Blogs
February 17, 2022
Public Chatter

7 Rules of Thumb for Subsidiary Governance

Subsidiary governance is not very sexy, but it can be a big problem if not done well. If you haven't worked with subsidiaries much, you might not realize how much paperwork can be involved. The inexperienced might not recognize the difficult issues – some of which are internal controls-related – that can arise about sub governance. A few things to note upfront. The board members for a subsidiary are often officers of the parent; sometimes even mid-level officers. Confusion may arise about whether the subsidiary must approve a budget – and other operational items like that – since the parent is typically funding everything. Learning about the corporate law that governs subs outside the U.S. can produce quite a few surprises. Here are seven general rules of thumb to consider: 1. A subsidiary must perform all the governance stuff required by its jurisdiction. In many cases, it doesn't matter that the subsidiary is controlled by the parent. The jurisdiction of the formation does not care that it's not an operating subsidiary; to them, it's a company within their remit.

---

2. Because a subsidiary is a separate entity, it can act in accordance with the law of the jurisdiction of incorporation and the subsidiary's governing documents.

---

3. Sometimes a company will have subs that are not operating subs. Perhaps they were initially established to create a home presence for a bid on a piece of business. Or for tax planning purposes. Or for some other historical reasons that have ceased to be relevant. [Shutting down those subs is a blog for another day – well worth reading because it might save you some money.]

---

4. Some subsidiaries are formed to limit liability flowing up to the parent. Because of the sub's limited activities, the sub's board typically doesn't have to approve much.

---

5. If a subsidiary is operational and needs approvals, the subsidiary's board likely must appoint the subsidiary's officers, authorize bank accounts and other operational matters, and approve the subsidiary's budget and similar items (or delegate the authority if delegation is permitted – which is not easy in some jurisdictions).

---

6. Apply common sense here. It's hard to wrap your head around the fact that an officer of the parent – because they are a director or officer of a subsidiary – has greater approval authority to act for the subsidiary than they do for the parent. There are two basic approaches to address this type of problem. One is to have an officer at the parent level – who has the authority to act for the parent – either delegate authority to the subsidiary's board member or officer or have the person at the parent level also approve the action. The other approach is to put only high-level executives on the subsidiary board that would have the authority at the parent level to do what is being approved at the subsidiary level. This can be unrealistic if those high-level executives don't have time for these additional duties as many large enterprises have hundreds of subs in many different jurisdictions. For both approaches, the subsidiary's board gets involved in the approval, but the board members have some basis from the parent to approve the action. In addition, if the parent company has a delegation of authority grid or policy establishing approval levels for different officers, consider also having each subsidiary's board adopt the company-wide grid or policy.

---

7. The questions often get trickier if the subsidiary board includes non-employees. You'll have to consider the governance laws – and sometimes the tax requirements – or other regulatory requirements (such as for health maintenance organizations) in your subsidiary's jurisdiction.

Explore more in

Corporate Law
Blog series

Public Chatter

Public Chatter provides practical guidance—and the latest developments—to those grappling with public company securities law and corporate governance issues, through content developed from an in-house perspective.

View the blog