

Summary

Transparency Index of Productive State Enterprises (IT-EPE)

This summary presents the main findings and recommendations regarding the Transparency Index of Productive State Enterprises (IT-EPEs), Pemex and CFE, which served as a diagnosis tool for identifying the presence and quality of corporate transparency practices exercised as a result of corporate governance within those companies.

Reshaping Pemex and CFE's faces can be a smart strategy if good transparency and corporate government practices are implemented in order to achieve more value for these companies whilst safeguarding them from corruption.

Our goal at México Evalúa is to contribute with evidence to enhance corporate transparency within Mexican state-owned companies and get an impact on them by granting information that may help to make them more efficient, more competitive and smarter at preventing corruption acts within them. Corporate transparency is a smart tool for discouraging corruption due to the fact that transparency enables visibility to processes and decision-making, hence, scrutiny is feasible.

Mexico Evalúa's Index becomes more relevant in today's political context as a new initiative to reform Pemex Act has been presented by majority party MORENA on January 9, 2019. Such initiative is now waiting to be discussed at the Energy Commission of the Chamber of Deputies. The core change of such reform consists of profound modifications to Pemex current institutional arrangement in its corporate government by granting more strategic and operative power to PEMEX CEO –who is directly appointed by Mexico's president- and diminishing decision capacity to its Executive Board. Derived from this modifications to the legal regime, greater political interference in all the company's decision-making processes can be anticipated as internal checks and balances will be diminished hindering Pemex itself, the Mexican society and the whole country.

Our conclusions

In this report México Evalúa presents an evaluation which serves to identify the presence and quality of corporate transparency practices in Production State Enterprises, Pemex and CFE, (EPEs). The objective is that this study serves as a diagnosis tool relative to one of the fundamental elements of good corporate governance. Since the Energy Reform enacted in 2013 and 2014 in Mexico, Pemex and CFE received a special legal regime which allowed them to shape their own corporate governance as the most competitive companies do in the world.

Our results, nevertheless show that implementation of corporate governance good practices has not been successful at all. There exist a lot of opportunity areas in which Pemex and CFE must work. Our findings are accompanied by specific recommendations based on the best international standards developed by international institutions and a group of comparable companies that we found can serve as excellent referrals for planning and developing a path towards a new transparency culture within our EPEs.

To fortify state-owned companies in Mexico is among the priorities of president López Obrador administration. We believe our evaluation can be an opportunity for considering the urgency of implanting a comprehensive corporate transparency policy within Pemex and CFE.

Along our research report we describe how transparency may serve as a powerful tool for triggering confidence among present and future business partners and investors; and for preventing corruption acts within companies.

The results of our evaluation demonstrate that as of today, Pemex and CFE have not used the benefits of implementing a full-fledged transparency policy.

We appeal to Pemex and CFE Executive Boards to consider our recommendations for enforcing major transparency levels at EPEs' i) proprietary policy including its objectives; ii) reporting organizational structure, operational and performance results; iii) playing fair game when competing in the playing field against private competitors; iv) signing productive agreements with the private sector; v) reporting on their corporate responsibility strategy activities and results, as well as internal control programs and results; and vi) reporting activities and performance of their Executive Boards.

It is not enough to say a company is not transparent. Our research focused on the proactive transparency the companies exercise. For performing our analysis, we examined information contents published by Pemex and CFE and evaluated their quality based on international parameters of good corporate transparency practices at state-owned companies resident in countries such as Norway and especially in counties of Latin America such as Colombia or Chile.

We consider our main contribution through this research is the evaluation of how accessible, timely, reliable and complete information is when published by Pemex and CFE to differentiated audiences. Should information disclosed complies with said qualities, transparency objectives will be certainly achieved and good accountability towards citizens and investors and social partners will be done in order to trigger trust.

Main Findings

Our main conclusions regarding corporate transparency practices at EPEs are the following:

1. Both Pemex and CFE registered global insufficient marks on a corporate transparency tabulator designed by México Evalúa for purposes of measuring the presence and quality of corporate transparency practices in those companies according to the standards set by international practices.
 - There is a lot work to do for bolstering a comprehensive corporate transparency policy at the EPEs.
 - Based on the results obtained, we can conclude that neither Pemex nor CFE use transparency as an essential tool for triggering value for both companies.
 - Neither Pemex nor CFE use transparency and reporting of information as a powerful tool for building trust among present and future commercial partners or investors; or for bolstering behavior within the companies for reducing and preventing corruption acts. We will delve later on that point in this document.
 - Only 28% of analyzed variables for Pemex and 22% in the case for CFE reported good or excellent transparency practices.
 - We identified absent elements of corporate transparency in Pemex and CFE websites and/or public documents. From a universe of 50 key variables analyzed throughout our research, only 12 of them for Pemex and CFE respectively registered zero.
 - According to Transparency International, transparency and information distribution are one of the most effective tools for fighting against corruption in state-owned companies. However, neither Pemex nor CFE have explored this option as it is clear in analysis of OECD Guideline 5 (Transparency at corporate responsibility policy and internal control).
 - EPEs do not publish information regarding commitments, follow-up and results of corporate policies related to entrepreneurial responsibility, integrity or anti-corruption programs.
 - *It is worth mentioning that previous to the Energy Reform of 2013, CFE did not count with a corporate governance legal structure. On the contrary, since 2009 Pemex was granted with certain legal scaffoldings that allowed the Company to implement some corporate governance best practices. Hence, it would be unfair and inaccurate to compare Pemex and CFE under the same basis due to the fact that implementation of good practices requires learning curves and time for cultural change and assimilation.*
2. Main sources of information at EPEs websites and documents are not accessible to inexperienced audiences.

- We observed that the cases where good transparency practices have been implemented by Pemex and CFE are due to compliance obligations established by regulatory authorities such as the Securities Exchange Commission (SEC) of the United States of America or the Comisión Nacional Bancaria y de Valores (BMV) of Mexico who oblige companies who quote at international debt markets to comply with the formats and requirements established which sometimes concur with minimum standards set by transparency best practices.
- Information provided to authorities and later published as annual reports, financial statements, and statistical data is deemed to be public and is usually used by experienced audiences.
- Nevertheless, we also found that limited public information is available for unskilled audiences in terms of formats, technicalities, languages (i.e. information submitted to SEC is also available in English language).
- Only 26% of all analyzed variables for Pemex and 24% for CFE reported good accessibility quality.

Recommendations

- New legal framework set by the Energy Reform included important changes in their corporate governance. We believe that a correct implementation and supervision of this model could contribute to enhance competitiveness, efficiency and effectiveness for preventing corruption acts.
- We believe that it is fundamental to work on strengthening institutional capacities towards good performance.
- New goals for EPEs of generating economic value and elements of corporate governances included as part of the Energy Reform represent a cultural change that needs to be gradual.
- Good corporate transparency practices sum and enrich the cultural change towards a strengthening of the adopted model. That is the main objective of this evaluation.
- That is why we address our recommendations directly to the Executive Boards of the EPEs.
- A lot of our recommendations are related to strategic actions for developing a transparency culture within the companies for establishing positive incentives that may build good management and an adequate transparency and social communication policy.

- Due to their strategic character, a lot of our recommendations are addressed to the Executive Board, the most important corporate governance body within the EPEs.
- The Executive Board must find the ways to promote this new culture within the EPE and must establish the adequate follow-up mechanisms.
- Implementation and execution of strategic plan must be addressed directly by the Management. This is fundamental and requires the will and understanding of the CEO and all his/her administrative body for achieving the benefits of such separation between the Executive Board and the Management.
- Executive Boards at state-owned companies must count with authority, competence and objectivity for performing functions focused on strategic orientation or planning and the supervision of the implementation. They must act with integrity and take charge of the responsibility related to their actions.
- Executive Boards at EPEs in México have historically taken as reference the OECD Guidelines. Nevertheless, there is a lot of work to do in relation to the design of self-regulation and internal checks & balances.
- The Energy Reform took as one of its fundamental pillars the establishment of a modern model of corporate governance for its EPEs, including the establishment of new Executive Boards as maximum ruling body within those companies responsible of the strategic vision and planning for the Company. Such Executive Board is ultimately responsible of defining the policies, the guidelines and the strategic vision of the EPEs and their subsidiaries and affiliate companies as well as the design and approval of their business plan.
- Regarding the Executive Board design, the EPEs Board considered including independent members nominated by the president of Mexico and approved by the Senate. The Boards also include public officials appointed by the president. Pemex and CFE laws establish that independent members of the boards must be nominated in accordance to their experience, capabilities and professional prestige. Nevertheless, there exist some necessary adjustments to be made for aligning correctly the incentives so that the Board is well recognized by the management of the company as the most important technical board whose members comply with their duties objectively and without undue influence or political interference.
- Despite the fact that specific elements of corporate governance at EPEs are out of scope of our analysis, due to the relevance of the topic, herein we list a

series of specific measures that could contribute to strengthen their Executive Boards:

1. Regarding the composition of the EPEs Boards, the presence of the Secretary of Energy and the Secretary of Finance (SHCP) as proprietary board members is not an ideal mechanism. There exist other mechanisms with better controls for exercising the State's proprietary function without interfering with the administration and the strategic operation of the EPEs.
2. Appointed board members by the president of Mexico should comply with the same prerequisites independent members are obliged to satisfy and with no exceptions. Currently, proprietary members who are public officials are excused of accomplishing said requisites.
3. The Executive Board must have a role at the nomination and appointment process of Pemex and CFE's CEOs.
4. A professional evaluation mechanism of the Executive Board must be designed and implemented according to international best practices. Each board member performance must also be professionally evaluated at least annually as well.