

PUBLIC POLICY
AND
PRODUCTIVE
TRANSFORMATION
SERIES

N° **37**
/ 2021

GUIDELINES FOR GOOD CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

CAF DEVELOPMENT BANK
OF LATIN AMERICA

CREDITS

Guidelines for Good Corporate Governance of State-Owned Enterprises

PUBLIC POLICY AND PRODUCTIVE TRANSFORMATION SERIES

Editor
CAF

Legal Deposit: **DC2021000670**
ISBN Complete Work: **978-980-6810-67-9**
ISBN Volume: **978-980-422-227-6**

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We would like to thank Andres Bernal and Catalina Rojas
for their contributions and valuable comments.

The ideas and proposals contained in this edition are the
sole responsibility of their authors and do not necessarily
reflect the official position of CAF.

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The digital version of this publication can be found at:
<https://scioteca.caf.com/>

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PROLOGUE

As a development bank, CAF's agenda is to seek regional integration and the sustainable development of its member countries. In this regard, corporate governance is one of the many instruments available to the institution to reinforce the business fabric while maintaining a long-term vision of inclusion and sustainability. Through the Corporate Governance Program, CAF seeks to contribute to responsible competitiveness both at the individual level of public and private companies and at the aggregate level with supervisory and regulatory bodies. To this end, the Program develops conceptual and practical tools and disseminates this knowledge in order to raise awareness of the importance this topic has for the development of the region.

Corporate governance should be understood as a mechanism for reinforcing companies' institutional and managerial abilities as well as encouraging transparency, accountability, and effective management at the same time that it defines clear rules of the game for the main players: the owners, Board of Directors, and upper management as well as other stakeholders.

In contrast, its absence in state-owned enterprises appears in many forms such as a lack of independence and integrity in audit processes, failures in risk management, and the hiring of

personnel who are not qualified to carry out their duties, etc. These shortcomings do not allow for efficient management of resources, nor do they safeguard the assets of the organizations.

CAF presents these Guidelines for Good Corporate Governance of State-Owned Enterprises as an update to the document published in 2010. The objective is to provide the state-owned enterprises, ownership representatives, regulators, and public policy makers in the region with a set of basic principles that constitute the foundations for good corporate governance. Through this publication, CAF seeks to continue to provide state-owned enterprises with solid support in the creation of a true culture of corporate governance.

Even when this is a long-term task, the adoption of the guidelines could make a significant contribution to the sustainable development of the region and contribute to optimizing the relationships between the companies and the state as their owner and with the various stakeholders they interact with.

Jorge Arbache
Vice President Private Sector

EXECUTIVE SUMMARY

State-owned enterprises in Latin America continue to play an important role in the economies of almost all the countries in the region by providing various utilities and their participation in sectors identified by the different governments as priorities. In addition, in some cases, these companies actively participate in the local capital markets whether this is through the issuance of debt securities or having their shares listed on stock exchanges.

Considering the above, corporate governance reforms in Latin American state-owned enterprises are very relevant for the development policies in the region and critically important for improving the management and impact of these institutions that, historically and as a whole, have yielded poor results when measured against the objectives for which they were created.

In this respect, all of the participants in a state-owned enterprise –government, ministry or management agency, Board of Directors, and managers– should ensure that the company is organized and functioning as a model of excellence in corporate governance, good environmental practices, and high ethical standards.

These guidelines should be seen as recommendations that serve as a basis for orienting public policies as well as the management decisions that contribute to consolidating corporate governance of state-owned enterprises in the region and, therefore, improve their performance and transparency.

Key words: Corporate governance, state-owned enterprises, SOE, Latin America, Board of Directors, shareholders, control architecture, information transparency, state ownership

CHAPTE I

INTRODUCTION

Background

In 2010, CAF - Latin American Development Bank - published the first version of the Guidelines for Good Corporate Governance of State-Owned Enterprises as a benchmark for corporate governance focused on the entire sector of state-owned businesses. This document was prepared by taking the CAF Guidelines for a Code of Corporate Governance (2004) that target private sector companies as well as the "OECD Guidelines on Corporate Governance of State-Owned Enterprises " (2005) as a starting point.

Since their publication, and thanks to both their solid conceptual rigor and strong practical focus, the Guidelines have been the basis for implementing reforms in corporate governance practices in Latin American State-Owned Enterprises (SOEs) with the support of CAF in many cases and thus contributing to the effective advancement and reinforcement of corporate governance in the region.

This initiative is another example of the importance that CAF has given to the dissemination and implementation of good corporate governance practices as a tool to increase companies' competitiveness regardless of their size and type of ownership as well as to facilitate their sustainability since the first 2004 Guidelines for private sector companies.

Rationale for the Revision

From then until today, corporate governance as a discipline has experienced remarkable development, both globally and regionally, hence the importance of this update.

The present Guidelines do not constitute a break with the Guidelines that were initially published in 2010, but rather a further development. This makes it possible to adapt them to the new advances experienced in corporate governance as well as to respond to the current challenges in this area. From a practical point of view, the content of the current Guidelines is also influenced by the significant and relevant practical experience acquired in their effective implementation in SOEs in the region. This makes it possible to ensure that they are applicable to the reality of this type of business. In this respect, significant contributions are made in this update, in particular the following:

- A revision of the dynamics and operations of the Boards of Directors and their committees, as a key aspect for the proper exercise of their duties.
- The development of a completely new area related to control architecture in which risk management and internal control are addressed.
- The inclusion of new corporate governance practices in all areas as well as the revision of those already outlined in the 2010 Guidelines.
- The deepening of the pragmatic approach initially proposed in the 2010 Guidelines.

From the implementation processes in which we have participated, multiple lessons have been derived about the relationship between SOEs and their ownership

representatives, about the importance of the Board of Directors, the tools needed to reinforce their independence and operations as effective decision-making and supervisory bodies as well as the mechanisms needed to have sound oversight and accountability systems. However, in spite of the formal progress that has been made in different countries, the problems of adoption and, more specifically, of compliance with good corporate governance practices in SOEs are far from being resolved.

Our vision with this new edition of the Guidelines for Good Corporate Governance of State-Owned Enterprises is for it to continue to be a reference document that meets the expectations of the SOE community, ownership representatives, public policy makers, regulators and supervisors as well as a tool that is significantly important for effectively enhancing and reinforcing corporate governance in the region's state-owned enterprises.

Importance of corporate governance in SOE

The decision on whether a company should be in the hands of the private sector or the state is a question that still generates a lot of debate and controversy in the field of public policy in Latin America. This document is not intended to solve this dilemma. **On the contrary, the intention is to leave it partially aside in order to tackle another question that we consider equally complex:** once a company is owned by the state, regardless of the economic sector in which it operates, what principles of corporate governance can make its management more effective and transparent?

The framing of this question implies that state-owned enterprises can – under certain institutional conditions –

resolve many of the dilemmas involved in public ownership and, in particular, the tensions that arise between upper management and the state and that often extend to the relationship between the company and the citizens.

The incorporation of best practices into corporate governance for SOEs is geared towards helping public administration contribute to better performance for state institutions whether at the level of the central government or the sub-national one. Furthermore, if, in the future, the decision is made to evaluate the possibility of privatizing it, the fact that these practices have been implemented would improve the value of the SOE to the extent that the principles of transparency and accountability are applied. In this regard, it is important to emphasize that the adoption of corporate governance for SOEs is neutral in terms of the readiness or lack thereof to keep these companies in the hands of the state.

It may be thought that corporate governance practices for SOEs should be the same as those commonly recommended for private companies, both those that are privately held and those listed on the stock exchange. However, although many of these guidelines can be harmonized, the characteristics of SOEs are distinctive in certain respects. One of the main distinctions is its relationship with the state as a shareholder or owner. In this respect, understanding the characteristics of SOEs is essential to identifying the types of risks they face as well as the types of business practices that should be encouraged to mitigate many of these problems. To this end, their characteristics are listed below:

- The creation of SOEs is not always driven by commercial considerations but by mandates from different sources. Based on the models that are usually presented in Latin America and taking the study document "Corporate

Governance in Latin America as a reference. Importance to State-Owned Enterprises (2012) the classification of these can be placed in four not necessarily mutually exclusive categories: (i) the ones created to achieve public policy objectives; (ii) the ones involved in providing public services (e.g. Water, electricity, gas, etc.); (iii) those established as exclusive providers of goods or services needed by the state (for example, military suppliers) and; (iv) those responsible for producing income for the state and competing with the private sector on equal terms.

Often, when certain economic sectors are reserved to the state for economic development or as a mechanism to guarantee greater equity in access to services, these mandates have constitutional status. The important thing in creating a SOE is that the mandate be as clear as possible so that the state can translate it into identifiable objectives and that there be a positive balance between the social benefits and costs associated with the state-owned enterprise. Thus, the expectations in terms of economic and social profitability would be better defined with respect to the management of the entities as would the definition of efficiency and accountability indicators. Similarly, once the classification of SOEs has been defined and communicated, their corporate governance can be structured and adjusted to serve the objectives of the state as the owner.

- Due to the mere fact of its public nature, both the Board of Directors and the upper management of a SOE may perceive that it is feasible for the company to be the object of "bailouts" by the government in office, be it national, state, or municipal. This simple fact could generate lax restrictions that could encourage unprofessional management behaviors and lead to the

company not being oriented towards its true social and commercial purpose. In other words, to the extent that the Board of Directors and upper management of SOEs are not exposed to market discipline the same way that private companies are, they can – and often are – subject to capital injections by the government when they face financial problems caused by poor management performance or the granting of collateral benefits to access financial markets on a privileged basis by those who exercise property rights on behalf of the state.

- In the absence of proper public controls, the state can use SOEs as an instrument of fiscal policy or, in extreme cases, as a clientelist political culture by the government in office involving itself in the daily operation of the company to fulfill electoral favors. It is in these types of situations that the upper management of the SOE is forced to deviate from its social, strategic, or commercial purpose, and this negatively affects their performance. For example, governments may try to use SOEs to increase current spending (e.g., hiring more staff than necessary) or investment spending (i.e., adopting investment projects that are not in their budget nor strictly necessary to improve the productivity of the business). Likewise, the government may extract resources, beyond the established dividend policy, directly from the company to finance the expansion of public spending to the detriment of the investments required by the company. All of the above limits the management capability of the company and, therefore, reduces its productivity.

There is no escaping the fact that, since the very birth of democratic regimes, transparency and accountability have been understood to be their basis. "Along these lines,

public affairs, including the management of state-owned enterprises, must be open to social scrutiny, and those who manage them must be held accountable in a timely and reliable manner. Transparency and accountability give legitimacy and credibility to the democratic political system, make it possible to ensure that it serves the common good, and help governors, legislators, and public officials to serve the general interest rather than their own particular interests."¹

Thus, SOEs – especially in the area of public services – maintain a direct relationship with not only the state, as the owner of the company, but also with the citizenry, who are not always properly represented by the state. This reality should force SOEs to develop information and accountability mechanisms geared to meeting both the needs of the shareholder or owner and those of the stakeholders linked to the company, particularly its users. This dual accountability creates different, but often complementary, obligations for both the Board of Directors and upper management.

- SOEs are usually created under special legal systems which makes the regulations governing their operations different from those governing private companies. This distinct legal treatment usually results in market access requirements and conditions and particular tax obligations for this type of company. In addition, certain legal forms adopted by SOEs do not facilitate the structuring of advanced governance models or encourage transparency about the relationships between different levels of company governance, i.e., the level where property rights are exercised, the level from which the company is managed, and the level responsible for day-to-day operations.

1. Revista *Polis*. Gustavo Ernesto Emmerich Isaac "Transparencia, rendición de cuentas, responsabilidad gubernamental y participación ciudadana" (Transparency, accountability, government responsibility, and citizen participation) (2004)

- Considering the fact that the administrations in office last approximately four to six years – depending on the countries’ electoral cycle – it is not uncommon for there to be a perverse incentive to draw up short-term goals and strategies, which can also change diametrically with the change to a new administration.

Some of these points can be mitigated with a proper application of corporate governance principles. These provide the organization with an institutional structure and sustainability, thus allowing it to better meet the objectives for which it was created.

The recommendations on guidelines for adopting better corporate governance practices for SOEs should be oriented towards overcoming this particular reality they face as public institutions. In fact, when SOEs are mixed, that is, they include a minority participation on the part of the private sector, they must ensure that the majority shareholder (in this case, the state) does not succeed in extracting a bonus because of its control over the directors and management and its privileged political position as a state shareholder. In other words, due to its status as a state-owned enterprise, the SOE could abuse minority (private) shareholders, so it is necessary to generate mechanisms to protect the interests of these shareholders and those of the company.

In this respect, it must be understood that the corporate governance of an SOE must be oriented towards ensuring that the state act as a responsible and proactive shareholder whose main interest is to maximize the value of the company in accordance with its mandate, be it social or economic, without getting directly involved with its daily operations. At the same time, it must seek to ensure that the Board of Directors and upper management do not take over the

company to the detriment of a potentially passive shareholder – as can sometimes be the case with a state that does not appropriately exercise its role as owner – and act in accordance with objectives that benefit them to the detriment of the state. They should also ensure that if there are minority shareholders, they receive equal treatment with access to the same information as the majority shareholder and that in public service companies, citizens are duly consulted and informed.

Due to the characteristics mentioned above, their participation in sectors considered strategic by governments and the importance that SOEs have at the social and economic level, it is not surprising that they are the most visible in many emerging markets and, therefore, should play an active leadership role in the implementation of robust corporate governance models.

To the extent that corporate governance principles are increasingly recognized globally as a starting point for healthy markets and business development, state-owned enterprises can help advance these initiatives within the markets in which they operate in order to raise awareness of how the adoption of advanced corporate governance models can yield important benefits for the SOE, such as:

- i.** Maintaining a long-term business perspective; and
- ii.** Efficient achievement of the company’s objectives, through the following objectives, etc.:
 - Balance between economic results and the social objectives for which it may have been created.
 - Clear processes and structures for business-oriented decision making and compliance with organizational purposes.

- More stable Board of Directors and upper management teams.
- Transparency and accountability.
- Stricter risk controls.
- Management of conflicts of interest and self-contracting.
- Improved social and environmental practices.
- Improved public relations with the media, and reinforced communication with stakeholders.
- Reduced pressure from both the public interest and the supervisory bodies.
- Better long-term economic performance.
- Increased competitiveness by eliminating social losses.
- Better access to capital markets and reduction in the cost of capital.
- Attracting the types of investors that institutionally strengthen the company.
- Compliance with regulations.
- Improving relations with minority shareholders.

In this document, SOEs will be defined as companies or institutions where the state exercises control over the property in its entirety, with a majority position, or through a significant

minority. In the SOE, **the shareholder or owner will be referred to as the public entity, be it a ministry, agency, sovereign fund, or mayor's office, which has the power to exercise the state's property rights over the company it controls.**

The Board of Directors refers to the Management Council or Advisory Board of the SOE, understood as the corporate body of direction and administration in charge of setting the company's guidelines and strategy and supervising the management directly by mandate of the shareholder or owner.

Likewise, reference will be made to the executive team, management or upper management as an instance in which a group of professionals – under the leadership of the chief executive – directly operates the business or service under the guidelines and strategy established by the Board of Directors.

Finally, the corporate governance of SOEs will be defined as the formal and informal institutional arrangements that shape the company's oversight, transparency, and leadership relationships and that govern the relationships between the shareholder or owner, the Board of Directors, the management, and the various groups of stakeholders in the company (employees, citizens, and consumers, etc.).

CHAPTER II

REFORMS OF STATE-OWNED ENTERPRISES

The implementation of these corporate governance guidelines for SOEs implies a reform process in the public sector and in the performance of SOEs. The experience gained by CAF in the implementation processes it has led over the last few years shows that these reforms are not simple to carry out. In fact, they are extremely complex processes for reasons that go beyond the following:

1. Many SOEs are incorporated under special laws, and reforming them requires a high level of commitment from the political authority, something that does not always exist, since the various state representatives involved in SOEs may not have recognized the importance of this issue.
2. The resistance to change and the failure to recognize the underlying conflicts of interest that can be perceived in the different representatives of the state, ministries, controlling bodies, agencies, and other branches of public power that influence SOEs given the possibility of losing influence as a result of modernizing the SOEs through the implementation of good corporate governance practices.
3. When faced with corporate governance reform processes, the attitude of the management and employees of SOEs (often referred to as public servants) can vary from enthusiastic support to lack of interest and even obstruction since the changes advocated involve higher standards of transparency and accountability at all levels. It is important to note that, in general, the decision-making authority the SOE management teams have is minimal when it comes to adopting and implementing certain corporate governance practices. So, if they do not have the commitment and support of the Board of Directors and the shareholder or owner, the reform process will be very limited or simply not move forward.

4. The timing for implementing corporate governance processes in SOEs plays such a decisive role that choosing the right moment to put them into effect can mean the success or failure of the process. Experience shows that, in most cases, it is necessary to start these initiatives at the beginning of the government's term of office, so that the political authorities committed to reform have a time horizon of three to four years for suitable implementation and consolidation.

In spite of the difficulties and the recognition that there is no single model of good corporate governance, the states that own SOEs, regardless of the ideology of the government in office, should take on the modernization, through corporate governance, of their companies as a non-negotiable challenge since the benefits for the company are, after all, very substantial.

Thus:

- A clear distinction between the state's ownership and regulatory roles can facilitate a more dynamic and robust market in which both private companies and SOEs are involved.
- A clearly identified state shareholder can exercise a healthy and productive supervision that stimulates the creation of value by the SOE without necessarily getting involved in the company's daily operations.
- A well-functioning Board of Directors who provide leadership can produce appropriate strategies that professional managers can successfully implement.
- A stable executive team contributes to the management of the SOE based on technical and professional criteria that is oriented to the fulfillment of the organizational objectives and to the generation of economic and social value.

- Dissemination of information on SOE performance leads to not only a better-informed citizenry but also a more attractive business for potential investors who could enhance SOE equity.
- Good corporate governance implies an SOE with better, more open management, and, therefore, more accountable to its closest shareholders and stakeholders (employees, customers, suppliers and citizens).

As was discussed above, the first thing that an institutional change process of this nature requires is a political commitment at the highest level coupled with a credible vision that communicates the need for this transformation. One of the first decisions that must be made at the level of the Presidency, the Ministry, the Mayor's Office in charge is to try to ensure that the ownership of the SOEs is clearly concentrated in the relevant bodies that are capable of exercising their rights as shareholders or owners. This must be done while recognizing what an owner's fields of action are and that implies being fully aware that they are not to be an extremely passive agent nor play an intrusive role in the daily activity of the SOE. The starting point for this is to understand what it means to be an owner of a company or public institution and how this role is linked to other essential components of a corporate governance system such as the Board of Directors and the executive team. Therefore, the upper management of the SOEs must perceive that this effort is a credible mandate and that they must lead this transformation together with the different agencies of public administration that are related to the SOEs.

In this regard, the importance of leadership and commitment on the part of both the unit that exercises property rights on behalf of the state and the upper management of the SOE is crucial. Reform processes fail when any of these conditions

are not present: i) there is no high-level commitment in the government; ii) there is no clearly identifiable state shareholder that makes a commitment to the SOE to promote change; and iii) the leadership of the Board of Directors and upper management is not aligned with and committed to the idea of furthering the implementation of better corporate governance practices in the company.

The second aspect that is crucial to effectively implementing better corporate governance practices is to have an independent diagnosis of the company's situation. This diagnosis must be comprehensive, that is, it must analyze both the role and actions of the owner state and of the person or persons who exercise the property rights on its behalf as well as the situation of the SOE in this matter. It must also be shared and lead to a feasible work plan for institutional transformation. Good corporate governance is not decreed, but built through changing the behavior of the various parties based on the role they play in the company's governance system. This implies a gradual and sustained process of organizational modifications. That is why the diagnosis must be accompanied by concrete, feasible, and scalable recommendations to achieve the desired goal.

It is essential to understand that corporate governance is not simply a nominal change (resulting from laws, regulations, or statutes), but also requires a change in the behavior of those individuals who lead the company as well as in the culture of those that the company is made up. This process of adopting better corporate governance practices should be continuous and be monitored in order to identify progress and/or setbacks. This monitoring process is the responsibility of not only the state and the SOEs, but also the employees,

clients, regulators, the community and, should they exist, the investors. It is, therefore, essential for SOEs to produce timely, reliable, and relevant public information so that all stakeholders can monitor the company's progress or setbacks. Transparency then becomes a core factor in making these reforms viable.

Last of all, in the nomination and election process, the most qualified professionals should be selected for directors and executives of the SOE since it will be the Board of Directors and upper management who will carry through a substantial part of these changes. To the extent that the state guarantees a better level of leadership for the company, it will be in a better position to achieve success.

In this respect, corporate governance reforms require a combination of the following components in order to ensure the soundness of the measures implemented.

State Policy: There is a clear mandate from the state through the government to pursue these types of reforms.

Ownership role: the President, Minister, Governor, or Mayor encourages changes so that the ownership of the SOE is not unclear and is under the supervision of the appropriate ministry, office, agency, or fund; or better yet, in a unit, or office specializing in the particular field, known as Specialized Ownership Agency (SOA).

Diagnosis: the diagnosis of the public institutions and the various SOEs that will be subjected to reforms in corporate governance is furthered by experts – sometimes with the support of multilateral organizations.

Legal and regulatory suitability: the necessary legal and regulatory changes are advocated to ensure that corporate governance practices are harmonized with the requirements demanded by the existing legal framework.

SOE Leadership: suitable leadership for the selected SOEs must be ensured for the Chairman of the Board, the Board as a whole, and upper management to carry out this process. To achieve this, having an open and transparent process for nominating and selecting directors is crucial as is including market incentives in order to define remuneration systems, linked, where appropriate, to the achievement of objectives. There should, in turn, be real consequences to penalize poor performance by SOEs. In addition, the commitment and the willingness that the owner shows in terms of supporting and respecting the processes of nomination, selection, and remuneration that reflect business criteria and contribute to fulfilling the purposes the SOE was created for is crucial.

Business independence: the commitment of public institutions to the business autonomy of SOEs is guaranteed. In that respect, even though the state may play a more active role as stockholder or owner that does not imply a violation of the professional codes of management nor direct involvement in the operations of the SOE.

Transparency: the obligation of disclosing relevant information should be supported by both the SOE and the state.

Monitoring: there is a process for evaluating the progress and setbacks of these reforms by both public institutions and citizen organizations.

Finally, it is important to note that matters such as business ethics, environment, social responsibility, or corruption are related to corporate governance to a greater or lesser extent depending on the type of company.

However, the importance of these matters in the business environment is so significant that, over the last few years, each one of them has developed its own identity and its own frames of reference at the legal, regulatory, and self-regulatory levels. That is why with respect to SOEs, there is no intention to venture into the development of the above-mentioned matters with these guidelines. Nonetheless, experience shows that companies that have adopted appropriate corporate governance models are much more sensitive and likely to strengthen their performance in relation to them.

CHAPTER III

BEST PRACTICES FOR THE CORPORATE GOVERNANCE IN STATE-OWNED ENTERPRISES

It is important for any type of company to develop a climate of trust with the different agents involved and maintain it over time by means of a continuous exercise of transparency to ensure that the value of the company and the benefits (social or financial) to the owner and the citizens increase over time through a correct administration and implementation of control mechanisms.

To this end, it is essential that the state, in its capacity as owner, provide for the implementation of a legal framework that allows better corporate governance practices to be adopted and requires its companies to implement them in order to improve their performance.

It should be clear that, in addition to improving the business performance of their public companies, there are additional compelling reasons for states to encourage the strengthening of their SOEs through corporate governance, among which are included at least the following²:

- 1. Credibility for the state:** Because of the importance and visibility of SOEs in the communities and countries where they operate, these companies should exemplify the best practices of the state itself. The SOEs, therefore, should be emblems of compliance with the law and be considered a model for the application of legal standards and best practices, thus setting an example for all the companies subject to state laws and regulations. Conversely, the lack of corporate governance in a state-owned enterprise could reduce the credibility of the state and undermine the legal framework.

². For more detail see the chapter “Importance of Corporate Governance in State-Owned Enterprises” in “Corporate Governance in Latin America. Importance to State Owned Enterprises” (CAF, 2012)

- 2. Compliance with global standards.** Corporate governance principles and best practices have become a global standard. Governments, regulatory agencies, and stock exchanges in virtually all parts of the world, including developed and developing countries, have adopted standards of corporate governance through laws, regulations, and private sector initiatives.

Various global institutions – including the Organization for Economic Cooperation and Development (OECD), the World Bank, the International Finance Corporation (IFC), BidInvest, the Principles of the United Nations Global Compact for Responsible Investment (UNPRI), the *International Corporate Governance Network* (ICGN), The Latin American Companies Circle, CAF itself, and many other regional groups – are part of a global network that strongly supports the principles of corporate governance and confirms its commitment to good practice. Companies that ignore global governance standards can be targeted by an efficient network of institutional investors, activists, special interest groups, and the media with the corresponding negative impact on their value not only commercially but also in terms of reputation. Poorly governed companies often suffer a significant discount in value. In addition, institutional investors, under increasing pressure to exercise “guidance” in the portfolio of companies they own, further amplify the importance of corporate governance in the calculation of the cost of capital.

- 3. Defense of the public good.** When public companies are well governed, well managed, and meet the objectives for which they were created, the economic and social benefits directly impact the communities they serve. The statement “what’s good for business is good for the country” has an additional meaning when referring to state-owned enterprises. The obvious direct public benefits include increased employment, a stronger income base, and social and political stability. Indirectly, in the long term, public benefits include reduced demand for state assistance, less dependence on regulatory interventions, increased investor confidence, and the fostering of an entrepreneurial culture that occurs when the state is seen as a promoter of development.
- 4. Business integrity.** When the state supports and enforces corporate governance standards in its own SOEs, it is actually setting a standard of integrity for all companies – both domestic and foreign – doing business in the country. Since corporate governance standards improve the quality of domestic companies, they also act as a barrier to foreign companies with lower integrity, thus reducing the likelihood of a “downward spiral” and reinforcing domestic companies to compete with their peers abroad.
- 5. Market Efficiency.** As has been empirically demonstrated, corporate governance standards expand the access companies have to global capital and reduce its cost.³

3. The Novo Mercado in Brazil demonstrates the excellent relationship between governance and improvement in performance. The benefits extend from the market to businesses, to the infrastructure that directly supports them, to the communities they serve, and ultimately, to the general public and the economy.

CHAPTER IV

REGARDING THE GUIDELINES FOR GOOD CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

To update the “Guidelines for Good Corporate Governance of State-Owned Enterprises” published by CAF in 2010, the updates of the “OECD Guidelines on Corporate Governance of State-Owned Enterprises” (OECD 2015), the “G20/OECD Principles of Corporate Governance” (OECD 2016), and the “Guidelines for a Latin American Code of Corporate Governance” (CAF 2013) have been taken as the main framework of reference.

The OECD documents are comprehensive and detailed and are intended to assist legislators in developing public policy on corporate governance in general and on SOEs in particular. Broadly speaking, they establish how the relationship between the shareholder or owner (state), the Board of Directors, and management is structured.

As a complement to that, CAF documents focus more on the business reality and have been written to guide the operations of the corporate governance of the companies themselves, i.e., they establish best practices to ensure an efficient, transparent and equitable performance of the relationship between all the stakeholders (shareholders, Board of Directors, and upper management).

Based on its own experience, CAF has selected, simplified, and adapted the OECD recommendations and principles and has maintained those practices considered most valuable for the region’s SOEs. Thus, the guidelines presented in this document contain the foundation that should guide public policies and management decisions that contribute to consolidating the corporate governance of these types of companies and, therefore, to improving their performance and transparency.

In addition, for the preparation of these guidelines, experiences affecting SOEs or their context have been reviewed and are included, along with others, in the following documents: “Institutional frameworks for managing SOEs” (OCDE 2016); “Ownership and Governance of State-Owned Enterprises” (OCDE 2018); “Governance Challenges of Listed State-Owned Enterprises around the World: National Experiences and Framework for Reform” (ECGI 2017); “Governance of Cities” (CAF 2015); “Corporate Governance in Latin America: Importance for State-Owned Enterprises” (CAF 2012); “Effectiveness and Structure of Boards of Directors at State-Owned Enterprises in Latin America and the Caribbean” (CAF 2017). “Transparency in the Corporate Governance of State-Owned Enterprises in Latin America” (CAF 2015) and “Profile of a Corporate Secretary in Latin America” (CAF 2018).

A. Structure

The structure of these “Guidelines for Good Corporate Governance of State-Owned Enterprises” is presented based on the areas established as essential for the corporate governance of state-owned enterprises in both the CAF Latin American Code and in the OECD guidelines. These aspects are as follows:

- 1. Need for an effective legal and regulatory framework**
- 2. The role of state ownership.**
- 3. Equal rights and treatment of shareholders.**
- 4. General Assembly of Shareholders.**
- 5. Board of Directors**
- 6. Control architecture**
- 7. Transparency and financial and non-financial information.**

In this respect, the current corporate governance guidelines are based on recommendations associated with each one of these seven areas.

The use of this practical knowledge is particularly relevant because it ensures that the recommendations made are pertinent and based on the social, economic, and political reality of the countries in the region, and not simply on the transfer of experience from more developed nations. Hence, the guidelines included in this document have a sense of practical orientation based on business reality that allows for an effective transformation of the institutional framework surrounding SOEs.

B. Target beneficiaries

The guidelines are addressed, primarily, to companies in which, regardless of their specific legal form, the ownership is one hundred percent in the state, or those others, normally in the form of a corporation, in which the state is the controlling shareholder (mixed companies with public and private capital), whether or not they are listed on the stock exchange.

In view of the above, there is nothing to prevent the regulator from considering giving force of law to some of the corporate governance practices proposed here some of which are already present, to a greater or lesser extent, in the regulatory framework in force in various countries. In fact, in these guidelines, some practices can be identified that should be considered for the applicable legal and regulatory framework in order to provide an impetus, from an obligatory standpoint, for the maintenance of minimum standards in terms of

corporate governance. Thus, these guidelines are a tool to support regulators in developing their standards and in their search for the necessary balance between self-regulation and regulation.

C. Basics of Compliance

This is an eminently practical document that is designed for maximum dissemination and real applicability throughout the business community.

To meet these objectives of dissemination and applicability, it would be advisable for SOEs that freely decide to follow these guidelines to adopt the internationally accepted principle of “comply or explain,” whereby companies that implement these guidelines must comply with their content or explain those guidelines or recommendations that they either do not comply with or only partially comply with. This information on the degree of compliance with the guidelines must be disclosed in an annual corporate governance report or, failing that, in the management report or annual report at the end of the fiscal year, which should be available on the corporate website.

In our opinion, the comply or explain mechanism is the most appropriate for a company that, in whole or in part, adopts the corporate governance practices included in the Guidelines, so that it is able to publish the progress achieved in corporate governance for interested third parties (shareholders, investors, banks, regulators, etc.). Moreover, it is a mechanism that entails a commitment and, at the same time, is very flexible. It creates a commitment since both the corporate governance report and the management report are corporate documents for which the Board of Directors is exclusively responsible, and therefore, the Board must be especially rigorous in publicly

explaining the degree of their compliance with each of the corporate governance practices. It is flexible, since it allows the company to explain and demonstrate the actual implementation of a particular corporate governance guideline or to give a reasoned explanation regarding its noncompliance whether this is because there is an obstacle in the current legislation against its application, or because the company disagrees with what is included in the practice or the advisability of its adoption.

D. Implementation and application

Corporate governance and the guidelines are not a “one-size-fits-all” but a tailor-made suit that must consider the specific characteristics of the company (industry in which it operates, size, complexity, geographical scope of operation, ownership structure, etc.) in order to identify the corporate governance requirements to be applied.

The guidelines include a series of corporate governance practices that, if adopted, should be incorporated into the internal rules of the companies. This would make them legally binding for those stakeholders covered by the SOE governance system from that moment on.

To this effect, internal rules are understood to be the set of documents and internal rules of the company itself and/or its shareholders such as the Articles of Incorporation, Corporate agreement, Bylaws, or equivalent documents, and other instruments, normally of a voluntary nature, such as the Internal Regulations of the Board of Directors, its Committees, the Internal Regulations of the General Assembly of Shareholders, the statute regarding the role of internal audit, or others.

The actual implementation of the guidelines will, therefore, entail making changes, in many cases substantial ones, to the company's rules of operation. Sometimes the actual implementation of corporate governance in SOEs implies the reform of a special law approved in the congress/parliament which regulates the constitution of the company or its constitutive document; this makes it difficult to adopt the corporate governance measures that are needed to reinforce the company. However, in these cases, there are multiple variables to be taken into consideration by the proponents and those responsible for corporate governance reform. In that regard, it will be necessary to resort to the internal regulations of the company itself in order to be able to implement, with the adjustments that are necessary in each case, the corporate governance that one wishes to adopt without contradicting the applicable law.

Because of all this, it is essential to consider the Guidelines not as a set of isolated practices to be incorporated into internal corporate regulations, but as an entire business culture that should guide the actions and relationships between ownership, administration, and ordinary management.

Consequently, before proceeding to a formal implementation, a process must be carried out to achieve full intellectual adoption or adherence by the ownership, administration, and

management with the scope that corresponds to each of these levels about the effective incorporation of these corporate governance practices. Moreover, if full conviction about the suitability of incorporating some of the practices proposed in this document is lacking, it would be preferable to proceed with the implementation of exclusively those practices for which there is a majority agreement, rather than proceed with their full implementation and risk non-compliance with them in practice.

In short, we understand that a process of strengthening the corporate governance practices of a given company, in accordance with the content of these guidelines, must be a graduated process in which gradual changes are undertaken to allow the best governance of the company without unnecessarily putting its operation under stress and avoid possible adverse effects.

Finally, corporate governance is a vibrant reality. Understandably, the practices implemented by a given company should be periodically reviewed in order not to build a regulatory structure that is considered a "straitjacket" that could compromise its flexibility, but rather, a set of practices that are suitable for each company and allow it to operate more efficiently over time.

CHAPTER V

BEST PRACTICE GUIDELINES FOR CORPORATE GOVERNANCE OPERATIONS IN STATE-OWNED ENTERPRISES

This section is focused on the types of practices that could contribute to improving the performance of SOE corporate governance.

For each of the seven major areas of corporate governance presented previously:

1. **Need for an effective legal and regulatory framework**
2. **The role of state ownership.**
3. **Equal rights and treatment of shareholders.**
4. **General Assembly of Shareholders.**
5. **Board of Directors**
6. **Control architecture**
7. **Transparency and financial and non-financial information.**

Specific guidelines have been identified that are understood to be major principles of corporate governance and are complemented by an explanation that make it possible to substantiate practical compliance with the guidelines.

The first two should be understood as areas managed by the state in its role as regulator and owner of the companies. The rest are directly related to SOEs.

1. NEED FOR AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework for public companies should ensure a level playing field in the markets where public sector companies and private sector companies compete in order to avoid market distortions.

As was mentioned above, the legal and regulatory framework in which public companies operate is often complex. If it is not consistent and coherent, it can easily cause costly market distortions and undermine the accountability of both the Board and executive team as well as the state as owner. A clear division of responsibilities among the authorities, simplifying the legal structures together with a coherent and consistent regulatory framework will contribute to improving the corporate governance of public companies.

Several of the practices detailed in this section are addressed, not to the SOE, but to the state as the one responsible for the property since they imply changes in legislation or in the regulatory framework. It will be the responsibility of the SOE to bring these recommendations to the appropriate government level in order to raise awareness of the importance of making these regulatory changes

Guideline 1. The regulatory framework for SOEs should ensure a clear separation between the roles of the state as owner and as market regulator.

This practice seeks to ensure that the legislation does not mix the role of the state as owner with its role as regulator and thus manage the conflicts of interest that arise when SOEs are used as a vehicle for developing government policy.

The link between the SOE and the state as regulator, on the one hand, and as owner, on the other, may not be used to facilitate the conditions for the duties and activities of the SOE to be protected by the regulatory framework in order to use state prerogatives to obtain a competitive advantage over other companies whether public or private.

The existence of a regulatory framework in which the separation of the state as regulator and the state as owner is made evident must be accompanied by the institutional reinforcement of the corporate governance of SOEs as well as the autonomy and capability of the regulatory bodies.

Guideline 2. A “corporate governance framework” for SOEs that will facilitate the processes of reinforcing corporate governance should be pursued.

The “corporate governance framework” of SOEs should be based on not only legal standards with different rankings, but also incorporate self-regulatory practices, voluntary commitments, and business practices that, to the extent possible, enable the management of the excesses or limitations that are inherent in regulation, a circumstance that sometimes makes it difficult for SOEs to compete with private companies.

Guideline 3. Governments should advocate the simplification of the legal forms for SOEs for two purposes: to facilitate the implementation of advanced governance models that are comparable to those of the private sector so that creditors can exercise their rights and pursue legal actions when there are insolvency proceedings.

The creation of specific legal frameworks for SOEs that set up exceptional structural, commercial, and labor conditions should be avoided.

For example, SOEs with legal forms unlike that of the corporation normally lack a body or authority comparable to the General Assembly of Shareholders, where the state can exercise its rights as a shareholder or owner of the company. This circumstance represents an evident anomaly since it forces the owner to exercise its property rights directly within the Board of Directors and/or through channels other than the SOE itself. In extreme cases, the state may exercise its ownership role directly through the executive team of the SOE.

Likewise, there should be no legal framework that overprotects or leaves workers unprotected simply because they work for this type of company. In general terms, it would be advisable for SOEs to be administered under the same legal structures that correspond to private entities. This situation makes it possible for creditors, suppliers, and employees to exercise their rights and make demands in accordance with the general provisions of the law as they do in private companies. In general terms, the special legal framework for the SOE should be limited to specifying the mandate and objectives of such companies.

Guideline 4. The legal and regulatory framework should be flexible enough to allow for adjustments in the capital structure of SOEs when these are necessary to achieve the company's objectives.

In addition to being flexible and being able to change the capital structure of SOEs, clear limits must be set and supervision by the relevant authorities ensured. In this respect, the legal framework must provide the company – subject to shareholder authorization and in accordance with the law governing the sector – with the possibility of modifying their capital structure if they consider it necessary in order to increase their capitalization or to better fulfill their corporate purpose.

Guideline 5. SOEs must operate under market conditions to obtain financing. Their relationships with banks, public financial institutions, and other SOEs must be based on criteria that is strictly commercial in nature.

The legal framework should prevent SOEs from using state prerogatives – such as state collateral – to obtain better financing conditions than private companies. In this respect, automatic guarantees on the part of the state to support the indebtedness of SOEs should be avoided.

It is understood that there are situations in which SOEs – especially those providing basic utilities – channel subsidies or resources collected with a state guarantee. In these cases, the important thing is that the subsidies be explicit, come from the public budget, and do not affect the company's assets.

In addition, the legal framework should encourage or at least not discourage SOEs from tapping the capital markets for financing. These practices are critical to preventing not only inequities in access to financing, but also distortions that favor

an SOE that is not well managed and enable it to access the market at preferential rates thanks to state guarantees. The introduction of such guidelines into the legal framework allows SOEs to be subject to minimum market disciplines.

2. THE ROLE OF STATE OWNERSHIP

In order to carry out its ownership duties effectively and in an orderly manner, the state should act as an informed and active owner and foster the greatest possible harmonization of private and public sector corporate governance standards.

To this end, the government, in the development of public policies related to corporate governance, may take into consideration the recommendations included in the “Guidelines for a Latin American Code of Corporate Governance” (CAF 2013) and the “G20/OECD Principles of Corporate Governance” (OECD 2016).” Both documents represent an exhaustive compendium of best practices and recommendations on corporate governance and although it is true that with respect to their origin, the documents are focused on the corporate governance of private companies, they include many aspects that can also be applied to public companies.

In addition to the CAF and OECD principles of corporate governance, there are a number of specific aspects of public company corporate governance that either warrant special attention or should be documented in more detail in order to guide public company board members, management, and the public entity responsible for exercising state property rights so that they fulfill their respective roles effectively.

Finally, it is imperative that civil society, markets, and the state understand that good corporate governance is a term that

encompasses a number of international standards that do not relate to any particular political movement. Good corporate governance provides companies based on public capital with a framework for action that allows them to define, respect, and monitor the achievement of their objectives. It also clarifies the line of command and defines the responsibilities of the state as owner, of the Boards of Directors as strategic authorities, and of the upper management as executives responsible for the day-to-day running of the company.

This approach is emphasized as having benefited both SOEs and citizens from the very beginning of the process of implementing corporate governance practices in several countries in the region – regardless of the ideological inclinations of their governments – and that commitment at the highest levels is also indispensable.

Guideline 6. Governments should define a scope of action, in the form of a public company law or ownership policy, that determines the role of the state as a shareholder or owner of SOEs, its role in strengthening the corporate governance, and the manner in which such laws or policies will be implemented.

As cited by the OECD in their document “*Ownership and Governance of State-Owned Enterprises. A compendium of National Practices*”, to a greater or lesser extent, these laws or public policies, as instruments, make it possible to give SOEs, markets, and the general public clarity and predictability about the objectives of the state and its priorities as an owner of a public company. These instruments range from a law passed in congress/parliament that represents a law of the highest legal rank to regulations of lower rank that can take different forms such as agreements, resolutions, or government decrees.

In all cases, the framework must facilitate a balanced approach by the state so that it is not totally passive towards the company or, conversely, does not become too involved in the day-to-day management of SOEs.

The structure of the law should be clear, consistent, and have a medium- and long-term horizon. In it, the state must clearly establish the reasons why it is acting as a business owner and the business and social objectives that the companies are required to pursue. In addition, it must actively seek the adoption of corporate governance practices that improve the performance and transparency of its companies. It must also specify the mechanisms for implementing these practices and the role to be assumed by the different state or government bodies with respect to SOEs.

Recognizing the obvious difficulties that may arise in passing a law with the above-mentioned characteristics through the congress/parliament or at the government level, the state entities responsible for the property may, as an alternative, encourage the use of other mechanisms, which, although they do not have the highest legal status, allow for order and transparency in the actions of the owner state with respect to its SOE. Among these mechanisms or instruments, the following stand out:

1. Declaration by the state in its capacity as majority shareholder.
2. Bilateral governance agreements between the SOE and the state represented by whoever exercises property rights on its behalf.
3. Corporate governance code issued by the SOE.

Further details on these instruments can be found in Appendix 1.

Guideline 7. The government should not interfere in the day-to-day management of SOEs and should grant them operational autonomy to achieve their business objectives.

In line with the OECD, the main mechanisms by which the state actively and in an informed manner exercises ownership are a clear and consistent ownership strategy, a well-structured process for nominating and electing directors, and a clear mandate for the company and its directors as well as effective exercise of established property rights. On the part of the government, any interference in ordinary SOE management matters should be avoided since it is up to the company's upper management, under the control of the Board of Directors, to implement the strategy approved by the Board.

Consequently, "The state's broad mandates and objectives for SOEs should be revised only in cases where there has been a fundamental change of mission. While it may sometimes be necessary to review and subsequently modify an SOE's objectives, the state should refrain from modifying them too often and should ensure that the procedures involved are transparent."⁴

Guideline 8. The state as owner must allow the directors of the SOE to exercise their duties and respect their independence.

When nominating directors, the state should take into account the need for the SOE Board of Directors to always act responsibly, professionally, and independently. There should not be an excessive number of directors from the public administration (a maximum limit of 20% of the Board of Directors is proposed) much less the existence of ex officio

4. OECD Guidelines on Corporate Governance of State-Owned Enterprises (2015).

directors, that is, those persons who sit on the Board of Directors of an SOE exclusively because of the position they hold in public administration.

All directors – whether they represent the state or not – must have the same responsibilities, duties, and rights. Disclosure of Board members' conflicts of interest should be mandatory. The Board of Directors should not respond to political influences, except those expressly authorized by congress/parliament or approved through specific procedures. The state must ensure that its directors have the appropriate professional and ethical conditions to exercise their position independently.

As a way to give the Boards of Directors more stability and to reinforce the independence of their members, the state should evaluate the advisability of choosing the directors of the SOE on a phased basis, so that they are elected and/or renewed over at least two electoral periods.

Depending on the length of the electoral cycle and the possibility of officeholders being re-elected, the implementation of this practice technically presents several options and does not present great difficulties.

Once the decision is made to elect the directors on a staggered basis, the practice must be implemented through the corresponding corporate document (Articles of Incorporation, Corporate agreement, and Bylaws). Therefore, it will be necessary, more or less in the middle of the electoral cycle, to modify the article that regulates the period for which

directors are appointed or to keep it unchanged and include a temporary provision such that, during a pre-determined General Assembly of Shareholders, the directors are elected, only once, for periods different from the statutory one. Thus, for example, if a Board of Directors is made up of seven directors who are elected for three years, then, to implement the staggered election at the corresponding General Assembly of Shareholders, it will necessary to establish that two directors will be elected for one or two years, three other directors for two or three years, and the remaining three directors for three or four years. After the period for which they have been elected (one, two, three or four years), directors may be re-elected for three years or, if not re-elected, new directors will be elected for three years.

Another option for implementing the staggered election consists of arranging for directors to be reelected, as an exception and on a single occasion, one per year, for the period established in the Corporate agreement or Bylaws, until the number of directors foreseen is completed. Thus, depending on the number of directors, two or more election periods will be covered.

Undoubtedly, the staggered election is a practice that can potentially be rejected by the politicians since, in one way or another, it limits their ability to influence the administrative bodies of the SOEs and requires political will to change assuming that the system for electing directors is set out by law, which would require a congressional procedure to change.

Guideline 9. The Specialized Ownership Agency (SOA) must be clearly identified. In some cases, identification may be easy because there is a single centralized legal entity that oversees property or entity that coordinates the various agencies involved in the SOEs. However, in other models, there may be, with different variants, two or more government entities involved in the ownership of SOEs.

It is essential that the body exercising property rights over a state-owned enterprise be clearly identifiable, and develop the appropriate institutional strength to exercise those rights both through its action at the General Assembly of Shareholders, if any, and through the nomination of its directors.

Many times, the state's ownership of the company is dispersed, and if it is not, the respective body (ministry, agency, etc.) may not have the institutional strength to exercise this role. As cited by the OECD in their document *Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices (2018)*, within the various possible models, it may sometimes be advisable to centralize the ownership role in a single entity that is not dependent on the national budget, or under the authority of a single ministry (centralized model), or in a single entity that coordinates the action of the various public bodies that are related to the SOEs. In other cases, the so-called dual model, in which two government institutions, e.g., the Ministry of Finance plus the Ministry responsible for the SOE operations share the ownership of the SOEs, or the "twin track" model in which one entity centralizes the ownership of several SOE portfolios which are supervised by different government institutions may be chosen.

As suggested by the OECD in its OECD Guidelines on Corporate Governance of State-Owned Enterprises (2015), the SOA, in whatever form it has, should have the capability and the power needed to carry out its duties effectively based on formal arrangements and procedures consistent with those applicable to companies in which it exercises state property rights.

Guideline 10. The SOA shall be accountable to congress/parliament and other representative bodies exercising public oversight.

The responsibilities of public officials, as part of the Executive Branch and their relations with the SOEs, must be clearly identified and differentiated.

The SOA, whether a centralized ownership or coordination unit, should be responsible for the exercise of the property rights held by the state over the SOEs. From this perspective, in addition to acting as an informed shareholder or owner at the General Assembly of Shareholders and in the nomination and election of the directors that corresponds to it based on the shares it holds, the state should define the individual objectives of the SOEs and monitor their performance.

The SOA shall submit a management report that is not limited exclusively to budgetary aspects but includes other matters such as: strategic vision, SOE performance in the market or sector in which it operates, and the goals achieved during the period as opposed to those indicated in the government's plans; social balance, actions carried out in the field of environmental policy, corporate governance, etc.

The cases in which the authorization of congress/parliament is required ex ante to carry out certain operations should be very limited and involve only matters that are significant such as strategic operations related to changes in the ownership structure or the size of the SOE, etc.

Guideline 11. The state, as owner, must actively exercise its property rights in accordance with the legal structure of each SOE as it endeavors to preserve institutional soundness and fulfill organizational objectives.

The state must be represented at the General Assembly of Shareholders or the highest body of ownership the SOE has and exercise the right to vote responsibly.

An objective and transparent process that is competitive and consistent with the long-term interests of the company should be established for the nomination and election of board members.

As a means of strengthening accountability, the Board should act, for all practical purposes, as the hierarchical superior of the chief executive officer (CEO, General Manager, Executive President, General Director, etc.) of the SOE. To do so, the state must guarantee that the appointment and removal of the CEO of the SOE falls on the Board of Directors and is not reserved to the SOA, the President of the Republic, the Mayor, the Governor, the Minister, or the Council of Ministers. If the legal framework does not allow this, the Board of Directors should be the body that proposes the candidates for the position of CEO of the SOE based on technical and professional criteria.

Reporting mechanisms should be established to do periodic monitoring and regularly evaluate the management and performance of the SOEs and ensure that the specific objectives that were assigned are met.

It is extremely important for the state, by means of government action, to ensure that the various public bodies responsible for supervision, control, and auditing (Comptrollers, Attorneys General, etc.) differentiate between the business reality of an SOE that is possibly in competition with the private sector and other public administration bodies. In those cases in which the internal control laws for state entities or their equivalent do not differentiate between the business operations of the SOEs and the institutional activity of, for example, a Ministry, the government, and the SOEs themselves, they should establish permanent contact with the corresponding public agencies in order to jointly identify possible alternatives that allow the implementation of control architecture models appropriate to an operating company.

3. EQUAL RIGHTS AND TREATMENT OF SHAREHOLDERS

To the extent that the SOE is structured under a corporate model of ownership by shares, the recognition of shareholders' rights and the mechanisms for their exercise is one of the most relevant issues from the perspective of corporate governance since shareholders, regardless of whether they are controlling, significant, or minority, are the true owners of the company and those who provide the capital for it to carry out its operations.

As a result, shareholders must have recognized rights that facilitate their exercise of ownership and be able to carry out what are considered key roles, which in many cases are recognized in the legislation in force in each country, and which are usually linked to:

- Influencing the company, mainly through their participation and vote at the General Assembly of Shareholders.
- Receiving – and requesting – information.
- Sharing in the profits of the company (or be responsible for losses).

Since corporate administration and management is a complex matter, which requires agile decision making and demands certain skills, the shareholders cannot be the ones who exercise these duties directly (except for very small companies). Therefore, they normally delegate the administration of the company to the members of the Board of Directors, who in turn delegate the ordinary management to the members of the upper management of the company, thus establishing the three levels of Ownership, Administration, and Management.

The above, which is the basis of the agency problem, is the *raison d'être* of corporate governance, which devotes its attention to the relationships between these three levels.

Within the SOE framework, it is essential to recognize that the company's shareholders must have the same opportunities to exercise their property rights as they would in the case of private companies. Therefore, when shareholders act solely and exclusively as such (without being, in turn,

members of the Board of Directors or upper management), they must be able to exercise a series of rights focused on certain key ownership issues such as the election and removal of Board members, the amendment and approval of the bylaws, the approval of extraordinary operations, the receipt of information on the progress of the company, the transfer of shares and, in general, a series of basic issues that, in many cases, are established in the corporate legal framework as well as in the Company's Bylaws.

In addition, the time horizon in the exercise of property rights by shareholders must be considered. Thus, the power of shareholders to exercise preferential rights or qualified majorities to make certain decisions as *ex ante* rights, and the exercise of certain rights *ex post* such as the possibility of demanding a certain reparation for the violation of a right must be recognized.

Finally, with the adoption of the necessary safeguards to avoid excessive litigation, one of the ways in which shareholders can assert their rights is the possibility of legal actions and administrative appeals against directors or Board members, or resort to arbitration procedures.

It is in the recognition of these rights, but especially in the mechanisms for their equitable exercise, where the attention lies from the perspective of corporate governance.

In these Guidelines, therefore, we should not stop to make an exhaustive list of them, but address their treatment in the place that is considered most appropriate to clarify and, sometimes, delve deeper into their content.

Guideline 12. One share, one vote.

Each share of common stock within the SOE must be entitled to one vote without limitation or variation. The same participation in the capital stock of the SOE must be attributed the same voting rights. It is essential for the state as a shareholder and the Board of Directors to allow minority shareholders to exercise this right without coercion or restrictions at the General Assembly, and also to establish protective measures. To this end, the SOA shall develop guidelines and principles regarding the equitable treatment of minority shareholders and make a special effort to comply with them. This practice is essential to increasing the credibility of SOEs and improving their effectiveness in attracting investments through a change in the capital structure.

Guideline 13. Principle of parity in the treatment of shareholders.

SOEs, whether they are listed on the stock exchange or not and which, in addition to the state has other shareholders with different profiles, must provide equal treatment to all those shareholders who are in the same conditions.

Therefore, companies should develop internal practices to, as far as possible, learn the profile of their shareholders based on their circumstances and characteristics and distinguishing between significant and non-significant shareholders, those with a conflict of interest (actual or potential) with the company or not, institutional or individual, majority or minority, stable or transitory, and between shareholders who are active and have the will to influence corporate life and those who are passive. On the basis of this knowledge, the company will be able to prevent shareholders of the SOE who are in the same position from being treated differently in their relationship with the company.

The Board of Directors of the SOE will approve a communication policy that defines how the company will interact with shareholders whose conditions vary in matters such as, for example, access to information, resolution of information requests, communication channels, forms of interaction between shareholders and the company, its Board of Directors, and other managers.

The communication policy must make it possible to reconcile the rules against market abuse and the absolute prohibition against listed companies illegally communicating privileged information – which would undermine the imperative principle of equality of information among shareholders – with the usefulness and legality of discussions and conversations of a general nature on business issues and the development of the company and the markets between the executives of an SOE and its shareholders or investors.

Guideline 14. When the governing bodies of the SOEs propose extraordinary or strategic operations, these must be sufficiently supported by the shareholders.

In extraordinary or strategic operations, such as mergers or large acquisitions, among others, which significantly affect the rights of minority shareholders or require approvals from the SOA, a special, reinforced quorum of the capital stock must be required to approve the operation. This measure is desirable to ensure that minority shareholders are informed and consulted on decisions as well as to ensure the widest possible support for the change in the strategic direction of the company. It is advisable for the Board of Directors to explain – based on strategic criteria and external studies – their motivations for proposing these types of operations and obtain the necessary feedback and support (see Guideline 15 which follows).

Guideline 15. The SOEs must have: i) a report from the Board on operations that may affect minority shareholders and, in general, on extraordinary or strategic operations; ii) an external advisor's opinion on strategic operations and, (iii) publicize such reports.

Proposals for certain extraordinary or strategic operations (mergers, issuance of shares or convertible bonds without respecting the right to preferential subscription, spin-offs, etc.) made by the Board of Directors must necessarily be supported by an ad hoc report made by the same body, particularly when it directly affects the interests of minority shareholders. Ideally, this report should be supported by the opinion of an external advisor with recognized experience and professional solvency and made public to all shareholders.

In the particular case of business groups in which the obligation of the directors to be loyal may be ambiguous and even be interpreted as a commitment to the business group, when the decisions of the parent company negatively affect the minority shareholders of a subordinate company, compensatory measures may be designed in favor of these adversely affected shareholders.

Guideline 16. SOEs with more than one shareholder should ensure effective communication with all shareholders. One of the most efficient mechanisms is the creation of a specific department to assist shareholders and investors.

SOEs should have mechanisms for communicating with their shareholders that go beyond the General Assembly so that they can request information and raise issues of interest. SOEs

should have a specific investor service unit or designate a person or area with the specific responsibility to channel information from the company to the shareholders, and vice versa. It is recommended that the Board of Directors ensure that management create this unit or designate the person or area to take on the responsibility, and make sure it has sufficient resources to fulfill its task of developing relationships and communicating with shareholders and investors.

Guideline 17. SOEs must implement the following measures to strengthen their communication with shareholders: i) maintain a website that contains corporate information, ii) implement warning systems on material information, iii) permanently update the registry of shareholders, and iv) introduce electronic communication mechanisms between SOEs and their shareholders.

SOEs must carry out their work under the principle of open communication through which channels of interaction are established with both their shareholders and the various stakeholders. The most effective system for carrying this out is to have electronic channels that contain relevant corporate information. They must also establish an electronic warning system, which allows investors to be notified in real time when decisions are made that affect their interests. The registry of shareholders must be updated in order to be able to send relevant information to them in a timely manner.

Also, in certain large and/or capital-dispersed SOEs, it is desirable to institutionalize the holding of periodic informational meetings with shareholders and/or market analysts.

Guideline 18. The participation of minority shareholders in the General Assembly of Shareholders should be encouraged in order to further their involvement in fundamental corporate decisions such as the election of the Board of Directors.

As the OECD notes in its guidelines, “Where the state is not the sole owner of an SOE, it is generally not in a position to formally “mandate” the fulfilment of specific objectives, but should rather communicate its expectations via the standard channels as a significant shareholder.” In accordance with this reality, the SOE should establish mechanisms that encourage and facilitate the participation of minority shareholders in the Assemblies (qualified majorities for certain matters, cumulative voting, electronic and/or distance voting, or implementation of transparent proxy mechanisms). The Board should make an effort to ensure that they are properly informed about all points to be discussed at the meeting. It is desirable that minority shareholders actively participate in the process of nominating and electing directors to ensure that they feel adequately represented.

Guideline 19. SOEs should provide alternative methods for resolving disputes.

SOEs must adopt commitment clauses regarding submitting the resolution of disputes within the company to arbitration with the exception of those matters whose treatment has been restricted to legislation or ordinary and/or administrative justice. This practice is recommended to increase credibility, transparency, and equity with investors and the company’s various interest groups by adopting mechanisms to facilitate dispute resolution scenarios.

Guideline 20: Specialized audits requested by SOE shareholders.

The bylaws of the SOE, or an equivalent document, must provide that a shareholder or group of shareholders representing at least 5% of the capital may request specialized audits on matters other than those audited by the external audit firm.

To exercise this right, the SOE must have a written procedure that specifies:

1. The reasons why the company defined a percentage lower than 5% if that should be the case.
2. The requirements for requesting a specialized audit.
3. The company’s obligation to respond to the requesting shareholders in writing as soon as possible through its Board of Directors.
4. How to designate who is responsible for doing the audit requested.
5. Who should assume the cost of the specialized audit.
6. Precise deadlines for each of the stages or steps of the procedure.

Guideline 21: Organizational structure of a business group composed of SOEs.

When a group of SOEs, one acting as a parent or controlling company and the others as subordinates (subsidiaries or affiliates), are part of a business group, formal or otherwise, the group must have an organizational structure that defines the key individual bodies and positions for the three levels of governance – General Assembly of Shareholders, Board of

Directors and upper management – as well as the relationships among them. This structure must be public, clear, and transparent, and must make it possible to identify clear lines of responsibility and communication, and facilitate the strategic orientation, supervision, control, and effective management of the business group.

Likewise, the parent company and its most important subsidiaries must define an “institutional relations framework of reference” through the signing of an agreement that is public in nature and approved by the Board of Directors of each of the companies and which regulates:

1. The definition of the interest of the group to which they belong, understood as the primary interest that all the companies must pursue and defend.
2. The levels of responsibility and duties of the parent and subsidiary Boards of Directors in relation to the definition and implementation of the group and the companies’ strategy.
3. The recognition and use of synergies between companies in the group under the premise of respect for minority shareholders.
4. The respective areas of activity and possible business between them.
5. Common services provided by the parent company, a subordinate company and/or third parties.
6. The criteria or manner of determining the price and conditions of business between the companies in the group and the common services provided by any of them or by third parties.
7. The pursuit of group cohesion, through a common and shared vision of the key Control Architecture positions such as internal audit, external audit, and risk management.

8. The action and coordination of the committees of the Board of Directors of the parent company and of the committees that it is advisable or mandatory to set up in the Boards of Directors of the subordinates.
9. The mechanisms envisioned to resolve possible conflicts of interest between companies.
10. The stipulation that when related transactions occur between a subordinate company that issues securities and its parent company, whether it is an issuer or not, the conflict-of-interest management policy will be applied with special care and rigor, to ensure, among other things, that the transactions are in line with market prices and conditions.

4. GENERAL ASSEMBLY OF SHAREHOLDERS

For an SOE with minority shareholders, the General Assembly of Shareholders is the supreme and sovereign body of a company. The shareholders come together here and jointly exercise the powers that correspond to the Assembly, many of which are set out in the laws and, on occasion, extended in the bylaws themselves.

Consistent with the three levels of government, ownership, administration and day-to-day management, it could be stated that the true key authority of the General Assembly of Shareholders is the shareholders’ effective control of the company’s progress and, consequently, of the actions of the Board of Directors, to whom the shareholders have delegated the management of the company.

However, the reality is that, despite its critical significance and the extreme relevance of its powers, in practice, the General

Assembly of Shareholders is a body that, on many occasions, is undermined by its formalism and lack of agility.

This situation is even more evident when it comes to the General Assemblies of Shareholders of companies listed on the public stock market, where the existence of many shareholders as individual investors (only capital contributors) rather than true shareholders committed to the company, has brought about a progressive reduction in the active role of the General Assembly of Shareholders as a key governing body or what is more serious, unfortunately, the fact that there are still important SOEs set up under special legal forms, under the protection of special laws in the region. In several cases, one of the characteristics of these special legal forms is the lack of a General Assembly of Shareholders where the public ownership can manifest itself and exercise its rights, since these companies are not based on shares.

Given this reality, we are seeing a whole set of measures that, through corporate governance, will revitalize the role of the General Assembly of Shareholders as the governing body and effective control of the managers so that the shareholders move from a state of "shareholder apathy" to a state of "shareholder activism".

These types of measures go hand in hand with the development of new technologies in the corporate universe so that access to information, the existing channels of communication between the company and its shareholders, the mechanisms for exercising voting or representation, or the groupings of shareholders are maximized.

Guideline 22. SOEs must recognize the exclusive and non-delegable powers of the General Assembly of Shareholders.

The Bylaws of the SOE should recognize the General Assembly as the supreme body of the company, and as such, provide for which duties are non-delegable and which can be delegated to the Board of Directors or other bodies.

By their nature, clearly non-delegable duties are usually already included in the applicable legal framework as exclusive to the Assembly. These include the approval of year-end financial statements, the election of the directors, the amendments to the bylaws or the approval of the Board's remuneration policy, or major corporate operations such as mergers, spin-offs, transformations, etc.

The responsibilities specific to the General Assembly of Shareholders which are usually attributed to it within the framework of self-regulation are related to decisions that affect the company's assets and liabilities. This is true with respect to the issuance of debt instruments, the sale or pledge of strategic assets or liabilities of the company or certain complex financial structures.

Although these types of decisions could be delegated to the Board of Directors to all intents and purposes, it is our view that the best practice is for approvals of these matters to be made at the General Assembly of Shareholders with the possibility of delegating their implementation – within the limits approved at the Meeting – to the Board of Directors and, where appropriate, to the company's upper management.

Guideline 23. The SOEs must have Internal Procedure Regulations for the General Assembly of Shareholders.

When the SOE, due to its capital structure and/or its corporate regime, has a General Assembly of Shareholders, it must adopt a regulation for the operation of this body.

The purpose of the Regulations is to govern the issues that concern the General Assembly of Shareholders such as its convocation, attendance, and preparation of information so that the shareholders have a clear framework of rules that allows them to exercise their rights and the procedure of the meetings in order to achieve healthy discussion and adequate decision making.

Guideline 24. The SOEs should recognize and, if necessary, regulate the right of shareholders to request the calling of an extraordinary General Assembly of Shareholders when a certain percentage of the ownership requires it.

This right is provided for in most commercial laws. From a corporate governance perspective, what is really important is that the percentage of shareholder participation required to be able to request the Board of Directors to call an extraordinary General Assembly of Shareholders has been calculated according to the degree to which the company's capital is concentrated, so that this right can be exercised in practice by the shareholders. Thus, if the commercial legislation establishes a percentage, for example, of 25% of the capital and the capital of the SOE is very diluted among minority shareholders, the SOE can make the right more secure by lowering the required percentage to 5% or 10% of the capital via bylaws.

In all cases, obstacles must be avoided so that shareholders can come together to exercise a right that requires a certain percentage of capital.

Guideline 25. The Bylaws of the SOEs should recognize the right of shareholders, regardless of the number of shares they hold, to propose the introduction of one or more items to be discussed into the agenda of the General Assembly of Shareholders or the inclusion of new proposed resolutions within a reasonable limit and provided that the request is accompanied by a justification.

The request by shareholders to include new items on the agenda must be made within five ordinary days following the publication of the notice of the meeting.

If the request is rejected by the Board of Directors, the Board is obliged to respond in writing to those requests supported by at least 5% of the share capital, or a lower percentage established by the company based on the degree of ownership concentration, explain the reasons for their decision, and inform the shareholders of their right to make their proposals during the General Assembly.

If the Board of Directors accepts the request, a supplement to the notice of the General Assembly of Shareholders will be published with the new agenda at least fifteen calendar days prior to the meeting once the shareholders' time to propose topics has expired.

With the same deadlines and procedure as for the proposal of new items on the agenda, shareholders may also submit new proposed resolutions on items previously included on the agenda based on a substantiated rationale.

Proposed Resolution means the literal proposal that is related to the items on the agenda, which is submitted to a vote and ideally should include the Board's recommendation to the shareholders on how to vote.

Guideline 26. For a better exercise of the shareholders' right to information, SOEs must have a sufficient period of time to call the Assembly that would guarantee its wide dissemination and the collaboration of depositary entities when appropriate.

Recognizing that the advance notice for the meetings of the General Assembly of Shareholders is in many cases regulated by the legislation of each country, a minimum of thirty (30) calendar days is considered a reasonable period of time in which to publish the announcement of the meeting. In addition to the mandatory means provided by law, SOEs must try to ensure maximum dissemination and publicity of the notification, for example, through electronic means (company website or e-mails, etc.).

The notice of the meeting will set the place, date, and time of the meeting, the agenda of the day for the Assembly, and the proposed resolutions as well as the format and place where the documentation related to these proposals is made available to the shareholders.

Guideline 27. The SOEs should ensure the right of shareholders to request written information in advance of the Assembly as well as to request oral information during the meeting.

The principle of information transparency must permeate all relations between the company and its shareholders so that

the exercise of the right to information can only be qualified or adjusted for reasons justified by the confidentiality, reasonableness, or irrelevance of the information requested.

Companies must overcome the limitations that most commercial laws impose on the shareholders' right to information. The main example of this is the recognition of the shareholders' right to consult the documents associated with the items on the agenda of the General Assembly of Shareholders only at the company's offices, and on specific days, at specific times, and under specific conditions.

Under this premise, the Bylaws of the SOEs must provide for the possibility that shareholders may request, sufficiently in advance of the assembly, the information or clarifications they deem to be necessary regarding the matters included in the agenda. When the answer given to a shareholder may put him in an advantageous position, the company will guarantee access to that answer to the other shareholders simultaneously in accordance with the mechanisms established for that purpose, and under the same conditions.

Likewise, the internal regulations of the SOE, in particular the regulations of the General Assembly of Shareholders, must provide mechanisms for shareholders to address the company's executives, the external auditor, and the members of the Board of Directors during the course of the Assembly.

As stated by the OECD in the OECD Guidelines on Corporate Governance of State-Owned Enterprises, "The state as an owner should fulfil its fiduciary duty by exercising its voting rights, or at least explain if it does not do so. The state should not find itself in the position of not having reacted to propositions put before the SOEs' general shareholder meetings."

Thus, it is important to establish appropriate procedures for the representation of the state at the General Assembly of Shareholders. Accordingly, the ownership entity must be clearly granted the status of representative of the state's shares. The SOA, or whoever exercises the property rights, in turn, must ensure that they have the necessary human, information, and technical resources to build informed opinions on the various issues raised at the General Assembly of Shareholders.

Guideline 28. The SOEs should ensure that the agenda items to be discussed at the General Assembly of Shareholders are precise.

The points contained in the agenda must be clear and precise. Thus, the agenda proposed by the Board of Directors must accurately reflect the content of the topics to be discussed and prevent important topics from being hidden or masked under imprecise, generic, too general or broad wording such as "others" or "proposals and miscellaneous."

The wording of the items on the agenda should ensure that they are better understood and the rules for holding the General Assemblies of Shareholders should make it possible for each item to be discussed separately during the session and thus facilitate its analysis and prevent joint voting on issues or proposed resolutions which, by their nature, should be resolved individually.

In the case of amendments to the Bylaws, each article or group of articles that are substantially independent must be voted on separately. In any case, an article will be voted on separately if any shareholder or group of shareholders,

representing at least 5% of the capital stock, so requests during the Assembly, a right that shall be previously disclosed to the shareholders.

The proposed resolutions corresponding to each agenda item presented by the Board of Directors to the General Assembly of Shareholders must indicate:

- a. The justification and timeliness of the proposed agreement.
- b. The resolution that is proposed, which clearly reflects the position or sense of vote proposed by the Board (approve or reject).

Guideline 29. For SOEs listed on a stock market, the possibility of exercising the right to vote through remote means must be enabled.

The SOEs must have electronic voting mechanisms in order to encourage the maximum participation of the shareholders in the shaping of the corporate purpose.

Guideline 30. The SOEs must recognize the right of shareholders to propose the dismissal of or the initiation of an action for legal liability against the directors.

Shareholders should be able to request the dismissal of or bring corporate liability actions against Board members with no need for the item to be included in the agenda of a General Assembly of Shareholders. Minority shareholders have the right to challenge the decision of the Assembly or the Board of Directors if they consider it necessary in the pertinent judicial proceedings.

Guideline 31. Even though the applicable legal framework allows it, the SOEs should encourage the non-representation of shareholders by Board members within the framework of the General Assembly of Shareholders.

As a general rule, neither the Board of Directors, nor its individual members, nor the members of upper management should be empowered to represent shareholders at the General Assembly of Shareholders.

If, in the end, the decision is made to allow directors to represent shareholders at the Assembly, representation using blank proxies without voting instructions must not be allowed. To that end, the SOEs must design and provide the shareholders with a standard proxy document that includes the agenda and the proposed resolutions so that the shareholders can advise their representatives on how to vote on each item or proposed resolution included in the agenda.

In those countries where companies are allowed to obtain proxy votes, how the Chairman of the Board (as the regular recipient of proxy votes obtained by the company) will exercise the rights of those proxy votes for which no voting guidelines have been specified must be made public.

Guideline 32. SOEs must ensure the attendance of external advisors, upper management and members of the Board of Directors at the General Assembly of Shareholders.

In line with the current trend of revitalizing the role of the General Assembly of Shareholders in shaping the corporate will, and making it a much more dynamic body, it is understood that in the SOEs that are listed, the members of the Board of Directors, and especially the Chairmen of the

Audit, Appointments and Remuneration, and Risk Committees as well as the accounts auditor must attend the meeting unless a justified exception is communicated to the Chairman of the Assembly.

For all types of SOEs, it is imperative for Chief Executives to report to the Assembly on the progress of company affairs, and therefore, logically they must attend the Assembly on a mandatory basis. However, their non-attendance shall not affect the valid convening of the Assembly.

The Chairman of the Assembly may authorize the attendance of any other person he deems appropriate although the Assembly may revoke such authorization.

5. BOARD OF DIRECTORS

The Board of Directors is the key governing body in any company, including SOEs since it plays a unique and fundamental role in defining the strategic orientation for achieving the expected results, controlling the day-to-day management, supervising the control architecture, and governance of the company.

Furthermore, it is the only body that can and must report to the SOA (head of state or any other public entity, and other shareholders when they exist) on the achievement of the specific objectives that have been previously communicated to it.

Therefore, considering the fact that the Board of Directors coordinates with the SOA, and that it is responsible for strategic orientation and follow-up on the upper management, this body plays a basic role for the governance of the SOE and the achievement of results.

However, the simple fact of having a Board of Directors and/or assigning a set of responsibilities and duties to it does not guarantee that they will carry them out correctly nor, by extension, does it allow us to assume that the SOE will achieve its goals.

Consequently, it is in the common interest of both the SOA and the SOE to have a Board of Directors that is as efficient and professional as possible so that it can fulfill its critical roles as thoroughly as it is able in order to generate the greatest value for the SOE.

There is a whole set of corporate governance recommendations that make it possible to enhance the Boards of Directors of SOEs and contribute to the management of the main challenges inherent to these types of companies, such as:⁵

- The makeup of the Board of Directors in which there are usually public positions associated with membership on the Board of Directors of certain SOEs.
- The time of commitment and re-election of the members of the Board of Directors.
- Understanding the operations and business of the SOE.
- The internal dynamics of the Board meetings and especially, the relationship between the Board of Directors and the management of the SOEs.

Given the gradual adoption and implementation of corporate governance recommendations by the SOEs in the region, their Boards of Directors have been significantly strengthened in recent years through their increased involvement in strategic decision-making, reinforced planning of their meetings, the

minimization of the use of alternate directors, or their advances in setting up Board Committees, particularly the Audit Committee.

The final objective of this section of the Guidelines is to propose a set of specific corporate governance practices to reinforce this positive trend in which the Boards of Directors of the SOEs in the region find themselves so that, once they are implemented, these Boards will be better and contribute to a greater extent to the strengthening of the governance and effective direction of the SOEs.

Guideline 33. SOEs should recognize the need for a Board of Directors as a governing body.

Within the four possible options for the management of companies (sole administrator, joint administration, joint and severally liable, and the Board of Directors), the Board of Directors is considered to be the optimal figure, due to:

- Its character as a collegial body and, therefore, deliberative;
- The possibility of representing different interests as well as;
- The professionalism in the decision-making process that an effective Board of Directors generates in the company.

In its initial conception, the Board of Directors was considered to be an almost exclusively controlling body through which, acting on behalf of the shareholders (or in the case of SOEs that are not corporations, of the ownership), the directors were in charge of supervising and controlling the behavior of the executives.

⁵ A practical analysis of how SOE Boards of Directors operate in the region can be found at “Effectiveness and Structure of Boards of Directors at State-Owned Enterprises in Latin America and the Caribbean” (CAF 2017).

In addition, many Boards retain an almost exclusive focus on verifying formal compliance with regulatory obligations, in what is known as conformance. This *conformance* approach may lead the Board to the false belief that they are fully meeting their fiduciary obligations, when in fact they may be limiting the chance of achieving the true mission of an effective Board which must be linked to:

1. The design and construction of the strategic orientation of the SOE, based on the proposals made by the upper management, and coordinating the expectations of the owner and the purposes for which the company was created.
2. Control of upper management, in the form of appointment, dismissal, and performance evaluation as well as monitoring of management activity.
3. The oversight of the main risks and business opportunities.
4. The direct implementation of certain acts of great importance for the SOE. In particular, reporting on results achieved and accountability to the SOA and possibly to stakeholders who have been identified is a critical responsibility within this role.
5. The definition of guidelines for an effective SOE governance is understood as the structural organization of the company, the issuance of internal regulations, corporate policies, and the monitoring of the effectiveness of its own governance system.

Given the importance of this mission, only the Board of Directors can be considered the ideal body for corporate administration, and not the other possible figures of corporate administration that, in practice, would see achieving this as much more complex, if not directly impossible.

Based on the above, in practice there are many Boards of Directors that contribute little or no value to the company because the mere existence of a Board of Directors, by itself, is not enough to ensure that they are able to effectively fulfill their mission.

In practice, the first step – although an insufficient one – for a Board of Directors to fulfill their mission, is to know and have available a set of clear, public duties, recognized both by the Board members themselves and by any third party, that allow them to structure their tasks, define their agendas, and organize their actions.

The legislation applicable to SOEs almost always provides for a generic, and in most cases scarcely practical, set of roles for the Board of Directors. As a result, there is often a high level of uncertainty as to what specific responsibilities the Board of Directors should, in practice, assume to provide the SOE with the maximum value.

In general, an effective SOE Board of Directors should have a set of non-delegable duties grouped around the following five broad categories:

1. Strategic definition

This is usually based on the idea that the strategic definition corresponds to the upper management because they are the ones who know the key variables of the business and the environment in which the company is operating best.

However, because of the importance of this role, the Board of Directors are the ones that must approve the strategic

orientation of the SOE, its objectives, and the means at its disposal to achieve them.

Nonetheless, for this process to be successful, it is essential for the Board of Directors to have the close collaboration of upper management, and it would be ideal if it also had a commitment from the SOA with regards to how the assignment of public service obligations will be managed as well as the expected procedure for the appointment and rotation of Board members.

A large number of tasks assigned to the Board are derived, in turn, from the task of strategic definition and can be synthesized in:

- Approval of the corporate strategy, annual budgets, and business plan.
- Analysis of the risks inherent in the strategic plan, its monitoring, and control.
- Definition of the organizational structure of the SOE and/or business group.
- Approval of the investment and financing structure of the SOE.
- Establishment of proper management or performance indicators (KPIs), monitoring of compliance.
- Design and supervision of succession plans for key personnel in the SOE.
- Integration of strategic implementation monitoring, through:
 - The organization of annual sessions hand in hand with the upper management for strategic discussion and the construction of the annual work agenda on strategic subjects and initiatives.
 - The definition of a key strategic information set to enable effective monitoring.

- The inclusion of strategic topics in periodic and pre-established sessions of the Board of Directors.

In the case of SOEs, in particular, this feature is especially critical given:

- The periodic rotation of Board members and the Chief Executive Officer as a consequence of the rotation in the representatives of the owner after changes caused by the electoral cycle can lead to important modifications of the strategic orientation of the SOE and its lack of stability.
- The establishment of certain public service obligations may jeopardize the economic or operational resources (technical or human) of the company and may even threaten the achievement of its strategic objectives.

2. Supervision of specific subjects.

There is a whole set of matters that are critical for the proper operation of the company that are managed by the upper levels of management. However, their supervision should be the responsibility of the Board of Directors who are linked to:

- The Control Architecture, i.e., the system through which the financial and non-financial risks faced by the SOE, integrity of the internal control systems, and the soundness and comprehensiveness of the programs for regulatory compliance are identified, managed, and monitored
- Monitoring of conflicts of interest and transactions with related parties.
- The quantity and quality of internal and external information.
- The supervision of the financial statements and the Annual Report.

Generally, for practical reasons, many of these tasks are assigned to the Internal Audit department.

If this is the case, it is the responsibility of the SOE Board of Directors to ensure that there is direct access and communication with the person responsible for the regular monitoring of these matters and, consequently, that there is no direct reporting line to upper management since it is, in a way, the performance of the latter that is evaluated.

Finally, the Board should ensure that the necessary mechanisms and channels are in place for employees and members of the SOE to report unethical or unlawful behavior without fear of reprisal since this can provide Board members with direct knowledge of what is happening in the organization as well as enable them to make corrective decisions in the shortest time possible.

The section of these Guidelines referring to Control Architecture describes in more detail the responsibilities and tasks that the Board of Directors of the SOE must have agreed to and carry out in practice to fully comply with its supervisory function.

3. Supervision of the day-to-day management.

The traditional role of the Board of Directors is to oversee upper management and the performance of the company as a whole.

In general, the oversight of the upper management implies the acceptance of important duties by the Board of Directors:

- Appointment of the Chief Executive and, in some cases, members of the upper management.

- Establishment of the remuneration policy for the Chief Executive and members of the upper management.
- Monitoring the performance of the Chief Executive and members of upper management.
- Supervision and analysis of compliance with the annual budget.
- Removal of the Chief Executive and, in some cases, members of the Upper Management.
- Supervision of the succession plans for the Chief Executive and members of the upper management.

Being aware that in certain legislations the appointment of the Chief Executive of the SOE corresponds to the SOA, it is advisable for the Board of Directors to be the one that has the powers of appointment and dismissal of the Chief Executive together with determining the remuneration.

If the above is not possible, due to local regulation restrictions or other causes, there are several alternatives that will preserve the integrity of the Board as well as reinforce its responsibility and maintain the balance of power between the Board and upper management and among them, the following stand out:

- That the Board collaborate with the SOA in making decisions regarding the appointment, dismissal, and remuneration of the Chief Executive.
- That the Board of Directors can define the profile and professional and personal requirements that must be met by candidates for Chief Executive Officer and even propose specific candidates.
- That the SOA carry out the appointment under strictly professional criteria for which the rules, processes, and practices are public and transparent.

4. Carrying out acts of major consequence.

The Board of Directors must reserve the approval of those acts of implementation or provision that, due to their amount or the implications derived from them, are critical for the SOE. The following are included among them:

- The presentation of proposals that alter the pre-established maximum debt limits, the capital, or that assume a substantial modification of the SOE balance sheet.
- The approval of strategic operations, considering the fact that internal regulations must define what is meant by strategic operation.
- The establishment of the amounts within which the Chief Executive shall be empowered to act without the direct approval of the Board of Directors.
- In the absence of a policy regarding this topic, the creation or acquisition of shares in special-purpose entities or entities domiciled in countries or territories considered to be tax havens as well as other transactions or operations of a similar nature which, due to their complexity, could undermine the transparency of the SOE.
- The approval of operations that affect strategic assets of the SOE.

5. Governance of the SOE.

The position of the Board of Directors plays a double role: first of all, this is the body that reports to the SOA on the results of the SOE and the degree to which its objectives are achieved. Second, they control the Chief Executive, over whom they have a superior hierarchical position.

This position the Board of Directors has makes them responsible for leading the development of a governance model that fits the nature and features of the SOE, and this implies assuming the following responsibilities:

- Monitoring the effectiveness of the governance model for the SOE and the established corporate governance practices as well as the implementation of changes in it
- Ensuring that the process of nominating and electing directors is formal and transparent.
- Evaluating the Board of Directors.
- Issuing internal regulations.
- Approving corporate policies and, where appropriate, their submission to the SOA.
- Approving the policies for informing and communicating with different types of shareholders, markets, interest groups, and public opinion in general. This includes serving as a link between the SOE and the SOA, or where they exist, the body of shareholders.
- Managing conflicts of interest between the SOA and shareholders, if any, upper management including the Chief Executive, and members of the Board of Directors as well as control of related transactions.
- Reporting to the SOA on the results obtained and model of accountability to the SOA and other stakeholders.

The correct assignment of duties to the Board of Directors based on the five previous groups will be the central component that will allow for the construction of a high-value, efficient Board of Directors for the SOE.

Assigning roles is the first step in creating an efficient Board of Directors. Nevertheless, there is also a need to strengthen the organizational aspects of the Board of Directors to make it an active and key agent for the SOE.

SPECIAL MENTION OF THE SOES THAT CONSTITUTE A BUSINESS GROUP

The reality of many SOEs in the region is that they are or have been incorporated into business groups whose economic importance and influence is growing.

From the perspective of corporate governance, although the guidelines and good practices are fully applicable, there is the challenge of how to implement them in the cases of business groups given that they have an economic and management unity derived from the search for the common interest but a legal plurality since they are composed of independent companies.

Given the above, the position of the Board of Directors changes depending on whether it is the Board of the group's parent company or the Board of the subordinate company. This leads us to propose, from the perspective of corporate governance, the advisability of having a differentiated treatment of Boards of Directors which distinguishes between the duties of the Board of Directors of the parent company (which will have a group scope) and the roles of the Board of Directors of the subordinate companies who will answer to the subordinate company itself and to the parent company for the actions of the subordinate company.

In order to reinforce the group vision and the unity of action in the business group, particular attention should be paid to the existence of the five groups of roles indicated, but, in addition:

- Board of Directors of the parent company:
 - The definition of duties with a group scope.
 - The approval of group policies and guidelines.
 - The defense of the group's interest as a primary principle of action.
 - The follow-up on the general results of the group.
- Board of Directors of the subsidiary:
 - The definition of roles with a subordinate scope but consistent with those of the Board of Directors of the parent company.
 - The implementation of group policies and guidelines with the necessary nuances and adjustments needed for their suitability for the subordinate group.
 - Periodic rendering of accounts to the Board of Directors of the parent company.

Achieving coordinated action among the Boards of Directors of business group SOEs and, therefore, achieve unity of action and defense of the group interest, it is crucial to have mechanisms that allow the transmission of instructions and group guidelines.

To do this, it is very advisable to:

- Establish and formalize the common interest of the business group as well as the adoption of this interest by the companies that make up the group.
- Have members of the group's management who may be members of the subsidiary's Board of Directors and must be a minority with respect to the total number of its members.
- Have members of the Board of Directors of the parent company who simultaneously are also members of the Board of Directors of the subordinate company.
- Establish mechanisms for alignment and coordination between the management teams of the parent and subordinate companies to ensure the coordinated action of all companies in the business group.

Guideline 34. SOEs should provide for managing the succession of members of the upper management.

The Board of Directors should manage the succession process of key upper management positions in a manner that is timely, anticipatory, and planned in order to minimize the impact of the transition when changes occur and ensure stability at the management team level since this is a particularly sensitive issue in the context of the SOEs.

Thus, the preservation and continuity of key and strategic knowledge is safeguarded as is the culture and leadership of the SOE at its highest levels of management. Similarly, it ensures that the rotation of upper management obeys technical, objective, and performance criteria in order to have a suitable, professional management team that is oriented towards the fulfillment of the company's objectives.

The Board of Directors' role in the succession of upper management should be undertaken in a manner that:

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

Although it is true that in several countries in the region the appointment of the Chief Executive does not correspond exclusively to the Board of Directors of the SOE but to the SOA or the state entity that holds the ownership of the company (President, Ministry, Mayor's Office, Agency, etc.), it would be advisable to try to apply the previous recommendations both as harmoniously and in as much coordination with that representative as possible.

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

- Establish the profiles required within it in accordance with the approved strategic plan and the particular context of the company.
- Evaluate their own performance and dynamics to detect the main areas where specific profiles would be required.

- Maintain a fluid communication with the SOA about the requirements, profiles, and needs that would be required by the Board for them to function better.

Guideline 35. The SOEs must have an Internal Regulation for the Board of Directors.

The SOE should adopt an Internal Regulation of the Board of Directors which would regulate their organization, operations, and dynamics. It would constitute a self-regulatory document that would be binding on the directors and transgressing it would entail legal liability.

In addition to serving a merely informational function, the Board of Directors' Internal Regulations serve as an ideal tool to complete the legal and statutory treatment of the Board and thus provide full regulation specially adapted to the nature of the SOE and its unique characteristics.

The Regulations, the approval of which should be the responsibility of the Board of Directors itself, should regulate the exercise of the rights and duties of the members of the Board, therefore, they usually, and in accordance with the provisions in the Bylaws or in the company's Articles of Incorporation, deal with subjects such as:

- Mission of the Board of Directors.
- Duties of the Board of Directors.
- Categories and requirements to become a director.
- Membership and key roles of the Board of Directors.
- Internal organization of the Board of Directors (advance notice of meetings, system of face-to-face and non-face-to-face meetings, quorum, system of invitees to the sessions, along with other aspects).

- Relationship of the Board of Directors with the SOA, the different types of shareholders if any, the management, and the auditors.
- Rights and Duties of Board Members.
- Formal obligations of the Board of Directors.
- Evaluation of the Board of Directors
- Removal of Directors
- Guidelines for the management of conflicts of interest.
- Rules for handling confidential information.
- Operational model for the Board of Director Committees

Guideline 36. The Board of Directors of the SOEs must have an appropriate size and provide for the specific treatment of substitutes. The suggested number of members is always odd.

The Boards of Directors should be large enough to be representative while recognizing that if their size turns out to be too small or too large, it could have a negative impact on the effectiveness of this collegial body. To do this, it is advisable for Boards of Directors to be structured with an odd number of members, and if the legislation allows it, ideally without substitutes.

If there are substitutes, the Board of Directors' Internal Regulations must specify the reasons for and manner in which these alternates are invited. They may also participate actively if the Board thinks that their knowledge adds value to the strategic, financial, and managerial decisions of the SOEs.

The size of the Board is usually determined in the SOE's Bylaws or founding regulations and generally set a maximum and minimum limit on the number of members. The final specific decision on this matter is the responsibility of the

General Assembly of Shareholders or whoever exercises ownership depending on the complexity of the SOE.

In general, the size of a Board of Directors should not be less than five nor more than eleven members and the most frequent size is between seven and nine members.

Guideline 37. SOEs should provide for the existence of different categories of directors, their symmetry with the capital structure, and for external directors to be in the majority on the Board.

There can be different types of directors on any Board of Directors:

- **Internal or Executive Directors:** members who, along with their status as directors, are also members of the company's upper management and therefore have a working relationship with the company.
- **External Directors:** members only of the Board of Directors, without any responsibility or management position in the company and act as representatives of the shareholder base. Within this group, there is a distinction:
 - **External Proprietary Directors:** are the shareholders who acquire the status of director or directors proposed by the direct holders of significant holdings (or groups of shareholders), and who are appointed to represent the interests of the proposing shareholder (or group of shareholders) on the Board.

- **Independent Outside Directors:** directors who have no connection with the company, its managers or shareholders and their appointment does not involve any specific shareholder. They contribute by providing an external and independent view to any shareholder or group of shareholders. And it is believed that they provide a beneficial counterweight to the vision of other directors.
- **External Directors:** are those people who, due to their personal circumstances or those of the company, cannot be qualified as Internal or Executive, nor as Proprietary or Independent.

The existence of different types of directors is meant to achieve a balance within the Board of Directors.

Thus, External Directors (both Independent and Proprietary) will be more able to carry out the role of supervision and control, at least a priori, over upper management than the Internal Directors who, in their control duties, occupy the positions of both judge and partisan. They are also called upon to complete the profiles, knowledge, and experience of the other directors with respect to the different areas of expertise (experiences, knowledge, influence, approaches, or points of view).

The inclusion of External Directors, both Independent and Proprietary, on the Board of Directors reinforces the idea that people outside the daily management of the company may know and monitor the performance of its managers.

Internal or Executive Directors, in turn, may (and should) make contributions that complement the External ones such as internal information and day-to-day knowledge of the company.

Whether or not Executives should also be members of the Board of Directors is one of the great debates in the world of corporate governance.

In accordance with the practical reality of SOEs as well as corporate governance practices, it would be reasonable to consider:

- That at the level of Internal Directors only the Chief Executive can be a member of the Board of Directors and not chair it.
- That, in the case of Boards with seven or more members, the number of Internal Directors may not exceed three, and in any case, should always be a minority.

The determination of one or another alternative will be a consequence of the analysis of the needs of the Board of Directors, their knowledge of the company's operations, or the complexity of the business moment in question.

Guideline 38. SOEs must have a specific procedure for the proposal and selection of directors that includes, along with other things, the establishment of general requirements for being a Director and an Independent Director as well as a justified proposal for each candidate.

The makeup of the Board of Directors is a foundational pillar for the existence of an efficient and value-adding Board of Directors.

To achieve an appropriate makeup of the Board, special attention must be paid to the process of nomination and election of directors since it is the central key to achieving an effective suitability of the directors. That is, who can propose candidates and what requirements or profiles those candidates should meet as well as who elects them.

Thus, it is suggested that the process of nominating candidates meet the following conditions:

A. Identifying the needs of the Board of Directors: it is highly recommended that the Board of Directors have a combination of personal and professional profiles that allow for proper monitoring of the SOE's strategic orientation.

Professional profiles are associated with aspects such as knowledge and professional experience while personal profiles relate to career, age, gender, recognition, prestige, availability, leadership, or group dynamics, etc.

Furthermore, and depending on the complexity of the SOE, various companies have established a minimal commitment of 20 to 40 days per year for the Board of Directors including both attendance at the sessions and the time for proper preparation. Therefore, the candidate's time availability should be considered as an additional factor to be taken into account.

It is appropriate for the Board of Directors to play an active role in determining the most suitable profiles for each change in the Board and communicate them to the SOA, the ownership entity, or the Assembly of Shareholders, if there is one, in order to align the proposed candidates with the recommended profiles as much as possible.

Given the changing nature of business activity and, therefore, the SOE's strategic orientation, it becomes essential to always have the most appropriate profiles at all times.

B. Search for candidates for Director: with the most suitable profiles established, the next step is to search for and identify candidates, a process that is normally carried out by the SOA, the ownership entity, and/or other shareholders if they exist.

The following mechanisms can contribute to the implementation of this step in the process:

- **Databases of directors:** while this is normally the responsibility of the SOA, one possible source of candidates is to develop databases of directors. This would make it possible to keep updated on candidates considered to be potentially eligible.
- **Support from specialized firms:** such as headhunting firms which specialize in identifying and selecting board members.
- **Influence of the outgoing Board of Directors:** the outgoing Board itself may propose specific candidates to the SOA or the Shareholders' Assembly if there is one.

C. Evaluation of the candidates: the Board has the responsibility of devising a mechanism for evaluating, sufficiently in advance of the election of directors, the suitability of the candidates for directorship. Objectively, the most appropriate body for this task would be a Board of Directors' Appointments and Remuneration Committee and, for cases where such a committee does not exist, the full Board itself or, preferably, the task should

be done by an ad hoc committee. However, this option is made more difficult when the election of directors is not staggered or partial and all the members of the Board are subject to possible election. In this case, the creation of an ad hoc committee, even including people outside the Board of Directors, seems to be the most valid option.

Nevertheless, in those cases where there is a SOA, and this does not coexist with other shareholders, it may be a responsibility of the SOA itself to assess the candidates' compliance with the election requirements as well as their suitability with respect to the defined profiles prior to the formal nomination and election of directors.

D. Nomination of candidates: for practical reasons, the Board of Directors is the body that can best centralize the candidate nominating process for the General Assembly of Shareholders so that it becomes a formal and transparent process.

From the standpoint of corporate governance, it is proposed that the Board of Directors itself, in agreement with whoever exercises ownership of the SOE (whether that is the SOA, the Assembly of Shareholders, or another body), should regulate a formal and transparent nominating process that responds to the above steps, and that this be the process that the entity responsible by law for the election of directors approves and commits itself to.

E. Election of directors: the election of directors is the final phase of the process of assembling the Board of Directors, and it takes place during the General Assembly of Shareholders when that exists or, when it is lacking, it is done by the SOA.

If it is not possible for the Board of Directors to take responsibility for the nomination of its members due to local regulatory restrictions or other causes, it is proposed that it collaborate with the SOA or entity that exercises the property rights over the company in order to preserve its integrity in that process.

In this respect, considering the fact that the demands of the organization and in particular those of the Board of Directors may vary for each new period of Board member selection, the Board must be able to foresee those requirements in advance, autonomously, and independently. That way, it will be able to submit to the SOA or the ownership entity that exercises the rights over the company a proposal regarding the required profiles for directors that includes a suitable balance that will allow the proper exercise of the assigned duties in practice. The same applies to the election or replacement of new directors in the event of dismissal, resignation, disability, or death.

It is likewise important for the SOA to commit itself to and implement an appointment process in which strictly professional criteria are paramount and that has rules, processes, practices that are public and transparent, and clearly defined requirements that candidates must meet.

In its corporate governance principles for SOE, the OECD recognizes, as a good corporate governance practice, the existence of “a specialized commission or “public board” to oversee nominations in SOE boards. Even though such commissions or public boards might have only recommendation powers, they could have a strong influence in practice on increasing the independence and professionalism of SOE boards. Proposed nominations

should be disclosed in advance of the general shareholders meeting, with adequate information about the professional background and expertise of the respective.”

In addition to the above, along with the general process of appointing Board members, the reality for SOEs is that, on many occasions, it is the legal and regulatory framework itself that unwisely determines the actual membership of the Board of Directors by associating membership on the Board with certain executive or governmental positions (for example, the respective Minister and other positions), or in the majority of the cases, tying the nomination of candidates for director to specific ministries or public bodies.

For these cases, how can the process for the nomination and election of directors operate? Together with the need or advisability of arguing for the fitness of elected public officials, the key will be to propose a series of induction and periodic training programs that will make it possible for directors to understand their role and exercise it as suitably and securely as possible.

The selection of these induction and training programs, which must be formalized, will be a consequence of the SOE’s Strategic Plan, suggestions from the outgoing Board of Directors, and the results of the evaluation process done by the Board.

Finally, together with the reinforcement of the procedures for nominating and electing directors in order to make the principle of director suitability a reality, it is key from the perspective of corporate governance to evaluate how to manage the risk of political influence on the Board’s decisions.

In this respect, SOEs are often exposed to the dynamics of wholesale changes in the membership of the Board of Directors. In many cases, this often leads to critical changes in the company's strategic orientation, the decisions made, or the implementation and allocation of budgets.

In order to better manage this situation in the SOEs that are definitely committed to reinforcing their corporate governance, it is advisable to suggest that the election of the Board of Directors be staggered – understood as directors appointed by blocks – as explained in the section of these Guidelines entitled State as Owner (see Guideline 8).

Guideline 39. The SOEs must take into account the pre-established conditions for considering directors, and most especially, for the Independent Directors.

Generally, the majority of legislation includes a set of requirements for a person to be appointed to be a member of the Board. These are essentially linked to holding the legal standing or not being declared bankrupt, etc.

Nevertheless, a company's internal regulations may include a number of requirements in addition to these that any candidate, regardless of his or her subsequent personal or professional profile, must meet in order to be eligible to be a director.

These requirements are:

- Expertise, professional prestige, experience, and proven honorability.
- Age to be appointed director shall be between a minimum of thirty-five and a maximum of seventy-five years of age unless approved by the Board.

- Not holding representative, managerial, or advisory positions or offices in competing companies or holding of the same positions or offices in companies that hold a dominant position or one of control over competing companies.
- Not belong to more than five Boards of Directors at the same time, excluding, for these purposes, the Boards of Directors of the various affiliated companies, the administrative bodies of those companies in which the director's personal or family shareholding entitles him/her to be part of such Boards, and those of philanthropic entities.
- Not be regular clients nor suppliers of goods and services for the SOE whenever this may give rise to a conflict of interests with those of the SOE.
- Not be in permanent conflict of interest with the SOE.
- Not be involved directly or indirectly in a judicial proceeding that could, in the opinion of the Board, jeopardize the reputation of the SOE in the future.

The above requirements are applicable to any member of the Board whether they are internal or external.

However, Independent External Directors should also meet a number of additional requirements in order to be considered independent. Although the legislation in different countries also stipulates certain requirements to be met by the Independent External Directors, it is important that the SOE reinforce this definition of independence in accordance with the particularities of the company and the strategic risks it faces.

People with well-known professional prestige who can contribute their experience and knowledge to the Board of Directors and who, being neither Executives nor Proprietary Directors meet the conditions that ensure their impartiality and objectivity in judgment shall be eligible to be appointed as Independent External Directors.

The mission of the Independent Director is to look after the general interests of the company, all of the diffuse interests that coexist in it, and the interests of minority shareholders. Since neither the Proprietary Directors represent the majority nor the Independent Directors represent the minority but, as we have stated before, the Independent External Directors should ensure that the SOE is managed in such a way that the interests of the minority shareholders (if any) as well as the various interest groups are considered and that the interests of the Proprietary Directors are not confused with those of the company.

The Independent Director is the one that has the ability to say “no” to a proposal made by the Chairman of the Board and/or the Proprietary Directors as a whole when this affects the SOE: The greater this ability, the greater the degree of independence and this prevents the fear of disagreement from prevailing over the Board of Directors’ desire for transparency. It does not prevent managers from being aware of the responsibilities they assume when they take their positions and do their jobs and non-compliance with the most advanced laws falls within the scope of criminal liability.

In this respect, in order to be truly independent, it is necessary to have a wide field of professional activity and, in the economic sphere, not depend exclusively on membership in a particular Board of Directors since true economic independence substantially reinforces one’s independence of criteria. The By-laws shall lay down the criteria that must be taken into account in the definition of independent directors. Among the requirements or conditions to be considered independent, the following stand out:

- Have a personal and professional profile that inspires shareholders with a sense of trust in the director’s independence.

- Not belonging to the country’s ruling political party.
- Not representing the specific interests of a particular government entity (ministry, governor’s office, municipality, etc.) that was the source of, or was related to the director’s appointment.
- Not being a director or employee of the company or of any other company in the same business group that is a shareholder of the SOE or of any company that is a shareholder in the company holding a stake equal to or greater than 5% of its capital stock regardless of whether or not, as a shareholder of the SOE, it has appointed External Proprietary Directors to the SOE’s Board of Directors.
- Not being employed by an individual shareholder holding 5% or more of the company, whether or not this person is a member of the Board or a director or employee of companies linked to the SOE.
- Not having or not having had a commercial or contractual business relationship, directly or indirectly, in the last three years that is significant in nature with the SOE or any other company in the same group, their executives, the External Proprietary Directors, or with any other company in the same business group whose shareholding interests in the SOE the above represent either in their own name or as a shareholder, director or senior executive of an entity that maintains or has maintained such a relationship.

Business relationships are considered those of a supplier of goods or services and work as an advisor or consultant.

The business relationship shall be presumed to be significant when invoices or payments for values of more than 1% of the annual income of either party have been exchanged.

- Not having any close family relationship with significant shareholders, the External Proprietary Directors, Internal or Executive Directors, or the rest of the SOE's upper management. A close family relationship is understood to exist in the case of a spouse or persons with a similar emotional relationship, ancestors, descendants, and siblings of the manager or of the manager's spouse and spouses of the ancestors, of the descendants, and of the siblings of the manager.
- Not being a director or member of upper management of another company in which any director or member of the upper management of the SOE is an External Proprietary Director.
- Not having been a member of upper management or employee of the SOE, of companies in the same business group, or of companies that are shareholders of the SOE in the last three years.
- Not receiving from the SOE or from any other company in the same group any amount or benefit for any reason other than the remuneration of a director unless it is insignificant.

Pension benefits received by the director as a result of his or her previous professional or employment relationship shall not be considered in this item provided that such benefits are unconditional and, consequently, the SOE that pays them may not, at its discretion, suspend, modify, or revoke their payment without breach of contract.

- Not have been a partner or employee of the external auditor during the past three years or of the auditor of any company in the same group.
- Not be a shareholder, director, or member of upper management of an entity or institution that receives or has received significant donations from the SOE or from any other company in the same group during the last three years. Those who are mere employers of a foundation receiving donations shall not be considered included in this point.
- Not have been evaluated prior to being appointed director by the Board of Directors or their committees or by an external body independent of the owner's representative who made the nomination.
- Not having served as director for the SOE for more than 6 continuous or alternating years during the past 15 years.

Along with the above, the selection process must be supplemented by a double or even triple obligation:

- 1.** One active obligation of the candidate for Independent External Director is to declare publicly and explicitly that he is independent both with respect to the SOE itself and to its shareholders and directors. The candidate also has an express duty to state any factor or fact that, in the eyes of a third party, could call into question such independence.
- 2.** The Board itself must declare that they consider the candidate to be independent based on his own declaration and any additional inquiries the Board may have made.

3. Ideally, if there is an external committee or commission that evaluates members of the Board of Directors, there should be a statement from this body explaining the reasons why they considered the candidate for Independent External Director.

This statement would make it possible to resolve a frequent reality for SOEs in the region which is whether or not candidates appointed directly by the executive body or whoever exercises ownership, or that of those public officials who, in practice may be independent, but their status as civil servants may affect their appearance of independence should be considered Independent External Directors.

In any case, regulating whether or not the condition of independence is lost under these conditions can be complex given that there are countless personal and professional circumstances that cannot be predicted in a definition and will be the ones that will influence the effective independence of these candidates.

Therefore, as a good corporate governance practice, it is recommended that the set of personal and professional circumstances that explain and justify the independent status of these candidates be explained in the statement of independence so that any third party who is interested can effectively assess their actual independence.

Furthermore, the Independent Director himself must accept the responsibility for constantly reviewing any circumstance that could affect his/her status as an Independent during the course of his/her duties as well as reporting such to the Chairman of the Board or the property representative in a timely manner.

Guideline 40. SOEs must establish the causes for the dismissal of directors which, in any case, shall be preceded by a prior report from the Board of Directors.

In addition to what is provided for in the applicable regulatory framework, specific grounds for the dismissal of directors should be established. The Board may only submit a proposal to the General Assembly of Shareholders or to the SOA for the dismissal of any of its members for one or more of the grounds set forth in the Bylaws or rules and regulations since, otherwise, the positions of members of the Board of Directors could be jeopardized by the decisions adopted regarding certain specific matters that are submitted for their consideration.

As for the resignation, the following reasons should motivate its presentation:

- When involved in any of the cases of incompatibility or prohibition provided by law or the grounds for dismissal provided for.
- In those cases in which the continued presence of a given director on the Board of Directors could adversely affect the Board's operation, the credit and reputation of the SOE, or could jeopardize its interests.
- In the case of an External Proprietary Director, when the shareholder whose equity interests he is representing on the Board of Directors disposes of his/her interest in the SOE.

As regards to the grounds for dismissal, these may be defined indirectly as grounds for resignation so that if the director does not voluntarily submit his resignation in those cases in which the bylaws require him to do so, the Board

of Directors may ask the General Assembly of Shareholders to remove him from office.

Among the causes for dismissal that should in any case be formally recognized are the following:

- When the period for which he/she was elected has elapsed.
- When involved in any of the cases of incompatibility or prohibition provided by law and he/she does not resign.
- When he/she is prosecuted for an allegedly criminal act or is responsible for serious or very serious misconduct by final resolution of any supervisory authority and does not resign.
- When he/she is severely reprimanded by the Board for having violated his/her obligations (attendance, dedication, performance, conduct, or others) and does not resign.
- When his/her remaining on the Board of Directors may put the interests of the SOE at risk.
- When the reasons for which the person was appointed disappear and he/she does not resign.

How does the termination procedure work? The Board of Directors is basically the only body that can propose a dismissal to the General Assembly of Shareholders or the proprietary body in charge of appointing the members to the Board for violation of any of the previously defined grounds.

To this end, the Board as a whole should prepare a preliminary report in which they express their support for dismissal and explain the reasons why they consider it pertinent so that the shareholders present at the meeting can make an informed decision regarding dismissal.

Since the preceding report in favor of dismissal is made by the Board of Directors as a whole, it prevents the proposed dismissal from arising from any situation in particular regarding specific directors that could lead to excessive instability in exercising the office of director.

Note that, obviously, directors who are affected by proposals for dismissal from office should refrain from intervening in the deliberations of the Board of Directors and, when appropriate, from voting, and the preparation of the dismissal report to be submitted to the General Assembly of Shareholders.

Last of all, for the SOEs that, due to their legal structure, do not have a General Assembly of Shareholders, the SOA should take on the responsibility of approving the dismissal by following the same process as the one mentioned above.

Guideline 41. In addition to the provisions of the Law, SOEs must stipulate the definition and regulation of the duties of the directors in its Bylaws and/or Regulations of the Board of Directors.

The members of the Board of Directors of an SOE assume a high responsibility that may even lead to personal criminal liability due to the exercise of their duties.

Normally, regulation of the Board members' duties is generally established by legislative means although these duties are commonly treated generically and, as a result, these duties are not specifically defined.

In any case, the law does require directors to comply with diligent and loyal administration. Thus, it is advisable to

develop the content of those laws using the SOE's internal regulations as precisely as possible in order to explain what the duty of diligence is and what the duty of loyalty is.

The following points can summarize the specific content of the duty to do due diligence.

- Faithfully fulfill the duties of diligent administration provided for by law.
- To gather the necessary information and properly prepare the meetings of the Board of Directors and of the corporate bodies to which they belong, if any.
- Attend the meetings of the Board of Directors as well as those of the other corporate bodies of which they are members.
- Participate actively and knowledgeably in their deliberations, in order to contribute effectively to the decision-making process.
- Do any specific tasks entrusted to them by the Board of Directors provided that it is reasonably included in the obligations they are committed to.
- Advocate investigating any irregularity in the management of the SOE and the monitoring of any risk situation that has been reported.
- Independently inform and update themselves with respect to issues they believe they should reinforce or delve into more in order to contribute to a decision-making process that generates value for the company.

The correct fulfillment of the duty of the members of the Board of Directors to do due diligence is, therefore, critical to the proper exercise of their responsibilities and to ensure that the Board itself shall be a key active body for the SOE.

In fact, and going further, directors who do not exercise their duty of due diligence are:

- Affecting the very functioning of the Board of Directors as a body.
- Impoverishing the correct exercise of the duties assigned to the Board of Directors.
- Jeopardizing the overall corporate governance of the SOE.
- Betraying the commitment made to the shareholders or the SOA by accepting their appointment as director.

The duty to do one's due diligence also requires observance of the duty of loyalty to the SOE that could be understood as the obligation under which the members of the Board must act in good faith and honesty, always seeking to optimize the interest of the SOE in the exercise of their office, and excluding any interest other than this one, especially their own or that of people linked to them.

Ultimately, the duty of loyalty is understood to mean that the members of the Board comply with the duties imposed by law and the internal regulations of the SOE in keeping with the corporate interest which is understood to be the interest of the SOE.

Just as in the case with the duty of due diligence, in order to encourage directors to act in a fully responsible manner, it is advisable to try to specifically detail the specific content of the duty of loyalty, which can be summarized as follows:

- **Duty to not use the name of the SOE for personal operations**

The members of the Board of Directors may not use non-public SOE information for private purposes except in the event of the absence of any harm to the SOE.

The directors may not use the name of the SOE nor use their status as directors of the SOE to carry out transactions on their own behalf or on that of people related to them.

- **Duty to not take advantage of business opportunities for personal gain**

No director may make investments or any transactions linked to the assets of the SOE for his own benefit or that of people related to him based on knowledge he has acquired in the performance of his duties provided that the SOE has not disallowed such investments or transactions without the director's influence and that the use is authorized by the Board of Directors.

- **Duty to not intervene in cases of conflicts of interest**

Directors shall inform the Board of Directors of any situation of direct or indirect conflict that they may have with the SOE's interest.

In the case of a conflict of interest, the director concerned shall refrain from intervening in the discussion of the generic assessment of the conflict of interest, if any, of the transaction to which the conflict refers.

- **Duty of non-competition**

The directors shall disclose any shares they hold or business interests they may have in the capital of other competing companies as well as positions or responsibilities they exercise in them and the performance on their own account or that of others of operations similar to the corporate purpose of the SOE.

The Bylaws may stipulate that a director who ceases to hold office may not accept appointment as a director of another competing company for a period of two years starting from the time he quits unless expressly authorized by the Board of Directors of the company he left and without prejudice with respect to the regulations established in these cases.

Experience shows that clear rules should be drawn up to prevent a director who leaves and who is also an Executive director from starting to compete with the company he has just left by attracting more qualified staff, customers or use information from the previous company to benefit the new employer. It does not appear that the limitations on providing services to the competition must be extended to the Independent Directors or Proprietary ones, who in any case, would be subject to the following secrecy constraint.

- **Duty of confidentiality**

Even after leaving office, the members of the Board of Directors shall keep confidential information secret.

Obviously, the circumstances under which the laws allow for the communication or disclosure of such information to third parties should be exempted from the above requirement.

- **Duty not to use the assets of the SOE for personal use**

No director may make personal use of SOE assets nor use his position in the SOE to gain a proprietary advantage unless the appropriate consideration is satisfied.

In the event that such consideration is waived, the proprietary advantage thus obtained shall be considered an indirect remuneration and must be authorized by the

Board and approved by the General Assembly of Shareholders or whoever exercises ownership rights.

With proper regulation of directors' duties, what is ultimately sought is the best interest of the company itself which is focused on ensuring the good and continuity of the company over time.

The correct wording of these duties is key for two reasons:

1. Inform the members of the Board of Directors what action is expected of them.
2. Demand that they be held accountable in the event of non-compliance, which may range from a mere reprimand to a request for their resignation or the presentation of grounds for dismissal and even include a requirement to compensate the SOE.

Like directors, the chief executive and members of upper management are also subject to the duty of due diligence and of loyalty even though the scope may be more limited. In any case, the duty of loyalty must always be fully enforceable on the members of upper management just as are the principles of due diligence.

Finally, and given its relevance to the responsibility of the SOE Board members who belong to a corporate group, it is essential to insist that the parent company of the corporate group needs to define the interest of the group (and therefore the unity of purpose and governance of the companies it is composed of) so that both parent and subordinate companies can prove that their individual decision making is always done in the interest of the group as a whole.

In the event of such a statement, the directors, regardless of their position as directors in the parent or subordinate company, will always have a clear criterion that will enable them to solve the possible or potential conflicts of interest between the parent and the subordinate company, comply with the legal independence and reasonable autonomy of the companies that the group is made up of, but especially, contribute to achieving the common interest of the group with their decisions and, therefore, to the effective exercise of their duty of loyalty to both the company they are directors of and to the group that their company is a part of.

Guideline 42. In addition to the provisions of the Law, SOEs must stipulate the definition and regulation of the rights of the directors in its Bylaws and/or Internal Regulations of the Board of Directors.

In order to effectively exercise their duties and be consistent with the high responsibility assigned to them, a set of rights that is equivalent to the existing set of duties that the members of the Board of Directors have must be recognized.

- **Right to Information:** This right takes on special relevance since it is the keystone on which the diligent exercise of the director's position is based.

In general, directors should be able to demand that they receive the information they deem appropriate and/or useful for the correct performance of their duties. In other words, without correct and timely information, it is impossible for directors to diligently exercise their responsibility.

Based on the foregoing, they must combine the exercise of this right with the necessary precautions to avoid hindering the ordinary management of the various departments and preserve, where appropriate, the confidential nature of certain information.

Quality information, in due time, form, and context, is the necessary basis for the directors, after study and analysis, to achieve in-depth understanding and true knowledge of the business and operations of the SOE they manage.

It is important that this information be handled in the most secure and confidential manner possible, and the use of computer platforms adapted for this purpose is recommended.

Only directors with in-depth knowledge can ask the right questions at the right time, and thus fully comply with their duty to give diligent and loyal management.

As a complement to the right to general information, it is relevant to further develop the information when the Board of Directors is convened since the effectiveness and value contribution of these sessions depends, to a great extent, on the time and type of information that reaches them.

When the Board of Directors is convened, they must receive the documents or sufficient information to enable their members to make reasoned and justified decisions and to provide maximum value in the sessions.

A common mistake is to consider quantity of information as synonymous with quality. Nothing could be further from the truth given that an excess of information can become irrelevant and generate confusion among Board members, especially considering the time constraints a director faces prior to a Board meeting.

Therefore, information on subjects dealt with periodically by the Board of Directors must correspond to a set of summarized but complete information which will allow the Board to make informed decisions.

Along these lines, the quantity and quality of the information should facilitate the progress of the meeting and allow the directors, apart from specific issues, to focus on the regular monitoring of the company's main indicators.

Along with the above, it would be advisable to define the characteristics that the information that the Board of Directors receives for dealing with any issue, whether periodic or specific, must generally comply with. Among these characteristics, the maximum amount of information, the presence of indicators and, especially, the advance notice required for its receipt by the directors, except in the case of confidential information, should be assessed.

The directors should be able to request supplementary information and clarifications that they consider pertinent to the matters to be discussed so that the Board meeting time is essentially focused on active

discussion, construction of proposals, and decision making, rather than on SOE executives or technicians merely listening to explanations.

- **Right to expert advice or assistance:** regarded as complementary to the right to information, it must also be regulated and formalized in the SOE internal regulations.

By means of this right, directors are granted the right to request the assistance of experts to obtain advice on matters within their competence at the expense of the Board's own budget, or at the expense of the SOE.

In order to alleviate possible abuses of this right, it is desirable to establish formally that before requesting the hiring of professionals from outside the SOE, the Board of Directors should verify whether the required advice can be provided by officials of the SOE itself.

This right is particularly useful for SOEs in cases where there are those who are members of the Board of Directors by reason of their public office and who may possibly require the use of this right to finalize their judgment and vision on specific matters that may not be directly linked to their professional profile or previous knowledge.

Likewise, this right is particularly useful in the case of extraordinary or strategic operations, very specific operations in the life of the SOE but which require specialized analysis and specific training to enable the best decision making. In this respect, one can even recognize the right of the Board of Directors to obtain a fairness opinion from a specialized and independent firm that can contribute to the fully informed decision making for these types of operations.

- **Right to remuneration,** understood as the right of directors to receive compensation for the performance of their duties.

Given the importance of this subject, its sensitivity, and the current state of development of the SOEs in the region, which still face significant challenges, this right is treated under a guideline of its own.

- **Right to Orientation,** understood as the right of the directors, once they join the Board for the first time, to receive a proper orientation about the reality of SOE, its complexity, and key issues so that they can have the deepest possible vision about the company in the shortest time possible as well as the role expected of them as directors.

Guideline 43. SOEs must require a declaration of conflict of interest from the directors, and the bylaws must provide a management procedure for conflicts of interest.

A conflict of interest occurs when a person, as a manager or employee of a company, is influenced by personal considerations in the performance of his or her job and/or making decisions.

In this situation the person faces various choices regarding conduct in relation to incompatible interests none of which can be privileged in view of their legal, contractual and ethical obligations. In short, as against his duty of loyalty.

Conflicts of interest cannot be avoided absolutely. In fact, potential conflicts of interest are virtually inherent in the operation of any SOE.

That is to say, there is a very significant probability that, in the course of business of the SOE, there will be situations in which there will be a conflict of interest with respect to a particular director.

Hence, in terms of corporate governance, the objective is to have a defined and formal procedure in the internal corporate regulations for managing conflicts of interest that is applicable to not only the directors but also members of the upper management as well as to significant or relevant shareholders and that should include the following steps:

1. First of all, the procedure must begin with the obligation of the directors who find themselves in a conflict-of-interest situation to inform the Board of Directors so that the Board can apply the procedure established for managing conflicts of interest.
2. Secondly, identify the assumptions of the party linked to the director, which in any case and at a minimum should include:
 - The spouse of a Board member, or persons with a comparable relationship of affection.
 - The ancestors, descendants, and siblings of the Board member or his/her spouse.
 - The spouses of the ancestors, descendants, and siblings of the Board member.
 - Legal entities in which the director or any of the above-mentioned people related to him, maintain a stable and significant participation or have an ongoing business relationship.
3. Thirdly, the Board of Directors, or the Appointments and Remuneration Committee if one exists, must be assigned its own assessment of a conflict-of-interest situation.

Exceptionally, the Board of Directors may submit the assessment of certain conflict-of-interest situations to the General Assembly of Shareholders or, in its absence, to the SOA.

4. Fourth, it must be stipulated that the director concerned must abstain from intervening in the assessment of and voting on the conflict situation. In addition, it must be ensured that the Board member does not have access to information associated with the situation and thus generate a potential conflict of interest.
5. In addition, qualified majorities may be established for the approval or assessment of certain conflict situations although this is not mandatory.
6. Finally, when the conflict of interest is permanent, the compulsory resignation or proposed dismissal of the person concerned must be provided for.

The analysis of conflicts of interest would not be complete if attention were not given to existing conflicts of interest between companies that make up the same business group, and which must be understood from a dual perspective:

- From the perspective of managers and directors, this is the situation in which the interests of both the parent company and its subordinates, who are in opposition, must be defended.
- From the perspective of the shareholders, this is the plurality of interests which are contrary to each other that the shareholder is cognizant of when voting at the General Assembly of Shareholders of a subordinate company.

The above leads to the conclusion that a conflict of interest in the business group is especially peculiar and is closely linked to the very nature of the group since it is, from the economic point of view, a unit of companies while from the legal point of view it is several companies with legal autonomy.

It is necessary to differentiate the three different categories of interests in the business groups

1. The interest of the parent company.
2. The interest of the subordinate companies which may be individual.
3. The interest of the business group itself, which is the one that really balances and gives meaning to the two previous ones, since:
 - The subordinate companies derive a key benefit from their membership in the group, and this really gives them a sense of direction.
 - The unity of purpose and management requires seeking and defending the interest of the group, exerted from a single direction (the parent company), which in turn has corporate control of the subordinates.
 - This could result in an absurd blocking situation in the subordinate companies, whereby the director affected by the conflict of interest would not be able to vote on the Board of Directors, and the controlling shareholder could not vote either in the General Assembly of Shareholders. This could lead to decision-making becoming impossible or governance by the minority in the cases of subordinate companies in which there are minority shareholders.

Thus, from the perspective of corporate governance, as was mentioned above, it is essential for the group to publicly define its interest as a business group so that there is always a higher criterion on which to base solutions of potential conflicts of interest that could arise between companies in the group and their managers.

Guideline 44. SOEs must have a procedure for assessing, authorizing, and disclosing transactions between related parties.

Although it does not happen in all cases, conflicts of interest are often associated with a related operation.

Therefore, it is essential that these types of operations, which cannot be prohibited, be regulated so that there is a process that allows them to be carried out with the best possible guarantees while recognizing the following:

1. The recognition of an ad hoc principle of waiver, whereby certain transactions that are between related parties that arise from a situation with a conflict of interest may be authorized on a case-by-case basis.
2. The independence of the body that grants the waiver, which should be the Board of Directors, the Audit Committee, or the Appointments and Remuneration Committee, if these exist, or as an exception, if the Board considers it appropriate, the General Assembly of Shareholders or the entity exercising ownership when the decision is especially important.
3. The responsibility of the Board of Directors, or one of the previous Committees if they exist, to independently and

specifically assess and possibly approve any transaction between related parties.

4. The extension of the obligation to analyze related-party transactions carried out between the SOE and directors with individuals and corporations that are considered to be parties related to the SOE and/or directors.
5. When the person involved in the conflict of interest is, directly or indirectly, a director, he or she must abstain from participating in the deliberation or approval of the related operation.
6. As far as voting on the operation is concerned, the following aspects should be considered:
 - a. **Significant or material operations:** the knowledge and assessment of related-party transactions and any policy that the SOE decides to apply with respect thereto should only refer to transactions that are significant in the sense that they are for amounts that are considered relevant as defined by the SOE itself.
 - b. **Prior approval of related-party transactions:** it would be desirable for a Board Committee, ideally the Appointments and Remuneration Committee or the Audit Committee to be empowered to report to the Board on transactions involving related parties prior to their approval.

This Committee would analyze the transaction and submit its proposed resolution to the Board of Directors.

Ideally, once this Committee's report assessing the transaction is received, its final approval by the Board could even be subject to a super majority of its members that is not greater than two thirds in any case. Of course, the member(s) of the Board of Directors who are affected due to being considered a related party, if any, must absent themselves and abstain from the discussion and voting.

The above approach is fully consistent with best corporate governance practices. However, International Accounting Standard 24 broadens the definitions, scope, and type of information to be disclosed so that an SOE whose operations regularly include related-party transactions or such transactions are significant may find in this IAS the basis for formulating a fully reinforced way to deal with this issue.

Guideline 45. SOEs must ensure proper remuneration for the members of the Board of Directors approved by the Assembly, or in its absence, the ownership body, and it must be consistent with the results of the SOE and the characteristics of the industry. The SOEs should ensure that compensation for directors is transparent and approved by the shareholder or property representative.

The remuneration of Board members is one of the main rights of directors and one of the most controversial issues in corporate governance, particularly in SOEs given that:

- There is a special sensitivity in everything surrounding SOEs and particularly in their social and economic profitability.

- In general, membership on the Board of Directors is considered a personal recognition rather than an obligation that demands dedication and generates legal responsibilities. To that extent, it is not a general vision that remuneration should be the product of a compensation policy that makes it possible to attract good professionals.
- Occasionally, certain public positions are associated with membership on the Board of Directors of certain SOEs and this means that remuneration is not considered an element that attracts professionals to the Board.

In fact, this leads to the fact that remuneration plans for SOE Board members in the region are essentially based on their attendance at sessions of the Board and other aspects that should be remunerated are not included. Today, this continues to be a challenge for SOEs.

Thus, to the extent that the salaries are paid per session and since these are limited, incentives may be generated to increase the number of sessions per year so that it has an impact on the amount of remuneration. These would not necessarily be merited and would affect the work of the upper management team. This situation also fosters several short sessions instead of regular sessions of several hours.

From a corporate governance perspective, it is fully advisable to propose a remuneration structure for the Board of Directors based on two main characteristics:

1. That it be public and transparent, so that it is known by shareholders and interested third parties.
2. That it be sufficient, so as to attract and retain talent as well as to demand effective commitment.

The following elements should be combined when determining the compensation for SOE directors:

- a. Definition of a Remuneration Policy: the compensation for directors should be outlined in a Remuneration Policy the design of which is the responsibility of the Board of Directors and, ideally, the Appointments and Remuneration Committee, if any. Its approval, in turn, corresponds to the SOA, the entity exercising the property rights or the General Assembly of Shareholders when this body exists.

The remuneration policy must set out all the components included in remuneration and there may be no components other than those stated in the Policy. These may include other items such as a fixed monthly honorarium, variable bonuses, pension plans, payment of insurance premiums, etc. in addition to honoraria and attendance allowances.

- b. The directors' remuneration structure must be designed on the basis of fixed and, possibly, variable components.

In this respect, although the most common remuneration system is based on the existence of a per diem, which is usually low, for attendance at Board meetings, whether or not other fixed components may be added such as per diems or a fixed annual amount as well as a variable component in recognition of a director's effective commitment or achievement of the strategic objectives set should be considered.

Whether or not it makes sense to pay the directors who contribute the most the same as those who contribute the least, or even if the directors should be paid the same regardless of whether or not they have achieved the objectives set out in the Strategic Plan must be assessed.

Clearly, the usual practice of exclusively paying the directors for their attendance at Board meetings is often excessively basic and probably one of the reasons there are Boards of Directors that do not contribute as much as they could.

If it exists, the variable component must be satisfied after the close of the fiscal year after verifying that the indicators (strategic, economic or financial) that trigger its accrual have been met.

- c. The remuneration system for directors (and this should be reflected in the Compensation Policy) must consider proper incentives within that which is allowed by local legislation in those cases where there are directors who are also public officials.
- d. The remuneration structure must be public. Thus, the paid components and the global percentage that the remuneration to the Board of Directors represents over the total personnel expense of the SOE are disclosed. The Compensation Policy should provide for the mandatory disclosure of the Board's compensation structure.

Guideline 46. The SOEs should evaluate and analyze how the Board of Directors' sessions work in order to allow for the greatest value generation by the Board in its decision making.

Attention should be paid to not only the structural aspects of the Board but also the dynamics of how the Board functions since it has a very significant impact on this body's actual contribution of value and, therefore, on their efficiency.

The dynamics of the Board of Directors refers basically to the "how" of the Board meetings: from the summons to the sessions, to their proceedings, frequency, commitment of the directors, planning the annual activities of the Board or the existence of a catalog of confidential subjects with their corresponding calendar.

In this regard, it is essential to pay attention to the following aspects:

- Prepare properly for the Board of Directors' meetings ahead of time since that is the only way to ensure that these sessions are truly productive and valuable.

To do so, it is advisable to comply with the following conditions:

- Preparation of the agenda for the meeting which the Chairman of the Board of Directors shall be in charge of with the assistance of the Secretary of the Board or whoever assumes that role and the Chief Executive.
 - Information on time and form: both the Board of Directors and the Directors must have sufficient information in a timely manner and proper form.
 - Availability: Directors must have the necessary time to carry out their duties.
- Consider the result of the progress of Board meetings by analyzing (by studying the minutes of the sessions or interviewing the members) the following aspects:
 - Wealth of points analyzed.
 - Existing degree of deliberation.
 - Participation of all of the members of the Board of Directors.
 - Frequency of voting versus unanimous voting.

- Tracking the attendance of members of the Board of Directors.
- Control of the attitude and value contributed by the members of the Board of Directors in the sessions.
- Plan the sessions for the entire fiscal year so that the Board approves a Plan of Work at the beginning of each year that will make it possible to define the number of sessions, the recurring topics, and the frequency with which they should be analyzed. Thus, a specific calendar of regular meetings may be prepared without prejudice to the possibility of meeting as often as necessary in order for directors to plan their regular participation in the meetings of the Board or their committees, if any, sufficiently in advance and this, together with the annual evaluation of the Board of Directors, will reinforce the dynamics of the sessions as a whole and the input of its members on an individual basis.

Regarding what the most appropriate number of meetings per year is, it is difficult to recommend a specific number since this depends on multiple factors such as the complexity of the issues, the situation of the SOE, its regional presence, structure of the Board, and other variables that must be considered when preparing the work plan.

However, both the Boards that normally meet too many times (for example, more than once a month) and those who meet very rarely (for example, four times a year) suggest that either their roles are not well defined and fall into the realm of co-administration or, on the contrary, they act as formal Boards and have no real content.

As a result, for publicly listed SOEs and in the financial sector, it is estimated that the most reasonable number of meetings should be between eight and twelve meetings per year while for closed SOEs that are not excessively complex, this figure could range between six and ten meetings per year.

A recommendation for all types of companies is to have at least one or two extraordinary meetings per year that are clearly strategy oriented and that are organized away from the company's headquarters (off-site meetings).

- Consider the advisability of holding meetings or sessions of the Board of Directors that are not in person or at least that individual attendance need not be in person in order to facilitate the attendance of the members of the Board as much as possible especially if they reside in places other than where the SOE headquarters is.

Only through a Board of Directors with an appropriate size, structure, membership, and dynamics will it be possible to ensure that they contribute the greatest value to the SOE given that, even if there are individually excellent members, the value of a Board with poor dynamics will be much lower than the value of its members as individuals.

Guideline 47. The SOEs must elect the Chairman of the Board from among their external members. They should also encourage the separation of the position of Chairman of the Board from that of the Chief Executive, define the position of Vice Chairman of the Board, and reinforce the role and independence of the Secretary of the Board.

For the proper functioning of the Board of Directors, there are a number of key figures who play a critical role in its success.

1. Chairman of the Board of Directors

Elected by the Board of Directors from among all the members with the recommendation that it be not only one of the external members, but also independent, according to the conditions detailed in Guideline 39. Has a key function in that he is responsible for both the efficient and proper functioning of the Board of Directors, and the timely and sufficient receipt of information by its members.

In addition, in the SOE, this person is the one who is mainly responsible for interacting between the state (or the SOA), the rest of the Board of Directors, and the Chief Executive and, thus, acts as a liaison with the representative of the property and public policy makers on the one hand, and the different levels of the company on the other and, therefore, constitutes an important channel of communication between them.

From a corporate governance perspective, the Chairman of the Board must have and exercise a recognized set of key duties.

- Establishes the agenda of the sessions based on the subjects and responsibilities defined in the planning of sessions of the Board of Directors. In order to do so, must coordinate with the Chief Executive and listen to the Committee Chairpersons and other directors in case they want to include topics for discussion.
- Calls meetings together with the Secretary periodically, preferably based on a pre-established calendar approved by the Board.

- That the information reaches the directors on time and in an appropriate form.
- That the meetings are participatory, not informative, and that discussions take place when needed.
- That an induction program for new directors, regular updating on various topics of relevance to the Board, and the necessary training programs be carried out.
- That the procedures of the General Assembly of Shareholders, when it exists, be appropriate given that as a general rule, the position also involves heading up the Shareholder Assembly.
- That an evaluation of the Board of Directors be carried out and enhancement practices are proposed and implemented.

Likewise, the Chairman has the power to entrust certain members of the Board of Directors with certain tasks to carry out and to guide and channel the pace of the Board's sessions. In this respect, one of the main responsibilities of the Chairman of the Board is to lead and build an effective team from a group of individuals.

In short, an important part of the good or poor functioning of a Board of Directors can be attributed to the person of its Chairman. The interpersonal management as well as the knowledge and follow-up of the business must be such that they can extract from the members of the Board their maximum capabilities for the proper fulfillment of the Board's duties.

2. Chairman of the Board as Chief Executive Officer

In addition, there is also an important debate about whether the Chief Executive should also be the Chairman of the Board.

It is difficult to categorically express the best practice applicable in any case since even in some countries within the scope of the OECD, as is the case of the United States, the union in one person of both positions is the dominant practice.

However, as best practice in corporate governance, in order for the Board to be able to effectively exercise its control over upper management and supervision, these Guidelines suggest that it is more advisable for the Chief Executive to not be the Chairman of the Board as well.

Nevertheless, in specific cases and when it is appropriate due to the business situation or complexity of the company, the Chief Executive may also be considered to be the Chairman of the Board of Directors on a temporary basis.

For these cases, it would be advisable to compensate this doubling up of positions by:

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

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

3. Vice-Chairman of the Board of Directors

The Vice-Chairman of the Board, who shall also be elected from among the external members of the Board, and in the event that the Chief Executive is also the Chairman of the Board, shall replace him in the event of the latter's absence or unavailability.

Additionally, in the event that there is a relevant percentage of Internal Directors, and of course in the event that the position of Chief Executive Officer and Chairman of the Board coincide in the same person, the Vice-Chairman of the Board must play a reinforced role that allows him, at his own initiative:

- Convene the Board of Directors;
- Sign the announcement of the General Assembly of Shareholders or maintain the direct relationship with the SOA if deemed advisable;
- Hold meetings with the rest of the External Directors;
- Be able to meet with members of upper management independently; and
- Carry out the evaluation process of the Chairman of the Board.

4. Secretary of the Board of Directors

The Secretary of the Board of Directors, traditionally linked in the region simply to the drafting and keeping of minutes, is nevertheless a key player in strengthening the efficiency of the Board's actions, given that:

- This person is of great help to the Chairman of the Board in carrying out his duties; and,

- Helps ensure that the decisions of the Board of Directors comply with formal and material legality applicable to an SOE.

He is also a key player in the efficient functioning of the Board of Directors as he supports the Chairman of the Board in:

- Shape and structure the agenda of the Board of Directors' meetings.
- Ensure the directors' right to information and guarantee the appropriateness of information provided for Board meetings.
- Follow up on the decisions and mandates of the Board of Directors.

Therefore, it is advisable to undertake an internal reinforcement of the figure of the Secretary whose key duties should include the following in the SOE:

- Act as a liaison between the upper management and the Board of Directors, facilitate the flow of information to the latter, and ensure that the information presented is sufficient and suitable.
- Ensure the formal and material legality of the actions carried out by the Board of Directors and guarantee that its procedures and rules of governance are followed and regularly reviewed.
- Preserve the documents of the company, duly record the progress of the sessions in the minutes, and attest to the agreements between the corporate divisions.
- Verify the statutory regularity of the actions of the Board of Directors, the compliance with the regulations issued by the regulatory bodies, and the consideration, if applicable, of their recommendations.
- Ensure compliance with the principles or criteria of corporate governance accepted by the SOE.

- Provide the Board of Directors with assistance on issues related to corporate governance.
- Support the Chairman of the Board of Directors in the follow-up on the commitments, agreements and requests generated within the meetings of the collegial body
- Act as Secretary of the General Assembly of Shareholders.

Given the relevant functions of the Secretary, it is a good corporate governance practice for the functional reporting line to go directly to the Board and for the Secretary's appointment, evaluation, and severance to be especially reinforced as well as for his profile to include legal expertise without this meaning he must be a career lawyer.

Guideline 48. SOEs shall consider the distribution of responsibilities among directors through the establishment of specialized committees of the Board of Directors that are made up mostly of External Directors.

The creation of specialized working committees, composed of directors who are qualified in the specific areas they work on is intended to support the Board of Directors in carrying out their duties and making their operations more efficient since the more complex and technical issues are dealt with by members who are appropriately qualified and informed.

In this respect, the Boards of Directors of SOEs will be able to set up specialized committees within the company to act as study and support bodies with the right to submit proposals to the Board and, possibly, to exercise certain duties delegated to them. These committees may be temporary or permanent.

The most common committees are Audit, Risk, Corporate Governance, and Appointments and Remuneration all of which are specific topics that usually require technical and specialized knowledge for good management.

If the law dealing with SOEs or the company's own rules do not stipulate how to organize the Board of Directors and their committees, it will fall upon the Board to do so and to determine each committee's specific area of knowledge along with its specific responsibilities.

The Board of Directors is responsible for approving Internal Regulations for each Committee it decides to create so that the following aspects are formally established:

- Membership of the Committee.
- Members' area of expertise.
- Specific roles.
- Minimum frequency of sessions.
- Reporting lines to the Board of Directors and communication arrangements with upper management.
- Appointment and dismissal of its members.
- Modification of the Regulations.
- Evaluation of its performance and proposal of improvements.
- Rules for holding face-to-face and non-face-to-face sessions.
- Management of conflicts of interest and confidential information.
- Chairmanship and Secretary of the Committees.
- Annual work schedule.
- Conditions for the compensation of Committee members.

To address the above points, it is appropriate to extend the same spirit and approach of corporate governance practices that are recognized and in force for the Board of Directors as a whole to the Committees so that they are fully aligned with the corporate governance operations and approach in effect for the SOE.

The creation of Committees must take into account different variables among which the following stand out:

- **Number and Topics of the Committees:** The specific issues that the SOE needs to give special attention to must be considered either because of their corporate purpose or due certain temporary situations and include committees which are binding by law or regulation.

It is also important to consider the size of the Board of Directors in order to determine the Committees that need to be set up. When faced with small Boards of Directors (of five members or less), it would not make sense to set up more than one or two committees, as it could lead to the paradox of creating parallel Boards. Therefore, in these cases, it is advisable to assign the committees to individual directors who have superior knowledge on certain specific subjects.

- **Committee membership:** The number that seems most appropriate is between three and five members. When nominating the directors to be part of a given Committee, their knowledge and professional experience in the field relevant to the Committee should be taken into account.

The above will in some ways determine the profile of some members of the Board of Directors. That is why it is so important that the Board itself, when it comes to replacing members, can report on the necessary profiles that its members must meet.

In the absence of a specific rule that is mandatory, determining the specific number of directors as well as the directors that will be members of each committee is a function of the Board of Directors. In determining this, they must consider the knowledge and professional experience of each candidate in the field that each committee deals with.

In the case of the Audit and Risk Committees, these must consist exclusively of external Directors with the appropriate professional profile and ideally led by an independent Director with a high level of experience in the areas within the purview of said committees.

Where there is a commissary, auditor or trustee, they may be summoned to the meetings of the Audit Committee, with the right to speak but not to vote. Similarly, although it is recommended that members of the upper management participate as invited members, if their permanent attendance is required, they should do so with the right to speak but not to vote.

- **Permanent or temporary:** Certain temporary situations may require that a committee be created but this does not mean that they should be retained over time when the need that led to their creation has been resolved. Therefore, the permanence or temporary nature of each Committee must be determined.
- **Formalization:** The organization, functions and everything related to its makeup must be regulated and formalized in the Committee's own specific Rules of Procedure the approval of which shall be vested in the Board.
- **Operation and evaluation:** in addition to establishing the appropriate number of meetings to discharge their duties, it is essential to carefully analyze the following aspects that could lead to the failure of a particular committee such as:
 - Lack of content regarding the issues to be addressed.
 - Deficient approach to meetings.
 - Information is scarce, of poor quality or lacking the necessary advance notice.

- Low participation of the members due to lack of knowledge regarding Committee matters.
- Lack of follow-up on issues between meetings.
- Lack of motivation –economic and professional– of the member directors to actively participate in Committee tasks.
- Little receptivity on the part of the Board of Directors to the proposals emanating from the Committees when it comes to study and support.
- Weak definition of the information channels from the Board Committees to the Board itself.

In order to properly follow up on the above-mentioned aspects and prevent them from adversely affecting the dynamics of the committees, they should be evaluated once a year as should the Board to detect operational weaknesses and propose the pertinent improvements.

- **Report:** Together with the above, the committee should also prepare a record of their activities that will be made available to shareholders, the SOA, or interested third parties to make them aware of their usefulness and be accountable for the discharge of their duties.
- **Duties:** The Bylaws or the Board of Directors may stipulate that the committees have decision-making powers or, on the contrary, that their role shall be exclusively that of advisor to the Board.

Determining whether the committee's role should be decision-making or advisory depends on the will of the Board and especially on the composition of the committees if there are no rules that define it.

Thus, if the Committee is composed exclusively of Board members, they may have delegated functions. However, if

the Committee includes members who are not part of the Board of Directors, they may only have information or advisory functions for the Board.

In any case, the existence of Committees does not eliminate or replace the Board's full responsibility for the matters dealt with by the Committees.

Ultimately, the committee should be an instrument that reinforces the Board's effectiveness in dealing with certain matters which, due to their technical component, should be dealt with in depth and in detail by independent or external members with a particular specialized profile.

The following are duties that should correspond to the indicated Main Committees.

1. Audit Committee

The main task of the Audit Committee will be to assist the Board of Directors in their oversight role by evaluating the accounting procedures, the relationship with the External Auditor, and the review of the control architecture.

Specifically, the Audit Committee should take on the following responsibilities along with others:

- Inform the SOA (or the General Assembly of Shareholders if it exists) about questions raised by the shareholders during the meeting or that the SOA needs to know regarding matters within its responsibility.
- Suggest that the Board submit the appointment of an External Auditor and the terms of employment or, if applicable, removal or non-renewal to the SOA or General Assembly of Shareholders, if any.

- Supervise external audit services.
- Manage relations with external auditors, act as their counterpart and, in particular, evaluate all those issues that could jeopardize their independence and any other issues related to the auditing plan, and the conduct of the audit as well as other communications provided for in the legislation regarding auditing accounts and in the technical auditing standards.
- Receive the final external audit report and, in the event that it contains reservations and qualifications, explain its content and scope to the SOA and if it is listed or registered as a securities issuer, to the capital markets.
- Verify that upper management is taking the external auditor's recommendations into account and, when appropriate, lead the process of responding to the observations made in the auditor's report.
- Ensure that the accounting criteria in effect at the time are properly applied in the preparation of the financial statements that the Board submits to the SOA or the Shareholders' Assembly, if any, and make sure the company does not remain on the sidelines of the implementation processes of the International Financial Reporting Standards (IFRS) on the national or sector level.
- Know and evaluate the financial information process.
- Supervise the operation of the SOE website and other information dissemination mechanisms.
- Monitor compliance with regulations and legal requirements.
- Verify that all periodic information offered to the markets is prepared according to the same professional principles and practices as the annual accounts and monitor this information before it is disseminated.

- Know and evaluate the SOE internal control systems.
- Monitor and periodically report on the application of the SOE’s risk policy so that the main risks, whether financial or non-financial, on balance sheet and off-balance sheet, are properly identified, managed, and reported.
- Supervise internal audit services.
- Propose the selection, appointment, re-election, and dismissal of those responsible for the internal audit service in the SOE to the Board of Directors.
- Review the Annual Work Plan for Internal Audit and the annual activity report.
- Ensure the independence and effectiveness of the internal auditing area, receive information periodically on their work and verify that upper management is taking the conclusions and recommendations from their reports into account.
- Review compliance with actions and measures resulting from reports or inspections by supervisory and control authorities.
- Report on the transactions that the company carries out, directly or indirectly, with directors, significant shareholders or shareholders represented on the Board, members of upper management, intra-group transactions, or persons associated with them prior to their being authorized by the Board of Directors.
- Regularly monitor the degree of compliance with the Code of Ethics and the effectiveness of the whistleblower system by evaluating the unethical actions and content of the complaints filed and making the appropriate recommendations to the Board.

2. Appointment and Remuneration Committee

The main task of the Appointments and Remuneration Committee is to assist the Board to the extent that local regulation permits in their duties to appoint, re-elect, remove, and compensate the directors and upper management of the SOE.

Specifically, the Appointments and Remuneration Committee should assume, along with others, the following responsibilities:

- Inform the SOA or the General Assembly of Shareholders if it exists, about their actions and the issues raised therein by the SOA or required by the shareholders on matters within their purview.
- Periodically evaluate the skills, knowledge, and experience that are needed on the SOE Board of Directors.
- Propose and review the criteria to be followed for the makeup of the Board of Directors and the evaluation of candidates.
- Report on the suitability of candidates for membership on the Board of Directors. In the cases of re-election or ratification of directors, the committee shall make a proposal containing an evaluation of the work and effective commitment to their position during the latest period of time in which the proposed director has held the position.
- Inform the Board in those cases where directors may adversely affect the work of the Board or the credit and reputation of the SOE and, particularly, when they are involved in any case of incompatibility or prohibition provided by law.

- Examine and organize a planned process of succession or substitution in the event of termination, announcement of resignation or dismissal, incapacity, or death of members of the Board or its Committees.
- Define and organize a planned succession or replacement procedure in the event of dismissal, announcement of resignation or retirement, incapacity, or death of the Chief Executive Officer, other people in upper management positions, and key executives of the SOE and submit the proposal to the Board of Directors.
- Propose the Directors' Remuneration Policy – to be approved by the SOA – and the upper management Remuneration Policy to the Board of Directors.
- Within the framework of the Remuneration policy approved by the SOA, propose the individual amount of the compensation for directors including the Chairman of the Board and the Internal Directors, if any, for the discharge of duties other than those of the Board and other conditions of their contracts to the Board.
- Ensure the adherence to the Directors' Remuneration Policy and the transparency of their compensation.
- Periodically review the directors' and upper management's compensation programs and make appropriate recommendations to the Board of Directors.
- Prepare the annual report on the Remuneration Policy for Directors and the Remuneration Policy for upper management.
- Advance the evaluation processes of the Chief Executive of the SOE.

3. Risk Committee

The ultimate role of the Risk Committee is to support the Board of Directors in fulfilling its risk management responsibilities by periodically reviewing and evaluating the:

- The integrity and appropriateness of the risk management role.
- The suitability of the SOE's economic and regulatory capital and its allocation to the different lines of business and/or products when appropriate.
- Risk limits and risk reports and making appropriate recommendations to the Board of Directors.

Specifically, the Risk Committee should assume the following responsibilities along with others:

- Inform the SOA or the General Assembly of Shareholders when it exists, about its actions and the questions raised on matters under their jurisdiction.
- Propose the SOE Risk Policy to the Board of Directors.
- Systematically assess the SOE's strategy and general risk policies translated into the establishment of limits by type of risk and business with the breakdown level to be established by business, economic or business groups, clients, and areas of activity.
- Analyze and evaluate the ordinary risk management in the SOE, in terms of limits, risk profile (expected loss), profitability, and capital mapping (capital at risk)
- Analyze and evaluate SOE risk control systems and tools.

- Prepare improvement initiatives on the internal oversight and risk management systems that are considered necessary.
- Submit the proposed delegation rules for the approval of the different types of risks to be assumed at each level of the SOE to the Board of Directors.
- Inform the Board of Directors about the transactions that the Board must authorize that are beyond the powers delegated to the lower levels or bodies.
- Evaluate and follow the indications prepared by the supervisory authorities in the exercise of their duties.
- Foster the adaptation of how the SOE treats risk management to an advanced model that allows a risk profile to be configured to be in line with the strategic objectives and monitor the degree of adaptation of the risks assumed under that profile.

4. Corporate Governance Committee

The main task of the Corporate Governance Committee is to assist the Board of Directors in its role of making proposals and supervising the corporate governance measures adopted by the SOE. Specifically, the Corporate Governance Committee should assume, along with others, the following responsibilities:

- Ensure that shareholders, investor groups and stakeholders in general have full, truthful and timely access to company information that should be disclosed.
- Review and propose that the Annual Corporate Governance Report be included on the website with the approval of the Board of Directors along with any other corporate governance information that the Board must communicate or include in the company's public documentation.
- Oversee compliance with the requirements and procedures for the election of Board members by the Appointment and Remuneration Committee.
- Define the systems for monitoring the company's corporate governance practices included in the bylaws or internal regulations and consider the commitments assumed in relation to each of the stakeholders, the results obtained, and the conflicts that have arisen.
- Propose a corporate governance structure for the company and evaluate and inform the Board about the degree of compliance with corporate governance practices and suggest adjustments and reforms that are deemed necessary for its improvement.
- Monitor the alignment of the company's corporate governance practices with applicable laws and regulations, with the corporate governance rules approved by the supervisory bodies, and the corporate governance regulations in general applicable to the company.
- Coordinate the induction process of the new members to the Board of Directors with the Secretary of the Board or the unit responsible and encourage their training and updating in areas related to their skills.
- Study the proposals for reforming the bylaws or internal regulations that relate to the company's governance practices and present the modifications, updates, and repeals of the provisions they deem necessary.
- Ensure that the company's corporate governance practices are in line with internal and regulatory standards.
- Act as support for the Chairman of the Board of Directors in the annual evaluation process of the collegial body itself.
- Support the Board of Directors in the study and analysis of events that generate conflicts of interest that are within the jurisdiction of the collegial body.

Guideline 49. The SOA, or in its absence the Board of Directors itself, must evaluate the management of the Board of Directors within a reasonable period of time.

The SOA shall evaluate the efficiency of the performance of the Board of Directors as a collegial management body, the effectiveness of its internal rules, and the commitment and productivity of its members within a reasonable period of time and based on the company's mandate and strategic objectives.

The purpose of this evaluation is to detect the weaknesses in the work of this body and, consequently, to propose a whole set of improvements.

For now, this practice is a major challenge for SOEs in the region.

The experience in the region tells us that it is not easy to evaluate the Boards of Directors for a number of reasons but mainly because of the varying length of time directors have been in their positions, the lack of accumulated experience in the subject, or the degree of sensitivity that a process like this can generate.

There is a first question to be asked, and that is: what is most advisable? The evaluation of the Board of Directors as a body or that of its individual members considered individually?

The evaluation of the Board of Directors as a body is the least problematic method but, despite shedding light on the main weaknesses in the operations of the Board, its results do not necessarily reveal the critical areas for improvement.

In contrast, an individual evaluation of each director provides the most information, but among its disadvantages is the fact that it is a process that sometimes generates internal friction.

It is not so much a question of determining which is the best option, but rather to determine what stage the SOE is at, what kind of culture has been developed with this type of evaluation, and from there, to decide which option fits best.

In general, it would be advisable that, at least once a year, an evaluation be done of the effectiveness of the Board of Directors as a collegial body, the rationality of its internal rules, the commitment and productivity of its members, but most especially, all aspects related to its operational dynamics.

Based on the result of the evaluation carried out, the following should be proposed:

- Modifications to its organization, membership and/or operations that are considered appropriate, regardless of the approval or rejection of its actions and overall management by the General Assembly of Shareholders, when it exists, or the SOA.
- Changes or improvements in practices related to the internal organization and operational dynamics of the Board.
- Induction or training processes that are necessary to increase the knowledge of the directors on matters of special importance for the SOE.

Usually the evaluation process, which is directed by the Chairman of the Board, is usually done with the support of an external firm, at least in the first few years.

Furthermore, it is very advisable to evaluate the relationship of the Board of Directors with the upper management since the degree of understanding the Board of Directors has of the business depends significantly on this relationship.

In evaluating this relationship, aspects such as the following should be considered:

- Type of information generated by management for the Board of Directors.
- Management's contribution to the sessions of the Board of Directors.
- Time dedicated by management to preparing for and participating in Board of Director sessions as well as training and sensitizing Board members.

In particular, for the Chief Executive, the following should be observed:

- Preparation of Chief Executive's own succession plan as well as the succession of key positions in the SOE.
- Conclusions of evaluation processes carried out by the Chief Executive Officer of upper management and, if any, by the upper management with respect to the Chief Executive.
- Leadership of the Chief Executive, and his influence on the conduct of Board meetings.

In the case of individual director evaluations that are usually linked to the appropriateness of the director's profile and his or her own performance on the Board, a methodology called peer evaluation is usually used. Under this method, a director anonymously evaluates the performance of the other members of the Board.

The main purpose behind this type of evaluation is to provide individual feedback to each director about areas where there are opportunities for improvement, and to reinforce existing skills that have been useful in meeting the Board's responsibilities.

In addition, when an individual evaluation of its members is carried out, these results are usually used by the Appointments and Remuneration Committee, and failing that, by the Board itself when considering the renewal of the Board and even, in the most advanced compensation plans, for setting each director's own remuneration although today these plans are not a reality for the SOE.

6. CONTROL ARCHITECTURE

The carrying out of any business activity implies being exposed to and having to manage a whole set of corporate risks.

Totally avoiding any risk is absolutely impossible since it would imply the total absence of business activity, and even then, we would still be exposed to unpredictable or unforeseen risks.

Corporate risks occur at any level of the company, and in general, can be strategic, managerial, operational, or disruptive:

- Operational risks occur internally in the company (for example, the risk of theft, system failure, fire, or accident, etc.).
- Management risks reflect risks arising from the business operations themselves (e.g., environmental risk, risks arising from one's products or services, or supplier risks, etc.).

- The strategic risks include those risks derived from the strategic plan due to its inadequacies, wrong decisions, changes in the environment, or events that alter the company's strategic position.
- Finally, disruptive risks are defined as ambiguous risks that are difficult to manage, internal or external, with significant economic, operational or reputational impact derived from the VUCA environment (volatility, uncertainty, complexity and ambiguity) in which public and private companies currently operate. Frequently identified with the risks derived from the appearance of new technologies, these risks are not limited to the technological environment but can affect companies in any sector or activity.

The relationship between the concept of risk and that of business activity is direct given that the former is a consequence of the latter.

In fact, the greater the risk assumed, the greater the expected return given the classic risk-return equation whereby the greater the risk of a given business activity, the greater the expected return.

Considering the relationship between risks and business activity, proper risk management becomes essential to strengthen the sustainability of the SOE since it is dependent on the alignment between the risks the company faces to achieve its objectives and the solutions provided.

The treatment of an SOE's response to the risks has a double perspective:

- i. On the one hand, there is a fully technical, pure risk management component based on the upper management's active role, and the existence of risk management systems (or ERM - Enterprise Risk Management) as well as technical risk management methodologies, which are applied for the proper management of operational risks and management risks.
- ii. On the other hand, there is a fundamental component from the perspective of corporate governance, linked to both the consideration given to the subject of internal control and global risk management in the organization, and the key roles and responsibilities that must exist in the SOE at its different levels to properly manage the risks to which it is exposed: the supervision by the Board of Directors of the handling of operational and management risks by upper management as well as their role in the active management of strategic risk and disruptive risks.

Along these lines, the definition of the roles and responsibilities of the company's key bodies will differ depending on the major types of risks to be managed.

Therefore, the concept of Control Architecture has appeared. This is understood to be an overall system that empowers a SOE to have an organizational structure, policies, and procedures exercised by the entire company (from the Board of Directors to the upper management as well as the employees themselves) that makes it possible to provide reasonable security in relation to the achievement of its objectives in a way that is aligned and consistent with the risks assumed to achieve those objectives.

The Architecture of Control is an integrated concept that unites everything that has to do with the matter of:

- 1. Environment of control:** understood as the tone of the organization in terms of risk management and control. It is related to the philosophy of the SOE about risk management and control, the definition of suitable structure (roles and responsibilities), as well as ethical values.
- 2. Risk management:** understood as the treatment of the identification and management of risks in the organization, which includes:
 - Establishment of goals to be achieved (strategic, operational, reporting of financial and non-financial information, and compliance).
 - Identification of events, which may affect (positively or negatively) the achievement of the goals.
 - Risk assessment (probability and impact), through which potential events can affect the business goals.
 - Risk response: basically avoiding the risk, mitigating the risk, sharing the risk, or accepting the risk.
- 3. Control activities:** policies and procedures that help management ensure that responses to risks are carried out appropriately and in a timely manner.
- 4. Information and Communication:** internally, communication throughout the organization is needed for the operation of the entire Control Architecture. At the external level, reliable and truthful information regarding the SOE intended for the stakeholders.
- 5. Monitoring:** evaluation to ensure the effective operation of the Control Architecture.

In general, any SOE has control and risk management systems that, in certain cases, are supplemented by external control systems run by different bodies or agents (the External Auditor, the Comptroller, as representative of the Comptroller's Office or equivalent body or, more often, the supervisory body in the case of supervised companies).

However, this whole system does not always operate systematically nor, more importantly, is it a system that is fully adapted to the reality and/or complexity of the risks that SOEs actually face as a result of their operations.

Given the importance of the Control Architecture to reinforce the sustainability of the SOE and to contribute to its strengthening, there is a notable development in best practices with respect to the internal control system and the risk management system which together are understood as the Control Architecture of a company.

This good practice framework has been developed by COSO (Committee of Sponsoring Organizations of the Tradeway Commission), an international body that establishes the main guidelines for the implementation, management, and control of an internal control system (developed in its best practices document COSO I and COSO III) and risk management (in its COSO II document).

From the perspective of corporate governance, and in full alignment with COSO, a set of guidelines are proposed to strengthen the Control Architecture.

Finally, there are two important nuances:

1. In the case of business groups, the Control Architecture is an area of special importance since it allows the consolidated supervision of the group with regards to meeting its objectives based on the risk profile approved for the group.

Therefore, each business group must develop its own Control Architecture in line with its complexity and needs based on best practices with a consolidated, formal scope that groups all levels of the group, establishes different responsibilities, and defines clear reporting lines that make a consolidated view of the risks to which the group is exposed possible and allow for timely control measures.

In addition, as a specific feature, the Control Architecture group model shall:

- Establish the responsibility of the Board of Directors of the parent company to ensure that there is a suitable Control Architecture adapted to the reality and complexity of the group, based on the best practices on the subject (COSO I, COSO II and COSO III).
- Approve a control policy and a risk management policy with group scope which allows a consolidated view on both matters to be implemented in the different subordinate companies.
- Assign top managers in the group over the Control Architecture, with top positions in the management line, and with clear reporting lines.
- Involve the whole organization with different levels of responsibility defined around the Control Architecture, to further its effective operation.
- Assign a set of duties to the Boards of Directors of the subordinate companies that are related to the Control Architecture so that they are responsible for

the implementation of the control policy and risk management of the group in the subordinate company as well as the subordinate's adaptation of the Control Architecture to the guidelines issued by the parent company.

2. SOEs are usually subject to governmental control which is understood to include supervision, monitoring and verification of the operations and results of their public management as well as compliance with legal regulations through evaluation of the administration, management and control systems.

This control is carried out by bodies and officials belonging to the state administration, and is, therefore, external to the SOE itself regardless of whether their work is done on the premises of the SOE or if their position is part of the organizational structure of the SOE.

The existence of this government control is mandatory for SOEs, and the scope of their responsibilities and objective of their work is usually assessed by the Law itself.

From the point of view of corporate governance, these bodies and public officials should supplement the traditional model of the Control Architecture to be developed and implemented in the SOE, so that:

- The existence of these bodies and officials is not considered a substitute for the need to develop a solid Control Architecture in the SOE.
- There is clarity in the allocation of duties between these bodies and officials and those defined by the Architecture Control model at the SOE.

- The public control entities maintain a business approach in the course of their duties that is aligned with the sectors and markets in which the SOEs operate and in some cases, they compete with the private sector in open markets due to which their control methodologies and techniques must be different from those used to control a ministerial or municipal department for example.
- Ideally, collaboration and coordination should be established between the work carried out by these positions and bodies and the SOE's own employees.
- Clear lines of reporting and accountability are established.

Guideline 50: The Board of Directors is responsible for the existence of a sound control environment within the SOE, adapted to its nature, size, complexity, and risks.

What is understood by the term control environment is the tone, attitude, or philosophy that exists in the SOE with respect to the internal oversight and risk management system. Consequently, it deals with the following major subjects:

- The existing philosophy of the SOE on internal supervision and integrated risk management.
- The structure defined in the SOE for risk management and control with clear roles of responsibility and reporting established.
- Attitudes consistent with the integrity and ethical values of the SOE.
- Suitable processes and structures for behavior assessment.
- A high degree of competence and a strong sense of responsibility for achieving the objectives.
- A profound involvement of the Board in the supervision of the internal control and risk management system.

It is important that the system of governance recognizes the Board of Directors as ultimately responsible for a strong supervisory environment. To that extent, internal SOE instruments should assign the following six major responsibilities to the Board in order to fulfill these purposes:

1. Act independently and objectively on behalf of the property, be it the state, an agency of the state, the shareholders and/or other key investors.
2. Define a supervisory structure appropriate to the needs of the SOE and, in particular, ensure that there is suitable coordination and interaction between external oversight and supervision carried out by state agencies (Comptroller, Syndics or the like) and internal oversight and supervision carried out by SOE bodies and officials.
3. Supervise the definition of SOE standards of conduct and evaluate their level of application.
4. Evaluate the performance of the Chief Executive and upper management in terms of internal oversight based on existing expectations and defined corporate objectives.
5. Promote a culture of risk and oversight throughout the SOE, and especially ensure the effectiveness of existing controls and identify opportunities for improvement.
6. Consider the risks that derive from the business processes, and from the strategic definition of the company in order to properly follow-up, evaluate, and manage them. In particular, special attention should be paid to the data generated by the business activity and its impact on both risks and the strategic orientation of the SOE.
7. Follow up on the improvements identified and request information from upper management on the effective implementation of these improvements.

Guideline 51: The Board of Directors should ensure that there is a risk management process, which provides reasonable assurance that the company's objectives are achieved in accordance with the defined risk profile in place in the SOE. Likewise, the Board of Directors must be responsible for verifying that the risk management structure clearly indicates the role and responsibilities of the board, upper management, and other employees.

Any strategic decision implies increasing or reducing the exposure to particular risks when not assuming new risks or avoiding others. Therefore, strategy and risks are two sides of the same coin.

The term risk management refers to a structured, coherent, and continuous process used to identify, evaluate, manage, and report on opportunities and threats that affect the achievement of SOE objectives.

A suitable risk management process requires the coordinated action of the Board of Directors, the upper management and the entire staff of the organization.

A. Role of the Board of Directors

In general, the Board of Directors is responsible for recognizing, understanding, and accepting the set of risks (also called risk profile) inherent in the strategy defined by the Board, and therefore approving the SOE's so-called "risk appetite."

Thus, proper risk management must provide for the definition of a risk management policy to be approved by the Board of

Directors, which includes the obligation of mapping both quantitative and qualitative risks faced by the SOE with regard to implementing its strategy and achieving its objectives.

The risk map is understood as the identification and monitoring of financial and non-financial risks to which the SOE is exposed (e.g., market, credit, liquidity, business, reputation risks, etc.).

This risk map should be formalized and brought to the attention to the Board of Directors, so that they are aware of the set of risks to which the SOE is exposed and supervise the specific actions developed for the correct management of these risks.

Together with the risk map, the risk management policy must recognize and set:

- The fundamental principles that should underpin the risk culture of SOE.
- The maximum limits for exposure each identified risk.
- The risk limits that can be directly managed by each level of the SOE.
- The frequency and scope for monitoring the effective exposure of the SOE to the defined maximum risk limits;
- The power of the Board of Directors to propose and implement corrective actions in case of deviations.
- The responsibility of the upper management to evaluate, control, monitor and report the risks, define methodologies, and ensure that the risk management is consistent with the strategy, defined risk policy, and approved maximum limits.

In addition to the above, the Board of Directors must ensure that:

1. The significant risks faced by the SOE are identified, through an appropriate internal control system.
2. Risk assessment and management systems exist and are effective throughout the SOE.
3. The procedures for monitoring risks are robust, efficient, and effective.
4. Policies for risk management exist, are up to date, and are applied in practice.
5. Last of all, the Board of Directors is also responsible for:
 - Considering external and internal factors that may pose relevant risks for the achievement of the objectives.
 - Supervising and approving risk assessments made by upper management.
 - Evaluating the proactivity of the organization in relation to how it handles relevant changes (e.g., innovation, technological changes, changes in the environment, and others).
 - Effectively managing, in collaboration with upper management, strategic risk and disruptive risk by:
 - a. The inclusion of strategic risk and disruptive risk in specific sessions of the Board.
 - b. Analysis of the data generated by business activity and its potential impact on both the risk profile of the SOE and on strategic definition and subsequent monitoring.
 - c. The recognition that the risk management system may not necessarily identify these two types of risks correctly.
 - d. The dedication of at least one annual Board meeting for an in-depth discussion of strategic risk and the vulnerability of the SOE to disruptive risk.

- e. The existence of information on these subjects in a format that allows productive dialogue and decision making.

B. Role of Upper Management

Upper management, in turn, must understand the SOE's risk tolerance (understood as an acceptable level of relative variation in risk exposure for the achievement of business objectives) and assess whether there are appropriate mechanisms for risk identification and analysis.

In addition, upper management should evaluate the use of external and internal factors in identifying risks that affect SOE goals, analyze the potential relevance of the risks identified, and determine the response to them.

But the key role of upper management with respect to risk management follows two fundamental paths:

1. First of all, the definition, approval, and implementation of specific procedures for implementing the risk policy previously approved by the Board.

These procedures must make it possible for upper management to evaluate, control, monitor, and report risks while defining methodologies and ensuring that risk management is consistent with the SOE strategy, the risk policy defined by the Board of Directors, and the maximum exposure limits approved by the Board.

2. Secondly, control the above procedures through the definition of a set of qualitative and quantitative indicators that show the status of a process and the degree of compliance with predefined goals.

This point is developed in more detail in the next Guideline regarding internal oversight.

Given the complexity of risk management, SOEs with a complex risk profile and, in any case, those that are financial institutions, should have a Risk Manager or Chief Risk Officer (CRO), understood as the person with the highest responsibility at upper management level for risk management in the SOE. In the absence of a person in this position, these duties shall be assumed by the Chief Executive.

In order for the Risk Manager to carry out his duties with full effectiveness, this person must have:

- High internal status, sufficient resources to carry out the duties, and defined responsibilities.
- Direct relationship with the Chief Executive and upper management since risks and business are two sides of the same coin.
- Ability to influence organizational decisions that affect the degree of exposure to corporate risks.
- Full access throughout the organization to the information necessary for the exercise of his duties.
- Direct reporting line to the CEO and Board of Directors (or to the SOE Risk Committee where one exists).
- Strengthened position, so that his appointment and dismissal is a Board decision, and he has no management responsibilities other than risk management.

C. Role of SOE staff and officials

Finally, regarding the definition of roles, the rest of the officers or personnel of the SOE are responsible for the identification and management of risks in the respective processes under their responsibility.

Through the coordinated work of the Board of Directors, upper management, and all SOE employees, effective risk management is achieved. Therefore, weaknesses in the role played by any of the above three levels will result in potentially jeopardizing the achievement of the company's objectives or its effective exposure to risk.

Guideline 52: The Board of Directors is responsible for ensuring the existence of a suitable internal oversight system, adapted to the SOE and its complexity, and consistent with the risk management process developed as well as for supervising its effectiveness and suitability.

For maximum effectiveness and for the best contribution to value, risk management requires an internal monitoring system to ensure that:

- Each one of the risks identified in the different SOE business processes is appropriately managed based on the risk policy and culture in effect and, for this, there are specific checks such as:
- The policies, processes, and measures developed for risk management are effectively applied in practice.

However, in order for the internal control system to be consistent with the risks and complexity of the SOE, it is essential that the system be based on the principle of self-control consistent with the COSO approach. This is understood as the responsibility of the organization as a whole and of each of the people involved in the company's different operations to consider control as an inherent part of their responsibilities, fields of action, and decision making.

The entire organization, all personnel, have the responsibility to identify where the risks are in their business operations, and from there, propose controls that allow them to be managed.

This plan must be scaled up in the organization with the existence of a person ultimately responsible for providing an overall and complete vision of the set of defined controls in the organization, a responsibility that falls on the Chief Executive.

Consequently, the Board of Directors should ensure that there is an appropriate and robust system of internal control adapted to the complexity of SOEs as well as monitor its effectiveness.

However, the task of designing, creating, and implementing it is a responsibility of the organization as a whole, and the responsibility for this falls on the Risk Manager with the Chief Executive being ultimately responsible for it.

Naturally, evaluating and securing the controls in place cannot be the responsibility of those who design the controls but is rather the exclusive responsibility of the Internal Audit area which, in turn, may propose needed improvements to the Audit Committee.

Finally, in determining the internal oversight system, the impact that technology has generated cannot be ignored.

Thus, supervisory activities and technology are related in two ways:

- Technology as a component of business processes:
When technology is integrated and is part of the business

processes, controls are needed to mitigate the risk that it stops working correctly.

- Technology as automating certain supervisory activities: many supervisory activities within an organization are partially or fully automated.

The set of controls that exist to ensure the effective operation of the SOE technology as well as the automated controls are referred to as “general technology controls.”

Within an internal control system, the existence of proper general technology controls is crucial since the achievement of the company’s objectives will depend to a large extent on the effectiveness of the technological operation, so it is essential that upper management:

- Understand and determine the dependency and links between business processes, automated controls and general technology controls.
- Select and develop controls that are designed and implemented to help ensure the effective operation and availability of the technology.
- Select and develop controls designed and implemented to restrict access rights in order to protect company assets from external threats.
- Select and develop supervisory activities with respect to the acquisition, development, and maintenance of technology and its infrastructure.

As a result, an internal control system cannot be understood without considering the impact of technology not only because of the technological risk that exists in the companies’ business processes but also because of the automation of controls that can be obtained thanks to the use of technology.

Guideline 53: The Board of Directors is responsible for the existence of a system in the SOE that allows for the internal communication of the information generated by the risk management process and the internal control system at the corresponding levels of the organization.

Information is understood as the generation and presentation of both internal and external SOE reports mainly to address the established regulations and standards as well as responding to requests from shareholders and other stakeholders.

From the perspective of the Control Architecture, the challenge is to generate reliable, timely, structured, quality financial and non-financial information so that it becomes the basis for decision-making in achieving the company's objectives.

For the information to be considered high quality, the following features must be present:

1. Proper: it has the appropriate level of detail.
2. Timely: it is available when required and within a proper time frame.
3. Updated: it is the latest information available.
4. Exact: the data are correct.
5. Accessible: it can be obtained with relative ease.

A proper transmission throughout the organization is just as relevant as the information itself so that all parties involved (employees, upper management, and Board of Directors) can exercise their responsibilities using valid information.

To this end, it is crucial that the culture, philosophy, and risk policies are communicated both vertically and horizontally throughout the SOE in order to consider risk issues and control activities in the daily activities of the whole organization.

To achieve this objective, it is essential that the structure of the SOE facilitate the existence of effective communication channels through clear lines of authority and responsibility, internal communication channels, and relationship (either functional or hierarchical) between different positions and levels of the SOE so that the information flows properly in line with the method below:

At the implementation level:

1. The employees, as the people in charge of each process, are responsible for managing the risks in their processes following criteria given by the upper management and the Chief Executive, who, in turn, comply with the risk policies defined by the Board of Directors. At the same time, the employees gradually define controls for their processes in order to identify and evaluate the risks present.
2. Based on the policies defined, the Chief Risk Officer, or Risk Manager, is the highest executive responsible for the effective management of risks in the SOE as well as the top executive responsible for making sure that the whole set of control activities carried out by the rest of the SOE employees is consistent with the risks the SOE faces. These duties must be exercised by the Chief Executive in those SOEs where this position does not exist.
3. The Chief Executive is the highest executive responsible for the day-to-day running of the business and ultimately responsible for the effective management of the risks the SOE has and the strength and upgrading of its internal system of control.

In terms of communication, the relationship between the employees, the Risk Manager, and the Chief Executive

becomes key so that the information flows up and down between these levels to ensure that the business decisions made to achieve the established objectives are made using reliable, truthful, and timely information, and that the business risks are properly managed.

Upper management should make sure that all of the SOE's personnel get involved by highlighting their responsibility in risk management and the definition of controls. Likewise, the SOE's employees should themselves understand their role in risk management and the identification of controls as well as their individual contribution in relation to the work of others.

At the supervision level:

1. The **Risk Committee** has the duty of understanding and monitoring each one of the risks to which the SOE is exposed as well as the techniques used for measuring and managing them, approving the general policy on risks, and reviewing the information on risks provided by the upper management. In the absence of this committee, its duties are usually discharged by the Audit Committee or the Board itself.
2. The **Audit Committee** is responsible for supervising whether the system for internal control has a proper scope in terms of information reliability. To do this, it is usually supported by the internal auditor who must design a plan that includes an analysis of the scope of the internal control system, ideally based on risks, so that the audit is not carried out like a checklist but instead based on the intensity of the risks faced by the organization.
3. The **Internal Auditor** is responsible for carrying out and closely monitoring internal control activities, communicating the findings, and proposing improvements to the employees, the Chief Executive, and the Board of Directors when appropriate.

4. The **External Auditor** is responsible for providing shareholders with a reasonable degree of assurance that the financial information made public by a given company faithfully reflects its real equity.
5. The **Compliance Officer** is responsible for the culture of regulatory compliance, both internal and external, of the organization.

At this point, there is a particularly important emphasis on the communication channels or whistle-blowing procedures.

In general, the normal lines of information in a company are the appropriate channels of communication.

However, on many occasions it turns out to be advisable to develop independent communication lines that serve as a safety mechanism in case the normal channels are not working.

Independent lines of communication are understood as direct channels available to any person in the company, regardless of position, by means of which one may communicate with the head of internal audit, the legal counselor, or other member of upper management with access to the Board of Directors.

This channel involves having a contingency plan in case of an action taken against the company on the part of employees or members of the upper management. As a result, this channel is always available to communicate situations of corporate fraud.

It is important for the staff to understand that there will be no retaliation for the communication of relevant information. It would also be ideal for the company to develop a comprehensive and relevant Code of Ethics, hold training

sessions for the staff, propose permanent corporate mechanisms for communications and feedback and, especially, ensure that the behavior of upper management becomes an example for the rest of the staff.

Guideline 54: The Board should guarantee the existence of a process for monitoring the Control Architecture that is independent of upper management and makes it possible to evaluate its effectiveness and propose improvements.

The governance framework includes identifying the responsibilities of the different parts of the organization in order to distinguish and manage the risks. Thus, the Three Lines of Defense model helps improve the effectiveness of the risk management systems where each line plays a role: (i) the first line of defense corresponds to the business where the management or operational divisions are in charge of the risks and manage them as part of carrying out their work; (ii) the second line encompasses risk and compliance management where the risks and controls of the first line are identified, measured, and monitored and compliance with regulations is followed-up on; (iii) the third line is the Internal Audit which must have the highest level of independence in order to guarantee the Board the effectiveness of the governance structure in the management and control of risks at the level of the first two lines.

In that respect, the monitoring or oversight of the Control Architecture can be done through the following activities:

- Permanent oversight or monitoring carried out during the normal course of business by the different people in charge in upper management and who react to the information that reaches them through their subordinates.

The permanent supervision or monitoring activities are integrated into the normal and recurrent operational activities of an organization, are implemented in real time, and allow for a reaction to the different changes that the business experiences on a daily basis.

- Independent evaluation, with a scope and frequency that vary in line with the significance of the risks and the importance of the responses to them as well as the corresponding controls available to manage them.

These evaluations are normally done by both internal and external auditors (in addition to the Comptroller's Office or public supervisory control body), and their basic objective is to assess the suitability of the entire system of internal control, detect and report findings, and propose improvements in the system.

A. Chief Risk Officer (CRO)

This officer's duties are detailed in Guideline 51.

B. Chief Compliance Office

The compliance function consists of establishing appropriate and sufficient policies and procedures to guarantee that a company's activities and business are carried out in accordance with current regulations and internal policies and procedures thus fostering a culture of compliance within the organization.

Given the importance of this function, in addition to the usually extensive regulations affecting the SOEs, the Compliance Officer (or Chief Compliance Officer) is a figure of critical importance in the organization and, as such, the

function, requirements of professional competence to be able to fill the position, responsibilities, reporting, and resources should be part of a Statute regarding Compliance Officer which should recognize the following:

- Profile with links to the legal branch.
- Appointment by the Chief Executive, subject to the acknowledgment of the Board of Directors.
- Proper position on the company's organizational chart.
- Periodic reporting to the Chief Executive as well as to the Board of Directors on major findings in compliance activities.
- Direct access to the Board of Directors (or relevant Committee) when deemed necessary due to possible compliance failures.
- Resources for the full exercise of the officer's functions
- Possibility of receiving preparation and training for all key positions in the organization.
- Reinforced responsibility to ensure regulatory compliance and compliance with regulations relating to the Prevention of Money Laundering and Financing of Terrorism as well as the Integrity and Anti-Corruption regulations.
- For SOEs with large volumes of data, having GRC (Governance, Risk and Compliance) technology systems make it possible for a Compliance Officer to effectively discharge his duties.

Finally, it should be noted that the obligations of regulatory compliance and the prevention risks inherent in business activities do not depend solely on the size of the company but, much more on the risks that are part of the business activity itself that is being carried out.

As a consequence, a proper assessment of the risks of the business activity is the determining factor for the company to be able to satisfactorily focus on prevention needs, obligations of regulatory compliance, and specific resources and responsibilities to be assigned for the effective exercise of the compliance function.

C. Role of the Internal Auditor

The internal auditor is a key figure in the Control Architecture given that this person is responsible for implementing and carrying out a detailed follow-up of the internal control activities.

In discharging their duties, the internal auditors assist upper management and the Board (or the Audit Committee, if there is one) by examining, evaluating, and reporting on the suitability and effectiveness of the Control Architecture.

Since, therefore, the internal auditor will be responsible for identifying weaknesses, assessing the suitability of the system of internal control as well as proposing improvements to it, it is essential that the internal auditor:

- Maintain a collaborative relationship with the SOE staff and the upper management so that he can report findings, receive assignments, or propose improvements to the control system.
- Maintain a reporting relationship with the Board of Directors or the Audit Committee, but in no case with upper management since, in this situation, he would be reporting to those he is theoretically controlling. This could, logically, affect the quality of the control function that the internal auditor undertakes significantly.

- The importance of the role of internal auditor demands that a set of requirements regarding professional competence be internally defined for the SOE internal audit position.
- To ensure that the internal auditor can carry out his work objectively and effectively, it is essential that he hold an appropriate position on the company's organizational chart and has means and equipment at his disposal as well as access to the Board of Directors, which is the only body that should be responsible for his appointment and dismissal, and the only one to which he should report (or to the Audit Committee, if there is one).
- In order to strengthen the internal auditor position, everything related to his appointment, duties, and reporting lines should be defined in an Internal Audit Statute, approved by the Audit Committee, if any, and, if not, by the Board of Directors. This statute should explicitly include:
 - The necessary freedom and independence required for the exercise of his duties.
 - The work of assessment and verification of the processes of risk management and their proper evaluation.
 - The evaluation of reports on key business risks.
 - The review of the management of key risks.

D. The External Auditor

The external audit has two main objectives:

1. First, to provide a reasonable degree of certainty as to whether the financial information made public by a given company faithfully reflects its real assets.
2. Second, it ultimately facilitates securing third-party financing.

The reasons why an SOE audits its accounts range from legal requirements to the desire to keep the SOA or Shareholders' Assembly (when this exists) duly informed, reinforce its reliability, and/or attract or retain resources.

Normally, the practice of the auditing profession is widely regulated in most countries given how important the role of the external auditor is as it provides the SOA or the Shareholders' Assembly as well as interested third parties with an opinion on whether the accounts and financial statements presented by the SOE faithfully reflect the equity and the company's financial situation.

Considering the importance of the external auditor's role, the position of external audit should be reinforced and independence in the exercise of their duties encouraged, especially with regard to the following aspects:

- a. The establishment of limits to the provision of additional services other than that of account auditing.
- b. The appointment and remuneration of the external auditor.
- c. The conditions for the auditor's rotation.

These aspects should be part of a policy for the appointment of the external auditor that must be approved by the SOE Board of Directors. In the case of a business group, the policy should also provide the requirement that the external auditor shall be the same for all the companies in the group.

a. Establishment of limits on the provision of services in addition to the audit itself.

It is very common to prohibit contracting with the external auditor for services other than auditing such as tax advice, systems and process auditing, legal advice, consultancy, corporate finance, etc. Some of these, due to their very nature, can generate much higher volumes of business with the company compared to traditional account auditing services.

If, due to local circumstances, it is not suitable to opt for the prohibition, at least the contracting of additional services shall constitute a minority part of the total remuneration agreed to be paid to the auditing firm. This percentage must also be disclosed within the information made public by the SOE.

b. Appointment and remuneration of the external auditor by the SOA or the Assembly.

The external auditor shall preserve the independence necessary to exercise his duties. Therefore, the mechanism of his appointment and the publication of his remuneration play an important role.

APPOINTMENT

At the proposal of the Board of Directors, the appointment of the external auditor must be the responsibility of the SOA or Shareholders' Assembly, if there is one. Since ultimately those who hold property rights are the ones with the greatest interest in the truthfulness of the information presented by the SOE, therefore, it is logical that they choose the firm responsible for auditing the SOE's accounts.

REMUNERATION

The publication of the external auditor's remuneration in the SOE Annual Report is another measure designed to provide the SOA or Shareholders' Assembly (if there is one) and other stakeholders with an image of independence on the part of the auditor in the exercise of his duties.

While publishing the auditor's gross wages may be controversial, at least the percentage that the services provided by the auditor to a particular SOE represent with respect to his total local remuneration (or at least an approximate percentage) should be included.

Moreover, in those cases where services other than auditing are contracted with the external auditor, the information published by the company should include the proportion that the amount paid for these services represents with respect to the auditing services carried out in the company.

By doing this, the importance of the rest of the auditor's services done for the SOE compared to that of account auditing may be reflected. Therefore, it is possible to determine whether the exercise of his own duties as auditor could be undermined by having contracts with the SOE for the provision of services other than auditing services.

c. Establishment of rotation mechanisms either by the partner responsible or by the firm itself.

The independence of the external auditor requires that limits be established to the period of appointment in order to avoid excessive links between the auditing firms and/or their work teams and the audited company.

Normally, there are two alternatives:

- i.** The standard five-year rotation of partner and work teams.
- ii.** The more demanding standard that refers to the rotation of the auditing firm once a certain period of time has passed, normally between eight and ten years.

In any case, the rotation of the auditing firm would be mandatory once this period of time has been completed.

Guideline 55: The Board should ensure that there is a data strategy that is fully aligned and coherent with the SOE's strategic direction and its model of control architecture.

Data are the main assets of all disruptive technologies that are impacting the business models of all kinds of companies in different sectors of the economy, and, therefore, can be considered: (i) a source of value and an essential component in the definition of the strategic direction of the company; and (ii) the basis for a whole set of risks that must be identified and properly managed in order to measure and monitor the risk profile accurately.

In spite of its importance, the focus and attention given to the data generated in business activity is still limited, mainly because of:

- **Ignorance:** it is common to find that everything related to data is completely isolated from the Board of Directors. As a result, the latter is unaware of the value and nature of the data generated by business activity as well as of the opportunities created and the risks that are assumed.
- **Ambiguity:** Given that many new technologies and disruptive business models are still in an incipient stage of adoption, determining what data will be needed to best take advantage of these new technologies and business models turns out to be difficult and, as a consequence, assessing the risks and opportunities presented by the data generated by the company is uncertain and ambiguous.
- **Complexity:** the economic and business value of any data-based strategy is only revealed if the company is able to apply new technologies and tools and if this is done from a position of leadership and innovation or in response to competition in its sector.

The effective implementation of the internal changes necessary to be able to give value to the data generated by business activity and influence both the company's strategy and their risk management are highly complex subjects that make their practical accomplishment difficult. In addition, specialized profiles at the level of the Board of Directors and upper management are required. However, at the moment they are not often available.

Nevertheless, despite the abovementioned difficulties, any company is exposed to a set of disruptive risks today which require a defined data strategy to manage them properly.

Thus, it is critical that the Board of Directors, in collaboration with upper management, makes sure that:

1. **A Data Culture is Created in the SOE:** The first step is to define a data culture for the SOE. This is understood as a common language and comprehension based on generally accepted principles regarding the benefits and risks of "datafication" in the SOE and in its sector. Datafication is understood as the process of reformulating internal processes, products, and business models based on data.
2. **The Data Generated is Aligned with the Business Strategy:** data are essential assets for defining the business strategy. As a result, the Board of Directors must make sure that the data obtained after the company's datafication becomes known, controlled, and interpreted in the process of defining the strategic orientation and its subsequent monitoring.
3. **An Internal Datafication Process is Developed:** datafication is a long and, in many cases, ambiguous process. Therefore, it is essential that upper management,

under the oversight of the Board of Directors, develop a plan for gradual datafication fully aligned with the SOE's strategic orientation.

- 4. The SOE's Readiness to Incorporate a Data Culture is Assessed and Determined:** in addition to monitoring the aforementioned steps, the Board of Directors should guarantee the existence of sufficient profiles, expertise, and capabilities within the Board itself and upper management to enable the creation, implementation, and supervision of a data culture in the SOE.

7. TRANSPARENCY AND FINANCIAL AND NON-FINANCIAL INFORMATION.

Transparency is the act of disclosing information regarding the SOE in which the content, presentation format, and timing must meet certain requirements. The generation and transmission of confidence are based on transparency, i.e., the reputation of the company as its main intangible asset.

Unlike the initial notion in which it was considered a regulatory obligation, today transparency is considered a fundamental element of corporate culture with both internal and external effects for the company:

- **Internally**, transparency is essential for making informed decisions at the various levels where decisions must be made and, therefore, for the proper operation of the company. Likewise, it reinforces the processes of accountability from and to the different levels of the SOE's corporate governance system.

- **Externally**, transparency is critical to both the generation of trust and its transmission to the market and, as a result, to the company's reputation.

Given the above, it is understood that transparency has an instrumental character.

In other words, it is not an end per se, an objective or purpose worthy of protection in itself, but rather it is a means that should be protected in order to achieve the intended objectives, whether in terms of control, determination of the level of risk, investment decision-making or improving the company's reputation.

In the particular case of the SOEs that operate with public assets, transparency is the main mechanism used for communication with all stakeholders, whether the public entity that has ownership or the whole set of groups of interest including citizens.

Transparency is understood as the basic premise behind having an appropriate accountability which, in the context of the SOEs, refers to the obligation of providing information, explanations, and justifications concerning the company's activities so that both the SOA or Shareholders' Assembly (if any) and the citizens can discern whether or not the SOE is acting in agreement with the guidelines and mission in its articles of incorporation and, if not, denounce the deviations identified.

Furthermore, when the social objectives, which the SOEs often have, and the type of auditor that both users and the company in general accept are taken into account, the transparent and continuous disclosure of financial and

non-financial information, even while recognizing that it has limitations, is the best strategy for increasing confidence in the SOE and its operations.

Guideline 56. The SOEs should have an Information Disclosure Policy approved by the Board of Directors that makes it possible to facilitate monitoring and follow-up on the part of the different stakeholders.

The Board of Directors of the SOEs must approve an information disclosure policy that includes at least the following items:

- **Target Public**
The SOE must identify the potential users of the different types of information to be disclosed in order to take into account the group to which it is addressed and to be able to present it to them clearly and coherently.
- **Information Disclosure Channels**
In line with the identification of the target public mentioned above, the SOEs must also have defined the appropriate channels for the transmission of information and the interaction with the recipients so as to allow equal access to the information.

In any case, the following are among the channels that must be defined:

1. The corporate website.
2. Institutional profiles on social networks.
3. Face-to-face sessions and/or meetings with shareholders and interested third parties.

- **Matters subject to information disclosure**

In general, topics subject to disclosure are classified into financial and non-financial information.

- FINANCIAL INFORMATION, which corresponds to the accounting information and economic results that must at least include:
 - » Profit and loss statement.
 - » Balance sheets.
 - » Comprehensive statements of changes in net equity.
 - » Cash flow statements.
 - » External auditor's report on the financial statements and their notes.
 - » Report on interrelated transactions, including significant transactions between companies in the same group (intra-group transactions). In addition, off-shore transactions must be disclosed if transactions of this nature have taken place.
- NON-FINANCIAL INFORMATION, corresponds to the SOE's operational progress, its structure and procedures, and any other non-financial matters.

At the same time that the SOE determines the information to be disclosed, it must also establish the information for which dissemination is restricted. The goal of this is to protect the SOE from any possible undesired impact derived from the disclosure of confidential or sensitive information.

- **Regularity**

The SOE must define the frequency with which the different types of information will be made public and updated so that the transmission of this information to its recipients is always done on a timely basis.

- **Responsibilities**

The SOE must establish the responsibilities among the different corporate bodies when generating and disclosing information in order to avoid errors in disclosure such as the dissemination of privileged or restricted information.

- **Procedures to guarantee the quality of the information**

The SOE must ensure the existence of proper processes and internal (internal audit and internal control systems) and external (external auditor) controls to reinforce the quality of the information disclosed.

In the cases of SOEs that belong to a business group, the policy must allow a third party to come to an opinion founded on the reality, complexity, and operation of the group as a whole. Thus, the Board of Directors of the parent company will be the one that must approve of and establish the main criteria for the disclosure of information as well as who will be responsible for it based on the scope of the group.

This policy shall be channeled to the various subordinate companies in the group, which must make the following known:

- The corporate governance structure of the subordinate company and how it is integrated into the governance model of the group.

- Clear, accurate, and understandable financial and non-financial information for the target public.
- The main implications in terms of corporate governance as a result of the subordinate company's membership in the group.

Guideline 57. The SOEs must present their financial and non-financial information in accordance with high-quality, internationally accepted standards.

The quality of the information will depend, to a large extent, on the standards applied when this information is generated and disclosed.

Most countries require the use of internationally recognized standards for financial reporting, in particular the disclosure of IFRS-based financial information that can be useful for improving the transparency and comparability of financial statements and other financial reports between countries.

The SOE's Board of Directors must, therefore, provide and present the financial statements properly using the accounting principles applicable in the country where the SOE is headquartered but, in addition and ideally, following the IFRS principles.

Furthermore, the financial statements of the SOEs are not always audited by external auditing firms since it is often argued that SOEs are already under the control and supervision of different governmental auditing bodies, in particular the Comptroller's Office, Syndic or the equivalent.

However, the work carried out by these types of bodies cannot be considered a substitute for external audit since,

depending on the country, they tend to be more focused on verifying procedural and legal aspects; examining, verifying, and evaluating the objectives and results of the public company; and inspecting the use of public funds and resources or restoring public assets.

Therefore, the financial information must be accompanied by an audit report prepared by an external auditor. In addition to expressing an opinion on the quality of the financial statements, the report should include an opinion on the method whereby the financial statements have been prepared and presented.

It shall be the responsibility of the Audit Committee (and, in its absence, the Board of Directors) to supervise the overall relationship with the external auditor in order to contribute to gradually strengthening the quality of the financial information. The reports of the Audit Committee (or, in its absence, of the Board of Directors) on this matter must be submitted to and approved by the SOA or Shareholders Assembly (if any).

Also, the GRI (The United Nations Global Reporting Initiative) is essential when dealing with non-financial information.

As in the case of financial information, presenting non-financial information in compliance with international standards contributes to generating confidence in its veracity and the comparability between companies.

Finally, it is advisable for the Board of Directors to have the capability to define a set of indicators and principles for the presentation of financial, environmental, social, and policy implementation results to facilitate an accurate and prompt evaluation of the SOE's actions.

Guideline 58. The SOEs must provide stakeholders with accurate and timely information, both financial and non-financial.

In order to be publicly transmitted, the information disclosed by an SOE must always meet the following criteria:

- Be relevant for the recipients.
- Be correct and true.
- Be symmetrically and equally transmitted.
- Be transmitted on time.

Compliance with the abovementioned criteria must be applicable to any information the SOEs make public. In any case, it must include the following:

1. Audited financial statements, including the balance sheet, income statement, cash flow, and financial report.
2. Financial information related to any public assistance or subsidies that the SOE may have received or, if it is the case, the guarantee granted by the government to the SOE to carry out its operations as well as any commitments made by the state on behalf of the SOE in question.
3. In the case of SOEs belonging to business groups, off-balance sheet items that provide guarantees or similar commitments between related companies.
4. Legal ownership of the state's stock and where the responsibility for exercising state ownership rights lies.
5. Special rights or agreements that could distort the SOE's ownership or control structure, such as "golden shares" and the ability to veto certain decisions. In particular, the signing, extension or modification of an agreement between shareholders or between these, individually or as a group, and the SOA.

6. Information on any kind of remuneration received by the members of the Board of Directors and key members of the upper management. If there are confidentiality or sensitivity reasons that make it inadvisable to publish this information, it shall be possible to opt for the publication of the global cost of remuneration. Otherwise, the percentage representing the total cost of remuneration assumed by the SOE should be considered.
7. All substantial transactions (i.e., with a significant impact or of considerable importance, along with the definition of what is meant by substantial when it has not been established by applicable law) with related parties in conjunction with the terms of such transactions on an individual basis.
8. Information on cost structure, especially when the SOEs receive or offer state subsidies or enjoy other preferential treatment.
9. All transactions between SOEs and related entities such as an investment made by one SOE in the capital of another SOE to avoid potential abuses and conflicts of interest. The disclosure of information on transactions with related entities should facilitate all data necessary to be able to assess the fairness and advisability of these operations.
10. Main predictable risk factors.
11. Summary of the SOE's governance model, including its main policies and practices and, especially, a summary of its control architecture model.

In addition, the SOEs shall have a user-friendly website so that accessing the abovementioned information is simple.

To do this, the following headings are proposed for a possible structure:

1. **About the SOE:** history, main data, vision and values, business model, and other foundational considerations.
2. **Ownership:** capital structure, body holding the ownership rights, listing if the SOE participates in the stock market, dividend history, capital, contributions made by the state or whoever holds ownership rights, reported relevant facts, financial information (annual report, management report, presentation of interim results, etc.), methods of contact, FAQs, and other aspects related to ownership.
3. **Market relations:** results, presentations (of results, of operations, conferences, events, etc.), financial reports (annual report, management report, quarterly reports, risk management report, information to supervisory bodies, significant news, periodic public information, etc.), issuances of debt securities, ratings, and other aspects.
4. **Corporate Governance:** Bylaws, Charter, Shareholders' Assembly Rules (if any), document regulating the relationship with the SOA or any other similar entity, members of the Board of Directors and their Rules of Procedure, Board Committees, their memberships and Rules of Procedure, Corporate Governance Report, Committee Reports, information rights, shareholders' agreements, Code of Conduct, Code of Ethics, and others.
5. **Sustainability:** policies, groups of interest, community, environment, and any other aspect linked to business sustainability within the framework of the SOE's operations.

If the company decides to publish an annual report, an electronic version should always be available in addition to

the printed version. The recommendation is to structure the information in this order:

- Chief Executive's Management Report.
- Financial statements prepared by the Board of Directors and presented to the SOA or the General Assembly of Shareholders (if there is one).
- Audit report on the accounts issued by the external auditor along with the corresponding notes.
- Corporate governance report of the Board of Directors.

Guideline 59. The SOEs shall issue an annual corporate governance report.

The SOEs shall prepare an annual corporate governance report, and its contents shall be the responsibility of the Board of Directors.

It must be presented along with the annual report and the rest of the documents for the end of the accounting period. In addition, it must be communicated as a relevant fact and included in the corporate website.

To the extent they are applicable, both the structure and the generic content the report shall include are normally identified by the following aspects:

1. Details on corporate information.
2. Ownership structure, with particular mention of:
 - Capital and ownership structure of the SOE.
 - Identity of the shareholders with significant direct or indirect holdings and of their related parties.
 - Information on the shares owned directly (as an individual) or indirectly (through companies) by

the members of the Board of Directors and on the voting rights they represent.

- Known agreements between shareholders and their modifications.
- Treasury stock, if any.

3. Structure and establishment of the SOE's administration, with special mention of:

- Makeup of the Board of Directors and the committees constituted within the board and position of each one of their members.
- Delegated powers held by board members or committees.
- Directors on the parent company's board who hold executive positions in subordinate companies (in the case of business groups).
- Policies approved by the Board.
- Process of appointing directors.
- Remuneration policy for Board of Directors.
- Remuneration of the Board of Directors and the members of upper management in line with point 6 of the preceding guideline.
- Board of Directors Quorum.
- Attendance information on the meetings of the Board of Directors and the committees.
- Chairman of the Board of Directors (duties and key topics).
- Secretary of the Board of Directors (duties and key topics).
- Board of directors' relationship with the external auditor, financial analysts, and any other relevant market stakeholder.
- Board of Directors' external consultants.
- Management of the information going to the Board of Directors.
- Duties of the Board of Director Committees

4. Information on relationships, conflicts of interest, and related operations.
 - Powers of the Board of Directors over these types of operations and over conflict-of-interest situations.
 - Details of transactions with related parties, including intra-group transactions.
 - Conflicts of interest presented and actions taken by directors regarding them.
 - Mechanisms to resolve conflicts of interest between companies in the same business group.
5. Principles of action in the area of corporate governance and documents which they are based on.
6. Internal control and risk management system, with special mention of:
 - Description of the risk policy.
 - Materialization of risks during the accounting period.
7. Agreements on corporate governance adopted during the accounting period and which are a topic in the report.
8. General Assembly of Shareholders.
 - Measures adopted to encourage shareholder participation.
 - Information provided to shareholders and communication with them.
 - Attendance and voting restrictions.
 - Assembly attendance information.
 - Details of the main agreements reached.
9. Dividend payment policy.
10. Others.

Generally, even though it will depend on the jurisdiction, the cornerstone on which said report is based is the principle of “comply or explain.” In other words, what the market and groups of interest actually value are the explanations given by the company itself with respect to the corporate governance practices that it has or has not implemented over the course of the accounting period.

As previously stated in these guidelines, the principle known internationally as “comply or explain” requires that the companies’ annual corporate governance report state the degree of compliance with corporate governance recommendations or, given the case, the explanation for the lack of compliance with such recommendations.

Guideline 60: The SOA shall prepare a Consolidated Annual Report on all the SOEs in which it reports on their performance.

The SOA must give an account for the results of the SOEs.

Therefore, this report should contain, in addition to financial data, information on the degree of implementation of the ownership policy or the declaration of majority shareholder. As seen in the section of these guidelines that refer to the actions of the state as owner, both documents contribute to clarifying the SOE’s objectives and reinforcing its stability.

In particular, this aggregate report should also focus on the financial performance and the value of the SOEs and, wherever possible, should include:

- An indication of the total value of the state’s portfolio.
- A general statement on the state’s ownership policy as well as information on how the state has applied that policy.

- Information on the organization of the ownership role.
- An overview of the progress of the SOEs, aggregate financial information, and information on changes in the SOEs' Boards of Directors.
- Main financial indicators, including total sales, profits, cash flow from operations, gross investment, return on equity, equity/assets ratio, and dividends.
- The methods used for the aggregation of data.

It is important to emphasize that the delivery of aggregate information should not duplicate but rather complement the current requirements on information disclosure, for example, annual reports to congress/parliament or other political bodies.

Some owner entities may also seek to publish only "partial" aggregate reports, i.e., reports that cover the operations of the SOEs in comparable sectors.

In this respect, it is advisable that those who exercise ownership create a website so that any interested party can more easily get access to information on public companies.

As with the SOEs, this website is an ideal tool to provide information both on the organization of the ownership role and the general ownership policy as well as on the size, evolution, performance, and value of the governmental sector.

In addition to the supervisory control body, all this information should be endorsed by the external auditor.

CHAPTER VI

FINAL REMARKS

The SOEs, which are generally focused on the provision of public services, infrastructure development, or their role as public policy instruments, represent a very significant and influential segment of the economic environment as well as the business and industrial structure of many countries in the region.

Created, in certain cases, for industrial policy or regional development reasons, these types of companies face a double challenge: on the one hand, to generate economic and financial profitability for the state and, on the other, to serve the company's interests through participation in public policies or in the provision of public services. The governance model of the SOEs is, therefore, a basic component for the best management of this challenge so that these types of companies achieve their objectives of creating economic and social value efficiently and responsibly.

Thus, a solid and coherent model of corporate governance, adapted to the circumstances and specific nature of the SOE, will contribute to:

- maximizing the SOE's leadership position.
- maintaining the long-term perspective.
- achieving the objectives of creating economic and social value efficiently.

These guidelines are intended to define the reference framework in order to design and implement a model of self-governance specific to the reality of the SOEs. As was mentioned at the beginning of this document, the result is to contribute to a more transparent and effective management, and therefore, to their own creation of economic and social value.

In this respect, these Guidelines should serve as a basis so that any SOE, once a diagnosis on corporate governance has been made, can define and implement a governance model as a harmonious, coherent whole that responds to its own challenges.

To achieve this, various key stakeholders in the SOE play a decisive role and face a set of permanent challenges:

The owner's representative

- The SOEs must have a clear, specific, and known mandate from which a set of economic and social objectives are defined that are in full alignment with it and are a part of the long-term vision of the state as owner.
- The state, acting as a responsible and proactive shareholder, should continuously evaluate the mission and objectives of the SOEs to ensure that they remain valid or to make appropriate modifications and adjustments. In any case, both the SOE's mission and objectives should be publicly and expressly communicated to the Board of Directors, upper management, and all interested third parties.
- The SOE's public ownership should be periodically evaluated over time to ensure that it continues to generate value as understood from both an economic and a social perspective.

- The process of electing the members of the board of directors as well as the mechanisms for their evaluation and the methods of remuneration should be formal, public, and fully transparent.

The Board of Directors

- The evaluation of the SOE's results must be carried out in accordance with the mandate for which it was created as well as its known and established public objectives.
- The existence of an appropriate balance between the SOE's economic and social objectives, which must be aligned and consistent with its mission, is essential for the SOE's generation of value and strategic stability over time.
- To ensure that decisions are made correctly, both the economic and social objectives should be assessed and considered in the evaluation of the SOE's performance, especially when adjustments must be made between the two.
- The Board of Directors itself must verify that, as a governing body, it has the necessary profiles, competencies, integrity, authority, and sufficient autonomy to exercise its role optimally at all times.

Upper Management

- The administration of the SOE should be carried out based on the principles of transparency and responsibility and be accountable to all stakeholders on time and in an appropriate manner.
- In the current environment of innovation and digitalization, the SOE's operation must be evaluated periodically to detect opportunities for improvement and increased performance efficiency, new business possibilities, and assessment of possible associated risks.

- Upper management must make sure that it includes the necessary profiles, expertise, integrity, and authority as well as the appropriate distribution of roles to enable it to act efficiently.

The correct definition of a model of corporate governance specific to an SOE, established on the basis of these

guidelines, is a basic component that will allow the SOE's key players to adjust their actions in order to respond appropriately and consistently to the aforementioned challenges. As a consequence, the SOEs of the region will be able to consolidate and maximize the generation of economic and social profitability that gave rise to their own creation and their contribution of value to the company.

CHAPTER VII

REFERENCE GUIDE TO THE GUIDELINES

- The guidelines contained in this section are based on the considerations included in Section IV, which delves into each one of the most critical aspects that affect corporate governance today.
- It consists of 60 guidelines in the form of recommendations grouped under seven major areas of corporate governance. The first two should be understood as areas managed by the state in its role as regulator and owner of the companies. The rest are directly related to the SOEs:
 1. **Need for an effective legal and regulatory framework**
 2. **The role of state ownership.**
 3. **Equal rights and treatment of shareholders.**
 4. **General Assembly of Shareholders.**
 5. **Board of Directors**
 6. **Control architecture**
 7. **Transparency and financial and non-financial information.**
- The adoption of the guidelines will require reforming the company's bylaws and the approval of corporate standards in the form of internal regulations that develop specific mechanisms of corporate governance.

- It is essential to consider the guidelines not as a set of isolated practices to be integrated into the internal corporate regulations, but rather as a whole business culture that should guide the actions and relations between ownership, administration, and ordinary management.
- The acceptance of a guideline on the part of a company should take into account the applicable legal framework and the practices of the local market in which it operates.
- The guidelines may serve as an ideal framework for the SOE to make a preliminary assessment of its governance model.
- The implementation of the guidelines requires the involvement of the owner's representative, the Board of Directors, upper management, and all the SOE's collaborators.
- The implementation should not be seen simply as the use of a checklist to formally incorporate regulations, statutes, and written codes, but instead as an instrument that, when properly understood and implemented, makes it possible for the organization to operate efficiently.
- The guidelines that are adopted and implemented must constitute an integrated and harmonious whole, be compatible with each other, and support a logical, effective governance model consistent with the needs of the company.
- The guidelines may provide support to regulators in developing their standards and in the search for the necessary balance between self-regulation and regulation.

1. NEED FOR AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK

Guideline 1. The regulatory framework for SOEs should ensure a clear separation between the roles of the state as owner and as market regulator.

Guideline 2. A "corporate governance framework" for SOEs that will facilitate the processes of reinforcing corporate governance should be pursued.

Guideline 3. Governments should advocate the simplification of the legal forms for SOEs for two purposes: to facilitate the implementation of advanced governance models that are comparable to those of the private sector so that creditors can exercise their rights and pursue legal actions when there are insolvency proceedings.

Guideline 4. The legal and regulatory framework should be flexible enough to allow for adjustments in the capital structure of SOEs when these are necessary to achieve the company's objectives.

Guideline 5. SOEs must operate under market conditions to obtain financing. Their relationships with banks, public financial institutions, and other SOEs must be based on criteria that is strictly commercial in nature.

2. THE ROLE OF STATE OWNERSHIP

Guideline 6. Governments should define a scope of action, in the form of a public company law or ownership policy, that determines the role of the state as a shareholder of SOEs, its role in strengthening the corporate governance, and the manner in which such laws or policies will be implemented.

Guideline 7. The government should not interfere in the day-to-day management of SOEs and should grant them operational autonomy to achieve their business objectives.

Guideline 8. The state as owner must allow the directors of the SOE to exercise their duties and respect their independence.

Guideline 9. The Specialized Ownership Agency (SOA) must be clearly identified. In some cases, identification may be easy because there is a single centralized legal entity that oversees property or entity that coordinates the various agencies involved in the SOEs. However, in other models, there may be, with different variants, two or more government entities involved in the ownership of SOEs.

Guideline 10. The SOA shall be accountable to congress/parliament and other representative bodies exercising public oversight.

Guideline 11. The state, as owner, must actively exercise its property rights in accordance with the legal structure of each SOE as it endeavors to preserve institutional soundness and fulfill organizational objectives.

3. EQUAL RIGHTS AND TREATMENT OF SHAREHOLDERS

Guideline 12. One share, one vote.

Guideline 13. Principle of parity in the treatment of shareholders.

Guideline 14. When the governing bodies of the SOEs propose extraordinary or strategic operations, these must be sufficiently supported by the shareholders.

Guideline 15. The SOEs must have: i) a report from the Board on operations that may affect minority shareholders and, in general, on extraordinary or strategic operations; ii) an external advisor's opinion on strategic operations and, (iii) publicize such reports.

Guideline 16. SOEs with more than one shareholder should ensure effective communication with all shareholders. One of the most efficient mechanisms is the creation of a specific department to assist shareholders and investors.

Guideline 17. SOEs must implement the following measures to strengthen their communication with shareholders: i) maintain a website that contains corporate information, ii) implement warning systems on material information, iii) permanently update the registry of shareholders, and iv) introduce electronic communication mechanisms between SOEs and their shareholders.

Guideline 18. The participation of minority shareholders in the General Assembly of Shareholders should be encouraged in order to further their involvement in fundamental corporate decisions such as the election of the Board of Directors.

Guideline 19. SOEs should provide alternative methods for resolving disputes.

Guideline 20. Specialized audits requested by SOE shareholders.

Guideline 21. Organizational structure of a business group composed of SOEs.

4. GENERAL ASSEMBLY OF SHAREHOLDERS

Guideline 22. SOEs must recognize the exclusive and non-delegable powers of the General Assembly of Shareholders.

Guideline 23. The SOEs must have Internal Procedure Regulations for the General Assembly of Shareholders.

Guideline 24. The SOEs should recognize and, if necessary, regulate the right of shareholders to request the calling of an extraordinary General Assembly of Shareholders when a certain percentage of the ownership requires it.

Guideline 25. The Bylaws of the SOEs should recognize the right of shareholders, regardless of the number of shares they hold, to propose the introduction of one or more items to be discussed into the agenda of the General Assembly of Shareholders or the inclusion of new proposed resolutions within a reasonable limit and provided that the request is accompanied by a justification.

Guideline 26. For a better exercise of the shareholders' right to information, SOEs must have a sufficient period of time to call the Assembly that would guarantee its wide dissemination and the collaboration of depositary entities when appropriate.

Guideline 27. The SOEs should ensure the right of shareholders to request written information in advance of the Assembly as well as to request oral information during the meeting.

Guideline 28. The SOEs should ensure that the agenda items to be discussed at the General Assembly of Shareholders are precise.

Guideline 29. In SOEs listed on a stock market, the possibility of exercising the right to vote through remote means must be enabled.

Guideline 30. The SOEs must recognize the right of shareholders to propose the dismissal of or the initiation of an action for legal liability against the directors.

Guideline 31. Even though the applicable legal framework allows it, the SOEs should encourage the non-representation of shareholders by Board members within the framework of the General Assembly of Shareholders.

Guideline 32. SOEs must ensure the attendance of external advisors, upper management and members of the Board of Directors at the General Assembly of Shareholders.

5. BOARD OF DIRECTORS

Guideline 33. SOEs should recognize the need for a Board of Directors as a governing body.

Guideline 34. SOEs should provide for managing the succession of members of the upper management.

Guideline 35. The SOEs must have an Internal Regulation for the Board of Directors.

Guideline 36. The Board of Directors of the SOEs must have an appropriate size and provide for the specific treatment of substitutes. The suggested number of members is always odd.

Guideline 37. SOEs should provide for the existence of different categories of directors, their symmetry with the capital structure, and for external directors to be in the majority on the Board.

Guideline 38. SOEs must have a specific procedure for the proposal and selection of directors that includes, along with other things, the establishment of general requirements for being a Director and an Independent Director as well as a justified proposal for each candidate.

Guideline 39. The SOEs must take into account the pre-established conditions for considering directors, and most especially, for the Independent Directors.

Guideline 40. SOEs must establish the causes for the dismissal of directors which, in any case, shall be preceded by a prior report from the Board of Directors.

Guideline 41. In addition to the provisions of the Law, SOEs must stipulate the definition and regulation of the duties of the directors in its Bylaws and/or Regulations of the Board of Directors.

Guideline 42. In addition to the provisions of the Law, SOEs must stipulate the definition and regulation of the rights of the directors in its Bylaws and/or Internal Regulations of the Board of Directors.

Guideline 43. SOEs must require a declaration of conflict of interest from the directors, and the bylaws must provide a management procedure for conflicts of interest.

Guideline 44. SOEs must have a procedure for assessing, authorizing, and disclosing transactions between related parties.

Guideline 45. SOEs must ensure proper remuneration for the members of the Board of Directors approved by the Assembly, or in its absence, the ownership body, and it must be consistent with the results of the SOE and the characteristics of the industry. The SOEs should ensure that compensation for directors is transparent and approved by the shareholder or property representative.

Guideline 46. The SOEs should evaluate and analyze how the Board of Directors' sessions work in order to allow for the greatest value generation by the Board in its decision making.

Guideline 47. The SOEs must elect the Chairman of the Board from among their external members. They should also encourage the separation of the position of Chairman of the Board from that of the Chief Executive, define the position of Vice Chairman of the Board, and reinforce the role and independence of the Secretary of the Board.

Guideline 48. SOEs shall consider the distribution of responsibilities among directors through the establishment of specialized committees of the Board of Directors that are made up mostly of External Directors.

Guideline 49. The SOA, or in its absence the Board of Directors itself, must evaluate the management of the Board of Directors within a reasonable period of time.

6. CONTROL ARCHITECTURE

Guideline 50. The Board of Directors is responsible for the existence of a sound control environment within the SOE, adapted to its nature, size, complexity, and risks.

Guideline 51. The Board of Directors should ensure that there is a risk management process, which provides reasonable assurance that the company's objectives are achieved in accordance with the defined risk profile in place in the SOE. Likewise, the Board of Directors must be responsible for verifying that the risk management structure clearly indicates the role and responsibilities of the board, upper management, and other employees.

Guideline 52. The Board of Directors is responsible for ensuring the existence of a suitable internal oversight system, adapted to the SOE and its complexity, and consistent with the risk management process developed as well as for supervising its effectiveness and suitability.

Guideline 53. The Board of Directors is responsible for the existence of a system in the SOE that allows for the internal communication of the information generated by the risk management process and the internal control system at the corresponding levels of the organization.

Guideline 54. The Board should guarantee the existence of a process for monitoring the Control Architecture that

is independent of upper management and makes it possible to evaluate its effectiveness and propose improvements.

Guideline 55. The Board should ensure that there is a data strategy that is fully aligned and coherent with the SOE's strategic direction and its model of control architecture.

7. TRANSPARENCY AND FINANCIAL AND NON-FINANCIAL INFORMATION

Guideline 56. The SOEs should have an Information Disclosure Policy approved by the Board of Directors that makes it possible to facilitate monitoring and follow-up on the part of the different stakeholders.

Guideline 57. The SOEs must present their financial and non-financial information in accordance with high-quality, internationally accepted standards.

Guideline 58. The SOEs must provide stakeholders with accurate and timely information, both financial and non-financial.

Guideline 59. The SOEs shall issue an annual corporate governance report.

Guideline 60. The SOA shall prepare a Consolidated Annual Report on all the SOEs in which it reports on their performance.

CHAPTER VIII

APPENDICES

Instruments by means of which the actions of the owner-state with respect to the SOE are organized and made transparent.

Appendix 1 is a complement to Guideline 6, which includes an explanation of three instruments that can be used to make the state's actions transparent with regard to its role as owner.

1. Declaration by the state in its capacity as shareholder or majority owner.
2. Bilateral governance agreements between the SOE and the state represented by whoever exercises property rights on its behalf.
3. Corporate governance code issued by the SOE.

Instrument	Type	Issuer	Enforceability	Monitoring of Compliance
1. Declaration by the Majority “Shareholder”	Unilateral	Executive Branch	Average	Executive Branch SOE Community
2. Governance Agreement	Bilateral	Executive Branch SOE	Average	Executive Branch SOE Community
3. Code of Corporate Governance	Unilateral	SOE	Low	SOE Community

1. Declaration by the state in its capacity as shareholder or majority owner.

The declaration by the state as majority “shareholder” or owner of the SOE seeks to communicate the state’s objectives and commitments of corporate governance for a SOE or a group of SOEs. In the case of business groups, it is also used to commit the parent company to respect the corporate governance of the group in general and that of the subordinate companies in particular.

Normally, this instrument focuses on elements of corporate governance that, from an ownership perspective, can generate a greater impact on minority shareholders. Typically, it does not imply a general regulation of all the elements that are part of a governance model which is composed of a set of complementary instruments such as statutes and regulations.

In some countries, such as Colombia, the declaration of the majority shareholder is a common and accepted practice for SOEs listed on the stock exchange and in which the Colombian government retains control from the position of shareholder.

2. Governance Agreement

The governance agreement is a bilateral instrument established to define the framework of relations and general conditions of activity between the owner state and the SOE.

The following results are expected from the implementation of the provisions contained in the governance agreements:

- Strengthen the role of the state as owner and clarify its framework of action, oversight, and control with respect to the SOE.

- Establish the rights and responsibilities of the SOE's decision makers so that its decision and accountability processes become more effective.
- Reduce the risks associated with the confluence of political, public, and private players in the administration of the SOE.

Usually, a governance agreement is signed with the intention of maintaining an indefinite term, not limited to a specific election period. As a result, it implies the existence of political will on the part of the person exercising ownership to arrange the content and scope of the agreement away from interests of partisan, patronage, or circumstantial character and solely oriented to the benefit and interest of the SOE.

3. Code of Corporate Governance.

The code of corporate governance is an instrument issued by the SOE itself in which it consolidates the company's governance model and the practices of corporate governance adopted.

It is a powerful, technical tool that has a clear informative approach. The structure and content of this tool makes it possible for third parties to understand the governance of the SOE in terms of its legal and regulatory components as well as with respect to self-regulation.