How COVID-19 could be a game changer for entity compliance and governance

Mike Fry / Seth McNary
EY Network of Law Firms
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The pandemic has had a major impact on global reporting requirements, and businesses may reap the rewards if they chart the right way forward

In brief

- COVID-19 has changed how businesses around the world have to meet statutory reporting requirements.
- This is leading to a broader re-evaluation of entity compliance and governance issues.
- Organizations that want to transform their global operations need to break down traditional silos and entrenched ways of thinking.

Multinational companies (MNCs) face a wide range of operational, governance and reporting challenges as they seek to manage complex statutory requirements on a global scale. Maintaining legal entity compliance requires ongoing monitoring and management of local formalities amidst a labyrinth of jurisdictional rules. Failure to stay compliant can result in operational and reputational risk, and director and officer liability, not to mention penalties and fines.

The COVID-19 pandemic has added additional stress to those legal and compliance teams tasked with legal entity compliance and has significantly impacted the compliance and governance landscape. COVID-19-related office closures and remote working, not to mention the frustration of several aspects of the normal legalization and notarization process, has forced regulators to defer filing deadlines and relax local execution requirements.

Many jurisdictions implemented interim COVID-19-related legislation to enable the relaxation of signature requirements and allow for virtual notarizations and e-signature protocols, where previously only in-person, "wet-ink" signatures were permitted.

As countries locked down and international travel ground to a halt, virtual board meetings, and virtual and hybrid shareholder general meetings became the norm. For countries where a director's physical presence was required for a board meeting, not least for issues of substance, this was a major shift and may well have required a shuffling of board composition.

Likewise, extensions to filing deadlines were instituted, with many governments around the world excusing or extending deadlines for statutory reporting, including approval and publication of annual accounts and related reports.

Several of these temporary measures hold the promise of positive change if left in place post COVID-19.

What comes next?

While all of these changes undoubtedly provide welcome support at a difficult time, COVID-19-related challenges have potentially exposed significant issues and inefficiencies in the process, technology and governance models that many MNCs have relied on for legal entity compliance.

As we slowly return to a pre-COVID-19 footing, MNCs would be well served to take a longer look at defining the new normal for legal entity management from a systems, data and resource perspective. This is even more so the case considering that, for many industries, the new normal will also require significant reduction in internal and external spend.

It is worth noting the role that technology has played in helping both businesses and governments navigate the pandemic. Many local registrars were already undertaking a process of digital transformation, enabling the lodging of electronic filings, and COVID-19 may well have accelerated that trend. This move toward a more digital execution framework will largely be welcomed.

Of course, this doesn't mean that countries around the world will converge towards a standard, harmonized governance model. Entity compliance will continue to require country-by-country expertise and constant vigilance to monitor legislative change.

Reassessing the group structure

While businesses had to act quickly to adapt to regulatory change in the wake of COVID-19, they are now operating in a new landscape and need to consider the demands of the new normal as we emerge from the pandemic. This means shifting from being reactive to proactive and putting risk front and center, so that they can better govern the business and manage any future challenges.

The more complex a business, the more it may well choose to focus on a differentiated, more risk-based, governance model. This could involve looking at its subsidiary structures and necessary governance model tiering. For instance, the top tier may comprise 10% of its entities that will get a differentiated governance approach, with the rest being systematized.

Identifying risk in the group structure and building governance around that is key. That entails identifying which entities are critical, significant or present a higher risk to the business – this could be specific to the complexity of a jurisdiction, the nature of operations, or structure – and ensuring those are managed with an appropriate layer of governance that would be different from, say, a dormant or inactive entity.

This process of re-evaluation provides a real opportunity to consolidate or rationalize parts of the larger group structure, including identifying where the cost lies from a function or administrative perspective and how that can be reduced or eliminated.

There is also the opportunity to look more strategically at infrastructure in general – not just the group entities, but the people and processes that are part of in-country business and whether the status quo forms part of a long-term solution. This can facilitate an informed discussion around functional organization design and considerations around centralization, offshoring or outsourcing, or the development of a more sophisticated and cost-efficient model.

Central to this decision-making process will be the need to engage General Counsel and Company Secretaries so they understand the risks involved, such as whether any given entity can be managed from abroad. This may well involve a far more collaborative approach and the breaking down of traditional silos within an organization – something the pandemic has seen businesses do as a matter of course.

Harnessing technology

While technology played a major role in dealing with change during the pandemic, the strategic use of technology will become more critical. In the past, the focus on technology has centered on "off the shelf" solutions and visibility into basic entity information, so that an organization can see what its entities look like and the attributes they have.

What needs to be explored is how technology enables the governance process – for instance, what are the implications of going "lights out" in a number of jurisdictions and regionalizing the resource model; which management structure will be most effective; and what analytics can help provide more transparent and efficient governance?

Technology could make a significant contribution to a different model of risk-based subsidiary governance and the ability to manage and monitor complex organizations.

The challenge within large and complex businesses is that technology is typically disconnected. At the top there is technology around governance and the executive board, while further down there is entity data. But there is often a disconnect between how the governance trickles down to the subsidiaries across the broader group and how this is owned, managed and administered.

The role of the legal and governance department

To get ahead of the curve, entity compliance and governance can't be viewed in a vacuum and this means, for instance, reassessing how the in-house legal department operates in this space. Too often, legal departments are seen as "elevator assets". As a result, they are often remote from other business functions and are reactive to the business needs and the global governance and compliance risks.

Admittedly, it is a picture that is slowly changing, with General Counsel's office increasingly starting to remove the silos of the legal department and understand where it converges with or contributes to the larger business enterprise process.

Another part of this challenge is assessing who within the department is undertaking, has responsibility for and oversight of compliance and governance, and whether the right processes and systems are in place. Essentially, are people spending their time performing highest-value work, contributing to efficiencies in the business, and how are routine low-value activities being resourced.

It's all about agility

The dangers of not re-evaluating business operations from a compliance and governance perspective can be considerable. Not getting this right even with regard to basic compliance can impact an organization's deal readiness, as restructuring or tax clearance may become an issue.

Similarly, a reactive function can't effectively service the business with operational requirements such as funding, capitalizations, distribution or repatriation requirements. This is compounded when operating across multiple and complex jurisdictions.

The risk remains of director exposure to personal liability in the form of civil or even criminal sanctions in some instances. However, subsidiary boards, who are typically senior management, may have an expectation that their interests are being protected.

Despite the challenges of the COVID-19 pandemic, even the largest, most complex businesses have adapted and flexed to the new world. Working together across business silos and externally with third-party providers, as well as with governments and regulators, has helped to keep the economic wheels turning while mitigating risk and safeguarding the interest of the board, management, employees and shareholders. This has laid a strong foundation for progress, but building on this is the next critical step.