



Corporate Governance Reform: Implications for UK subsidiaries of overseas companies

The UK Government has introduced new regulations on corporate governance for private companies, including subsidiaries. These companies will need to include explanations about their corporate governance policies, processes and controls and how they have applied them in their annual report and/or website. This will be the case even if the subsidiary's parent company already operates corporate governance across the group.

There could be sanctions against the company and criminal prosecution/severe fines for directors of the company for failure to comply with the new requirements.

Effective for financial years beginning on or after **1 January 2019**, UK companies, including subsidiaries owned by overseas companies ('**UK Subsidiaries**'), will need to report on how:

1. their directors have fulfilled their statutory duties;
2. they have applied appropriate corporate governance arrangements; and
3. they have engaged with their employees and stakeholders.

There are four new and distinct reporting requirements, and whether any or all of these apply will depend on which of the qualifying conditions the UK Subsidiaries satisfy. Directors will first need to assess which of the reporting requirements apply to their company in any given financial year.

The table below broadly summarises each reporting requirement and the relevant qualifying conditions:

Reporting requirement	Threshold ¹	Requirement
Corporate governance statement	<ul style="list-style-type: none"> • Companies that on a global basis exceed: <ul style="list-style-type: none"> – 2,000 employees; or – More than £200m in turnover and more than £2bn in total balance sheet assets. 	<ul style="list-style-type: none"> • Explain which governance code applied, how it is applied and the reasons for any departure. • If no code was applied, explain, why not and the governance arrangements in place.
Section 172 statement	<ul style="list-style-type: none"> • Companies that fall under the definition of 'Large' under the Companies Act 2006 (the 'Act'), so exceed two of the following three thresholds: <ul style="list-style-type: none"> – £36m in turnover; – £18m in total balance sheet assets; or – 250 employees. <p>If the UK Subsidiaries' overseas parent's shares are traded on a regulated market, medium sized companies also qualify.</p>	<ul style="list-style-type: none"> • Explain in the strategic report and on the corporate website how directors have considered and applied their statutory duty to promote the success of the company under section 172 of the Companies Act.
Stakeholder engagement statement	<ul style="list-style-type: none"> • Companies that exceed two of the following: <ul style="list-style-type: none"> – £36m turnover; – £18m total balance sheet assets; or – 250 employees. 	<ul style="list-style-type: none"> • Explain how directors have considered the need to foster business relationships with suppliers, customers and others as well as the effect this has had on decisions.
Employee engagement statement	<ul style="list-style-type: none"> • Companies with over 250 UK employees (regardless of financial thresholds). 	<ul style="list-style-type: none"> • Describe action taken to engage with employees. • Summarise how directors had regard to employees in decision-making.

¹ Consolidation rules may apply.

How we can help:

We are working with the directors of UK Subsidiaries (and their parent companies), to address the implications of the new rules, including:

- 1 : Assessing which qualifying conditions UK Subsidiaries satisfy in order to determine which of the new rules apply.
- 2 : Undertaking a gap analysis in respect of the existing governance infrastructure in UK Subsidiaries against the required changes.
- 3 : Designing appropriate governance policies and procedures for UK Subsidiaries, taking strategic objectives of the company (and group) into account.
- 4 : Identifying, constructing and implementing the most appropriate employee and stakeholder engagement arrangements.
- 5 : Training and equipping directors of UK Subsidiaries with the requisite technical skills to meet regulatory requirements and to effectively communicate with stakeholders.
- 6 : Supporting parent companies by ensuring adequate systems are implemented and defining clear protocols for decision-making e.g. global subsidiary governance

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PwC commentary

Acknowledging the increasing importance attributed by stakeholders to a company's governance infrastructure, directors of UK Subsidiaries will need to ensure that they have the requisite skills, systems and policies in place (at the local level), to enable them to understand, apply and report on the required governance matters. The new rules are likely to necessitate UK Subsidiaries undertaking a comprehensive review of their existing processes and procedures, independently of their parent company, to determine how they can most appropriately address the new requirements.

Until now, many UK Subsidiaries have operated a very limited corporate governance infrastructure or relied on their parent. Significant changes will be required and it will be important for UK Subsidiaries to begin preparing now. In practice, the requirements represent much more than a reporting obligation; in order to make the relevant disclosures, UK Subsidiaries will either need to design and implement their own policies and processes or explain how they have applied their parent's policies and processes.

Stakeholders widely recognise the value the new rules bring in seeking to mitigate potential risk and liability related to wider regulatory breaches and corporate failures. If companies do not respond appropriately to the new rules, in addition to reputational and brand implications for UK Subsidiaries (and potentially for their parent and wider group too), repercussions could extend to personal liability for the directors of UK Subsidiaries and potential litigation against UK Subsidiaries. As such, this really is a matter which the directors of UK Subsidiaries need to actively embrace and manage appropriately.