ICGN Seoul Conference – *Board Duties and Responsibilities in Company Subsidiaries and Groups*
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- **Cristina Ungureanu, Governance Manager, Qatar Investment Authority**
- **David Semaya, Executive Chairman, Sumitomo Mitsui Trust Asset Management**
- **Nagendra D. Rao, Council Member, ICSI**

- **Chaired by Mike Cho, Professor of Strategy and Corporate Governance, Korea University Business School**

Mike Cho:
This discussion is relevant to Korea, where business group structures are common. David Semaya's 30-year career spans US, Europe and Asia, as Nikko Asset Manager Executive Chairman, and CEO of Barclays Asset Management, Barclays UK and Ireland Wealth Manager. Nagendra Rao has 16 years' experience specialising in corporate and security law, capital market transactions, mergers and acquisitions and financial restructuring, and serves as Vice President of Corporate Secretaries International Association 2022. Dr Cristina Ungureanu was previously Head of Corporate Governance at Eurizon Capital, having worked in South Africa, UK and Italy. She's Co-Chair of ICGN's Global Governance Committee.

Boards of Directors in business groups can have complicated duties. They respond to challenges, including conflicts of interest between parent companies and subsidiaries and between controlling shareholders and minority subsidiary shareholders. Cristina, are there widely accepted practices for subsidiary decision-making management?

Cristina Ungureanu:
It's a constantly evolving issue. One company group/subsidiary governance model, in practice, is centralised, with strong parent and passive subsidiary company boards. It focuses mainly on regulatory compliance, day-to-day decision-making and regulation. The benefits are the framework gives more direct control and clearer responsibilities. However, subsidiary decision-making is impeded, e.g., creativity, initiative and decision-making processes slowed. Specifically with multijurisdictional subsidiaries, good understanding of local practice variations is essential, despite recent globalisation of corporate governance. Clear and relevant information flows from group to subsidiary companies remains essential, particularly multijurisdictional subsidiaries.

The other model is decentralised, with empowered subsidiary boards, with freedom to develop a locally tailored business, without irrelevant interference from parent boards. Both parent and subsidiary boards are more agile and proactive. Subsidiary boards respond quickly to local requirements. The challenge is to ensure subsidiaries adopt and follow parent group corporate governance framework and

feedback sufficient information regarding activities, enabling business monitoring and making corrections where necessary.

Recently, corporate governance trends allowing more flexibility have resulted in company groups having compromises between the models. There's no ideal model and it depends upon rationale for subsidiaries: sectors, jurisdictions, business function. Group corporate governance maturity is important, also size and composition of the group and subsidiaries. It's essential that appropriate elements are considered, tailored to group circumstances. A balance between top-down control and freedom at the bottom is essential. Problems arise with excessive parent company level control, but also with insufficient oversight.

Clear authority delegation can enable flexibility and clarity in subsidiary roles, reflecting who makes decisions, the information needed and timelines. Between centralised and decentralised models, this delegation informs subsidiaries and parent groups well on decision-making processes and those responsible. Parent companies of wholly owned subsidiaries may wish to retain complete financial and strategic control over subsidiary level decisions. Alternatively, parent companies make strategic decisions, allowing subsidiaries to implement them, with parent oversight, or Subsidiary Boards have complete authority, without interference from parent boards. Lastly, parent companies may retain veto rights on certain subsidiary company decisions, particularly over certain materiality thresholds.

The most important thing is a reporting mechanism from subsidiary to group board, including reporting components, timeframe and subjects involved.

Mike Cho:
In reality, adapting centralised models depends on jurisdictions. In Korea, parent companies cannot directly intervene in subsidiary management, even when they are 100% owned. The only thing they can do is appoint both Directors at subsidiary level at AGMs. In US, 100% owned subsidiaries are considered as a business division of parents and the centralised model applies.

David, please share your experience of separation of duties and conflict of interest with parent firms.

David Semaya:
Cristina's explanation of centralised and decentralised models is perfect and a great way to think about it. When leading asset management businesses, we must be corporate governance aware, but I'm not a specialist. Spending 14 years with Merrill Lynch, in US, 100% ownership of subsidiaries means you can amalgamate as a business unit, somewhat the case in UK, also. In financial services, in a regulated industry, sell and banking sides can do this, but the issue is with asset management. Fiduciary duty is foremost in discussions, alongside licensing, regulation issues and clients.
At Barclays Global Investors in 2004, then the largest global asset management company, I was surprised that, unlike Merrill Lynch, only one senior management and one audit employee came from the group. Regarding company value and its intangibles, trade-offs between centralised and decentralised, the market, business and segments you occupy are important, alongside what's best for shareholders. It was in Barclays' shareholders' interests to let management deal with it and drive value, ultimately being sold for around 18 billion during the financial crisis, to BlackRock, having been bought for approximately $550 million a decade before. Value creation is there and the company was run independently. Clients

reconsidered independence during the crisis, wanting bank support and guarantees in some investment strategies. Crises can instigate different behaviours.

On joining Barclays Global Investors, I was asked to become Japan's Country Manager. They operated through two legal entities. The Trust Bank does certain asset management activities, managing institutional pooled funds, providing investment advice, but cannot manage mutual funds. The other business could manage mutual funds and provide investment advice. I led both businesses. I exchanged business cards at the FSA and was informed I couldn't do that job. Japan's Corporate Code and separation of firewalls is hard. The decision made in San Francisco and London was not appropriate. Today, it's changed and with financial groups and holding companies, Japan has a new global model on running businesses, but back then we had to exit that business.

At Sumitomo Mitsui Trust Asset Management and Nikko Asset Management, part of the same group, we follow the decentralised model. Sumitomo engaged with the parent, discussing objectives and targets, but subsidiary management is very decentralised. We have Board of Directors and four members are from the group, with four external Directors. I was recruited externally, so am not officially from the group. The company is 100% parent owned. Nikko was similar, 90% group owned, with one or two minority shareholders. It was difficult to manage their engagement, hear their voices and objectives. As long-term shareholders, is the current investment reason the same as a decade ago, is the same management in place? It was like managing joint ventures, two companies combining with different ideas, etc.

Mike Cho:
Japanese and Western cases are quite different. Nagendra, how does the system work in India?

Nagendra D. Rao:
There are no specific mandatory rules and regulations. There are three parameters: holding companies, subsidiary companies and wholly owned subsidiaries. There is differentiation between subsidiaries and wholly owned subsidiaries. Subsidiaries have certain parameters with some requirements. Wholly owned subsidiaries don't have much differentiation from parent companies. Under Regulation 24, Securities Exchange Board of India, there is differentiation between related party transactions by holding companies to that of subsidiary companies. There is no bar in related party transactions but is regarding material related party transactions. Shareholder approvals are necessary, varying when shareholders are barred from voting on particular transactions. In transactions between holding companies and subsidiaries, Audit Committee approval is required, with Independent Directors of the majority company making the decision.

There are no rules prescribed, but prospective Directors must know the business well, whether Independent Director or not. Most Indian businesses are family-run, rather than professional. Decisions on independent CEOs depend upon geography, how the business is formed in the country. If professionally owned, separation between ownership and management is required. Securities Exchange Board of India had mandated separation of ownership and management, but after many representations by various companies, this was withdrawn.

Governing board members, with holding company or subsidiary, should have duty of knowledge, care and skill and particularly fiduciary responsibility and duties they will discharge as board members. There is duty of diligence and checking prior to

entering directorships and particularly, duty to avoid conflict of interest between holding companies and subsidiaries.

Why are subsidiaries formed? Some are formed only for purpose of risk or compliance to rules and regulations, or compliance of A, B, C. What happens with the subsidiaries in the future? There must be proper control and listed Independent Directors on boards. The thought process of parent companies must cascade to subsidiary companies, to understand the parent company's ethics, morality and expectations. The board should decide the type of control needed and how it should be maintained, to ensure the decisions taken by the holding company and subsidiaries.

Mike Cho:
The issue is structure and correct balance. There isn't a perfect approach. Cristina, please outline structure and design of effective subsidiary/parent governance, including parent and subsidiary level board member appointment.

Cristina Ungureanu:
It's a stimulating debate. We will hear more on the concept of subsidiary governance. It's related to appointment of parent and subsidiary board members, setting strategy and defining roles and responsibilities, evaluating boards, establishing risk accountability and responsibilities, which is not easy. The drive is to implement effective and functional subsidiary governance. There are common responsibilities for parent and subsidiary boards. Leading from the top on good corporate governance practices, to protect parent and subsidiary companies and Directors. Assessing stakeholder interests between the group and subsidiaries. Importantly, relaxing tensions between parent and subsidiary boards and potential parent board control imposition. To ensure effective multijurisdictional oversight and control, when considering legal and regulatory issues.

Parent board Directors are elected by shareholders. They must find the right balance between parent company need to set group strategy and co-ordinate oversight, and to respect subsidiary Director duties. The board composition and role may be less clearcut further down the corporate structure. The framework must therefore develop a mechanism for subsidiary Director appointment. To properly conduct their responsibilities, subsidiary Directors must act independently and objectively. Due to ownership structure, the objective isn't always easily achieved. Often parent organisations nominate Directors, Officers or employees of parent boards as Directors of subsidiary boards. They should include external Directors alongside internal. Proportion should relate to company needs and applicable regulatory requirements.

Sometimes parent company interest has precedence over that of subsidiaries. Subsidiary boards must act in the best interest of themselves and the parent organisation. Balancing responsibilities is vital. Ideally, both interests would align, but where not possible, subsidiary boards have responsibility to ensure parent understands the reasons behind decisions. Subsidiary boards should make their case to the parent board, allowing them to assess pros and cons of decisions, ultimately for the group's benefit, accounting for shareholders and all stakeholders.

Alongside ballots and alignment of interest, extremely important for avoiding issues is ensuring board composition is fit for purpose at all levels. It's a dynamic task, requiring much thought. Some principles are cross-board. Directors must fulfil fiduciary duties, act with due care, in good faith and in the company's best interest.

ICGN's Global Governance Committee are issuing a very thoughtful paper on board effectiveness, addressing Director fiduciary duties and need for parent and subsidiary boards to be appropriate. These are modern, forward-looking boards.

Mike Cho:
Boards should work for shareholders, not stakeholders. Are outside Directors in subsidiary boards needed when you own 100% shares?

Nagendra D. Rao:
Independent boards in listed companies participate in various discussions and deliberations, but review meetings or financial accounts of subsidiaries to know if subsidiaries perform to expectations. Independent Directors don't have this confidence. A Lead Independent Director becomes a Director in a subsidiary, vouching for their performance and activities, to dictate the board's expectations and whether holding company principles are being followed.

Holding and subsidiary companies are independent legal entities, but ensuring the three Ps: profit, people and planet, are met by both is more relevant. Sometimes holding companies may perform well on planet, but subsidiaries are spending significant sums but not doing much for planet. Independent Directors can investigate this. Investors invest in both holding and, indirectly, the subsidiary company, but won't know what value they create for shareholders and for society overall.

India has Bhagavad Gita, Mahabhrata, or Ramayana epics. Mahabhrata states "If you are following all ethics, all morality, you did not have to worry about anything." In the 3000BC Mahabarata war, Shri Krishna was asked why people commit sin, knowingly or unknowingly. He replied, "It is only the lust, the anger, the emotional attachment which creates disturbance in society." This also includes Board of Directors taking decisions, whether wholly owned subsidiaries, subsidiaries or holding companies. To ensure checks and balances, Indian regulation provides for an Independent Director on the subsidiary board.

David Semaya:
You can't generalise about subsidiaries. It's industry, business and jurisdiction dependent. For financial services and asset management, particularly, with bank, investment bank or brokerage house parents, you need governance of fiduciary driven businesses, versus transactionally based businesses. External Directors help that. Skillsets and experiences help subsidiary long-term value creation. In the old model Japanese conglomerate with lifetime employment and seniority-based systems, at age 55, you're often moved to a smaller subsidiary, where it's legally impossible to reduce salary unless you change companies. It's a human capital management model, fairly unique to the West. Many subsidiaries perform mid or back office functions. The purpose is often to keep people employed, fulfilling shareholder and stakeholder agreements, so important in Japan.

There's then the newer, decentralised, model. Our group has many subsidiaries with mid and back office function. External Directors would argue to outsource those functions, potentially creating issues around harmony. Joint ventures or licensed regulated business that banks or brokerage cannot do, having for example digital marketing expertise on the board, providing direct feedback and ideas for how Asset Managers inexperienced in digital marketing can help, or someone with global asset management experience, challenging how we manage money. We've recently welcomed a much needed non-Japanese female DEI expert.

The Journal of Investment Management in recent years highlighted how outside Directors with networking capabilities and expertise contribute to improve stock market performance. It's second/third order of magnitude benefits for businesses trying to grow and add value.

Cristina Ungureanu:
Parent Directors on subsidiary boards are also valuable in some situations, specifically maintaining synergies between parent and subsidiary, creating, enabling and maintaining harmony of the group's strategic objectives and corporate governance culture, another important aspect. Inside Directors in group companies could add value regarding parent versus subsidiary Directors.

Roland Bosch:
Europe has many big conglomerates splitting businesses and listing 20%, with similar situations in Korea. Is the ideal subsidiary board proportional to ownership or a majority independent board? Is an Executive Chair not best practice?

Nagendra D. Rao:
You must know the shareholding of the particular holding and subsidiary companies. In India, there may be 65% promoter shareholdings in listed companies, the remainder public. The promoter shareholder will be more interested in the subsidiary company and he or his relative will be on the board. Professional companies may have no more than 10-15% promoter stake. Professional Independent Directors can run the subsidiary companies. There can't be a tick box exercise to define board composition for company categories. It depends on culture, ethics, ownership and the Board of Directors, more so for professional boards. Listed companies always have professional boards, even with subsidiaries, family-controlled businesses less so.

David Semaya:
Listed companies pose many issues and questions around governance, Executive Chair versus independence. How we account for minority shareholders is another difficult question.

Cristina Ungureanu:
There's no formula, it's group specific. Directors' skills and calibre are essential. More parent companies create solid skill matrices, important across groups to build the right profiles. Clear alliance of authority is also important.

Mike Cho:
I recently spoke to Boards of Directors from SK Holdings and POSCO Holdings. Their key concern regarding separation of duties and responsibilities between parents and listed subsidiaries is how deeply they can be involved in subsidiary management. They don't want to simply monitor but get involved. Korean law strictly prohibits this.

David Semaya:
What criteria was behind the listing? If the parent believes they can manage it better, they should send their experts into the subsidiary.

Nagendra D. Rao:
Putting aside law, there are various ways to ensure this. You have second level management teams, alongside board level, who could present on behalf of, or with guidance of the board, running the subsidiaries.

Cristina Ungureanu:
For listed groups, it's not just protecting minority shareholder interest, but establishing framework of processes and attitudes adding value to the business, ensuring long-term continuity and success.

Mike Cho:
My recommendation was installing groupwide internal control systems, rather than intervening directly to subsidiary management.