

# Managing Risk in the State-Owned Enterprise Sector in Asia

Stocktaking of National Practices



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## *Foreword*

This report provides an overview of national approaches to risk management in the state-owned enterprise (SOE) sector in seven Asian economies (Bhutan, India, Korea, Pakistan, Philippines, Thailand and Viet Nam). It examines risk management requirements and practices at both the level of the state and at the level of individual enterprises.

The report is the result of the ongoing work of the OECD-Asia Network on Corporate Governance of State-Owned Enterprises, which provides a forum for policy makers in Asia to share good practices for improving the corporate governance of SOEs. The findings draw primarily on responses to a questionnaire shared with participants in the 10th meeting of the Asia SOE Network held in Kuala Lumpur on 19-20 September 2017, organised in collaboration with the Institute for Democracy and Economic Affairs (IDEAS) and the Malaysian Directors Academy (MINDA) and financed by the Korea Institute of Public Finance (KIPF). The report and its underpinning questionnaire build on similar work undertaken by the OECD Working Party on State Ownership and Privatisation Practices, published in a 2016 report entitled *Risk Management by State-Owned Enterprises and their Ownership*.

The report was prepared by Korin Kane of the Corporate Affairs Division of the OECD Directorate for Financial and Enterprise Affairs. In many cases, the descriptions of individual national approaches reproduce parts of questionnaire responses, for which acknowledgements are owed to respondents. Some desk research has been undertaken to enrich the information on national approaches to SOE risk management, but no attempt has been made to independently verify the information provided in questionnaire responses.



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## Acronyms

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CAG	Comptroller and Auditor General (India)
CRO	Chief Risk Officer (India)
DHI	Druk Holding and Investments (Bhutan)
DPE	Department of Public Enterprises (India)
GOCC	Government-Owned and –Controlled Corporation (Philippines)
PSC	Public Sector Company (Pakistan)
SEBI	Securities and Exchange Board of India

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## Executive summary

**In the majority of surveyed countries in Asia, statutory corporations are a prevalent – and in some cases the predominant – corporate form in the state-owned enterprise sector.** Statutory corporations are public enterprises that are established by statute and are not incorporated under general company law. Owing in part to their low degree of corporatisation, SOEs in the surveyed countries are not consistently subject to the same risk management requirements as privately-owned corporations. This does not necessarily mean that SOEs are subject to lower standards of risk management than their private sector peers. However, SOEs' legal forms could potentially have implications on the liabilities of SOE boards and individual board members and the related incentives (or disincentives) for risk-taking. The exceptions to this trend are Bhutan and India, where the majority of SOEs are incorporated subject to company law.

**The prevalence of statutory corporations among state-owned enterprises in Asia constitutes a divergence from international trends.** In the 40 countries surveyed in the latest OECD review of national SOE sectors, the large majority of SOEs by value are incorporated subject to company law, with less than 10% by value operating according to statutory legislation (OECD, 2017b). However, this finding merits a couple of nuances. Firstly, the conclusion that most SOEs in the surveyed countries are incorporated subject to statutory legislation is based on descriptive self-reporting, rather than a comprehensive inventory of SOEs' corporate forms. Secondly, many large SOEs in the surveyed countries – including those with international operations – are known to be incorporated according to company law.

**Regardless of their legal forms, SOEs in all surveyed countries are subject to some form of SOE-specific risk management guidelines, rules or their functional equivalent.** The forms that such requirements take vary and include: provisions dedicated to risk management that are set forth in broader SOE corporate governance codes or their equivalent (in Bhutan, India, Pakistan and the Philippines); risk management requirements expressed in high-level decrees on SOE governance (in Thailand and Viet Nam); and public sector internal control requirements that are also applicable to SOEs (in Korea). Public sector internal control requirements are not necessarily, or explicitly, established to mitigate risks in SOEs, but in systems where SOEs are run more closely to the public administration – or are subject to more harmonised oversight by the state – public sector internal control systems are arguably a close parallel to the risk management systems commonly employed in the private corporate sector. The development of SOE-specific risk management rules is not uncommon internationally: among the 33 countries examined in the 2016 OECD survey of SOE risk management practices, about one third has developed, or plans to develop, SOE-specific risk rules (OECD, 2016).

**Establishing a risk management function within SOEs is not a widespread requirement or practice in the surveyed countries.** However, it is often mandatory in some sectors and/or implemented by large SOEs. While all surveyed countries have

SOE-specific risk rules or guidance, this does not always translate into an explicit requirement for SOEs to establish a dedicated risk management function within the enterprise. This being said, in all four of the countries where such a function is reportedly not required or not a widespread practice (India, Korea, Pakistan and the Philippines), SOEs are required to implement some form of internal audit or control system, which could in principle serve as a functional equivalent to a risk management system. Three countries (Bhutan, Thailand and Viet Nam) report that the establishment of an internal risk management function and/or the employment of dedicated risk management officers is a common practice among SOEs. Furthermore, in most countries, many large commercially operating SOEs have taken steps to adopt internal risk management systems, regardless of the existence of related requirements established by the state. A number of countries also report that sector-specific risk management requirements – for example prudential regulations in the banking sector – apply to SOEs operating in the relevant sectors. For comparison, about half of the 33 countries examined in the 2016 OECD stocktaking on SOE risk management require that SOE boards of directors oversee the implementation of an internal risk management system (OECD, 2016).

**None of the surveyed countries have adopted a standardised approach to determining and communicating the state’s risk tolerance levels for SOEs.** Risk tolerance levels are basically indications of the degree to which a shareholder (in the case of SOEs, the state) is willing to accept variations in its expected returns on investment. None of the surveyed countries appear to have taken steps to systematically quantify the state’s expectations concerning risk tolerance. In the majority of surveyed countries, the state’s risk tolerance levels are determined by individual line ministries (Korea, Pakistan, Thailand and Viet Nam), then often communicated to SOEs through the state’s board representatives. In two countries (Bhutan and the Philippines), the determination of risk tolerance levels is delegated to boards of directors, informed by general guidelines elaborated by the state. In one country (India), there is no standardised approach to determining the state’s risk tolerance levels, but risk management practices are monitored in SOEs as one of the parameters used in the annual performance monitoring system. For comparison, in about two-thirds of the 33 countries examined in the OECD survey of SOE risk management practices, the determination of the state’s risk tolerance levels is either undertaken on an *ad hoc* basis according to SOEs’ risk profiles or is otherwise not subject to a standard approach (OECD, 2016).

## 1. Introduction

### 1.1. Background and scope

SOEs are not necessarily faced with different risks than private enterprises purely as a result of their state ownership. SOEs, like private enterprises, can be subject to myriad risks that can cause financial or reputational damage or threaten their commercial viability. This being said, by virtue of their state ownership, SOEs can be subject to different influences that can affect their propensity for risk-taking behaviour. On the one hand, SOEs might engage in excessive risk-taking because they are able to elude the market (including shareholder) pressures that induce privately-owned companies to establish rigorous risk management and disclosure practices. On the other hand, SOEs might be excessively risk averse compared to their private sector peers, owing for example to overly burdensome state controls or the absence of well-defined corporate objectives to allow for – and incentivise – commercially-sound risk taking.

Regardless of the incentives for risk-taking that the state ownership and regulatory environment confers upon SOEs (in other words, regardless of whether national circumstances make SOEs more inclined towards either excessive or insufficient risk-taking behaviour), the state as a shareholder should define and communicate its risk tolerance levels to SOEs. Communicating risk tolerance levels should not be done in isolation, but as an integral part of the state's broader responsibilities of defining, communicating and monitoring the implementation of well-defined objectives for SOEs. SOEs should, in turn, establish adequate measures to achieve these well-defined objectives, while respecting the state shareholder's risk tolerance levels. These and many other internationally-agreed principles concerning the respective responsibilities of the state and SOEs' corporate organs are set forth in the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*.

This report sheds light on national approaches employed in seven countries in Asia to ensure that risks faced by state-owned enterprises are adequately understood, managed and disclosed. The seven surveyed countries are Bhutan, India, Korea, Pakistan, the Philippines, Thailand and Viet Nam. For the purpose of the report, no attempt is made to define the scope of risks that national practices seek – or fail – to mitigate. The report focuses less on the types of risk that SOEs might face (which can include, for example, financial, operational, compliance or reputational risks) and more on the respective responsibilities for risk management undertaken by the different actors involved in corporate oversight and operations, namely: state ownership ministries and other public oversight bodies, SOE boards of directors and SOE management. In brief, the report identifies trends in national approaches to implementing the discipline of risk management, as employed by privately-owned corporations, in the state-owned enterprise

sector<sup>1</sup>. It provides examples of national practices as relevant, but makes no attempt to assess their effectiveness in mitigating risks.

It bears mentioning that approaches to risk management in the SOE sector are invariably linked, among others, to the prevailing state ownership arrangements in a given jurisdiction, to SOEs' legal forms and to the closeness with which SOEs are operated from the general government. To illustrate, in countries where most SOEs have been fully corporatised (i.e. are subject to general companies law) and where there is a stronger “commercial” culture in the SOE sector – including through the presence of boards of directors comprising mainly industry professionals – risk management practices are arguably more likely to mirror those employed in the private corporate sector. Conversely, where SOEs are run more closely to the public administration, the discipline of risk management as employed in private corporations might in many cases be supplanted by systems of state audit and internal control that are more common in the public administration. These broader factors influencing risk management practices are touched upon somewhat in the report but are not examined in great detail.

The report is structured as follows. After this introduction, it provides a synthesis overview of national approaches to SOE risk management in the seven surveyed countries in Asia (Section 2). The synthesis overview notably (i) discusses the impact of SOEs' legal forms on the risk management environment; (ii) highlights some of the characteristics of risk management systems employed within individual SOEs; and (iii) discusses whether and how the state communicates its risk tolerance levels to SOEs. Comparisons with international approaches are made throughout, drawing on the findings of the OECD's 2016 report on *Risk Management by State-Owned Enterprises and their Ownership*, which surveyed related national practices in 33 countries. The report then provides more detailed descriptions of the individual national approaches employed in the seven surveyed countries (Section 3).

## 1.2. International good practice for managing risk in state-owned enterprises

The good practice standards set forth in the *OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines)* contain a number of provisions pertaining to risk management, notably outlining the respective roles of the state and SOE boards in identifying, disclosing and managing material risks. The recommendations of the *SOE Guidelines* concerning risk management can be summarised as follows.

- **The state as an owner should communicate its risk tolerance levels to SOEs.** Among the state's prime responsibilities as an owner of enterprises is “setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels” (Guideline II.F.3).
- **State-owned enterprises should publically disclose information on foreseen risks and remedial measures.** The general public is considered the ultimate “owner” of SOEs. As such, SOEs should report to the public in line with the

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<sup>1</sup> For the purpose of this stocktaking, “privately-owned” corporations are those that are majority-owned or controlled by private, or non-state, actors. It includes companies that meet these criteria and that are listed on stock exchanges, which in many jurisdictions are referred to as “public corporations”.

same standards of transparency that shareholders expect of listed companies. In addition to disclosing financial and non-financial information in accordance with high standards of accounting, audit and disclosure, SOEs should also report on any information that may be of “significant concern for the state as an owner and the general public”. Examples of information that SOEs should disclose to the public include “any material foreseeable risk factors and measures taken to manage such risks” (Guideline VI.A.6).

- **SOE boards of directors should consider establishing risk committees.** “SOE boards should consider setting up specialised committees [...] particularly in respect to audit, risk management and remuneration” (Guideline VII.H).

The Annotations to Chapter 6 of the *SOE Guidelines* provide more detailed explanations concerning why it is important for SOEs to identify, assess and report on material risk. Box 1.1 reproduces the relevant text.

**Box 1.1. The importance of risk management and disclosure as explained in the *SOE Guidelines***

According to the Annotations to Chapter 6 of the *SOE Guidelines*, “Severe difficulties arise when SOEs undertake ambitious strategies without clearly identifying, assessing or duly reporting on the related risks. Disclosure of material risk factors is particularly important when SOEs operate in newly de-regulated and increasingly internationalised industries where they are facing a series of new risks, such as political, operational, or exchange rate risks. Without adequate reporting of material risk factors, SOEs may give a false representation of their financial situation and overall performance. This in turn may lead to inappropriate strategic decisions and unexpected financial losses. Material risk factors should be reported in a timely fashion and with sufficient frequency. Appropriate disclosure by SOEs of the nature and extent of risk incurred in their operations requires the establishment of sound internal risk management systems to identify, manage, control and report on risks. SOEs should report according to new and evolving standards and disclose all off-balance-sheet assets and liabilities. When appropriate, such reporting could cover risk management strategies as well as systems put in place to implement them. This should apply to financial and operational risks, but also where relevant and material to the SOE, human rights, labour, environment and tax-related risks. Companies in extractive industries should disclose their reserves according to best practices in this regard, as this may be a key element of their value and risk profile.”

*Source:* OECD (2015), *Guidelines on Corporate Governance of State-Owned-Enterprises*, OECD, Paris.

## 2. Synthesis overview of SOE risk management in Asia

### 2.1. Impact of SOEs' corporate forms on the risk management environment

In the majority of surveyed countries in Asia, most SOEs are reportedly not incorporated according to company law and are therefore not, as a rule, subject to the same risk management requirements as privately-owned corporations. This report has not undertaken to review the risk management requirements imposed on private corporations. It cannot therefore draw any conclusions on whether SOEs are subject to more, or less, stringent legal requirements for risk management than their private sector peers. As will be discussed later in this section, most surveyed jurisdictions have indeed adopted some form of SOE-specific risk management requirements, which could, at least in principle, be functionally similar to any requirements imposed on private corporations. This being said, SOEs' legal and corporate forms are important for risk management because they impact the responsibilities of the corporate organs and employees that oversee, or make, decisions influencing SOEs' exposure to risk. To illustrate, the boards – and sometimes board members – of private corporations can be held liable for actions undertaken that are not in the interest of the company or its shareholders. This is not always the case for the boards and/or board members of SOEs that are incorporated subject to statutory legislation.

Among the surveyed countries, national practices regarding the corporate forms of SOEs can be divided into three broad groups (Table 2.1). In two countries (**Thailand** and **Viet Nam**), all or most SOEs are incorporated according to separate, SOE-specific legislation. In three countries (**Korea**, **Pakistan** and the **Philippines**), SOEs generally have mixed legal forms, with no single corporate form prevailing. **Bhutan** and **India** are the only countries where all or most SOEs are reportedly incorporated under general company law and are therefore subject to the same laws and regulations – including those bearing on risk management – as privately-owned companies. For India, this finding is confirmed in the OECD's latest review of national SOE sectors, according to which only four of India's 270 SOEs have the form of statutory or quasi-corporation (OECD, 2017b). 68 of India's SOEs are additionally listed on the national stock exchange and therefore subject to the corporate governance and disclosure requirements of the Securities and Exchange Board of India (SEBI).

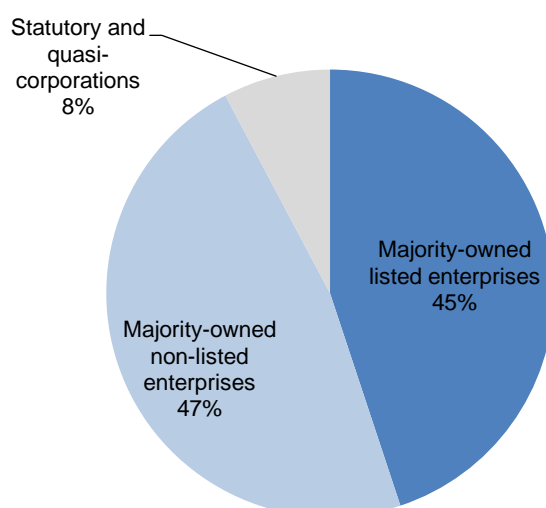
As an example of risk management requirements set forth in company law, Bhutanese companies, including all or most SOEs, are required to develop a code of conduct which must include, among others, information on their risk management practices. Indian companies, including most SOEs, are required to include in the annual board of directors' report information on the development and implementation of a risk management policy and an identification of any material risks that the board considers to be potential threats to the company's commercial viability. Large listed companies in India (specifically, the largest 100 companies by market capitalisation) are additionally required by SEBI's listing rules to establish a board risk management committee (OECD, 2017a).

**Table 2.1. SOEs' corporate forms in the surveyed countries**

All, or most SOEs subject to companies law	Bhutan, India
SOEs have mixed legal forms	Korea, Pakistan, Philippines
Most SOEs subject to only SOE-specific legislation	Thailand, Viet Nam

Source: Questionnaire responses provided by contributing countries or institutions.

The low degree of SOE corporatisation in Asia differs somewhat from international trends. According to the latest OECD review of the characteristics of SOE sectors around the world, the majority of SOEs by value are incorporated according to general company law, about half of which are listed on national stock exchanges (OECD, 2017b and Figure 2.1). Internationally, only 8% of SOEs (by value) have the form of statutory or quasi-corporations. This comparison merits two nuances. Firstly, in countries around the world where most SOEs are fully corporatised, there are often some SOEs that have the form of statutory corporation. Secondly, in the surveyed countries in Asia, many large and sometimes internationally operating SOEs are known to be incorporated according to company law.

**Figure 2.1. Corporate forms of SOEs around the world, by value**

Note: Data used for figure relates to 39 countries, comprising 35 OECD member and accession candidate countries as well as Argentina, Brazil, India and Saudi Arabia (for which only the SOEs in the portfolio of the Public Investment Fund of Saudi Arabia are included).

Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris.

## 2.2. SOE-specific risk management rules

Regardless of their legal forms, in nearly all of the countries surveyed, the state has developed SOE-specific guidelines or regulations on risk management (Table 2.2). These are described in detail in the relevant country sections in Section 3. In four countries (**Bhutan, India, Pakistan** and the **Philippines**), risk management provisions are included in broader SOE corporate governance codes or their equivalent. These are, namely: the corporate governance code applicable to the portfolio of enterprises in Druk Holding and

Investment’s portfolio in Bhutan; guidelines on risk management established by the Department of Public Enterprises in India; the Public Companies (Corporate Governance) Code applicable to SOEs in Pakistan; and the corporate governance code developed by the Governance Commission for Government-Owned and -Controlled Corporations (GOCCs) in the Philippines.

In two countries (**Thailand** and **Viet Nam**), risk management requirements for SOEs are included in broader state decrees on SOE governance or their equivalent, namely the Prime Minister’s regulation concerning the role of the State Enterprise Policy Committee in Thailand and the State Decree on Capital Management in Viet Nam. Among the surveyed countries, **Korea** stands out somewhat in that the Act on the Management of Public Institutions (which is applicable to SOEs) does not explicitly address risk management. However, it does require that all public institutions establish an internal auditor or audit committee to oversee internal control, which in practice could result in the functional equivalent of a risk management system. In the Philippines, in addition to the risk management provisions of the SOE corporate governance code established by the Governance Commission for GOCCs, a number of complementary laws and regulations concerning public sector internal control and audit also apply to SOEs.

The practice of developing of SOE-specific risk management rules – applicable to SOEs regardless of their legal forms – is similarly not uncommon internationally. Among the 33 countries examined in the 2016 OECD survey of SOE risk management practices, about one third has developed, or plans to develop, SOE-specific risk rules. These are established via a wide range of legislative or policy instruments, including for example SOE-specific corporate governance codes, provisions in the state ownership policy, or standalone government resolutions or decrees dedicated primarily to risk management (OECD, 2016).

**Table 2.2. Main sources of risk management requirements for SOEs**

Included in SOE corporate governance code or its equivalent	Bhutan, India, Pakistan, Philippines
Established by state decrees on SOE governance or their equivalent	Thailand, Viet Nam
Public sector internal control rules prevail	Korea

*Source:* Questionnaire responses provided by contributing countries or institutions.

### 2.3. Risk management practices at the enterprise level

In about half of the surveyed countries, SOEs are not explicitly required to establish a dedicated internal risk management function responsible for identifying material risks and reporting them to the board (Table 2.3). However, in a number of countries, SOEs do in practice establish such functions, supported in some cases by dedicated risk officers and board-level risk committees. The establishment of a chief risk officer or its equivalent is in a number of cases required by industry-specific rules, for example in the banking sector, where SOEs are often prevalent.

Four countries (**India**, **Korea**, **Pakistan** and the **Philippines**) report that the establishment of a risk management function for SOEs is either not required or not a widespread practice. However, in all four of these countries, SOEs are generally required to establish some form of internal audit or control system, which could in principle serve as a functional equivalent to a risk management system. For example, in India, although



SOEs are not explicitly required to establish an internal risk management function, DPE's corporate governance guidelines require SOEs to establish "internal procedures for identifying risks and reporting them to the board". Three countries (**Bhutan, Thailand and Viet Nam**) report that the establishment of an internal risk management function and/or the employment of dedicated risk management officers is either required or is a common practice among SOEs. In Bhutan, this is underpinned by the state holding company's corporate governance code, which requires that company boards establish a "sound risk management framework and controls system for the protection of shareholders' interests and company assets". In practice, DHI's risk management framework is implemented within portfolio companies through the employment of specialised risk officers or (in smaller companies) the assignment of risk management functions to company officers that are tasked primarily with other duties.

For comparison, in about half of the countries examined in the 2016 OECD survey of SOE risk management practices, SOE boards of directors are explicitly required – usually either by company law also applicable to SOEs or by SOE-specific rules – to establish and oversee the implementation of internal risk management systems (OECD, 2016). Among these countries, related requirements are communicated either (i) to SOE boards, who are then responsible for overseeing their implementation or (ii) directly to SOE management, the latter probably reflecting cases where SOEs are run more closely to the public administration, instead of at arms' length from the state and subject to oversight by a corporate board of directors.

**Table 2.3. Practices for establishing internal risk management functions in SOEs**

International risk management function required or established in most SOEs	Bhutan, Thailand, Viet Nam
Internal risk management function not uniformly required for SOEs; industry requirements prevail*	India, Korea, Pakistan, Philippines

*Note:* \*In these three countries, internal control and audit systems could serve as a functional equivalent to a risk management system.

*Source:* Questionnaire responses provided by contributing countries or institutions.

#### 2.4. Role of the state in determining and communicating risk tolerance levels

None of the surveyed countries have adopted a standardised approach to determining and communicating the state's risk tolerance levels for the SOEs in the state's ownership portfolio. In most countries, risk tolerance levels are determined by line ministries (**Korea, Pakistan, Thailand and Viet Nam**), then often communicated to SOEs through the ministries' board representatives (Table 2.4). For example, in Viet Nam, the state's risk tolerance levels are generally communicated through instructions from relevant shareholding ministries. Similarly, in Pakistan, the state's risk tolerance levels are generally communicated via board representatives, often based on guidance established by relevant ownership ministries. In one country (**India**), the determination and communication of the state's risk tolerance levels are not subject to a standard approach, but risk management is one of the parameters used in the annual performance monitoring system. For comparison, in about two-thirds of the 33 countries examined in the OECD survey of SOE risk management practices, the determination of the state's risk tolerance levels is either undertaken on an *ad hoc* basis according to SOEs' risk profiles or is otherwise not subject to a standard approach (OECD, 2016).

In two countries (**Bhutan** and the **Philippines**), the determination of risk tolerance levels appears to be generally delegated to SOE boards of directors, subject to general guidelines by the state. In Bhutan, related guidance is enshrined in DHI's corporate governance code. In the Philippines, it is set forth in the GOCC Governance Act and takes the form of general principles on internal control. The Governance Commission for GOCCs in the Philippines is reportedly in the process of establishing a more explicit risk management framework to guide SOEs in implementing sound risk management practices. Delegating the determination of risk appetite to SOE boards of directors is a common practice internationally. In about half of the countries surveyed in the 2016 OECD survey of SOE risk management practices, risk tolerance levels are determined by boards of directors, underpinned by some form of overarching guidance from the state (OECD, 2016).

**Table 2.4. How the state's risk tolerance is determined and communicated to SOEs**

Decisions on risk tolerance mostly delegated to the board	Bhutan, Philippines
Line ministries communicate risk tolerance, often through board representatives	Korea, Pakistan, Thailand, Viet Nam
Risk tolerance indirectly communicated through performance management system	India

*Source:* Questionnaire responses provided by contributing countries or institutions.

### 3. Individual national approaches

#### 3.1. Bhutan

##### *Legal and regulatory framework applicable to SOE risk management*

In Bhutan, all SOEs are incorporated as public limited companies and are thus generally subject to the same laws and regulations – including those bearing on risk management – as privately-owned companies. This includes notably the provisions of the Companies Act bearing on board responsibilities and directors’ duty of care. Concerning directors’ duty of care, the Companies Act 2016 establishes that in fulfilling their functions, board members must act in the interests of the company. Specifically, “every director of a company, in the exercise of his powers and discharge of his duties [...] shall act honestly and in good faith in the best interests of the company and shall exercise the care, diligence and skills that a reasonably prudent person would exercise in comparable circumstances”. The Companies Act also requires that all companies develop a code of conduct which, among others, must outline their risk management practices. SOEs are also, like comparable private companies, subject (as relevant) to industry-specific risk management requirements established by regulators, such as limitations to concentration in the financial sector or safety codes for the aviation industry.

In addition to the general risk management requirements laid out in the Companies Act and any relevant industry-specific regulations, SOEs in the portfolio of Druk Holding and Investments (DHI, the state holding company responsible for managing the state’s shareholdings) must comply with a number of additional risk management provisions that are set out in both DHI’s ownership policy and its corporate governance code. These provisions notably place responsibility for governing risk on the company’s board of directors and require that the board monitor internal controls and undertake regular related reporting to shareholders. Box 3.1 reproduces the provisions related to risk management set forth in DHI’s corporate governance code. Complementing this is a “risk management framework” which establishes the processes by which companies are expected to identify, disclose and mitigate risk within the company.

### **Box 3.1. Bhutan: Risk management provisions of DHI's corporate governance code**

Druk Holding and Investments' corporate governance code (which its portfolio companies are required to implement as of November 2013) applies to all majority-owned companies in DHI's portfolio and their subsidiaries. It sets out corporate governance standards that DHI's portfolio companies are expected to implement. It also presents common charters for company boards and audit committees (outlining, among others, their responsibilities, composition and functioning) and a code of conduct applicable to board members and senior managers. The excerpt below reproduces (with minor edits for clarity) the corporate governance codes' provisions on risk oversight, internal control, internal audit and the role of the audit committee.

#### **2.4.9 Risk Oversight and Internal Control Systems**

- i. The board shall be responsible for the governance of risk and shall establish a sound risk management framework and controls system for the protection of shareholders' interests and company assets.
- ii. At least annually, the board shall conduct a review of the company's risk management and internal control systems and report to shareholders. The review should encompass all material financial, operational and compliance controls.
- iii. The Corporate Governance Report section of the Annual Report shall include a statement acknowledging the directors' responsibility for internal control and risk oversight; and shall describe the ways by which this responsibility is discharged.

#### **2.4.10 Internal Audit**

- i. The board shall establish an effective, independent, internal audit function that reports directly to the board or to the Board Audit Committee.
- ii. The internal audit shall have all the authorities and access it requires for its reviews. Internal auditors should conduct regular reviews of the effectiveness of governance, risk management and internal control systems and processes in the company.

[...]

#### **6.8 Audit Committee**

[...]

- iii. The audit committee shall monitor and should give the board assurance on the operation of the internal control system and internal audit activities, financial reporting, external audit, accounting and legal compliance of the company. It may also monitor the effectiveness of the company risk management system.

*Source:* Druk Holding and Investments Ltd., "Corporate Governance Code", available at <http://www.dhi.bt/documents/10180/18128/CG+Code.pdf/1d8086d5-b036-42a0-bbcf-10d89dd2ffbe>.

### *Risk management practices at the level of individual SOEs*

The “risk management framework” in place for the SOEs in DHI’s portfolio sets out company- level requirements for identifying risks, reporting them to the board and establishing mitigation measures. Depending on the size of the company, specialised risk officers are put in place and assigned purely risk management functions, or, in smaller companies, officers with other duties are also assigned risk management functions. The range of risks assessed by those undertaking the risk management function generally encompasses financial, strategic, operational, reputational and legal risks. Financial and reputational impacts are the main criteria for determining materiality of risk. Risks are generally identified within the companies by the designated risk officer(s) (if in place) and are then disclosed to the board at the beginning of the year. Disclosure to the board includes a list of the risks along the five aforementioned areas (a “risk register”), an identification of their potential financial impact and an overall risk level based on a risk matrix. Risk officers then propose risk mitigation measures to the board and/or its relevant committees. Management determines whether any additional risk reporting to the board is merited. SOE boards in Bhutan are not required to establish specialised board committees with responsibility for risk management. In practice, most SOE boards have delegated this function to the audit committee.

### *Role of the state in SOE risk management*

In Bhutan, SOE risk tolerance levels are generally not determined at the level of the state, but are instead left to boards of directors to decide, informed among others by company size and turnover. Any (implicit) risk tolerance level by the state is therefore not considered when boards set target rates of return for the companies. However, boards are reportedly encouraged to take into account project-specific risks when setting target returns. In practice, the maximum leverage ratio (decided by boards) is reportedly set at around 70% of debt. Concerning reporting of risks to DHI (the state shareholder), SOE boards are required to submit the annual risk register (outlined above) and a compliance report, which DHI reviews and provides feedback on as relevant. To ensure that boards are adequately equipped to monitor companies’ risk management systems, DHI offers corporate governance awareness programmes for directors; reviews boards annually to assess their competencies and diversity; and reviews and approves the list of proposed board members. There is no link between SOE board member remuneration policy and risk-taking; remuneration of board members is reportedly nominal. Concerning reporting to the public, DHI’s corporate governance code requires that annual reports include a statement acknowledging the boards’ responsibility for internal control and risk oversight.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the Royal Audit Authority of Bhutan notably undertakes annual reviews of SOEs’ annual statutory audits and conducts bi-annual onsite audits of transactions and performance. While it does not have an explicit mandate to oversee risk management by SOEs, it could potentially address internal control and risk management issues in undertaking its broader functions.

## **3.2. India**

### *Legal and regulatory framework applicable to SOE risk management*

In India, most SOEs are incorporated according to general company law and are therefore subject to the provisions of the Companies Act (2013) concerning board responsibilities

and directors' duty of care. The Companies Act specifically requires that companies' annual board of directors' report include a statement regarding the development and implementation of a risk management policy, which must include an identification of any risk factors which the board considers threats to the viability of the company. The Companies Act also contains some provisions specifically related to SOEs ("Government Company" in national nomenclature), defining an SOE as "any company in which not less than 51% of the paid up share capital is held by the central government, or by any state government or governments, or partly by the central government and partly by one or more state governments", or a subsidiary of such a company. Among these SOE-specific provisions is the stipulation that the Comptroller and Auditor General is responsible for appointing SOEs' auditors.

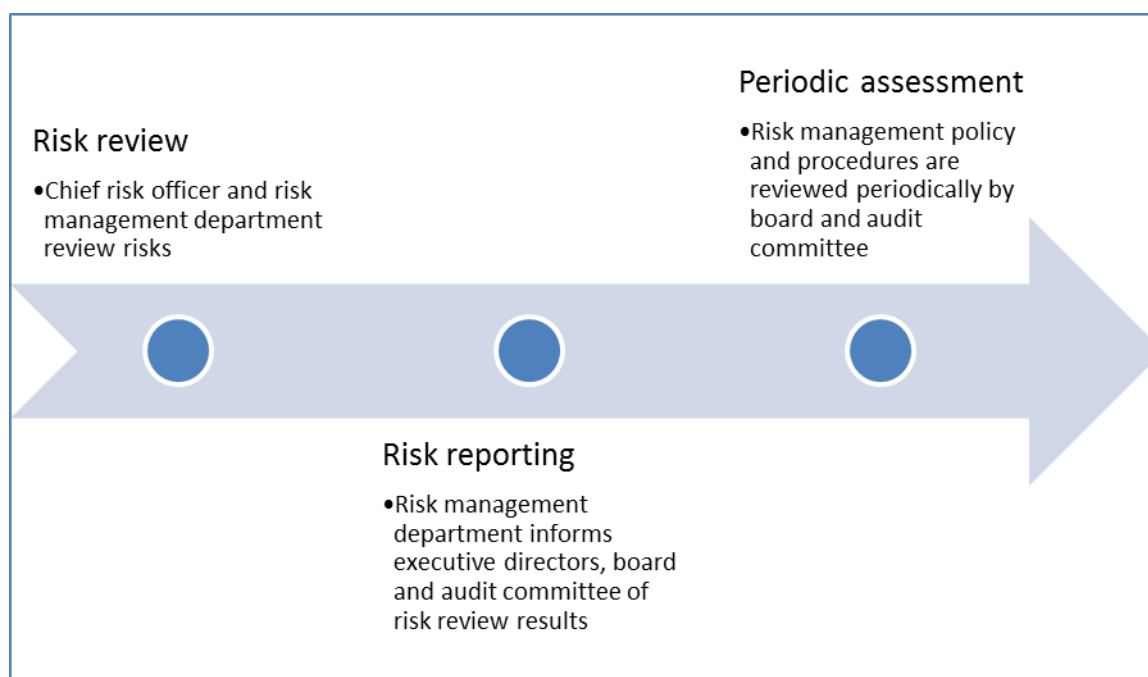
Listing rules established by the Securities and Exchange Board of India (SEBI) require that companies listed on the stock exchange – including India's 68 listed SOEs – establish a "risk management mechanism". Complementing these listing rules, the Companies Act requires that listed companies' boards establish audit committees responsible for evaluating internal financial controls and risk management systems.

In addition to these general risk management requirements applicable to non-listed and/or listed state-owned companies, all SOEs are required by separate guidelines elaborated by the Department of Public Enterprises (DPE) to establish internal procedures for identifying risks and reporting them to the board. (DPE is a central coordinating body with responsibility, among others, for coordinating the state's policies related to SOEs and managing the SOE performance management system.) While the DPE guidelines do not establish explicit criteria for determining materiality of risk, they do specify that internal procedures should address any risks which might threaten the viability of the enterprise. They also stipulate that risk oversight be one of the main responsibilities of the board.

### ***Risk management practices at the level of individual SOEs***

Risk management practices at the level of individual SOEs in India reportedly vary according to their sector of operation and their objectives. In practice, many SOEs have reportedly established dedicated risk management departments tasked with assessing material risks and have put in place Chief Risk Officers (CROs) who report on risks to boards. Generally, listed SOEs are subject to more stringent requirements for reporting risks to the board, including concerning the frequency of reporting. Figure 3.1 illustrates the process by which risks are assessed and reported by the executive management of one SOE in India.

Figure 3.1. Illustration of risk management process of an SOE in India



Source: Questionnaire response provided by the Standing Conference of Public Enterprises (SCOPE).

### *Role of the state in SOE risk management*

In India, the performance management system for SOEs is underpinned by Memorandums of Understanding (MoUs) which are signed annually between state representatives and SOEs' executive management. These MoUs are also the main channel by which the state communicates – and monitors SOEs' compliance with – its risk tolerance level. The MoU system also forms the basis for regular review of SOEs' internal risk management processes. The MoUs notably include risk management as one parameter for measuring performance. Practices for setting SOE rates of return and maximum leverage ratios reportedly vary across the SOE sector. To ensure that SOE boards are adequately equipped to monitor companies' risk management systems, the Public Enterprises Selection Board advises the government on the appointment of board chairs and members, based among others on their expertise, qualifications and industry experience. The state has taken some (albeit indirect) steps to link SOE executive remuneration policy with risk-taking, in that the MoU system, which includes parameters related to risk management, provides for performance-related pay based on an overall rating of performance against defined targets.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the Comptroller and Auditor General of India (CAG) is tasked with overseeing SOEs' compliance with applicable rules and regulations. Concerning reporting to the public, SOE boards are (as mentioned previously), required by the Companies Act to include information on the implementation of company risk management policies in their annual board of directors' report.

### 3.3. Korea

#### *Legal and regulatory framework applicable to SOE risk management*

In Korea, SOEs can take a number of legal forms. Many large SOEs are incorporated according to general company law, while a non-trivial number are established via entity-specific legislation. Regardless of their legal form, all SOEs are subject to the rules established by the Act on the Management of Public Institutions, which is applicable to both SOEs and governmental agencies. The Act notably requires that all public institutions (including SOEs) put in place an internal auditor or audit committee to oversee internal control. The resultant internal control arrangements could be (although not necessarily are) functionally equivalent to a risk management function. The Act also assigns the state-level Board of Audit and Inspection responsibility for investigating any alleged irregular practices within public institutions. Overall, the legislation applicable to SOEs in Korea does not define risk or provide any criteria or thresholds for determining materiality of risk. Concerning directors' duties, the Civil Act (applicable to civil servants employed by SOEs) and the Commercial Act (applicable to many SOEs) establish respectively directors' duty of care and directors' duty loyalty. Whether these duties are towards the owner, the company, or both, is reportedly debatable.

#### *Risk management practices at the level of individual SOEs*

In practice, risk management within Korean SOEs is undertaken collectively by management, the board and the audit committee (if in place). The composition and responsibilities of SOEs' audit committees (which are generally in place for the largest SOEs) reportedly correspond to those assigned to the audit committees of privately-owned companies. The establishment of a dedicated risk management function is not required for SOEs in Korea and is not a widespread practice among SOEs. However, in some sectors (e.g. the financial sector) it is common practice to establish a dedicated unit responsible for risk management, equipped with specialised staff such as compliance officers. No examples were made available on the implementation of internal risk management systems by SOEs' executive management.

#### *Role of the state in SOE risk management*

The state as an owner does not establish or communicate overall risk tolerance levels applicable to all SOEs in Korea. Similarly, the state does not set maximum leverage ratios for all SOEs or categories thereof. Ownership entities do, however, in practice set risk thresholds for individual SOEs, as the need arises and in consultation with experts. The main channel by which the state might monitor SOEs' risk management practices would be through the annual performance evaluation of auditors and audit committees. To ensure that SOE boards are adequately equipped to fulfil their functions (including, as relevant, oversight of risk management), state ownership entities establish board candidate requirements in accordance with the state's guidelines on human resources management applicable to public corporations. Potential SOE board candidates are also recommended by a Committee for Recommendation of Executive Officers, based among others on their qualifications, expertise and sectoral experience. The state has not taken any steps to link SOE executive remuneration policy with risk-taking.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the state Board of Audit and Inspection is notably tasked with investigating any alleged irregularities or misconduct within SOEs. Concerning reporting to the public,



SOEs are notably required to disclose: information on senior executives, including the professional profiles of directors and auditors; any relevant reports by the Board of Audit and Inspection or by the National Assembly; the results of the performance evaluations of the auditor and audit committee; and details on financial operations and performance, among others.

### 3.4. Pakistan

#### *Legal and regulatory framework applicable to SOE risk management*

SOEs in Pakistan are defined by the Public Sector Companies' (Corporate Governance) Rules (PSC Rules, 2013) to include any companies in which the government exercises direct or indirect beneficiary ownership or control. This includes companies in which the government or any agency thereof holds at least 50% of voting shares or otherwise has the "the power to elect, nominate or appoint a majority of its directors". All SOEs are required to comply with the PSC Rules, including those bearing on risk management. These include the requirement for SOE boards of directors to establish a risk management committee, to prepare reports on risk management practices and to elaborate a risk management policy. Specifically, the PSC Rules require that the board "formulate significant policies of the Public Sector Company, which may include the identification and monitoring of the principal risks and opportunities [...] and ensuring that appropriate systems are in place to manage these risks and opportunities, including safeguarding the public reputation of the Public Sector Company". Concerning directors' duty of care, the PSC Rules establish that SOE boards shall "assist the SOE to achieve its principle objective by exercising its powers and carrying out its fiduciary duties with a sense of objective judgement and in the best interest of the company". They also require that SOE boards take part at least annually in training in areas such as risk management and internal control.

Listed SOEs are furthermore subject to the Pakistan Stock Exchange rules (the "Rule Book of Pakistan Stock Exchange Limited"). Industry-specific risk management requirements also apply to SOEs as relevant, such as the State Bank of Pakistan's prudential regulations applicable to banks, which include provisions on risk management, corporate governance and operations. The basic legal requirements for risk management in SOEs apply to risk in the general sense, with no criteria based on materiality. SOE boards are required to define criteria for materiality in their risk management policy, which forms the basis for determining the board's risk appetite and developing corporate strategy accordingly.

Recent revisions to the Pakistan Companies Act (2017) introduced new provisions applicable to "public interest companies", which includes some SOEs, but the provisions mostly concern disclosure and reporting and do not concern risk management. The only governance-related provision of the Companies Act applicable to SOEs that are public interest companies is the requirement for boards to include at least one female director. Box 3.2 reproduces the definition of "public interest company" included in the amended Companies Act.

**Box 3.2. Pakistan Companies Act (2017) concept of "public interest company"**

According to the Third Schedule of the Pakistan Companies Act 2017, a company is considered a "public interest company" if it is a:

- (a) Listed company
- (b) Non-listed company which is :
  - (i) a public sector company as defined in the Act; or
  - (ii) a public utility or similar company carrying on the business of essential public service; or
  - (iii) holding assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity.
  - (iv) having such number of members holding ordinary shares as may be notified.
  - (v) holding assets exceeding such value as may be notified.

*Source:* Questionnaire response provided by the Pakistan Business Council's Centre of Excellence in Responsible Business, excerpted from the Pakistan Companies Act 2017, available at <https://www.secp.gov.pk/document/companies-act-2017/?wpdmdl=28472>.

***Risk management practices at the level of individual SOEs***

SOEs in Pakistan are not explicitly required to establish an internal risk management function or to employ risk officers or other staff specialised in risk management. Industry-specific rules in this respect are applicable to SOEs operating in the concerned sectors, for example prudential regulations elaborated by the State Bank of Pakistan that require all banks to employ senior-level Head of Risk Management. Box 3.3 provides a practical example of how the senior management of one large SOE, Pakistan Petroleum Limited, implements its internal risk management system. In practice, SOEs' internal risk management and control systems are generally assessed by external auditors, internal auditors and the board.

### **Box 3.3. Implementation of internal risk management by Pakistan Petroleum Limited**

A practical example of the internal risk management systems exercised by SOE's executive management could be Pakistan Petroleum Limited. It is one of the largest state-owned enterprises in Pakistan engaged in the exploration, production and operation of major oil and gas fields. At Pakistan Petroleum Limited, risk management is governed through an Executive Risk Management Committee (ERMC), with representation from core and support functions, which facilitates uniform implementation of risk management policies and procedures, supporting the drive towards fostering a risk intelligent culture across the company. This promotes a culture of risk ownership, where risk "owners" at the directorate/functional head level are responsible and accountable for monitoring and managing risks, duly supported by other participants within the company.

*Source:* Excerpted from questionnaire response provided by the Pakistan Business Council's Centre of Excellence in Responsible Business, based on the Pakistan Petroleum Limited Annual Report 2017.

### ***Role of the state in SOE risk management***

In Pakistan, the state as an owner generally communicates its risk tolerance levels through its board representatives, whose decisions are informed by related guidelines or notifications issued by the respective ownership ministries. For example, line ministries such as the Ministry of Water and Power and the National Electric Power and Regulatory Authority communicate their risk tolerance levels to the SOEs under their purview and request that the SOEs include related information in their performance reports. Similarly, the state monitors SOEs' internal risk management systems primarily through board representatives: SOE boards' risk management committees usually include one representative of the relevant line ministry. The state has not established a maximum leverage ratio or any related guidelines for SOEs, which reflects the broader absence of a common state ownership policy in Pakistan.

To ensure that SOE boards are adequately equipped to fulfil their functions (including, as relevant, oversight of risk management), the PSC Rules establish that "the Board shall consist of executive and non-executive directors, including independent directors and those representing minority interests with the requisite range of skills, competence, knowledge, experience and approach so that the board as a group includes core competencies and diversity considered relevant in the context of the Public Sector Company's operations". The state has not taken any steps to link SOE executive remuneration policy with risk-taking.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the Auditor General of Pakistan is responsible for undertaking performance audits of most SOEs, but does not appear to have an explicit responsibility for reviewing SOEs' risk management practices. Concerning reporting to the public, SOEs generally publish information on their risk management practices in the annual board of directors' report and the annual report's section on operations.

### 3.5. Philippines

#### *Legal and regulatory framework applicable to SOE risk management*

In the Philippines, SOEs, known as Government-Owned or – Controlled Corporations (GOCCs) in national nomenclature, are incorporated either subject to entity-specific legislation or to general company law (the Corporation Code of the Philippines). Risk management requirements for SOEs are established via a number of complementary laws and regulations, including notably (i) government-wide guidelines on internal control elaborated by the Department of Budget and Management; (ii) a complementary internal audit manual to support governmental agencies and SOEs in implementing effective internal controls; and (iii) the SOE corporate governance code elaborated by the Governance Commission for GOCCs (the state ownership coordinating entity). The SOE corporate governance code notably requires that SOE boards establish a risk management committee and an audit committee, together responsible for safeguarding the integrity of internal control and the transparency of the financial management system. It also assigns SOE boards responsibility for adopting a risk management policy. The SOE code reportedly contains somewhat less detailed requirements on risk management than the similar code applicable to listed companies in the Philippines. Concerning directors' duty of care, the SOE code establishes that SOE board members and officers owe a duty of diligence to the company and a duty of loyalty to both the company and the state.

SOEs are also subject to industry-specific risk management requirements as relevant, such as regulations issued by the Central Bank of the Philippines applicable to banks and non-bank financial institutions.

#### *Risk management practices at the level of individual SOEs*

All SOEs are at a minimum required to establish internal control systems and an internal audit function. SOEs are not uniformly required to hire specialised risk officers. However, SOEs operating in the financial sector are required to appoint a Chief Risk Officer or its equivalent, who must not undertake other executive and/or revenue-generating functions. The Chief Risk Officer in such financial companies is granted the authority to discuss key risk issues with the board of directors, the CEO and other members of senior management and to access any information deemed necessary to form a sound opinion on potential risks affecting the company. No examples were made available on the implementation of internal risk management systems by SOEs' executive management.

#### *Role of the state in SOE risk management*

No information was provided on the channels by which the state communicates its risk tolerance levels to SOEs in the Philippines. However, it was reported that the Governance Commission for GOCCs is currently developing a risk management framework to guide SOEs in implementing sound risk management practices. This framework could conceivably include guidance on the state's risk tolerance levels, which could subsequently inform SOE boards' strategies and financial targets.

To ensure that SOE boards are adequately equipped to fulfil their functions (including, as relevant, oversight of risk management), the Governance Commission recommends SOE board candidates to the President of the Philippines, based on pre-determined qualifications criteria. The SOE corporate governance code also explicitly requires SOEs to offer individual liability insurance to directors, to accord them the means to effectively

fulfil their fiduciary duty to act in the best interest of the SOE. The Philippine government does not appear to have taken any steps to link SOE executive remuneration policy with risk-taking.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the Commission on Audit is responsible, among others, for auditing the government's accounts and recommending measures to improve the efficiency and effectiveness of government operations. Regarding risk management, the Commission on Audit reportedly plans to develop a "Fraud-Risk Framework" for agencies to facilitate prevention, detection and mitigation of fraud risks. Concerning reporting to the public, the SOE corporate governance code requires that all SOEs maintain a website with information on financial and operational matters, including "any material risk factors and measures taken to manage such risks".

### 3.6. Thailand

#### *Legal and regulatory framework applicable to SOE risk management*

In Thailand, most SOEs are established via entity-specific legislation. A minority are incorporated according to general company law. SOE governance requirements are established primarily by a regulation of the Prime Minister concerning the roles and responsibilities of the State Enterprise Policy Committee. The Thai authorities reportedly plan to replace this regulation with a new State Enterprise Development Act currently under development, which would among others strengthen the supervisory authority of the Ministry of Finance as shareholder and establish additional measures to strengthen SOEs' transparency and corporate governance practices. With respect to risk management, the State Enterprise Policy Office (under the Ministry of Finance) has elaborated related guidelines addressed to SOEs, but they do not have a status equivalent to that of laws or regulations. Their provisions mirror those of the Stock Exchange of Thailand's guidelines on risk management applicable to listed companies. The guidelines notably encourage SOE boards to establish a risk management committee to oversee risk management practices within the company. The responses provided by the Thai authorities in the context of this report did not provide definitive information concerning whether SOE directors' duty of care is towards the company, the shareholders or both. However, Box 3.4 provides an overview of SOE directors' roles and duties, as established by the State Enterprise Policy Committee.

#### Box 3.4. Roles and duties of SOE directors in Thailand

In terms of “duty of care”, SOE boards of directors’ roles and duties have been categorised into the following four areas:

##### **I. Policy and planning**

- 1) Be responsible for determining SOE target and policy.
- 2) Supervise the SOE management in the preparation of a corporate plan.
- 3) Supervise the SOE management in the preparation of an action plan.

##### **II. Enterprise management**

- 1) Supervise the SOE management in establishing a suitable management structure, including with respect to accounting, finance, marketing, budgeting, procurement and internal control arrangements, and make SOEs more efficient.
- 2) Recommend SOEs’ management team for promotion or dismissal.

##### **III. Supervision**

- 1) Supervise SOEs’ operations and ensure positive revenues.
- 2) Supervise SOEs’ operations and compliance with government policy.
- 3) Monitor acts, regulations and cabinet resolutions related to SOEs’ operations and adopt them accordingly.
- 4) Support SOEs in complying with the government’s public private partnership policy.

##### **IV. Control**

- 1) Control, monitor and evaluate SOEs’ operational results and ensure that the operations comply with government policies.
- 2) Determine the system which will be used to evaluate SOEs’ operational results.
- 3) For SOEs that are subject to the Ministry of Finance’s performance management system, supervise the SOEs’ compliance with related timelines.
- 4) Supervise SOEs’ payment of dividends or other revenues to the Ministry of Finance.

*Source:* Edited excerpt of the questionnaire response provide by the State Enterprise Policy Office of Thailand.

#### ***Risk management practices at the level of individual SOEs***

In practice, the executive management of most Thai SOEs reportedly undertakes regular risk assessments which are subsequently reported to the board’s risk management committee. The assessments generally cover strategic, operational, financial and compliance risks and are often undertaken on a monthly basis. Internal risk management

practices are often informed by the related guidelines of the Stock Exchange of Thailand, but in some cases SOEs also use international enterprise risk management standards such as the Enterprise Risk Management Integrated Framework developed by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). SOEs are not required to employ risk management officers.

### ***Role of the state in SOE risk management***

The main channel through which the state communicates its risk tolerance levels to SOEs is through the Ministry of Finance's board representatives. The state monitors SOEs' risk management practices through both the SOE performance management system and through reporting from board representatives. SOEs' performance is assessed against a number of parameters, which include corporate governance and risk management practices. The process is overseen by a performance appraisal committee, which takes into account SOEs' risk exposure when deciding on financial targets against which to measure performance. The Thai government does not appear to have taken any steps to link SOE executive remuneration policy with risk-taking.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the Office of the Auditor General of Thailand does not play a direct role in overseeing SOEs' risk management practices. However, in the context of its financial audits, the state auditor could be in a position to comment on risk management issues that might come to light through the SOE's financial statements. Concerning public disclosure, the State Enterprise Policy Office (SEPO) publishes regular reviews on SOEs, which include information on their risk exposure. Individual SOEs also often include information on their risk management policy and practices in their annual reports.

## **3.7. Viet Nam**

### ***Legal and regulatory framework applicable to SOE risk management***

In Viet Nam, most SOEs are subject to the Law on SOEs, which is separate from general company law. SOEs are also required to comply with state "instruction decrees". The decree on state capital management (Decree 97/2012) notably requires that SOE boards establish dedicated committees charged with overseeing risk management. The state decree on SOE disclosure (Decree 81/2015/ND-CP) is also (at least peripherally) relevant in that it requires SOEs to periodically report to several state agencies on their financial operations and performance, which could in practice provide a basis for monitoring SOEs' risk management practices. The responses provided by the authorities of Viet Nam in the context of this report did not provide definitive information concerning whether SOE directors' duty of care is legally towards the company, the shareholders or both. However, responses confirmed that SOE boards are responsible, overall, for representing the interests of the state shareholder.

### ***Risk management practices at the level of individual SOEs***

In practice, many SOEs in Viet Nam reportedly establish internal risk management systems, supported by specialised committees and related internal regulations. The process entails an identification of material risk factors which are presented to the board periodically in risk management reports. SOEs are not required to employ specialised risk management officers, but in practice some SOEs do so, depending on the nature and scale

of their business operations. In a number of cases, senior management assigns the internal audit function the role of supervising and assessing internal risk management practices.

### *Role of the state in SOE risk management*

The state's risk tolerance levels are communicated SOEs primarily through instructions from the relevant shareholding ministries. These risk tolerance levels are reportedly taken into account when shareholding ministries set target rates of return. SOEs' maximum leverage ratios are decided by the shareholding ministries on a case-by-case basis. The primary channels through which the state monitors SOEs' internal risk management practices are (i) the SOE reporting process; (ii) regular discussions with the SOE boards of directors; and (iii) discussions with senior management on a periodic or as-needed basis.

To ensure that SOE boards are adequately equipped to fulfil their functions (including, as relevant, oversight of risk management), a decree on SOE board members issued in 2015 establishes explicit candidate criteria and outlines the foreseen selection process. The authorities do not appear to have taken any steps to link SOE executive remuneration policy with risk-taking.

Concerning the role of other state bodies with some degree of SOE oversight responsibility, the the state auditor of Viet Nam undertakes some risk management oversight functions, in the context of its periodic reviews of SOEs' operational and financial information. In practice SOEs generally do not disclose information on risk management to the public.



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