Reframing Subsidiary Governance

March 2024

pwc

Contents

Foreword

Global megatrends are generating greater demands for transparency and accountability that can only be achieved by transforming businesses. Boards and their CEOs could not be clearer: if their organisations fail to transform, they will fail.

In our 2024 CEO survey, 21% of UK CEOs warned that their business would not be economically viable within a decade on its current path and 53% are taking personal responsibility and sponsoring transformation within their organisation.

To see why, consider the megatrends that we expect to shape our world for years to come:

The race to confront climate change requires every business to reduce its carbon footprint.

The advance of technology, including artificial intelligence, necessitates new thinking about the intersection of people and digital tools, including ethical safeguards.

Demographic change implies a shift in approach to different markets.

Rising social instability will force businesses to confront issues such as inequality if economies are to survive and prosper.

Global geopolitics is creating uncertainty and challenging existing resilience models and business continuity planning.

Sustainability is focused on creating businesses that are sustainable for the long term.
If a business is to survive and create value, it needs a clear sustainability strategy with defined goals.

Company Secretaries will need to play their role in the business transformation required, building on the digital shifts and transformation seen in functions such as finance, tax and more and play a key role in the delivery of the sustainability strategy.

In doing so Company Secretaries will help deliver:

- Better governance and decision making across all levels of the business.
- Improved transparency with stakeholders and regulators.
- New opportunities for sustainable growth creating long-term value.

Jonathan Gibson
Partner

Matt Timmons
Partner

Our point of view

Now is the time for Company Secretaries to be the global owner of subsidiary governance and legal entity management. To achieve this, Company Secretaries will need to review and build corporate governance structures (especially at subsidiary level), teams and digital competencies that drive resilience, enhance risk controls and, above all, support value creation across the wider organisation.

01

The case for change

Part 1 – The case for change

The responsibility of Company Secretaries to protect the organisation remains as compelling as ever, but the desire to act as an enabler of growth is pressing too.

This position can be articulated through two viewpoints:

1. Sustainability laws and regulations

Sustainability laws and regulations are driving the need for change and reshaping the landscape in which businesses operate within. Parent and subsidiary boards are operating within new legal frameworks and face external reporting obligations that present new risks and liabilities.

2. Business model transformation

The external reporting obligations and greater levels of transparency associated with these is triggering business transformation, requiring businesses to rethink their:

- Core business.
- Operating model.
- Data management.
- Resource and composition of the workforce to activate the change and transformation required.

Company Secretaries are a fundamental part of the change equation and will need to develop their role as accelerators to the transformation.

1 Sustainability laws and regulations

New sustainability laws and regulations, such as the EU's Corporate Sustainability Reporting Directive, are mandating that boards report on how they oversee and monitor sustainability impacts, risks and opportunities in their operations.

Subsidiaries will now and in the future have to report more on their governance and operations.

It is clear that more responsibility for compliance is being placed on subsidiaries. The risks and liabilities associated with these new laws and regulations need to be managed.

Stakeholders are demanding increased engagement across a broad range of concerns. Subsidiaries play an important role in the engagement across the value chain and are responsible for vital business relationships.

Regulators and policymakers are focused on issues ranging from the push to achieve net zero, to the need to tackle social inequality. The reality is that much of the responsibility for meeting the organisation's net zero targets will fall on individual operating subsidiaries and their boards.

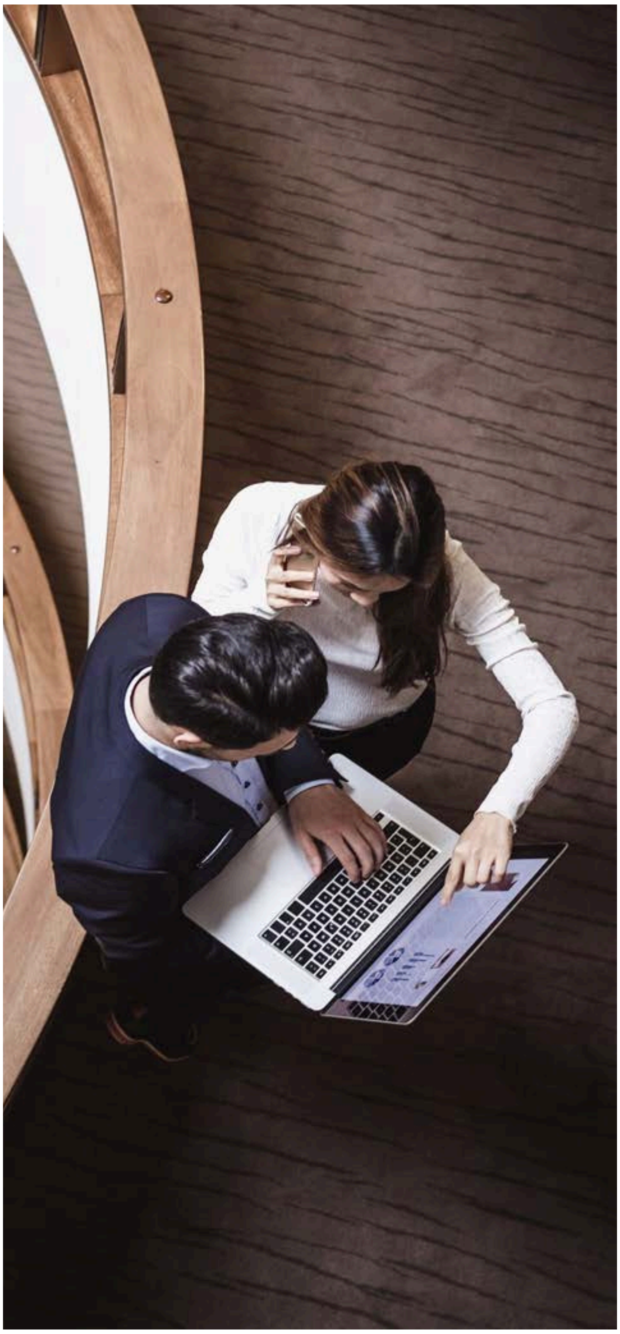
Subsidiary boards will need to have oversight of the risks and opportunities associated with the subsidiary's operations and the impact these have on the environment, businesses and people (including but not exclusively workforce).

Part 1 – The case for change

As bodies such as the International Sustainability Standards Board (ISSB) move to introduce global standards which will need to be implemented at an international level, businesses with subsidiaries across multiple countries will inevitably have to manage diverging regulatory approaches and standards to sustainability and as a result will run into increased difficulty.

This is likely to mandate new approaches to subsidiary governance and the infrastructure that underpins this.

An evaluation will need to be undertaken as to which regulations apply to which subsidiaries and as a result, how subsidiaries interact with group wide functions in the organisation to ensure compliance.



Our point of view

Company Secretaries have a vital role to play to ensure that subsidiaries are identified and have a place within the group's sustainability governance framework; that delegations are in place between subsidiaries and a organisation's sustainability committee; and that subsidiary boards are able to demonstrate the judgements they are required to make through clear board governance protocols.

Part 1 – The case for change

2 Business model transformation

Corporate purpose

The task for business leaders today is to define a clear corporate purpose in an environment where they must build trust through increased transparency, higher standards of conduct and greater social responsibility.

In addition, as organisations grapple with new reporting challenges across many parts of the world, the need to demonstrate progress against sustainability goals and strategy will be important. Boards will require decision making architectures that will enable them to function effectively in the context of that vision and purpose. That holds true both at parent and subsidiary level.

Operating model

This will lend global organisations to kick start business wide transformation with the objectives of embedding sustainability into business as usual.

Digital accelerators such as artificial intelligence and automation have the potential to help deliver transformation.

The impacts will be felt across areas such as supply chain, data management, business development, executive management and oversight, as well as in corporate reporting.

Part 1 – The case for change

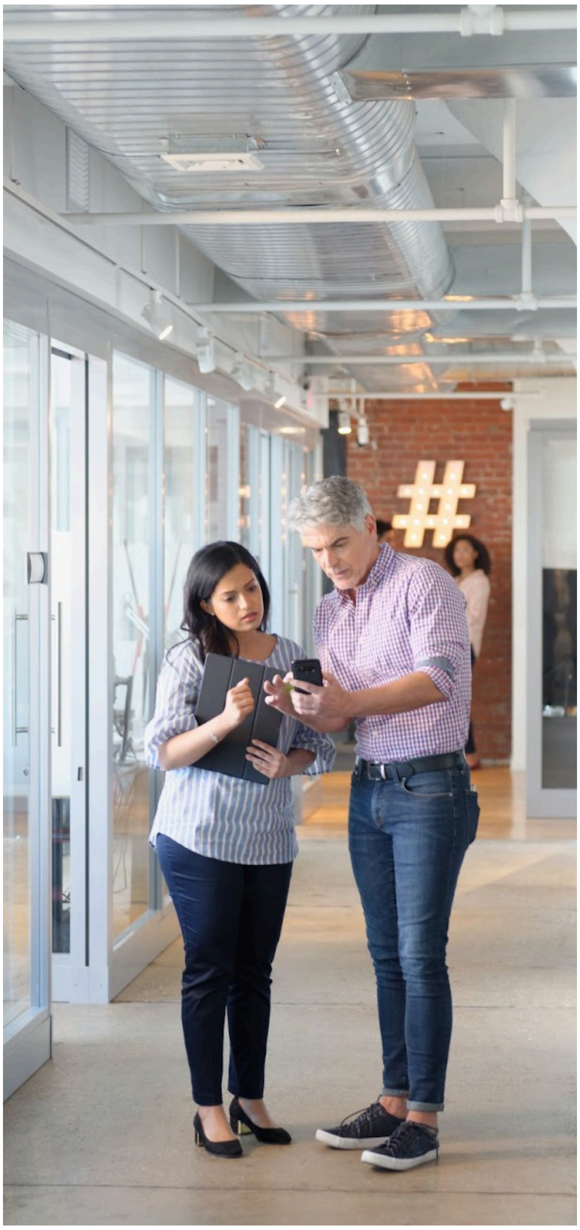
The role of Company Secretaries

Company Secretaries need to ensure the subsidiary and its directors are aligned to the corporate purpose and the transformation agenda.

As part of establishing new governance arrangements, Company Secretaries will need to think about how to make the best use of technology on an ongoing basis alongside existing or new delivery models.

The nuanced nature of individual country requirements for governance has traditionally made it difficult to operate with facilities such as shared delivery centres, but new technology can help drive greater efficiency and collaboration with subject matter experts. Data analytics tools may unlock valuable insights for in-country teams who have been deployed in strategic markets or business areas to support subsidiaries and their directors in partnership with the local management and group functions.

Ultimately, the use of digital assets and emerging artificial intelligence based technology will be fundamental to subsidiary governance.



Our point of view

Without a calculated and consistent approach to subsidiary governance, Company Secretaries will struggle to play their part in delivering against renewed corporate purpose and greater strategic ambition.

02

Driving the change required

Part 2 – Driving the change required

The ever increasing focus on subsidiary governance frameworks, owned and monitored by Company Secretaries, plays an important role in demonstrating the controls that the function has in place in managing risks at a subsidiary level as well as satisfying the demand from parent companies to establish clear oversight of subsidiaries.

Yet our most recent research found that 33% of companies said they did not feel comfortable that subsidiary risk was well managed in their organisation. Almost two thirds said they did not currently operate under a documented subsidiary governance framework.

A lack of clarity over where and how decisions are made, how (and how much) oversight comes from the parent company, and whether subsidiary supervision is legally required, can often amplify the impact when something goes wrong.

Even in the absence of a crisis, a piecemeal approach to governance creates vulnerabilities, but is also a missed opportunity to strive collectively for value creation. To manage the evolving risk, it is now an imperative to have a subsidiary governance framework.

A robust subsidiary governance framework can also form part of an organisation's armoury in providing comfort to those carrying out external assurance over sustainability reporting.

Organisations will need to take a risk based approach, working collaboratively on a cross functional basis to develop and implement a subsidiary governance framework that is agile and scalable.

A subsidiary governance framework should include the following building blocks with key requirements being mandated with a shift towards a more prescriptive approach to subsidiary governance evolving:

- **Board Governance**: To ensure appropriate board composition and structures;
- **Subsidiary Management**: To ensure that there are clear reporting authorities across the group;
- **Board Responsibilities and Training**: To provide the directors with a clear understanding of expectations of legal and internal governance responsibilities;
- **Data Governance**: To ensure legal entity data is appropriately managed in order to report and share information with stakeholders internally and externally; and
- **Disclosure Governance**: To provide awareness of global regulation impacting subsidiaries.

The tiering of entities will determine the level of governance and support needed for each subsidiary in the group. With the most significant entities applying the highest levels of governance. A move towards principles based tiering will require organisations to think more carefully about how subsidiaries are tiered to ensure that the risks facing subsidiaries are adequately managed and controlled within the framework.

1 Building a robust global subsidiary governance framework

Key aspects of each of the building blocks that should apply to significant entities are set out below:

Board Governance

- Subsidiary boards should have terms of reference and a schedule of reserved matters for the parent company to establish the parent/subsidiary relationship.
- A group wide sustainability committee should be established which should, under a delegated authority, act on behalf of the subsidiaries to have oversight over subsidiary governance disclosures to ensure alignment with parent company reporting.
- There should be a defined regular cadence of reporting to the ultimate parent and vice versa in respect of its sustainability risks and opportunities.

Subsidiary management

- Subsidiary boards should formally adopt the group wide delegations of authority framework to align with legal entity structure and ring fence liability.
- To demonstrate oversight, subsidiary boards should receive regular updates on how delegations are being exercised.
- Subsidiary boards should have a dedicated Company Secretary who is integrated with the business and has an informed role in decision making.

Part 2 – Driving the change required

Board composition and structure

- Subsidiary directors appointment policy should be in place to guide the nomination and selection process and the skills, experience and D&I requirements.
- Subsidiary boards should comprise of, as a minimum, representation from finance, the business and a director with sustainability expertise.
- The independence of the Legal function should be retained by ensuring no board representation to avoid conflict of interests.
- Independent non-executive directors should only sit on subsidiary boards as required by regulation but the use of group non-executive directors should be considered where an element of independence is required.
- Subsidiary boards should be subject to effectiveness reviews once every three years.

Board responsibilities and training

- Subsidiary directors to be trained on appointment and refresher training should be provided every 1-2 years thereafter.
- Training to be delivered and monitored through the group wide compliance training programme.
- Training to include local legal directors' duties requirements and local sustainability laws and regulations.
- Training to cover the subsidiary governance expectations as set out under the subsidiary governance framework.

Data governance

- A subsidiary governance policy on data governance should be implemented.
- The Company Secretary should be the legal entity owner who is also responsible for legal entity data and data governance across all group wide entities utilising a legal entity database.
- Legal entity data should be reviewed and verified twice a year by the legal entity owner.

Disclosure governance

- The Company Secretary should have responsibility or at least oversight over governance disclosures for subsidiaries, including sustainability disclosures.
- The subsidiary Company Secretary is responsible for ensuring that the subsidiary is compliant with all statutory and regulatory compliance and disclosure requirements in accordance with local law and the subsidiary governance framework.

Our point of view

Company Secretaries will need to oversee the levels of governance and support needed between subsidiaries. To ensure the governance is right sized, tiering of subsidiaries (including managed JVs) will be key. The tiering of entities should be principles based and be driven by: sustainability laws and regulations; commercial and materiality considerations; and the risk profile of the entity.

Part 2 – Driving the change required

2 A new digital delivery model fit for transformation

Digital capabilities

Having to rethink governance arrangements following new sustainability laws and regulations coming into force around the world may naturally lead to higher cost of compliance. The good news is that the advancement of technology, including artificial intelligence, gives Company Secretaries an opportunity to offset these costs whilst at the same time delivering enhanced value to stakeholders across the organisation.

The Covid-19 pandemic accelerated the pace of change and moved the dial on virtual meetings, electronic signatures, face to face meetings with the notary to virtual notarisation etc. It offered an enticing view of what might be possible. Artificial intelligence now makes this a reality.

New digital tools provide a range of opportunities to manage subsidiary governance more effectively and cohesively and it is important that Company Secretaries have clarity on their current and future digital delivery model which will help deliver on the transformation required.

It is now possible to digitise a large part of the global subsidiary governance framework into a single holistic platform that can be integrated within an organisations own infrastructure and connected to a wide range of other systems so everyone is continuously working with the same data and a single source of truth on a real time basis. Working in silos is no longer an option and therefore using technology to solve problems in a multidisciplinary team is a must.

On the next page, we have set out a digital delivery model that is human led, powered by technology. A digital delivery model that will help reduce cost of delivery and enhance value across the organisation. The human led part of this model is as important as the technology, as there will always be a need for Company Secretaries to intervene, perform certain actions and make decisions.

There are three distinct components of the digital delivery model:

- **Inputs**: Ensuring the technology understands the environment in which an organisation operates in and is continuously up to date with the pace of regulatory change;
- **Processes**: Using the technology to operationalise the subsidiary governance framework; and
- **Outputs**: What the technology will produce for you.

The promise for Company Secretaries is that no deadline is missed, data is complete on a real time basis and accounted for and subsidiary governance is operated efficiently and in a streamlined way. Company Secretaries will then focus on governance for growth rather than high volume but low value activities.

Our point of view

Company Secretaries have an opportunity to repurpose their role to create value across the organisation and provide a single source of truth for legal entity data. The absence of a digital strategy will undermine any effort to participate in and deliver transformation.

Part 2 – Driving the change required

Global Governance and Compliance platform with AI and data analytics capabilities

A single digital platform that acts as the golden source of legal entity data; knowledge base for subsidiary directors and company secretaries - underpinned by AI functionality to deliver automation and analysis capabilities. Supporting:

- **Regulatory horizon scanning.**
- **Assessment of risks and entity tiering.**
- **Corporate document automation.**
- **Reporting on compliance with local laws and the subsidiary governance framework along with analytics.**
- **Ongoing and assessment.**

Inputs

Driven by external environment - Digital to assess the impact on the legal entity structure

- Legal & Compliance Frameworks
- Local laws and Regulations
- External reporting
- M&A (transaction)

Company Secretary decision: Confirmation of outputs and assessment of entity level governance tiering to prioritise delivery

Process

1. Subsidiary approvals under the framework

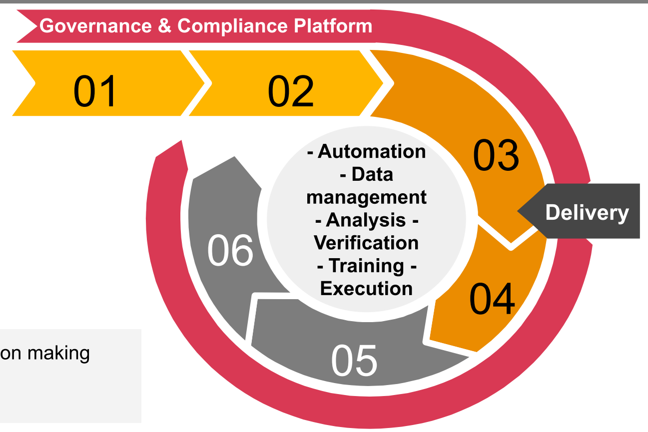
2. Certification of compliance

3. Compliance and corporate change documentation

4. Verification & Maintenance of subsidiary data

5. Director training

6. Subsidiary Board support



Company Secretary decision: Review decision making to determine outputs

Outputs

Driven by entity activities

- Data/KPI metrics
- Corporate filings
- Board minutes
- Disclosures
- Electronic tagging to central registries
- Ongoing compliance reporting with the framework

Company Secretary decision: Insights and analysis of outputs

Other systems across the organisation

03

How to succeed

Part 3 – How to succeed

1 Key accelerators to delivering the transformation required

As Company Secretaries work towards the development of a subsidiary governance framework that is fit for purpose, certain steps will move them forward at pace.

Parent board engagement and group wide engagement

The tone from the top is vital. The parent board must engage with the process of agreeing a governance framework for subsidiaries, ensuring that it is part of the group delegations framework. This is critical for consistency and compatibility, as well as in the context of recent court decisions in jurisdictions such as the Netherlands and the UK, where parent companies are being pursued for the actions of their subsidiaries.

Parent boards must recognise that in the absence of a subsidiary governance framework, their organisation faces natural risks within their governance and controls environment. The board is responsible for the group's strategy and operations. The legal entity structure is part of the organisation's architecture and as a consequence the legal liabilities and responsibilities of subsidiaries should be respected or the business should consider strategic change to the legal entity structure.

Establish a transformation taskforce and develop new skills

To allow business as usual to continue, a transformation task force should be created consisting of Company Secretaries, project management and technologists. This investment allows the transformation to remain on track, accelerate value creation, whilst continuing day to day support.

The changing role of subsidiaries and their boards vary from one subsidiary to the next, depending on the type of entity and its purpose.

However, subsidiary boards may need to increase their skills and experience in a broad range of areas, including:

- Governance
- Risk management
- Sustainability
- Digital data and innovation
- Culture and people
- Regulatory and public policy
- Cyber security

There will also be an increased role for Company Secretaries in this new world. They will need to upskill and take responsibility to act as the custodians of the subsidiary governance framework – to own and maintain the organisation's governance infrastructure.

Part 3 – How to succeed

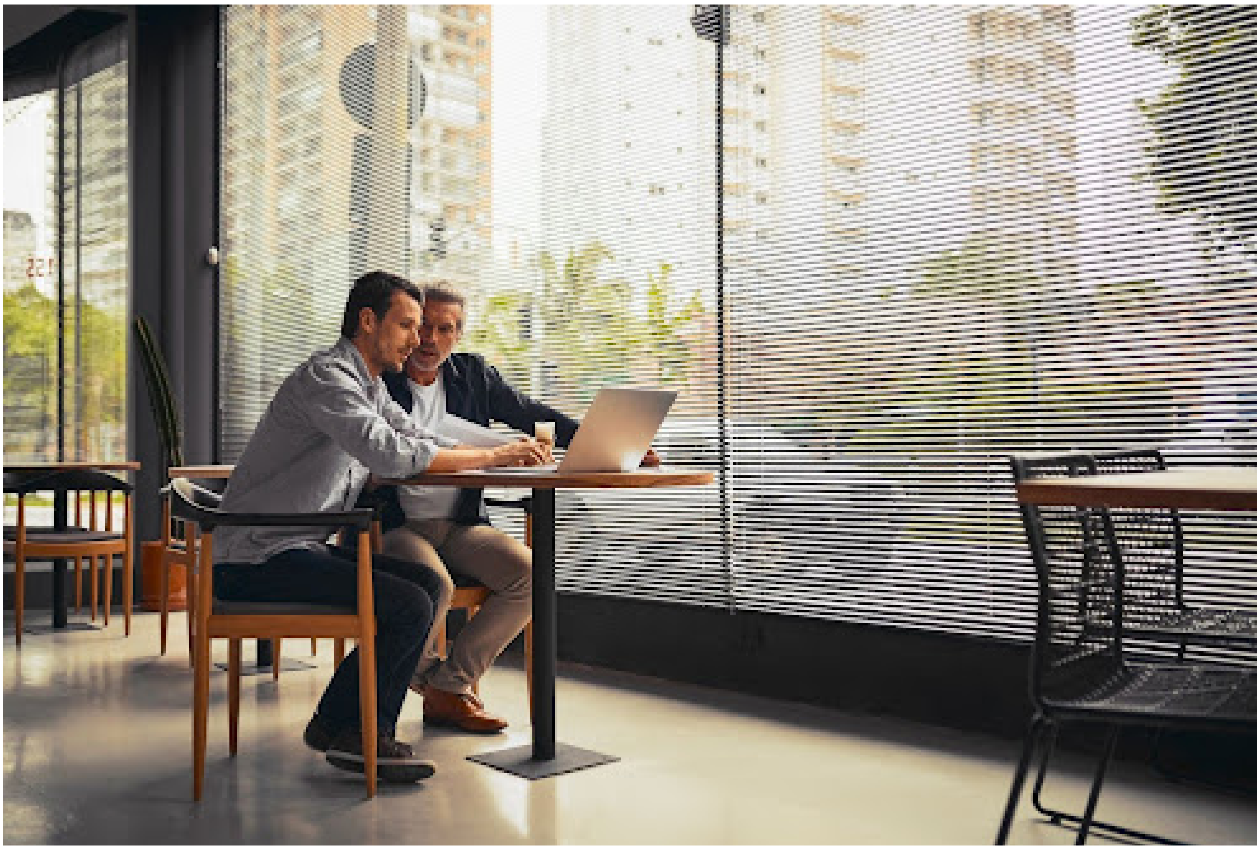
Organisational structure and oversight

As recently as a decade ago, large multinational businesses were comfortable with highly decentralised governance arrangements. That is no longer appropriate given regulatory requirements.

Given the growing regulatory burden on individual subsidiaries, organisations are moving towards centralisation of subsidiary management globally through their Company Secretarial functions. However, as they look at the change, they must work out what this new structure looks like and how it should operate.

There is no one-size- fits-all solution. Some organisations may choose hybrid arrangements, where they deploy dedicated Company Secretaries on the ground in their most important markets or where there are onerous legal and regulatory obligations, supported by managed service providers in others.

One increasingly popular option is to use managed service providers that can support local governance arrangements. The best such providers effectively function as an extension of the inhouse Company Secretarial team.



Our point of view

Company Secretaries need to seek engagement from the parent boards, develop a blueprint, and deploy a task force that will execute the blueprint for change and implement the digital delivery model.

Part 3 – How to succeed

A blueprint for transformation

The approach that Company Secretaries need to take in reframing subsidiary governance will be influenced by their organisation's operating model. Business wide transformation and the rapidly changing regulatory landscape will influence how operating models evolve and as a result, the design of the transformation needed.
Having a clear blueprint for transformation, which is agile to external business and regulatory drivers, will be fundamental to being successful and delivering value. One way to design the blueprint is by focusing on several key priorities over three interrelated phases as set out below and using technology as an enabler:

01 Discover and define

- Map the regulatory frontier – identify immediate and long-term impacts on governance (at both the parent and subsidiary level).
- Understand changes in stakeholders – internal and external – to initiate, manage and sustain engagement.
- Identify gaps in existing subsidiary governance and team capabilities to be supplemented by a task force.
- Consider governance tiering of legal entities – in relation to materiality and/or risk profile and/or regulatory exposure.

02 Design and deploy

- Develop a risk based subsidiary governance framework – this ensures governance remains agile to the changing business environment.
- Undertake legacy and future subsidiary risk mapping. Focus on how to track the impact on governance from M&A activity and divestments.
- Align parent and subsidiary governance – minimise duplication and maximise engagement.

03 Review and assess

- Develop an assurance map to underpin the long-term management and review of governance.
- Future proof the organisation. Look at how to incorporate subsidiary governance into group wide assurance controls.
- Downsize and upsize governance to ensure it is fit for purpose and that it minimises future subsidiary risk.

Our points of view

Success in transforming subsidiary governance will require openness to change and a stakeholder engagement strategy supported from the top of the organisation.

A blueprint for transformation should include:

1. Creation of a task force
2. Design and rollout of a subsidiary governance framework
3. Tiering of entities
4. Digital and operating model transition
5. Activate business as usual under new operating model

With a collaborative approach, Company Secretaries can deliver value and improve governance

Contacts

Jonathan Gibson
Partner
jonathan.gibson@pwc.com
+44 7764 235 240

Matt Timmons
Partner
matthew.j.timmons@pwc.com
+44 7764 958 130

Kris Charik
Director
kris.charik@pwc.com
+44 7483 435 200

Hannah Harris
Director
hannah.harris@pwc.com
+44 7764 958 585

Pritul Shah
Director
pritul.shah@pwc.com
+44 7841 498 798

Charlotte Thackrah
Director
charlotte.thackrah@pwc.com
+44 7710 396 675

Fabia Welch – Richards
Director
fabia.welch.richards@pwc.com
+44 7483 332 472

pwc.co.uk

RITM14990786