informal)</td>
<td>-</td>
</tr>
<tr>
<td>Latvia</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td>Mexico</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>
A reasonable number of Board members for Latin American SOEs could be between 5 and 7; in the case of larger companies with complex business structures, the recommendable number of Board members would be between 9 and 11.

According to the results obtained, 78% of the Boards are composed by an odd number of members. From the perspective of the good corporate governance practices put forward by CAF (2013), this facilitates deliberation and decision making for Boards of Directors.

Overall, it is expected that the complexity of the company and the needs of the directing body are taken into account when determining the number of directors, in such a way that Boards will:

i. Represent the company’s shareholders; in other words, there should be consistency between the company’s ownership structure, the rights granted to the shareholders to nominate directors, and the composition of the Board;

ii. Act as true collegiate bodies and be able to fulfill their duties and responsibilities; and

iii. Operate appropriately through committees set up to study issues in depth.

### 1.3 Substitute Board members at SOEs

<table>
<thead>
<tr>
<th>Country</th>
<th>Maximum size</th>
<th>Minimum</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>Norway</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Portugal</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Sweden</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Turkey</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

The table above shows the recommended maximum and minimum size of Boards of Directors in various countries. The recommended size ranges from 2 to 11 members.

Based on the sample, Colombia, Mexico, Argentina, Ecuador, Bolivia, Brazil and Costa Rica have at least one Board of Directors with substitute members.

Although the concept of substitute members was conceived to help quorum formation on Boards of Directors, in practice, numerous entrepreneurial experiences have determined that the existence of substitute directors implies increasing – in
an inappropriate way – the size of the Boards (doubling the number of directors) and hampering informed decision-making when they do not regularly participate in meetings. In general, institutions like CAF do not consider it convenient that substitute members should be appointed on the Boards of any kind of company. At some SOEs of the region, however, this scheme persists due mainly to compliance with a legal mandate.

1.4 Parties responsible for electing directors at SOEs

Election of directors through a public institution that represents ownership is the predominant practice in the study, with 64% of the companies following this method. Of these companies, 78% are solely owned by the State (100% State-owned). This practice is due to the powers conferred by legal mandate, be it on the State as owner or on the government in power, to elect directors at public enterprises falling under its scope of application.

Only 40% of the Boards are appointed through General Shareholders’ Meetings. Worthwhile mentioning is that most Argentinean and Colombian companies taking part in the study (83% and 75%, respectively) elect their directors in the framework of the Shareholders’ Meeting.

Overall, it is recommended that the Boards of Directors be constituted comprising an odd number of members who represent the company’s ownership structure and attend to its business and needs. Inasmuch as possible, the existence of substitute members should be eliminated.
Topic 2. Election of Directors and Terms of Office

2.1 Election periods for SOE directors

At a consolidated level, there is no consensus regarding election periods for Boards of Directors at SOEs. The most representative cases are companies that elect their directors for 2-year periods (26%) and for more than 4 years (26%).

In terms of countries, Mexico, Panama and Uruguay appoint their Boards of Directors for longer periods – every 5 years on average. Colombia, Ecuador and Brazil do so for the shortest terms, namely periods of between 1 and 2 years.

Even though there is no explicit reference from the field of corporate governance regarding election periods for Board members, analyzing this issue becomes important if there are high turnover rates of directors due to changing political/electoral dynamics.

When the election periods for directors are analyzed, what is important is to guarantee continuity and stability on the Board, especially in the case of independent directors. Ensuring stability and, thus, low turnover rates for independent directors is less complex than in the case of civil servants, as the latter may rotate more frequently as a consequence of their leaving their positions within the public administration or of changes in government terms.

2.2 Staggered renewal of the Board of Directors

In terms of countries, Mexico, Panama and Uruguay appoint their Boards of Directors for longer periods – every 5 years on average. Colombia, Ecuador and Brazil do so for the shortest terms, namely periods of between 1 and 2 years.

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As mentioned before, one of the main mechanisms to bestow continuity on the work of the Board of Directors and protect the companies from changes produced by political cycles is the staggered renewal of directors. However, this practice still shows low levels of implementation in the region’s countries taking part in the study, as merely 31% report applying it. The SOE Boards that have implemented staggered renewal processes have directors serving periods of at least 2 years and are predominantly made up of external members (80%).

Mexico is the country that most uses staggered elections to choose their directors (75% of the cases).

In terms of sectors, implementation levels are still low. Proportionally, the utilities, finance & insurance and electricity sectors are the ones that most use a staggered system to appoint their directors, with 33% in each case.

Even though the staggered process initially met resistance among SOE actors, especially among the representatives of the ownership, awareness has been raised on the importance of this mechanism in order to mitigate risks related to entrepreneurial sustainability. These risks correspond to a basic logic: any organization that has to completely reinvent its direction structures every three or four years faces serious risks to efficiency and sustainability (Bernal, Samboni; 2015).

The difficulty in implementing this practice lies, to a large extent, in the importance held by the appointment of directors under the scheme of “positions of trust”, which causes the appointment of directors in public companies to coincide with the election terms of the incumbent authorities – and even shorter periods – resulting in high turnover rates among directors at SOEs.

In the case of SOEs, the establishment of staggered Boards of Directors will depend exclusively on the willingness of the State as owner to acknowledge that, through this practice, the management of the companies can be improved by means of directing bodies with higher levels of professional independence in the decision-making processes and, consequently, on the creation of a sound governance culture vis-à-vis electoral changes that entail recurring changes in the company’s strategy and direction.

2.3 Permanence of directors

Internal and external directors of SOEs are elected predominantly for periods of between 2 and 4 years (71% and 59%, respectively). The existence of independent directors causes the terms of office to increase. Although directors in general – regardless of their category – may be reelected for several periods or indefinitely, it is recommended that a limit should be set for how long independent directors occupy the position, since serving as director for too many years can precisely subtract independence from their performance.

In many OECD countries, terms of between 3 and 5 years are established for independent directors to remain in their positions, and they can only be dismissed with just cause.

To manage this risk, many companies at an international level have started to set up strategies for the succession of directors by defining succession policies which will allow for planned, anticipated identification of the profiles required on the Board; mechanisms for the election/substitution of new directors in case of cessation, resignation, disability or death; as well as
Within the framework of the succession policy for directors, it is up to the Appointments and Retributions Committee, or otherwise the Board of Directors itself, to make assessments and recommendations to the State and other shareholders of the SOE as to how long the directors should remain in office, and to determine reasonable renewal periods.

Graph 11. Average permanence of directors

Between 1 and 2 years

- Internal Directors: 29%
- External Directors: 27%
- Independent Directors: 48%

Between 2 and 4 years

- Internal Directors: 71%
- External Directors: 59%
- Independent Directors: 14%

More than 4 years

- Internal Directors: 10%
- External Directors: 43%
- Independent Directors: 27%

Total: 72 answers*

* The sample corresponds to the number of companies that have the referenced category of Board members: 14 companies with internal directors, 37 companies with external directors and 21 companies with independent directors.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean
**Topic 3. Profile of the directors**

**3.1 Profile of SOE directors**

Proper fulfillment of duties and responsibilities is closely related to the appointment process, profiles and composition of the Board of Directors. In fact, one of the most effective mechanisms to protect the Board from improper political intervention is to rely on suitable enough individuals.

Not having defined profiles for directors, as is the case in 46% of the SOEs participating in the study, may make it easier for the appointment process to be guided by political criteria instead of by technical and professional criteria.

The suitability of the directors will help SOEs to drive changes that might be necessary to improve the company’s competitiveness.

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**Graph 12. Director profile**

- **54%** of the companies have defined a profile for their directors.
- **48%** of the companies that evaluate their Boards use the results as input for the next director nomination process.
- **21%** of the companies that evaluate their Boards use the results as input for the next director nomination process.
- **31%** of the companies have established a profile for the appointment of their directors, 67% evaluate their Boards; and, of this percentage, 44% use the results of the Board.

---

**3.2 Evaluation as input for the nomination of directors**

**Graph 13. Evaluation as input for the nomination of directors**

- **54%** of the companies have defined a profile for their directors.
- **48%** of the companies that evaluate their Boards use the results as input for the next director nomination process.
- **21%** of the companies that evaluate their Boards use the results as input for the next director nomination process.
- **31%** of the companies have established a profile for the appointment of their directors, 67% evaluate their Boards; and, of this percentage, 44% use the results of the Board.

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*Data obtained based on 29 companies that evaluate their Boards of Directors.*

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.
performance evaluation as input for the process of nominating directors.

11% of the SOEs, though they do not have a defined profile for the appointment of their directors, take into account the evaluation results during the process of composing the Board of Directors.

From the view of good corporate governance practices, in order to have a suitable profile to rely on, SOEs are recommended to establish a series of requirements in their bylaws, laws or regulations to elect ‘good directors’, as well as additional requirements for independent directors. These requirements must take into consideration specific skills, such as technical expertise and years of entrepreneurial experience in matters relating to the company’s business and sector, recognition, career, reputation, as well as teamwork skills.

Boards of Directors are expected to have, at least, members who are knowledgeable and experienced in legal, financial and strategic matters. In any case, SOE directors must have the appropriate skills and expertise in order to contribute effectively to deliberations and respond to the needs of the company.

For independent directors, besides the general requirements established, criteria should be defined which must be met in order to be considered independent. Generally, independence criteria are set forth by the law of each country and by the company itself, which is why there is no unified definition.

The Board of Directors itself, because of its knowledge of its own dynamics, is considered the most appropriate party to inform the State as owner and the other shareholders about its needs for new profiles according to the dynamics of the business. Therefore, the results of its evaluation become an important input not only to determine the continuity or reelection of some members but also to identify which areas of knowledge are to be enhanced or what needs of the Board are to be addressed.

Board evaluation allows for an opinion to be formed on the general functioning of the Board of Directors, the desirable attributes it should possess, and the needs that might be addressed through future director nomination processes. In order for the evaluation to provide useful feedback for Board nomination processes, it ought to be aimed at evaluating the Board of Directors’ performance – instead of focusing merely on operational elements, such as attendance and participation rates at meetings – and a process must be in place whereby the owners or entities responsible for Board nomination are informed about the results obtained.

Using the Board evaluation process as Input in the nomination of its members constitutes a sound mechanism to make Board succession-related decisions and to promote development activities for directors and actions to address skills/competencies lacking among Board members.
Topic 4. The role of the board of directors and its participation in decision making

4.1 The role of SOE Boards

Boards of Directors should focus on issues relating to strategic orientation, control and supervision, which includes overseeing the performance of the Executive President and Senior Management team, as well as to the effectiveness of the company’s risk and internal control system.

At least 70% of the companies find that there is a high level of involvement on the part of the Board of Directors in defining strategy and overseeing the Senior Management and the company’s risk and internal control system.

The area where the Boards seem to be less involved is the follow-up on the Risk and Internal Control System (only 27% of the companies claim they are).

All the SOEs in Uruguay, Bolivia, Trinidad & Tobago, Panama and Ecuador, as well as those belonging to the transport & logistics sector, consider that the level of involvement on the part of the Board is high in all three areas referred to in Graph 14. In the other countries, a much more self-critical attitude was shown with regard to how the Boards might contribute to these aspects of the company.

A recent survey conducted internationally by McKinsey (2016) on Boards of Directors shows that there is a need to continue increasing the time dedicated by the Board to strategic issues. The Board’s involvement in the SOE’s strategic issues is limited to providing the overall strategic framework, offering an external vision which complements the strategic alternatives presented by the Senior Management and, lastly, defining the strategic path for the SOE. At SOEs that execute public policy, strategy definition must be coordinated with the State. It is therefore indispensable that there be clarity regarding the contributions made by the State and by the Boards to the SOEs’ strategic processes and, so, align visions and generate the best possible results by optimizing efforts (Bernal, Samboní; 2015).

As a general rule, SOE Boards are to establish a clear division between the functions of ownership, administration and day-to-day management. Appropriate separation of these functions prevents conflicts of interest and disincentives from arising, and
Effectiveness and Structure of Boards of Directors at State-owned Enterprises in Latin America and the Caribbean

Figure 3. The role of the Board in a three-layer governance structure

Under this scheme, the Board of Directors is ultimately responsible for watching over the SOE’s performance as a whole. In order to achieve this purpose, the Board must essentially act as an intermediary between the ownership function and the regular business function, and enjoy full authority, autonomy and independence for decision making.
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The great challenge for SOE Boards is precisely focusing their functions towards performance and value adding, and keeping away from functions related to what OECD (2013) has called the conformance role, which means they must focus their role towards strategic guidance and performance instead of exclusively conforming to the established standards and checking that the guidelines given by the owner are being complied with.

The Board’s conformance role is generally revealed in functions related to budgeting and variation analysis of the company’s financial information and plans, at the cost of matters connected with effective implementation of the entrepreneurial strategy. Concentrating excessively on the conformance role may give the directors themselves, as well as the company’s owners, a false sense that they are fulfilling their fiduciary duties.

A rightly constituted and properly managed Board of Directors adds value if it helps the Senior Management to make better decisions. According to OECD (2013), the characteristics of a value-adding Board are related to the following skills:

i. Responsiveness to the Senior Management’s need for guidance.

ii. Capacity to offer the company strategic orientation.

iii. Capacity to analyze issues systematically.

iv. Ability to act objectively.

v. Willingness to encourage and listen to in-house expertise.

vi. Vision for innovation and the long-term future.

vii. Orientation towards economic and social results.

Ultimately, adding value means further and better developing interaction with the executive management and working with the owning entity in a structured way.

4.2 Participation of the Boards of Directors in appointing the Senior Management

Graph 15. Appointments by the Board of Directors

<table>
<thead>
<tr>
<th>Position</th>
<th>The Board is responsible</th>
<th>The Board is not responsible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive President (General Manager / CEO)</td>
<td>63%</td>
<td>37%</td>
</tr>
<tr>
<td>Second line of management (VPs or Managers)</td>
<td>67%</td>
<td>33%</td>
</tr>
<tr>
<td>Internal Auditor (Head of Internal Control or equivalent position)</td>
<td>55%</td>
<td>45%</td>
</tr>
</tbody>
</table>

Total: 146 answers*

* Data obtained based on 49 companies that answered the questions regarding the Board’s responsibility in appointing the Executive President and the Internal Auditor, and on 48 companies that answered the corresponding question for the second line of management.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.
In order for the Board to be able to effectively carry out its supervising role with regard to the company’s regular course of business and the Senior Management’s performance, it is fundamental that it have the power to appoint and remove the Executive President of the company.

According to the results shown in Graph 15, SOE Boards are predominantly responsible for appointing the management team and the Executive President, which proves there is greater empowerment granted to the Boards of SOEs in the region for the fulfillment of their duties.

There is no “ideal” model for the appointment of vice-presidents or of the Senior Management team, so this responsibility can be shared between the Board of Directors and the Executive President. In the case of the Internal Auditor, however, this person must be appointed by the Board.

Only 55% of SOE Boards are responsible for appointing their internal auditors, which is a low percentage compared to the power conferred on the Boards in countries across the region to appoint the SOEs’ Executive Presidents and the Senior Management teams.

The Board’s responsibility for appointing and dismissing the Internal Auditor lies in the nature itself of the position and its duties. From the point of view of corporate governance, the Board of Directors relies on the Internal Auditor to carry out its functions in terms of: i. overseeing the integrity and reliability of the internal information and accounting systems, ii. ensuring the existence of a sound internal control environment, and iii. providing objective assurance to the Board regarding the effectiveness of the company’s day-to-day management. Therefore, the internal audit function cannot depend functionally on, or account to, the Executive President.

Accordingly, it is also up to the Board to monitor the efficiency and independence of the Internal Auditor’s functions.

In terms of countries, all the SOEs in Chile and Trinidad & Tobago have entrusted the Board of Directors with the responsibility of appointing and removing the Executive President and the Internal Auditor. As for sectors, the Boards of SOEs belonging to the telecommunications sector are the only ones responsible for appointing and removing all of the Senior Management positions referred to in Graph 15.
**Topic 5. Frequency and duration of board meetings**

**Graph 16. Frequency and duration of Board meetings**

In consolidated terms, there is high dispersion regarding the frequency with which Board meetings are held at Latin American SOEs.

42% of the Boards meet weekly and biweekly, 34% meet monthly, and the remaining 22% meet less frequently (quarterly and bimonthly).

The average duration of Board meetings is 3 hours and 30 minutes. Board sessions that take place weekly and biweekly have an average duration of 3 and 4 hours, respectively – a rather high average duration time considering the frequency with which these meetings are held. On the other hand, Boards of Directors that meet quarterly and bimonthly do so for 3 hours on average – a low average considering the time elapsed between one meeting and the next.

It is not easy to recommend a reasonable number of Board meetings a year, as it depends on multiple factors, such as those related to the structure and complexity of the company’s affairs and the sector it operates in, the Board's duties and size, the size of the company, and other factors connected with the role the Board plays.

Most standards or studies existing on the operational aspects of Board meetings address the time (days) that the directors devote to Board work per year, and not how frequent or long the meetings are.

According to OECD (2008), directors are expected to work, at least, between 10 and 25 days a year. Depending on the size of the SOE, the time directors dedicate to carrying out their job might be between 40 and 90 days a year. If special situations or circumstances — such as a crisis — arise, time dedication can be greater.

Based on a worldwide survey conducted by McKinsey (2016), it is concluded that the members of the most effective Boards spend an average of 41 days a year on Board work and state that they do not wish to devote more time to it, whereas the members of the least effective Boards spend an average of 28 to 32 days on Board work and would be willing to work 5 more days. According to McKinsey, the time required to do the job well is usually more than what directors expect initially.
A reasonable standard for the number of Board meetings at Latin American SOEs could follow the same line as the listed companies and financial entities, i.e. between 8 and 12 regular meetings a year, of which Boards are expected to devote at least 1 or 2 to strategic matters.

Holding 4-hour long Board meetings weekly or biweekly fosters the constitution of Boards of Directors that are focused on co-management, i.e. of Boards that are highly involved in operational affairs belonging to the regular course of business, while Board meetings held quarterly and lasting 3 hours on average hamper the Board’s effectiveness and, thus, the fulfillment of its functions in terms of strategic guidance and control.

Operational involvement, or co-management, on the part of the Boards is one of the great problems and challenges SOE governance models face. A more strategic – and less operational – role is fundamental in order to add value to the companies and to suitably use the directors’ talent and time (Bernal, Samboni; 2015).

Monthly meetings lasting around 4 hours entail additionally devoting 4 hours to the preparation and previous review of information. This model should allow the Boards to address direction issues sufficiently. Chile, Ecuador, Panama, Bolivia and Trinidad & Tobago are the countries where a larger number of Boards comply with this good practice.

At least 30% of Boards at SOEs belonging to the sectors of electrical power, others, finance & insurance, utilities and transport & logistics hold monthly meetings, with a predominance of this frequency in the latter three.

SOEs are recommended to establish the periodicity of meetings and their conduction procedures in the Board Regulations, among other provisions, with the purpose of regulating the duration of the work sessions.

How the Board meetings are organized (frequency and duration) considerably influences the capacity of this body to carry out its duties. Whether the Board of Directors works effectively or not will largely depend on proper meeting planning and on the approach taken when developing the matters on the agenda.

The Annual Work Plan is the principal instrument Boards of Directors rely on in order to plan and determine the number and duration of regular Board meetings a year, as well as the issues they are to address during the year (see Topic 6. Operational Aspects of Board Meetings).
**Topic 6. Operational aspects of board meetings**

As has occurred in the private sector, expectations regarding the role played by Boards of Directors at SOEs have become considerably higher in recent years; Boards are increasingly expected to have broad, long-term perspectives so they can anticipate events and act accordingly. This has brought about an increase in the directors’ workload and, thus, a need to improve their operational models.

A director’s workload is not only limited to the number and duration of Board meetings (looked at in more detail in the previous section) but also includes the time invested in preparing information before the meetings.

One of the most important mechanisms to keep the Board of Directors’ workload within reasonable limits is to make sure that their meetings are scheduled enough in advance, clearly stating the agenda and indicating fixed dates – hence the importance of establishing the Board’s Annual Work Plan at the beginning of each year, setting a specific schedule of meetings and the topics to be addressed by the Board at each meeting during the year.

Therefore, the Annual Work Plan reflects both the number and planning of meetings, as well as the complexity of the affairs the Board of Directors is to handle.

**6.1 Planning of Board meetings**

**Graph 17. Schedule and topics of Board meetings**

| **98%** of the companies have a meeting schedule including the topics to be addressed at each Board meeting. |
| Total: 50 answers |

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean

Almost all Boards of Directors at the SOEs participating in the study have a defined schedule of regular Board meetings including the topics to be discussed at each of the work sessions. The foregoing notwithstanding, special Board meetings may be held as often as necessary.

The Annual Work Plan is the main instrument on which Boards of Directors rely to guide their operational model. The Plan is to be defined at the first regular Board meeting of the year, based on proposals or recommendations made by the Chairman of the Board or by a supporting committee fulfilling this function.

Several criteria must be taken into account for the construction of the Plan; the functions assigned to the Board of Directors by the company’s Bylaws or Internal regulations, ensuring that the focus is on strategic matters and its non-delegable duties; the frequency and duration of meetings; the Board’s interaction with the Senior Management team for the presentation of the topics, and the role to be assumed
by the Board vis-à-vis the topics included in the Plan (get informed, approve and construct). Regarding this last aspect, the Board is expected to assume a role that is related more to constructing and approving than simply to getting informed about the matters to be addressed at the meetings.

The existence of this mechanism per se does not necessarily guarantee the best operational model for Board meetings, nor does it ensure that it will be fully complied with. Nevertheless, if the Annual Work Plan is indeed constructed using the criteria referred to above, it will allow the Board to fully carry out its duties, effectively manage time at the meetings, improve the quality of the analyses and definitions that arise at the meetings, and thus add value to the SOE.

### 6.2 Sending of information to the Boards

81% of the companies taking part in the study send information to their directors no more than 5 days in advance of meetings so they can learn about the items on the agenda which will be addressed at the meeting.

From a corporate governance point of view, the spirit of Board meetings should be to foster deliberation and decision making in an informed fashion, and not to merely be a space dedicated exclusively to providing directors with information. Therefore, all information and other documents related to each point on the agenda should be sent together with the calling to the meeting at least 5 calendar days in advance – a predominant practice at SOE Boards in Colombia, Argentina, Mexico, Uruguay, Bolivia and Trinidad & Tobago.

The purpose of this practice is to give directors enough time to fulfill their duty of studying, in advance of Board meetings, the information based on which they will have to deliberate and make decisions. Making Board meetings more effective therefore implies that the directors are able to get informed, participate and make decisions in a reasoned and justified manner.

It is the responsibility of the Secretary of the Board to send the rest of the Board members the information that will be considered on the agenda at the meetings; the Chairman of the Board, in turn, is responsible for making sure the information
is received with enough anticipation and that it is useful and of good quality.

SOE Boards from the sample corresponding to Peru, Ecuador and Costa Rica send information to their members mostly within a short term before a meeting (less than 3 days in advance), whereas Boards in Panama and Brazil do so with the most time in advance (between 6 and 10 days before a meeting).

Most Boards at SOEs belonging to the sectors included in the study send information supporting the items on the Board meeting agenda 3 to 5 days in advance, except for SOEs operating in the telecommunications and the transport & logistics sectors, which do so mostly less than 3 days before the meetings.

**Topic 7. The chairman of the board**

The Chairman of the Board is another crucial factor to promote Board effectiveness. The Chairman’s main task is to build a highly effective team, for which a specific set of skills is necessary, including leadership, ability to build and motivate teams, receptiveness to different perspectives and approaches, and conflict resolution skills.

In addition, the Chairman of the Board at SOEs is to serve as a channel of communication to build collaborative relationships between the State or the ownership function, the Board of Directors and the Senior Management, and must understand the business and ensure that all legal and statutory obligations of the SOE are fulfilled.

Finding a suitable person to take on the role of Chair of the Board is important. The selection process for the Board leader has been evolving from a non-structured, random approach to one that resembles the best succession practices for Executive Presidents at companies.

**7.1 Profile of the Chairman of the Board**

At 44% of the SOEs, the Chairman of the Board is a civil servant (external to the SOE). This is the predominant situation in countries like Colombia, Mexico, Panama, Paraguay and Ecuador, where legal provisions are in place that confer authority on the civil servant (given his position) to be a Board member and to chair the Board of Directors at public companies within the State’s scope. In some cases, the composition of the Board and the appointment of its Chairman is pre-established by the law.
In 18% of the cases, the position of Chairman of the Board and that of the company’s Executive President coincide. This practice is used predominantly by Boards in Argentina and Costa Rica, and entails a series of governance risks related to the loss of independence for the Board.

From a corporate governance perspective, the overlapping of these two positions poses limitations to the balance of power, the differentiation of roles, and the accountability mechanisms between the Board of Directors (direction) and the Senior Management (management).

It is generally expected that Boards of Directors act according to efficiency, independence and objectivity criteria when carrying out their duties; it is therefore convenient to ensure, through Board composition, that the positions of Chairman of the Board and of Executive President are occupied by different individuals.

Were there to be reasons that justify the fact that the position of Chairman of the Board coincides with that of Executive President, additional mechanisms should be put in place so as to avoid power concentration. One of the most effective mechanisms is to create the position of a Vice Chairman of the Board, to be elected from among its independent directors, who will assume functions related to the Board dynamics.

Even though the position of Chairman of the Board is expected to be held by one of its independent members, only 14% of the companies have adopted this recommendation, the Boards of Chilean SOEs being the ones who have implemented it the most.

This rule aims at strengthening the independence of the Board of Directors vis-à-vis the Senior Management and at enhancing the effectiveness in fulfilling its functions of supervision and control of day-to-day management, thus preventing the concentration of functions and powers within the company’s management team.

It is worthwhile pointing out that having independent Board members serving as Chairman of the Board is not a common practice from the point of view of sectors.
7.2 The role of the Chairman of the Board

Graph 20. The role of the Chairman of the Board

98% of Board chairmen fulfill their role of leading meetings and conducting debates.

Total: 50 answers

The Chairman of the Board now has a new role that requires a significantly larger time investment compared to other Board members, and should therefore be paid a higher remuneration.

Most SOEs taking part in the study (98%) have established the following as functions of the Chairman of the Board: leading meetings, conducting debates and focusing the discussion on strategic matters and other issues of importance to the company.

Indeed, the position of Chairman of the Board has become considerably strengthened in the last five years: from carrying out duties related to conducting Board debates and complying with formalities set forth in current legislation, the Chairman of the Board is now responsible for coordinating and planning the functioning of the Board, reviewing the Board’s performance, driving the company’s governance actions, acting as a liaison between the State and other shareholders and the Board of Directors, ensuring that the Board as a whole defines and implements the company’s strategic direction, and guaranteeing that it works effectively.
Topic 8. The secretary of the board

8.1 The role of the Secretary of the Board

According to what was reported in the survey, in at least 90% of the SOEs, the Secretary of the Board carries out the duties of recording in the minutes the discussions and decisions made in the context of Board meetings, and of ensuring compliance with regulations, internal rules, good practices and commitments assumed by the company.

Cases where the role of Secretary of the Board is not fulfilled can be seen at some SOEs of the sample located in Colombia, Argentina, Paraguay and Costa Rica.

Graph 21. The role of the Secretary of the Board

From the point of view of corporate governance, the Board of Directors must be able to refer to the Secretary of the Board on legal matters, so the latter should therefore be able to determine the legal validity of the agreements adopted within the framework of meetings.

Specifically, the functions to be carried out by the Secretary of the Board should include – besides those mentioned above – ensuring compliance with the formal and material legality of the Board’s actions, the requisites laid down for the calling of meetings and the decision-making process; supporting the Chairman of the Board in the fulfillment of his or her duties, and guaranteeing the revision and implementation of the SOE’s governance rules and procedures.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean
**Topic 9. Induction of directors**

**9.1 Board induction**

Board induction and training of directors are the two specific kinds of processes to be used for professional development and human-capital building when it comes to Boards of Directors, with induction being one of the most recognized and implemented practices among the companies surveyed.

Induction is a common practice across most OECD countries, although its format and content may vary depending on the country and the kind of company. Of the total sample of Latin American SOEs, 62% have formally established and/or currently implement an induction procedure for directors.

Of the sample, all of the SOEs located in Colombia, Panama, Costa Rica and Trinidad & Tobago provide induction to members of the Board. In contrast, SOEs in Argentina, Ecuador, Paraguay, Uruguay and Bolivia seem to completely neglect this practice.

Good corporate governance regards induction as a right of directors that are newcomers to the Board. It must take place within the first month of appointment and always before the first Board meeting the new director is to take part in, with the aim of providing new board members with an informed view of the company in the least amount of time.

**9.2 Areas covered during Board induction**

In at least 63% of the SOEs, Board induction covers areas that include growth prospects for the sector, content of corporate documents and operational procedures of the Board of Directors.

Induction programs are generally expected to, at least, go over information related to the company’s actual situation, its complexity and key issues, in order for directors to start their activities having sufficient information and a comprehensive view of the company’s current situation and growth prospects.

Moreover, the induction process must identify the needs of the new Board members. A less experienced member, for example, may chiefly need to have corporate documents as supporting material. During the induction session, these needs for further...
development must be explored, and a plan to implement training strategies to address them must be devised.

In some cases, the induction process can be run by the company’s Executive President. If possible, other members of the Senior Management team, such as the Legal Secretary and other Board members with the necessary experience, should also attend.

The methodology and the scope of the induction process may vary depending on the company’s complexity, and may therefore require a more systematic induction program including: formal meetings, courses and other events for further development, meetings with executive staff and other Board members, a program of visits to the company’s premises, and more extensive reading material.

**Graph 23. Areas covered during Board induction**

<table>
<thead>
<tr>
<th>Area</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate documents of the company</td>
<td>77%</td>
</tr>
<tr>
<td>Growth prospects for the sector the company operates in</td>
<td>63%</td>
</tr>
<tr>
<td>Functioning of the Board</td>
<td>63%</td>
</tr>
<tr>
<td>Other areas</td>
<td>3%</td>
</tr>
</tbody>
</table>

*Total: 30 answers*

* Data obtained based on a sample of 30 companies that answered this question, 29 of which offer induction.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean
**Topic 10. Ongoing training for board members**

**10.1 Board training**

In general, Board training processes are not mandatory in many countries, nor are they, in most cases, a common practice. From the perspective of corporate governance, providing training to Board directors is not necessarily a formal requirement. Nevertheless, companies are encouraged to implement training processes in order to foster and support ongoing professional development of Board members. Training may also be provided to committees to address specific aspects of their competence.

Board training processes have not become as popular among SOEs in countries within the region as induction procedures have. 44% of the SOEs have formally established and/or are currently implementing Board training and strengthening processes.

Of the sample, none of the SOEs operating in Paraguay, Uruguay, Bolivia and Brazil offer training aimed at Board members.

Some of the methodologies used for Board training include:

- Thematic training in the form of workshops where issues that demand a more in-depth analysis or a different approach on the part of the Board are addressed and discussed, and where experiences, knowledge and good practices can be shared and exchanged. Among the topics more commonly addressed are updates to financial standards and the company’s legal and regulatory framework. This methodology is one of the most used by companies.

- “Off-the-shelf” training programs, i.e. programs based on director certification or accreditation processes. Even though the actual benefits of implementing “off-the-shelf” Board training programs are less well documented in the case of Latin American SOEs than in the case of companies in OECD countries, these programs are generally thought to be among the most comprehensive and effective Board training methodologies.

- Interaction with outside experts (such as consultants or advisors), site visits, meetings with executives, and even work meetings on technical issues are all considered professional development processes.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.

Graph 24. Board training

- Do not implement Board training: 44%
- Implement Board training: 56%

Total: 48 answers
Effectiveness and Structure of Boards of Directors at State-owned Enterprises in Latin America and the Caribbean

The importance of providing Boards of Directors with regular training, regardless of the methodology used, lies in the need of keeping directors updated on the ever-changing characteristics and challenges of the sector or the economic and social contexts, issues which may have an impact on the company’s viability and which need to be dealt with in a timely manner.

The State, as owner, must foster ongoing professional development of SOE Boards operating within its scope, especially when technical training is needed.

A complement to Board Induction, training processes enable directors to improve their competencies and capabilities, properly fulfill the functions and duties that come with the job, and rely on specific, up-to-date information on SOE characteristics and challenges.

10.2 Areas emphasized during Board training

Of the SOEs that have formalized and/or currently implement training processes, a majority of them (73%) focus on improving corporate governance practices; at least 50% focus on strategy, the development of the company’s businesses, risk management, and internal and external control systems; and a small percentage (9%) have offered training in international accounting and financial standards, as well as insurance policies.

The fact that training to SOE Boards focuses primarily on corporate governance issues evidences the importance of corporate governance as a tool in guaranteeing companies’ sustainability and competitiveness, its relevance in organizational strengthening processes, and the greater awareness on the part of owners and officers of the need to manage their companies under the principles of efficiency, transparency and accountability.

Graph 25. Areas emphasized during Board training

<table>
<thead>
<tr>
<th>Area</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate governance</td>
<td>73%</td>
</tr>
<tr>
<td>Strategy and business</td>
<td>59%</td>
</tr>
<tr>
<td>Risks and controls</td>
<td>50%</td>
</tr>
<tr>
<td>IFRS and accounting policy</td>
<td>9%</td>
</tr>
<tr>
<td>Another area</td>
<td>9%</td>
</tr>
</tbody>
</table>

Total: 22 answers*

* Data obtained based on a sample of 22 companies that answered the question, 21 of which offer Board training.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean

Good practices mandate that SOEs provide training aimed exclusively at directors at least once a year within a dynamic, participative and interactive space other than the regular Board meetings. The topics and focus of the training sessions will depend on the company’s business sector, its growth prospects, the macroeconomic context, and the legal and regulatory framework. However, topics such as corporate governance, strategy and new business models,
risk management, and new accounting and financial policies are always relevant to the innovation and fulfillment of the Board’s functions and duties.

**Topic 11. Evaluation of the board of directors**

Board evaluation concerns all types of companies, and has become one of the most important corporate governance practices as it enables the Board of Directors as a whole, and its members as individuals, to enhance their performance and receive feedback on the fulfillment of their duties and the work done over a specific period of time.

**11.1 Evaluation of SOE Boards**

**Graph 26. Board evaluation**

- **Conduct evaluations**: 58%
- **Do not conduct evaluations**: 42%

Total: 50 answers

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.
58% of the participating SOEs state that they evaluate their Boards. Most of the SOEs located in Colombia, Chile, Peru, Mexico and Brazil conduct Board evaluations; in contrast, none of the SOEs operating in Ecuador, Uruguay, Bolivia and Costa Rica do.

In most sectors, a majority of SOEs conduct Board evaluations (except for SOEs in the utilities, telecommunication and other sectors).

Latin American companies in the private sector have more experience in Board evaluation than SOEs. According to the results published in 2015 by Governance Consultants – GCSA on Board evaluation in 40 private companies that are part of the Pacific Alliance, 85% of the companies evaluate their Board of Directors, with self-evaluation being the mechanism primarily used.

From the perspective of the State as owner and the rest of SOE shareholders, Board evaluation offers a systematic view of the composition and functioning of the Board.

In general terms, the implementation of a good Board evaluation process:

i. Makes Board members more aware of their role as directors;

ii. Offers the chance to identify and discuss points to be improved as a team;

iii. Optimizes time management and operational aspects at meetings, by making adjustments in terms of the issues on the Board agendas and their focus areas;

iv. Promotes reflection upon the way the Board and the Senior Management interact;

v. Raises awareness among Board members on their responsibility to protect the company’s interests and manage conflicts of interest; and

vi. Increases the Board’s contribution to value by enabling better decision making.

Board evaluation assesses the performance not only of the Board as a collegiate body, but also of its members on an individual basis and of the supporting committees set up within it; it also addresses the fulfillment of the roles of the Chairman and the Secretary of the Board, and the interaction between the Board of Directors and the Senior Management of the company.

As part of the evaluation process and based on the results obtained, the Board must devise a plan to enhance its performance. Such plan will be aimed at establishing concrete actions for the Board of Directors to reinforce those areas where there is room for improvement.

Thus, the evaluation enables the Board of Directors as a whole, its members as individuals and its committees, to identify their strengths, efficiency levels and chances for improvement. It even enables them to modify their organization and functioning if deemed necessary.

From the point of view of corporate governance, the results of the evaluation must have an impact on other spheres of analysis of the Board, such as Board remuneration and the election process for Board members.

### 11.2 Frequency of Board evaluation

Based on the results obtained, and in alignment with the best corporate governance practices, most of the SOEs which conduct Board evaluations (97%) do so on an annual basis, as part of the closing of the work year.
Effectiveness and Structure of Boards of Directors at State-owned Enterprises in Latin America and the Caribbean

11.3 Methodology of evaluation

The evaluation methodology used the most by the companies taking part in the study (76%) is self-evaluation, which prevails among SOEs in Colombia, Mexico, Panama and Brazil, and in SOEs operating in the airline, electricity, finance & insurance, industrial and other sectors.

Self-evaluation is, indeed, the most widely used methodology from among the models of evaluation available to companies around the globe, as it is the usual way in which companies conduct a Board evaluation for the first time.

In second place, with 45% of the companies using this method, are Board evaluations performed with the support of an external, specialized firm. This methodology is applied by SOEs in Colombia, Peru, Chile, Mexico and Trinidad & Tobago, and by companies across all the sectors considered in this study, except for the airline, industrial and telecommunications sectors.

Externally facilitated Board evaluations have become especially widespread over the past years, as they allow for more objectivity and independence in the analysis, make it possible for companies to learn about other experiences from leading companies, and are usually more effective in terms of enabling the changes needed within the Board of Directors.

According to the results of the study conducted by Governance Consultants in 2015 in leading countries of the Pacific Alliance, a third of the total number of companies that use self-

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**Graph 27. Frequency of Board evaluation**

97% of the companies that evaluate their Boards do so annually.

* Total: 29 answers*

* Data obtained based on the 29 companies that conduct Board evaluations.

**Graph 28. Evaluation methodology**

- **Self-evaluation:** 76%
- **Externally assisted evaluation:** 45%
- **Evaluation from the Senior Management’s perspective:** 10%
- **Others:** 10%
- **Peer evaluation:** 3%

* Total: 28 answers*

* Data obtained based on the 29 companies that conduct Board evaluations.

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8 This is a methodology whereby each Board member performs the evaluation individually.
evaluation to evaluate their Boards do it with the assistance of an external facilitator.

External advisors, instead of acting as evaluators, usually act as facilitators of discussions on Board performance, using a variety of techniques, such as interviews and questionnaires.

10% of the SOEs that conduct Board evaluations have implemented the methodology of evaluation from the perspective of the Senior Management.

This methodology enables the Board to assess whether its work is adding to the management process, to have a comprehensive view of its performance, and to identify opportunities for improvement which are often hard to spot from within the Board, as management teams usually have a better insight into which areas it would be most important for their Board to contribute towards.

Only 3% of the SOEs that took part in the study apply peer evaluation as the methodology to evaluate their Boards.

It is worth noting that the only SOE that employs all the methodologies of evaluation, including peer evaluation, is located in Colombia and operates in the utilities sector.

The different models used for Board evaluation should be able to stimulate internal dialogue so as to strengthen the operational quality, efficiency and productivity of the Board, by helping its members to recognize that they must meet critical legal and regulatory responsibilities, as well as the expectations of the owner/shareholders and other stakeholders. Given the different methodologies of evaluation, which one to apply will depend on the Board’s experience in these processes and on the level of maturity and commitment of the Board as a whole and of its individual members to getting feedback on their work and enhancing their performance.

According to Governance Consultants, the main areas of improvement generally identified during a Board evaluation are related to: i) the quality of the information used for decision-making; ii) a work agenda that guarantees that the right amount of time is allotted to the discussion of key and strategic topics during the meetings; and iii) the synchronization of the Board of Directors as a collegiate body with its committees and the Senior Management itself. (Bernal, Samboni; 2015)

SOEs that have not yet implemented Board evaluation are advised to start by using self-evaluation, and then alternate it with an externally facilitated evaluation at least every 2 years. For SOEs with some experience in the aforementioned processes, it is recommended that they strengthen their evaluation model by complementing it with evaluations from the perspective of the Senior Management and peer evaluation.
Topic 12. Supporting committees of the board of directors

12.1 The existence of committees

Supporting committees can be permanent or temporary. For the purposes of this study, only the existence of permanent committees has been researched.

Graph 29. Existence of committees

80% of the Boards at the SOEs taking part in this study have set up specialized committees within itself as supporting bodies to assist the Board in the performance of its functions.

The Boards of all the SOEs operating in Chile, Ecuador, Mexico, Panama, Uruguay, Brazil, Costa Rica and Trinidad & Tobago have committees; the same is true for the SOE Boards in the finance & insurance, oil & gas and transport & logistics sectors.

The purpose of this corporate governance practice is to enable the Board to conduct a specialized, in-depth study of issues related to the responsibilities assigned to it, as well as to inform other Board members on topics concerning the Board and put forward related proposals and recommendations and, in some cases, to make decisions within the framework of Board meetings.

Committees do not take over the Board’s responsibilities, in any instance. They can, however, contribute to its efficiency, ensuring that technical matters are dealt with by members who are independent, trained and informed enough.

Committees are usually formed to thoroughly study issues concerning the functions of the Board in relation to corporate governance and the oversight of key issues for the company, such as preparation and disclosure of financial and non-financial information, legal and regulatory compliance, procurement, remuneration systems, operations with related parties, and effectiveness of the risk management and internal control system.

Although the creation of committees depends on the characteristics and complexity of the business, the committees most frequently formed within Boards are the Auditing Committee for all kinds of companies and the Risks Committee for financial entities.
According to a study conducted by Governance Consultants in 2015 on Board remuneration at 45 Latin American companies, the main committees found among Boards of Directors are the Auditing Committee, the Corporate Governance Committee, and the Appointments and Retributions Committee. The Auditing Committee is found in most of the companies that have committees (89.2%).

### 12.2 Classification of the Committees

**Graph 30. Classification of committees**

<table>
<thead>
<tr>
<th>Committee</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditing Committee (or equivalent committee)</td>
<td>92%</td>
</tr>
<tr>
<td>Risks Committee (or equivalent committee)</td>
<td>51%</td>
</tr>
<tr>
<td>Corporate Governance Committee (or equivalent committee)</td>
<td>34%</td>
</tr>
</tbody>
</table>

* Data obtained based on the 39 companies that stated having committees.

In many countries of the region, the creation of an Auditing Committee is a regulatory obligation, particularly for listed companies and for financial entities. According to the results obtained in this study, the Boards of all the listed companies and financial entities in the study have an Auditing Committee.

The main purpose of the Auditing Committee is to support the Board of Directors in the task of overseeing the effectiveness of the financial information and internal control system, and evaluating the company’s risk management system and accounting procedures.

In the case of financial entities, the creation of a Risks Committee is imperative primarily in order to support the Board in tasks related to risk management, follow-up and control. Of the SOEs that are part of the financial sector (30%), 87% have this committee.

The creation of a Corporate Governance Committee at a Board level, although still important, does not constitute a legal or regulatory obligation in the countries of the region; it is therefore part of the self-regulating commitment of the companies’ Boards to strengthen their functions in terms of overseeing the corporate governance measures adopted by the company.

The Boards of the SOEs that have decided to form a Corporate Governance Committee to act as a self-regulating mechanism account for 33% of the sample and are located in Colombia, Panama, Uruguay and Bolivia, and operate in the finance & insurance and oil & gas sectors.

It is worth pointing out that the non-existence of committees carrying such names does not mean that the Board of Directors, through the existing committees or other committees within the Board itself, does not fulfill these...
functions. In fact, it is quite common for the Auditing Committee, under the name of “Audits and Risks”, to take on not only its own functions but also those which according to this document are assigned to the Risks Committee. Likewise, the Corporate Governance Committee can take on those functions related to appointments and retributions.

Although the constitution of committees depends on the nature, size and complexity of the company, as well as the structure and functions of the Board, SOEs are advised to set up at least an Auditing Committee and, when necessary, to create committees to fulfill the following functions of the Board of Directors: appointments and retributions, corporate governance and risk management.

### 12.3. Committee members

In keeping with good corporate governance practices, most Boards of the SOEs that have participated in the study have committees composed of 3 Board members.

43% of the SOE Boards have set up committees with over 3 members.

The number of committee members largely depends on the size of the Board and the number of existing committees. Committee members are to be appointed by the Board of Directors.

In general, it is deemed that committees are to be composed of 3 to 5 Board members. A committee with fewer than 3 members could hamper the Board’s role as a collegiate body and the analysis of issues from different perspectives; a committee with more than 5 members, on the other hand, can turn into a sort of second Board of Directors, where consensus is hard to reach and meetings are not as effective due to the high level of participation in the analysis and discussion of the items on the agenda.

Regardless of their number, the members of SOE Board committees are to be selected from among the external and
independent members of the Board of Directors, except in the case of the Auditing Committee, which must be composed exclusively of independent members due to the nature of its functions and, consequently, the need for more objectivity in the analysis of information.

Likewise, committee members must be selected based on their profile to ensure that their knowledge and experience match the purpose and functions of the committee so as to maximize their value contribution to the company.

12.4 Committees’ decision-making power

Most of the Boards of Directors (84%) of the SOEs that rely on supporting committees have granted them additional power to make decisions on matters of their competence.

From a corporate governance point of view, this practice is to be adopted at the Board’s discretion. In these cases, however, it is advisable for Committee or Board Regulations to overtly state whether committees are or not entitled to make decisions within the framework of their functions.

Graph 32. Power of the committees to make decisions

<table>
<thead>
<tr>
<th>Have decision-making power</th>
<th>Do not have decision-making power</th>
</tr>
</thead>
<tbody>
<tr>
<td>84%</td>
<td>16%</td>
</tr>
</tbody>
</table>

Total: 38 answers

* Data obtained based on the companies that stated having committees.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.
**Topic 13. Operational aspects of committee meetings**

**Graph 33. Frequency and duration of committee meetings**

1. Auditing Committee

- Frequency (hours on average):
  - Monthly: 3h (59%)
  - Bimonthly: 2h (6%)
  - Quarterly: 2h (26%)
  - Semiannually: 3h (9%)

2. Risks Committee

- Frequency (hours on average):
  - Monthly: 3h (74%)
  - Bimonthly: 2h (16%)
  - Quarterly: 2h (10%)

3. Corporate Governance Committee

- Frequency (hours on average):
  - Monthly: 3h (42%)
  - Bimonthly: 2h (33%)
  - Quarterly: 2h (25%)

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean

All of the SOE committees meet mostly every month. Of the three committees considered in the study, it is the Risk Committee that meets most often (in 90% of the SOEs that have this committee, it meets monthly or bimonthly), while the Corporate Governance Committee is the one that meets least often (in 58% of the SOEs, this committee meets quarterly or semiannually).

Committee meetings usually last for 2 hours. Risk Management Committee meetings are the longest, lasting between 2 and 3 hours at 50% of the SOEs.

According to the results obtained, the SOE committees that meet the most often tend to hold the longest meetings. For example, monthly meetings – which occur predominantly in
all three committees – last for 3 hours on average, whereas quarterly and semiannual meetings last for 2 hours on average.

Based on good corporate governance practices and the experience gained in these processes, it is recommended that the Auditing Committee and the Corporate Governance Committee meet at least 4 times a year (through quarterly meetings), although companies have recently started to increase the frequency of the meetings to once every two months in the case of the Auditing Committee and once a month in the case of the Corporate Governance Committee, especially in companies which are restructuring their governance processes.

The frequency with which the Risk Management Committee holds meetings depends on the type of company and, thus, on the issues concerning the Board of Directors. Therefore, it would be inappropriate to recommend an operation model for this committee.

**Topic 14. Remuneration of directors**

From the point of view of corporate governance, it is the State’s responsibility, as active owner, to set up Board remuneration systems for the companies operating within its scope.

The criteria used by SOEs for Board remuneration purposes are determined based on a variety of factors related to the size of the Company, the workload of directors, the risk level and the comparable remuneration rates in the sector or the company.

**14.1 Board remuneration acknowledgement**

94% of the Boards of Directors at the SOEs that completed the survey stated that they receive remuneration in consideration of the performance of their duties and responsibilities. These SOEs operate across all sectors and countries in Latin America included in the sample. In most of the countries (10)\(^9\) and sectors (6)\(^10\), all the Boards are remunerated.

From the point of view of corporate governance, Board remuneration – just as Board induction – is deemed a right of the directors; it is even considered fundamental to guarantee the proper functioning of the Board.

Board remuneration is expected to be a “fair” compensation paid to directors for the knowledge and experience they bring to the company, the responsibility they take on as directors, the time they invest in attending meetings and, in general, for the fulfillment of their functions. Nevertheless, there is no commonly shared definition of “fairness” due to the political nature of salary-related matters in the public sector and the governments’ concern to avoid controversy regarding this issue.

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9 Countries where the total number of SOE Boards considered in the sample are remunerated: Peru, Argentina, Chile, Ecuador, Panama, Paraguay, Uruguay, Brazil, Costa Rica and Trinidad & Tobago.

10 Sectors where the total number of SOE Boards included in the sample are remunerated: airline, finance & insurance, oil & gas, utilities, telecommunications and transport & logistics.
From a technical approach, corporate governance views very low remunerations as entailing a number of risks, including the following:

- Limiting the capacity of SOEs and their owners to demand proper fulfillment of duties from directors.
- Discouraging directors from attending and preparing meetings.
- Failing to attract professionals with suitable profiles to join the Board of Directors.

On the other hand, excessively high remunerations can compromise the directors’ objectivity and independence of judgment when carrying out their functions.

In general, SOEs are advised to ensure that remuneration schemes for directors generate long-term interest in the company, attract and motivate suitable professionals, and are linked to the company’s results and performance.

### 14.2 Board remuneration competitiveness

**Graph 34. Remuneration of directors**

- 6% receive remuneration
- 94% do not receive remuneration

**Graph 35. Remuneration competitiveness**

- 54% competitive in terms of attracting directors
- 30% not very competitive in terms of attracting directors
- 16% not competitive at all

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean.
According to OECD (2011), there is a strong trend towards drawing remunerations of SOE directors nearer to the current practices in the private sector. Despite the efforts made, in most OECD countries today Board remuneration is below market levels, and in most of the SOEs (84%) taking part in the study remuneration is seen as barely or not competitive at all, and does not allow companies to attract directors with the capacities and expertise required to fulfill their duties and responsibilities.

Board remuneration at SOEs that operate in a competitive environment is differentiated from the remuneration paid to directors at SOEs that have high public policy priorities. The remuneration and working conditions for directors of SOEs operating in competitive markets are, by default, better (OECD, 2013).

The State, as owner, and the rest of shareholders are responsible for approving a Board remuneration policy that will, on the one hand, attract, retain and motivate professionals able to add positively to the Board of Directors and, on the other hand, specifically establish the remuneration model, the amount to be paid, and the remuneration components that Board members are to receive. Additionally, they are responsible for following up on the model’s implementation.

In some cases, it may be complex for the State to determine the amount to be paid to directors, which is why it is common, and even recommendable, for Boards to be consulted on this issue. In any case, the decision regarding Board remuneration must be made as transparently as possible, and must be in line with what the company can pay.

In keeping with their commitment to transparency, SOEs must regularly publish on their web pages, or in their annual management reports, the remuneration policy approved and the actual remuneration given to the Board of Directors. All directors, regardless of their category (internal, external and independent), should be granted the right to remuneration.

Board remuneration may include a fixed and a variable component. The fixed component is usually established based on an allowance for attending Board meetings, and on a fixed monthly or annual fee. In the first model, a specific amount is paid based on the number of Board meetings attended by the director; whereas in the second model, the company pays a fixed monthly or annual fee to the director for serving as a Board member. The variable component has to do with the fees paid to directors based on their value contribution to the company and its shareholders, as well as to the company’s performance in the long term. The value of this component is usually determined by using the results of the Board evaluation and the achievement of the company’s goals and performance indicators as a source of information.

Indeed, the State as owner and the rest of SOE shareholders can use the results of the evaluation of the Board to determine Board remuneration and to allocate the variable remuneration.

14.3 Remuneration model

The remuneration models most used by Latin American SOEs are those based on an attendance allowance (60%), and on fixed monthly or annual fees (36%).

All of the SOEs in Colombia, Peru, Ecuador, Panama and Costa Rica, as well as those operating in the airline and oil & gas sectors, use the remuneration model based on attendance allowance; while all of the SOEs in Argentina, Paraguay, Uruguay and Bolivia, and those operating in the
telecommunications sector use the model based on fixed monthly or annual fees.

Of the sample, the companies where the Board remuneration system is based on an attendance allowance pay amounts ranging between USD 74 and USD 995\textsuperscript{11}. On average, Board remuneration under this system is USD 467\textsuperscript{12}.

Only Chilean SOEs taking part in this study have introduced variable fees based on results as part of their Board remuneration model.

These results are consistent with the findings of the study carried out by GCSA, which show that the Board remuneration systems most commonly used in Latin America are the ones based on an attendance allowance (48.9%) and fixed monthly retainer fees (28.9%), whereas variable fees based on results are paid in only 2.2% of the cases.

The determination of variable fees based on results in the case of the companies that took part in the GCSA study depends on a specific policy. This sum is calculated based on a percentage of the net profit for the business year or a percentage of the ordinary dividends, so the amounts depend on the company’s performance for the corresponding year.

Therefore, the fixed component must take into account the level of responsibility attached to the functions carried out, and must match that of comparable companies. On the other hand, the variable component must be linked to the company’s performance, the attainment of long-term objectives and the profitability for the State as owner and/or for the rest of the company’s shareholders.

14.4 Remuneration components

Board remuneration not only takes into account attendance and time devoted to Board meetings. From the perspective of corporate governance, Board remuneration must be aligned with each director’s level of effective responsibility and actual dedication, which means that:

- Directors who are members of, and take part in, committees should be remunerated so as to acknowledge the time they invest in the fulfillment of their duties (attendance, preparation and follow-up of the issues), as well as their contribution and the expertise they bring to the Board. Most of the SOEs (71%) that participated in the study, however, do not remunerate committee members.
According to the study conducted by GCSA, of the companies that have committees (82.2%), a majority chooses to remunerate their members (75.7%).

- **Chairmen of the Board** should be remunerated differently from the rest of the Board members as a compensation for the role they play within the Board, and the extra time and dedication they devote to carrying out their duties. Likewise, differentiated (higher) remunerations should also be paid to chairmen of committees.

Although still rare across the region, the practice of paying a differentiated remuneration to the Chairman of the Board has seen a significant increase in its implementation. In 51% of the SOEs included in this study, the Chairman of the Board is better remunerated than the rest of the directors.

SOEs that pay an additional amount to the Chairman of the Board are predominantly found in Peru, Argentina, Chile, Paraguay, Uruguay and Trinidad & Tobago, and operate in the electricity, utilities, and transport & logistics sectors.

According to the results of the remuneration study conducted by GCSA, at the closing of 2015 only 28.9% of the companies paid an additional amount to the Chairman of the Board.

- **Obligations undertaken by the company regarding pensions or life insurance premiums, as well as liability insurance premiums for directors paid by the company, should be included.**

A little over half of the SOEs (54%) include, as part of the remuneration package for directors, a liability insurance policy for directors and officers. The SOEs located in Argentina, Mexico and Costa Rica are the ones that use this practice the most.

Nevertheless, the overall conclusion still is that, despite the differentiation methods, the remuneration of SOE Boards in general remains below the levels of comparable private companies.
**Topic 15. Management of conflicts of interest**

**15.1 Conflict of interest management policy**

Most of the SOEs (55%) that took part in the study have policies, procedures or formal mechanisms for managing conflicts of interests at Board level.

None of the Argentinean, Ecuadorian or Uruguayan SOEs have defined mechanisms to manage conflicts of interests at Board level.

Management of conflicts of interest within SOE Boards of Directors is particularly important due to the fact that the predominant position of the State as owner or majority shareholder generates a series of conflicts of interests.

SOEs should formally establish a conflict of interest management procedure setting forth the behavior expected from directors when dealing with a conflict of interest, and a sanction in the case of non-compliance. Said procedure could be developed directly by the SOE or the ownership function by way of a policy, an ethics code, the Board regulations or the company’s Bylaws.

As a general rule, if a director finds himself or herself in a real or potential situation involving a conflict of interest, this individual shall immediately inform the entire Board of Directors and refrain from participating in the discussion and decision-making process regarding the issue that is generating the conflict of interest.

Civil servants who are Board members shall refrain from taking part in regulatory decisions affecting the SOE and other related topics that could limit their role as guarantors of the SOE’s general interest.

Every year, and as part of the company’s commitment to information transparency, all the cases of conflicts of interest presented at Board level shall be publicly disclosed, as well as the procedure or mechanisms used to manage them.

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Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean
15.2 Conflict of interest follow-up within the Board of Directors

Graph 39. Conflict of interest follow-up

51% of the SOEs do a rigorous or very rigorous follow-up on the correct management of conflicts of interest at Board level; a significant percentage (34%) do no follow-up whatsoever, and the remaining 15% do regular or occasional follow-up.

Of the SOEs that rely on formal mechanisms to manage conflicts of interest at Board level, 85% rigorously follow up on their compliance.

According to corporate governance practices, the Board of Directors is responsible for being aware of, and following up on, the conflicts of interest presented at Board and Senior Management levels, as well as for overseeing that the procedures formally established for their management are complied with.

In any case, and when relevant, the Board of Directors must allocate the necessary means to appropriately manage the conflicts of interest within the company.

Source: Prepared by the authors based on the survey on effectiveness and structure of SOE Boards in Latin America and the Caribbean
CHAPTER 4

CONCLUSIONS

Based on the results obtained in the survey and the analysis conducted, we can see that the Boards of Directors at SOEs in countries of Latin America and the Caribbean have made significant progress in terms of corporate governance. Specific practices – such as the nonexistence of substitute members, the Board’s involvement in strategic decision making, the existence of an annual meeting schedule including the matters to be addressed at every session, the existence of committees (especially the Auditing Committee), and the acknowledgement of a remuneration for directors – are a clear example of how governance models at public companies have been strengthened in recent years as a mechanism to achieve efficiency, sustainability and transparency.

Nevertheless, ensuring effective Boards of Directors that add value to the SOEs, their owners and other shareholders, requires a greater commitment and joint effort whereby the companies themselves and the State work together to provide the Boards with a clear action framework, allowing directors to carry out their functions independently from the political/electoral dynamics and ensuring they rely on suitable mechanisms and tools to fulfill their duties.

Within the context of SOEs, the process of strengthening the Boards of Directors and of incorporating good corporate governance practices greatly depends on the willingness and commitment on the part of the State as owner to enhance the efficiency and transparency of its companies’ management, and to understand that SOEs must operate under professional and technical criteria (regardless of their categorization) and not as another branch of State.

The following are recommendations on public policy based on six aspects which have been chosen because of their impact...
on the construction of effective, objective and independent Boards of Directors, and of the influence the State as owner has on their materialization.

1. Structure and composition of SOE Boards

The strengthening of SOE Boards begins from the moment they are structured and composed, which is why it is recommended that the State apply strict criteria during the Board appointment and composition processes, thus ensuring that:

- The discretionary nomination model involving positions of trust is eliminated and more structured processes are incorporated which take into consideration the suitability, professionalism, contribution potential and independence of the directors. This entails a greater presence of independent members on the Boards of Directors at SOEs in Latin America.

- Staggered Boards of Directors are instituted as the main mechanism to protect companies from inappropriate political maneuvers, improve decision-making processes and guarantee the continuity of the company’s strategy and steering in the long term.

- The separation of positions and functions is established between those belonging to the Chairman of the Board and those belonging to the Executive President, making sure that the chair of this body is taken on by one of its independent members.

- Strategies are defined in order to mitigate succession-related risks at the Board level.

2. The role of the State as owner/shareholder of companies

Taking into account that it is up to the ownership function – headed by the State and other shareholders – to guarantee the separation of functions of the governing bodies (ownership and direction) and the effectiveness of the Board of Directors, it is recommended that the State provide SOE Boards with an action framework so they can carry out their duties effectively, autonomously, and with full authority and independence to make decisions.

What these kinds of recommendations seek is for the State to exert its ownership functions and rights responsibly, not acting either as a passive owner with little capacity to steer its companies or as an abusive, co-managing owner.

In order to define this action framework, a previous process is required whereby the SOEs are categorized based on their specific objectives and on the State’s expectations of desired results.

Additionally, respect must be paid to the mechanisms designed by the company for the State to exert the ownership rights it is entitled to, such as making decisions within the framework of the Shareholders’ General Meeting at those companies where the State shares ownership with other shareholders.

It is therefore recommended that an ownership policy, or an equivalent instrument, be defined as the main mechanism for State and SOEs to regulate and frame their relationship. Through this policy, the level of influence the State has over the SOEs' affairs can be determined, and thus the functions and action frameworks of the other governing bodies (Board of Directors and Executive President) can also be established, as well as the mechanisms for communication and information among the parties.
3. Appointment of the Executive President at SOEs

In order for SOE Boards to have enough empowerment and legitimacy so as to exercise control and oversee the Senior Management’s performance, they need to have power over the process of appointing and removing the Executive President.

It is therefore recommended that the State act exclusively as owner/shareholder of the SOEs and delegate the appointment and removal of the Executive President to the companies’ Boards of Directors. While legal provisions exist that authorize the ownership function – or the incumbent authorities – to directly appoint the Executive Presidents of the companies, it is expected that the Boards be consulted by the State and that the appointment processes be carried out under a relationship of coordination and agreement, based on criteria that will ensure the candidates’ professionalism and suitability.

4. Board induction and training processes

There is still a need to incorporate Board induction processes and, above all, training for directors into the practices of SOEs in countries across the region. The State should be aware of the need to generate human capital and professional development among the individuals it has appointed to manage and run its companies, as well as to provide appropriate mechanisms so they can perform their role.

The State is therefore advised to support processes aimed at informing and training SOE Boards, thus enhancing their members’ knowledge and skills so they can successfully carry out their duties and responsibilities. The contribution directors may make in terms of value will largely depend on how empowered they are with regard to how the company operates and the challenges it faces.

5. Evaluation and strengthening of SOE Boards

Board evaluation is, without a doubt, the main mechanism the State and other SOE shareholders rely on to measure and follow up on the directors’ performance and contribution to value, as well as other virtues.

Although this good practice has gained ground in recent years, its levels of implementation at SOEs in countries of the region continue to be low, and there is still a significant gap when compared with the extent to which it is implemented in companies belonging to the private sector.

In the context of SOEs, the State must be the main guarantor of the implementation of Board evaluation processes, as a token of support and commitment to the company’s good functioning and the strengthening of the Board’s structure, operation and performance.

In addition, the State should create sound, timely mechanisms to learn about the results of the evaluation process, ensure the implementation of any strengthening plans defined, and take corrective measures where necessary.

As some of the measures the State can take in these cases, the following are considered appropriate: mainly, the succession of directors; adjustments to the Board composition process and profiles; the promotion of development activities for directors; actions to address skills and competencies lacking among Board members; and adjustments to the incentive model.

As periodic, independent evaluation processes are conducted focusing on measuring the Board’s performance, the contribution to value made by the Board will increase and better decision-making will be enabled, thus benefitting the company.
6. Incentives for directors

Despite the fact that many SOEs in countries of the region remunerate their Boards of Directors, and although there is a generalized trend to draw Board remunerations at public companies closer to the models existing in the private sector, in a large number of SOEs remuneration is below market levels and is seen as barely or not competitive at all, which hinders these companies from attracting directors with enough skills and experience to fulfill their duties.

The State must create the necessary incentives to ensure that the companies where it acts as owner function well, which entails establishing Board remuneration systems that are competitive, promote the company’s interest in the long term, are linked to the company’s performance and results and, above all, attract and motivate suitable professionals.

To achieve this aim, and in order for a correlation to exist between the company’s performance and the directors’ time dedication and value contribution, the State may include “variable components” as part of the remuneration: a percentage of additional remuneration for the directors with the best results obtained during the Board evaluation processes or for the directors who chair the Board or committees.

Determining a “fair” remuneration for the Boards of SOEs, besides being a technical challenge, is a political one.

The technical challenge involves considering criteria such as the size of the company, the workload of directors and the comparable remuneration rates in the sector or the company in order to determine a remuneration that will allow directors to act objectively and independently, while allowing the State to demand results from the directors, as well as the fulfillment of their responsibilities.

The political challenge might be more complex, as it implies a cultural change – not only on the part of the State but also among citizens in general – whereby it is understood that SOEs, though part of the public treasure, are companies that need to be managed under efficiency, effectiveness and integrity criteria, and must thus generate the necessary incentives for them to function well (competitive salaries for officers).

To sum up, as these recommendations are progressively applied in SOEs across the region, we believe that the capacity and effectiveness of the Board of Directors to generate long-term social and economic value will become more tangible, which will in turn positively impact the companies, society and the State itself, both as owner and as promoter of public policies.
BIBLIOGRAPHY


ANNEX 1

SURVEY ON THE EFFECTIVENESS AND STRUCTURE OF THE BOARDS OF DIRECTORS AT 50 STATE-OWNED ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN.

Within the framework of the Corporate Governance Program designed by CAF - Development Bank of Latin America, and aiming at developing tools to promote good corporate governance among State-Owned Enterprises (SOEs) in the region, a study is being prepared to analyze the structure and operational aspects of Boards of Directors at SOEs representative of Latin America.

We thank you for your participation in this process and for the time taken to complete this questionnaire. All your answers will be treated as confidential and the data will only be used for academic and statistical purposes. Accordingly, the results of the study will not refer to the answers given by the participating companies individually so as to maintain the confidentiality of the information. The information at an aggregate level will help to generate recommendations on public policy and good practices for the region.

In this questionnaire, the term “Board” will be used to refer to Boards of Directors, Directorates, Management Boards, Executive Boards, etc.
### I. Characterization of the company

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Name of the company:</strong></td>
<td></td>
</tr>
<tr>
<td>2. <strong>Country of origin:</strong></td>
<td></td>
</tr>
<tr>
<td>3. <strong>Economic sector:</strong></td>
<td>If you answered “Others”, please specify which.</td>
</tr>
<tr>
<td>4. <strong>Ownership structure:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• 100 % owned by the State</td>
</tr>
<tr>
<td></td>
<td>• Majority ownership by the State (51 % - 99.9 %)</td>
</tr>
<tr>
<td></td>
<td>• Minority ownership by the State</td>
</tr>
<tr>
<td>5. <strong>The State shareholder is:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• National</td>
</tr>
<tr>
<td></td>
<td>• Sub-national (State, Department, Province)</td>
</tr>
<tr>
<td></td>
<td>• City – Municipality</td>
</tr>
</tbody>
</table>
6. The company issues debt securities in capital markets (several answer options possible):
   - Locally
   - Internationally
   - Does not issue debt securities

7. The company is listed on a Stock Exchange (several answer options possible):
   - Locally
   - Internationally
   - Is not listed on any Stock Exchange

II. Board composition and size

8. How many members are on the Board? Please distinguish between full and substitute members if applicable.
   
   Open answer (number):
9. Please indicate how the Board is composed.

<table>
<thead>
<tr>
<th>Type of Directors</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Internal Directors</td>
<td></td>
</tr>
<tr>
<td>b. Independent Directors</td>
<td></td>
</tr>
<tr>
<td>c. External Directors</td>
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</tbody>
</table>

Definitions for the completion of Question 9:
- **Internal or Executive Directors** are the legal representatives or Senior Management officers who participate in the day-to-day management of the company.
- **Independent Directors** are individuals of recognized professional prestige who can contribute their experience and expertise to the management of the company and whose relationship with the company, its shareholders or owner, directors and members of the Senior Management is circumscribed exclusively to their condition as a member of the Board.
- **External Directors** are individuals who, due to personal or company circumstances, cannot be qualified as Internal or Executive, or as Independent. Within this category are delegates of the government or of significant shareholders.

10. The Chairman of the Board is:

- A Civil Servant
- An Independent Director
- The Executive President (General Manager / CEO) of the company
- Someone else

If you answered “Someone else”, please specify who. Open answer:
11. How often is the Board elected?

- Every year
- Every 2 years
- Every 4 years
- With a frequency of more than 4 years

12. Is renewal of the Board staggered?

- Yes
- No

Definitions for completion of Question 12:
Staggered Board renewal: when the election of Board members is performed in portions or groups of members at pre-established intervals.

13. How long do directors remain in their position on average?

<table>
<thead>
<tr>
<th>Directors</th>
<th>Less than 1 year</th>
<th>Between 1 and 2 years</th>
<th>Between 2 and 4 years</th>
<th>More than 4 years</th>
</tr>
</thead>
</table>
| a. Internal Directors
| b. Independent Directors
| c. External Directors

III. Directors’ profile

14. Has a profile been defined and formalized for Board directors / members?

- Yes
- No

IV. Fulfillment of the Board’s role and participation in decision making

15. Please choose an answer for each question regarding the Board’s role and its participation in decision making:

<table>
<thead>
<tr>
<th>Question</th>
<th>Very high</th>
<th>High</th>
<th>Moderate</th>
<th>Low</th>
<th>Very low</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. How would you define the extent to which the Board is involved in the company’s strategic definition?</td>
<td></td>
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<tr>
<td>b. How would you define the extent to which the Board is involved in overseeing the company’s regular course of business and the Senior Management?</td>
<td></td>
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<tr>
<td>c. How would you define the extent to which the Board is involved in following up on the effectiveness of the internal control system and on the main risks faced by the company?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Question</td>
<td>Yes</td>
<td>No</td>
<td>Not by legal prescription</td>
<td>I do not know</td>
<td></td>
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<tr>
<td>-------------------------------------------------------------------------</td>
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<tr>
<td>a. Is it the Board that is responsible for appointing and removing the company’s Executive President (General Manager / CEO)?</td>
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<tr>
<td>b. Is it the Board that is responsible for appointing and removing the company’s Internal Auditor (Head of Internal Control or equivalent position)?</td>
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<td>c. Is it the Board that is responsible for appointing and removing the company’s second line of management (VPs or Managers)?</td>
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</tbody>
</table>

V. Supporting Committees of the Board

16. Does the Board have Committees?  
   (If you answered “No”, please continue to Question 22.)

   ▪ Yes
   ▪ No

17. What Committees does the Board have?  (You may choose several answer options.)

   ▪ Auditing Committee (or equivalent committee)
   ▪ Risks Committee (or equivalent committee)
   ▪ Corporate Governance Committee (or equivalent committee)
   ▪ Other committees
18. What is the average number of members per Committee (without including invited members)?

- 3 members
- 4 members
- 5 members
- 6 members or more

19. On average, how often do the Supporting Committees meet?

<table>
<thead>
<tr>
<th>Committee</th>
<th>Every month</th>
<th>Every 2 months</th>
<th>Every 3 months</th>
<th>Every 4 months</th>
<th>Every 6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Auditing Committee</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>b. Risks Committee</td>
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<tr>
<td>c. Corporate Governance Committee</td>
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<tr>
<td>d. Another committee (Please state which)</td>
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<tr>
<td>e. Another committee (Please state which)</td>
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<td>f. Another committee (Please state which)</td>
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<tr>
<td>g. Another committee (Please state which)</td>
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</tbody>
</table>
20. How long do the committee meetings last on average?

<table>
<thead>
<tr>
<th>Committee</th>
<th>Less than 1 hour</th>
<th>Between 1 and 2 hours</th>
<th>Between 2 and 3 hours</th>
<th>Between 3 and 4 hours</th>
<th>More than 4 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Auditing Committee (or equivalent committee)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Risks Committee (or equivalent committee)</td>
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<tr>
<td>c. Appointments and Retributions Committee (or equivalent committee)</td>
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<tr>
<td>d. Corporate Governance Committee</td>
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<tr>
<td>e. Another committee (Please state which:)</td>
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<tr>
<td>f. Another committee (Please state which:)</td>
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<tr>
<td>g. Another committee (Please state which:)</td>
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<tr>
<td>h. Another committee (Please state which:)</td>
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</tr>
</tbody>
</table>

21. Can the Committees make decisions within the framework of their functions?

• Yes
• No

VI. Operational aspects of Board meetings

22. Do you rely on a schedule of Board meetings including the matters to be addressed at each session?

• Yes
• No
23. **How often does the Board meet?**

- Every 2 weeks
- Every month
- Every 2 months
- Every 3 months
- Every 6 months
- With a different frequency

If you answered “With a different frequency”, please specify how often.
Open answer:

24. **How long do the Board meetings last on average?**

- Less than 2 hours
- Between 2 and 4 hours
- Between 4 and 6 hours
- Between 6 and 8 hours
- More than 8 hours
25. How much time in advance is the information sent to the directors so they can prepare for Board meetings?

- Less than 3 days
- Between 3 and 5 days
- Between 6 and 10 days
- More than 10 days

VII. The roles of the Chairman and the Secretary of the Board

26. Do the duties of the Chairman of the Board include leading meetings, conducting debates and focusing discussions on relevant issues?

- Yes
- No

27. Does the Secretary of the Board ensure compliance with the regulations, good practices and internal rules under the responsibility of the Board?

- Yes
- No
- I do not know

28. Does the Secretary of the Board record discussions and decisions in the minutes?

- Yes
- No
### VIII. Appointment process for directors

**29. Who elects the members of the Board?**

- A public institution representing the ownership
- The Shareholders’ Meeting
- The Chairman of the Board
- Someone else
  
  If you answered “Someone else”, please specify who.

  **Open answer:**

### IX. Board induction and training

**30. Is the induction procedure for new members formally established?**

*(If you answered “No”, please continue to Question 32.)*

- Yes
- No

**31. What areas are covered in Board induction?** *(You may choose several answer options):*

- General information about the company
- Growth prospects for the sector the company operates in
- Corporate documents of the company
- Functioning of the Board (evaluation results, annual plan)
- Another area
32. Is the ongoing training procedure for the Board formally established?
(If you answered “No”, please continue to Question 34.)

- Yes
- No

33. What areas has training emphasized in the last year?

- Strategy and business
- Corporate governance
- Risks and controls
- IFRS and accounting policy
- Technology
- Another area

If you answered “Another area”, please specify which.
Open answer:
X. Remuneration of directors

34. Do directors receive remuneration for executing their position?
(If you answered “No”, please continue to Question 40.)

- Yes
- No

35. What type of remuneration and what amount do you receive as a Board member?

<table>
<thead>
<tr>
<th>Type of remuneration</th>
<th>Amount (Opcional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed monthly or annual pay, regardless of the number of</td>
<td>$</td>
</tr>
<tr>
<td>meetings</td>
<td></td>
</tr>
<tr>
<td>Attendance allowance per meeting</td>
<td>$</td>
</tr>
<tr>
<td>Variable fees based on results</td>
<td>$</td>
</tr>
<tr>
<td>Another type of remuneration. Please specify:</td>
<td>$</td>
</tr>
</tbody>
</table>

36. Are directors remunerated for taking part in committees?

- Yes
- No

37. Is the Chairman of the Board paid a larger amount, compared to the other directors, for performing his role?

- Yes
- No
38. In your view, how would you describe the remuneration set for directors?

- Highly competitive in terms of attracting directors
- Not very competitive in terms of attracting directors
- Not competitive at all

39. Is a Directors and Officers Liability Insurance Policy maintained for directors?

- Yes
- No

XII. Board evaluation process

40. Is the Board evaluated? (If you answered “No”, please continue to Question 44).

- Yes
- No

41. How often is the Board evaluated?

- Twice a year
- Once a year
- Every two years
- With a different frequency

If you answered “With a different frequency”, please specify how often.
Open answer:
### 42. What evaluation methodology is used?  *(You may choose several answer options.)*

- Self-evaluation
- Externally assisted evaluation
- Evaluation from the perspective of the Senior Management
- Peer evaluation
- Another methodology

If you answered “Another methodology”, please specify which.

Open answer:

### 43. Are the evaluation results used as input in the nomination process?

- Yes
- No
- I do not know

### XII. Management of conflicts of interest at the Board

### 44. Are there clearly defined policies or mechanisms in place to manage conflicts of interest at Board level?

- Yes
- No
45. To what degree is follow-up done to ensure the correct management of conflicts of interest at Board level?

- Very rigorously
- Rigorously
- Regularly
- Occasionally
- No se hace

Please use this space to leave any general comments or observations