PRI RESPONSE

REVISIONS TO THE OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the OECD's call for feedback on the Revision to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs).

ABOUT THIS CONSULTATION

The OECD Working Party on State Ownership and Privatisation Practices is conducting a public consultation on revisions to the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The overall objective of the review is to strengthen the Guidelines to ensure that SOEs contribute to sustainability, and economic security and resilience, by maintaining a global level playing field and high standards of integrity and business conduct. The Guidelines are also being updated to ensure consistency with its two complementary instruments – the 2023 G20/OECD Principles of Corporate Governance, and the 2019 OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises.

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KEY RECOMMENDATIONS

The PRI welcomes the Working Party's decision to update the Guidelines to ensure complementarity with the G20/OECD Principles, and to include a new Chapter on Sustainability to reflect new substantive changes in the Guidelines.

In particular, the PRI welcomes the new Chapter on Sustainability which provides recommendations on:

- The state owners' role in setting sustainability expectations for the SOEs;
- Transparency and disclosure regarding sustainability;
- The role of boards and directors in setting sustainability objectives and overseeing implementation; as well as
- Stakeholder relations and responsible business conduct

The PRI's key recommendations are:

- Extend the definition of Sustainability to include other and evolving global sustainability goals in addition to the SDGs, such as those set in the Paris Agreement, the OECD Guidelines for Multinational Enterprises, and the UN Guiding Principles on Business and Human Rights.
- On disclosure, transparency, and accountability:
    - Requirements should be aligned with evolving internationally recognised standards, including the latest development of IFRS Sustainability Disclosure Standards
    - Specifically, for sustainability-related reporting, we recommend that the OECD follows the requirements listed in IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information or equivalent requirements.
    - Recognizing that sustainability issues are financially material, the ownership entity should consider and report those issues in the annual and aggregate report as material issues instead of as non-financial issues. In addition, the OECD should consider reporting the environmental and social impacts that SOE sectors have on a broad range of stakeholders.
- On state-owned enterprises and sustainability:
    - Exercising of active ownership should be considered as part of discharging state ownership entity's duties, rather than as a pure voluntary option.
    - Where relevant ownership policies and practices are missing, the state should specify the supporting legal and regulatory frameworks or requirements to enable the state ownership entities to set sustainability-related expectations and/or objectives for SOEs.
    - The state should develop supporting policies or regulations on sustainability-related performance evaluation and disclosure. The disclosure and reporting policy should be aligned with evolving internationally recognised standards, including the latest development of IFRS Sustainability Disclosure Standards.

- We recommend including an explicit reference to the alignment of remuneration outcomes and sustainability objectives.
- On shareholder's expectations on sustainability: we recommend that the state encourage regular dialogue or keep an open communication channel for minority shareholders, to capture a wider range of sustainability outcomes and impacts SOEs may have led to society. It is also helpful to have regular dialogue with well-recognized collaborative initiatives on certain sustainability-related issues to understand and address the risks and opportunities.
- We recommend that the OECD follows the requirements listed in IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information or equivalent requirements. SOEs shall provide disclosure about their (a) governance, (b) strategy, (c) risk management, and (d) metrics and targets.
- On just transition, we recommend that the OECD consider the risks and opportunities associated with social issues during the low-carbon transition and support the standardization of a framework for disclosure as a next step.
- Board accountability towards minority shareholders, particularly on sustainability issues, could be enhanced by encouraging the board to engage with investors to understand their views regarding controversial voting results.

DETAILED RESPONSE

APPLICABILITY AND DEFINITIONS

Sustainability. Sustainability, for the purpose of these Guidelines, refers to the attainment of sustainable development as generally embodied in the United Nations Sustainable Development Goals (SDGs)

PRI's recommendation:

- Extend the definition of Sustainability to include other and evolving global sustainability goals in addition to the SDGs, such as those set in the Paris Agreement and the UN Guiding Principles on Business and Human Rights.

V. DISCLOSURE, TRANSPARENCY, AND ACCOUNTABILITY

A. SOEs should report all material information on the enterprise in line with high-quality internationally recognised standards of corporate disclosure, including areas of significant concern for the state as an owner and the general public.

PRI's recommendation:

- The PRI welcomes the OECD's decision to add relevant matters and objectives relating to sustainability and stakeholder relations in the scope of material information. In the Annotations to Chapter V, the OECD further specifies that high-quality internationally recognised standards include "International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP), or national accounting standard consistent with these standards". We recommend that the OECD also refer to the IFRS Sustainability Disclosures in the list to follow global developments in sustainability-related reporting.
- Specifically, for sustainability-related reporting, we recommend that OECD follow the requirements listed in IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information or equivalent requirements. SOEs shall provide disclosure about their (a) governance, (b) strategy, (c) risk management, and (d) metrics and targets.

E. The ownership entity should develop consistent reporting on SOEs and publish annually and aggregate report on SOEs, including on financial performance and non-financial performance, such as information related to sustainability, governance aspects, as well as on the achievement of public policy objectives. The information should give a full, clear and reliable picture of the SOE portfolio and be of high quality, comparable, concise and accessible to stakeholders and the public including through digital communication.

PRI's recommendations:

- We recommend that the OECD recognises the financial materiality of sustainable performance in the annual and aggregate report on SOEs, and change the term "financial performance and non-financial performance" to "all material issues". System-level issues like climate change and pandemics may significantly impact the state's short-term and long-term development goals and alter the business and operation environment of SOEs.
- We recommend that the OECD consider including the environmental and social impacts that the SOE sector have on a broad range of stakeholders, in addition to the achievement of public policy objectives: given the sizes and economic significance of SOEs, SOEs' business and operation activities may have significant impacts on environmental and social aspects for employees, the communities SOEs operate, local regions, as well as business among their supply chains.

VII. STATE-OWNED ENTERPRISES AND SUSTAINABILITY

A. Where the state has set sustainability commitments, they should be integral to the state's ownership policy and practices, and be aligned with the state's broader national objectives and commitments related to sustainability. This includes:

> *1. Setting concrete and ambitious sustainability-related expectations and/or objectives for SOEs, consistent with the ownership policy and practices. In doing so, the state should respect the rights and fair treatment of all shareholders;*
> *2. Communicating and clarifying shareholders' expectations on sustainability through regular dialogue with the boards, with due consideration for stakeholder interests;*
> *3. Assessing, monitoring and reporting on sustainability objectives and performance of SOEs on a regular basis*

PRI's recommendations:

- The exercising of active ownership should be considered as part of discharging state ownership entity's duties, rather than as a pure voluntary option. While state ownership entities may have the **discretion** to decide when and how to integrate sustainability objectives and goals in their SOE portfolio, the state should clarify that state ownership entities **are responsible** for incorporating sustainability issues in the process of managing state assets and for taking actions to align their ownership impacts with sustainability commitments set by the state. This should not be done on a purely voluntary basis, especially when the ownership impacts may contravene the state's sustainability commitments or the portfolio SOEs may fail to meet their share of such commitments. Moreover, to facilitate state ownership entities to fulfil this responsibility, the supervising body should publish guidelines to guide state ownership entities in making decisions on when and how to integrate sustainability objectives and goals in their SOE portfolio. Such guidelines have been established for guiding private institutional investors practicing responsible investment in leading markets such as the UK[1], EU[2] and US[3]. When it comes to state ownership entities, the PRI believes it is imperative to establish stronger responsibility given the involvement of state ownership/action and the need for the state to comply and fulfil its own sustainability commitments.

- By setting sustainability objectives or goals in SOE portfolios, state ownership entities should clarify that this should not be understood as a ceiling for the sustainability efforts of SOE portfolios and should leave room for SOE portfolios to gradually progress to achieving or exceeding their share of the state commitments.
- Where relevant sustainability-related requirements are missing in the ownership policies and practices, the state should specify supporting legal and regulatory frameworks and requirements to enable the state ownership entities to set sustainability-related expectations and/or objectives for SOEs;
- The state should develop supporting policies or regulations on sustainability-related performance evaluation and disclosure. The disclosure and reporting policy should be aligned with evolving internationally recognised standards, including the latest development of IFRS Sustainability Disclosure Standards. In developing the performance evaluation standards, state ownership entities should take consideration of transition or progression pathways developed by internationally recognized organizations or widely used by leading institutional investors.
- On minority shareholder's expectations on sustainability: we recommend that the state encourage regular dialogue or keep an open communication channel for minority and long-term shareholders, to capture a wider range of views with regards to an SOE's sustainability risks, outcomes and impacts on society. It is also helpful to have regular dialogue with well-recognized collaborative investor initiatives on certain sustainability-related issues to understand and address the risks and opportunities.

B. The state should expect SOE boards to adequately consider sustainability risks and opportunities when fulfilling their key functions. The following prerequisites are essential for ensuring effective sustainability management at enterprise level:

1. SOE boards should develop, implement and disclose sustainability-related strategies, objectives and targets based on verifiable metrics, and in line with shareholders' expectations, applicable legal and regulatory requirements;

2. SOEs should integrate sustainability considerations into their risk management and internal control systems;

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[1] UK stewardship code, FCA Conduct of Business Sourcebook, DWP (2019) The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019.
[2] Shareholder Rights Directive I and II
[3] The Employee Retirement Income Security Act of 1974 (ERISA), Investment Advisers Act of 1940 and Investment Company Act of 1940, SEC (2019), Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release Nos. IA-5325; IC-33605, 23-24; DOL (2022), Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.

3. SOE boards should effectively assess and monitor management performance, including on sustainability. Where SOE boards introduce specific remuneration schemes, such incentives should be carefully balanced and linked to relevant and material risks and the company's strategy

PRI's recommendations:

- The PRI supports the guidance encouraging SOEs to integrate sustainability into business strategies, risk management, internal control and governance.
- The PRI recommends including an explicit reference to the alignment of remuneration outcomes and sustainability objectives. SOE boards should select relevant E, S and/or G factors and the appropriate balance of these factors in the remuneration package. The incorporation of ESG metrics into both long-term and short-term remuneration packages can be an important tool to drive value and better sustainability performance by holding executive management to account for delivering on sustainability goals.[4]
- There should also be a specific reference to the workforce. The COVID-19 pandemic has highlighted the need for companies to reign in excessive bonuses and stock grants to prevent stark divergences in the incomes for workers and executives. SOEs should demonstrate tangibly how pay and employment conditions of employees were considered when establishing directors' remuneration policy by identifying pertinent metrics to link to executive pay packages. This is important to ensure proportionate pay policies and structures are in place.

C. The state should expect SOEs to be subject to appropriate sustainability reporting and disclosure requirements, based on consistent, comparable and reliable information:

1. Sustainability reporting and disclosure should be aligned with high-quality internationally recognised standards that facilitate the consistency and comparability of sustainability-related disclosure across markets, jurisdictions and companies;

2. Phasing in of expectations or requirements should be considered for annual assurance attestations by an independent, competent and qualified attestation service provider, in accordance with high-quality internationally recognised assurance standards;

PRI's recommendation:

The PRI recommends that the OECD follow the latest development in global corporate reporting and refer to the requirements listed in the IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information. According to IFRS S1 requirements, SOEs should disclose information on the following aspects:

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[4] For more information see PRI's series on ESG linked pay, including Recommendations for investors and What does the research say?

- governance—the governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities
- strategy—the approach the entity uses to manage sustainability-related risks and opportunities
- risk management—the processes the entity uses to identify, assess, prioritise and monitor sustainability-related risks and opportunities
- metrics and targets—the entity's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation

Specifically, for the section B on board and governance, the OECD could consider to include:

- Disclosure of the SOEs' board's oversight of sustainability-related risks and opportunities
- Disclosure of the process and related policies the SOEs used to identify, assess, prioritise, and monitor material sustainability risks and opportunities that are in line with the state's sustainability goals, shareholders' expectations, and applicable legal and regulatory requirements;

D. The state as an owner should set high expectations for SOEs' responsible business conduct; and should fully recognise SOEs' responsibilities towards stakeholders. Such expectations should be disclosed in a clear and transparent manner. In particular:

> *1. Governments, state ownership entities and SOEs should recognise and respect stakeholders' rights established by law or through mutual agreements;*
>
> *2. SOEs should develop and encourage meaningful stakeholder engagement in advancing sustainability and ensuring a just transition, particularly from persons or groups that may have an interest in or could be impacted by an enterprise's activities;*
>
> *3. State ownership entities and SOEs should take action to ensure high standards of integrity in the state-owned sector and to avoid the use of SOEs as conduits for political finance, patronage or personal or related-party enrichment.*

PRI's recommendation:

- PRI welcomes the article that the state as an owner should set high expectations for SOEs' responsible business conduct, and should fully recognise SOE's responsibilities towards stakeholders. The PRI especially welcomes clause 2, SOEs should develop and encourage meaningful stakeholder engagement in advancing sustainability and ensuring a just transition. We recommend that the state encourage regular dialogue or keep an open communication channel for small shareholders, to capture a wider range of sustainability outcomes and impacts SOEs may have led to society. It is also helpful to have regular dialogue with well-recognized collaborative initiatives on certain sustainability-related issues to understand and address the risks and opportunities. For example, Climate Action 100+ (CA100+), an investor-led global collaborative initiative on greenhouse gas emissions, found in their updated investor guide for engaging in Asia that SOEs in Asia may need a different set of engagement priorities and approach to engagement due to their ties to the states, especially on certain issues and metrics, such as executive remuneration.

- On just transition, we recommend that the OECD consider the risks and opportunities associated with social issues during the low-carbon transition and develop a standardised framework for disclosure as a next step. In a China-focused report, the PRI has proposed a disclosure framework for companies in China to disclose their recognition of and commitments to addressing a just transition, which is aligned with other global recognized just transition reporting frameworks. (PRI: Investing for a just transition: Proposals for a just transition disclosure framework in China, August 2022).
- The state as an owner should encourage board accountability towards all investors, including minority shareholders, on sustainability issues. Further measures could be introduced to improve accountability of board members (including independent directors where applicable), members of the supervisory board, and senior managers with oversight of sustainability issues. Considering the lack of nuance afforded by “Yes”, “No” or “Abstain” votes, SOE boards should consider engaging with shareholders to understand concerns (and where deemed relevant and appropriate, providing a meaningful response) when:
    - management proposals or management-endorsed proposals receive a substantial level of shareholder opposition (>20%)
    - sustainability-related shareholder resolutions receive a substantial level of shareholder support (around 20 %)

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to further support the revision of the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org