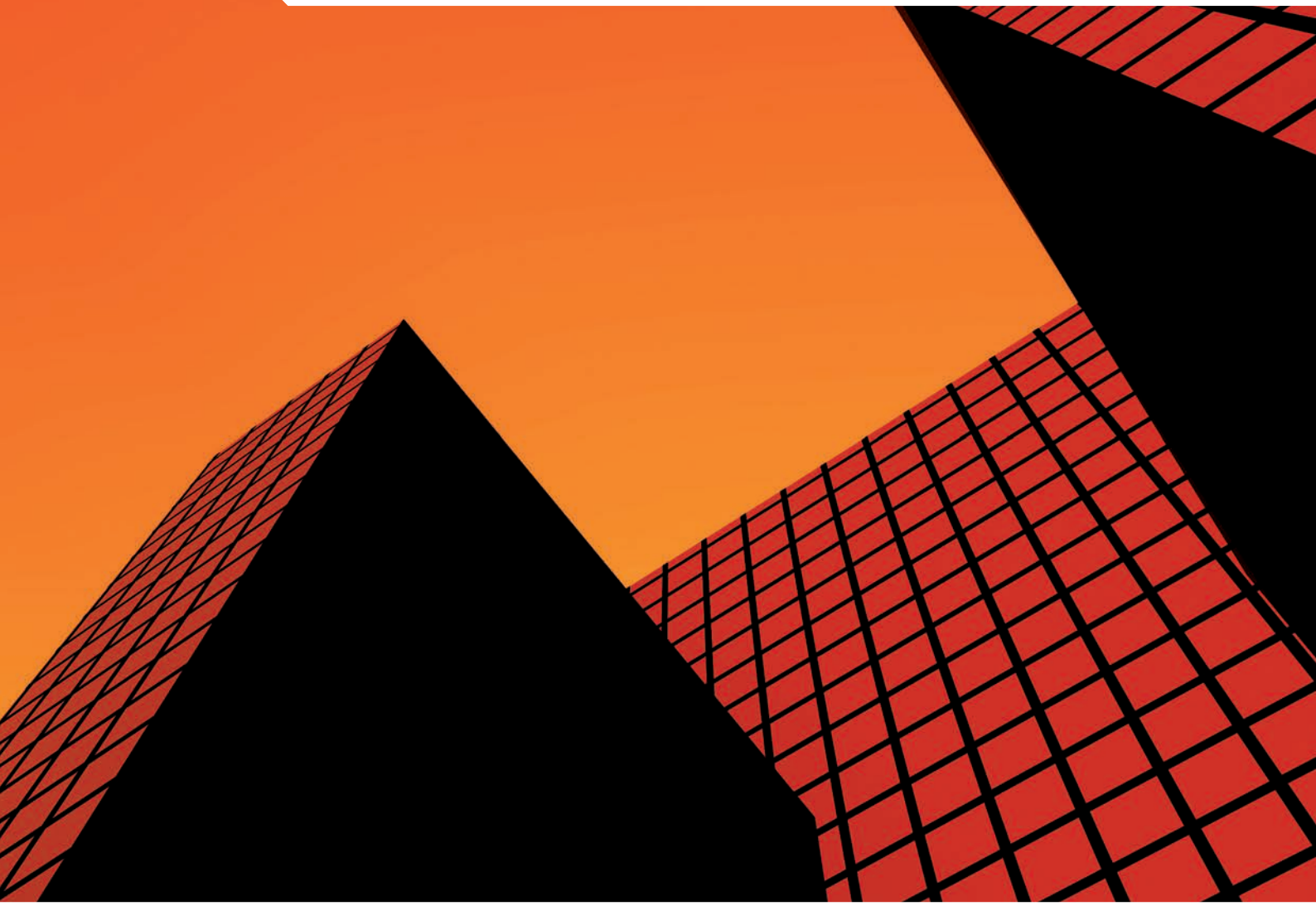
Corporate Governance

Corporate Governance in Costa Rica



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Foreword

This review of Corporate Governance in Costa Rica was prepared in the context of Costa Rica's accession process to the OECD, which was launched in April 2015 by decision of the OECD Council, and which led to an OECD Council decision on 15 May 2020 inviting Costa Rica to become the OECD's 38th Member country.

As part of its OECD accession process, Costa Rica underwent an assessment against the OECD's corporate governance standards for listed companies and state-owned enterprises (SOEs), namely the *G20/OECD Corporate Governance Principles* and the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*. It also reflects an assessment against the recently adopted *OECD Guidelines on Integrity and Anti-Corruption in State-Owned Enterprises.* These assessments were undertaken by the two OECD bodies responsible for these standards, the Corporate Governance Committee and its Working Party on State Ownership and Privatisation Practices. This review presents the results of that assessment and highlights the significant reforms undertaken by Costa Rica to further align its practices with these corporate governance standards.

Over the course of the accession review process, Costa Rica took significant measures to align its corporate governance framework and practices with OECD standards. For listed companies, these included, amongst others, the passage of a new corporate governance regulation, a regulation requiring regulated financial entities to transition to International Financial Reporting Standards (IFRS), and the enactment of a law to allow the securities market regulator to access and exchange information on beneficial ownership for the purposes of enforcement. These measures have helped strengthen Costa Rica's framework for the corporate governance of listed companies.

Costa Rica has also demonstrated a significant commitment to implementing better governance in its SOEs, including through the establishment of a Presidential Advisory Unit for the oversight of SOEs, requiring SOEs to comply with IFRS, a decree on the roles and responsibilities of SOE boards, a decree on SOE disclosure and transparency, legislation on creating a deposit insurance scheme to advance towards a more level playing field between SOE and private sector banks, the reform of SOE procurement procedures and the establishment of aggregate reporting on SOEs. These measures attest to Costa Rica's commitment to promoting more efficient SOEs, greater transparency and fair and open competition.

This review also includes a number of recommendations for continued improvement, with a view to ensuring that companies and markets create optimum value for the Costa Rican economy and society. In the future, as an OECD Member, Costa Rica will have the opportunity to further benefit from the reform experiences and expertise of its peers as it pursues its corporate governance reforms.

Successive versions of the review informed seven separate accession review discussions on Costa Rica held by the OECD Corporate Governance Committee and its Working Party on State Ownership and Privatisation Practices between October 2016 and October 2019, and its conclusions and recommendations reflect both bodies' assessments. However, reference to more recent developments through March 2020 have also been incorporated into this report.

The principal author of the review is W. Richard Frederick, under the oversight of Daniel Blume, and with project co-ordination and support of Katrina Baker of the OECD Directorate for Financial and Enterprise Affairs, building on an initial self-assessment of Costa Rica against the *G20/OECD Principles of Corporate Governance* and a detailed questionnaire response on Costa Rican SOEs prepared by the government and regulatory authorities of Costa Rica. It has benefited from substantial input from the Costa Rican government authorities throughout the accession process.

In accordance with paragraph 14 of the Roadmap for the Accession of Costa Rica to the OECD Convention, setting out the terms, conditions and process for accession, the Corporate Governance Committee agreed to declassify this review and publish it under the authority of the Secretary-General in order to allow a wider audience to become acquainted with its content.

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Glossary of terms and institutions

Acronym/term	Name in Spanish	Name in English
ARESEP	Autoridad Reguladora de los Servicios Públicos	Regulatory Authority for Public Services
Asamblea	Asamblea Legislativa	Legislative Assembly
ASDEICE	Asociación Sindical de Empleados Industriales de las Comunicaciones y la Energía	Association of Industrial Communications and Energy Employees Unions
AyA	Instituto Costarricense de Acueductos y Alcantarillados	Institute of Aqueducts and Sewers
BCR	Banco de Costa Rica	Bank of Costa Rica
BNV	Bolsa Nacional de Valores	National Securities Exchange
CANAFIC	Cámara Nacional de Finanzas, Inversiones y Crédito	National Chamber of Finance, Investment and Credit
CCPA	Colegio de Contadores Públicos de Costa Rica	Chamber of Certified Public Accountants
CGR	Contraloría General de la República	Comptroller General
CNE	Comisión Nacional de Prevención de Riesgos y Atención de Emergencias	National Commission of Risk Prevention and Emergency Response
CNFL	Compañía Nacional de Fuerza y Luz	National Energy and Electric Company
CODESA	Corporación Costarricense de Desarrollo	Costa Rican Development Corporation
COMEX	Ministerio de Comercio Exterior de Costa Rica	Ministry of Foreign Commerce of Costa Rica
CONAPE	Comisión Nacional de Préstamos para Educación	National Commission for Education Loans
CONASSIF	Consejo Nacional de Supervisión del Sistema Financiero	National Council for the Supervision of the Financial System
Consejo de Gobierno	Consejo de Gobierno	Council of Ministers
COPROCOM	Comisión para Promover la Competencia	Commission for the Promotion of Competition
FONATEL	Fondo Nacional de Telecomunicaciones	National Telecommunications Fund
Gerente General		General Manager
GSM	Junta General de Accionistas	General Shareholders Meeting
IAASB	El Consejo de Normas Internacionales de Auditoría y Aseguramiento	International Auditing and Assurance Standards Board
IAS	Norma Internacionales de Contabilidad (NIC)	International Accounting Standards (IAS)
IASB	Junta de Normas Internacionales de Contabilidad	International Accounting Standards Board
ICE	Instituto Costarricense de Electricidad y Telecomunicaciones	Costa Rican Institute of Electricity and Telecommunications
IDB	Banco Interamericano de Desarrollo (BID)	Inter-American Development Bank (IDB)

Acronym/term	Name in Spanish	Name in English
IFAC	Federación Internacional de Contadores	International Federation of Accountants (IFAC)
IFRS	Normas Internacionales de Información Financiera (NIIF)	International Financial Reporting Standards (IFRS)
IGC	Instituto de Gobierno Corporativo de Costa Rica	Costa Rican Institute of Corporate Governance (ICG)
INCOFER	Instituto Costarricense de Ferrocarriles	Costa Rican Railways
INFOCOOP	Instituto Nacional de Fomento Cooperativo	National Institute of Co-operative Development
INS	Instituto Nacional de Seguros	National Institute of Insurance
IVM	El Régimen de Invalidez, Vejez y Muerte	Regime for Disability, Old Age and Death
JAPDEVA	Junta de Administración Portuaria y de Desarrollo Económico de la Vertiente Atlántica	Atlantic Economic Development and Port Administration Board
JASEC	Junta Administrativa de Servicios Eléctricos de Cartago	Administrative Board of Carthage Electrical Services
MEIC	Ministerio de Economía, Industria y Comercio	Ministry of Economy, Trade and Industry
MIDEPLAN	Ministerio de Planificación Nacional y Política Económico	Ministry of National Planning and Economic Policy
MOPT	Ministerio de Obras Públicas y Transportes	Ministry of Public Works and Transport
OE	Unidad Asesora de la Propiedad Accionaria del Estado	Ownership Entity and/or Presidential Advisory Unit
PND	Plan Nacional de Desarrollo	National Development Plan (NDP)
PNDIP	Plan Nacional de Desarrollo y de Inversión Pública	National Development and Public Investment Plan (NDPIP)
Presidente		Chairman
Presidente Ejecutivo		Executive Chairman
PyME	Pequeña y Mediana Empresa	Small and Medium-sized Enterprise (SME)
RACSA	Radiográfica Costarricense	Costa Rican Radiographic
RECOPE	Refinadora Costarricense de Petróleo	Costa Rican Petroleum Refinery
ROSC	Informe sobre el Cumplimiento de Códigos y Normas	Report on Observance of Standards and Codes
S.A.	Sociedad Anónima	Corporation in civil law equivalent to Public Limited Company (PLC)
SALES	Sociedades Anónimas Laborales	Employment agencies
SCIJ	Sistema Costarricense de Información Jurídica	Costa Rican System on Juridical Information
SME	Pequeña y Mediana Empresa (PyME)	Small and Medium-sized Enterprise
SUGEF	Superintendencia General de Entidades Financieras	Financial Supervisor
SUGESE	Superintendencia General de Seguros de Costa Rica	Insurance Supervisor
SUGEVAL	Superintendencia General de Valores	Securities Supervisor
SUPEN	Superintendencia de Pensiones	Pensions Supervisor
SUTEL	Superintendencia de Telecomunicaciones	Telecommunications Supervisor

Executive summary

This review assesses Costa Rica's corporate governance framework for both listed and state-owned enterprises and Costa Rica's ability and willingness to implement the *G20/OECD Principles*, *SOE Guidelines* and the *Guidelines on Anti-Corruption and Integrity (ACI) in SOEs*. While challenges remain, Costa Rica has responded to most of the prioritised concerns raised by the OECD over the course of the accession review process.

Costa Rica has closely aligned its governance regulations for listed companies with the *OECD/G20 Principles*. However, its equities market lacks sufficient size and liquidity to attract active trading. The equities market is small both in nominal terms and as a percentage of GDP. Trading is concentrated mainly in a single company and, in most years, some of its 10 listed companies have no trading activity at all. Banks and financial intermediaries play a greater role in financial intermediation.

The securities supervisor (SUGEVAL) and listed companies have co-operated in developing proportional approaches to implementing Costa Rica's new Corporate Governance Regulation, which is having a positive impact on governance practices. The regulation is modelled after OECD practice and is being implemented using a risk-based supervisory approach.

Costa Rica's 28 SOEs play a far greater role in the economy than listed companies and pose greater governance challenges. Better governance practices are needed for SOEs to perform sustainably. Improvements in the governance of SOEs could yield an increase of as much as 1.1% of GDP per capita while the enhancement of competition and the creation of a level playing field could improve GDP per capita by 0.5%, according to one assessment.

Regarding the overall effectiveness of the corporate governance framework, Costa Rica is in line with the *G20/OECD Principles*, which call for a framework that promotes transparent and fair markets, and the efficient allocation of resources, and which is consistent with the rule of law and supports effective supervision and enforcement.

Regarding the enforcement of shareholder rights and the equitable treatment of shareholders, Costa Rica is aligned with the core OECD principle. Shareholders have the opportunity to participate effectively and vote in general shareholder meetings. The framework for the supervision of related party transactions is in place. There are norms regulating conflicts of interest, and both insider trading and market manipulation are prohibited. Some weakness was seen in minority shareholder protection, though recently improved.

While listed companies comply with International Financial Reporting Standards (IFRS), SOEs fall short. All listed non-financial companies must report according to IFRS. Listed financial firms must comply with current IFRS beginning in 2020, with certain exceptions phased in by 2024. The same deadline applies to financial SOEs. Amongst non-financial SOEs, three SOEs prepared 2018 statements according to IFRS of which two received an unqualified (positive) opinion from their external auditors and one received a qualified (negative) opinion. The remaining non-financial SOEs report according to national standards. The significant number of negative audit opinions in SOEs is a concern.

With respect to the separation of the state's role as owner versus regulator, there is no clear separation between commercial and policy objectives within SOEs. The separation of the roles of owner versus regulator is more apparent with respect to market regulation of the telecommunications and financial sectors. However, in SOEs, policy objectives often take primacy over commercial objectives. A stronger shareholder perspective is expected to emerge with the establishment of Costa Rica's Presidential Advisory Unit for SOE oversight in 2018. The unit issued an ownership policy in 2019, which expressed Costa Rica's commitment to bringing SOE governance in line with good practice. The unit issued a first aggregate report on the SOE sector and plans to develop further guidance on governance policies and practices.

Regarding ensuring a level playing field between state-owned and private enterprises, there are many distortions in the competitive landscape in particular in the financial sector. The recent adoption of a bill on deposit insurance for banks represents a step towards levelling the playing field. Furthermore, the government has submitted draft legislation to reform the Procurement Law to achieve greater efficiency and competition in public procurement. However, significant differences remain.

Regarding the recognition of stakeholder rights, Costa Rica is largely aligned with this core principle. The rights of corporate stakeholders are set down in labour, insolvency, shareholder, consumer and environmental protection laws, and banking legislation. Stakeholders may seek recourse through the courts though a significant weakness is the slowness of the judicial system. Legislation has been proposed to modernise the insolvency framework.

Regarding the duties, rights and responsibilities of boards, laws and regulations for listed companies are consistent with the G20/OECD Principles, while SOE boards' performance has been variable and has potential to improve. Scandals and recent fiscal reforms generated greater awareness of the importance of SOE governance, which increased the government's commitment to strengthening their boards, including through initiatives to strengthen SOE board composition and practices.

Costa Rica reports that its policy framework is aligned with the recommendations of the *ACI Guidelines* and that it is committed to improving anti-corruption and integrity standards in its SOEs. The "Cementazo" scandal emerged in mid-2017, featuring allegations of corruption in the Bank of Costa Rica, abetted by weak governance practices. It revealed the vulnerability of SOEs to corruption and the importance of strengthening boards and their capacity to oversee internal controls, and raised awareness of anti-corruption and integrity issues.

While challenges for listed companies remain, far greater attention is warranted in the SOE sector given its relative size. Despite establishing many remedial laws and institutional structures, this report recommends that Costa Rica take further steps to reduce risks and unlock the potential of stronger SOE performance. Priorities include fully implementing IFRS, establishing and monitoring financial and non-financial performance objectives, developing a consistently applied policy concerning information confidentiality, enacting pending legislation related to public procurement and a number of measures to further strengthen the composition and functioning of boards. Additional recommendations include corporatising and streamlining SOE legal and corporate reforms, and defining, assessing and reporting the costs of achieving public service objectives for each SOE

1 Introduction

This review of Corporate Governance in Costa Rica was prepared for the evaluation by the OECD Corporate Governance Committee in the context of Costa Rica's accession process to the OECD, to assess the corporate governance arrangements for listed and state-owned enterprises in Costa Rica against the G20/OECD Principles of Corporate Governance and the OECD Guidelines on Corporate Governance of State-Owned Enterprises. This introductory chapter provides an overview of the process and methodology of the review, including reference to the core corporate governance principles used to inform the assessment. The chapter also summarises measures taken by Cost Rica throughout the accession review process to implement OECD recommendations and further align Costa Rica's legal and regulatory framework and practices with OECD corporate governance standards.

The OECD Council's *Roadmap for the Accession of Costa Rica to the OECD Convention* (the *Roadmap*) called upon the Corporate Governance Committee, supported by its Working Party on State Ownership and Privatisation Practices, to assess Costa Rica's willingness and ability to implement the OECD's legal instruments in the field of corporate governance, and to evaluate its policies and practices. This review presents Costa Rica's progress in implementing the *Recommendation of the Council on Principles of Corporate Governance [OECD/LEGAL/0413] (hereafter the "G20/OECD Principles") and the Recommendation of the Council on Guidelines on Corporate Governance of State-Owned Enterprises [OECD/LEGAL/]0414]. (hereafter the "SOE Guidelines".* In addition, during the review process, a third OECD standard in the field of corporate governance was adopted by the OECD Council, the *Recommendation of the Council on Guidelines on Integrity and Anti-Corruption in State-Owned Enterprises [OECD/LEGAL/0451]* (the "ACI Guidelines"), which constituted an additional reference for this assessment. The *Roadmap* [C(2015)93/FINAL] focuses on five core corporate governance principles:

- Ensuring a consistent regulatory framework that provides for the existence and effective enforcement of shareholder rights and the equitable treatment of shareholders, including minority and foreign shareholders;
- Requiring timely and reliable disclosure of corporate information in accordance with internationally recognised standards of accounting, auditing and non-financial reporting;
- Establishing effective separation of the state's role as an owner of state-owned enterprises and the government's role as regulator, particularly with regard to market regulation;
- Ensuring a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions; and
- Recognising stakeholder rights as established by law or through mutual agreements and the duties, rights and responsibilities of corporate boards of directors.

The review was guided by the document entitled *Concepts to Guide Corporate Governance Accession Reviews* (the Concept Paper). The Concept Paper provides a methodology for conducting accession examinations. It identifies which *G20/OECD Principles* and *SOE Guidelines* recommendations are most relevant for assessing accession candidate countries against the five *Roadmap* principles.

The review draws upon a variety of sources including: information provided by the Costa Rican authorities in response to an OECD questionnaire on the Guidelines; Costa Rica's Self-Assessment against the *G20/OECD Principles*; and Costa Rica's Initial Memorandum, stating its position against the Guidelines and *G20/OECD Principles*. The Secretariat has worked in close co-operation with the Costa Rican authorities to obtain additional information, including through fact-finding missions that included discussions with a range of public officials, managers and board members of listed companies, state-owned enterprises, market participants, and other experts. Oral and written progress reports by the Costa Rican delegation to the Working Party and to the Committee also provided input to the review process. Other OECD Committee reviews of Costa Rica, independent research and press reports were also important sources of information. Successive versions of this review were made available as background to seven separate accession discussions held by the OECD Corporate Governance Committee and its Working Party on State Ownership and Privatisation Practices between October 2016 and October 2019. Box 1.1 summarises the key measures taken by the Costa Rican authorities to implement the recommendations communicated to Costa Rica in the context of the corporate governance accession review process.

Box 1.1. Key measures taken to implement recommendations from the corporate governance accession review of Costa Rica

To support the implementation of the *G20/OECD Principles* and the governance of listed companies:

- Development of a new Corporate Governance Regulation for listed companies modelled on international best practice.
- Implementation of the Corporate Governance Regulation through Risk-Based Supervision.
- Engagement of the securities market supervisor with listed companies while implementing the Corporate Governance Regulation, which permitted an exchange of views and adaptation of expectations and approaches.
- Development by listed companies of corporate governance codes with feedback from the securities market supervisor.
- Raising awareness and commitment to reform amongst the securities market supervisor and companies.
- Passage of a regulation that requires regulated financial entities to transition to IFRS.
- Enactment of laws to strengthen and consolidate supervisory responsibilities, including reinforced oversight of the audit profession and a requirement to report beneficial ownership to supervisory authorities to enable Costa Rica to become a signatory to the IOSCO Multilateral Memorandum of Understanding on exchange of information for purposes of enforcement.
- Introduction of a bill to the Legislative Assembly to modernise Costa Rica's insolvency framework.

To support the implementation of the *SOE Guidelines* and the *ACI Guidelines*:

- The creation of an SOE ownership entity (Presidential Advisory Unit)
- The staffing of the Presidential Advisory Unit with staff who have developed:
  - An ownership policy (Protocol of Understanding on the Relations between the state and the Enterprises under its Property)
  - An aggregate report on SOEs with comparative information on financial and non-financial performance and SOE governance practices
  - An SOE board member nominations policy
  - A website to manage board member nominations and an applicant pool
- Issuance of legal requirements for compliance with IFRS and commitment to a process of closing the gaps with IFRS
- Additional legal and regulatory changes, including:
  - A law enacted to remove the Minister of Energy and Environment from the board of the state-owned petroleum refinery company RECOPE
  - A law to establish a deposit insurance programme covering both state-owned and private sector banks to contribute to a more level playing field in the banking sector
  - A decree on the roles and responsibilities of SOE boards
  - A decree on the transparency of SOEs
  - A decree on board performance evaluation

- Government's intent to remove the Minister of Agriculture from the board of the institution that oversees the national liquor production company FANAL and transform it into a government concession
- Draft legislation to reform public procurement involving SOEs.
- Greater awareness of the importance of corporate governance to the performance of SOEs, an increase in commitment to reform and concrete measures with respect to board composition and board evaluations.
- Development of a training programme for SOE board members, executives and government officials on good corporate governance

The review is structured as follows. The Introduction (Chapter 1) is followed by an overview of Costa Rica's corporate governance landscape (Chapter 2); a detailed review of Costa Rica's practices against each of the five *Roadmap* core principles (Chapter 3); Costa Rica's framework for combatting corruption and review against the OECD Anti-Corruption and Integrity Guidelines for SOEs (Chapter 4); and conclusions and recommendations for strengthening corporate governance in Costa Rica (Chapter 5).

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OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition*, OECD Publishing, Paris, https://doi.org/10.1787/9789264244160-en.

OECD (2019), *Guidelines on Anti-corruption and Integrity in State-Owned Enterprises*, www.oecd.org/corporate/Anti-Corruption-Integrity-Guidelines-for-SOEs.htm

2 The corporate governance landscape

This chapter describes the corporate governance arrangements—the laws, regulations and institutions that shape company oversight—for both listed and state-owned enterprises in Costa Rica. Following an introductory overview of Costa Rica's economic context and business climate, the chapter describes the corporate ownership and control landscape for Costa Rica's 41 national issuers, including 10 listed for equity trading and the remainder for bonds. It then details the laws, regulations and institutions that constitute the corporate governance framework for these companies, with an overview of recent related legislative reforms. This is followed by a descriptive overview of the corporate governance arrangements for Costa Rica's 28 state-owned enterprises including a synthesis of recent or ongoing state ownership reforms.

The economy[1]

Costa Rica has been able to combine strong economic performance with rising living standards and a sustainable use of natural resources. In the past three decades, real GDP per capita has nearly doubled as the economy evolved from a rural and agriculture-based economy to one with high value-added industries linked to global value chains. Value-added is generated mainly in the service sector with 73% of total value added followed by industry and construction (21%) and the primary sector (5%).[2] The process of opening up to international trade and attracting foreign direct investment that started in the early 1980s has diversified the country's production, boosted exports and improved labour force utilisation.

Costa Rica provides virtually universal access to health care, pensions and education. It has low poverty by Latin American standards, low infant mortality and a life expectancy of 80 years, which is close to the average of the OECD. Its well-being indicators[3] are comparable or even above the OECD average on several dimensions. Costa Rica is also a leader in environmental sustainability. It has built a world-renowned green trademark and a strong eco-tourism industry based on judicious management of natural resources focusing on forest protection and renewable energy sources.

There are, however, a number of significant economic challenges, including anti-competitive regulations, high labour market segmentation, and stubborn unemployment. Inequality is high with approximately 43% of workers holding informal jobs. In spite of high education spending, outcomes are poor and overly complex regulations hold back entrepreneurship and innovation. The budget deficit exceeded 5% of GDP for the past five years and, as a consequence, central government debt soared from less than 25% of GDP in 2008 to 49% in 2017. These challenges and the public deficit have factored into the downgrading of Costa Rica's debt to below investment grade. The OECD Economic Survey 2018 concludes that, in order to ensure sustainable and inclusive growth, Costa Rica should focus on:

1. *Improving macroeconomic stability* (by reducing the budget deficit, streamlining public sector employment, and depoliticising the governance of the Central Bank among others);
2. *Making growth more inclusive*; and
3. *Boosting productivity growth* (by enhancing competition, reducing unnecessary bureaucracy and barriers to entrepreneurship, and innovation among others).

A key component of boosting productivity should be structural reforms that focus specifically on competition and the corporate governance of state-owned enterprises (SOEs). Though corporate governance of listed companies should not be lost from sight, SOEs play a far more significant role in the Costa Rican economy than equity listings which are both low in number and small in proportion to GDP.

A simulation undertaken for the OECD Economic Survey of the potential impact of some of the structural reforms suggests that improvements in the governance of SOEs could yield an increase of as much as 1.1% of GDP per capita. The removal of anti-trust exemptions (the enhancement of competition and the creation of a level playing field) could potentially improve GDP per capita by 0.5% and improved insolvency procedures could yield an improvement of up to 5.4%. The improvement in the employment rate is projected to be 0.3%, 0.2% and 1.1% respectively for the aforementioned reforms.[4]

The fragmented institutional framework for public sector institutions, highlighted in both the OECD Economic Survey (2018) and the OECD Public Governance Review of Costa Rica (2015),[5] also has implications for the SOE sector. Many government institutions, as well as SOEs, have independent budgets which are not approved or vetted by the Legislative Assembly, but only reviewed by the Comptroller General and the Ministry of Finance from a legal and compliance perspective. Transfers to

SOEs are automatic (earmarked) and ensured by separate legislation to avoid day-to-day political interference in the management of SOEs. An advantage of earmarking is that it protects resources for programmes or services, while a drawback is that it may contribute to budgetary rigidity and create economic distortions.[6] The OECD Economic Survey (2018) concludes that the use of legally mandated spending and earmarking of government revenues in Costa Rica is excessive.

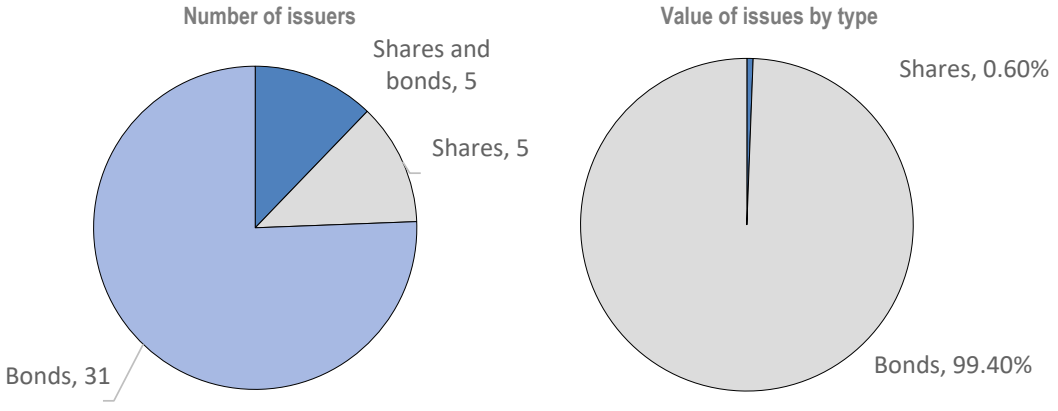
The capital market

All trading of equities and bonds in Costa Rica occurs on the National Securities Exchange (Bolsa Nacional de Valores, BNV).[7] Most of the issues traded on the BNV are in the form of bonds. Like many other securities exchanges, the BNV is experiencing decreasing interest in equity listings consistent with international trends and an increasing use of alternative investment vehicles. Prior to 2016, the BNV had sought to combat this trend through a 4-year initiative to promote the capital market. A strong government commitment and a willingness to list some of Costa Rica's largest SOEs on the BNV was advocated by some stakeholders as necessary for the market to grow.

The BNV has been conscious of the role of good governance in the establishment of a successful capital market. It has actively promoted good governance practices in an effort to raise the quality of the market and make it more attractive to investors. The BNV partners with the Costa Rican Institute of Corporate Governance (ICG) to whom it provides an annual stipend to organise conferences, train companies and investors, and provide other assistance in the area of corporate governance.

A total of 41 different national issuers use the BNV for equity or bond issues. Only 10 of these use the BNV for equity financing and none of these are SOEs or SOE banks. The other 31 entities referred to above use the BNV to raise capital through bond issues.[8]

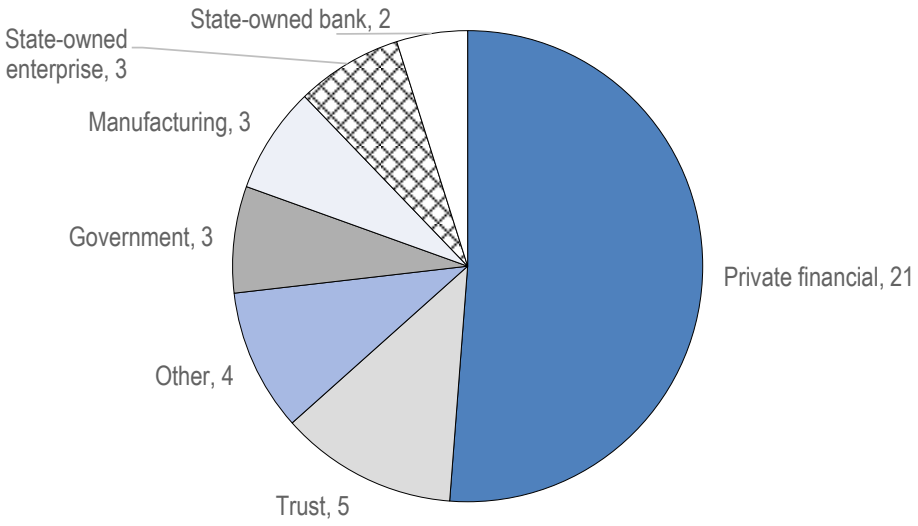
Figure 2.1. Types and value of issues



Source: SUGEVAL as of 31/12/2019.

The overriding significance of the bond market is clear when one considers the value of the different types of issues on the BNV. The total value of national bond and share issues combined was approximately USD 71 billion as of 31 December 2019 with 99.4% of the value raised in the form of bonds and the remaining 0.6% in the form of equity. Seventy-seven percent of the total issued was denominated in Costa Rican colones with the remaining 23% denominated in US dollars.[9]

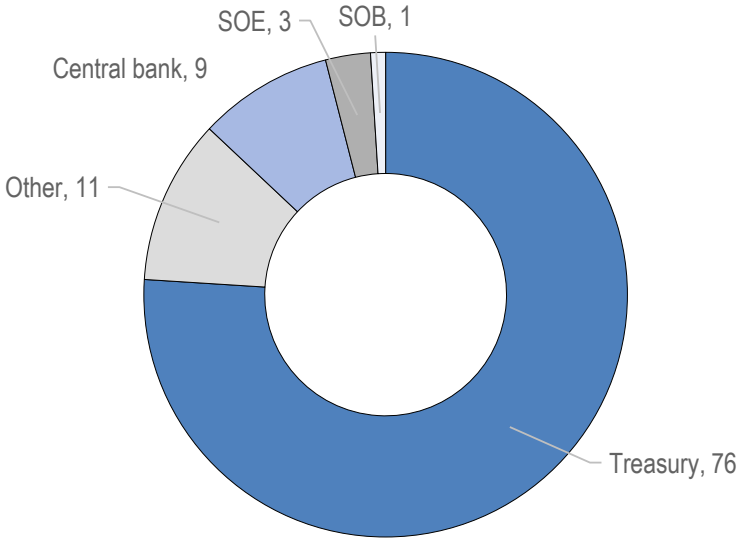
Figure 2.2. Number of national issuers by sector



Source: SUGEVAL as of 31/12/2019.

The most common profile of an issuer on the BNV is that of a private financial institution (21 of 41 issuers). However, in terms of value, the bond market is dominated by public institutions. The Costa Rican Ministry of Finance and the Central Bank combined make up approximately 85% of the total bond value issued on the BNV with non-financial SOEs and SOE banks representing an additional 4% of the total value issued. All other issuers combined represent only 11% of the value of national bond issues. The corporate bond market is, thus, comparatively small, with SOEs, in turn, representing only a fraction.

Figure 2.3. Composition of the national bond market by value (%)



Source: SUGEVAL as of 31 December2019.

Most share issuers on the BNV are active in the financial sector and tend to be closely held and of modest size. Some are subsidiaries of large international groups such as Holcim, which is part of Lafarge Holcim, a global leader in cement.

Table 2.1. Companies with share issues

Share Issuers	Sector
Ad Astra Rocket Company	Technology
Banco Cathay De Costa Rica S.A.	Private Financial
Corporación Davivienda (Costa Rica) S.A.	Private Financial
Corporación Ilg Internacional S.A.	Private Financial
Grupo Financiero Improsa S.A.	Private Financial

Source: SUGEVAL as of 31 December2019.

Table 2.2. Companies with both bond and share issues

Share and Bond Issuers	Sector
Florida Ice & Farm Company S.A. (FIFCO)	Beverages
Holcim (Costa Rica) S.A.	Cement
Banco Lafise S.A.	Private Financial
Banco Promérica De Costa Rica S.A.	Private Financial
La Nación S.A.	Media

Source: SUGEVAL as of 31 December2019.

Limited demand and easy access to finance have led to a decrease in the number of companies whose shares are publicly traded from a high of 31 in 1994 to 10 in 2018.[10] Costa Rica's equities market is small both in nominal terms and as a percentage of GDP, and is not generally considered an investable market by large international institutional investors. Table 2.3 below provides a comparison of the size of the equities market for other recent candidates for OECD accession as well as selected Latin American countries.

Table 2.3. Relative size of equities markets

Country/income category/region	Market capitalisation of listed domestic companies (% of GDP)	Stocks traded, total value (% of GDP)
Costa Rica[1]	3.5% (2019)	0.6% (2019)
Latvia	3.9% (2012)	0.1% (2012)
Lithuania	9.4% (2012)	0.4% (2012)
Panama	24.1% (2018)	0.5% (2014)
Mexico	31.5% (2018)	7.7% (2018)
Colombia	31.4% (2018)	4.1% (2018)
Latin America & Caribbean	40.1% (2018)	20.8% (2018)
Upper Middle Income Countries [2]	47.5% (2018)	70.1% (2018)
OECD Members	108.2% (2018)	115.4% (2018)

1. Data for Costa RIca provided by SUGEVAL
2. Note: Costa Rica is classified as Upper Middle Income.
Source: World Bank Data Catalogue and World Federation of Exchanges Database

The small size of the equities market is a result of several factors. For one, Costa Rica's economy is dominated by family-owned businesses and SMEs that have not needed to access the equities markets. In addition, alternative financing is available at competitive rates from private and state-owned banks as well as private equity investors. Table 3.5 below illustrates the availability of alternative sources of finance from Banks and Financial Intermediaries (BFIS). Securities markets are comparatively small with assets representing only 1.36% of GDP.

Table 2.4. Structure of the financial system

National financial system: Assets in terms of GDP (%), 2017	
Banks and Financial Intermediaries (BFIS)	94.68%
Insurance market	6.93%
Securities market	1.36%
National pension system (managers)	0.17%
Total assets	103.13%

Source: CONASSIF.

It is worth noting that the role of the state within the BFIS category is significant. State-owned banks, banks operating under special charters by the state, and savings and loan co-operatives provide the preponderance of lending with correspondingly less lending provided by the private sector.

Table 2.5. Breakdown of banks and financial Intermediaries

Number of companies and asset composition of banks and other financial intermediaries as of 2019		
Type of company	Number	Percent of Assets
State-owned banks	2	36.3%
Private banks	11	32.4%
Banks created by special laws	2	11.1%
Savings and loan co-operatives	22	11.0%
Other financial institutions	1	4.3%
National Housing System institutions	2	3.7%
Non-bank financial companies	5	1.1%
Currency-exchange institutions	2	0.0%
Total BFIS:	**47**	**99.9%**

Notes: As a result of the cessation of operations of Bancrédito, the total number of SOE banks as of January 2019 was two. The sum total percentage does not total 100% due to rounding.
Source: SUGEF

A crucial question with respect to Costa Rica's equities markets regards their ability to serve as a price discovery mechanism. OECD Principle III.G suggests that *"Stock markets should provide fair and efficient price discovery as a means to help promote effective corporate governance."* Price discovery depends on a variety of factors, principally the number of buyers and sellers in a market, the number of shares for sale, and the number of transactions in a given trading period. Each of these factors is limited in Costa Rica.

A significant limitation to price discovery is the limited number of share transactions on the BNV. For most listed companies, weeks and even months may pass without any buying or selling. In 2019, one company (Corporación Davivienda Costa Rica S.A.) had no trading activity at all. Of the total trading volume of USD 40.9 million for 2019, 81% was in Florida Ice & Farm Company S.A. (FIFCO) with the

next most traded company being Holcim Costa Rica) with 7.4%. Average monthly trading volume for the entire BNV was USD 3.4 million for 2019. However, the average is misleading since it mainly reflects trading in FIFCO shares. The median trading volume for individual companies is nominal during most months. Median monthly trading volume for the entire BNV was USD 2.5 million in 2019. It is important to put this figure in perspective. The Russell Europe Small and Mid-cap (SMID) 300 Index excludes all company shares below an average daily trading volume (ADTV) of EUR 2 million.[11]

Another limitation is that Costa Rican companies generally have limited free float. Free float refers to the number and proportion of shares easily available to buyers for investment. As a point of reference, the eligibility criterion for a stock to be considered for inclusion in the S&P 500 is that the public float needs to be at least 50% of the security. The companies with the highest free float in Costa Rica are Florida Ice & Farm Company S.A., La Nación and Grupo Financiero Improsa. In most other companies, the free float is nominal. In fact, the figures in the table below overstate the free float since investors in Costa Rican listings tend to retain their holdings for extended periods of time with the consequence that shares are not generally available to the public for purchase.

Table 2.6. Ownership structure of equities listings

Name of listed company	Ownership concentration (ascending order)	Breakdown of major holdings
Florida Ice & Farm Company S.A. (FIFCO)	<10%	No shareholder by itself or by any intermediary has more than 10% of the shares in circulation
La Nación S.A.	39.79%	Held by 3 shareholders (legal persons) with 10.22%, 12.65% and 16.92%
Grupo Financiero Improsa S.A.	41. 52%	Held by 2 shareholders (legal persons) with 17.11% and 24.41% respectively
Corporación Ilg Internacional, S.A.	60.60%	Held by 3 shareholders (legal persons) with 13.83%, 19.35% and 27.41% respectively
Holcim (Costa Rica) S.A.	65.00%	Held by 1 shareholder (foreign legal person)
Ad Astra Rocket Company	66.89%	Held by 1 shareholder
Banco Promerica De Costa Rica, S.A.	97.01%	Held by a holding company (Promerica Financial Corporation)
Banco Lafise S.A.	97.08%	Held by a holding company (Corporación Lafise Controladora, S.A.)
Corporación Davivienda (Costa Rica) S.A.	99.97%	Held by Grupo del Istmo (Costa Rica) S. A.
Banco Cathay De Costa Rica Sociedad Anónima	100.00%	Held by a holding company (Grupo Finanzas Cathay, S.A.)

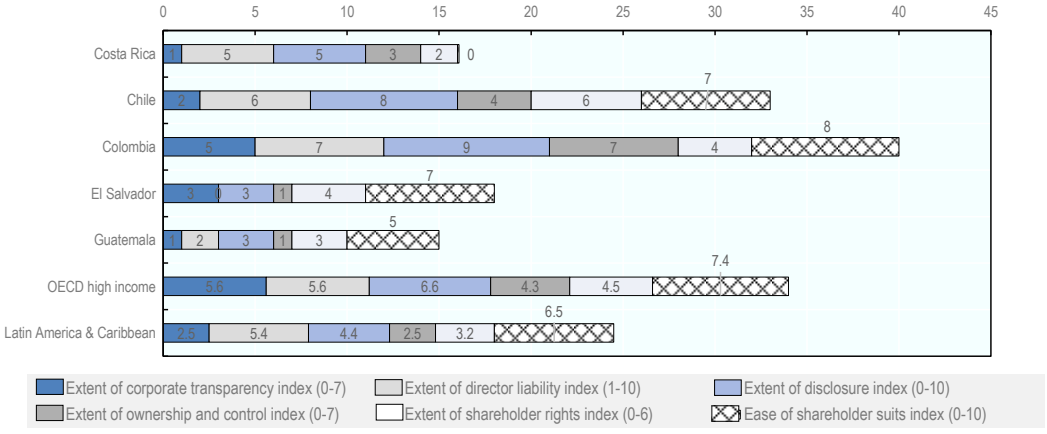
Source: SUGEVAL 2019.

The figures in Table 2.6 above also show that ownership in traded companies is highly concentrated. Most listed firms have a dominant shareholder associated with a family and a holding company group. As a consequence, the governance challenges that Costa Rican listed enterprises face are closely associated with concentrated ownership i.e. the protection of minority shareholders. This contrasts with the governance issues that arise under dispersed ownership where the challenge of aligning the interests of managers and shareholders dominates. Anecdotal evidence suggests that many BNV issuers face governance challenges. The governance challenges that typically confront family-owned enterprises are: 1) professionalising management after the founding generation; 2) suspicion of transparency and disclosure practices; 3) non-transparent related party transactions that favour family and friends; 4) a general reticence to relinquish control by opening the share capital; and 5) conflicts with minority shareholders regarding the fair pricing of shares.

An additional limitation to the market's capacity to act as a price discovery mechanism is the total number of buyers and sellers. In Costa Rica, in some cases, there may only be a single investor trying to buy or sell at a particular time. Though formal data is scarce, some analysts suggest that listed companies have a highly restricted number of shareholders and that the number of Costa Rican retail investors who invest in BNV equities is small. For most Costa Ricans, equities are not used as a tool for savings, investment or retirement planning. Retail investors appear to prefer the safety of government bonds and more liquid and diversified investment funds.

Minority shareholder protection is an area where there is potential for improvement. According to the 2020 World Bank Doing Business Report, Costa Rica ranks 110th among 190 economies on the strength of its laws and regulations for protecting minority investors, lower than Latvia and Lithuania, two recent OECD accession candidates who have become members, ranked 45th and 37th respectively. Overall, the data show that Costa Rica tends to approximate the regional average while falling somewhat short of the OECD high income average.

Figure 2.4. Protecting minority investors in Costa Rica and comparator economies—measures of quality



Source: World Bank Group, Doing Business 2020, Economy Profile, Costa Rica, https://www.doingbusiness.org/content/dam/doingBusiness/country/c/costa-rica/CRI.pdf

Box 2.1. Case study: Ad Astra Rocket and risky public offerings

Ad Astra Rocket is a well-known company within Costa Rica and widely-recognised internationally. This is largely due to the unusual nature of its business. It specialises in spaceflight technology and advanced plasma rocket propulsion, which have the potential to revolutionise space travel. Ad Astra Rocket is exceptional in Costa Rica for the nature of the business, its ownership structure and its risk profile.

The company is a US Delaware corporation that was established from a unit of the US National Aeronautics and Space Administration (NASA). Under the US Securities Act, the company's common shares were issued as a Restricted Public Offering (RPO). The RPO permits only non-US persons to acquire the stock via the Costa Rican public market. Ad Astra came to market in Costa Rica in 2009 through an alternative market (Mercado Alternativo para Acciones—MAPA), an initiative of the BNV

designed to help SMEs with significant growth potential access the financial markets. The company was initially offered only to sophisticated investors though it was eventually permitted to list on the BNV as the government relaxed its requirements.

The company is small. It had research and development income of USD 3.6 million in 2017 and USD 1.9 million in 2018, and earnings of USD 199 000 in 2017 and losses of USD 1.7 million in 2018. In both years, it had significant negative shareholders' equity. In its 2018 financial statements, the independent external auditors alert readers to the question of whether Ad Astra should be considered a "going concern". The going concern principle in accounting is the assumption that an entity has sufficient resources to continue to operate and will remain in business for the foreseeable future.

Franklin Chan, the founder and principal owner, is a former NASA astronaut and veteran of seven Space Shuttle missions and a local personality. Chan reports holding 63% of Ad Astra shares. There are approximately 200 other investors, including a pension fund and two Costa Rican state-owned banks.

The Ad Astra case raises questions regarding whether high-risk offerings are appropriate for retail investors and if sufficient protections are in place for non-professional investors. Ad Astra was considered too speculative for public listing in the US, and other countries would likely consider the company better suited for investment from angel investors, venture capitalists or private equity firms. Opinions on this would, predictably, be divided, with some arguing that the public listing of high-risk companies should be restricted, and others arguing—perhaps citing the example of early restrictions on the sale of Apple Computer shares to the public—that such restrictions deprive retail investors of some of the best investment opportunities.

The corporate governance framework

Costa Rica has aligned its governance regulations with the *OECD/G20 Principles of Corporate Governance* through the development of its new Corporate Governance Regulation (Reglamento de Gobierno Corporativo), promulgated by the National Council of Supervision of the Financial System (Consejo Nacional de Supervisión del Sistema Financiero—CONASSIF). The CONASSIF Governance Regulation came into force on 7 June 2017.

The CONASSIF Corporate Governance Regulation was designed to include all of the essential elements of the *G20/OECD Principles* and much of its language has been directly transcribed from them. The Governance Regulation is wide ranging and covers all entities operating in the financial markets including banks, listed companies, state-owned banks, state-owned enterprises making bond offerings, pension funds, insurance, institutional investors and market operators.

Costa Rica has been implementing the Governance Regulation using a risk-based supervisory approach. Globally, RBS is a regulatory approach used mainly to regulate banks and other financial institutions. It is a comprehensive, formal, and structured process that assesses risks and focuses on the resolution of those risks. RBS is closely associated with the concept of proportionality. Proportionality is an approach whereby supervisors' expectations are adjusted as a function of the characteristics of each supervised entity. RBS is often contrasted with rules-based regulation (or "merit-based" or "compliance-based" supervision), which is a method of regulation that focuses on checking and enforcing compliance with rules, legislation, regulations and policies. While securities exchange regulators may employ some risk-based approaches, they traditionally rely more heavily on ensuring rules compliance and disclosure.

Costa Rica's Self-Assessment recognises that RBS is not generally used by exchange regulators and that banking, pension and insurance supervisors can have interests that differ from securities market supervisors. During the initial stages of the Costa Rica accession review, it was not clear how RBS would be applied in practice. Listed companies had expressed concerns regarding, in particular, the potential for an arbitrary application of rules. Yet, as of mid-2019, there was growing evidence that both regulators and companies had worked in good faith to develop common sense solutions and that the implementation of governance practices through RBS was having a positive impact.

Despite this important advance, Costa Rica will need to be attentive in coming years to how to make RBS work in practice for equity listings. The continuing concern expressed by companies is the potential for an arbitrary application of rules and the absence of clarity that they had become accustomed to under compliance-based regulation. Companies are particularly concerned that the application of rules, which appears to have been measured and reasonable to date, could change with a change in the leadership of the securities supervisor or in the political administration. From a supervisory perspective, there are questions regarding how elements of the new Governance Regulation will be enforced and when and how to eventually apply sanctions and/or fines.

The legal framework

Costa Rica has an extensive set of laws, decrees and regulations that provide the framework for the governance of both private and public sector enterprises amongst which are the Constitution, the Code of Commerce, voluntary codes of corporate governance and CONASSIF regulations.[12]

The Constitution

The Constitution of Costa Rica was approved on 7 November 1949, after the civil war of 1948. The Constitution defines key parameters of SOE governance on the broadest level.

Regarding the powers of the Presidency, Title X establishes the executive branch and the powers of the President of the Republic and the Council of Ministers. The Council of Ministers is composed of the President and the Ministers. Title XIII regulates the approval and execution of budgets and the functions of the Comptroller General and the Ministry of Finance.

Several titles and articles deal specifically with the corporate governance of state-owned enterprises. Title XIV regulates autonomous institutions (instituciones autónomas), which enjoy independence from the state in their governance and administration. This is the main form that SOEs take in Costa Rica. They include state banks, state insurance companies and any new bodies established by the Legislative Assembly by a two-thirds vote.

The Constitution also regulates some aspects of potential conflicts of interest within SOEs. For example, under Article 112 legislators cannot have direct or indirect economic relations with the state or act as board members or managers in companies that contract with the state or any of its institutions.

Competition issues and the establishment of state monopolies are addressed under Article 46, which prohibits any act that threatens or restricts the freedom of trade. It establishes the public interest in preventing monopolistic practices and requires that any company acting as a monopoly be established under and subject to specific legislation. The establishment of any new monopoly requires the approval of two-thirds of the Legislative Assembly.

The Constitution also protects stakeholder rights. Consumers are entitled to the protection of their health, the environment, their safety and economic interests. They are entitled to receive adequate and accurate information, have the freedom of choice, and receive equitable treatment.

Code of Commerce (Código de Comercio)

Costa Rica's Code of Commerce was passed in 1964 and was based on the Mexican code of commerce at the time. The Code of Commerce regulates a multitude of commercial issues ranging from the types of enterprises that can legally be established (their registration, the establishment of financial accounts and accounting, general shareholders meetings, etc.) to bankruptcy and insolvency issues.

The Code of Commerce was assessed by a number of market participants during the accession review as being both outdated and poorly adapted to the needs of contemporary enterprises and economies. Companies have been able to accommodate their needs and address gaps in their corporate governance practices by changing their individual by-laws. However, this approach has limits and some changes to company law may be required, in particular with respect to the issue of the information rights of shareholders and minority shareholder protection, to accommodate modern corporate governance practices both with respect to private companies and SOEs.

The Voluntary Code of Best Corporate Governance Practices of 2011

Costa Rica developed its first governance code in 2007. This voluntary code was developed by the National Securities Exchange (BNV) and the Chamber of Securities Issuers (CCETV) with the aim of encouraging better governance practices. The code was used in 2009 by CONASSIF to develop its Regulation on Corporate Governance (Reglamento de Gobierno Corporativo) that was applied on a mandatory basis to financial entities supervised by the four financial Superintendencies under the supervision of CONASSIF: the General Superintendency of Financial Entities (SUGEF), the General Superintendency of Securities (SUGEVAL), the General Superintendency of Insurance (SUGESE) and the Superintendency of Pensions (SUPEN). Non-financial companies registered in the National Registry of Securities and Intermediaries (Registro Nacional de Valores e Intermediarios) administered by SUGEVAL were given a choice to either comply with the Regulation on Corporate Governance or to report against the recommendations of the Costa Rican voluntary code on a comply or explain basis.

The authority to further develop the voluntary code was given to the Costa Rican Institute of Corporate Governance (ICG) in 2011, whereupon the Board of Directors of the ICG decided that it would expand the applicability of the voluntary code to all companies in Costa Rica and not just those with issues on the BNV. The 2011 edition was replaced by a second code in 2014 that expanded its scope to include guidance for family-owned businesses and shareholders. For listed companies, CONASSIF has eliminated the alternative of subscribing to the voluntary code through its issuance of the CONASSIF Governance Regulation of 2016 that is mandatory for all financial and non-financial entities supervised by the four Superintendencies (SUGEF, SUGEVAL, SUGESE and SUPEN).

The CONASSIF Corporate Governance Regulation

The CONASSIF Governance Regulation was passed in late 2016 and came into force in June of 2017. The regulation draws upon leading international benchmarks for corporate governance, including the instruments of the Bank for International Settlements (BIS), the International Association of Insurance Supervisors, the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO) and the *OECD/G20 Principles of Corporate Governance*. Given that the regulation was modelled on the key international reference points, the result is a regulation that corresponds well with current best practices in corporate governance.

The CONASSIF Governance Regulation applies to virtually all organisations under the supervision of the four financial superintendencies including the securities market regulator SUGEVAL. It covers a wide spectrum of organisations involved in the financial markets including: 1) issuers; 2) banks; 3) market intermediaries; 4) insurance companies and 5) pension funds. It also covers a comprehensive

set of governance issues including: 1) board member duties; 2) board responsibilities; 3) board composition; 4) board member profiles; 5) nominations processes, 6) documentation; 7) board evaluations; 8) conflicts of interest; 9) committees; 10) risk management; 11) audit; 12) remuneration; 13) transparency; 14) subsidiary governance; 15) shareholder rights and so on.

For companies that have equity or bond listings, SUGEVAL is responsible for reviewing and enforcing the implementation of the Corporate Governance Regulation for non-financial companies, while SUGEF handles enforcement with respect to financial entities. Financial companies issuing preferred shares are subject to enforcement by SUGEVAL in collaboration with SUGEF.

Unlike past corporate governance codes that were voluntary and were implemented through the "comply or explain" principle, the CONASSIF Governance Regulation: 1) tracks best practice more closely; 2) is more detailed; and 3) is intended to be more prescriptive. Though the regulation is mandatory, Costa Rica has been implementing the regulation using risk-based supervision that allows "proportionality" (i.e. different degrees of implementation by companies based on their specific characteristics).

In practice, the main way in which SUGEVAL is implementing the Governance Regulation is by requiring non-financial listed companies to produce and publicly disclose their codes of governance. The objective is to encourage companies to introduce best practices found in the Governance Regulation into their by-laws and other internal norms. By May of 2018, SUGEVAL had received all of the new company codes, reviewed them and provided initial feedback.

Only five equity listings fall under the regulatory authority of SUGEVAL in questions of corporate governance (FIFCO, La Nación, ILG, Holcim and Ad Astra). A further five companies with equity listings on the BNV are financial firms that fall under the regulatory authority of the SUGEF who takes the lead in the application of the Governance Regulation for financial companies (Lafise, Promerica, Cathay, Corporacion Davivienda and Grupo Improsa). SUGEF and SUGEVAL's supervisory emphases differ though they co-ordinate their supervision of corporate governance practices.

Even taking into account SUGEVAL's additional supervisory responsibilities for issuers of bonds, the limited number of companies permits SUGEVAL to meet with each market participant individually, discuss regulatory expectations, develop in-depth insights into company practices, and establish a working relationship with the regulated entities. The supervisor's task in Costa Rica, thus, differs significantly from many other OECD countries where there may be hundreds or even thousands of listings that would make a one-on-one contact impossible.

According to SUGEVAL, the introduction of the Governance Regulation has had two important high-level benefits: 1) greater awareness of the proper role of boards and board members; and 2) greater sensitivity to risk. On a more practical level, non-financial listed companies now have a clearer understanding of corporate governance standards and are beginning to implement more robust governance structures. Some of the changes implemented during the accession review period were: 1) the establishment of direct channels of communication between internal auditors and boards; 2) an expanded role for and an increase in the number of meetings of audit committees; 3) improvements in by-laws; 4) greater awareness of and better management of risks; and 5) the enhancement of ethics codes among others.

Another positive impact was to encourage better organisation and clarity of governance disclosure on company websites. Previously, most companies disclosed information on their governance practices but their disclosure was often incomplete and/or disorganised. The requirement for companies to disclose their governance practices under the Governance Regulation led to an examination of disclosure practices and, eventually, a better organisation and greater user-friendliness of web pages.

The new Governance Regulation is also having an impact on the governance practices of companies with bond offerings including SOEs. One of the SOEs that is now required to comply with the Governance Regulation is the Costa Rican Petroleum Refinery (RECOPE),[13] which now finds itself having to comply with a higher standard of corporate governance than before. RECOPE has reported positive changes implementing its new expanded code of ethics, but also points out that there are challenges in dealing with the conflicting requirements of the Governance Regulation and existing laws with respect to board nominations and remuneration policies. These are still set by the laws establishing RECOPE and other legislation pertaining to the public sector and supersede the Governance Regulation. Full compliance with the Governance Regulation will require a rewriting of the laws constituting certain statutory SOEs.

Despite these advances, the implementation of the Governance Regulation and the practical application of the proportionality principle raise some difficult questions. The root question was how to apply practices that were originally developed for large companies in developed securities markets to small companies in a nascent one.

An example of a more specific question was whether all the board committees typically recommended under best practice are necessary in small companies. As a result of the dialogue between SUGEVAL and the companies, it was ultimately decided that it would be difficult to constitute truly independent nominations committees in small companies controlled by family shareholders and that they would only lead to superficial compliance. The recommendation for a board risk committee also elicited significant debate amongst companies, which is illustrated in the FIFCO case in Box 2.2 below.

Box 2.2. Case study: The Risk Committee of Florida Ice & Farm Company S.A. (FIFCO)

Risk committees are mandatory for financial firms under the Governance Regulation but not for non-financial firms, and SUGEVAL's suggestion to broaden their implementation to non-financial firms was initially received with scepticism from companies. The case of FIFCO, Costa Rica's largest and most actively traded listed company, shows how the Governance Regulation encouraged companies to think about risk in a new way and reconsider their risk management and risk governance practices.

Before the passage of the Governance Regulation, FIFCO had various corporate units that tracked and managed risks. But, risk had never been dealt with in a centralised way within the company. Nor had it been considered in a holistic fashion at board level. After careful consideration and in response to the new Governance Regulation, the company decided to establish a risk committee once it became clear that a company-wide vision of risk could bring important benefits.

The establishment of a risk committee permitted FIFCO to elevate the discussion of risk to the board level, provide the board with a greater capacity to monitor, understand and manage risks, and allow the company to better define its overall risk appetite. What had previously been done in a fragmented and unco-ordinated fashion could now be done in a more unified, organised and consequential manner. The establishment of a risk committee, as recommended by the Governance Regulation, eventually came to be seen as a positive contribution to FIFCO's operations.

Questions also arose regarding show-of-hands voting and other general GSM practices. Show-of-hands voting is a method to quickly decide the outcomes of resolutions. The practice has disadvantages including: 1) show of hands requires the physical presence of voters or a physical proxy; 2) the total number of votes held by a voter is not apparent and the proportion of shareholdings cannot be taken into account; and 3) voters are unable to express their opinion in anonymity.

In addition to show-of-hands voting, concerns arose regarding meeting notices, the provision of information both before and after GSMs and other rules. Further questions arose regarding disclosure including: 1) whether companies should produce an annual corporate governance report in addition to disclosing a corporate governance code; 2) whether such a report should be part of the company's annual report or whether it should be published separately; and 3) whether corporate governance reports should also describe issues of corporate social responsibility.

SUGEVAL has communicated to companies that many procedures, erstwhile permissible under the Code of Commerce, were no longer considered good practice. The introduction of the Governance Regulation has, thus, had the effect of encouraging a broader review of norms and practices under the Code of Commerce. Though the feedback of both companies and SUGEVAL on the introduction and implementation of the Governance Regulation is generally positive, the Chamber of Securities Issuers and Costa Rica's Institute of Corporate Governance (ICG) take a more cautious view. The ICG had originally lobbied in favour of a completely voluntary code of governance and argued against the Governance Regulation, which it saw as overly detailed and prescriptive. Nevertheless, both the Chamber and the ICG acknowledge that the interactions between companies and SUGEVAL have been constructive and that doubts regarding implementation are being answered gradually as all parties gain experience through the implementation process.

The ICG had also expressed concern that the Governance Regulation would dissuade smaller issuers and create incentives for companies to list in more permissive jurisdictions such as Panama. Despite these concerns, no companies de-listed in the wake of the Governance Regulation. In fact, SUGEVAL reported a new bond listing that it attributed to a resurgent interest in the securities markets. This new interest was ascribed to an extended period of deregulation of the securities markets and the effect of stricter bank regulation (resulting from the implementation of Basel III), which has made securities listing comparatively more attractive.

Overall, the initial assessment of the implementation of the Corporate Governance Regulation is positive tempered with some caution. Specifically, monitoring is required of how the provisions of the Governance Regulation will be enforced, and how and when companies will be subject to sanctions if they do not implement provisions. During the initial stage of implementation, sanctions were not being applied. Rather, SUGEVAL had sought to persuade companies to develop their own responses adapted to company needs though it has not precluded the use of sanctions in the future. Progress in implementation and actual outcomes will need to be monitored for some time to come.

Additional CONASSIF Regulations

CONASSIF developed complementary regulations on: 1) the profiles and aptness of board members and executives; and 2) operational risk management. The first is entitled Regulation on the Suitability of Members of the Management Body and Senior Management of Financial Entities (Reglamento sobre Idoneidad de los Miembros del Órgano de Dirección y de la Alta Gerencia de las Entidades Financieras), which entered into force on May 4, 2018. This regulation is narrower in scope than the CONASSIF Governance Regulation in that it applies only to organisations under the supervision of SUGEF, including state-owned and private banks. It focuses principally on defining the needed profiles of board members and executives of banking organisations. The regulation focuses on: 1) board member honesty, integrity, reputation and experience; 2) the fit of the board member profile with the needs of the bank; 3) the maintenance of information on the profiles of board members; 4) self-evaluations by boards; and 5) external evaluations of boards by SUGEF. The regulation does not permit the regulator to reject or remove a board member of a state-owned bank nominated by the Council of Ministers.

In addition, the Law on Consolidated Supervision of 2019 (Law 9768), widens the authorities of financial supervisors and establishes their power to recommend the removal of board members under certain circumstances. The law establishes the power for bank regulators to recommend the removal of board members when omissions or actions contrary to laws and regulations that threaten the security, stability and solvency of the entity, as well as when breaches of eligibility requirements occur and are duly substantiated. Similar powers are found in the regulation of some OECD member countries where the circumstances under which board members can be removed are carefully defined and circumscribed to prevent potential abuse.

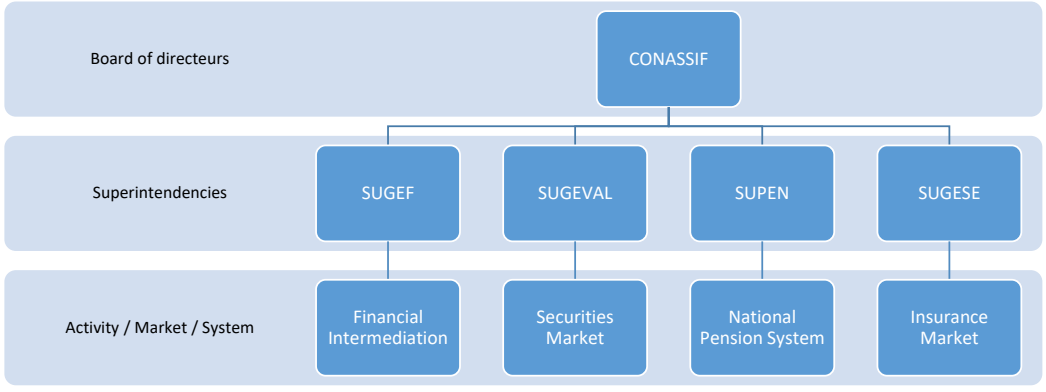
The second set of rules is entitled Regulation on Operational Risk Management (Reglamento Sobre Gestión del Riesgo Operativo). It applies only to organisations under the supervision of SUGEF and entered into force on August 9, 2016. It requires: 1) that systems for risk management be in place; 2) the development of a risk strategy; 3) board responsibility for risk management policies and implementation; 4) identification and management of a variety of risks; 5) public disclosure; and 6) reporting to SUGEF among others.

The institutional framework

The National Council for the Supervision of the Financial System (CONASSIF)

CONASSIF is the entity that regulates and supervises the Costa Rican financial system. CONASSIF's task is to foster the conditions to strengthen the liquidity, solvency and sound operation of the financial sector, and provide the prudential supervision of regulated entities.

Figure 2.5. The oversight authorities of CONASSIF



Source: Costa Rica self-assessment.

CONASSIF has authority over four superintendencies each responsible for a sector of the financial system:

1. *The General Superintendency of Financial Entities* (Superintendencia General de Entidades Financieras): SUGEF was created by Act 7558 of 3 November 1995. It is the state body responsible for the regulation and prudential supervision of banking and non-banking financial intermediaries in the financial system (state-owned banks, private banks, savings and credit co-operatives, and non-banking financial corporations).

2. *The General Superintendency of Securities* (Superintendencia General de Valores): SUGEVAL was created by the Regulatory Law of the Securities Market of 1997 (Ley Reguladora del Mercado de Valores—LRMV) hereafter the Securities Markets Law. It is the body responsible for the regulation and prudential supervision of entities involved in the securities market, including bond and share issuers, stock exchanges, brokerage houses, investment funds, management companies and risk rating agencies.
3. *The Superintendency of Pensions* (Superintendencia de Pensiones): SUPEN was created by Act 7523 of 7 July 1995. It is the state body responsible for the authorisation, regulation and supervision of complementary pension systems and plans, and individual investment plans, and of the entities responsible for managing them. It supervises the regimes administered by the Costa Rican Social Security Fund (Caja Costarricense del Seguro Social—CCSS) and by private agents.
4. *General Superintendency of Insurance* (Superintendencia General de Seguros): SUGESE was created by Act 8653 of 22 July 2008. It is the state body responsible for the authorisation, regulation and supervision of the persons and corporations involved in insurance and reinsurance activities, except for the compulsory social security regimes administered by the institution in charge of providing public health services (Caja Costarricense del Seguro Social—CCSS). It also supervises public offerings and the execution of insurance businesses.

The CONASSIF board has seven members who are: 1) the Minister of Finance (or the vice-minister in their absence); 2) the President of the Central Bank (or its general manager); and 3) five members designated by the Board of Directors of the Central Bank (who are not civil servants). Together, these board members deal with all issues related to SUGEF, SUGEVAL and SUGESE. On the other hand, for issues related to SUPEN, the board is composed of the Minister of Labour (or their representative) instead of the Minister of Finance, and an additional member designated by the Board of Directors of the Central Bank, chosen from among three candidates proposed by the Labour Assembly of the Banco Popular y de Desarrollo Comunal.

Some of the most important functions of CONASSIF are to:

1. Approve the norms to be enforced by the superintendencies regarding authorisation, regulation, supervision and surveillance.
2. Suspend or revoke the authorisation given by the superintendencies to regulated parties or to make public offerings under specific circumstances.
3. Order the suspension of or intervention in entities regulated by the superintendencies.
4. Approve the norms applicable to proceedings, requirements and time frame for mergers or transformation of financial entities.
5. Approve the norms regarding the constitution, sale, registration and functioning of financial groups.
6. Resolve appeals against resolutions of the superintendencies. CONASSIF's resolutions will exhaust administrative remedies.
7. Approve regulations that establish which person or corporation, owner or manager of the supervised subjects, will be considered part of the same economic group of interest, in order to secure adequate portfolio diversification and to resolve and prevent conflicts of interests.
8. Approve provisions regarding standards for accounting and audit of supervised subjects, as well as the frequency and disclosure of statutory audits.
9. Approve regulations regarding the periodicity, scope, proceedings and publication of external audit reports of supervised entities, with the objective of fostering confidence in of the external audit.

10. Approve the regulations applicable to internal audits of entities supervised by the superintendencies.
11. Designate and remove the Superintendent and Intendent of the superintendencies, and the Internal Auditor of CONASSIF.

The Securities Supervisor

SUGEVAL is the superintendency in charge of the supervision and regulation of the stock market. SUGEVAL's objectives and functions are regulated by the Securities Markets Law. Its primary objective is to provide the conditions and regulations needed for the proper functioning of a securities market such as transparency, price formation, investor protection and disclosure. SUGEVAL also provides the markets with information through the National Registry of Securities and Intermediaries. Among the entities supervised by SUGEVAL are bond and share issuers, stock exchanges, brokerage houses, investment funds, management companies and risk rating agencies.

The Central Bank

The Central Bank plays a role in ensuring an enabling macroeconomic environment and in promoting a stable, efficient and competitive system of financial intermediation. It is responsible for the stability of the payments system, liquidity assistance to markets and solvent institutions, and systemic stability. The Central Bank is an autonomous institution and it is not subject to the regulations of the SUGEF.

The National Securities Exchange

The National Securities Exchange (Bolsa Nacional de Valores) is a private company created to facilitate the trading of securities. The Costa Rican securities market trades almost exclusively in bonds.[14] The Central Bank and the Ministry of Finance are the main issuers on the BNV and represent 85% of the total value of issues. By the end of 2019, the BNV had a total of 41 national issuers of which 10 had equity listings.

The BNV was created in 1970 by a group of businessmen through the National Chamber of Finance, Investment and Credit (Cámara Nacional de Finanzas, Inversiones y Crédito—CANAFIC). In 1974, the shares were acuired by the Costa Rican Development Corporation (Corporación Costarricense de Desarrollo—CODESA). CODESA operationalised the nascent exchange. The first board was established, and the BNV was officially inaugurated in 1976. In 1977, CODESA sold 60% of its stake to private investors, leaving the capital distributed as follows: CODESA (40%), brokerage houses (7%), stockbrokers (6%), employees (1%) and other natural and legal persons from the private sector (46%). In 1993, the remaining shares held by CODESA were sold to private investors. With the entry into force of the current Securities Markets Law, the BNV was mutualised and now belongs exclusively to brokerage houses.

The general shareholders meeting of the BNV is held annually or as needed in the case of extraordinary meetings. The seven-member board is named by the GSM. The board has responsibilities ranging from receiving applications to issue securities, to the disclosure of information to the markets. The BNV is represented legally by a chair and a general manager whose positions can be either separated or combined.

The principal role of the BNV is to: 1) provide the conditions for brokers to conduct their operations; 2) ensure that brokerage operations are carried out in compliance with established legal norms, and governed according to high standards of professional ethics; and 3) ensure proper disclosure of financial reports and other relevant information on listed institutions.

With respect to its role in promoting good corporate governance practices, the BNV does not develop listing rules and is essentially required to accept any company to the market that meets basic regulatory requirements. The BNV had no enforcement powers in relation to the Voluntary Code of Best Corporate Governance Practices of 2011, which was enforced using the "comply or explain" principle. The BNV's role in promoting good corporate governance has since diminished with the issuance of the new CONASSIF Corporate Governance Regulation, which is enforced by SUGEVAL for non-financial listed companies and SUGEF for listed financial.

Share registration

One of the fundamental rights of shareholders is the secure registration of their shares. This right is described in Principle II.A of the *G20/OECD Principles*. In most OECD countries, the registration of listed company shares is typically fulfilled by a share registrar, often a bank or trust company, responsible for keeping records of bondholders and shareholders when an issuer sells securities to the public.

In Costa Rica, companies maintain their own share registers as required by the Code of Commerce. The BNV runs a parallel register that it uses to inform companies whenever a transaction occurs so that the company can, in turn, change its records, which remain the official register.

The question of share registration was addressed by Law 9416, "Law to Enhance the Combat against Tax Fraud" (Ley para Mejorar la Lucha Contra el Fraude Fiscal), which entered into force in December 2016. The new register centralises the registration process at the Central Bank in order to avoid timing differences in registration and potential discrepancies between registries. However, listed companies were addressed in a law amending the Securities Market Law (Law 9746 of 2019).

The Costa Rican Institute of Corporate Governance

The Costa Rican Institute of Corporate Governance (Instituto de Gobierno Corporativo de Costa Rica) is a non-profit association founded in 2009 whose mission is to promote good corporate governance in Costa Rica. It receives part of its funding from members and the BNV. ICG seeks to promote international best practice by making reference in its work to both the *G20/OECD Principles* and the *SOE Guidelines*. It participates actively in the OECD Latin America Corporate Governance Roundtable and has worked with the International Finance Corporation (IFC), a member of the World Bank Group, on various projects to raise awareness of good governance practices.

The ICG had supported the development of the Voluntary Code of Best Corporate Governance Practices of 2011. But, with the emergence of the CONASSIF Governance Regulation, the role of the ICG and the Voluntary Code have changed. ICG now promotes the use of the Voluntary Code mainly amongst non-regulated SMEs and are pursuing other activities to promote good governance more widely. In September 2018, the ICG reached an agreement with the government to help conduct a new training programme for SOE board members, executives and government officials that began in early 2019.

Overall effectiveness of the corporate governance framework

The Concept Paper guiding corporate governance accession reviews calls for the corporate governance landscape section to make an assessment against key recommendations in Chapter 1 of the *G20/OECD Principles*. This section therefore builds on the previous introduction of Costa Rica's corporate governance framework and assesses its implementation according to *G20/OECD Principles* 1.A to 1.F. The discussion of Costa Rica's corporate governance framework for listed companies is distinct from its corporate governance framework for state-owned enterprises, which is described in the following section.

The over-arching recommendation of Chapter 1 of the *G20/OECD Principles* is that "The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement."

Corporate governance framework (Principle I.A)

Principle 1.A further specifies that the corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and well-functioning markets.

The corporate governance framework in Costa Rica has sought to emulate best international regulatory practices. The CONASSIF Governance Regulation was designed with a view towards consistency with guidelines issued by international organisations, such as the OECD and the Basel Committee, and enforcement practices were developed in consultation and with the assistance of international financial institutions such as the World Bank with expertise in international guidelines and good practices. Costa Rica's regulatory framework, thus, adheres closely to OECD recommendations and, overall, the implementation of Costa Rica's corporate governance framework appears consistent with the rule of law and supportive of effective supervision and enforcement.

On the other hand, the small size of the Costa Rican equities market makes it difficult for it to be considered a well-functioning market or as having any significant impact on overall economic performance as recommended under Principle I.A. The capital market is too small and too illiquid to be effective in providing: 1) investment opportunities for investors; or 2) a source of capital for companies. Trading is so thin that the equity markets do not effectively fulfil a price discovery function. The World Economic Forum's Global Competitiveness Report of 2017-2018 ranks Costa Rica as 117 out of 137 countries for it capacity to provide financing through the local equity market. In the end, Costa Rica's governance framework is, arguably, far in advance of the development of the market itself. Some commentators have described it as "an undeveloped market with developed country rules".

Consistency with the rule of law, transparency and enforcement (Principle I.B)

Principle I.B states that "The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable."

Costa Rica has a legal and regulatory framework fully consistent with the rule of law. Costa Rica enforces the principle of hierarchy of laws through its General Law on Public Administration (Ley General de la Administración Pública—Ley N° 6227), by virtue of which the administrative legal system is first subject to the Political Constitution, international treaties, laws and regulations. All shareholders have the right to have their rights respected as specified under the Political Constitution, the Code of Commerce and other laws.

Furthermore, the legal and regulatory requirements that affect corporate governance practices are fully transparent. Laws and regulations are published on the Costa Rican System on Juridical Information (Sistema Costarricense de Información Jurídica—SCIJ).[15] The system provides access to documents through any commonly available web browser and is being constantly updated as new laws, decrees and regulations emerge. The system was used extensively in the preparation of this review and has been shown to be effective in providing up-to-date access to virtually all extant legislation. At present, documents are provided only in Spanish.

Costa Rica also has a well-developed judicial system that permits the enforcement of rights. According to the US Department of State Bureau of Economic and Business Affairs Investment Climate Statement for 2019, Costa Rica's judicial system generally upholds contracts. On the other hand, the Investment Climate Statement advises caution when making investments in sectors protected by the Constitution and specifically with public entities. The Investment Climate Statement reports that investments in state-

protected sectors can be complex and may be subject to frequent legal challenges and that Costa Rica's many autonomous government agencies, including municipal governments, may contradict the decisions of other independent agencies, thus causing significant project delays. [16]

In addition, litigation in Costa Rica can be long and costly. The legal system is significantly backlogged and civil suits may take five years or longer from beginning to final sentence. Some cases have been reported to exceed 10 years. And, when cases are finally resolved, the penalties and damages may be insufficient to dissuade potential offenders. This assessment is echoed in the Investment Climate Statement which reports that the most frequently heard complaints from U.S. companies are long and costly litigation and the unpredictability of outcomes.

Table 2.7. Average time to sentence for civil courts by type in 2017

Type	Months to Sentence
Simple executive order	138
Foreclosures	124
Collateral enforcement	96
Payment procedures	78
Ordinary	59
Abbreviated (Excluding Family)	31
Asset freeze	31
Disclosure of documents	31
Bankruptcy	28
Dissolution of Associations	18
Calls to Shareholder Meetings	15
Pre-trial evidence	13
Atypical precautionary measures	7
Insolvency	3
Arrangement declarations	1
Average:	**45**

Source: Statistics Division, Planning Department, Judicial Branch., Costa Rica Ministry of Justice

The OECD Public Governance Committee has reviewed Costa Rica's judicial system as part of its review of the effectiveness of public governance in the context of the accession process. Their review cites international studies pointing to timeliness issues especially in civil justice. According to these studies, only 48% of Costa Rican nationals perceive that their judiciary is functioning well, with 65% of their complaints related to court delays. Trust in Costa Rica's judiciary was reported as declining, although it is high in some areas (e.g. high trust in constitutional justice).

In brief, effective redress, as contemplated by the *G20/OECD Principles*, appears to be constrained by the lack of timeliness. This has been attributed by legal experts to a number of potential factors including: 1) excessive caseloads; 2) a lack of institutional capacity; 3) excessively complex laws and procedures; 4) outdated laws; and 5) excessive opportunities to contest decisions on technical and even trivial grounds.

Costa Rica's government has long been aware of the issue and has undertaken initiatives to streamline and speed judicial processes and simplify laws and regulation dating back to the 1990s. Though progress has been grudging, the Public Governance Committee cites positive steps, including the development of alternative dispute resolution mechanisms, performance appraisals for officers of the judiciary, the implementation of quality standards and new information technologies.

Alternative dispute resolution (ADR) and commercial arbitration have become increasingly common. Arbitration is possible under the civil and commercial codes. In addition, the law on Alternative Dispute Resolution and Promotion of Social Justice, Law N°7727 of December 1997, seeks to encourage arbitration and simplify arbitration procedures. Fourteen private ADR centres operate across the country and offer mediation and arbitration services, as well as 16 Justice Houses, which were established in the year 2000 to decongest the courts and provide more effective remedies to citizens. ADR is reported to deliver decisions in as little as six months under the best of circumstances and as much as 20 months when issues are contested.

Focusing more specifically on the securities market, the legislative framework establishes that any breach of a CONASSIF regulation can result in sanctions to the offending institution. Sanctions may also be applied to employees and directors under Articles 161 to 163 of the Securities Market Law. In addition, the Securities Market Law establishes specific sanctions related to non-compliance with certain corporate governance practices such as the duty of diligence, abuse of privileged and confidential information, market manipulation, insider trading and the lack of disclosure.

With respect to sanctions, data from SUGEVAL show that sanctioning of listed companies is rare. Over the past five years, some 20 cases were brought against brokers, fund managers, credit rating agencies, auditors and others though none resulted in sanctions. One case before 2013 did, however, the case regarded an investment fund administrator and not a listed company.

In the initial stages, the implementation of the new CONASSIF Governance Regulation has downplayed the role of sanctions. For the moment, supervisors appear to be reluctant to issue detailed guidance because they do not want the implementation of the Governance Regulation to become a “box-ticking exercise”. Supervisors have chosen to encourage companies to adopt prudential measures through a process of interaction and feedback, more specifically, by helping non-financial listed companies develop corporate governance codes. But as the transition to RBS and the implementation of regulation proceeds, having timely, transparent and full explanations of regulatory (enforcement) interventions will be important.

In summary, despite initial positive experience and growing clarity regarding supervisors’ expectations, there is still some uncertainty surrounding how the CONASSIF Governance Regulation will be enforced. Some of these questions are expected to be addressed as the implementation of the Governance Regulation proceeds.[17]

Division of enforcement responsibilities (Principle I.C)

Principle I.C states that “The division of the responsibilities among different authorities should be clearly articulated and designed to serve the public interest.”

The division of responsibilities amongst different regulatory authorities is clear. The supervision and regulation of the Costa Rican financial system has been assigned to five bodies, each with functions clearly defined by law. The law defines the competences and functions of each superintendency and regulator: Article 131 paragraph 10) of the Structural Law of Costa Rica´s Central Bank (Act 7558); Article 38, paragraph 11) of the Private Complementary Pension Regime Law (Act 7523); Article 28 of the Insurance Market Regulatory Law (Act 8653), and Article 8, paragraph 6) of the Securities Market Law (Act 7732). These laws frame the entire legal system that determines the authorities of the supervisors and regulators, as well as the spheres of action developed by participants in the financial system.

In the past, there was one area where there was some duplication of functions between SUGEVAL and the BNV, in the area of the regulation and supervision of stock brokers and stock dealers. This was addressed, initially, through a verbal agreement and then in the Rules on Securities Exchanges

(Acuerdo SUGEVAL-50-10 Reglamento de Bolsas de Valores), which establishes that the BNV should supervise the execution of trades and SUGEVAL the relations between brokerage firms and clients amongst other things.

This amendment established a joint supervisory regime between the BNV and SUGEVAL, which aims to reduce duplicative functions, and to promote more efficient supervision. Specifically, the Supervision Unit of the BNV will monitor the execution of exchange operations to detect possible irregularities in execution or market practices and to carry out the corresponding preliminary investigations. It will also detect conduct that undermines the transparent formation of prices. SUGEVAL is in charge of the supervision and control of all market participants, especially the compliance with the rules of conduct contained in the Securities Market Law.

Stock market regulation (Principle I.D)

Principle 1.D recommends that "Stock market regulation should support effective corporate governance."

The CONASSIF Governance Regulation provides requirements for governance that are in line with international guidelines such as the *G20/OECD Principles* and those of the Basel Committee. The new regulation is designed to support effective governance as recommended by the *G20/OECD Principles*, but it is too early to tell how effective it will be, given its generality and questions regarding its implementation using RBS. Furthermore, and as described above, the BNV plays a limited role in market supervision focused on monitoring the execution of exchange operations to detect possible irregularities, and carrying out preliminary investigations before they are referred to SUGEVAL.

Integrity and resources of enforcement authorities (Principle I.E)

Principle I.E calls for supervisory, regulatory and enforcement authorities to "have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent, and fully explained."

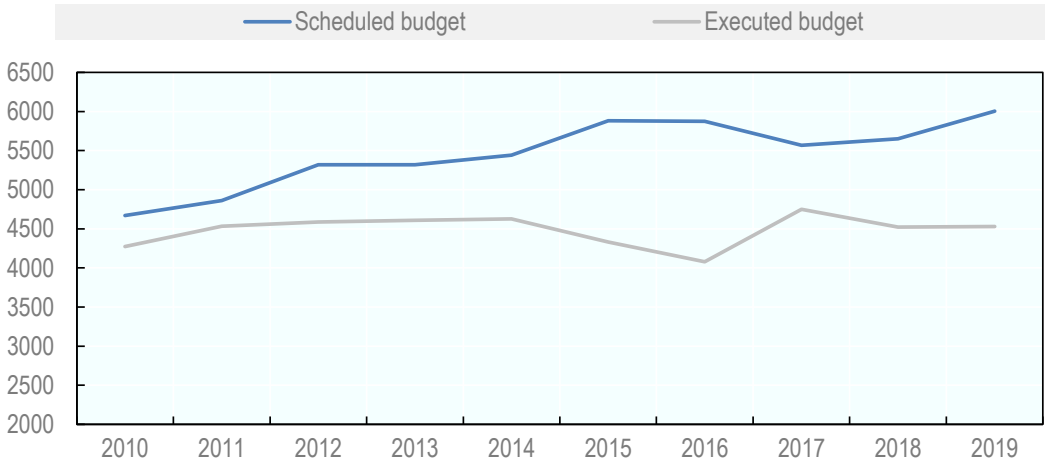
Costa Rica's supervisory, regulatory and enforcement structures comprise established institutions with long histories of operation. They are respected both within government and among the public. Though there are inevitable differences in views regarding the optimal approaches to financial system regulation, the regulatory structures have, on the whole, demonstrated their authority and integrity.

Supervisory, regulatory and enforcement authorities appear to have adequate resources. Each superintendency develops a budget proposal that must follow the guidelines established by the Central Bank and CONASSIF, the Comptroller General of the Republic and the provisions that have been established by the Technical Secretariat of the Budgetary Authority (STAP) of the Ministry of Finance. Neither the government nor the Legislative Assembly intervenes in the budget process.

SUGEVAL's budget proposal for 2019 was approximately USD 10.4 million. The number of staffing positions available to SUGEVAL as of December 2019 was 87, of which 73 were occupied and 14 were unfilled. Figure 2.6. above shows the evolution of proposed and actual budget expenditures for the period from 2010 to 2019. According to the Self-Assessment, SUGEVAL has the capacity to carry out additional work associated with its functions without modifying its budget.

Figure 2.6. SUGEVAL scheduled and executed budget

(Millions of colones 2010-2019)



Source: SUGEVAL

Cross-border co-operation (Principle I.F)

Principle I.F calls for cross-border co-operation to be enhanced, including through bilateral and multilateral arrangements for exchange of information.

Costa Rica has made efforts to enhance cross-border co-operation and information exchange through both bilateral and multilateral arrangements. SUGEVAL has signed bilateral technical co-operation agreements with the securities exchange regulators of Chile, the Dominican Republic, Spain, the United States and other countries and regional bodies. These generally contain agreements for collaboration and information exchange, as well as training in the investigation and prosecution of entities responsible for violating stock exchange rules. Most of the agreements pertain to technical assistance rather than information exchange. In practice, these agreements are not often used.

The amendment to the Securities Market Lawnecessary to provide SUGEVAL access to information on beneficial ownership of securities was adopted on 17 September 2019. This constitutes an important step towards enabling Costa Rica to become a signatory to IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information (MMoU).

Overview of the SOE sector

SOEs play an important role in the Costa Rican economy. Costa Rica has 28 SOEs at the central government level of which 16 are subsidiaries (See Annexes for detailed list and figures). SOE employment is 1.9% of total employment, which is roughly proportionate to the OECD average of 2.5%.[18] SOEs also fill an important developmental role by providing broad access to electricity, water, transport, banking and insurance services for the population, and reflect Costa Rica's historical commitment to social equality and also the country's statist tradition. Irrespective of the pros and cons of public versus private approaches, Costa Rica's SOEs have helped the country achieve results on a number of important social indicators, which has led to a broad, popular consensus on the value of SOEs in the economy. Still, at the same time, better governance practices are needed to promote fiscal sustainability for Costa Rica and the conditions for SOEs to thrive and perform and, indeed, survive in a competitive global economy.

According to the 2018 OECD Economic Survey of Costa Rica, SOE governance remains a top reform priority.

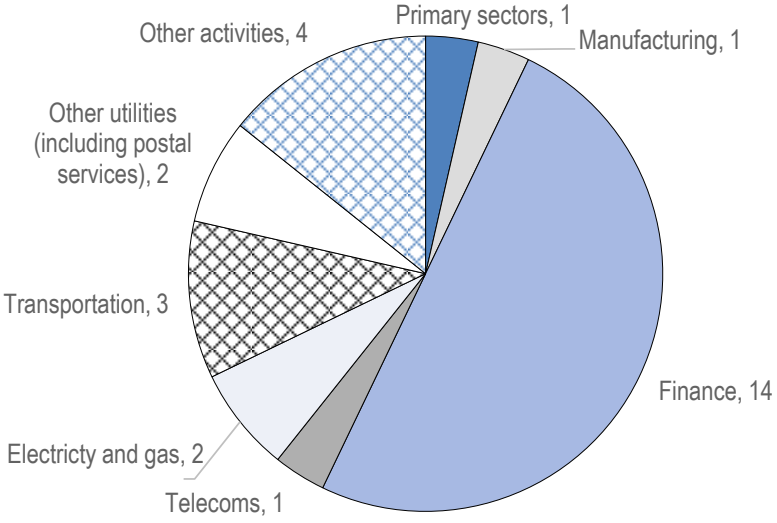
It should also be noted that the importance of promoting better governance practices extends far beyond the abovementioned group of 28 SOEs. Costa Rica has a number of institutions that were excluded from the later phases of this review because they were not legally under the direct control of the central government or did not otherwise formally fit the definition of SOE per the *SOE Guidelines*. Nevertheless, many have similar governance structures as SOEs and suffer from the same governance dysfunctions visible in what can formally be classified as SOEs. While a number of institutions were removed from the list of SOEs covered by the review, the Costa Rican authorities have acknowledged the desirability of applying good governance practices to the regional and municipal enterprises and other autonomous bodies originally considered to be SOEs in 2015, and have held some initial discussions with these institutions with this objective in mind.

SOE sectoral distribution

State-owned enterprises play a dominant role in key sectors of the economy such as electricity, telecoms, transportation, banking, insurance and petroleum products. Ten of Costa Rica's SOEs are statutory corporations established under their own specific legislation, with their subsidiaries typically being established as public limited companies

Most of Costa Rica's SOEs are active in the financial sector, and the banking sector itself is dominated by SOE banks. In November 2019, the two SOE banks (and subsidiaries) plus Banco Popular[19] accounted for 59% of the total banking system assets and 59% of total banking system loans. Foreign-owned banks accounted for the lion's share of private banking activity, representing more than 92% of privately-held assets. Local banks play a nominal role in the banking market.[20] According to the IMF, Costa Rica has the largest presence of state-owned financial institutions in Latin America.[21]

Figure 2.7. Sectoral breakdown of SOEs (%)



Source: Ministry of the Presidency

State-owned banks are managed to achieve public policy objectives including lending to support public policy goals such as affordable housing, agriculture and infrastructure, and SME development. The dominant position in the market of SOE banks results in weak competition whereby the SOE banks set the interest rates and private banks follow suit.[22] Inefficiencies and lack of competition in public banks contribute to high interest rate spreads between loans and deposits in local currency[23] and hamper credit provision.[24]

Improving the governance and management of SOE banks should help to improve their accountability and efficiency. In addition, levelling the playing field between private and SOE banks should spur competition in the banking sector and contribute to increased monetary policy effectiveness.[25]

Table 2.8. SOE employment by sector

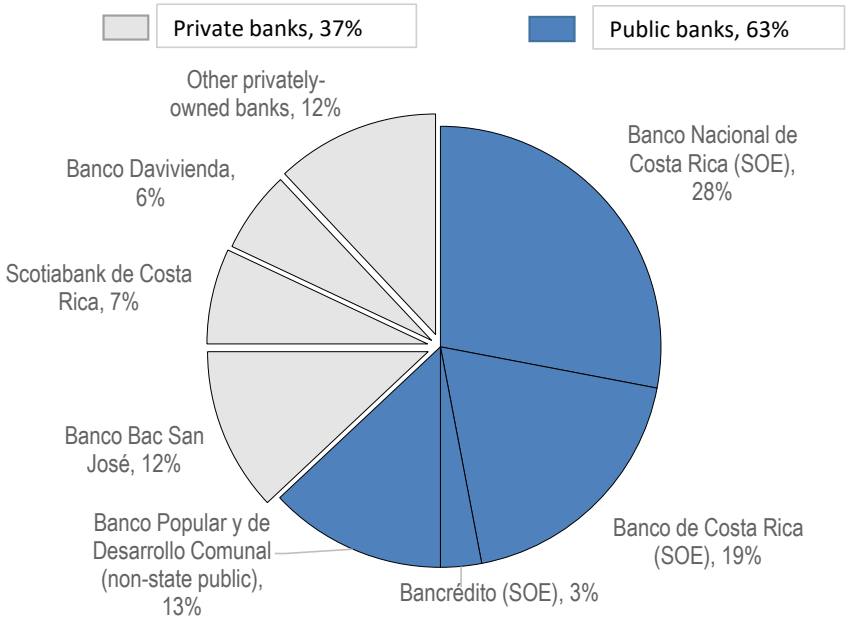
	Number of employees	Share in %
Electricity and gas	15 267	34
Finance	13 736	30
Primary sector	1 718	4
Other utilities (including postal services)	6 237	14
Transportation	1 430	3
Telecoms	1 239	3
Other activities	5 758	13
Manufacturing	181	0
Total:	45 566	100

Source: Ministry of the Presidency 2018.
Note: Percentages do not add up to 100% because of rounding.

Energy is the second largest sector in terms of number of SOEs (although if subsidiaries are counted as separate SOEs, insurance would be considered the second largest state-owned sector). However, energy is the largest in terms of employment. The electricity sector is dominated by the Costa Rican Institute for Electricity (Instituto Costarricense de Electricidad—ICE), a holding company, which is both a generator and a distributor through its subsidiary the National Energy and Light Company (Compañía Nacional de Fuerza y Luz—CNFL). Imports, refinery and distribution of wholesale petroleum and its derivatives occur under a legal monopoly granted to the Costa Rican Petroleum Refinery (Refinadora Costarricense de Petróleo—RECOPE).

In transportation, there are two SOE ports. The Costa Rican Institute for Pacific Ports (Instituto Costarricense de Puertos del Pacífico—INCOP) and the Port Board of the Caribbean Coast (Junta de Administración Portuaria de la Vertiente del Caribe—JAPDEVA) dominate maritime transport through the exclusive rights to manage all ports on the Atlantic and Pacific coasts respectively. Both have the double role of port authorities and port operators. In the case of JAPDEVA, in 2011, the government signed a concession contract with APM Terminals for the reform and operation of the port. The Costa Rican Railways Institute (Instituto Costarricense de Ferrocarriles—INCOFER) is the sole provider of rail services throughout the country.

Figure 2.8. Public and private bank assets



Note: As of November 2018, Bancrédito was merged into Banco de Costa Rica after the former experienced financial difficulties (See the mini-case study on Bancrédito in Box 4.6). Since Banco Popular is owned by workers and is not state-owned, it does not fall under the definition of SOE bank despite significant public sector influence over its operations. Banco Internacional is listed as an SOE bank in the accession review but does not appear on the chart above since it is a jointly-owned subsidiary of BCR and Banco Nacional de Costa Rica. As a consequence, Costa Rica can be considered to have two SOE banks.
Source: OECD Economic Surveys: Costa Rica 2018

Telecommunications are provided by the Costa Rican Institute for Electricity and two subsidiaries of the ICE Group, Costa Rican Radiographic (Radiográfica Costarricense—RACSA), which focuses on internet services, and Cablevisión, which provides cable television and internet services. In December 2018, ICE Group assumed all of the rights and obligations of Cablevisión S.A., which it absorbed into its operations. As of then, the functions of Cablevision were fulfilled by ICE's Directorate for Corporate Telecommunications.

Telecommunications is the SOE sector that has evolved most in recent years due to greater competition and independent regulation. This evolution was encouraged by the ratification of the Central American Free Trade Agreement (CAFTA), which was preceded by the country's first referendum in 2007. CAFTA includes a set of laws that call for competition within the telecommunication and insurance sectors. The telecommunications state monopoly was consequently opened in 2009 to competition in internet and other related services.

The first public auction for cellular frequencies was held at the end of 2010, with two private companies (Claro and Telefónica) entering the market. Within a few months of launching their networks, these new companies had secured around 500 000 customers between them. As a result, Costa Rica has experienced lower prices, and a large expansion of the sector and use of telecommunication services, which helped to close the gap with peer countries. Competition within the insurance sector started in 2010 with medical policies and was extended in 2011 to include vehicle and liability insurance. These developments serve to illustrate the potential improvements that could be achieved in other SOE sectors.

Fiscal sustainability[26]

The 2018 OECD Economic Survey highlighted the need to restore fiscal sustainability for Costa Rica. Since the start of the 2009 global crisis, the public deficit and debt had risen from a surplus of 1% of GDP in 2008 to a running deficit of approximately 5% of GDP for the five years up until 2018. During Costa Rica's fiscal reforms, ratings agencies downgraded Costa Rica's debt to below-investment grade.

According to the OECD Economic Survey, recent efforts to increase tax collection have not reduced the budget deficit due to the extensive use of earmarking, public sector fragmentation into autonomous agencies that are difficult to control centrally, and spending mandates. As a result, central government debt rose from less than 25% of GDP in 2008 to 49% in 2017. In 2018, a number of executive orders and presidential decrees were issued and the Law on the Strengthening of Public Finances (Ley de Fortalecimiento de las Finanzas Públicas) was adopted to contain public spending and increase tax revenues.

Budgetary impact of SOEs

SOEs do not present a significant drain on the state budget. Historical data describes only modest net transfers of funds to SOEs from the state budget. Data from 2018 shows the amount of net current transfers to SOEs of a total of approximately USD 88 thousand and net capital transfers from SOEs to the state of approximately USD 92.8 million.

Table 2.9. Current and capital transfers to and from SOEs 2018 in USD

	Current Transfers			Capital Transfers		
	Inflow	Outflow	Net Outflow	Inflow	Outflow	Net Outflow
Financial SOEs	2 462 000	0	2 462 000	0	52 707 000	-52 707 000
Non-financial SOEs	0	2 550 000	-2 550 000	0	40 107 000	-40 107 000
Total:	2 462 000	2 550 000	-88 000	0	92 814 000	-92 814 000

Notes: 1. Current transfers are disbursements to finance current spending in order to meet public needs of various kinds.
2. Capital transfers are disbursements to enable beneficiaries to acquire and produce capital assets, compensate for damage or destruction, or increase their financial capital.
3. An inflow is defined as an inflow to the SOE. An outflow is defined as an outflow from the state to the SOE.
4. Information was not available for most bank subsidiaries.
5. Colon to US Dollar exchange rate: 1 USD=570 CRC
Source: Presidential Advisory Unit based on information prepared by the Budgetary Authority.

Disaggregated data show that cash inflows and outflows impact individual SOEs distinctly. In the financial sector, the National Bank of Costa Rica (Banco Nacional de Costa Rica—BNCR) was the greatest revenue source for the state during 2018. The Bank of Costa Rica (Banco de Costa Rica—BCR) received 100% of the capital inflow for financial SOEs in 2018 due to its absorption of the insolvent Bancrédito. Disaggregated data for non-financial SOEs show that the Costa Rican Railways Institute was the largest recipient of capital transfers, followed by the Institute of Aqueducts and Sewers (Instituto Costarricense Acueductos y Alcantarillado—AyA) both of which are undergoing significant investment programmes.

Costa Rica contrasts with many other countries where SOEs are associated with high state investment, subsidies, and/or chronic arrears problems. The generally good liquidity of SOEs in Costa Rica may be linked, in part, to the efforts of ARESEP to support full cost recovery through tariff setting. In addition, some Costa Rican SOEs are protected from competition and are thus able to exercise considerable market power and demand higher prices from consumers.

Despite the low direct cost of SOEs to the state budget, this analysis does not reflect contingent liability risks created by the state's guarantee of SOE banks that remains relevant despite the adoption of a deposit guarantee and a bank resolution scheme in 2020. Nor does it consider the expected return on investment the state might expect to receive if it were to use the investments made in SOEs for other purposes or the cost to the state of forgoing dividends. This issue is discussed in greater detail with respect to Guideline III.F.3.

Bond issues

Five SOEs, including most of Costa Rica's largest SOEs, have made bond issues. Together they represent approximately 4% of the total value of issues on the BNV. No Costa Rican SOEs have equity listings. Most of the corporate bond offerings in terms of size are by financial firms.

Table 2.10. SOEs with bond offerings

Financial	Non-financial
Banco de Costa Rica	Compañía Nacional De Fuerza y Luz
Banco Nacional de Costa Rica	Instituto Costarricense de Electricidad (ICE)
	Refinadora Costarricense de Petróleo (RECOPE)

Source: SUGEVAL 2019.

Bond issues require SOEs to comply with the CONASSIF, SUGEVAL and BNV rules. This has consequences for their financial reporting and governance. Previously, all SOE issuers had been required to provide a statement of compliance with the Voluntary Code of Best Corporate Governance Practices of 2011. As of 2017, all bond issuers have to comply with the new CONASSIF Governance Regulation.

Labour relations

Labour is able to exercise considerable influence in Costa Rica and relations with SOEs may be strained when SOEs or the government try to achieve flexibility or reduce costs.

SOE board members are considered part of the public administration and are subject to public sector employment rules and rules of conduct. SOE employees, on the other hand, are subject to different rules depending on the legal status of the SOE. SOEs constituted as PLCs (Sociedades Anónimas) are generally entitled to enter into private law employment relationships with their employees just as any other company in the private sector. SOEs that are not PLCs are expected to follow the rules of the public administration. Increasingly such enterprises pursue new forms of contractual relations that allow them to achieve flexibility and reduce costs. One example is INCOFER, which contracts with employment agencies (Sociedades Anónimas Laborales—SALES) in order to avoid what are perceived as excessively rigid employment conditions.

Many SOEs are considered to have excessively high salaries and numbers of employees compared to the private sector, and the government has taken action to re-negotiate clauses on collective labour agreements.[27] Attempts to reduce employment and labour costs tend to spark public protest and have been legally contested. Another business practice that was contested was the plan of ICE to reduce expense travel reimbursements for workers. In that case, the decision went from the Labour Court (Juzgado de Trabajo) to the Labour Tribunal and subsequently to the Court of Cassation (Casación) where the case was finally decided in favour of ICE.

The governance of state-owned enterprises

The country has a decentralised public administration composed of autonomous and semi-autonomous institutions and state-owned enterprises.[28] State-owned enterprises respond directly to the Presidency of the Republic and to the Council of Ministers (Consejo de Gobierno) with formal supervision of financial, legal and performance issues by the Comptroller General. The boards of directors of SOEs are in most cases appointed by the Council of Ministers.

The legal form of SOEs

Costa Rica's SOEs operate under a complex mix of governance practices. SOEs are constituted under a variety of legal forms and operate under different sectoral laws. Consequently, the legal treatment and the governance and management of SOEs is highly heterogeneous. In practice, SOEs have different degrees of freedom in: 1) their governance and decision-making; 2) board nominations processes; 3) requirements regarding board composition; 4) obligations to the state and other stakeholders; 5) tax obligations; 6) capacity to take on credit, and so on.

The result is that developing and implementing considered and uniform governance policies for the SOE sector is difficult with changes in SOE governance practices often necessitating time-consuming legislation and a complex adaptation of a number of different laws. Overall, the legal form of SOEs is overly complex and prevents the implementation of best governance practices, in particular with respect to the composition of SOE boards. A simplification of the legal forms of SOEs could bring significant benefits.

The most common types of legal forms are those of the public limited company (PLC) (Sociedad Anónima) and Autonomous Institutions (Instituciones Autónomas). The Autonomous Institutions can be further subdivided into autonomous and semi-autonomous. Semi-autonomous institutions are those created by the Legislative Assembly with a simple majority vote. Fully autonomous institutions are created by the Legislative Assembly by a two-thirds vote. Some autonomous institutions have their own subsidiary bodies.

In all cases, SOEs are governed by two governance structures: 1) a board that directs management and sets the direction of the SOE (policies, directives, and guidelines); and 2) an executive function responsible for operations based on the policies, directives and guidelines set by the board. The differences between the legal forms are the degree of autonomy they have from the state with PLCs having the most and semi-autonomous entities being more closely integrated into the state.

In general, board members are appointed by the Council of Ministers. Board composition is, in turn, determined by the constituting law of each individual SOE. The following table summarises the most common options for board nominations:

Table 2.11. SOE board and executive nominations

Nominations of:	SOE owned by the state	SOE owned by an autonomous institution	Autonomous institutions Primary variant	Autonomous institutions Secondary variant
Board members	Council of Ministers	Board of the SOE that owns the subsidiary	Council of Ministers	Council of Ministers
Executives	Council of Ministers or the board	The board of the subsidiary SOE	Council of Ministers	The board of the SOE

Source: 2015 Questionnaire on the Corporate Governance of SOEs, Latin American SOE Network, Part 1 Final.

The governance of a subset of SOEs has been altered by Law No. 5507 entitled Reform of Boards of Autonomous Institutions Creating Executive Presidencies, (Reforma Juntas Directivas de Autónomas Creando Presidencias Ejecutivas). The law, which was passed in 1974, permits the Council of Ministers to nominate a combined Chair/CEO (Presidente Ejecutivo). SOEs with a Chair/CEO also have a general manager (Gerente General). The result is two top-level executive positions, one of which is subject to appointment and removal by the Council of Ministers (the Chair/CEO) and the other, which is not (the general manager). The law applies to a heterogeneous group of public institutions. Law 5507 results in a combination of the roles of Chairman and CEO, which is contrary to the recommendations of the *SOE Guidelines*.

Table 2.12. Organisations operating under Law 5507

National Production Council	National Training Institute
National Institute of Housing and Town Planning	Costa Rican Institute of Pacific Ports
Costa Rican Institute of Electricity and Telecommunications	Board of Port Administration and Development
National Institute of Rural Development	of the Caribbean Coast
Institute of Aqueducts and Sewers	National Institute of Insurance
Costa Rican Department of Social Security	Institute of Municipal Development and Assessment
Costa Rican Tourism Institute	Joint Institute for Social Aid

Source: Law 5507

The Presidency

In Costa Rica, executive powers are vested in the President of the Republic who is supported by the Ministry of the Presidency (Ministerio de la Presidencia) and the Council of Ministers.

The Council of Ministers

Oversight of SOEs is exercised mainly by the Council of Ministers. The Council of Ministers is a collegial body consisting of the President of the Republic and Ministers (or Vice Ministers acting on their behalf) under Article 147 of the Political Constitution and Article 22, paragraph 1) of the General Law on Public Administration (Ley General de la Administración Pública).

Line ministers exercise sectoral co-ordination and have some steering capacity related to national strategies or priorities, but no direct hierarchical relation to the SOEs in their sector. The Council of Ministers has the power to appoint, reappoint and dismiss the board members of autonomous institutions (with one exception for Correos de Costa Rica where a line minister also has appointment authority). Grounds for dismissal of board members are established under the Law on Internal Control (Ley de Control Interno), the Law Against Corruption and Illicit Enrichment in the Public Service (Ley Contra la Corrupción y el Enriquecimiento Ilícito), the General Law on Public Administration and/or SOE statutory laws.

In making appointments, the Council of Ministers must consider the laws that establish each individual SOE. These laws specify the profiles of individuals who may serve as board members, and contain requirements regarding eligibility such as for education and sectoral experience. At times these laws can be restrictive and make it difficult to develop a board composition that complies with best practice and that meets the needs of the SOE. Historically, the Council of Ministers did not use public tenders, search firms or other mechanisms to make appointments. This provided for a significant degree of discretion in making appointments as long as they complied with the statutes that established the individual SOE.

As part of the accession review process, Costa Rica established an ownership entity in 2018 (referred to as the Presidential Advisory Unit) under decree 40696-MP entitled Creation of the Advisory Unit for

Management and Co-ordination of State Shareholdings and the Management of Autonomous Institutions (Creación de la Unidad Asesora para la Dirección y Coordinación de la Propiedad Accionaria del Estado y la Gestión de las Instituciones Autónomas). The decree, passed on 20 October 2017, gives the Presidential Advisory Unit the mandate, among other things, to formalise and professionalise the appointment process of SOE board members and make it more transparent. The Presidential Advisory Unit officially began operation in September 2018 headed by the Secretary of the Council of Ministers who divided their time between the Council of Ministers and the Presidential Advisory Unit. By 2019, the Presidential Advisory Unit had three full-time technical support staff in substantive roles with plans for an additional two.

The staffing of the Secretariat to the Council of Ministers (which includes the President, two Vice-Presidents and 21 ministries) was nine people in 2019, with three staff members dedicated to support activities and six staff members in substantive roles. The Office of the Presidency has an annual budget of approximately USD 100 000, which includes both the Presidential Advisory Unit for SOEs and the Council of Ministers.

The Ministry of National Planning and Economic Policy (MIDEPLAN)

The Ministry of National Planning and Economic Policy (Ministerio de Planificación Nacional y Política Económica) is the body responsible for formulating the development strategies of the government. MIDEPLAN was established under the Law of National Planning (Ley de Planificación Nacional) of 1974 as the successor to a planning function established 10 years earlier. MIDEPLAN's main functions are to:

- Prepare the National Development Plan (NDP), which was combined in 2018 with the National Public Investment Plan to form the new National Development and Public Investment Plan (NDPIP);
- Define the country's development strategy and establish targets;
- Monitor and evaluate outcomes;
- Evaluate the services provided by the public administration; and
- Co-ordinate the allocation of resources (budget, public investment and international co-operation) in support of government priorities.

The defining output of MIDEPLAN was the NDP until the introduction of the NDPIP (its replacement) in 2018. In the past, each new government developed its own four-year NDP, which it used to guide its development strategies and assess outcomes. The overall direction was set by the President while line ministries and other relevant sectoral institutions collaborated in setting supporting goals. The policy directions set down in the NDP focused mainly on the achievement of social goals for entire industrial sectors. These sectoral goals were, in turn, supported by the implementation plans of individual SOEs, which were developed and approved by SOE boards.

The development of the NDP provided for significant stakeholder involvement and took into account a variety of stakeholder perspectives. The NDP was circulated for commentary among different stakeholders, including SOEs, public institutions, local governments and civil society organisations. MIDEPLAN also co-ordinated its planning with the Central Bank, which considered the economic impact of the NDP and its ramifications for international agreements. The plan was reviewed by the Legislative Assembly and finally disclosed on the MIDEPLAN website.

MIDEPLAN had no power to enforce the NDP and there were no formal performance contracts or performance agreements between MIDEPLAN and individual SOEs. However, observers suggest that there was a sense of personal obligation amongst boards and executives to comply with the NDP's directions. Though the NDP only served to orientate SOEs, both MIDEPLAN and the Comptroller General monitored achievement against its goals. For example, a goal for AyA, Costa Rica's water and sanitation SOE, was

the provision of services to a target percentage of the population. Similar performance indicators were established for other SOEs in other sectors.

MIDEPLAN had the duty to evaluate the implementation of the NDP in accordance with the National Planning Act, the Law for Financial Management and Public Budgets (Ley de la Administración Financiera de la República y Presupuestos Públicos) and the National Evaluation System (Sistema Nacional de Evaluación—SINE). Performance against the plan was monitored on a quarterly, semi-annual and annual basis and the results of evaluations were presented to the Council of Ministers.

A significant concern with respect to the NDP performance monitoring process was that it focused mainly on the achievement of social outcomes. There was no systematised tracking or analysis of key financial indicators that would provide the government with information on the financial health of the SOE sector or that might alert the government to risks in an individual SOE. Performance monitoring did not track financial indicators (such as return on equity or assets, working and operating ratios, free cash flow, debt equity ratios) or non-financial indicators (such as asset or labour utilisation or customer satisfaction) that are used by state-of-the-art ownership entities in some OECD countries.

Overall, the NDP planning process had been characterised as being resistant to innovation and in need of reform. A number of improvements were considered in 2017 and implemented in 2018. First, the NDP and the National Public Investment Plan were unified as a single instrument to form the National Development and Public Investment Plan (NDPIP). The NDPIP for 2019-2022 was published on 11 December 2018.[29] Several inter-sectoral goals were included in order to guide institutions towards a more coherent public sector policy as well as more efficient public spending. Second, NDPIPs after January 2019 include online reporting thus allowing for easier public access. Under the NDPIP system, public investment, including by SOES, is monitored every trimester by the National Public Investment System, and every semester as part of NDPIP monitoring reports. The Council of Ministers also plans to introduce “expectation letters” in 2020 that establish high-level performance expectations for SOEs that take account of national development strategies. As of late 2019, it was unclear whether the new NDPIP would monitor the financial health of SOEs. This type of financial analysis was conducted for the first time by the Presidential Advisory Unit in October 2019.

The Comptroller General and budgetary control

SOEs in Costa Rica are subject to the control and oversight of the Comptroller General (Contraloría General de la República), the government’s supreme audit institution, which performs audits on behalf of the Legislative Assembly. Typically, the Comptroller General conducts a variety of risk-based audits sometimes in response to the allegations of reporting persons. Audits of individual SOEs do not necessarily occur on an annual or regular basis. Rather, the Comptroller General aims to audit all of its subjects over an eight-year period with audits occurring with more or less frequency depending upon an assessment of need or risk. The Comptroller General tends to focus on budgetary and compliance risks and not on the financial performance of SOEs or key performance indicators such as those noted in the section immediately above. Partly as a result of the accession process, the Comptroller General has become more attuned to issues of governance in SOEs and in 2019 issued a report entitled Follow-up Report on the Corporate Governance of the Boards of Costa Rican Public Entities (Informe de Seguimiento de la Gestión del Órgano de Dirección en el Gobierno Corporativo de las Entidades Públicas Costarricenses) that provides a critical analysis of SOE governance.

The Comptroller General’s powers and responsibilities are established in the Political Constitution, in the Organic Law of the Comptroller General of the Republic and in the General Law of Internal Control, in addition to a series of laws that establish specific functions, such as the Law of Administrative Contracting. The Comptroller General examines the use of public funds by SOEs and has the mandate to review, approve or reject SOE budgets and supervise their execution (such reviews are reported to

focus on compliance with procedures and plans). The Comptroller General also generates reports on the fiscal, financial and management practices of SOEs, which it submits to the Commission of Public Income and Expenditure Control of the Legislative Assembly.

The Law for Financial Management of the Republic and Public Budgets (Ley de la Administración Financiera de la República y Presupuestos Públicos) requires SOEs to submit periodic reports regarding budget execution, as well as reports on their performance. These reports should be in compliance with requirements that the Ministry of Finance, MIDEPLAN and the Comptroller General establish to evaluate the public sector. Reports are presented by MIDEPLAN and the Ministry of Finance[30] to the Comptroller General who, in turn, issues an opinion and submits them to the Legislative Assembly. The Legislative Assembly may establish an investigative committee to study the compliance and performance of institutions if they deem it necessary.

The internal audit function of SOEs

Article 20 of the Law on Internal Control (Ley de Control Interno) stipulates that all SOEs must establish an internal audit unit. The objective of an internal audit unit is to independently and objectively validate and improve the entity's operations. The entities themselves are responsible for implementing the internal control systems established under law. Internal auditors are appointed by boards of directors. If circumstances require that an internal auditor be removed by the board, the decision must be approved by the Comptroller General.

The Comptroller General has the right to supervise the internal audits of SOEs to ensure that they comply with the provisions of the legal framework. In principle, this arrangement would seem to support strong external oversight by establishing external accountability of the internal audit unit. However, it also risks shifting one of the key responsibilities of SOE boards (to ensure that systems for control and risk management are in place and functioning properly) to the Comptroller General.

Conversations with Costa Rican SOE board members suggests that, at least in some cases, SOE boards do not recognise that ensuring a proper control environment is one of their key responsibilities. The "Cementazo" case and the weakness of internal controls at the Banco de Costa Rica would appear to bear out this conclusion (See Box 4.1. The Big Cement scandal or the "Cementazo".) The Presidential directive entitled General Guideline for the Review of the Functions of Management Bodies and the awareness-raising efforts of the Presidential Advisory Unit were designed to address this gap. In addition, the new SOE board induction and training programmes being implemented under by the Presidential Advisory Unit aims to remedy this concern.

Structures are in place to support the independence of the internal audit function in SOEs. Beyond the selection of the internal auditor by the board, under the General Law for Internal Control, both the internal auditor and the assistant internal auditor are selected by public tender. A shortlist of three candidates is established by the SOE's human resource department and is submitted to the board for final decision. However, before the final appointment is made, the shortlist must be sent to the Comptroller General who considers whether the proper process was followed. The Comptroller General limits their review of the process to ensuring that it complies with rules but does not review the qualifications of the internal auditor selected through the process. This would appear to ensure the professionalism of the internal audit function and their independence. Though the Comptroller General disagrees, some critics have voiced concern that the outcomes of the selection process may be influenced, and not yield the quality of internal auditor or the independence desired.

With respect to the Comptroller General's involvement in monitoring the governance of SOEs, as of January 2019, the Comptroller General reported increased awareness of the importance of good governance amongst Costa Rican SOEs and their internal audit departments. Internal auditors that follow COSO internal audit standards are now required to consider the corporate governance of their subjects, meaning that

corporate governance audits by internal audit departments should become more common in Costa Rica. Furthermore, in 2019, the Comptroller General completed their first audit of SOE boards.

The Regulatory Authority for Public Services (ARESEP)

Tariffs for SOEs exercising monopoly power are set by the Regulatory Authority for Public Services (Autoridad Reguladora de los Servicios Públicos). The Law of the Public Service Regulating Authority (Ley de la Autoridad Reguladora de los Servicios Públicos) establishes ARESEP as an autonomous multi-sectoral regulator. According to the law, the board of directors is named by the Council of Ministers subject to approval by the Legislative Assembly. ARESEP is financed by charging regulated entities. Charges are set annually and are subject to the approval of the Comptroller General.

ARESEP sets the tariffs for:

- Drinking water
- Electricity
- Bus transport
- Gasoline
- Ports
- Taxi services
- Other services such as airports, toll roads and sanitation

The Telecommunications Supervisor (SUTEL)

Tariffs for the telecommunication sector are set by the Telecommunications Supervisor (Superintendencia de Telecomunicaciones). SUTEL is a fully independent body created by the law entitled Strengthening and Modernisation Law of Public Sector Telecommunications Entities (Fortalecimiento y Modernización de las Entidades Públicas del Sector Telecomunicaciones). Telecommunications is a competitive sector whose regulation was separated out from the multi-sectoral regulator as a result of the adoption of the Dominican Republic–Central America Free Trade Agreement with the United States (CAFTA-DR), which entered into force in 2009 and resulted in a significant liberalisation of trade in goods and services in the region. SUTEL is responsible for regulating the telecommunications sector and ensuring efficiency, equality, continuity, quality, better and broader coverage as well as innovation in the provision of telecommunications services. SUTEL has the mission of an independent telecommunications regulator while the National Telecommunications Fund (Fondo Nacional de Telecomunicaciones—FONATEL) and ARESEP have the mission of ensuring telecommunications services for the part of the population that has access to limited resources.

Subsidiary governance

Subsidiary governance is an important issue in Costa Rica. Twelve of Costa Rica's 28 SOEs are owned directly by the state. However, four of these, in turn, own a total of 16 subsidiaries (See 0. State-owned enterprises and subsidiaries 2018). Subsidiary governance practices in Costa Rican SOEs vary considerably from those of SOEs that are directly owned by the state, especially as they relate to the nomination of board members. For example, unlike the board members of parent companies who are appointed by the Council of Ministers, board members of a subsidiary are nominated by their parent.

Subsidiary nominations practices have led to problems in the past. In the case of the Bank of Costa Rica (BCR), two members of the parent board were also board members in BCR's four subsidiaries. This had the positive effect of providing parent board members direct insight into subsidiary operations.

On the other hand, the rules also prevented BCR executives from sitting on subsidiary boards. Good practice in the banking sector would have suggested that parent executives be permitted to be members of the board of a closely-integrated subsidiary.[31]

This situation persisted in part because board members were able to increase their income by collecting fees from multiple company boards. As a consequence, in February of 2018, the directive entitled General Guideline for the Review of the Functions of Management Bodies and Strengthening of their Strategic Role in State-Owned Enterprises and Autonomous Institutions (Directriz General Para la Revisión de las Funciones de Órganos de Dirección y Fortalecimiento de su Rol Estratégico en las Empresas Propiedad del Estado e Instituciones Autónomas) limited the number of subsidiary boards on which parent board members could sit to two in addition to the parent board.

Furthermore, the new directive requires subsidiary board member nominations to follow the same rules as the parents themselves and to report on how subsidiaries are governed, thus bringing parent and subsidiary governance practices more into line. With respect to the specific case of BCR, BCR's 2018 revision of its corporate governance code establishes that "any person external to BCR's financial conglomerate, any BCR employee and any member of BCR's board may sit on its subsidiary boards" thus resolving the issue of not being able to place parent executives on subsidiary boards.

The company with the most significant subsidiaries in Costa Rica is the ICE Group. In January 2019, it was reported that the group had made changes to the composition of its subsidiary boards. RACSA received an independent chair whereas the previous one had been an executive of the parent. The new structure also permitted greater autonomy. On the other hand, the Cablevisión subsidiary of ICE Group was merged into ICE's Directorate for Corporate Telecommunications. The ICE Group example shows how subsidiary governance practices can vary and how they need to be adapted to the specific circumstances of the parent, the subsidiary and to market conditions.

Privatisation

Privatisation has been negligible in Costa Rica. Anecdotal feedback suggests that some political parties and much of the public are not supportive of privatisation, and the issue is politically sensitive. In 2018, Costa Rica had no plans to pursue a privatisation programme. Even simple and useful reforms, such as providing SOEs with a uniform limited liability legal structure, are viewed with suspicion because corporatisation is viewed by some as a precursor to privatisation. As an alternative to privatisation, the state has focused on administrative reforms to improve the efficiency of SOEs. It has also introduced competition, particularly in the telecommunications and insurance markets.

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Notes

[1] This section draws upon OECD Economic Surveys: Costa Rica 2018. It reuses figures and parts of the text with additional updated information where available.

[2] Figures do not add to 100% because of rounding.

[3] As measured by Costa Rica's National Institute of Statistics and Censuses (INEC); National Electoral Tribunal (TSE); and Gallup (2015), and Gallup World Poll Database. For OECD comparison: OECD Better Life Index Database.

[4] OECD Economic Surveys: Costa Rica 2018, p 63.

[5] OECD (2015), Costa Rica: Good Governance, from Process to Results, OECD Public Governance Reviews, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264246997-en.

[6] World Health Organization, Arguments for and against earmarking, http://www.who.int/health_financing/topics/public-health-taxes/for-against-sin-tax/en/

[7] For more complete and up-to-date information on the BNV and trading, see the BNV website at: https://www.bolsacr.com/.

[8] In addition, there are 27 exchange traded funds that raise capital through the BNV by issuing certificates of participation. However, the Accession Review limits itself to an assessment of the corporate governance framework for listed companies against the *G20/OECD Principles of Corporate Governance.*

[9] SUGEVAL data and exchange rates as of 11/05/2018.

[10] Source: World Bank Data Catalogue drawing upon World Federation of Exchanges Database: https://data.worldbank.org/indicator/CM.MKT.LDOM.NO.

[11] FTSE Russell, Russell Europe SMID 300 Index, Construction and Methodology v. 2.0.

[12]Costa Rica provides access to its laws via the Costa Rican System on Juridical Information (Sistema Costarricense de Información Jurídica—SCIJ): https://www.pgrweb.go.cr/scij/ayuda/nrm_ayuda_simple.aspx

[13] RECOPE has not refined petroleum since 2011 and acts as a reseller of imported refined petroleum products. A draft law proposes changing the name of RECOPE to Costa Rican Company of Fuels and Alternative Energies, Public Limited Company PLC (ECOENA) to better reflect its mission.

[14] El Financiero, "Sector bursátil pierde importancia relativa en la economía", Sergio Morales Chavarría, 9 October 2015.

[15]Costa Rican System on Juridical Information (Sistema Costarricense de Información Jurídica—SCIJ) See: https://www.pgrweb.go.cr/scij/ayuda/nrm_ayuda_simple.aspx

[16] The discussion on the judicial system draws upon conclusions published in the US Department of State, Bureau of Economic and Business Affairs, Investment Climate Statement for Costa Rica, 2018.

[17] Additional details on the transition to risk-based supervision can be found in the Accession Review of Costa Rica conducted by the OECD Committee on Financial Markets.

[18] Costa Rican data is from the Costa Rican authorities for 2018, while the OECD average is based on 2012 data published in OECD (2014), The Size and Sectoral Distribution of SOEs in OECD and Partner Countries, OECD Paris.

[19] The situation of Banco Popular is unusual. It does not fit any of these categories perfectly. It is not formally an SOE bank according to its founding law and does not appear on the list of SOEs in the accession review. It is, nevertheless considered a public institution by Fitch Ratings, is significantly under state influence, is a systemically important financial institution and has an impact on the state's budget though it is not technically guaranteed by the state. It is fully owned by Costa Rica's workers who maintain deposits at the bank and in whose interest and on whose behalf it operates. The state has the right to nominate three out of its seven board members with the remaining four being nominated by the GSM, which is composed of workers' representatives. Its employees are paid according to public sector guidelines. In 2018, the Presidency instructed the bank's board to promote the reduction of executive salaries, with the goal of addressing concerns regarding public sector spending.

[20] OECD Economic Surveys: Costa Rica 2018.

[21] IMF, Costa Rica Financial Sector Stability Review, April 2018.

[22] Estado de la Nación, 2016

[23] Castro Arias and Serrano López, 2013

[24] OECD Economic Surveys: Costa Rica 2016.

[25] This paragraph draws upon OECD Economic Surveys: Costa Rica 2018.

[26] This section largely repeats the text and recommendations of the OECD Economic Surveys: Costa Rica 2018 Economic Assessment

[27] OECD Economic Surveys: Costa Rica 2016.

[28] OECD Public Governance Reviews Costa Rica 2015 citing MIDEPLAN classification of the institutionally decentralised public sector.

[29] For information on MIDEPLAN and copies of NDPs and NDPIPs see: https://sites.google.com/expedientesmideplan.go.cr/pndip-2019-2022/documentos

[30] Although the Ministry of Finance tracks inflows and outflows of funds received by the government from SOEs and from the government to SOEs, they do not generally have approval authority over budgets for SOEs as autonomous and semi-autonomous institutions.

[31] IFC, Challenges in Group Governance: The Governance of Cross-Border Bank Subsidiaries, https://goo.gl/dsz3U3.

3 Review against the core corporate governance principles

This chapter assesses Costa Rica's policies and practices with respect to core corporate governance principles that are set out in the OECD Corporate Governance Committee's agreed methodology for undertaking corporate governance accession reviews. These principles relate to: 1) ensuring the rights and equitable treatment of shareholders, including minority and foreign shareholders; 2) requiring timely and reliable disclosure of corporate information in line with internationally recognised standards; 3) ensuring effective separation of the government's role as owner and regulator of state-owned enterprises; and 4) maintaining a level playing field between state-owned enterprises and their private competitors. The final core principle found in the methodology is subdivided into two components: 5) recognising stakeholder rights and the duties, rights and 6) the responsibilities of boards of directors.

Ensuring the enforcement of shareholder rights and the equitable treatment of shareholders

Ensuring a consistent regulatory framework that provides for the existence and effective enforcement of shareholder rights and the equitable treatment of shareholders, including minority and foreign shareholders.

As noted in the introduction, Costa Rica was reviewed against all of the recommendations of the *G20/OECD Principles of Corporate Governance* and the *Guidelines on Corporate Governance of State-Owned Enterprises*. This report integrates the elements most relevant to assessing each of the core corporate governance accession principles, following the Concept Paper of the Corporate Governance Committee. This section is therefore divided into five sub-sections: 1) shareholder rights and equitable treatment, including treatment of the market for corporate control (Principles II.C, D, E, G, and H); 2) related party transactions and conflicts of interest (Principle II.F 1 and 2); 3) institutional investor disclosure, corporate governance policies, conflicts of interest and voting (Principles III.A and C); and 4) insider trading and abusive self-dealing (Principle III.E). The fifth and final section of the chapter deals with equitable treatment of shareholders among state-owned enterprises (Guidelines IV.A and IV.C).

Shareholder rights and equitable treatment

Effective participation in general meetings (Principle II.C)

Principle II.C states that shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings. This includes consideration of six sub-topics dealing with: 1) provision of sufficient and timely information regarding general meetings; 2) processes allowing for the equitable treatment of shareholders including procedures that do not make it unduly difficult or expensive to vote; 3) asking questions to the board and placing items on the general meeting agenda; 4) facilitation of effective participation in key corporate governance decisions such as nomination and election of board members and remuneration; 5) voting in person or in absentia; and 6) eliminating impediments to cross-border voting.

Costa Rica's governance framework is substantially consistent with the recommendations of Principle II.C whose detailed recommendations are described below.

Provision of sufficient and timely information regarding general meetings (II.C.1)

Costa Rica's legal requirements clearly specify the provision of sufficient and timely information regarding general meetings. Article 163 of the Code of Commerce provides that the agenda of general meetings contain a description of the matters to be submitted for discussion and approval at the meeting. An ordinary meeting must be held at least once a year, within the three months following the end of the fiscal year, which must address the following matters, in addition to any other items included in the agenda:

- Discussion, approval or rejection of the financial statements presented by management and any measures considered appropriate;
- Agreement on the distribution of profits, if any, as provided in the corporate bylaws;
- Appointment or revocation of managers and board members; and
- Any other ordinary matters provided in the corporate bylaws.

Regarding meeting notice, Article 164 of the Commercial Code specifies that the meeting be convened with the notice as established in the articles of incorporation or, by default, 15 working days prior to the date of the meeting, during which time, the books and documents related to the purpose of the meeting must be made available to shareholders in the offices of the company. During the meeting, shareholders may request all reports and clarifications they deem necessary regarding the items on the agenda.

The CONASSIF Governance Regulation reinforces the articles in the Code of Commerce by requiring easy access to information in advance about the date, venue and agenda of shareholder meetings, as well as complete and specific information regarding the matters to be decided in said meetings. In addition, the CONASSIF Governance Regulation requires the provision of relevant and substantive periodic information about the company, and with mechanisms to address questions, claims and complaints.

Observational evidence suggests that companies comply with these legal requirements in practice. There have been cases where the level of information provided was contested by minority shareholders. However, such shareholder complaints are infrequent. In recent years there has only been one case of an investor claiming lack of information.

Processes allowing for equitable treatment of shareholders including procedures that do not make it unduly difficult or expensive to vote (II.C.2)

Both the Commercial Code and the CONASSIF Governance Regulation require the provision of sufficient information to make it possible for shareholders to participate in the governance of the enterprise. The procedures for participation comply with standard OECD practice and are neither expensive nor unduly onerous. One area where there may be room for improvement is in the procedures to prove share ownership before a general meeting. Some companies require the advance deposit of shares before a shareholder meeting in their articles or bylaws. In the event that the articles of incorporation require such a deposit in order to participate, the Commercial Code demands that the meeting be convened sufficiently in advance to allow shareholders to make the required deposit. Such procedures under the Commercial Code may be time consuming and could be streamlined by a simpler process of shareholder identification.

Asking questions to the board and placing items on the agenda of the general meeting (II.C.3)

The Commercial Code specifies that during a general meeting, shareholders may request all reports and clarifications they deem necessary regarding any agenda item. Shareholders holding 25% of the share capital may request that issues be placed on the agenda. It is also possible for the owner of a single share to place items on the agenda when no meeting has been held for two consecutive financial years and when the meetings held at that time did not deal with ordinary matters such as the discussion and approval of the financial reports or the distribution of profits, among others. The right to information enshrined in the Commercial Code has been upheld by the courts. The First Chamber of the Supreme Court of Justice indicated in Sentence 879 of December 2007 that shareholders have the right to demand and receive explanations from boards.

The CONASSIF Governance Regulation (Article 46.7) provides that the governance of the institution must protect and facilitate the exercise of shareholders rights, amongst, which it mentions the opportunity to participate effectively and vote in the general shareholders meetings, and the right to be informed of the rules governing such meetings, including voting procedures. The Governance Regulation also covers the right to raise questions at board meetings and submit resolutions to general meetings.

Effective shareholder participation in key corporate governance decisions such as the nomination and election of board members and remuneration (II.C.4)

The Code of Commerce does not specifically provide for the right to participate in nominations, elections or remuneration decisions. However, the Governance Regulation fills this gap. The Governance Regulation (Article 46.7.iii) specifies that shareholders have the right to participate effectively in key corporate governance decisions such as the appointment or election of board members. Shareholders should also have the opportunity to make their views known regarding the compensation policy for board members and senior management, with share remuneration being subject to shareholder approval.

Shareholders should be able to vote in person or in absentia and impediments to cross-border voting should be eliminated (II.C.5 and II.C.6)

According to the Code of Commerce, shareholders have the right to be represented at general meetings by proxy (Article 146). And, if a company's articles of incorporation do not expressly prevent it, there is no impediment to voting from abroad. The Governance Regulation goes somewhat further in that it requires that fair treatment be guaranteed to all shareholders, including minority shareholders and foreigners.

However, neither the Code of Commerce nor the Governance Regulation address the issue of electronic voting. The absence of a detailed rule regulating the subject of cross-border voting and voting through electronic means is a potential area for improvement in the governance framework. The solution would be a legal standard regulating the use of technology to ensure cross-border voting and prohibiting the restriction of such right via articles of incorporation or bylaws.

Shareholder consultation and co-ordination in the exercise of their rights (Principle II.D)

Principle II.D states that shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the *G20/OECD Principles*, subject to exceptions to prevent abuse.

In Costa Rica there is no prohibition against investors consulting with each other or reaching agreements, except in the case of illicit activities such as price fixing or undue use of privileged information.

Equal treatment with respect to different share classes (Principle II.E)

Principle II.E states that all shareholders of the same series of a class should be treated equally. Capital structures and arrangements that enable certain shareholders to obtain a degree of influence or control disproportionate to their equity ownership should be disclosed.

The Code of Commerce establishes in its Articles 120 and 121 that common shares grant identical rights and represent equal parts of the company capital. The Code of Commerce also states that any stipulations that exclude one or more owners of common shares from participating in the profits of the company shall have no legal effect. It thus guarantees equal treatment with respect to dividends. The CONASSIF Governance Regulation establishes in its Articles 46.4-5 the obligation to disclose agreements, capital structures and other types of capital groupings that might enable some shareholders to acquire a disproportionate degree of control compared to the shares that they own.

Five of the equity issuers on the BNV[1] also issue preference shares without voting rights. There is no indication that shareholders with preferred shares receive differential treatment with respect to ownership of this class of shares. Furthermore, there is no indication that the issuance of preference

shares by these companies has enabled the controlling shareholders of these companies to exert disproportionate control. In four out of five companies with preference shares, a controlling owner or owners own a majority of the company's shares, in some cases exceeding 90%.

Regarding the disclosure of shareholder agreements and other structures that might be used to exercise disproportionate control, in the past, there was no regulatory obligation to disclose such agreements or structures. SUGEVAL became aware that such arrangements could affect share prices through the case of Grupo Financiero Improsa, which resulted in the disclosure of an agreement between Improsa and the International Finance Corporation (IFC). The CONASSIF Governance Regulation now requires issuers to disclose all such agreements.

Minority shareholder protection (Principle II.G)

Principle II.G states that minority shareholders should be protected from abusive actions by controlling shareholders and should have effective means of redress. This principle was added to this review, in addition to the principles set down in the Concept Paper, because the issue of minority shareholder protection is acute in Costa Rica. In Costa Rica, when conflicts occur between minority shareholders and listed firms, it is usually with respect to access to information and, in particular, as regards dividends. Such conflicts are usually resolved with the controlling shareholder but, on occasion, go to the regulator or the courts.

Depending on the right that the shareholder wants to exercise (whether it falls under law such as the Commercial Code or under securities market regulation), the shareholder may appeal to legal authorities and/or the regulator. Fundamental principles of company law (for example, Article 47.4 of the CONASSIF Governance Regulation, which specifies that the processes and procedures of general shareholders meetings allow all shareholders to enjoy fair treatment and not unduly hinder the issuance of votes) must be resolved by a judge.

On 4 August 2016, the Minority Shareholder Protection Law (Protección al Inversionista Minoritario) was approved as a way to address some of the weakness in minority shareholder protection detected in the World Bank's assessment of Costa Rica in its Doing Business Report. The law modified Articles 26 and 189 of the Code of Commerce. Article 26, as revised, regulates shareholder access to company books. This had, on limited occasions, been identified as an area of dispute between minority and controlling shareholders. Article 189, as revised, establishes board members' duties of diligence and loyalty, and the obligation to act in the best interests of the company, taking into account the interests of the company and its shareholders.

The CONASSIF Governance Regulation provides for some general protections in its section on the equitable treatment of shareholders. Article 47 calls for the equitable treatment of all shareholders, including foreign and minority shareholders, and allows shareholders to seek redress in the event their rights are violated. The discussion of Principle I.B provides some context regarding the degree to which shareholders may seek redress from the regulator and the courts. Article 47.2 also specifies that minority shareholders are protected from direct or indirect abusive actions by, or in the interest of, controlling shareholders.

Costa Rica's initial Self-Assessment concluded that further attention was required to bring minority shareholder protection up to the OECD standard. The reasons were that the modifications to the Code of Commerce only regulate shareholder access to information, the right to demand audits, and the responsibility of the board members, while the Governance Regulation remains general.[2] As a consequence, Costa Rica should consider the development of more detailed regulations that address the issue of how new provisions of the Governance Regulation may be implemented, for example, with respect to the recommendation that companies protect shareholders from direct or indirect abusive actions.

Transparency and the market for corporate control (Principle II.H)

Principle II.H, recommends that markets for corporate control be allowed to function in an efficient and transparent manner.

The rules and procedures regarding markets for corporate control are clearly articulated in Costa Rica's law and are disclosed and easily available on the web. Tender offers, corporate control agreements, mergers and transformations, and company control matters are regulated through a combination of the Securities Market Law, the Public Offering of Securities Regulation (Reglamento de Oferta Pública de Valores), the Code of Commerce and the law On Mergers and Transformation of Companies. The CONASSIF Governance Regulation draws directly on the wording of the *G20/OECD Principles* to articulate the need for transparency in extraordinary transactions.

In addition, the Governance Regulation requires that the norms and procedures applicable to acquiring company control and special transactions, such as mergers or the sale of substantial portions of the company's assets, be clearly articulated and disclosed to the shareholders so that they may participate in decisions and understand their rights and avenues of recourse. Control transactions must be carried out at transparent prices and under fair conditions that protect the rights of all shareholders within their respective categories.

Regarding mandatory offers (the requirement that a shareholder holding more than a certain percentage of a company must offer to buy the remaining shares on terms as good as its most recent purchases), according to the rules on takeover bids found in the Public Offering of Securities Regulation (Reglamento de Oferta Pública de Valores), when an offeror intends to acquire a stake equal to or greater than 25% of share capital, but less than or equal to 50%, the offer must be made on a number of securities representing at least 10% of the capital of the company concerned. When the offeror intends to acquire a stake greater than 50%, the offer must be made on a number of securities that enable the acquirer to reach at least 75% of the capital of the company concerned. The offer should be addressed to: 1) holders of all shares of the affected company with voting rights; and 2) holders of all rights to acquire or subscribe for shares with voting rights, as well as holders of bonds convertible into shares with voting rights.

The price is to be determined by the offeror and may consist of cash or shares of another company. In the event of an exchange of shares, the offer must be clear as to the nature, valuation and characteristics of the securities offered in exchange, as well as to the proportion in which the exchange is to take place. All offers must ensure equal treatment of securities of the same class. If the compensation consists of shares, the offering must include a valuation of the company made by an independent expert. If the shares are quoted on a stock exchange, the market value of the shares presented by a brokerage firm that is not part of its economic group must be included. Additionally, the offering shall state information on the issuer of the offered shares in the exchange, including the main activities of the company and an analysis of the trajectory of the company in terms of its financial situation and the results obtained in the last two reporting periods. Finally, the offering must disclose agreements between the offeror and the board of the affected company, including any specific advantages that might accrue to the members of the board. The board of the affected company must publish a detailed report with their opinion about the final offer, including the disclosure of any agreement between the affected company and any of the offerors.

Principle II.H.2 further states that anti-takeover devices should not be used to shield management and the board from accountability

To date, there has been no use of anti-takeover devices in Costa Rica. Though anti-takeover devices are not explicitly prohibited by law, there are limitations on actions designed to thwart a takeover. Regulations require that the board of directors of the affected company refrain from carrying out any transaction that is not specific to the ordinary activity of the company or that may hinder an offer during the period of the tender.

In particular, the board may not: 1) agree to the issuance of debt, except when executing prior agreements or those related to the usual activities of the company; 2) carry out transactions in the securities affected by the offer that may affect them; or 3) dispose, tax or lease company assets that may disturb the offer, except as per prior agreements. In addition, any previous agreement between the company and the bidder or between any of these and the members of the board should be disclosed.

The CONASSIF Governance Regulation specifies that anti-takeover devices may not be used to reduce the accountability of senior management or the board of directors.

Related party transactions and conflicts of interest

Principle II.F states that related party transactions should be approved and conducted in a manner that ensures proper management of conflicts of interest and protects the interest of the company and its shareholders. More specifically: 1) Conflicts of interest inherent in related party transactions should be addressed; and 2) Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Framework for the supervision of related party transactions (Principle II.F.1)

The framework for the supervision of related party transactions is in place. The Code of Commerce requires companies to adopt related party transaction policies. The policies must include the obligation for any transaction, acquisition, sale, mortgage or pledge of assets that involves the general manager, any board member, or a related party to be reported to the board, and provide all relevant information on the interests of the parties in the transaction. In line with the above, the persons involved are to recuse themselves from decision making in the transaction. In addition, the Code of Commerce provides the definitions and criteria for identifying relationships of influence and interest of persons and institutions.

Furthermore, the Governance Regulation requires the board to identify, prevent and manage conflicts of interest, establish minimum conditions including the definition of conflict of interest for the board of directors, committees, support units and staff, as well as establish mechanisms to determine the existence of conflicts of interest and the manner in which these will be disclosed and managed. Specific related party transactions must be disclosed under Article 43.9 of the Governance Regulation and are also required under IAS 24 in the event the company produces IFRS compliant financial statements.

There are, however, difficulties in identifying conflicts of interest and who may be involved in a related party transaction based on publicly available information. The fundamental impediments to transparency are the Data Protection Law (Ley de Protección de la Persona Frente al Tratamiento de sus Datos Personales) and privacy rights embedded in the Political Constitution. Both serve to protect the identities of beneficial owners. The Securities Market Law also restricts access to certain information kept at the National Register of Securities and Intermediaries (Registro Nacional de Valores e Intermediarios). According to Article 6 of the law, the registry must contain information on all market participants, except investors. However, Article 8 (m) requires information on significant shareholdings (equal or greater than 10% of the subscribed capital) to be made public in the prospectus that is filed with the National Register of Securities and Intermediaries. In addition, with the reform to the Securities Market Law adopted in October 2019, SUGEVAL was provided with access to confidential beneficial ownership information of shareholders of listed companies for regulatory purposes. Furthermore, there is a new registry of shareholders managed by the Central Bank that was created in response to a recommendation made by the OECD in relation to tax matters. The law that establishes the registry is entitled the Law to Enhance the Combat against Tax Fraud, (Ley para Mejorar la Lucha Contra el Fraude Fiscal).

Framework for disclosing interests in transactions (Principle II.F.2)

The Code of Commerce requires the general manager, board members, and related parties to report conflicts of interests in transactions to the board, providing all relevant information on the interests of the parties in the transaction. The Governance Regulation establishes the duty of board members and all personnel to disclose any matter that could result or has resulted in a conflict of interest. The Governance Regulation also requires companies to disclose an annual corporate governance report on their websites that includes information on related party transactions.

In addition, all listed companies produce financial statements according to IFRS. Under IFRS, International Accounting Standard, IAS 24 requires disclosure of basic information on related party transactions. This information is to include: 1) the name of the person acting as counterparty in the transaction; 2) type of operation; 3) terms and conditions of the operation in case guarantees are granted or received; 4) the currency; and 5) the amount of the operation.

Institutional investor disclosure, corporate governance policies, conflicts of interest and voting (Principles III.A and III.C)

Principles III.A states that "Institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights". **Principle III.C** states that institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

The Securities Market Law provides in Article 114 that SUGEVAL will dictate the necessary norms to regulate conflicts of interest between stock market participants including the prohibition of operations between companies belonging to the same group, and to prevent operations or the transfer of information that may harm the investing public. Market participants can be understood to include: issuers, intermediaries, risk rating agencies, investment fund management companies, stock exchanges and any other company that participates directly or indirectly in the securities market.

The Governance Regulation reinforces prior legislation and regulations. Under the regulation, institutional investors acting as trustees should disclose their general corporate governance and voting policies in relation to their investments, including the procedures foreseen to decide on their use of the right to vote. In addition, they should disclose the way in which they manage conflicts of interest that could affect the exercise of fundamental ownership rights regarding their investments.

Insider trading and abusive self-dealing (Principle III.E)

Principle III.E states that insider trading and market manipulation should be prohibited and the applicable rules enforced.

Both insider trading and market manipulation are sanctioned by the Securities Market Law (Articles 102, 103, 104, 157 sub-paragraph 30 and 157 sub-paragraph 10), and by the Criminal Code (Articles 251 and 252). Moreover, CONASSIF published a regulation whereby the regulated parties must have policies in place to prevent insider trading. Additionally, under the CONASSIF Governance Regulation, regulated parties must establish mechanisms to avoid the use of insider information and abusive treasury stock transactions by shareholders.

Insider trading and price manipulation are conducts regulated by the criminal court. If they are detected, SUGEVAL has the duty to report them to the Public Prosecutor's Office to begin investigations and judicial process. For the purpose of administrative sanctions, it is necessary to demonstrate that the

person who has privileged information has carried out operations directly or indirectly, or has communicated the information to which they had access, or recommended operations with securities.

Once this is demonstrated, the individual can be fined. In the case of legal persons, the fine can be five times the benefit obtained as a direct consequence of the infraction, or 5% of the assets of the company whichever is higher. In the case of natural persons, they can be sanctioned with a fine of five times the benefit obtained as a direct consequence of the infraction committed, or with a fine of 200 base salaries (approximately USD 145 000), whichever is higher.

In practice, there have been some recent preliminary investigations into two cases of suspected insider trading and market manipulation, but SUGEVAL dismissed both cases due to insufficient evidence.

Equitable treatment of shareholders of state-owned enterprises

Shareholder protections (Guideline IV.A)

Guideline IV.A provides that the state should strive toward full implementation of the *G20/OECD Principles of Corporate Governance* when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes: 1) the state and SOEs should ensure that all shareholders are treated equitably; 2) SOEs should observe a high degree of transparency, including equal and simultaneous disclosure of information, towards all shareholders; 3) SOEs should develop an active policy of communication and consultation with all shareholders; 4) the participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board elections; and 5) transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.

As noted above, shareholder protection for private sector enterprises and listed firms had previously been identified as a weakness in Costa Rica. In order to address certain shortcomings, the Executive Branch developed a series of reforms to the Code of Commerce (Project N°19530), which were approved by the Legislative Assembly in August 2016. While reforms have taken place in the legal framework for private sector enterprises, the issue of minority shareholder protection has limited consequences for Costa Rica's SOEs. Of the 29 SOEs in the state's portfolio, only CNFL (a subsidiary of the ICE Group) has minority shareholders. And, both the percentage shareholding and the number of minority shareholders in CNFL are small.

Treatment of SOEs' transactions with the state and other SOEs on market consistent terms (Guideline IV.A.5)

Guideline IV.A.5 calls for transactions between the state and SOEs, and between SOEs, to take place on market consistent terms. (This issue is addressed below under: Ensuring a level playing field between SOEs and private sector competitors.)

Disclosure of public policy objectives (Guideline IV.C)

Guideline IV.C states that, where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

There are virtually no non-state shareholders in Costa Rican SOEs with the minor exception of CNFL mentioned above. Nevertheless, making information available on the pursuit of public policy objectives remains an important objective and the OECD recommends that the costs of public services in SOEs be defined, assessed and reported.

Timely and reliable disclosure in accordance with international standards

Disclosure and transparency: Requiring timely and reliable disclosure of corporate information in accordance with internationally recognised standards of accounting, auditing and non-financial reporting

The Concept Paper, in its guidance for assessing Costa Rica's corporate governance framework suggests three main areas of focus. A first key issue is the application of accounting and auditing standards and practices (Principles V.B and C and Guidelines VI.A, B, and C). A second key emphasis is the importance of disclosing information on two aspects of corporate information: 1) enterprise governance, ownership and voting structures (Principles II.E.2, V.A.3 and V.A.9 and Guideline VI.A.3); and 2) disclosure of related party transactions (Principle V.A.6 and Guideline VI.A.8). This section, therefore, is broken down into three substantive sections: 1) accounting and auditing standards; 2) disclosure of governance, ownership, and voting structures; and 3) disclosure of related party transactions.

Accounting and auditing standards

Accounting standards for listed companies (Principle V.B)

Principle V.B recommends that information should be prepared and disclosed in accordance with high-quality standards of accounting and financial and non-financial reporting, while **Principle V.C** calls for an annual audit to be conducted by an independent, competent and qualified auditor in accordance with high-quality auditing standards.

With respect to the *G20/OECD Principles*, Costa Rica's governance framework is now substantially consistent with the recommendations of the *G20/OECD Principles* as a result of measures taken during the accession review process. All companies accessing the capital markets through the BNV must report according to IFRS.

With respect to regulated entities, i.e. listed companies and financial sector entities, the Regulation on Financial Information was issued in the second half of 2018. It requires all regulated financial institutions to comply with current IFRS by the beginning of 2020 and establishes the automatic adoption of new standards or reforms adopted by the IASB. The regulation permitted eight temporary deviations from IFRS that were to be phased out through 2024 through additional legal or regulatory actions. One legal reform was approved in December 2018 (Law No. 9.635) and two other legal reforms were addressed through the Law on Consolidated Supervision. An action plan to achieve full consistency with IFRS was approved by CONASSIF in October 2019.

For unregulated entities, CONASSIF accepts the national accounting standards set by the Chamber of Certified Public Accountants (Colegio de Contadores Públicos de Costa Rica—CCPA) for private companies and those set by the Ministry of Finance for SOEs (a fuller discussion of reporting standards for SOEs is found below). Through its Circular Nº 06-2014, the CCPA ratified IFRS and its respective interpretations as the valid accounting standard for private companies in Cost Rica.

The independent external audit and audit standards (Principle V.C)

Principle V.C recommends that an annual audit should be conducted by an independent, competent, and qualified auditor, in accordance with high-quality auditing standards in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

The auditors of the financial statements of all regulated entities are expected to follow the requirements set by the Chamber of Certified Public Accountants (CCPA). Regarding the implementation of International Standards of Auditing, ISA was formally adopted by the CCPA in 1998. In 2005, the CCPA updated its standards and agreed that all subsequent updates to ISA would be incorporated automatically into national practice.

In 2015, the IFAC Member Compliance Program Dashboard Report indicated that Costa Rica had demonstrated commitment to IFAC's mission and capacity to participate in IFAC's compliance programme. In the Dashboard Report, the CCPA was deemed to have appropriate levels of: 1) operational and financial viability; 2) governance structures; and 3) operational structures. These conclusions were confirmed in later reviews of Costa Rica by IFAC.

According to the Regulation of External Auditors (SUGEF Agreement 32-10), supervised subjects must undergo an annual audit by an external audit firm or independent external auditor listed in the Register of Eligible Auditors, which is part of the National Register of Securities and Intermediaries established by the Securities Market Law. Independent external auditors must comply with ISA and must be independent from the institution, financial group or conglomerate to be audited.

In 2012, the World Bank Report on Observance of Standards and Codes (ROSC) on Accounting and Audit had shown that in many cases the actual conduct of audits fell short of good practice. In response, the CCPA reported that it had made efforts to improve the application of ISA in practice and that practices have improved.

Nevertheless, some issues merit further attention. The CCPA continues to labour under capacity constraints that restrict their ability to close the gaps between actual practices and the global standards and to improve the quality of the accounting and audit profession. The nature and scale of this challenge should not be misunderstood. Improving accounting and audit practices implies a cultural change that will require a significant investment in training and systems.

Furthermore, the profession has no formal public oversight or external accountability as has increasingly become the norm in OECD countries. According to the *G20/OECD Principles*, independent oversight of the profession is an important factor in improving audit quality. Some efforts have been made to strengthen oversight since the beginning of the accession review. The legislation necessary to this effect was adopted in October of 2019 (Amendments to Law Regulating the Securities Market and other related laws). The law reinforces oversight of the audit profession and the implementation of ISA by allowing SUGEVAL to impose sanctions on auditors when irregularities or other infringements are detected. The law also establishes that an auditor can be removed from the registry of certified auditors and prohibited from providing services to supervised entities if they do not comply with standards. While the introduction of sanctioning power may serve to strengthen accountability, they cannot be expected to have the same impact as that of an accounting and audit oversight body.

Be that as it may, the various challenges facing the accounting and audit profession are not necessarily germane to the enterprises that fall under the scope of the *G20/OECD Principles* or the *SOE Guidelines*. Listed companies and SOEs do not generally rely on the audit services of small audit firms that with limited capacity and/or resources. More often, they typically choose to be audited by leading international audit firms (the so-called Big 4) who are not only expected to comply fully with ISA but who also have mechanisms to ensure the quality of their audits.

Accounting standards for SOEs (Guideline VI.A)

Guideline VI.A recommends that all SOEs report material financial and non-financial information in line with high-quality internationally recognised standards of corporate disclosure. In addition, the Guideline

requires SOEs to report on significant concerns for the state as an owner and the general public taking into account their size and capacity to do so.

The legal and institutional framework for reporting

The Accountant General's office (Contabilidad Nacional), which is part of Ministry of Finance, is the technical body responsible for the financial reporting practices of SOEs and IFRS implementation. In addition, Costa Rica has a general policy that establishes the transparency and disclosure requirements for SOEs and autonomous state institutions. In April of 2018, the Ministry of the Presidency issued Directive 102-MP, General Policy on Transparency and Disclosure of Financial and Non-Financial Information for SOEs, their Subsidiaries and Autonomous Institutions (Política General sobre Transparencia y Divulgación de Información Financiera y No Financiera Para Empresas Propiedad del Estado, sus Subsidiarias, e Instituciones Autónomas). The directive is wide-ranging in scope and establishes a disclosure policy for both financial and non-financial information for SOEs.

As with the Governance Regulation, the General Policy on Transparency makes reference to best international practice including the *G20/OECD Principles* and *SOE Guidelines*, the OECD's Accountability and Transparency Guide for SOEs (2010), the World Bank toolkit entitled Corporate Governance of SOEs (2014) and the United Nations Conference on Trade and Development (UNCTAD) Guidance on Good Practices in Corporate Governance Disclosure. As a consequence, the General Policy on Transparency corresponds with international and OECD practices and its full implementation would serve to bring Costa Rica's SOEs in line with OECD and other international standards. The Costa Rican authorities began to monitor and report on implementation through information provided in its first aggregate report on SOEs published in October 2019. The report found only partial compliance with expected reporting practices, indicating the importance of maintaining such monitoring and reporting in the future.

With respect to financial reporting standards, Costa Rica had experienced considerable delays in implementing IFRS since the original passage of legislation in 2009. In February 2018, the government issued Decree 41039 entitled Closing of Gaps with International Accounting Standards in the Public Sector of Costa Rica and Adoption and/or Adaptation of the New Regulation (Cierre de Brechas en la Normativa Contable Internacional en el Sector Público Costarricense y Adopción y/o Adaptación de la Nueva Normativa), which sets the deadline for SOEs to close remaining gaps in the implementation of IFRS at 1 January 2020. As noted in greater detail below, full implementation for some SOEs is, nevertheless, expected to take longer.

Reporting in financial SOEs

Financial SOEs fall under a special reporting regime. All financial SOEs are subject to financial disclosure regulations issued by CONASSIF. Financial SOEs are required to comply with the IFRS in accordance with Chapter IV of the Regulation of Financial Information. They must also send quarterly or annual financial reports to the Superintendencies depending on their national or foreign status.

CONASSIF regulations had required the use of an outdated and modified version of IFRS. By late 2018, all financial institutions, with the exception of Banco Internacional de Costa Rica and INS, were still using IFRS valid as of 1 January 2011. The consequence was that, as of 2018, financial statements for financial SOEs were not comparable to banks internationally. In September 2018, CONASSIF and SUGEF passed an accord entitled Regulation on Financial Information (Reglamento de Información Financiera) to close the gaps with IFRS. The accord also establishes 1 January 2020 as the deadline for private and public financial institutions to comply with extant IFRS, but allows for certain exceptions that will be gradually phased out through 2024. While current variances from IFRS are expected to

disappear over the next few years, there is a risk that future changes in tax law and other regulations could encourage continued deviations.

Actual reporting practices

Amongst non-financial SOEs, two (INCOP and INCOFER) are fully compliant with IFRS and received unqualified (positive) opinions from their independent external auditors for their 2018 financial statements. An unqualified opinion is issued if the financial statements are presumed to be free from material misstatements. In addition, RECOPE applied IFRS in 2018 but received a qualified (negative) opinion. A qualified opinion is a reflection of the auditor's inability to give an unqualified, or clean, audit opinion. The remaining non-financial SOEs report according to national standards. Of these, two (AyA and Correos de Costa Rica) received unqualified (positive) opinions from their auditors while four (FANAL, ICE, JPS, and SINART) received qualified (negative) opinions. JAPDEVA reported using national standards but had only produced unaudited 2018 statements as of October 2019. As of October 2019, SINART had audited financial reports, which had, nevertheless, not been published.

As of 2019, the auditors of Costa Rica's two SOE banks (BCR and BNCR) report the use of CONASSIF and SUGEF accounting standards for their 2018 financial reports. For INS, the independent external auditor reports compliance with CONASSIF and SUGEF standards and the use of IFRS only when national norms do not prescribe an accounting treatment. Though financial statements prepared under regulatory accounting standards are sometimes accepted by investors, some independent auditors noted in their audit opinions that statements may not be suitable for the purposes of users other than local regulators.

Causes for delays in transition to IFRS

Part of the reason for the slow transition to IFRS is that the laws themselves envisaged gradual change, which allowed SOEs to avoid full compliance for years. More technical justifications for the delays were attributed to: 1) the need to train accountants; 2) the lack of appropriate computer systems; 3) potential fiscal impacts; 4) concerns regarding how IFRS statements might impact national accounts; 5) the pricing of regulated products and services such as water and electricity; and 6) that IFRS statements would reveal that some SOEs were in worse financial condition than previously understood. In the end, the delays in implementation appear to be due less to technical challenges than: 1) the considerable reticence amongst SOEs to comply fully with IFRS; 2) the policy of the Accountant General to pursue a policy of gradual implementation; and 3) the absence of political will.

In any event, the state of disclosure amongst SOEs and SOE banks suggests that the implementation of IFRS will require more time and effort. In terms of its future evolution, all financial firms including SOE banks should be compliant with current IFRS beginning in 2020, with exceptions to be gradually phased out by 2024. INS anticipates being fully compliant by 2021, with the exception of implementation of IFRS 17 (insurance contracts), which may take longer. ICE reported that full IFRS implementation is anticipated in 2022-23. While IFRS may be in sight for these enterprises, a significant number of SOEs still operate without publishing annual financial statements that are fully compliant with IFRS and which fail to receive a positive opinion from their independent external auditors. Irrespective of the accounting standard used, it remains an important goal for all SOEs to publish audited annual financial reports on a timely basis.

The impact of SOE reporting on national accounts

Beyond what financial reporting practices mean for the overall quality of disclosure (and the lack of comparability between SOEs), Costa Rica's mix of accounting practices undermines the government's capacity to prepare high-quality national accounts. The Costa Rican government has been aware of the

problem and in February of 2018, the Presidency and the Ministry of Finance issued Executive Decree 41039 entitled Closing of Gaps with International Accounting Standards in the Public Sector in order to remove the differences between accounting practices in Costa Rica's public sector and International Public Sector Accounting Standards (IPSAS).

While the decree focuses on public sector accounting (IPSAS), the proper preparation of national accounts also relies on the application of a uniform set of standards across public institutions and SOEs (Government Business Enterprises or GBEs under IPSAS nomenclature) in order for proper consolidation to take place. For SOEs, which IPSAS defines as commercially orientated entities that have been assigned the financial and operational authority to sell goods and services at a profit, the applicable accounting standard is IFRS. However, precisely what state institutions should apply IFRS versus IPSAS has been the matter of some controversy within the IASB. Achieving clarity on what constitutes a GBE and what accounting standards to apply will likely prove to be a challenge in Costa Rica and it may be some time before the national accounting system will be in a position to produce consistent national accounts.

Confidential information and public access to information

Access to information is a public right in Costa Rica. Article 30 of the Political Constitution provides that "open access is guaranteed to administrative departments in order to inform matters of public interest." More specifically, the Comptroller General has the legal backing to access any information on SOEs including confidential information. The Political Constitution and the of the Law Against Corruption and Illicit Enrichment in the Public Service (Ley Contra la Corrupción y el Enriquecimiento Ilícito en la Función Pública) guarantee public access to information, specifically information related to income, budgeting, custody, control, management, investment and the spending of public funds unless such information could endanger the public interest and, specifically, SOEs operating in a competitive context.

In practice, however, there have been different interpretations of what constitute state secrets, confidential information and the public interest so that such differences have needed to be adjudicated in the courts. For example, there have been cases of SOEs trying to prevent the Comptroller General from publishing their findings or transmitting their reports within government. While enterprises in OECD countries have a generally recognised right to maintain the confidentiality of certain business information, in Costa Rica such justifications may have been used to avoid publicising the financial difficulties of certain SOEs or other critical findings of the Comptroller General.

Disagreements over what can legitimately be held secret have led to unusual workarounds. In the case of the ICE Group, (following the recommendation of the Comptroller General to ensure better access to ICE Group information for relevant oversight bodies), the Council of Ministers decided to designate the Environment and Energy Minister and the Science, Technology and Telecommunications Minister to request information from the ICE Group board and to inform the Council of Ministers regarding any aspect that should be known.

Box 3.1. Case Study: ICE Group and Confidential Business Information

The general rule for Costa Rica's SOEs is that information can be made public and that keeping information confidential is the exception. On the other hand, Article 35 of Law 8660 (Strengthening and Modernisation Law of Public Sector Telecommunications Entities) allows SOEs to declare confidential any information fulfilling certain requirements, though they must provide such information to government control and auditing bodies.

ICE Group has tried to limit the use of its information within government, raising the question of whether all government bodies should have equal access to confidential information. Complaints regarding the Group's level of transparency were aired by the Comptroller General of Costa Rica in 2015 during a confidential closed-door meeting of the Commission on Control, Collections and Public Expenditures of the Legislative Assembly. Press articles reported that both the Comptroller General and the Commission were alarmed by losses at ICE's RACSA subsidiary and its possible insolvency. The Comptroller and the Commission were reportedly concerned regarding restrictions on their ability to communicate their findings to the Council of Ministers. ICE Group had interpreted the definition of confidential information broadly and argued that disclosure put it at a competitive disadvantage and that Law 8660 and the founding legislation of the Group permitted withholding of confidential business information.

ICE Group's position on transparency and confidentiality evolved during the accession review process. An opinion piece published in La Nación in November 2018, expressed both surprise and approval when the ICE's Chair publicly acknowledged the difficulties facing the Group and announced that it would become more transparent in future. The Chair made direct reference to the need to adhere to OECD practice in the context of the accession process.[3]

The different views on the issue had even resulted in lawsuits being filed against the Comptroller General, which were widely covered in the press. The view of the Comptroller General was that its attempts to share information within government had legal basis. They argued that under the inter-institutional co-ordination principle, issued by the Supreme Court's Constitutional Chamber, confidentiality protections cannot be used by public entities under state control to restrict information flows within the state and concluded that the confidential information of any SOE may be communicated between state bodies to fulfil their legal responsibilities for control and supervision.

As of January 2019, confidentiality policy was being addressed in a decentralised manner at the level of each SOE. Article 5 of the General Policy on Transparency and Disclosure instructs SOEs to develop a confidentiality policy that establishes the motivations and exceptional circumstances under which information may be declared confidential as well as its legal basis. A potential weakness of this decentralised approach is that SOEs can decide themselves what is confidential and that there may be little incentive for them to be transparent. As of October 2019, five of 12 parent SOEs had provided their confidentiality policies to Costa Rica's Presidential Advisory Unit, of which only one had developed a confidentiality policy that clearly defined what should and should not be disclosed to the public in the interest of open government and transparency.

Independent external audit of SOEs (Guideline VI.B)

Guideline VI.B recommends that SOE financial statements be subject to an independent external audit based on high-quality standards. The Guideline also specifies that specific state control procedures do not substitute for an independent external audit.

The degree of implementation of International Standards on Auditing (ISA) is fundamentally dependent upon the quality of the local audit profession. ISA was formally adopted by the Chamber of Certified Public Accountants (CCPA) in 1998. With respect to audit, there is no direct legal requirement for SOEs to be audited using ISA. There is, however, a more general requirement under Law 1038 for auditors of all regulated and non-regulated entities to follow the requirements set by the CCPA, which call for the use of ISA. Among the SOEs and SOE banks that provided financial statements audited by an independent external auditor in 2019, all complied with ISA.

An additional, relevant contextual factor is that many SOE boards appear to lack expertise in accounting, auditing, control and good governance practices, each of which is needed to effectively oversee the work of the independent external auditor. Furthermore, in early 2019, whilst all financial SOEs had audit committees, only five non-financial SOEs had functional audit committees.

Aggregate annual reporting on SOEs (Guideline VI.C)

Guideline VI.C recommends that government ownership entities develop consistent reporting on SOEs and publish annually an aggregate report on SOEs.

The Presidential Advisory Unit prepared an aggregate report on SOEs that was presented to the Council of Ministers in September 2019 and made public in October 2019. Overall, the report is a strong first attempt at aggregate reporting that compares favourably to similar efforts by ownership entities in OECD countries. It contains summary descriptions of SOEs, their missions, and basic financial performance indicators, which are accompanied by some discussion and analysis. The length and layout of the document make it easy to read and user-friendly.

In addition to financial data, the aggregate report contains a section that describes the governance practices of SOEs based upon their public disclosure. While this section only reports if disclosures (required under the General Policy on Transparency) were made, it gives an excellent idea of the degree to which SOEs comply with the good governance practices that are being promoted as a result of the accession process.

In future, some additional items could usefully be added to the aggregate report including: 1) a discussion of the state of the SOE sector as a whole and its impact on the state budget and the economy; 2) the objectives that the state wishes to achieve through state ownership; 3) more information on the achievement of specific public service objectives; 4) the performance of the state in exercising its ownership and oversight responsibilities; and 5) a consolidated financial statement for the SOE sector. The difference between combined and consolidated statements is that consolidated statements net out inter-company liabilities and thus present a more accurate picture of the financial health of the SOE sector as a whole.

Disclosure of governance, ownership and voting structures

Capital structures and control arrangements for listed companies (Principles II.E.2 and V.A.3)

Principle II.E.2 recommends requiring the disclosure of capital structures and control arrangements, and **Principle V.A.3** similarly recommends requiring the disclosure of material information on major share ownership, including beneficial owners, and voting rights.

Article 8 (m) of the Law Regulating the Securities Market requires information on significant shareholdings (equal or greater than 10% of the subscribed capital) to be made public through the prospectus that is filed at the National Register of Securities and Intermediaries. CONASSIF Regulation SGV-A-19 also establishes the requirement for shareholders of listed equity issuers with a significant

participation (equal or greater than 10% of the subscribed capital) to report their ownership to the issuer, the BNV and SUGEVAL. The CONASSIF Corporate Governance Regulation requires that companies make available information on their ownership and significant holdings on their website or through other easily accessible means. These disclosure requirements offer the stock market information regarding those who have significant influence in the decision making process and in the running of the company's business.

In addition, with the Law Amending the Law Regulating the Securities Market, adopted in October 2019, SUGEVAL now has access to beneficial ownership information of all shareholders of listed companies. This means the regulator can take measures to detect improper practices. While shareholders of listed equity with ownership equal to or greater than 10% must report their ownership to the issuer, BNV and SUGEVAL, other legal provisions may make public access to such information difficult. Both the Data Protection Law (Ley De Protección de la Persona Frente al Tratamiento de sus Datos Personales) and privacy rights embedded in the Political Constitution may increase the difficulty for the public to obtain information establishing the identity of beneficial owners, or to determine how an enterprise might be controlled. On the other hand, the CONASSIF Governance Regulation requires that companies make available information on their ownership and significant holdings on their website or through other easily accessible means, but this review did not assess the extent to which such reporting provides clear information on beneficial ownership.

Disclosure of beneficial ownership has been a contentious issue in Costa Rica. Major shareholders and beneficial owners have sought to guard their privacy rights and attempts to draft laws to promote greater transparency have been contested in the Legislative Assembly. And, while legislation such as the Law to Enhance the Combat against Tax Fraud, (Ley para Mejorar la Lucha Contra el Fraude Fiscal) has made it possible, at least in principle, for tax authorities to trace beneficial ownership, such information is not generally made public. This reticence to disclose information on beneficial owners can make it difficult to gain a full appreciation of capital structures, control arrangements, and related party transactions.

Governance disclosure (Principle V.A.9)

Principle V.A.9 calls for the disclosure of governance structures and policies, including the content of any corporate governance code or policy, and the process by which it is implemented.

The CONASSIF Governance Regulation requires that all listed companies disclose information on their corporate governance practices on their web sites or through other easily accessible media to interested parties. This information must be made available annually, and updated whenever major changes are made, and must include, at least:

- Ownership of shares with significant holdings;
- Remuneration policy applicable to members of the governing body and senior management;
- Information on the board, including composition, size, members, selection process, independence criteria;
- Information on members of the board, including qualifications and experience, management positions in other companies, stakes in transactions or matters that affect the company, and independence status;
- Information on senior management, including responsibilities, line reporting, qualifications, and experience;
- Transactions with related parties in the last year;
- Major events that could hinder the achievement of business objectives;

- Information regarding committees, including objectives, responsibilities, composition, and meeting frequency; and
- Any other information or clarification related to its corporate governance.

The Governance Regulation also requires listed companies to have governance codes and disclose them.

SOE disclosure of governance, ownership and voting structures (Guideline VI.A.3)

Guideline VI.A.3 calls for disclosure of the governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes.

To the extent SOEs fall under the CONASSIF Governance Regulation that applies to regulated entities, they are required to have governance codes and disclose them in addition to other information on their governance practices. Furthermore, all SOES are required to comply with best practice disclosure under the General Policy on Transparency, which requires SOEs to indicate whether they have policies regarding ethics and corporate governance.

With respect to the actual practice of governance reporting, an examination of websites in 2016 showed that most SOEs provided little information on their governance. It was apparent from the examination that SOE disclosures had been viewed mainly as a "box-ticking" compliance exercise. Important information such as the composition of boards, data on individual board members and whether board members might or might not be considered independent was not provided in a systematic fashion. Other key corporate governance disclosures were infrequent such as, for example, ethics policies, and material risk factors, or information on risk management systems. Nor was there any disclosure of a qualitative discussion of governance by SOE boards. Furthermore, the majority of SOEs did not issue a Directors' Report with their financial statement though this is widely viewed as a good practice.

In 2018, a follow-up review of SOE websites suggested that governance disclosure had improved. For example, both INS and RECOPE disclosed their governance codes. However, disclosure remains far from uniform and stands to improve significantly. It would appear necessary for the Administration to both track the level of disclosure, assess it in comparison to best practice, and ensure that good disclosure becomes the norm rather than the exception. The Presidential Advisory Unit has already moved in this direction and can be expected to play an even more important role in encouraging better and more uniform disclosure in future.

Disclosure of related party transactions

Material information on related party transactions (Principle V.A.6)

Principle V.A.6 recommends requiring the disclosure of material information on related party transactions and the terms of such transactions to the market individually.

As noted above with respect to related party transactions and reporting on conflicts of interest, Costa Rica's governance framework requires disclosure of information on material related party transactions both to the board and to the public as per SUGEVAL regulations, the Corporate Governance Regulation and IAS 24 for companies that produce their accounts under IFRS.

To the extent that listed companies comply with IFRS, they would be in compliance with Principle V.A.6 that requires disclosure of transaction terms on an individual basis. IAS 24 specifically requires the disclosure of the following: 1) the amount of the transaction; 2) the amount of outstanding balances, including terms and

conditions and guarantees; 3) provisions for doubtful debts related to the amount of outstanding balances; and 4) expense recognised during the period in respect of bad or doubtful debts due from related parties.

However, the restrictions on the disclosure of beneficial ownership discussed above, may limit the ability of shareholders and other market participants to identify related parties, making it more difficult for them to verify whether related party transactions are being correctly identified and reported.

SOE disclosure of material transactions with the state and other related entities (Guideline VI.A.8)

Guideline VI.A.8 recommends that SOEs disclose information on any material transactions between SOEs and the state or other related entities.

The General Policy on Transparency clarifies what is understood by related party transactions, as well as the duty to disclose these in the annual report or, if applicable, as a notification of a material event. In addition, material related party transactions are disclosed when SOEs prepare their annual financial reports according to IFRS. Since SOEs with equity and/or bond listings on the BNV are required to disclose IFRS statements, such SOEs should be disclosing material related party transactions. A related concern is that SOEs do not generally have or disclose any formal related party transaction policy though some elements thereof are found in administrative law.

The separation of the state's role as owner versus regulator

Establishing effective separation of the state's role as an owner of state-owned enterprises and the state's role as regulator, particularly with regard to market regulation

The Concept Paper and the *SOE Guidelines* focus on the overall responsibilities of the SOE ownership entity and ensuring that there is a clear separation between the government's role as an owner of SOEs and its role as regulator. Relevant recommendations under the *SOE Guidelines* in this regard include: the development of an SOE ownership policy (Guideline I.B); the rationale for SOE ownership and objective-setting for SOEs (Guideline I.D); simplifying and standardising SOE legal forms (Guideline II.A); the operational autonomy of SOEs (Guideline II.B); the centralisation of the ownership function and exercise of state ownership rights (Guideline II.D); board nomination processes (Guideline II.F.2); board member remuneration (Guideline II.F.7); and the separation of the state's ownership and other state functions (Guideline III.A).

The SOE ownership policy (Guideline I.B)

Guideline I.B recommends development of an ownership policy defining the overall rationale for state ownership.

The ownership policy

The Protocol of Understanding of the Relations between the state and the State-Owned Enterprises (ownership Protocol) is Costa Rica's ownership policy. The ownership Protocol contains a cover letter signed by the President of the Republic expressing Costa Rica's commitment to improving the direction of companies governed by the Executive Branch and seeking to implement the principles and guidelines of good corporate governance adopted by the international community with particular reference to the G20 and the OECD. It is an important achievement that should help guide Costa Rica's SOE policy and the work of the Presidential Advisory Unit in the future. The ownership Protocol was published in

October 2019 after a process of consultation with SOEs and the Council of Ministers and is accompanied by a directive reflecting the official position of the government.

Costa Rica's ownership Protocol dedicates a significant amount of space to consolidating various bits of extant legislation and regulation. The ownership policy also contains additional aspirational recommendations that reflect international best practice, even if the details of how such aspirations remain to be fleshed out in practice. While it is not possible to summarise the ownership Protocol in detail, some major themes are noteworthy.

The rationale for SOE ownership in the ownership policy

One major theme is the discussion of the rationale for state ownership. The *SOE Guidelines* suggest that a rationale for state ownership should exist and that countries justify their continued ownership through periodic reviews of their SOE portfolio. The ownership Protocol states that SOEs must meet at least one of the following criteria:

- Its functions or purposes are necessary to safeguard a national economic or strategic interest;
- It is the only way to ensure universality in the provision of public service;
- The direct provision of some good or service by the state is required; or
- There is a strategic policy or project that justifies state investment.

The discussion of an ownership rationale is a large step in Costa Rica where the role of the state in the economy and SOEs has largely been an unquestioned article of faith. It could be hoped that a reflection on the rationale for state ownership would encourage a closer examination of whether the state's policy objectives are being achieved and if the SOE structure is the best method for achieving such objectives.

Financial performance, objective setting, and performance monitoring

Another major theme regards the financial performance of SOEs, objective setting and performance monitoring. The ownership Protocol now introduces the need to ensure the financial sustainability of SOEs. This is of crucial importance in Costa Rica because, historically, the indicators tracked by the state focused almost exclusively on the attainment of social goals; some indicators looked at budgetary impacts and expenditures but none monitored the financial health of SOEs from a shareholder perspective.[4]

What is meant by "shareholder perspective" in this case is an assessment of the SOE's financial health, sustainability and financial performance, which would typically include an analysis of turnover and profitability indicators (sales and operating margins), financial efficiency indicators (such as return on assets), leverage and solvency (such as debt-equity ratios and free cash flow); and other non-financial efficiency indicators (such as labour efficiency e.g. revenues per employee). A shareholder perspective in this sense provides information to the state and, in particular, the Ministry of Finance, that is essential for understanding the economic sustainability of SOEs, their impact on the macro-economy and possible financial and fiscal risks associated with SOEs.

Additionally, the ownership Protocol sets out the broad outlines of objective setting and a performance monitoring system that has the capacity to analyse and report on the efficiency and financial health of SOEs. The ownership Protocol indicates that performance targets will be set via a "note of expectations" sent from the Administration to SOEs, which will establish goals and Key Performance Indicators (KPIs). In turn, the board of the SOE is to be given the opportunity to provide feedback on the performance targets and may make their own proposals before the final note of expectations is agreed.

Overall, the implementation of this new system for setting performance objectives corresponds with practice in other OECD countries and should allow for far better monitoring of SOEs. While the process

described in the ownership Protocol has yet to be implemented, the Presidential Advisory Unit had already begun to monitor both the financial and social performance of SOEs as part of the preparation of the government's first aggregate report on SOEs, published in October 2019.

SOE ownership rationale and objective-setting (Guideline I.D)

Guideline I.D recommends that the state define the rationales for owning individual SOEs and subject these to recurrent review. Guideline I.D also recommends that any public policy objectives assigned to an individual SOE or group of SOEs be clearly mandated and disclosed.

A description of the rationale for state ownership is described above. Prior to the passage of Costa Rica's ownership policy, various pieces of legislation described the purpose of state ownership. Previously, the discussion of rationale was limited to general statements in the Political Constitution on SOEs serving the public interest and detailed statements in the founding documents of SOEs that set down specific objectives such as, for example, providing broad access to electricity, telephony or sanitation services. Neither set down the specific criteria that could help determine how to decide whether an SOE should remain under state ownership or not. This can now be found in Costa Rica's new ownership policy.

The main tool for establishing policy objectives for SOEs, besides their founding laws, has traditionally been the NDP (which was supplanted by the NDPIP). The NDP contained national, sectoral and individual SOE strategies and focused on social performance goals. This approach to objective-setting will be supplemented by a new objective setting and performance monitoring system, as described in Costa Rica's new ownership policy, which should permit a greater focus on the sustainability of SOEs and include financial and non-financial performance measures.

Simplifying and standardising SOE legal forms (Guideline II.A)

Guideline II.A recommends that governments simplify and standardise the legal forms under which SOEs operate and that SOEs' operational practices follow commonly accepted corporate norms.

Practice with respect to standard legal forms does not correspond to the *SOE Guidelines,* which recommend that, as far as possible, governments should base the legal form of SOEs on private law and avoid creating a specific legal form when this is not absolutely necessary for the achievement of the enterprise's objectives. This OECD recommendation reflects the belief that the adoption of commercial structures (e.g. corporatisation) increases transparency and that making state commercial activities comparable with those of the private sector facilitates their control and levels the playing field for competitors in deregulated and competitive markets.

Costa Rica's legislative framework, on the other hand, results in a highly heterogeneous treatment of SOEs. While there is some commonality in rules, the individual laws that establish most SOEs come with distinct rights, obligations and governance practices. One area in which the differences are particularly visible is with respect to the nominations of board members, which make it difficult for the state to apply nominations policies uniformly across all SOEs.

For example, in the case of ICE, improving board composition was made difficult because of its founding law. ICE's founding law requires that three of seven board members be engineers, with expertise in electricity or telecommunications, one board member must have a degree in economics, one in computer sciences, and another in law with a specialisation in public law. The Chair must also have a specialisation in one of these fields. In addition, each must be a member of their corresponding professional associations. Such a narrow legal requirement significantly reduces ICE's flexibility in developing a board composition that responds to its own needs. It skews boards overly towards engineers, and makes it more difficult to find board members with other important skills such as

business, finance, accounting and control, innovation, corporate turnaround and restructuring, governance, etc.

The conclusion that can be drawn from Costa Rica's experience is that statutory legal forms unnecessarily restrict SOEs. Should the standard legal form of a limited liability company have been used, decisions regarding board composition would have been left up to the owners and the board. A simpler legal structure would also be useful to avoid; 1) contradictions in Costa Rica's many laws that impact SOE governance; and 2) the need to modify multiple laws in order to implement policy consistently.

As consciousness of good governance increased in Costa Rica over the course of the accession review process, the problems with past legal traditions and the use of different legal forms for SOEs became more apparent. At the time of writing, the set of laws that provides the framework for the governance and operation of SOEs remains complex. Some SOEs continue to enjoy exclusive rights to operate in certain markets under more or less competition, have different social obligations, are required to have different board compositions, may or may not combine the roles of the Chair and CEO, enjoy exemptions from procurement rules, and enjoy certain fiscal exemptions and advantages amongst others. Reforms to standardise legal forms and streamline this complex set of laws should remain an objective for Costa Rica in the longer term.

SOE operational autonomy (Guideline II.B)

Guideline II.B recommends that governments allow SOEs full operational autonomy to achieve their defined objectives and to refrain from intervening in SOE management. The annotations clarify that governments may still act as active owners, but that direction given by the state to the SOE or its board should be limited to strategic issues and public policy objectives.

Costa Rican SOEs have some autonomy. However, that autonomy is mainly permitted with respect to achieving social goals. Furthermore, public finance controls and anti-corruption rules restrict certain actions of SOEs. In the end, though legally autonomous, extant rules allow SOEs and SOE boards little room for manoeuvre. This does not mean that there is any direct interference by the state in the decision-making processes of the SOE. No significant direct interference was reported during the accession review process. Nevertheless, press reports do seem to suggest that the possibility exists and that, in the absence of a legal instrument that sets down the decision-making rights of government versus boards versus management, there is the potential for overstepping limits.[5]

A positive side to Costa Rica's tight framework of rules is that the rule of law prevents the government from changing the duties or objectives assigned to SOEs in an unpredictable fashion. The actions of SOEs must follow the NDP within its legally established responsibilities. So, while SOEs have some autonomy, at the same time, they are circumscribed in their actions outside of the framework of what is permitted by official plans and law. The concern with respect to Costa Rican SOEs may, thus, be the effect on innovation rather than direct government interference.

Centralisation of the ownership function (Guideline II.D)

Guideline II.D recommends that the exercise of state ownership rights should be clearly identified within the state administration and that the exercise of such rights should be centralised in a single ownership entity or carried out by a co-ordinating body. This "ownership entity", the Guideline further recommends, should have the capacity and the competencies to effectively carry out its duties.

Establishment of a centralised ownership function

At the beginning of the accession process, Costa Rica did not have a centralised institution to fulfil the functions of an ownership entity as defined under the *SOE Guidelines*. Rather, it had a decentralised system of ownership supervision and control. Several governmental entities collected information and implemented legal requirements and policies across all governmental institutions. The most important institution centrally responsible for exercising SOE ownership rights is the Council of Ministers. Its main power over SOEs was the appointment of board members to autonomous institutions, and the removal, by a qualified majority of two-thirds of the votes, of board members of autonomous entities.

By October 2017, a decree was passed to establish an ownership entity (the Presidential Advisory Unit). The decree was entitled Creation of the Presidential Advisory Unit for Management and Co-ordination of State Shareholdings and the Management of Autonomous Institutions (Creación de la Unidad Asesora para la Dirección y Coordinación de la Propiedad Accionaria del Estado y la Gestión de las Instituciones Autónomas). The decree makes specific reference to the need to establish an ownership entity in order to comply with the needs of the OECD accession process.

The decree also makes direct reference to the responsibilities of an ownership entity as defined in the *SOE Guidelines*. The responsibilities of the Presidential Advisory Unit under the decree include: 1) develop an ownership policy; 2) develop systems to inform the Council of Ministers on the performance of institutions and to support decision making; 3) analyse audits and studies on institutions; 4) advise the Council of Ministers on how to fulfil their role as a shareholder; 5) advise on the nominations of board members; 6) advise on setting objectives; 7) co-ordinate disclosure policy; 8) recommend remuneration practices; 9) inform on good governance practices; and 10) design and promote training, amongst others.

According to the decree, the Presidential Advisory Unit has responsibility not only for state-owned enterprises but also other government bodies. These other bodies include the Central Bank and ARESEP the general tariff regulator in Costa Rica and other institutions dedicated to development objectives such as the Institute for Rural Development (Instituto de Desarrollo Rural).

There could be important implications for the decision to put the oversight responsibilities for SOEs and government agencies in the same institution. Costa Rican authorities suggest that combining oversight of SOEs and other state bodies is necessary because the Council of Ministers is responsible for both. In addition, it is argued that it is sometimes difficult to define with precision what constitutes an SOE in Costa Rica (as is the case with Banco Popular, which is owned by workers but has strong state influence through its board and is subject to public sector rules in its management).

On the other hand, there is also a potential risk that the Presidential Advisory Unit might become unfocused and that its resources become stretched. Furthermore, the skills required for the oversight of government bodies are not the same as for the oversight of SOEs for whom shareholder-style oversight (i.e. a greater focus on efficiency and returns, and good management and governance) is a goal. To address this concern in the short term, the decree states that the Presidential Advisory Unit should focus solely on SOEs during its first two years of existence and that, at the end of this period, it will evaluate its resource requirements before broadening its scope to encompass autonomous institutions.

When originally established, the Presidential Advisory Unit answered to the Presidency of the Republic (although all board appointments—with one exception, were to be approved by the Council of Ministers). At the time of writing, the ownership policy indicated that the Presidential Advisory Unit would continue to answer to the Presidency and Council of Ministers but would also come under the oversight of a steering committee composed of the Ministry of the Presidency, MIDEPLAN and the Ministry of Finance. The involvement of MIDEPLAN (which has traditionally focused on the achievement of social

policy goals) and the Ministry of Finance (which could be expected to demand greater accountability for business and financial performance) could contribute to achieving a balance of economic and social objectives.

The Presidential Advisory Unit became operational in early summer 2018 and with its establishment being formally announced in January 2019.

Capacity of the centralised ownership function

The new ownership entity should have sufficient skills and capacity for information gathering and analysis, policy development and the capacity to provide both the Council of Ministers and SOEs with guidance on the governance of Costa Rica's SOEs. As of late 2019, the Secretary of the Council of Ministers served in a dual capacity as the head of the Presidential Advisory Unit. The unit is supported by three additional civil servants in technical support roles with backgrounds in public administration and financial analysis and plans to add two more.

In its short existence, staff have demonstrated a good grasp of technical aspects of SOE governance, which they have demonstrated through: 1) the drafting of an ownership policy; development of an aggregate report on SOEs; 3) the development of a web-based system for selecting board members and creating a candidate pool; 4) the implementation of a new board member selection system; 5) overseeing the development of a corporate governance training programme for board members; and 6) feedback on draft laws related to the governance of SOEs.

On the other hand, the Presidential Advisory Unit has not yet had the time or opportunity to develop the authority to drive some important governance reforms. These would include establishing performance indicators for SOEs, developing a common remuneration policy for SOE board members and executives, and forcefully pushing the implementation of IFRS amongst other things. This is understandable given the newness of the unit, the number of reforms required, and its lean staffing. It is anticipated that, in future, the Presidential Advisory Unit will emerge as a proactive resource in the development of SOE policy in line with best practice.

The founding decree does not specify sources or levels of funding but suggests that financial, human and technical resources may be provided by both the public and private sectors and that the unit may benefit from the support of other government institutions such as MIDEPLAN.

Board nomination processes (Guideline II.F.2)

Guideline II.F.2 recommends that the state, in exercising its rights as an informed and active owner, should establish well-structured, merit-based and transparent board nomination processes in full—or majority-owned SOEs and should actively participate in the nomination of all SOE boards and contribute to board diversity.

The board member nominations process

The initial examination of the nominations process for SOE board members that took place in 2016 showed that Costa Rica's nominations process was structured but not formalised in writing beyond basic parameters set down in law. The basic process was:

- The Presidency gathered CVs received in response to a public request for expression of interest;
- The list was supplemented by individuals recommended by ministries;
- CVs were screened to identify a smaller group of qualified candidates;

- Candidates were assessed for their competence and integrity and to ensure that they complied with the specifications in the constituting law of the SOE;
- Sworn statements were collected from individuals to ensure candidates' probity; and
- Potential nominees could be discussed with the chairs of SOE boards.

Unlike the *SOE Guidelines*, which aim to de-politicise boards, individuals with political backgrounds were considered as part of the recruitment process. Costa Rica's process ultimately yielded individuals who the Presidency could trust and who were politically acceptable to a variety of stakeholder constituencies. Neither the process nor the identity of potential candidates were disclosed to the public.

One of the key recommendations that emanated from the accession review was to formalise the board nominations process and to focus on merit and getting board members with more business experience. It was also recommended that the nominations process become more transparent to the public. In response, a draft decree was developed in 2017 that aimed to bring board member nominations processes in line with the *SOE Guidelines*. The decree was entitled the Regulation for the Selection and Evaluation of Board Members of SOEs and Autonomous Institutions (Reglamento para la Selección y Valoración de Candidatos para Cargos del Órgano de Dirección de Empresas Propiedad del Estado e Instituciones Autónomas).

The Selection and Evaluation decree was ultimately issued in August 2019 and formalises the nominations process by establishing criteria for candidate selection and the stages and outcomes of the process. In addition, the decree that establishes Costa Rica's Presidential Advisory Unit specifies that it has the responsibility for the assessment of candidates and for making recommendations to the Council of Ministers while the decree on Selection and Evaluation provides details regarding how selection should be done including that it must be based on merit, and that formal and transparent procedures should apply. It also specifies the basic criteria that must be fulfilled by candidates, calls for the creation of a database of candidates and requires the development of an online tool where persons may express their interest in SOE board positions. The decree does not alter the power of SOEs to nominate board members to their own subsidiaries, but requires subsidiary SOEs to produce formal nominations procedures in line with the precepts of the decree.

The website, developed by the Presidential Advisory Unit, has been functioning since June 2019 and collecting a variety of information to better inform the decision-making process of the Council of Ministers. Thirteen board members were selected under the new process in 2019 with nine more scheduled for 2020.

The staggering of board appointments

Costa Rica has a system of staggered terms for board members that is designed to prevent a wholesale change in board composition as a result of changes in political administrations. Law No. 5507, adopted in 1974, establishes a system that ensures continuity under what is commonly referred to as the "4-3 rule".[6] The system allows incoming administrations to nominate four of seven board members while three of the previously nominated board members are allowed to stay on. Overlapping terms amongst board members and executives also encourage continuity. Board members generally have terms of eight years, the Chair (Presidente) four years and the General Manager six years. The system also results in a balance of political views and is generally viewed positively despite occasions when strong differences arise at board level from opposing political factions.

Nevertheless, the eight-year terms for most board members and the timing of the expiration of terms have certain disadvantages. One is rigidity in board composition, which makes it difficult to replace board members who are not performing well or to shape the board to address gaps in skills and experience. Another is that the law requires that new board members be appointed immediately after an

administration comes to power, making the process rushed and possibly working to the detriment of finding the best available board talent.

A change in law would be useful in order to avoid situations where a new administration is forced to nominate a large number of board members all in one go within a short period of weeks. A new law should contemplate allowing existing board members to stay on until a proper process can be completed. A slight delay in changing board members could make the board transition more fluid, reduce pressures at the beginning of a new administration, and provide the time to find the talent that is best suited to the SOE.

The government's new ownership policy, described above, calls for future action to develop "legal reforms to allow a staggering of the appointments of the members of the boards of directors. This is in the aim of ensuring that there is an adequate transition to preserve the knowledge acquired by the members of the board as a complement to new members, as well as a reasonable period of time to implement the selection mechanism for new members of the Board of Directors."

Remuneration for SOE boards (Guideline II.F.7)

Guidelines II.F.7 calls for establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

Board member remuneration

The relevance of board member fees is multi-fold. First, if fees are too low, it becomes difficult to attract competent candidates to board posts. While high fees are not generally acknowledged to motivate better performance, excessively low fees have been shown to reduce the level of satisfaction and commitment that individuals feel in the workplace.[7] On the other hand, excessively high fees raise costs and may imperil board member independence. Ideally, fee levels should be sufficient to attract and motivate board members while being competitive with other SOEs and institutions of similar importance in the private sector. Increasingly, best practice recommends that board members have at least part of their compensation paid in the form of a fixed honorarium thus reducing the incentive to conduct overly-frequent meetings.

In Costa Rica, board members of autonomous or semi-autonomous institutions are remunerated through meeting fees as reflected in the Law on Allowances for Directors of Autonomous Institutions of 1962, which provides that fees are adjusted to inflation. Executive Chairs are paid under a separate regime and receive a fixed salary. Other laws, such as the Organic Law of the National Banking System, or laws specific to individual statutory SOEs establish meeting fees for SOE board members. Fee maximums are also regulated under the Special Budget Law of 1989, which originally set them at approximately USD 5 per meeting. The Special Budget Law was modified by the Strengthening of Public Finances law, which sets a monthly limit of 10 base salaries (approximately USD 4 800 per month).

In practice, fees range widely between SOEs, as shown in a recent inventory in Table 3.1 below. In a separate study, the Comptroller General reported that SOE board member allowances for 2018 ranged between approximately USD 80 and USD 1 000, with an average payment per meeting of approximately USD 270. Total monthly remuneration averaged approximately USD 900 with a maximum reported at USD 3 800 in a single month. A number of observations can be made from the limited available data:

- The remuneration of board members is far from uniform.
- There may be incentives for board members to increase the number of board meetings because they stand to increase their earnings significantly.

- Board members are able to augment their fees even further by holding board positions on SOE subsidiaries and by organising extraordinary board meetings.
- There is no public disclosure of board member fees thus limiting transparency and public accountability for remuneration practices.

The ownership Protocol describes the challenges of remuneration in broad terms and describes the goal of building compensation schemes that are formal, objective, fair and able to attract and maintain talent. Current law is both specific and restrictive, which suggest that achieving the objectives of the ownership policy and changing laws will be a challenge. At the time of writing, a broader research study was being conducted on remuneration practices in the public sector in co-operation with the IDB and MIDEPLAN. That study has the objective of establishing new fee scales for SOE boards based on data from the public and private sectors. The study is expected to be completed by July 2020.

Table 3.1. Fee levels of board members for a selected group of SOEs and their subsidiaries

Institution	Allowance by session 2019 (in USD)	Maximum legal N° of sessions per month
National Cultural Radio and Television System	496	Not defined, subject to provisions of Law 3065
Bank of Costa Rica (BCR)	369	5
BCR Subsidiaries	369	2
National Bank of Costa Rica (BNCR)	369	5
BNCR Subsidiaries	369	5
Costa Rican Institute of Electricity (ICE)	369	8
Costa Rican Mail Service S.A.	369	8
National Energy and Electric Company (CNFL)	331	Not defined, subject to provisions of Law 3065
Costa Rican Radiographic (RACSA)	331	4
National Insurance Company (INS)	158	8
INS subsidiaries	132	Not defined
Costa Rican Railways Institute (INCOFER)	89	8
Board of Social Protection (JPS)	89	6
Atlantic Economic Development and Port Administration Board (JAPDEVA)	89	4
Institute of Aqueducts and Sewers (AYA)	89	8
Costa Rican Petroleum Refinery (RECOPE)	88	8
Costa Rican Institute of Ports of the Pacific Ocean (INCOP)	77	8

Source: Technical Secretariat to the Council of Ministers and Presidential Economic Council. Fee levels converted at exchange rate of CRC 570 per USD

Separation of functions (Guideline III.A)

Guideline III.A calls for a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation. The review seeks to establish whether SOEs are used as vehicles for industrial, regional and/or sectoral policies, and if the responsibility for industrial/sectoral policies are separated from the state's ownership function.

The laws establishing SOEs in Costa Rica, in addition to sectoral regulation, provide SOEs with the explicit objective of helping achieve the fulfilment of public goods. All the systems for planning (NDP and, more recently, the NDPIP), monitoring (MIDEPLAN) and control (Comptroller General and Ministry

of Finance) coincide in aiming at achieving policy goals, ensuring the proper control of activities, ensuring their efficiency, and monitoring policy outcomes.

The SOE ownership function (viewed as the actions that a shareholder might take to ensure that the enterprise is profitable and remains sustainable in a commercial environment) is not represented within state oversight structures (despite the fact that both the Comptroller General and the Ministry of Finance perform financial control functions). Ownership is, in practice, strongly decentralised and, until the recent establishment of the Presidential Advisory Unit, no individual central institution had taken a shareholder perspective on SOEs.

Table 3.2. Policy objectives set out in founding laws and sectoral legislation

SOE	Founding legislation	Examples of public policy objectives in founding and sectoral legislation
AyA	Law 2726 of 1961	Promote conservation and ecological protection and monitor pollution (Article 2.C.). Exercise the powers under law of the state, ministries, and municipalities over waters in the public domain (Article 2.F.). Enforce compliance with the law on drinking water in the name of ministries and municipalities (Article 2.H.). Build, expand and reform water and sewerage to satisfy national needs (Article 2.H.i.). Criteria for fair social distribution will be applied in tariff setting so that those with greater means subsidise those with lesser means. The state may totally or partially subsidise users who are unable to pay for services (Article 4).
Correos de Costa Rica	Law 7768 of 1998	Guarantee efficacy, efficiency, quality, security and access to its services. (Article 4.a). Guarantee national coverage of postal services (Article 4.d). It is obligatory for the state to provide postal communications throughout the territory as a public service via Correos de Costa Rica. (Article 6). Proceeds from auctions of undeliverable mail go to hospices for orphans (Article 12).
All SOE Banks	Organic Law of the Banking System of 1953 as amended	[Banks] shall avoid inactive means of production within the country, seeking out producers in order to put at their disposal the economic and technical means of the [banking] system. (Article 3).
RECOPE	Law 6588 of 1981	The objectives of RECOPE are to… maintain and develop necessary installations… and implement the development plans for the energy sector in conformity with the NDP. RECOPE may assign to the Ministry of Natural Resources, Energy and Mines, financial, human, technical and logistical resources to achieve the requirements set down in this law (Article 6).
ICE	Law 449 and Law 8642 on Telecommunications	The fundamental responsibility of ICE is to foment the use of hydroelectric energy in order to strengthen the national economy and promote the wellbeing of the people of Costa Rica. (Article 1)…and encourage the development of new industries…. (Article 2.a). …promote industrial development making preferential use of electric energy as a source for locomotion and heating…. (Article 2.c.) ...end destructive exploitation of natural resources… and promote domestic use of electricity for heating in substitution of combustibles from forests and from importation… (Article 2.d.) …aid in the development of agricultural lands through irrigation (Article 2.f.). Guarantee the right of citizens to telecommunications services… strengthen universality of access… promote telecommunications in the context of an information society in support of health, social security, education, culture, commerce and e-governance (8642.2.a-j.).
INCOFER and ICE	Law 8810 of 2010	ICE and INCOFER are to donate scrap metals and other materials to the Orphans' Hospice of San Jose (Article 7 as cited in ICE Law 449).

Source: Founding legislation and sectoral laws.

The confluence of policy and ownership objectives in Costa Rica is reflected in a number of ways. For one, both are present in the founding legislation of SOEs where greater prominence is given to an SOE's policy objectives. In addition, policy and execution were linked in the NDP process. Other indicators that policy and ownership functions are closely intertwined are: 1) the presence of ministers and former legislators on SOE boards; b) board compositions that have frequently included appointees with political backgrounds; 3) SOEs providing staffing and other resources to ministries (See RECOPE in Table 3.2 immediately above); and 4) the combination of the roles Chair and CEO in Law 5507 companies, which permits politically appointed chairs more direct control of the operations of the SOE. Furthermore, SOE boards have, in the past, been significantly politicised. At the SOE level, extensive

interviews with SOE boards and executives suggests that there is no clear separation between commercial and policy objectives within SOEs.

On the other hand, Costa Rica does have a number of institutional arrangements to support independent regulatory oversight of certain SOEs. The separation of regulation and policy is somewhat clearer, for example, in the banking sector (independent oversight of the financial sector is handled by CONASSIF and the Central Bank), and with respect to tariff-setting in certain monopoly sectors (ARESEP and SUTEL).

Tariff setting for SOEs exercising monopoly power (ARESEP)

With respect to market regulation, the main interaction between the state and non-financial SOEs is through tariff setting. Tariff setting is principally under ARESEP. ARESEP had its origins in the National Electricity Service (Servicio Nacional de Electricidad), which was established in 1928. Today, ARESEP is an autonomous regulator that enjoys broad freedom in defining tariffs and the methodologies for setting them.

The ARESEP board is appointed by the Council of Ministers and ratified by the Legislative Assembly. The board is composed of a Regulator General and three additional experts in regulation. The ARESEP board's principal task is to define the policies and the methodologies for tariff setting. In addition, they have some responsibility for monitoring and ensuring that public policy objectives related to access to and quality of services are achieved. Methodologies are intended to be consistent with Costa Rica's overall social development strategy, which aims to provide fair access to public services and achieve sustainability objectives. Methodologies are subject to public discussion before being approved by the board. Despite legal and institutional safeguards that reinforce ARESEP's independence, press coverage in 2016 regarding the appointment of a new Regulator General raised some questions in this regard.

Box 3.2. Case study: The ARESEP controversy

In 2016, a case of potential conflict of interest and the politicisation of regulatory functions was being discussed in the Costa Rican press. The issue arose with the nomination of a new General Regulator for ARESEP.

The individual who was nominated by the Presidency and approved unanimously by a commission of the Legislative Assembly was Director of Environmental Planning at ICE's Centre for Electricity Planning (Centro Nacional de Planificación Eléctrica). He had a long and distinguished curriculum vitae and had been associated with ICE in various capacities for 30 years.

Concerns were raised in the press regarding the potential for conflict of interest because ICE is one of the main entities under the oversight and tariff-setting authority of ARESEP. Furthermore, initially, the nominee intended to retain his position at the ICE Centre while exercising his new role as chief regulator.

Concerns regarding the independence of the General Regulator were countered by citing his experience, legal requirements that call for industry and sectoral experience, as well as institutional structures and policies that ensure ARESEP's independence. While disputing concerns regarding his capacity for independent judgement, the nominee eventually relinquished his role at ICE.

ARESEP reports being guided by the principles of economic efficiency, social equality, environmental sustainability and resource conservation in the price-setting process, and the sectoral goals set in the NDP. ARESEP aims to set tariffs in a manner that allows for full cost recovery by establishing rates of

return built around recognised costs. This is intended to allow SOEs to retain earnings in order to ensure proper maintenance and reinvestment.

Costa Rica avoids some common pitfalls of other countries where tariff-setting comes under political pressure to keep consumer prices low and where there is a tendency to compensate SOEs to the least extent possible for the services they provide in order to minimise their impact on state budgets. Such pressures often generate severe budget constraints for SOEs and may eventually cause systemic arrears problems. This is not the case in Costa Rica. Most SOEs report tariffs that are satisfactory from their perspective. To cite one example, AyA reported that it was able to both cover costs and retain a cushion for future investment.

On the other hand, the risk that such tariff-setting may lead to excessive prices for consumers must also be recognised. Although it was beyond the scope of this review to assess the reasonableness of current tariffs for SOE services in Costa Rica, other OECD reviews have raised concerns about pricing levels in regulated sectors such as energy, transport and water where SOEs are predominant. The OECD Economic Survey of Costa Rica of 2016 suggests that between 2006 and 2014, the tariffs of regulated services rose more than any other business cost. The survey pointed specifically to electricity tariffs that are higher in Costa Rica than in most OECD countries. The survey concluded that while price regulation ensures that tariffs are set at recovery levels, there is little incentive for productivity improvement since cost increases can easily be passed on to consumers.[8]

Tariff setting for the telecommunications sector (SUTEL)

SUTEL is the regulator of the telecommunications sector while ARESEP and the National Telecommunications Fund (Fondo Nacional de Telecomunicaciones—FONATEL) have the mission of ensuring that telecommunications services are provided to those parts of the population with limited resources. SUTEL was established as a fully independent regulator as a result of the 2004 free trade agreement with the United States. SUTEL has the double role of regulator and competition agency for the telecommunications sector, which may risk the confusion of regulatory and competition considerations.[9] It is a decentralised agency with its own budget partly funded with charges on companies.[10]

Box 3.3. Independent regulation by SUTEL

According to SUTEL, ICE (a state-owned telecommunications company that used to operate under monopoly conditions and which, at the time of the complaint, was still dominant in the market) offered discounts to consumers at prices below the interconnection fee that other competitors had to pay to connect to ICE's network.

Following a thoroughly reasoned decision, which considered international experiences and referred to the work of a number of international bodies and other competition agencies, SUTEL found against ICE and imposed sanctions.

The decision followed COPROCOM's (Costa Rica's Competition regulator) non-binding opinion, which had concluded that "there was evidence indicating that a pricing scheme or predatory conditions conduct was being executed, or a margin squeeze, in order to generate a barrier to entry for competitors".

Source: Competition Committee Accession Review of Costa Rica

SUTEL is widely perceived to be independent. SUTEL is hierarchically dependent on ARESEP but with legal and budgetary independence, as well as technical and administrative autonomy. It is not subject to the Executive branch's legal framework. Its board is appointed through a public tender organised by the ARESEP board and must be ratified by the Legislative Assembly. SUTEL is financed through taxes and fees directly apportioned to it and paid by telecommunications operators and service providers. Lastly, SUTEL has a legal personality, and is able to defend its own cases in court without having to resort to or rely on the Attorney General's Office.[11] History suggests that SUTEL is able to act with genuine independence.

Ensuring a level playing field between state-owned and private enterprises

Ensuring a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions

The Concept Paper calls for consideration of effective redress against SOEs (Guideline III.B); the disclosure of SOE public policy objectives and their costs (Guidelines III.C and III.D); the equal application of law to SOEs and other market competitors (Guideline III.E); access to debt and equity financing under market consistent conditions (Guideline III.F); and competitive and fair public procurement (Guideline III.G). (Guideline III.A is addressed above under: Separation of functions.) The assessment of conformity with the *SOE Guidelines* is preceded by a background discussion of the level playing field in a number of key sectors. The Accession Review of Costa Rica by the OECD Competition Committee of the OECD should be considered in conjunction with the assessment against the *SOE Guidelines*.

Background discussion on the level playing field

In Costa Rica, the playing field is more or less level depending upon the sector. The main sectors where SOEs compete with private sector companies are banking, insurance, and telecommunications. Whether the playing field tilts in favour or against SOEs is not always clear. In some cases, conditions favour SOEs. In other cases, conditions work to their detriment, particularly as regards their capacity to innovate. In terms of market conditions, some of the main differences are:

Favouring SOEs:

- The state provides a guarantee to SOE banks and INS the state-owned insurance enterprise. Regarding SOE banks, this guarantee covers passive banking operations and its quantitative limit is set by the solvency of the state itself.
- Sovereign guaranties, e.g. the agreement of Costa Rica to guarantee USD 500 million in lending by the Inter-American Development Bank to ICE in 2018, and a past guarantee provided to the government of Spain for lending to RECOPE.
- SOEs have comparatively easier access to lending from IFIs and DFIs.
- There is an implicit guarantee of SOEs by the state as reflected in the reports of ratings agencies.
- State procurement and SOE procurement practices may favour SOEs.

Hindering SOEs:

- Some employees of SOEs have civil servant status, and operate under civil service rules and pay structures.
- Difficulty in rationalising human resources.

- Procurement practices of SOEs are set by the state and can be cumbersome.
- The obligation to provide public services in certain cases.
- Restrictions on SOEs' ability to innovate and compete freely.

State-owned banks

There are three types of banks in Costa Rica: 1) private; 2) state-owned; and 3) co-operatives. All compete in the same market and are subject to the same banking regulations though there are significant asymmetries with respect to policy, laws and regulation. The system is based on a multitude of different conditions, and is generally assessed as being both overly complex and non-competitive.[12]

The lending policies of SOE banks are clearly directed towards providing easier access to capital with the purpose of promoting social goals or to assist certain sectors (such as agriculture), or promoting certain functions (such as education). State-owned banks benefit from an unlimited guarantee from the state. The Organic Law of the Bank National System establishes that "the banks of the state will possess the guarantee and the most complete co-operation of the state and of all its dependences and institutions". The full value of such guarantees has not been quantified though, in principle, the limit of the state guarantee would be set by the solvency of the state itself.

Table 3.3. Differences between private, state-owned and co-operative banks

Difference	Private banks	State-owned Banks	Co-operative Banks	Advantages/disadvantages
State guarantee against liabilities	No	Yes	No	SOE banks have an advantage due to guarantee against the totality of liabilities, which may be applied under conditions of intervention and insolvency. Recent enactment of a deposit insurance law will significantly reduce this imbalance.
Tax regime	Taxes and contributions for a total of 35%. Long-term deposits are taxed at 8% of the fees charged to the depositor.	Mandatory contributions to funds and taxes of 63% of earnings. Long-term deposits are taxed at 8% of the fees charged to the depositor.	Taxes and contributions for a total of 35%.	Co-operative banks have an advantage in taking long-term deposits. State-owned banks are at a disadvantage due to higher total mandatory contributions and taxes.
Legal framework	Operate under the private law principle that the bank is allowed to do what is not prohibited under law.	SOE banks may only do what is explicitly permitted under law. Public sector rules apply for penal, civil and disciplinary issues Labour regime that regulates stability, process, and collective agreements. Public sector procurement and contracting rules.	Same as state-owned banks.	Private banks have an advantage in that they are able to operate more flexibly both in their decision making and the rules under which they operate.

Difference	Private banks	State-owned Banks	Co-operative Banks	Advantages/disadvantages
		Control by the Comptroller General.		
Mandatory liquidity reserve at Central Bank	Yes. 15% of liabilities.	Yes. 15% of liabilities.	No.	Co-operative banks have an advantage.
Mandatory deposits of private banks with state banks (peaje bancario)	Yes. 17% of deposits of private banks must be held in state banks. 10% if the private bank engages in social lending.	No	No	Uncertain advantage. On the one hand, deposits with state banks are remunerated and SOE banks may have cheaper alternative sources of funding. On the other hand, private banks view this as a lost source of funding.
Right to have deposits of SOE banks.	No	Yes	No	SOE banks have an advantage due to guaranteed access to funds.
Savings accounts protected from seizure	No	No	Yes	Co-operative banks have an advantage since depositors' accounts are protected from seizure.
Dual mission of the bank	No	Yes	Yes	SOE banks have less flexibility since they are required to provide favourable rates and treatment to fulfil the objectives of the state while at the same time operating in a competitive environment.
Governance adapted to the needs of the bank	Yes	No	No	SOE banks have less capacity to select board members with relevant profiles and to govern flexibly in the interest of the bank.

Source: OECD adapted from Banco de Costa Rica (BCR)

A draft study by the Central Bank from July 2018 entitled Regulatory Asymmetries in the Costa Rican Banking Market, attempted to quantify various asymmetries between SOE and private banks. Although the study notes that it excluded a number of asymmetries due to the difficulty of quantifying them, it concludes based on a partial review that such asymmetries are significant, while also suggesting that the net costs of regulatory asymmetries are of a similar magnitude for private and SOE banks.

Regardless of the net effect, the different treatment of private and public banks results in distortions to competition and is a source of inefficiency that is imposed on the economy. In Costa Rica, private banks operate mostly on deposits and credits in US dollars, while SOE banks tend to operate in Costa Rican colones. As a consequence, private banks tend to do more business with multinational enterprises that function on the basis of deposits and credits in US dollars. Furthermore, SOE banks tend to lend to clients in regions that are the targets of government policy and do so at lower prices than the private sector. Banks may thus have little incentive to compete when their market shares are stable and effectively assured.

Regarding the impact on efficiency, reports comparing the efficiency levels of SOE versus private banks are equivocal with some suggesting that there are significant differences and others suggesting that these differences are nominal, especially after the introduction of competition into the banking sector in the early 1990s. Yet, most parties agree that the Costa Rican banking sector, as a whole, is less efficient when compared internationally, and that the dominance of SOE banks within the banking sector appears to be dampening competition overall.[13] In order to increase SOE bank efficiency, the government issued a directive in November 2015 instructing SOE banks to cut their administrative

expenses, so as to reduce their intermediation margin by at least one percentage point by 2018 (La Gaceta, 2015).

While the relative costs and efficiency of private versus public sector banks may be somewhat comparable, the essential point is that the different treatment of private and SOE banks distorts competition and is a source of inefficiency that is translated to the economy. With respect to the future, addressing the various asymmetries to enhance competitive neutrality remain important goals. A significant step towards levelling the playing field was taken through the enactment in February 2020 of a bill to create a deposit insurance and bank resolution scheme applying to both SOE banks and private banks.[14]

Insurance

In the insurance field the National Insurance Institute (Grupo Instituto Nacional de Seguros—INS) conducts insurance and securities activities in addition to operating a hospital and the Costa Rican Firefighters. INS had a monopoly on insurance services from 1924 until 2008. Despite the opening of the insurance market in 2008, the level of competition has not increased dramatically, with INS retaining 82% of the insurance market in 2018. INS is subject to regulatory oversight by SUGESE the Insurance Supervisor. In addition, it must comply with reporting requirements of the Legislative Assembly, the Attorney General (Procuraduría General de la República), the Presidency and the Comptroller General.

While the overall legal and regulatory framework under CONASSIF applies to INS and private sector insurers in the same way, INS also operates under some different rules. Operating in favour of INS is the Law on the National Insurance Institute (Ley Del Instituto Nacional de Seguros), which grants INS the same state guarantees extended to SOE banks. Another advantage is that SOEs must buy insurance from INS, although a reform introduced by Law 8653, conditioned this upon INS offering the most favourable terms.

On the negative side, procurement rules are cited as being inflexible and sometimes against the interests of the company. Furthermore, insurance must be provided at cost; there is no profit built into the calculation of insurance prices. In addition, the pay-out on insurance policies may be influenced by public policy concerns e.g. it may be considered in the public interest for an insurance pay-out to be made. Finally, INS also reports that bureaucratic constraints make it difficult for the company to adapt to the requirements of a modern and competitive insurance market.

Energy[15]

Costa Rica's 98.6% electrification rate is the highest in Central America. Its per capita power consumption of 1 611 kWh/year, is ahead of the Latin American average.[16] Power system operations are largely the responsibility of ICE, CNFL, and some small municipal utilities. A handful of rural co-operatives generate, distribute and market electricity in rural areas not covered by ICE or CNFL. ICE generates the bulk of electricity supply (around 80%), provides all transmission services in the country, and is responsible for just over a third of electricity distribution.

CNFL, whose main corporate purpose is to distribute and market electricity in the capital, San José, accounts for around 5% of electricity generation and distributes more than 40% of electricity generated in the country. Two municipal companies and four co-operatives cover the rest of power distribution in Costa Rica. These companies also produce a further 3% of electricity.

Private companies, including small hydroelectric projects, sugarcane refineries and wind plants, produce the remaining electricity in Costa Rica. All of the electricity they produce must be sold to ICE, which then transmits it to distributors. Changes introduced by Laws 7200 of 1990, and 7508 of 1995, permit limited private sector participation in electricity generation (30% of the market). At present, the

only competition in generation is through ICE contract tendering. ICE and all other companies participating in the distribution market, moreover, provide their services under monopolistic conditions, since all have exclusive market allocation areas.

Another area subject to state concession, and hence outside the scope of competition law, concerns the import, refining and distribution of wholesale petroleum and its derivatives, including fuels, asphalt and gasoline. In these markets, RECOPE has had a legal monopoly since 1993. ARESEP is in charge of setting prices for all hydrocarbons that RECOPE commercialises, as well as safeguarding compliance with other service conditions.

Box 3.4. Case study: Sovereign guarantees for RECOPE

A sovereign guarantee was granted by Costa Rica to the Institute of Official Credit of the Government of Spain for a USD 12 million credit to RECOPE in 1990, which was paid off in 2013.

The use of a sovereign guarantee was not viewed positively in Costa Rica at the time. The Legislative Assembly initially resisted, and only provided the guarantee because of the insistence of the Spanish state. In fact, the approval of the guarantee was so contested that it took almost four years to approve.

The fact that RECOPE has the state-sanctioned monopoly for hydrocarbons and implicit guarantees helps in the risk assessments conducted by international banks and improves the financial conditions under which lending is granted, particularly in what concerns term and margin.

In this respect, it is possible to obtain lending for 13 years or more, whilst the usual terms for the private sector are approximately seven years. In relation to borrowing costs, the margins are less than those charged to the private sector for similar periods.

Alcoholic beverages

The production and manufacture of alcoholic beverages commercialised in Costa Rica is also a legal monopoly and, therefore, exempt from competition law. This monopoly was created by a law issued in 1885 that aimed at fostering the sugarcane industry and protecting society from health problems derived from alcohol. Under the law, private companies can only manufacture spirits through a state concession provided by the National Liquor Factory (FANAL) and with raw material provided exclusively by the latter. In addition to being the sole manufacturer of raw materials for spirits and derived products in Costa Rica, FANAL also commercialises the finished product. Notwithstanding the above, commercialisation of liquor is open to competition, and COPROCOM (Costa Rica's Competition regulator) may intervene in case of competition law infringements as, in fact, it has done in the past.

Stakeholders' access to redress (Guideline III.B)

Guideline III.B recommends that SOEs' stakeholders and other interested parties, including creditors and competitors, should have access to efficient redress through unbiased legal or arbitration processes when they consider that their rights have been violated.

A variety of laws protect stakeholder rights. The right to redress is embedded in Articles 41 and 43 of the Political Constitution, which guarantees expeditious, effective redress for offenses or damage received personally, to property or to moral interests. The Law on the Promotion of Competition and Effective Defence of Consumers provides that any economic agent who feels affected by a conduct that implies unfair competition may resort to court action to assert their rights. The Law on Alternative Dispute Resolution and Promotion of Social Justice, provides that individuals have the right to

mediation, conciliation, arbitration and other techniques to settle property-related differences. It is difficult to assess the extent to which effective redress can be achieved when sought against public sector entities. However, there is nothing to suggest that public institutions are in any way above the law. The case of the Comptroller General seeking to assert rights to information against ICE can be cited as an example.

Transparency and disclosure of public policy objectives and related costs (Guidelines III.C and D)

Guidelines III.C and **III.D** recommend that state ownership entities and SOEs be transparent and disclose costs and revenue structures in cases where SOEs combine economic activities and public policy objectives. In the case of the latter, costs should be clearly identified, disclosed and adequately compensated by the state on the basis of specific legal provisions and/or through contractual mechanisms. The purpose of the recommendation is to help the state and SOEs to better understand the costs and benefits of such services. Such information is considered essential for SOEs to understand whether they are being fairly compensated for their policy commitments and what parts of their activities consume the most resources.

The financial statements of Costa Rican SOEs do not generally break out the portion of revenues and costs that are associated with the provision of public services. Such a breakdown is not required by either national or international financial reporting standards. Consequently, it is difficult to: 1) calculate the return on investment of policy commitments; 2) calculate the efficiency of expenditures; or 3) make decisions on where greater investment in public services might be required or where expenditures should be reduced.

Feedback from both RECOPE and ICE Group suggests that the costs of policy commitments are not being fully compensated by ARESEP, the independent tariff setting authority, and that the capacity to demonstrate the real costs of public services would be of enormous benefit. Despite the challenges that it presents, the introduction of better systems for tracking the benefits and costs of policy commitments would likely have a significant impact on SOE management and governance.

For the moment, no concrete plans exist, though the government's ownership policy pledges that "The state will also seek to establish in a clear and transparent manner the prioritisation between its business objectives and its public policy objectives, so as to quantify in economic terms the investment that the institution makes in order to fulfil these public policy objectives and the source of their financing (cross-subsidies, tax breaks, direct transfers from the state). This gives the state a global picture of the resources invested to meet its social goals and make informed decisions to focus those resources on social investment with greater return to the population."

Application of general laws, tax codes and regulations (Guideline III.E)

Guideline III.E recommends SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations, that laws and regulations should not unduly discriminate between SOEs and their market competitors, and that SOEs' legal form should allow creditors to press their claims to initiate insolvency procedures.

Overall, SOEs are not formally exempt from the application of general law, tax codes or regulations. However, the legal regimes under which SOEs operate remain significantly different from those of private companies. This is due, in part, to the constitution of many SOEs under their own legislation, which often carves out special rights and obligations. Furthermore, the status of employees of some SOEs as civil servants means that personnel issues are subject to the rules that apply to the civil

service. Rather than creating an advantage, this makes the resolution of labour issues more cumbersome than in the private sector.

Taxation

SOEs and private sector companies are subject to the General Tax Code. However, there are numerous differences in the application of tax laws. Some of the differences with respect to the banking sector are described in

Table 3.3 above. For telecommunications, traditional fixed line telephone service is exonerated from the payment of tax. In other cases, SOEs may have different tax treatments defined in law, such as in the case of the Junta de Protección Social, which has an obligatory income tax of 10%. INS is required to pay the costs of Costa Rica's firefighters, which is a form of taxation. On the other hand, some SOEs have the right to collect taxes. Before its dissolution, the SOE bank Bancrédito benefited from a monopoly right to collect airport tourist taxes. Overall, the numerous laws that regulate SOEs make for a highly heterogeneous tax treatment.

SOE insolvency

For information on the general insolvency regime, see Principle IV.F below. With respect to SOEs, there is no case experience in Costa Rica with SOEs that were formally declared insolvent. However, contextual information suggests that both Costa Rica's financial and non-financial SOEs may not be subject to insolvency claims on an equal basis with the private sector. As reported earlier in this review, SOE banks enjoy an explicit guarantee by the state. This reflects an international reality for Systemically Important Financial Institutions (SIFIs) even if the guarantee is often just implicit.

During the Bancrédito crisis of 2017, Costa Rica stepped in to prevent Bancrédito's failure not because it was systemic but because of the potential social, employment and reputational impact. An attempt was made to refloat the bank and, when this proved difficult, proposals were made to repurpose the bank into a development finance institution rather than allowing insolvency to take its course. Bancrédito creditors suffered no losses as a result of its failure partly due to the rapid intervention of the state.

Costa Rica's non-financial SOEs also appear to enjoy either an explicit or an implicit backing by the state. In principle, statutory SOEs cannot cease to function without the intervention of the Legislative Assembly and the abrogation or alteration of their constituting laws. Their legal status would, thus, appear to preclude the application of insolvency law.

This being said, there is evidence that state backing may not always be forthcoming. The 2012 bond offering of RECOPE explicitly warns investors that they stand to lose their investment in the case of an insolvency though such warnings are not evidence of what might occur in practice. On the other hand, Costa Rica's recent co-operation agreement with the IDB on behalf of ICE explicitly protects creditors against losses.

In contrast to statutory SOEs, subsidiaries are generally constituted as limited liability companies and can, in principle, be declared insolvent under normal insolvency procedures. While there have not been any cases of insolvency where creditor rights might have been tested, the state has indicated a willingness to provide whatever support is necessary to avoid formal insolvency proceedings. This reticence to go the insolvency route was illustrated by the situation of RACSA, a subsidiary of ICE Group, in 2016. RACSA was suspected of being vulnerable to insolvency. However, information on the SOE's financial health was closely guarded and never fully divulged to the public. The issue of the application of insolvency laws thus never arose.

Access to debt and equity finance (Guideline III.F)

Guideline III.F recommends SOEs' economic activities should face market consistent conditions regarding access to debt and equity finance. In particular, the Guideline recommends: 1) SOEs' relations with all financial institutions, as well as non-financial SOEs, should be based on purely commercial grounds; 2) SOEs' economic activities should not benefit from any indirect financial support[17] that confers an advantage over private competitors; and 3) SOEs' economic activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

Commercial grounds

SOE relations with financial and non-financial institutions vary significantly and do not always occur on fully commercial grounds. In some cases, the government has guaranteed SOE borrowing. The case of guarantees provided to RECOPE was highlighted above, and ICE has also received sovereign guarantees for borrowing from multilateral banks. State-owned banks report that they are at times encouraged to provide credit to institutions fulfilling public policy objectives, even if they have the capacity to reject such lending. Anecdotal feedback suggests that insurance pay-outs from INS to policy holders fulfilling public sector objectives are more easily approved than other institutions. Where significant infrastructure investment is required, the state may provide capital as was illustrated in the case of AyA. Both the ICE Group and AyA are excluded from the requirements of the Organic Law of the National Banking System, which limits banks from lending more than 20% of their capital reserves to state-owned enterprises. AyA benefits from this exclusion provided the credit is used to build sewage systems, water treatment plants or potable water supply systems. Also excluded from normal rules are Public Works Construction Trust Funds (Fideicomisos para Construcción de Obra Pública).

Direct and indirect financial support

There are limited cases of direct subsidies to SOEs. INCOFER, the state railway company (like most railway companies internationally) is unable to fully recover costs from consumers and receives subsidies to maintain services. Other SOEs such as AyA benefit from subsidies. There may also be forms of cross-subsidisation in Costa Rica that are difficult to account for. For example, INCOFER makes up part of its operating shortfall through advertisements placed on rolling stock. However, to date, advertising has been purchased mainly by Banco Popular, which, though not formally an SOE bank, operates under significant influence by the state. Business groups have also insinuated that procurement orders from SOEs are given preferentially to other SOEs rather than private offerors.

Competitive rates of return and dividends

There is no general requirement for SOEs to generate any rates of return, nor is there any general policy for dividend payments or how to distribute retained earnings. There are, nevertheless, rules that effect the returns of SOEs. For example, some SOEs must offer services at cost including the cost of capital. This is the case of the ICE Group, AyA (the water company), JAPDEVA (port company), and others where surpluses must be just sufficient to guarantee the sustainability of the service. On the other hand, in other cases, SOEs may generate surpluses, which can be retained and capitalised. Finally, some SOEs are obligated to distribute all or some of their surpluses to associations, institutions or organisations of social interest such as, for example, hospitals, pensions, education, small enterprises, as is the case of the state-owned banks and the Junta de Protección Social.

The capital structure of SOEs

Essentially two types of SOEs exist with respect to autonomy to decide their capital structures. The first group must submit decisions impacting their capital structure to the Central Bank of Costa Rica, the Department of Planning and Economic Policy, and the Treasury. A second group, operating under a modernised corporate structure, has greater autonomy and flexibility in structuring their capital.

SOEs with newer legal forms enjoy wide margins of autonomy in the determination of their capital structure within the limits of the law. Executives determine the capital structure, bearing in mind the SOE's policy objectives. Nevertheless, the establishing laws of SOEs have thresholds that must be respected, particularly for debt. For example, ICE Group, is authorised to take on debt up to 45% of total assets. In the case of JAPDEVA, the threshold permits debt of up to 50% of its assets.

The more restricted group (which includes the Postal Services of Costa Rica, JPS, and RECOPE) operate under Article 7 of Law 7010. In addition, Article 80 of Law 8114 on the Direction of Public Credit authorises the Minister of Finance to request an SOE to undergo certain credit operations. SOE banks are exempted from the authorisations of the Budgetary Authority and MIDEPLAN and the Direction of Public Credit. Overall, these laws discourage borrowing and typically encourage SOE's to use retained earnings for investment projects.

SOE engagement in public procurement (Guideline III.G)

Guideline III.G recommends that, when SOEs engage in public procurement, the procedures applied should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

At the beginning of the accession process, cumbersome procurement practices were identified as a cost imposed upon SOEs that made it difficult for them to compete with the private sector. Later in the process, concerns were raised by the private sector that exceptions written into the Public Contracting Law of 1995 to allow public entities greater flexibility to contract with other public entities without a public bidding process were being applied so as to prevent the private sector from competing on a fair footing. Some private sector observers claimed that direct contracting had led, in some cases, to excessive costs to the state and poor service delivery and that procurement practices were a way for SOEs to cross-subsidise each other and protect themselves from competitive pressures. Furthermore, some SOEs such as ICE and INS had their own specific exemptions, making for an uneven treatment not just between the private and public sectors but also between SOEs.

In 2017, the government took steps to qualify the broad wording of the Public Contracting Law, Article 2c, through the passage of the Regulations of the Law on Administrative Procurement. Nevertheless, there is still a widespread perception, particularly amongst the private sector, that the Public Contracting Law needs a deeper overhaul. The government now envisages a full reform of the Public Contracting Law to achieve greater efficiency and competition in all public procurement procedures.

The draft law (No. 21.546) aims at reducing the number of exceptions to ordinary procurement procedures and introduce new requirements for their use. Furthermore, it includes principles from the OECD Recommendation on Government Procurement and considers other recommendations made by the OECD Public Governance Directorate. If passed, all Costa Rican SOE's would be governed by a new and comprehensive law that is aligned with international standards.

These proposed legislative reforms are being preceded by reforms on the operational level through the introduction of an electronic platform for public procurement called the Integrated System for Public Procurement (SICOP).[18] The system is designed to rationalise procedures, reduce the potential for discretionary decision-making and corruption, and help the state take advantage of buying economies of scale. Some 80% of all public institutions already report using SICOP. And, some of the biggest

public procurement entities such as ICE, INS and the Social Security Administration have committed to start using SICOP in 2020. The use of SICOP is also expected to enhance transparency and improve the state's capacity to consolidate and analyse information related to its public procurement practices.

While comprehensive legal reforms are promising, the legislative process is still in its initial stages and it is too early to predict when it might be completed. A second, more narrowly focused legislative proposal has also been submitted to the Legislative Assembly, which focuses narrowly on amending Article 2c of the Public Contracting Law to eliminate the exceptions that have raised concerns. This more targeted reform, if passed, could act as a stopgap while work on more comprehensive procurement reform continues.

Recognising stakeholder rights

Recognising stakeholder rights as established by law or through mutual agreements and the duties, rights and responsibilities of corporate boards of directors

This *Roadmap* core principle relates mainly to Chapters IV and VI of the *G20/OECD Principles* and Chapters V and VII of the *SOE Guidelines* on stakeholders and boards. The Concept Paper recommends focusing on: 1) listed company stakeholder rights (Principles IV.A, B and E); 2) the rights, duties and responsibilities of listed company boards (Principle VI.A); 3) SOE stakeholder rights (Guidelines V.A, B and C). A discussion of Costa Rica's insolvency framework and the enforcement of creditor rights (Principle IV.F) was added to the items identified in the Concept Paper.

The boards of listed company and, in particular, SOE boards received considerably more attention in the Costa Rica review than in other accession reviews. The board section that had appeared under the combined stakeholder and boards principle in past reviews was expanded significantly and therefore has been moved to its own section. Information on board composition, independence, nominations and qualifications of listed company boards (Principle VI.A) and SOE boards (Guideline VII.C) can now be found in below under the heading: The duties, rights and responsibilities of boards.

Listed company stakeholder rights

Respect for stakeholder rights (Principle IV.A)

Principle IV.A recommends that the rights of stakeholders that are established by law or through mutual agreements should be respected.

Costa Rica has the usual legislation and regulations that establish the rights of corporate stakeholders including: labour law; insolvency law; shareholder, consumer and environmental protection laws; and banking legislation. The first line of defence against the infringement of stakeholder rights is the compliance and control function within the enterprise. The second line of defence is the judicial system through, which stakeholders may seek redress in the event that their rights are infringed.

The CONASSIF Governance Regulation has extensive requirements for compliance and control functions that serve to protect stakeholders' legal and contractual rights. It requires the board to act considering the legitimate interests of clients, owners and other stakeholders and ensure compliance with laws and regulations applicable to the entity. Boards are required to establish a compliance unit or function responsible for promoting and ensuring that the entity operates with integrity and in compliance with laws, regulations, policies, codes and other internal provisions. Such a function should have authority and resources, independence from senior management, and a reporting obligation to the board. The board also has the power to apply disciplinary measures against senior management and

other employees in the event of deviations or transgression of its culture, policies, code of conduct, and corporate values.

Stakeholder access to redress (Principle IV.B)

Principle IV.B recommends that, where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Stakeholder rights are protected by and stakeholders may seek legal redress through the courts. When rights are violated, the Political Constitution provides that individuals have recourse to justice and may initiate legal proceedings. They may resort to the Code of Commerce, the Civil Code, the Civil Procedural Code, Labour Law, or any other law or regulation as may correspond. In turn, Costa Rica has a judicial system with a reputation for thoroughness and effectiveness. Additional mechanisms are in place for stakeholders to obtain redress, including alternative dispute resolution mechanisms such as arbitration, conciliation and mediation. However, a significant weakness is the slowness of the judicial system as discussed under Principle I.B.

Communicating concerns about illegal or unethical practices (Principle IV.E)

Principle IV.E recommends that stakeholders, including individual employees and their representative bodies, be able to freely communicate their concerns about illegal or unethical practices to the board and to the competent public authorities and their rights should not be compromised for doing this.

Numerous avenues exist to communicate concerns regarding illegal or unethical practices. Formal channels are internal auditors, the police and public prosecutors. Reporting persons who choose to pursue legal channels to report illegal practices are protected under the Law for the Protection of Victims, Witnesses and Others in the Penal Process (Ley de Protección a Víctimas, Testigos y Demás Sujetos Intervinientes en el Proceso Penal).

The CONASSIF Governance Regulation requires boards to establish mechanisms to promote transparency and accountability to stakeholders, including to encourage stakeholders, including employees and their representative bodies, to openly express their concerns to the board regarding possible illegal or unethical practices, knowing that their rights will not be affected for expressing such concerns. Any attempt at retribution against employee whistleblowers would fall under the protections of labour law.

Under the directive on Strengthening the Strategic Role of SOE boards, passed in February of 2018, boards and managers are required to ensure the existence of whistleblowing policies and procedures, as well as monitor their integrity, independence and effectiveness. They are also required to protect whistleblower confidentiality.

Insolvency framework and enforcement of creditor rights (Principle IV.F)

Principle IV.F calls for the corporate governance framework to be complemented by an effective and efficient insolvency framework and by effective enforcement of creditor rights.

While the Concept Paper does not specifically call for corporate governance accession reviews to cover this principle, interviews during the accession review process, findings of the 2018 OECD Economic Survey of Costa Rica as well as a World Bank Report on Observance of Standards and Codes review of Costa Rica's insolvency framework point to significant weaknesses in this area that merit consideration. Furthermore, according to the World Bank Doing Business Report 2020, resolving insolvency was the area where Costa Rica's performance was weakest among the 10 business topics covered by the report. Costa Rica's rank for resolving insolvency is 137 of 190 countries compared to the OECD average of 28. With respect to the recovery rate, creditors can recover 29.5 cents on the United States dollar compared to the OECD average

of 70.2 cents on the dollar. Regarding time to resolution, Costa Rica requires 3.0 years for resolution compared to the OECD average of 1.7 years.

Legislation has been proposed to modernise and update the insolvency framework and interviews with insolvency specialists suggest that the implementation of the proposed reforms could lead to important gains in the efficiency and effectiveness of the framework and the economy. A bill of law to modernise Costa Rica's insolvency framework was introduced before the Legislative Assembly in May 2019. The bill was being developed based on best international practices and proposes to make insolvency systems more effective in enforcing creditor rights and promoting the restructuring and reorganisation of debtors.

SOE stakeholder rights

This section assesses Costa Rica's position against Guideline V.A (recognising and respecting stakeholder rights); Guideline V.B (reporting on stakeholder relations); and Guideline V.C (internal controls, ethics and compliance programmes or measures).

Recognition of and respect for stakeholder rights (Guideline V.A)

Guideline V.A calls on governments, the state ownership entities, and SOEs themselves to recognise and respect stakeholders' rights established by law or through mutual agreements.

Costa Rica is a state based on the rule of law. It has an institutional structure and a legal framework that seeks to recognise the rights of all citizens. Mutual agreements between any interested party and an SOE are considered enforceable and, provided they do not breach the legal framework, must be respected by all parties. While stakeholder groups may vary depending on the sector, a recurring stakeholder group across all SOEs are employees. The Constitution protects the right of workers to organise and bargain collectively. In interviews conducted for this review, a number of cases were cited in which unions played a visible role in SOEs, particularly with respect to collective bargaining agreements and other decisions related to workforce size and structure. The majority of the statutory corporations SOEs have collective bargaining agreements with their employees.

Reporting on stakeholder relations (Guideline V.B)

Guideline V.B recommends that listed or large SOEs report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.

In Costa Rica, SOE stakeholder reporting tends to be to the government and not directly to stakeholders from the SOE in the form of an annual stakeholder report. This being said, some SOEs have stakeholder reports on their websites. This practice appears to be informal and at the discretion of the SOE.

The main form of stakeholder reporting occurs through the publication of the National Development Plan (NDP), now NDPIP, which was described above. The NDPIP is a consolidated report that provides readers with an assessment of existing social and economic conditions in Costa Rica and describes the government's plans to achieve public policy goals. Though SOEs report on their performance against objectives set by the NDP on a semi-annual basis to MIDEPLAN, the NDP does not report on stakeholder performance for individual SOEs. Furthermore, the NDP appears only every five years whilst good practice for private and public enterprise is increasingly to publish stakeholder reports on an annual basis.

New developments should encourage greater transparency towards stakeholders. The General Guideline for the Review of the Functions of Management Bodies and Strengthening of their Strategic Role in State-Owned Enterprises and Autonomous Institutions (Directriz General Para la Revisión de

las Funciones de Órganos de Dirección y Fortalecimiento de su Rol Estratégico en las Empresas Propiedad del Estado e Instituciones Autónomas—099-MP) was passed in February 2018. The directive, hereafter referred to as the Strategic SOE Board Directive, suggests that establishing an organisational structure that responds to the legitimate interests of stakeholders is a fundamental responsibility of the board. In addition, the directive requires that indicators be established that can be used as part of the board performance evaluation process overseen by the Presidential Advisory Unit. Moreover, the NDPIP can now be tracked through a website that updates on the progress of the indicators each semester.

Internal controls, ethics and compliance programmes (Guideline V.C)

Guideline V.C calls on SOE boards to develop, implement, monitor and communicate internal controls, ethics and compliance programmes or measures, including those that contribute to preventing fraud and corruption.

All SOEs are required to have systems of control. The Law on Internal Control requires all public institutions to have internal control mechanisms to: 1) protect and preserve public property against losses, waste, undue use, irregularities and illegal acts; 2) provide reliable and timely information; 3) guarantee efficient operations; and 4) comply with the legal framework.

Ensuring that the internal controls required by law function properly depends significantly on the Comptroller General. Internal auditors and deputy auditors who are appointed by SOE chairs must comply with due diligence requirements including the possibility for the Comptroller General to contest the appointment process if it does not follow proper procedures. The Comptroller General can also audit SOE internal auditors directly. Resources for such audits are limited with the Comptroller General scheduling approximately four audits per year based upon a risk-based assessment. SOEs in the financial sector, in compliance with the CONASSIF Governance Regulation, must have a system to inform their boards, audit committees and other internal committees regarding their internal policies, controls and procedures to ensure best practices in corporate governance.

Interviews with board members, executives and accounting and audit professionals throughout the time period of the accession review, suggest that SOE boards do not rigorously monitor systems of control and that most board members do not have sufficient knowledge of control systems to evaluate whether controls are functioning properly. The oversight and monitoring of the internal control systems is widely viewed by board members and executives as the proper role of the Comptroller General.

The Presidential directive on Strengthening the Strategic Role of SOE boards brings Costa Rican more into line with international expectations. It discusses the role of the board in ensuring sound governance practices and “the existence of policies and procedures for the prevention, detection and combat of any kind of corruption, irregularity or fraud”.

The systems of control required under the Law on Internal Control provide some basic parameters for ethical and responsible behaviour, but the law does not go into the same detail as an ethics or CSR code. With respect to ethics and corporate social responsibility codes, the government’s aggregate report on SOEs indicated that six SOEs had a code of ethics and a sustainability policy available on their web sites.

Regarding the financing of political activities, legislation prohibits the financing of political activities from SOE funds. Rather, the Costa Rican legal framework has a mechanism for state contributions to political parties through Supreme Elections Tribunals. According to the Political Constitution, and the Electoral Code, 0.19% of the gross domestic product from two years prior to the election is set aside for political purposes.

The duties, rights and responsibilities of boards

This chapter of the *G20/OECD Principles* covers the overarching principle that the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. The Concept Paper calls for the accession review to focus particularly on the legal framework in place, including an assessment against Principle VI.A. However, the Concept Paper also provides a flexible framework to address issues in greater detail when, through the review process, additional issues, gaps or priorities for attention are identified. Accordingly, this section of the review was expanded to cover: committees in listed companies (Principle VI.E.2); the responsibility of the SOE board for performance, its role, and the duty to act in the interest of the SOE (Guideline VII.A); SOE board composition and independence (Guideline VII.C); political influence and ministers on SOE boards (Guideline VII.E); the separation of the positions of Chair and CEO in SOEs (Guideline VII.F); and SOE board performance evaluations (Guideline VII.I).

The rights, duties and responsibilities of boards in listed companies (Principle VI.A)

Principle VI.A, states that board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interest of the company and the shareholders.

The Code of Commerce appears to subsume the multiple duties of loyalty, care and good faith, common in other jurisdictions, into a single duty of diligence. The 2016 Minority Shareholder Protection Law, establishes board members' duties of diligence and loyalty, and the obligation to act in the best interests of the company, taking into account the interests of the company and its shareholders. In addition, the CONASSIF Governance Regulation explicitly defines the duties of care and loyalty and the obligation of the board to act on an informed basis in the interests of the company's shareholders and other stakeholders. Article 23 on conflicts of interest also prohibits actions that conflict with the corporate interest.

The Governance Regulation also establishes requirements related to the roles and responsibilities of boards. Regarding nominations processes, a clear, formal and rigorous nominations process is recommended to identify, evaluate and select nominees to the board. Regarding board composition, board members are expected to have broad and demonstrable knowledge, skills and experience in relevant areas to foster a diversity of views. In addition, board members should be individuals of recognised repute. All are expected to have an understanding of governance practices and their role in the governance of the company and be capable of exercising sound and objective judgment.

Requirements for transparency include the disclosure of information on board members including credentials and experience, leadership positions in other businesses and interests in transactions or matters that might affect their independence. These disclosures should serve to help assess the degree to which board members may have conflicts of interest. It is to be noted that the Governance Regulation makes a specific reference to information that must not be disclosed. This clause is intended to ensure compatibility with existing laws that protect the identities of beneficial owners, which were described above. Furthermore, any other information should be disclosed that would help to better understand the governance of the enterprise such as information on committees, objectives, responsibilities, composition, meeting frequency, etc.

The Governance Regulation also has requirements with respect to independence. In terms of composition, the board should have at least two independent board members. In addition, the board, as a whole, is expected to fulfil its responsibilities with an independent perspective. The regulation specifies that the board member selection process should aim at independence and that board member

elections should result in candidates who are free of conflicts of interest that could prevent them from acting in an objective and independent manner.

Board committees in listed companies (Principle VI.E.2)

Principle VI.E.2 states that boards should consider setting up specialised committees to support the full board in performing its functions, particularly in respect to audit, and, depending upon the company's size and risk profile, also in respect to risk management and remuneration. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

In Costa Rica, boards are enjoined to establish committees to support their work. The Governance Regulation mentions four committees: 1) audit; 2) risk; 3) nominations; and 4) remuneration. The heads of both the audit and risk committees are supposed to be independent, while the nominations and remuneration committees are required to have at least one independent board member. The audit committee is mandatory for all enterprises and the risk committee is mandatory for financial companies. Under CONASSIF's proportional and flexible approach to implementing the regulation, both the nominations and remuneration committee are considered voluntary. In addition, the SUGEF Agreement on Compliance with Law 8204 (Acuerdo SUGEF Normativa Para el Cumplimiento de la Ley Nº 8204) requires any institution under the supervision of any of the superintendencies to have a compliance committee to consider topics related to anti-money laundering and terrorism. Such committees are not board committees but may have the participation of a board member and report to the board.

Responsibility for performance, board role and acting in the interest of the SOE (Guideline VII.A)

Guideline VII.A states that the boards of SOEs should be assigned a clear mandate and ultimate responsibility for the SOE's performance and that the role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners and act in the best interest of the enterprise.

The board's responsibility for SOE performance

At the beginning of the accession review process in 2016, there was little systematic survey information available to provide an objective account of how effectively boards function. With respect to SOEs, some SOE board members and managers interviewed for the accession review reported that board performance was variable, that the profile of board members in some SOEs lacked important skills and that there was limited capacity for independent thinking. Few board members had the capacity to oversee the financial reporting, risk management or control functions of the SOE and there was broad agreement that the profiles of board members needed to improve. Since that time, a number of relevant developments have occurred, including the Bancrédito crisis described in Box 3.5 below, and the government's policies and practices related to board composition and performance have evolved considerably.

Box 3.5. Case study: The role of the board in the Bancrédito crisis

Costa Rica faced a crisis within Bancrédito in early 2017, which brought to light significant problems in the governance of SOE banks. The crisis arose when the bank was found to be non-viable. The bank had traditionally relied on state-sanctioned monopolies for the collection of airport exit taxes, the management of a state development fund and other government-granted commissions. Once these

privileged sources of revenue dried up, the bank lost access to critical life-sustaining cash flow and the government had to intervene to keep it afloat.

As the crisis became acute, other state-owned institutions were called in to prop it up. A presidential decree constrained Banco Nacional de Costa Rica and Banco de Costa Rica to maintain their funds with Bancrédito. Other SOEs, including the National Insurance Institute, the Costa Rican Oil Refinery, the National Institute of Education, and other autonomous state institutions were instructed to maintain their investments until at least the end of 2017.

The board of Bancrédito was seen as a core cause of the crisis and the bank's problems. Board members lacked experience in banking and political differences were fought out in the board room, which may have hindered the board's capacity to make decisions to address the bank's immediate challenges. Weak oversight also played important role. Bancrédito had serious and longstanding viability issues and these issues had never been adequately addressed by government in its role as owner. Prior to the crisis, the government's oversight was insufficient to correct the fundamental business problems confronting Bancrédito. Nor did government act upon the problems with Bancrédito's board.

On the most fundamental level, the problem was that the bank was unable to adjust its mission and operations to a changing environment. Neither government, nor the board, nor management pushed Bancrédito to adapt itself to its external environment and reinvent itself as a sustainable business.

Costa Rica avoided a potentially serious economy-wide crisis because Bancrédito was not a systemically important financial institution. However, several other SOE banks in Costa Rica are systemic and have operated in the past under similar governance practices. The Bancrédito crisis had the immediate impact of sensitising the government and the public towards the importance of good governance, which helped to encourage governance reforms.

Source: Interviews with government and regulatory officials and management involved with the case.

The role of the board in Costa Rica's SOEs

In Costa Rica, the role of the board is usually defined in the founding laws of SOEs. Their functions are, generally, to:

- Direct the SOE and exercise strategic control
- Appoint and remove managers and assistant managers
- Define and approve institutional policies and business development strategies
- Define and approve the administrative structure and organisation of the SOE
- Set investment policies
- Appoint the external auditor
- Protect the SOE's finances
- Dictate internal regulations

Though the legal requirements for SOE boards cited above correspond well with the *SOE Guidelines*, at the beginning of the accession review process, there were some gaps with the *SOE Guidelines* including: 1) the responsibility of the board for its own governance; and 2) the responsibility of the board for public disclosure.

Furthermore, while much of the law, rules and regulation appear to be in step with OECD practice, a key issue identified at the beginning of the accession review process was the actual role of the SOE

board in practice. To illustrate, in Costa Rica, the law requires boards to meet on a weekly basis (limited to a maximum of eight meetings per month). Meeting practice varies considerably between SOEs with board members attending between one and up to a maximum of 11 meetings per month (not including extraordinary meetings), according to a report from the Comptroller General from June 2014. The report found that, on average, board members attend approximately three ordinary board meetings per month.

The number of meetings in Costa Rican SOEs is in strong contrast with the number of board meetings of listed companies in the world's largest financial markets, which can serve as a benchmark. These would meet on average between seven and eight times per year while it is entirely possible for a Costa Rican SOE board to have that many meetings in a single month.[19] The high frequency of SOE board meetings suggests that boards may be micro-managing SOEs and that boards provide a compliance checking function rather than a high-level strategy, oversight and policy-setting function. This conclusion was confirmed by interviews with SOE boards in 2016. Interview feedback also suggests that, at least in some cases, management's capacity to attend to their main responsibilities is diminished because of the constant demands of meeting preparation.

Acting in the interest of the enterprise

Another important concern was with respect to the duties of board members. The *SOE Guidelines* and *G20/OECD Principles* suggest that the duty of board members is to act in the interest of the company and its shareholders. At the time of writing, SOE statutes, law and SOE business culture suggest that the duty of board members is mainly to the state and to the achievement of the state's policy goals. In principle, this is consistent with the view that the state is the shareholder of the SOE and that board members act in the shareholder's interest. However, the priority given to the state's policy goals over the interests of the SOE means that there has been far less consideration of company interests versus policy interests. The trade-offs and costs involved in choosing between policy goals versus commercial goals are often unclear to the detriment of sound decision-making.

Nevertheless, concerns remain regarding the degree to which SOE boards act in the long-term interest of the SOE they govern. For example, in the cases of FANAL, ICE and RECOPE, environmental and social objectives as set out in the NDPIP take precedence over business concerns and have, to some extent, in the past, even taken precedence over the sustainability of the business.

Two important measures have been passed to re-focus on the higher-level roles that are important to move SOE boards towards good practice. The first measure was Costa Rica's Strategic SOE Board Directive issued in February 2018. The purpose of this directive was to: 1) align board practices with international standards and specifically with the recommendations of the *G20/OECD Principles* and *SOE Guidelines* and the instruments of the Basel Committee; 2) require SOEs to evaluate the roles of their own boards with the purpose of determining what functions are appropriate for board versus management; and 3) report findings to the newly established Presidential Advisory Unit.

The Strategic SOE Board Directive is a significant step forward in defining the proper roles of boards and also in establishing a process of board self-evaluation. The directive clearly places the responsibility for strategy in the hands of board members, requires that board members be qualified, and that board members ensure effective decision-making systems amongst many other best practice recommendations. The directive also defines a duty of loyalty and care to the SOE.

But there are a number of areas where the directive's articles could be open to significant interpretation. For one, while the duty of loyalty and care towards the SOE are clearly developed, there is also an explicit obligation to act according to the instructions of the state and the Council of Ministers as owner. The problem is not that the Council of Ministers may have final authority but that the decision-making authorities of boards versus the Council of Ministers are not defined. And, while boards are expected

to comply with the objectives defined in the NDPIP, there is no explicit definition of the NDPIP's relative authority. A situation of unclear decision-making authorities and loyalties thus persists.

The second measure was the Regulation on Suitability of Members of the Management Body and Senior Management of Financial Entities, which also came into force in 2018. That regulation defined the profiles of board members and executives needed for banking organisations including SOE banks. Despite foreseeable challenges in implementation, these two measures set the framework for achieving the desired higher-level outcomes of board nominations.

Guideline VII.C recommends that SOE board composition allow the exercise of objective and independent judgment and that all board members—including any public officials—be nominated based on qualifications and have equivalent legal responsibilities.

SOE board composition, nominations and qualifications

An analysis of the composition of SOE boards was done by the Presidential Advisory Unit in 2018. This analysis suggested that while SOE boards had a mix of profiles, they tended to have a very strong representation of lawyers, engineers, academics, and individuals with public sector backgrounds.

The founding laws of individual SOEs generally define the needed characteristics of board members. Board members can come from the public or private sectors though some SOEs require board members to have some public sector experience. The most common requirements made in founding documents relate to educational background or sector-specific experience. In some cases, these requirements can be quite specific without necessarily responding to the needs of the SOE.

Box 3.6. Laws impacting board composition

In some SOEs, board posts are allocated to representatives of private organisations (often professional guilds) or to employee representatives. For example, the board of the railway SOE INCOFER has one representative of a union, and another board member who represents the users of INCOFER services. Other examples of board compositions are as follows:

- SINART (National Institute for Radio and Television) has an eight-member board composed of: 1) a Chairman appointed by the Council of Ministers; 2) a representative of the Federation of University Professional Associations of Costa Rica (specifically an expert in social sciences appointed by the Council of Ministers from a list submitted by the Federation); 3) a representative appointed by the National Council of Rectors; 4) a representative of the Ministry of Culture, Youth and Sports, appointed by the Minister; 5) an official from the Ministry of Education, appointed by the Minister; 6) a representative appointed by the Unit of Rectors of Private Universities; 7) an official from the Ministry of Science and Technology or the Ministry of Environment and Energy designated jointly by both Ministers; and 8) a prosecutor appointed by the Attorney General of the Republic, with voice but no vote.
- In ICE Group, three board members must be engineers with expertise in telecommunications or electricity; one must have a B.A. in Economic Sciences with a Masters in Administration; one must have a B.A. in Computer Sciences with an emphasis in telematics; and one, a degree in Law with an emphasis in public law. They must all be members of their corresponding professional associations. Additionally, board members must have a minimum of seven years of recognised professional, management or business experience in their specified areas.
- In the Postal Services (Correos de Costa Rica) the board is composed of five members, four appointed by the Presidency and one by the Board of the Chamber of Commerce of Costa Rica.

The Organic Law of the National Banking System states that the position of “member of the Board of Directors” is incompatible with that of “managers, authorities and employees of the bank itself.” In other words, bank workers cannot also be SOE bank board members.

Since its establishment, the new Presidential Advisory Unit was able to gain practical experience with its new web-based board member selection process. The profile of board members is still determined first and foremost by the statutory laws under which SOEs are established. Once those and other legal requirements are fulfilled, the requirements under the new Rules for the Selection and Valuation of Candidates for Charges of the Management Body of SOEs of 2019 must be followed. At that point, the selection procedures of the Presidential Advisory Unit are followed and the needs of the SOE and the views of the existing board can be taken into account. The current practice is for ministers to conduct interviews with a short list of candidates and share their views with the Council of Ministers who makes the final decision on appointment.

The new board member nominations process was used in 2019 to appoint 13 board members, and the results can be seen in RECOPE, ICE and INS. Overall, an assessment of the current board composition amongst these three SOEs suggests that boards continue to have similar profiles as before with a relative under-representation of individuals with deep business experience albeit, in many cases, with fresh faces who can be expected to bring new views to the SOE. Nevertheless, while there are positive indications that the new board member selection process will yield better board compositions, the impact on board practices and performance can be expected to take time.

The case of ICE Group, the flagship of Costa Rica’s SOEs, illustrates both the benefits and challenges of good board composition. During the first half of 2019, the government suspended six of ICE’s seven board members (all but the newly appointed executive chair) in connection with allegations of wrongdoing related to decisions taken between 2014 and 2018. Pending the investigation, six new board members were appointed in a temporary capacity, according to the new Presidential Advisory Unit process.

The new members bring commercial skills that are hoped will contribute to a better capacity for analysis, particularly in business and finance. Board members now look into financial performance in detail and it is reported that board discussions are richer. Perhaps as a result of changes in the board (but, certainly, also in response to ICE’s poor financial performance), greater impetus has been given at board level to making ICE financially sustainable.

One of the predictable challenges in implementing the Strategic SOE Board Directive is that the laws establishing SOEs define overly-specific board member profiles and limit the SOE’s capacity to have board members with needed expertise such as financial reporting or knowledge of risk management or systems of control. Furthermore, statutory SOEs may limit the roles and responsibilities of board members to certain functions that do not correspond to the requirements of the Strategic SOE Board Directive. Consequently, despite the directive’s positive intent, an actual modification of board practices will likely pose challenges and require changes in law, the mind-set of government oversight bodies, board members and management.

For Costa Rica’s two SOE banks, the Organic Law of the National Banking System, requires that four out of seven board members must have an academic degree (equivalent to a bachelor degree) and that one of them has to have a degree in economics and one in law. In addition, they must be Costa Rican citizens over 25 years of age and have knowledge and experience in economics, finance, bank, administration or in topics related to economic and social development. No other banking experience is required.

A new regulation was enacted in May of 2018 entitled Regulation on the Suitability of Members of the Management Body and Top Management of Financial Entities, which applies to all financial companies supervised by SUGEF including SOE banks. It covers essential issues in board member selection including fit and proper testing, experience, the need to select board members in response to company needs, conflicts of interest, proper selection procedures and so on.

The issue of gender diversity on boards was considered during the accession review process. Some requirements exist to ensure gender diversity on boards through the Law on Promotion of the Social Equality of the Woman and the law on the Minimal Percentage of Women on Boards of Associations, Unions and Solidarity Associations of 2010. The law establishes a 50% quota for representation of each gender on SOE boards. In the case of uneven numbers of board members, the policy calls for the SOE to alternate between a female majority and male majority to maintain an equal ratio over time. Gender representation on SOE boards was 57% male and 43% female as of October 2019.[20]

Objective and independent judgment

Independence of mind is, arguably, the ultimate protection against the risks and failures one observes in some SOEs and SOE banks globally. The Strategic SOE Board Directive prescribes the roles and responsibilities of SOE boards though it does not specifically address the issue of independence or objectivity of mind. On the other hand, independence is required by the laws establishing SOEs as well as legislation applying to civil servants, and, in practice, all Costa Rican SOE boards are composed of non-executive board members who are at least technically independent from management. The only exception is where the roles of Chair and CEO are combined.

The concept of independence is embedded in the individual laws establishing SOEs as well as in other legislation. For example, the founding law of INS suggests that “the Board of Directors shall exercise its duties with full independence and under its exclusive responsibility, within the rules established by law, applicable regulations and the principles of procedure.” In addition, the Law Regulating the Insurance Market limits the number of board members who can be owners, with no more than 40% of Board members being shareholders in the entity, or relatives of such shareholders, up to third degree of kinship or affinity. Nor can they be employees of enterprises of the same economic or financial group. In addition, Costa Rica’s ownership Protocol restates legislative requirements that board members be able to “form an objective opinion” and be free of “any other internal or external influence on their judgment”.

The concept of independence is also embedded in the laws that rule state-owned banks. The Law of the National Banking System says: “Each Board of Directors shall exercise its functions with absolute independence and under its exclusive responsibility, within the rules established by law, applicable regulations and the principles of the procedure. Board members shall have complete freedom to exercise their functions in accordance with their consciences and their own criteria, and shall therefore be personally liable for any action they take in connection with the overall direction of the respective bank.” In addition, the law seeks to create independence by restricting board members from being: 1) members and employees of any branch of government; 2) employed by the bank itself; 3) board members or employees of any other bank; 4) current or previous board member of a private financial corporation, or related to such an individual; or 5) a shareholders or authorities of those corporations.

The recently established Presidential Advisory Unit is expected to develop further mechanisms to promote the capacity of SOE boards to act independently in their decision making.

Ministers and high-level government officials on SOE boards (Guideline VII.E)

Guideline VII.E calls for mechanisms to be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and limiting political interference in board processes.

In the past, SOE board members were often selected along party lines, and in the banking sector, board members were sometimes reported to be former members of the Legislative Assembly. In some SOEs, there were cases where ministers or their adjuncts, and civil servants were board members. Interviews conducted in 2016 and 2017 showed that in some cases ministers (or vice ministers) were directly involved in decision making and had, for example, instructed SOEs to be more active in investing in certain technologies and services rather than others. The level of state involvement in SOE affairs was illustrated by the frequency of meetings between ministers and CEOs, which could occur on a monthly basis. Some interviewees insisted that such involvement was positive but also acknowledged the possibility of subjecting SOEs to undue influence and diminishing the accountability of the board.

In 2018, a sample of 12 SOEs (excluding FANAL and subsidiary boards) showed that 16% of board members had overtly political backgrounds (e.g. having served in the Legislative Assembly or former ministers or vice ministers). This does not mean, however, that the remaining 84% of board members acted independently from government because Costa Rica is a small country where informal interactions between government and SOE officials are frequent.

One of the key recommendations of the *SOE Guidelines* is that ministers and other high-level government officials not sit on SOE boards.[21] As of September 2019, there were ministerial representatives on two SOE boards: 1) the Costa Rican Petroleum Refinery (RECOPE); and 2) indirectly, the National Liquor Factory (FANAL), which is considered an SOE for the purposes of the accession review and which does not have a board of its own.

In 2019, the Legislative Assembly approved a law that prevents ministers or vice ministers from acting as board members of RECOPE. The law is entitled Law Derogating Article 9 of Law No. 7152, Organic Law of the Ministry of Environment, Energy, of 5 June 1990, and Impediment of the Governing Council to Appoint Ministers or Vice Ministers on the Board of Directors of the Costa Rican Petroleum. The legislation required the Minister of Environment, Energy and Telecommunications to leave the RECOPE board by the end of 2019. Interviews with RECOPE board members suggest that the departure of the minister would allow both board members and executives to act more independently in accord with the recommendations of the *SOE Guidelines*. The departure was also seen as an opportunity to find a replacement board member with business experience and thereby strengthen the board and provide needed impetus for the renewal and transformation of RECOPE.

FANAL has the monopoly for licensing of alcoholic products in Costa Rica. The monopoly was originally granted to foster the sugarcane industry and protect society from health problems associated with alcohol consumption. FANAL is governed by the board of the National Council for Production (CNP), which, in turn, has the Minister of Agriculture on its board of directors. As of October 2019, the Executive submitted a draft bill to the Legislative Assembly, to remove the Minister of Agriculture as CNP board member, in order to comply with the OECD's recommendation. At the time of writing, the government was also considering the possibility of turning FANAL into a government concession. In the event that FANAL remains an SOE, a better long-term solution would be to provide it with its own board and ensure that the board has no ministers, is sufficiently apolitical, has independent members, and is able to act with objective and independent judgement.

Separation of the positions of board Chair and CEO in SOEs (Guidelines VII.F)

Guidelines VII.F calls for the position of the board Chair to be separate from the CEO.

Regarding the separation of the roles of board chairs and executives, the *SOE Guidelines* recommend that the functions of the Chair and the CEO not be held by the same person in order to create greater independent oversight of the SOE's executives. In Costa Rica, SOEs subject to Law 5507 combine the Chair (Presidente) and chief executive officer (Ejecutivo) into the single position of Executive Chairman (Presidente Ejecutivo).

Performance evaluation in SOEs (Guideline VII.I)

Guideline VII.I states that SOE boards should, under the Chair's oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

The assessment of SOE boards is now considered a key oversight responsibility of the state according to Costa Rica's ownership Protocol, issued in 2019. In fact, the provision of such information is required under the Strategic SOE Board Directive and, in addition, Directive 039-MP General Policy for Board Performance Evaluation, issued in March of 2019. These provisions instruct SOE boards to conduct self-evaluations and report the results of those evaluations to the Presidential Advisory Unit tasked with SOE oversight. Such information had been provided to the Presidential Advisory Unit by the preponderance of SOEs at the time of writing. The Unit was conducting an analysis, with individual recommendations being issued to SOEs in order to strengthen the final evaluation instrument.

Induction and corporate governance training

The *SOE Guidelines* suggest that evaluations could also be instrumental in developing effective and appropriate induction and training programmes for new and existing SOE board members. Costa Rica has recognised the importance of training to change attitudes and practices. Since February 2019, training was being provided by the Costa Rican Institute of Corporate Governance (ICG) under the supervision of and in collaboration with the Presidential Advisory Unit. As of August 2019, 106 board members from 13 SOEs had received training with the objective of eventually reaching all SOE board members, key SOE executives, and selected government officials over the following year-and-a-half. Many SOEs report that training has provided them with new insights that have led to some practical changes. In addition, training sessions have provided board members from different SOEs the opportunity to interact with each other and exchange views on practices and how to meet governance challenges. Feedback suggests a continuing need to reinforce board practices and capacities and further attention to topics such as financial reporting practices and the implementation of International Financial Reporting Standards, risk management, oversight of internal controls, and ensuring the financial sustainability of the enterprise.

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Notes

[1] Banco Cathay de Costa Rica, Banco Lafise, Banco Promerica de Costa Rica, Corporación ILG International and Grupo Financiero Improsa

[2] Costa Rica Principles Self-Review 2017.

[3] La Nación, Transparencia en el ICE, 6 November 2018: https://www.nacion.com/opinion/editorial/editorial-transparencia-en-el-ice/UTUJMMF6DJCWLOEODX6CBI2JPY/story/

[4] Quantitative data and budgets have been closely followed by the Comptroller General. However, their purpose is to check budget compliance and not financial performance or achievement of financial performance objectives.

[5] La Nación, Directivos del Banco Popular crean cinco altas jefaturas antes de irse, 10 June 2018: https://www.nacion.com/data/directivos-del-banco-popular-crean-cinco-altas/GDTZBRA3KVDRDHFPEVVOT6ZKOQ/story/

[6] See Table 2.11 above for a list of the SOEs to which this law applies. In addition, separate legislative acts establish similar systems for additional SOEs: RECOPE, RACSA, CNFL, SINART, INCOFER, the Junta de Protección Social, and Correos de Costa Rica.

[7] Frederick Herzberg (1968), One More Time: How to Motivate Employees, Harvard Business Review. The article is considered a classic and has influenced a generation of scholars and managers on issues of compensation.

[8] OECD Economic Survey of Costa Rica of 2016, pp. 119-125. The issue of pricing levels is not taken up in the more recent OECD Economic of Survey of 2018.

[9] OECD Accession Review Competition Committee.

[10] OECD Economic Survey of Costa Rica of 2016, p. 115.

[11] OECD Accession Review Competition Committee.

[12] BCR.

[13] OECD Economic Survey of Costa Rica of 2016.

[14] The new law on deposit insurance is not reviewed or described in detail in this report, due to its enactment after the Corporate Governance Committee completed its review in October 2019.

[15] This section is largely based upon the OECD Accession Review of Costa Rica for the Competition Committee draft report by the Secretariat.

[16] Renewable Energy Policy Network for the 21st Century, www.ren21.net.

[17] This includes, for example, preferential financing, tax arrears or other preferential trade credits from other SOEs. It can also include SOEs' receiving inputs (such as energy, water or land) at prices or conditions more favourable than those available to private competitors.

[18] SICOP (Sistema Integrado de Compras Públicas) https://www.sicop.go.cr/index.jsp.

[19] Numerous studies have been made of the frequency of board meetings. The number of meetings depends on the size and type of company and the country but little information on SOE boards is available. For private companies, a Compliance Week study of 1 500 S&P companies conducted in 2011 suggests that the figure is 7.8 meetings per year and that this figure has been declining over time. Simple averages should be viewed with caution; it is important to consider ranges of practice. Figures from the Conference Board, Deloitte, E&Y and Spencer Stewart suggest that major listed companies generally do not go below six or above 12 meetings per year.

[20] Aggregate Report on SOEs 2019, Republic of Costa Rica: https://presidencia.go.cr/wp-content/uploads/2019/11/Reporte-agregado-empresas-del-Estado-2019-v8Nov2019.pdf

[21] OECD Guidelines on the Governance of State-owned Enterprises (2015), Annotations, Chapter VII.C.

4 The landscape for combatting corruption and review against the OECD Anti-Corruption and Integrity Guidelines for SOEs

After a brief introduction, this chapter includes a discussion of the overall anti-corruption landscape in Costa Rica. This is followed by a summary review of Costa Rica's policies and practices compared to the OECD Anti-corruption and Integrity Guidelines in State-owned Enterprises (ACI Guidelines). The ACI Guidelines apply specifically to SOEs and cover the following issues: 1) the integrity of the state; 2) exercise of state ownership for integrity; 3) the promotion of integrity and prevention of corruption at the enterprise level; and 4) accountability of state-owned enterprises and of the state.

Introduction

Costa Rica's framework for combatting corruption was initially considered during the accession review process through an assessment of Costa Rica with respect to the recommendations of the *G20/OECD Principles*, the *SOE Guidelines* and other relevant OECD work[1]. This included the development of a general description of the landscape for anti-corruption. Later in the process, in 2019, the *OECD Anti-corruption and Integrity Guidelines in State-owned Enterprises (ACI Guidelines)* were issued. Given the advanced stage of the accession review process, the review against the *ACI Guidelines* was based largely on a self-assessment of Costa Rica against its recommendations and some selected interviews but was not exhaustive and did not obtain sufficient information to reach a clear assessment against all detailed recommendations. Nevertheless, sufficient information was available to reach broad conclusions and develop an overall description of compliance with the recommendations made in the four substantive chapters of the *ACI Guidelines*.

The general landscape for anti-corruption

The government of Costa Rica formally applied to the OECD Secretary-General in 2013 to become a full participant in the OECD Working Group on Bribery in International Business Transactions (WGB) and to accede to the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (*Anti-Bribery Convention*). In the context of the WGB's Accession Review of Costa Rica, the WGB concluded that "Costa Rica is willing and able to pursue corruption cases," and that "Costa Rica has actively and co-operatively participated in the WGB and other review mechanisms. It has also taken significant steps to prepare for accession to the *Anti-Bribery Convention* by making amendments to its legislative framework and holding events to raise awareness of foreign bribery, improve enforcement of the offence, and prepare for the WGB monitoring process." Accordingly, Costa Rica became the 43rd Party to the *Anti-Bribery Convention* in July 2017.

Costa Rica's legal framework for anti-bribery and its compliance with the *Anti-Bribery Convention* was subsequently examined in 2017. This resulted in a set of recommendations made to Costa Rica. In response, the law on the Liability of Legal Entities for Domestic Bribery, Transnational Bribery and other Crimes Law was enacted in June 2019 (Responsabilidad de las Personas Jurídicas sobre Cohechos Domésticos, Soborno Transnacional y otros Delitos). The law aims to fulfil the commitments acquired with the ratification of its adherence to the *Anti-bribery Convention* and strengthens, among others, the mechanisms to establish the liability of legal persons in cases of transnational bribery.

Costa Rica has laws, regulations and penalties to combat corruption, and has demonstrated some capacity to enforce them despite limited resources. The country scored 56 out of 100 points on Transparency International's Corruption Perception Index of 2018 and had a rank of 48 out of 180 countries. According to the World Economic Forum Global Competitiveness Report 2018-2019, Costa Rica ranked 44 out of 141 countries on the criterion of incidence of corruption. In the same report, corruption is classified as the seventh out of the 16 most problematic factors in Cost Rica. This represents an improvement from the 2012-2013 report where corruption ranked fourth.

During the initial phase of the accession review, contacts with civil society organisations suggested that while corruption was not generally visible, there were cases of cronyism, nepotism, and abusive related party transactions. Subsequently, the "Cementazo" (Big Cement) scandal emerged in mid-2017. It featured allegations of corruption in the Bank of Costa Rica, abetted by weak governance practices in state-owned banks, and provided a more concrete illustration of the problems alluded to by civil society organisations.

The case exposed both the vulnerability of SOEs to corruption and the importance of strengthening boards and their capacity to oversee the effectiveness of internal controls. The Cementazo case, which garnered widespread publicity, contributed to reinforcing Costa Rica's commitment to reform SOE boards through an improved appointment system, and the implement of board training and board evaluation programmes.

Box 4.1. Case study: The Big Cement scandal or the "Cementazo"

The Banco de Costa Rica (BCR) scandal came to be known as the "Cementazo" because it revolved around a credit for the importation of cement from China. The Cementazo has been described as a case of influence trafficking wherein executives at BCR provided a credit to Juan Carlos Bolaños (and his company Sinocem), who was associated with various government institutions and political parties.

According to press reports, rules and regulations were changed unduly in order to favour Sinocem's business. Bolaños defended himself against accusations of misconduct by arguing that his actions were an attempt to break a government-identified duopoly on cement importation held by Holcim and CEMEX. Both Holcim and CEMEX, on the other hand, deny the allegations of market dominance. Ultimately, a network of mainly public banks (BCR, Bancrédito, Banco Popular, and Banco Internacional de Costa Rica) became involved, lending approximately USD 45 million to Bolaños and his company.

The Cementazo is a complex case. It garnered significant public attention precisely because it involved various government institutions. Irrespective of the details of the case, the Cementazo illustrates the problems that often emanate from opaque governance arrangements. It implicates the state as the owner of BCR and the board of directors, and highlights the problems that result from weak systems of control.

Summary review against the ACI Guidelines

The OECD Council adopted the *Recommendation of the Council on Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises* (*ACI Guidelines*) in May of 2019. The *ACI Guidelines* bring together recommendations on anti-corruption and integrity found in a number of existing OECD instruments and provide complementary recommendations specific to SOEs. In its position statement with respect to the *ACI Guidelines*, Costa Rica reported that its policy framework is not only aligned with the principles and recommendations of the *ACI Guidelines*, but that it is committed to improving integrity and ethical standards in its SOEs and in the exercise of the public service at large.

The following evaluation of Costa Rica's compliance with the *ACI Guidelines* focuses almost exclusively on the legislative and institutional framework. It was not possible to obtain sufficient information to assess the actual policies, systems or procedures in place at the SOE level, or reach conclusions regarding the effectiveness of the legal and institutional framework in preventing corruption and promoting integrity. Such an assessment would have required considerably more time. There are, however, already some indications regarding the practical capacity of SOE boards and executives to implement anti-corruption and integrity policies that can be inferred from the parts of the accession review that assess Costa Rica against the *SOE Guidelines*.

This assessment has led the Corporate Governance Committee to reach an overall positive assessment of Costa Rica's legal framework for anti-corruption and integrity in SOEs, as noted in greater detail below. Costa Rica's position underlines a continuing commitment to preventing corruption and promoting integrity in SOEs. However, similar to its implementation of the *SOE Guidelines*, Costa Rica

should continue to work to strengthen implementation, particularly at the level of SOEs and their boards, to ensure effective oversight of internal controls and corruption risks. This will also require mutually-reinforcing approaches, which emanate not only from the state and SOEs, but from the regulatory, judicial and supreme audit institutions to foster an effective cultural change towards better integrity and anti-corruption practices.

The legal framework for anti-corruption in SOEs

At the level of its overall legal framework, Costa Rica fosters a general environment of transparency and integrity in the public sector. Costa Rica has a legal and regulatory framework fully consistent with the rule of law and SOEs are subject to the general rule of law. Costa Rica also has a well-developed judicial system that permits the enforcement of rights. The following are the main legal provisions that establish the framework for corruption and integrity in SOEs:

- The Constitution establishes specific provisions related to integrity and anti-corruption such as: the prohibition for legislators to contract with the state or receive concessions of public assets and the right of the Comptroller General to oversee the use of public funds.
- Since 2004, regulations were added outlining the duties and obligations of public officers in matters of anti-corruption and integrity. The Law against Corruption and Illicit Enrichment in Public Service and Executive Decree 32333-MP-J of 2005 define the duty of integrity. They also introduce rules regarding conflicts of interest and abuse of public office.
- In accordance with the Law against Corruption and Illicit Enrichment, ethics principles are legally binding for all public officers, including officers and individuals working for public enterprises. They also apply to proxies, administrators, managers and legal representatives of legal entities that safeguard, administer or exploit funds, goods or services property of the Administration.
- Regarding integrity of the state, Costa Rica's legal and regulatory framework applies high standards of conduct to the state and encourages a culture of integrity. The Political Constitution establishes the obligation for public servants to comply with the duties imposed by law, as well as the prohibition to assume any faculties that are not explicitly granted by law.
- Costa Rica's legislation defines "corruption" in Executive Decree No. 32333 as the use of public functions and attributions to obtain or concede benefits, in violation of legal provisions and existing regulation. More specifically, it is the undue exercise of power and public resources for personal or political gain for oneself or on behalf of a third party. The definition is further complemented by other decrees that include list of acts of corruption, as well as Law 7670 of 1997, which ratifies the American Convention against Corruption.
- Under the General Law of the Public Administration of 1978 and administrative case law, public officials including SOEs board members are subject to the legal and regulatory provisions of Public Law. In matters of criminal responsibility, they are considered legitimate public agents.
- The General Guidelines about Ethic Principles and Statements to be Observed by Heads, Subordinate Holders, Officials of the Comptroller General of the Republic, Internal Audits and Public Officials in General issued by the Comptroller General, establishes that no public servant shall participate, directly or indirectly, in financial transactions taking advantage of confidential information, thus mitigating the risk of insider trading.
- The Review of the Functions of Management Bodies and Strengthening of their Strategic Role in State-Owned Enterprises and Autonomous Institutions (referred to in this review as the Strategic SOE Board Directive) establishes that one of the responsibilities of the board is to ensure the existence and integrity of whistleblowing procedures, as well as the protection of whistleblowers. Further, Decree 32333 safeguards the confidentiality of whistleblowers after launching an investigation or legal procedure in observance with Laws 8422 and 8292.

The institutional framework for anti-corruption in SOEs

The following are the main institutional structures that create the framework for implementing corruption and integrity measures in SOEs:

- Public Ethics Office of the Attorney General of the Republic (PEP) is a unit created within the Office of the Attorney General (PGR), which acts as the main body responsible for anti-corruption and prosecution.
- The Comptroller General of the Republic has broad operational and administrative independence in the performance of its duties including auditing systems of control and detecting potential malfeasance. The Comptroller General has traditionally been active in conducting examinations but also in developing guidelines for internal control of SOEs and the oversight of procurement procedures.
- The National Commission for the Recovery of Values (CNRV) is responsible for promoting and strengthening ethics and integrity within the public sector, private organisations and civil society.
- The Office of the Ombudsman participates in a wide range of anti-corruption activities, including the Interinstitutional Transparency Network and offers training and workshops on corruption prevention, as well as training for the general public on how to file complaints in the case of corruption.
- The Deputy Prosecutor of Probity Transparency and Anti-Corruption (FATPA) is a specialised unit within the Office of the Public Prosecutor of the Judiciary, which prosecutes ethical violations and integrity-related offences.
- The General Directorate of the Civil Service (DGSC) is the central co-ordinating agency for public employment and human resources management. The DGSC sets policies for 47 entities under the civil service regime including directives related to probity and integrity. Since 2012, the PEP, the Comptroller General, FATPA, and the Costa Rican Institute on Drugs have implemented a joint commission that works as a co-ordination mechanism in the fight against corruption and promotes inter-institutional programmes.

Review against the main chapters of the ACI Guidelines

The main chapters of the *ACI Guidelines* cover: Chapter II: Integrity of the state; Chapter III: Exercise of state ownership for integrity; Chapter IV: Promotion of integrity and prevention of corruption at the enterprise level; and Chapter V: Accountability of state-owned enterprises and of the state.

Integrity of the state (Chapter II)

Chapter II recommends for SOEs to be autonomous legal entities overseen by governments and high-level public officials and subject to the general rule of law. Adherents should establish and adhere to good practices and high standards of behaviour, on which integrity in SOEs is contingent. The *ACI Guidelines* seek to: 1) establish ownership arrangements that are conducive to integrity; and 2) apply high standards of conduct to the state

Costa Rica is trying to encourage a culture of transparency in government and SOE oversight through a variety of initiatives and laws. The PEP, the Comptroller General, FATPA, and the Costa Rican Institute on Drugs have implemented a joint commission that works as a co-ordination mechanism in the fight against corruption. The Political Constitution establishes that “all public servants must be elected using criteria of proven suitability”. The law against Corruption and Illicit Enrichment in Public Service seeks to address cases of conflict of interest and abuse of public office. The General Guidelines about Ethics Principles and Statements establish that no public servant shall participate, directly or

indirectly, in financial transactions taking advantage of confidential information that might give them a privileged position. The Law on Anti-Corruption, incorporates provisions to protect any person who reports irregular or illegal situations in public institutions. According to The General Law of the Public Administration, all public officials are required to observe principles of objectivity, impartiality, neutrality and independence requirements in case of conflict of interest. Furthermore, the Electoral Code prohibits the use of public funds to induce voters to choose or abstain from choosing a specific candidate. This prohibition extends to SOEs.

Some possible gaps from the ACI Guidelines are that the Presidential Advisory Unit, as the government's ownership entity, does not have a direct accountability to or a formal reporting relationship with the Legislative Assembly. In addition, disclosure of the costs and revenue structures of SOEs that combine economic activities with public policy objectives to allow for an attribution to main activity areas is not currently being done. The Protocol of Understanding (ownership policy) establishes a long-term goal of better quantifying and reporting on SOE activities. Finally, the Presidential Advisory Unit, being newly established, is not yet equipped to regularly monitor, review and assess SOE performance against standards related to anti-corruption and integrity.

Exercise of state ownership for integrity (Chapter III)

Chapter III recommends that adherents act as active and engaged owners, holding SOEs to high standards of performance and integrity, while also refraining from unduly intervening in the operations of SOEs or directly controlling their management. Ownership entities should have the legal backing, the capacity and the information necessary to hold SOEs to high standards of performance and integrity. Adherents should make their expectations regarding anti-corruption and integrity clear. The *ACI Guidelines* aim to: 1) ensure clarity in the legal and regulatory framework and in the state's expectations for anti-corruption and integrity; and 2) act as an active and informed owner with regard to anti-corruption and integrity in SOEs.

The General Law of the Public Administration and administrative case law state that public officials, including board members of SOEs, are subject to the legal and regulatory provisions of public law, and are subject to criminal responsibility. The legislation that requires the presentation of financial statements according to IFRS is now in place for both financial and non-financial SOEs and the Ministry of Finance, through the National Accounting Office, and CONASSIF and SUGEF continue efforts to close gaps. The capacity for monitoring the SOEs and engaging with boards on corruption risk exists in principle. In practice, the Presidential Advisory Unit has not engaged with boards on the issue of anti-corruption, given the newness of the unit and other tasks that have engaged it since its establishment. SOEs are subject to a variety of relevant disclosure obligations.

Some ACI Guidelines recommendations from this chapter merit further attention. Obtaining an accurate compilation of financial support provided to Costa Rican SOEs is challenging. In addition, there is no document, which presents the state's overall risk exposure to SOEs. Such a document would, presumably, detail potential budgetary and reputational impacts under a variety of circumstances and would propose contingences. Nor is there any document that assesses the risk of corruption amongst SOEs.

Promotion of integrity and prevention of corruption at the enterprise level (Chapter IV)

Chapter IV recommends that adherents ensure that their ownership policy fully reflects that a cornerstone of promoting integrity and preventing corruption in and concerning SOEs is effective company internal controls, ethics and compliance measures that prevent, detect and mitigate corruption-related risks, and enforce rules. Adherents should ensure that SOEs are overseen by effective and competent boards of directors that are empowered to oversee company management and

to act autonomously from the state as a whole. The *ACI Guidelines* aim to: 1) encourage integrated risk management systems in SOEs; 2) promote internal controls, ethics and compliance measures in SOEs; and 3) safeguard the autonomy of SOE decision-making bodies.

The law specifies the duty of boards to ensure the adequate and effective function of internal controls and their oversight. On the institutional side, the Comptroller General and MIDEPLAN have developed a robust framework of guidelines and regulations regarding the internal control of SOEs. Furthermore, the ownership Protocol suggests that boards adopt, supervise and disseminate internal control methods, ethical codes and compliance programmes, including those that contribute to the prevention of fraud and corruption. Costa Rica has also responded to the recommendations of the WPSOPP to remove ministers on SOE boards through legal reforms. SOE boards have considerable autonomy and are composed exclusively of non-executive members with the exception of some enterprises that permit the chair to simultaneously exercise the role of the CEO. In most cases board members are independent from the state and SOE officials need to make full declarations of any potential conflict of interest.

While Costa Rica has established legal requirements or policy positions to address most of the recommendations in this chapter, in some cases, insufficient information was available to assess compliance with the ACI Guidelines, which call for a detailed examination of SOE risk management systems. Such an assessment would require the involvement of risk experts. Consequently, it is difficult to report the degree to which SOEs comply. The Costa Rican government did report, however, that risk analysis of SOEs is conducted with the support of a computer application, the Specific System of Institutional Risk Assessment (SEVRI). Such assessments must be conducted as part of the Institutional Strategic plan of all public institutions and must be approved by the board.

In general, SOE statutes, law and SOE culture suggest that the duty of board members is mainly to the state and to the achievement of the state's policy goals. However, the government's Protocol of Understanding does indicate as an overall policy objective a board member obligation to ensure the sustainability of the SOE. Insufficient information was available to assess Costa Rica's compliance with the recommendation to boards to exercise oversight of SOE hiring practices. Some anecdotal evidence suggests that it is common for individuals to freely move between the public and the private sectors i.e. there may be a "revolving door", which could potentially create conflicts of interest.

Accountability of SOEs and of the state (Chapter V)

Chapter V recommends that systems exist to ensure the detection of corruption, as well as investigation and enforcement, and that key processes are entrusted to institutions that are insulated from influence or suppression of said processes or dissemination of public information regarding their conduct. Strong, transparent and independent external auditing procedures are means of ensuring financial probity, informing shareholders about overall company performance and engaging stakeholders. The *ACI Guidelines* aim to: 1) establish accountability and review mechanisms for SOEs; 2) take action and respect due process for investigations and prosecutions; and 3) invite the inputs of civil society, the public and media and the business community.

The Legislative Assembly has broad investigative powers and could call SOEs to testify or other bodies such as the Comptroller General to report on SOE activities. SOEs generally provide reports on performance as well as audited financial statements. (Annual reports, financial reporting standards, audit, aggregate reporting on SOEs are all discussed in the part of the review covering the OECD Guidelines above.) Costa Rica has mechanisms to detect and investigate any action contrary to public ethics. At the administrative level, the investigation of irregularities is carried out by the Office of the Attorney of Public Ethics, the Comptroller General of the Republic, as well as internal auditors who all enjoy independence in the exercise of their functions. Law 9699 of 2019 created criminal liability for legal persons for foreign bribery. The Strategic SOE Board Directive establishes that one of the

responsibilities of the board is to ensure the existence and integrity of whistleblowing procedures, as well as protection and confidentiality measures for the claimant. Overall, Costa Rica's enforcement record has demonstrated its commitment to pursuing corruption allegations, including against political figures, representatives of SOEs, and active bribers. Finally, various initiatives have been taken by government during the period of the accession review process to promote improved public knowledge and transparency about SOEs including the fourth Open Government National Action Plan for 2019-2021, which contemplates broad stakeholder involvement.

Compliance with more detailed recommendations related to the effectiveness of enforcement mechanisms in practice was not assessed, such as with respect to the degree to which stakeholders and other interested parties, including creditors and competitors, have access to efficient redress. Additionally, this review did not identify any information that might suggest that representatives of the state or SOEs repress or otherwise restrict civil liberties, including liberties to criticise or investigate, of civil society organisations, trade unions, private sector representatives, the public or the media.

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Notes

[1] The assessment against the *ACI Guidelines* draws mainly upon the following sources: the WGB Accession Report (2016) and WGB Phase 1 Report (2017); the Public Governance Accession Review (2017); Costa Rica's statement of its position against the ACI Guidelines; and information obtained during the August 2019 Secretariat fact-finding mission.

5 Conclusions and recommendations

This chapter provides an overview of the strengths and weaknesses of Costa Rica's corporate governance framework for listed and state-owned enterprises, including the potential impact of recent or prospective reforms. The chapter ends with a set of recommendations to further align Costa Rica's policies and practices with OECD corporate governance standards.

Accession review procedure

This review provides an assessment of Costa Rica's corporate governance framework for listed companies and state-owned enterprises with respect to the "core corporate governance principles" set out in the *Roadmap* for the Accession of Costa Rica to the OECD Convention, which draws upon the *G20/OECD Principles of Corporate Governance* (*G20/OECD Principles*) and the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (*SOE Guidelines*). Second, it provides a set of additional recommendations by which Costa Rica may further align its framework with the *G20/OECD Principles* and the *SOE Guidelines*.

Assessment of corporate governance in Costa Rica

The OECD Corporate Governance Committee and Working Party on State Ownership and Privatisation Practices welcomed the progress made by Costa Rica as a result of the recommendations made during the course of the accession review. While challenges remain, particularly with respect to implementation, Costa Rica has responded to most concerns raised over the course of the review process, via new and/or pending legislation and other reforms. The strengths and weaknesses of Costa Rica's corporate governance framework, including the potential impact of recent and pending reforms, are summarised as follows.

Overview of the corporate governance landscape

Corporate governance landscape for listed companies

The capital market

Costa Rica's capital market, with only 10 listed companies issuing equity, lacks sufficient size and liquidity to attract active trading by foreign institutional investors. The market is small both in nominal terms and as a percentage of GDP. Trading is concentrated mainly in a single company and, in most years, some companies had no trading activity at all.

All trading of equities and bonds in Costa Rica occurs on the National Securities Exchange (BNV). Most of the issues traded are in the form of bonds. The total value of bond and equity issues was approximately USD 71 billion in 2019 with 99.4% of the value in bonds and the remaining 0.6% in equity. The Costa Rican Ministry of Finance and the Central Bank combined make up approximately 85% of the total bond market. The corporate bond market is comparatively small, with SOEs, in turn, representing only a small fraction.

Banks and financial intermediaries play a far more important role in the financial system. The assets of banking and financial intermediaries represent 89.2% of GDP while the securities markets represent only 1.4% of GDP. The role of the state within banks and financial intermediaries is significant. State-owned banks and savings and loan co-operatives make up the preponderance of lending activity with correspondingly less lending provided by the private sector.

Most listed firms have a dominant shareholder associated with a family and a holding company group. As a consequence, the governance challenges of listed enterprises are those typically associated with concentrated ownership where the protection of minority shareholders is the main concern. Issuers face governance challenges more commonly found in family-owned enterprises than those of normal equities listings.

The corporate governance framework

Despite Costa Rica's small equities market, its market supervisors—the National Council of Supervision of the Financial System (CONASSIF), the Supervisor for Financial Entities (SUGEF) and securities market regulator (SUGEVAL) have devoted considerable efforts during the accession process to ensure that Costa Rica's corporate governance laws, structures and protections are consistent with the recommendations of the *G20/OECD Principles*. In this regard, a key initiative has been the development of its Corporate Governance Regulation promulgated by CONASSIF in 2016, which came into force in June of 2017.

Costa Rica has been implementing its new governance framework using a risk-based supervisory approach (RBS). Globally, RBS tends to be a regulatory approach used mainly to regulate banks and other financial institutions. While securities exchange regulators may employ some risk-based approaches, they traditionally rely more heavily on ensuring rules compliance and disclosure. However, by the end of 2019, there was growing evidence that both the supervisor and companies had worked in good faith to develop common sense solutions and that the implementation of good governance practices through RBS was having a positive impact.

Costa Rica has an extensive set of laws, decrees and regulations that provide the framework for the governance of both private and public sector enterprises including: 1) the Constitution; 2) the Code of Commerce; 3) the new Corporate Governance Regulation issued by the markets regulator in 2016 and; 4) a framework for combatting corruption.

Overview of the state-owned enterprise landscape

Costa Rica has 28 SOEs at the central government level of which 16 are subsidiaries. SOE employment is 1.9% of total employment, which is roughly proportionate to the OECD average at 2.5%. SOEs have traditionally fulfilled an important development function and have helped ensure broad public access to electricity, water, transport, banking and insurance services for the population. In this context, the focus of SOEs has been more on achieving public policy and public service objectives than on financial performance. Most of Costa Rica's SOEs are active in the financial sector and the banking sector itself is dominated by SOE banks. According to the IMF, Costa Rica has the largest presence of state-owned financial institutions in Latin America. Energy is the next largest sector in terms of number of SOEs and is the largest in terms of employment. The electricity sector is dominated by the Costa Rican Institute for Electricity (ICE Group), a holding company, which is both a generator and a distributor of electricity but also a provider of telecommunications services. Import and distribution of wholesale petroleum and its derivatives occur under a legal monopoly granted to the Costa Rican Petroleum Refinery—RECOPE.

Since the start of the 2009 global crisis, Costa Rica's public deficit and debt rose from a surplus of 1% of GDP in 2008 to a running deficit of approximately 5% of GDP for the five years up until 2018. This being said, SOEs do not present a significant drain on the state budget. During the accession review process, outflows changed from modest net transfers to SOEs to modest inflows to the state budget in 2017. On the other hand, greater attention to the financial performance of SOEs would have the potential to achieve efficiency gains that could yield additional gains either for the state budget or in the form of lower prices for consumers. An additional concern relates to contingent liability risks, particularly given the full state guarantee of deposits held in SOE banks. Furthermore, disaggregated data show that cash inflows and outflows impact individual SOEs distinctly. The financial sector is the greatest revenue source for the State, while the SOE water company and rail services are the largest recipients of funds.

Costa Rica's SOEs are constituted under a variety of legal forms and operate under different sectoral laws. Consequently, the legal treatment and the governance and management of SOEs is quite heterogeneous. The result is that developing and implementing uniform governance policies for SOEs is difficult, with changes in policies and practices often necessitating time-consuming legislation and a complex adaptation of different laws.

The country has a decentralised public administration and SOEs have a considerable level of autonomy. SOEs respond directly to the Presidency of the Republic through the Council of Ministers with formal supervision of financial, legal and performance issues by the Comptroller General. Boards of directors of SOEs are in most cases appointed by the Council of Ministers. The Ministry of National Planning and Economic Policy (MIDEPLAN) is the body responsible for formulating the development strategies of the government. MIDEPLAN has no power to enforce strategy and there are no formal performance contracts or performance agreements with SOEs. However, MIDEPLAN has established monitoring processes that include regular reporting involving SOEs and other public entities, and "expectation letters" setting down high-level goals for SOEs are envisioned for 2020 that will take account of national development strategies. Tariffs for SOEs operating under monopoly conditions are set by the Regulatory Authority for Public Services (ARESEP), which is an autonomous multi-sectoral regulator. Tariffs for telecommunications services are set by the Telecommunications Supervisor (SUTEL), which is a fully independent body.

Non-financial SOEs have experienced considerable challenges in implementing IFRS and, in some cases, have not published audited annual financial reports. Since 2015, all financial SOEs produced financial reports under supervisory accounting standards that were developed based on a 2011 version of IFRS. During the accession process, various government institutions and SOEs began to recognise the importance of IFRS and new initiatives to implement international standards have been developed, although full implementation is still expected to take more time.

Costa Rican SOEs are subject to the same laws and regulations applicable to private companies, including those on competition. However, the legal framework for statutory SOEs results in significant differences in their corporate governance practices. SOE boards have operational independence and the number of board members with overt political affiliations has decreased during the accession process. Only two SOEs had ministers on their boards. This situation is being addressed as a result of recommendations made by the Working Party during the course of the accession review, with legislation adopted in one case and legislation that is pending to address the other.[1] All board members are technically independent with the exception of some cases where the posts of Chair and CEO are combined. Improvements in the composition of boards and board member training as a result of the Working Party's recommendations are expected to strengthen the independence and objectivity of boards.

In summary, the Working Party's recommendations to Costa Rica focused on measures in four areas, namely to: 1) strengthen SOE boards, in particular, through the removal of ministers from RECOPE and FANAL, and by encouraging boards to perform their duties professionally and competently in line with good practice including through board nominations and better board composition; 2) strengthen the state ownership function including through the establishment of a co-ordinating body for SOEs and development of an ownership policy and aggregate reporting; 3) ensure that SOEs are subject to high quality accounting standards and that clear rules for confidential information be established; and 4) work towards a more level the playing field, particularly in the banking sector, and through consideration of other measures including with regard to public procurement.

Implementation of the core principles

The following section assesses the corporate governance framework for listed and state-owned enterprises in Costa Rica with respect to the five core principles set out in the *Roadmap*.

Ensuring the enforcement of shareholder rights and the equitable treatment of shareholders

Costa Rica has legal requirements in place to ensure enforcement of shareholder rights and equitable treatment with respect to most of the relevant recommendations of the *G20/OECD Principles*. Shareholders have the opportunity to participate effectively and vote in general shareholder meetings (GSM) and are informed of the rules, including voting procedures that govern general shareholder meetings. Procedures do not make it unduly difficult or expensive to cast votes. Shareholders are able to ask questions to the board and place items on the agenda of the GSM and participate in key corporate governance decisions. They are able to vote in person or in absentia, and there are no undue impediments to cross-border voting. Shareholders, including institutional shareholders, are allowed to consult with each other on issues concerning their rights, and shareholders of the same series of a class are treated equally under law.

Rules and procedures regarding markets for corporate control are clearly articulated and allow the market to function in an efficient and transparent manner. To date, there have been no control transactions due to the limited size of the market and no use of anti-takeover devices, though anti-takeover devices are not explicitly prohibited by law. The framework for the supervision of related party transactions is in place. The Code of Commerce requires the general manager, board members, and related parties to report conflicts of interests in transactions to the board and provide all relevant information on the interests of the parties in the transaction.

Shareholder protection for private sector enterprises and listed firms is an area that has been recognised as a weakness in Costa Rica. This includes difficulties in identifying conflicts of interest and who may be involved in a related party transaction based on publicly available information. The fundamental impediments to transparency are the Data Protection Law and privacy rights embedded in the Political Constitution restricting disclosure of beneficial ownership. However, the legal framework for private sector enterprises has been improved, notably through the adoption of a new law in September 2019, requiring disclosure of beneficial ownership to the regulator for purposes of enforcement. This reform is expected to enable Costa Rica to become a signatory to the IOSCO Multilateral Memorandum of Understanding on the exchange of information.

There are norms to regulate conflicts of interest between stock market participants, including the prohibition of operations between companies belonging to the same group, and to prevent operations or the transfer of information that may harm the investing public. Institutional investors acting as trustees should disclose their general corporate governance and voting policies in relation to their investments, including the procedures foreseen to decide on their use of the right to vote. In addition, they should disclose the way in which they manage conflicts of interest. Both insider trading and market manipulation are prohibited by the Securities Market Law. Insider trading and price manipulation are regulated by the criminal court.

All Costa Rican SOEs are wholly-owned by the state with one exception with insignificant outside ownership. Consequently, issues of the protection of minority shareholders for SOEs do not arise, though they may in future if the country decides to open the share capital of SOEs to outside investors. If this should occur, Costa Rica has the basic legal requirements in place and the institutional structures to ensure enforcement of shareholder rights and equitable treatment for non-state shareholders though these are untested in practice.

Timely and reliable disclosure in accordance with international standards

Costa Rica is largely aligned with this core principle. CONASSIF is responsible for setting financial reporting standards for regulated entities, i.e. listed companies and financial sector entities. While all companies accessing the capital markets through the BNV must report according to International Financial Reporting Standards, the accounting standards that apply to financial institutions and SOEs have been evolving.

Disclosure of beneficial owners of listed companies and, by extension, control arrangements, has been a contentious issue in Costa Rica. The reticence to disclose information on beneficial owners can make it difficult to gain a full appreciation of capital structures, control arrangements, and related-party transactions. However, as noted above, legislation to allow market supervisors to obtain access to beneficial ownership information for the purposes of exchanging information on enforcement was adopted in September 2019 as a step in the direction of addressing these concerns.

Costa Rica has experienced considerable delays in implementing IFRS in SOEs since prior to the accession process. Further to recommendations made to this effect by the Working Party during the course of the accession process, an executive decree was issued in February 2018, providing non-financial SOEs with a 1 January 2020 deadline to fully comply with IFRS. However, there are indications that a significant number of SOEs will take longer. A 2018 CONASSIF regulation calls for financial institutions including SOE banks to implement current IFRS standards by 2020, with six remaining transitional provisions to be gradually phased in by 2024. The most recent information on reporting practices shows that three non-financial SOEs were in full compliance with IFRS. The state of disclosure amongst SOEs and SOE banks suggests that the implementation of IFRS will require more time and effort. During the most recent reporting cycle, a significant number of SOEs received qualified (negative) opinions from auditors and five did not produce audited financial statements, although this is required by regulation and the Presidential Advisory Unit (Costa Rica's co-ordinating body for SOEs) is following up with the SOEs concerned. Both the Ministry of Finance and the Presidential Advisory Unit have indicated an intent to follow up to promote full implementation of IFRS, as well as publication of audited financial statements by all SOEs, as soon as possible.

Concerning disclosure of the state on its stewardship of SOEs, Costa Rica has responded to the Working Party's recommendation by publicly issuing an aggregate report on SOEs. Overall, the report represents a strong first attempt at aggregate reporting that compares favourably to similar efforts by ownership entities in OECD countries. It contains summary descriptions of SOEs, their missions, and basic financial performance indicators for both 2017 and 2018, which are accompanied by some discussion and analysis. The length and layout of the document make it easy to read and user-friendly. To support preparation of the aggregate report in response to the Working Party's recommendations, the Ministry of the Presidency issued Directive 102-MP, General Policy on Transparency and Disclosure of Financial and Non-Financial Information for SOEs, their Subsidiaries and Autonomous Institutions in April 2018. The directive is wide-ranging in scope and establishes a disclosure policy for both financial and non-financial information for SOEs. The aggregate report shows that SOEs still have significant gaps to address to fully implement the directive's requirements for financial and non-financial reporting. However, the aggregate report establishes a benchmark against which the Presidential Advisory Unit can encourage and track progress in the future. The Costa Rican government's plans to ensure that SOEs fully implement IFRS and to develop and track financial and non-financial performance indicators are expected to further enhance the information to be presented in future aggregate reports, which the Presidential Advisory Unit plans to issue annually.

The separation of the state's role as owner and its regulatory role

The laws establishing SOEs give them the explicit objective of providing public goods and the systems for planning, monitoring, and control coincide in aiming at achieving policy goals. There is no clear separation between commercial and policy objectives within SOEs, where policy objectives often have primacy over commercial objectives. In some cases, Costa Rica has arrangements to support independent regulatory oversight of certain SOEs. The separation of regulation and policy is clearer, for example, in the banking sector and with respect to tariff setting in certain monopoly sectors.

Costa Rican SOEs have a high degree of autonomy. However, that autonomy is mainly with respect to the actions that SOEs can take to achieve public policy goals. SOE boards do not play an active role in strategy-setting, and focus on implementing government directions, such as those established in the National Development and Public Investment Plan, and on compliance and checking implementation.

At the beginning of the accession review process, Costa Rica did not have a centralised institution to fulfil the functions of an ownership entity. The Presidential Advisory Unit was established as a result of recommendations by the Working Party, and became operational in the summer of 2018, with its establishment being formally announced in January of 2019. The Council of Minister's Secretary became the head of the Presidential Advisory Unit and the unit received three additional analysts, with an intent to add two additional staff in the coming period. The Presidential Advisory Unit issued an ownership policy entitled Protocol of Understanding of the Relations between the State and the Enterprises under its Property (the ownership Protocol), on 13 October 2019. The ownership Protocol expresses Costa Rica's commitment to improving the direction of SOEs governed by the Executive Branch and seeks to implement the principles and guidelines of good corporate governance adopted by the international community with particular reference to the G20 and the OECD.

The ownership Protocol also contains a discussion of the rationale for state ownership. The definition of an ownership rationale is a large step in Costa Rica where the role of the state in enterprises has largely been an unquestioned article of faith. A regular examination of the rationale for state ownership in SOEs could encourage a closer examination of whether the state's policy objectives are being achieved by SOEs and if SOEs are the best vehicle for achieving the state's objectives.

Concerning the legal form of SOEs, the set of laws that provide the framework for the governance and operation of SOEs remains complex. Most SOEs have been established through statutory laws with varying requirements, while some of their subsidiaries have a different, corporatised legal form. The result is that some SOEs have different social obligations, are required to have different board compositions, may or may not combine the roles of the Chair and CEO, enjoy exemptions from procurement rules, and benefit from certain fiscal exemptions and advantages amongst others. Reforms to streamline this complex set of laws should remain an objective for Costa Rica in the longer term. In future, the rollout of uniform governance policies for SOEs will be complicated by this diverse legislation, and simplifying and harmonising the legal form of SOEs should remain a medium to longer term goal. The government acknowledges the importance of the recommendations of the Working Party to this effect and has indicated that it will continue to work on streamlining its SOE governance framework and practices.

Ensuring a level playing field between state-owned and private enterprises

Costa Rican SOEs are not formally exempt from the application of general laws, tax codes and regulations. However, in practice, differences in the operational conditions between SOEs and private enterprises create distortions in the competitive landscape. These include: 1) the granting of legal monopoly rights or the carving out of certain markets; 2) the rights to provide licenses and collect fees; 3) the obligation to provide public services; and 4) the absence of rate-of-return requirements. The

degree to which a level playing field exists depends upon the sector. The main sectors where SOEs compete with private sector companies are banking, insurance, and telecommunications.

The banking sector is where level-playing field concerns are the greatest and where there are a number of significant differences between private and public entities that lead to distortions in competition and inefficiencies in the economy. On the one hand, deposits in state-owned banks are legally guaranteed by the government, while private sector banks do not have this protection. Government institutions are also required to use SOE banks for their deposits. On the other hand, SOE banks are subject to a range of charges and restrictive regulations on procurement and human resource management that their private sector counterparts do not have. Although there are many differences in treatment between SOE banks and private banks, legislation on deposit insurance was enacted in February 2020, representing a significant step towards levelling the playing field.

Regarding procurement, at the beginning of the accession process, cumbersome procurement practices were identified as a cost imposed upon SOEs that hindered them from competing with the private sector. Later in the process, opposing concerns were raised that exceptions written into procurement laws that allowed for direct contracting, were being used by to prevent the private sector from competing on a fair footing with SOEs for public procurement.

A comprehensive draft legislative proposal (Bill No. 21.546) that envisages a full reform of the Procurement Law to achieve greater efficiency and competition in all public procurement procedures, including for SOEs, was under discussion within a special commission of the Legislative Assembly as of March 2020. A second, more narrowly focused draft legislative proposal has also been submitted to the Legislative Assembly to address the specific concerns raised with respect to exemptions allowing SOEs to engage in or benefit from direct contracting. These legislative proposals are being preceded on the operational level by the introduction of an electronic platform for public procurement designed to rationalise procedures, reduce the potential for discretionary decision-making and corruption, and help the state take advantage of purchasing economies of scale. Its enhanced transparency is also expected to improve the government’s capacity to consolidate and analyse information related to its public procurement practices.

Recognising stakeholder rights and the duties, rights and responsibilities of boards

Costa Rica has legislation and regulations that establish the rights of corporate stakeholders through labour, insolvency, shareholder protection, consumer, environmental protection, banking and other laws and stakeholders may seek redress through the courts. Although Costa Rica has a well-developed judicial system, a significant weakness is its slowness. This problem is known and a number of government programmes have been undertaken to make the judicial system more responsive. Numerous avenues exist to communicate concerns regarding illegal or unethical practices. Formal channels are internal auditors, the police and public prosecutors. Reporting persons (also referred to as whistleblowers) who choose to pursue legal channels to report illegal practices are protected.

According to the World Bank Doing Business Report 2019, resolving insolvency was the area where Costa Rica’s performance was weakest among the 10 business topics covered. Legislation was proposed to the Legislative Assembly in May 2019 to modernise and update the insolvency framework, and interviews with insolvency specialists suggest that the implementation of the proposed reforms could lead to important gains in the efficiency and effectiveness of the framework and the economy.

Regarding the duties and rights of boards, the CONASSIF Governance Regulation that applies to financial entities establishes board members’ duties of diligence and loyalty and their obligation to act in the best interests of the company, taking into account the interests of its stakeholders. The CONASSIF Governance Regulation provides for clear, formal and rigorous nominations processes, and requires transparency and disclosure of information on board members.

The laws that establish SOEs and other laws and directives also establish board duties of loyalty and care, and the protection of stakeholder rights. Mutual agreements between any interested party and an SOE are considered enforceable and, provided they do not breach the legal framework, must be respected by all parties. SOE stakeholder reporting tends to be to the government and not directly to stakeholders of the SOE though some SOEs publish annual stakeholder reports on their websites.

The OECD conducted interviews of the board members, managers and stakeholders of most large SOEs in the context of the accession review to form a picture of SOE board effectiveness. These interviews suggested that board performance was variable, and that legal requirements for some SOE board compositions constrained the scope to appoint people with business backgrounds. Anecdotal evidence also suggests that SOE boards may not rigorously monitor systems of control and that many board members may not have sufficient knowledge of control systems to evaluate their efficacy.

SOE boards are increasingly aware of the need for better governance practices. SOE scandals and the 2018 fiscal reforms generated greater awareness of the importance of corporate governance, which resulted in an increase in the government's commitment to strengthening SOE boards. Since then, and as a response to the Working Party's recommendations, the government has undertaken numerous initiatives to strengthen SOE board composition and practices. A Presidential Decree was passed to better define board member profiles and the roles and responsibilities of board members. In addition, public tenders for board members have been initiated for board appointments in 2019, and are expected to improve the skills available on boards. The government also initiated a comprehensive training programme for existing and prospective board members, key executives and certain government officials with the goal of developing a better shared understanding of their roles and their decision-making authorities. Such training is expected to be an important contributor to professionalising boards and cultivating a more professional governance culture in SOEs.

Tracking board performance has also become part of the government's priorities for SOE reform and has been formalised as one of the board's responsibilities under the Strategic SOE Board Directive, which requires the implementation of "an objective and structured annual performance evaluation programme". In addition, a regulation was passed in May of 2018 that applies to all financial companies including SOE banks that requires fit and proper testing, and an examination of experience and potential conflicts of interest. Most SOEs have language in their statutes that permits the board to exercise its duties with full independence within the rules established by law, applicable regulations and the principles of procedure. However, feedback from interviews suggest that as the government continues to promote the implementation of the above measures, it remains an important goal to underscore the need for objective and independent thinking amongst board members and the duty of board members to act in the company's interests.

Review against the Anti-Corruption and Integrity Guidelines

At the beginning of Costa Rica's accession process, a general evaluation of anti-corruption practices was conducted by the WPSOPP and those findings were described in Costa Rica's accession review. Following the adoption of the *ACI Guidelines* by the OECD Council in May 2019, and as required in relation to new legal instruments pursuant to the *Roadmap*, the government of Costa Rica submitted its position on the instrument. In its position, Costa Rica reported that its policy framework is not only aligned with the principles and recommendations of the *ACI Guidelines*, but that it is committed to improving integrity and ethical standards in its SOEs and in the exercise of the public service at large, and that this is reflected at the highest political level.

Overall, Costa Rica has a legal and regulatory framework fully consistent with the rule of law, and SOEs are subject to the general rule of law, contributing to a general environment of transparency and integrity

in the public sector. Costa Rica's position underlines a continuing commitment to preventing corruption and promoting integrity in SOEs. However, Costa Rica should continue to work to strengthen implementation, particularly at the level of SOEs and their boards to ensure effective oversight of internal controls and corruption risks. This will require mutually-reinforcing approaches, which emanate not only from the state and SOEs, but from the regulatory, judicial and supreme audit institutions to foster an effective cultural change towards better integrity and anti-corruption practices.

Recommendations for future action

The Corporate Governance Committee and the Working Party on State Ownership and Privatisation Practices recognise that Costa Rica has made considerable progress in its implementation of the *G20/OECD Principles* and *SOE Guidelines* compared with its situation at the start of the accession review.

Regarding Costa Rica's implementation of the *G20/OECD Principles*, Costa Rica's greatest challenge relates to the development of a more active capital market with a larger number of actively traded companies. However, it is beyond the scope of this review to develop specific recommendations in this respect. Regarding the more specific focus on Costa Rica's corporate governance framework, the Corporate Governance Committee finds that the government has taken positive steps to address the recommendations made during the accession review process. Notably, this has included issuance and implementation of a comprehensive corporate governance regulation; steps to ensure full implementation of IFRS and international audit standards by listed companies; to strengthen supervisory authority with respect to oversight of the audit profession; and to strengthen disclosure of beneficial ownership for the purpose of strengthening shareholder rights.

While Costa Rica has also made substantial progress in implementing recommendations of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises,* considerable challenges remain to further align practices with the *SOE Guidelines'* recommendations. The following priority recommendations are therefore addressed to Costa Rica:

- **Fully implement IFRS.** Costa Rica has defined IFRS as the reporting standard for SOEs. Governance scandals, fiscal reforms, pressure from lenders and international organisations have encouraged a greater commitment to IFRS. It is recommended that Costa Rica's government ensure full implementation and compliance with IFRS without further delays to current legal and regulatory requirements.
- **Develop and implement a system for establishing and monitoring the achievement of financial and non-financial performance objectives.** Costa Rica's ownership policy envisages that performance targets will be set via a "note of expectations" sent from the Government Executive to SOEs, which will establish goals and indicators for what the state deems important to achieve. The implementation of this system for setting performance objectives should allow for far better monitoring of SOEs. Achieving this will require sufficient resources and a continued strengthening of the Presidential Advisory Unit's capacity.
- **Develop a consistently applied policy regarding information confidentiality.** Presidential decrees have been adopted that call for greater transparency amongst SOEs that circumscribe the right to withhold confidential information. However, these decrees do not define in detail what information is confidential and what is not, which has led to differing interpretations. Costa Rica allows SOEs to develop their own confidentiality policies, thus opening the door for a heterogeneity of approaches. It is recommended that a clarification occur at central level followed by active monitoring and enforcement to ensure consistent application of confidentiality policies in line with best practices.

- **Enact legislation to remove the Minister of Agriculture from the board overseeing FANAL.** The government has introduced a draft bill to the Legislative Assembly that would remove the Minister of Agriculture from the board of directors of the National Production Council, the parent body whose board currently takes decisions on behalf of its subsidiary SOE, the national liquor production company FANAL. The government has also announced its intention to re-structure and/or privatise these entities. In the event that the government decides to retain FANAL as an SOE, it should ultimately establish a separate board of directors for FANAL.
- **Pursue public procurement reforms to monitor and limit the use of exceptions for direct public procurement between public entities including SOEs.** Costa Rica plans to enact a comprehensive reform of the Procurement Law and aims to achieve greater efficiency and competition in all public procurement procedures. The draft laws would reduce the number of exceptions to ordinary procurement procedures and introduce new requirements for their use.
- **Make further progress on implementing initiatives to strengthen the functioning of boards, including the implementation of board evaluations, and effective risk management and control systems.** SOE boards continue to need board members with greater private sector, financial, international and business expertise and knowledge of best practices in SOE governance. An important step in developing stronger boards is to conduct board self-evaluations mandated by law, analyse them at central level and develop remedial action plans. Further, boards need to act on their responsibility under best practice to ensure an effective control environment including one that monitors and manages risks associated with conflicts of interest and corruption. The establishment of audit committees may assist in this regard.
- **Review SOE board remuneration and develop recommendations to support competitive remuneration and incentives that are aligned with good board practices.** A research study was being conducted on remuneration practices in the public sector in co-operation with the Inter-American Development Bank and MIDEPLAN. That study has the objective of establishing a fee scale for SOE boards using labour market data from the public and private sector as reference. The study was expected to be completed by July 2020.

The Committee and Working Party also address the following additional recommendations to Costa Rica concerning implementation of the *SOE Guidelines*:

- **Corporatisation and other streamlining of SOE legal and corporate forms.** Costa Rican SOEs are established and operate under a complex web of laws. These laws should be simplified and made more uniform. One of the principal recommendations in the accession review was to use the legal structure of a public limited company (Plc) for SOEs, which would simplify adaptation of SOE governance to best practice.
- **Consider further reforms to strengthen boards, including staggering of board appointments and separation of the role of Chair and CEO.** At present, the law requires that a significant portion of board members be appointed virtually immediately after an administration comes to power, making the process rushed and possibly working to the detriment of finding the best available board talent. A change in law that would allow existing board members to stay on until a proper process can be completed would be desirable. Further, Costa Rica should work towards removing the possibility for a board Chair to simultaneously exercise the powers of CEO.
- **Continue to work towards a more level playing field, particularly in the banking sector through enactment of deposit insurance reform.** At the time of the Corporate Governance Committee's final review of Costa Rica in October, 2019, the government had submitted a draft bill to the Legislative Assembly to create a deposit insurance and bank resolution scheme

applying to both state-owned and private sector banks. The legislation has subsequently been enacted in February, 2020.

- **Defining, reporting and assessing the costs of public service objectives for each SOE.** The financial statements and internal budgets of Costa Rican SOEs do not generally break out the portion of revenues and costs that are associated with the provision of public services and feedback from SOEs suggests that the costs of policy commitments are not fully recognised. Efforts should be put into better defining public service costs and ensuring that they are fully compensated.

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Notes

[1]In the case of the Costa Rican petroleum refinery company, RECOPE, the new law required the Minister of Energy and Environment to leave the board by 1 January 2020, whereas for the second SOE, the National Liquor Factory FANAL, the legislative proposal would remove the Minister of Agriculture as chair of the board of the National Production Council, FANAL's parent body, by 31 December 2020, to be replaced by an independent board member. FANAL does not have its own board and the National Production Council board takes decisions on its behalf.

Annex A. Aggregate data on SOEs held at the central government level 2018

	Majority owned unlisted enterprises			Statutory corporations and quasi-corporations		
	Number of enterprises	Number of employees	Value of enterprises (USD mln)	Number of enterprises	Number of employees	Value of enterprises (USD mln)
Primary sectors[3]	1	1 718	1.11	-	-	-
Manufacturing	-	-	-	1	181	0.01
Finance	11	736	-	3	13 000	3.84
Telecoms	1	1 239	-	-	-	-
Electricity and gas	-	-	-	2	15 267	4.62
Transportation	-	-	-	3	1 430	1.45
Other utilities (including postal services)	1	2 155	0.06	1	4 082	1.27
Real estate	-	-	-	-	-	-
Other activities	3	5 337	-	1	421	0.06
Total	**17**	**11 185**	**1.17**	**11**	**34 381**	**11.25**

Notes: SOEs' share of domestic value added (GDP) is 0.51%; SOE employment as share of total employment is 1.91%; Costa Rica has no listed state-owned enterprises.
Source: Republic of Costa Rica (2019), Aggregate Report on SOEs 2019. SOEs classified as "majority owned unlisted enterprises" are subsidiaries of SOE company groups, and therefore their value of enterprise is comprised in that of its holding company (a statutory corporation or quasi/corporation).
https://www.hacienda.go.cr/docs/5dd69dd20f54e_Reporte%20agregado%20empresas%20del%20Estado%202019%20v8Nov2019.pdf.

Annex B. State-owned enterprises and subsidiaries 2018

Name of the SOE and its subsidiaries	Main sector of operation [1]	Corporate form	Size of enterprise 2018 (USD)					Share of the enterprise owned by the state	Govt.body owning & exercising ownership function
			Asset Value (activo total)	Book Equity (capital)	Market Capitalisation (patrimonio neto)	Annual Turnover (ingresos totales)	Number of Employees		
Instituto Nacional de Seguros	65	Statutory Corporation	INS Group: 3 910 623 613 INS: 3 665 600 524	INS Group: 1 132 398 500 INS: 1 136 745 158	INS Group: 1 610 349 033 INS: 1 610 417 643	INS Group: 3 597 810 323 INS: 3 568 334 588	INS Group: 5 070	100%	Council of Ministers
Subsidiaries: Red de Servicios de Salud S.A.	77, 82	Enterprise (S.A.)	12 313 931	15 666 925	7 817 838	51 924 510	1 402	100% owned by INS Group	INS Goup Board of Directors
INS Servicios S.A.	86	Enterprise (S.A.)	15 872 931	6 815 703	11 787 553	32 356 374	1 452	100% owned by INS Group	INS Goup Board of Directors
INS Sociedad Administradora de Fondos de Inversión, S.A. (INS SAFI)	64	Enterprise (S.A.)	22 240 091	8 448 367	21 141 322	4 280 051	18	100% owned by INS Group	INS Goup Board of Directors
INS Valores Puesto de Bolsa, S.A.	64	Enterprise (S.A.)	218 808 487	23 536 840	53 019 488	26 052 586	73	100% owned by INS Group	INS Group Board of Directors

Name of the SOE and its subsidiaries	Main sector of operation [1]	Corporate form	Size of enterprise 2018 (USD)					Share of the enterprise owned by the state	Govt.body owning & exercising ownership function
			Asset Value (activo total)	Book Equity (capital)	Market Capitalisation (patrimonio neto)	Annual Turnover (ingresos totales)	Number of Employees		
Banco Nacional de Costa Rica	64	Statutory Corporation	Grupo Banco Nacional: 12 266 384 685 Banco Nacional: 12 172 535 112	Grupo Banco Nacional: 302 080 134 Banco Nacional: 302 080 134	Grupo Banco Nacional: 1 135 372 161 Banco Nacional: 1 135 372 161	Grupo Banco Nacional: 1 277 489 850 Banco Nacional: 1 242 303 823	Banco Nacional: 4 974	100%	Council of Ministers
Subsidiaries BN- Valores	64	Enterprise (S.A.)	116 890 036	11 575 495	26 328 958	14 093 054	70	100% owned by Banco Nacional Financial Group	Banco Nacional Financial Group Board of Directors
BN- Vital	65	Enterprise (S.A.)	2 526 551 713	2 630 794	13 899 521	14 894 067	177	100% owned by Banco Nacional Financial Group	Banco Nacional Financial Group Board of Directors
BN- SAFI	64	Enterprise (S.A.)	14 421 596	5 261 589	13 454 668	10 683 610	78	100% owned by Banco Nacional Financial Group	Banco Nacional Financial Group Board of Directors
BN- Corredora de Seguros	65	Enterprise (S.A.)	6 611 587 632	648 403	5 250 513	$10 319 602	89	100% owned by Banco Nacional Financial Group	Banco Nacional Financial Group Board of Directors

Name of the SOE and its subsidiaries	Main sector of operation [1]	Corporate form	Size of enterprise 2018 (USD)					Share of the enterprise owned by the state	Govt.body owning & exercising ownership function
			Asset Value (activo total)	Book Equity (capital)	Market Capitalisation (patrimonio neto)	Annual Turnover (ingresos totales)	Number of Employees		
Banco de Costa Rica	64	Statutory Corporation	10 482 489 304.26	285 092 206.85	1 092 412 769.70	702 425 998.97	3 692	100%	Council of Ministers
Subsidiaries: BCR- SAFI	64	Enterprise (S.A.)						100% owned by BCR Financial Group	BCR Financial Group Board of Directors
BCR Seguros	65	Enterprise (S.A.)						100% owned by BCR Financial Group	BCR Financial Group Board of Directors
BCR-Valores	64	Enterprise (S.A.)						100% owned by BCR Financial Group	BCR Financial Group Board of Directors
BCR- Pensiones	65	Enterprise (S.A.)						100% owned by BCR Financial Group	BCR Financial Group Board of Directors
Banco Internacional de Costa Rica	64	Enterprise (S.A.)						51% owned by BCR Financial group, 49% owned by Banco Nacional Financial Group	BCR Financial Group Board of Directors

Name of the SOE and its subsidiaries	Main sector of operation [1]	Corporate form	Size of enterprise 2018 (USD)					Share of the enterprise owned by the state	Govt.body owning & exercising ownership function
			Asset Value (activo total)	Book Equity (capital)	Market Capitalisation (patrimonio neto)	Annual Turnover (ingresos totales)	Number of Employees		
Instituto Costarricense de Electricidad	35	Statutory Corporation	10 645 236 842.11	271 929.82	4 623 933 333.33	2 455 382 456.14	16 506	100%	Council of Ministers
Subsidiaries Compañía Nacional de Fuerza y Luz	35	Statutory Corporation						98.60% owned by ICE Group and 1.4% of private shares	ICE Group Board of Directors
Radiográfica Costarricense	61	Enterprise (S.A.)						100% owned by ICE Group	ICE Group Board of Directors
Correos de Costa Rica S.A.	53	Statutory corporation given an Enterprise (S.A.) legal form	65 852 236.18	7 017 543.86	57 228 707.91	46 693 299.83	2 155	100%	Council of Ministers
Fábrica Nacional de Licores	11	Statutory Corporation	52 191.95	10 722.55	10 722.55	72 948.30	181	100%	National Production Council´s Board of Directors
Junta de Administración Portuaria de la Vertiente Atlántica	52	Statutory Corporation	442 295 087.72	27 820 596.49	431 159 947.37	78 089 473.68	1 298	100%	Council of Ministers
Refinadora Costarricense de Petróleo	19	Statutory Corporation	1 663 168 292.01	351 057 894.74	1 111 011 417.09	2 857 861 918.18	1 718	100%	Council of Ministers

Name of the SOE and its subsidiaries	Main sector of operation [1]	Corporate form	Size of enterprise 2018 (USD)					Share of the enterprise owned by the state	Govt.body owning & exercising ownership function
			Asset Value (activo total)	Book Equity (capital)	Market Capitalisation (patrimonio neto)	Annual Turnover (ingresos totales)	Number of Employees		
Junta de Protección Social	92	Statutory Corporation	184 101 757.01	4 879 346.64	57 870 298.03	744 722.03	421	100%	Council of Ministers
Sistema Nacional de Radio y Televisión S.A. (SINART)	60	Statutory corporation given an Enterprise (S.A.) legal form	8 881 118.91	833 147.24	4 656 443.41	11 856 609.07	267	100%	Council of Ministers
Instituto Costarricense de Puertos del Pacífico	52	Statutory Corporation	34 201 050.84	21 167 300.61	23 179 718.22	9 712 501.71	79	100%	Council of Ministers
Instituto Costarricense de Ferrocarriles	49	Statutory Corporation	997 505 168.01	970 596 154.14	996 885 341.24	6 823 507.66	53	100%	Council of Ministers
Instituto Costarricense de Acueductos y Alcantarillados	36 37 38	Statutory Corporation	1 420 681 732.41	771 740 117.07	997 505 168.01	268 976 707.07	4 082	100%	Council of Ministers

Note: [1]For sector of operation, please follow the two-digit ISIC classification, which can be found at: http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=27&Lg=1
Changes within the last five years of the ownership and control structures (change in government ownership share; change in corporate structure; reallocation of the ownership/control within the general government sector) were noted for Refinadora Costarricense de Petróleo. In April, 2016, RECOPE communicated its decision to leave the joint venture enterprise established with the Chinese National Petroleum Company CNPC, Soresco S.A..
Source: Republic of Costa Rica (2019), Aggregate Report on SOEs 2019, https://www.hacienda.go.cr/docs/5dd69dd20f54e_Reporte%20agregado%20empresas%20del%20Estado%202019%20v8Nov2019.pdf.

Corporate Governance

Corporate Governance in Costa Rica

This review of *Corporate Governance in Costa Rica* was prepared as part of Costa Rica's accession process for OECD membership. During the three-year period of the review, the government made substantial progress in strengthening its institutional and legal framework in line with the G20/OECD Principles of Corporate Governance and OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs). The report evaluates Costa Rica's corporate governance policies and practices for both listed and state-owned companies. It finds that while Costa Rica's capital market is quite small, its framework for corporate governance of listed companies is largely consistent with the Principles. Costa Rica has seen particular progress in issuing a new corporate governance code and requirements related to ownership disclosure. For SOEs, which play a key role in the Costa Rican economy, the Presidency has taken important steps to establish a co-ordinating unit which has spearheaded numerous reforms. These reforms include issuing a government ownership policy, more transparent and structured appointments of SOE board members (while removing politicians from boards), and reporting on SOEs' performance. To further strengthen SOE performance and accountability, the report recommends additional steps to improve board practices, clarify performance objectives and implement International Financial Reporting Standards.

Consult this publication on line at ***https://doi.org/10.1787/b313ec37-en***.

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