Relief and Rescue: Suspensions and Elasticity in Financial Regulation, and Lessons from the UK's Management of the Covid-19 Pandemic Crisis

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I. INTRODUCTION

The outbreak of the Covid-19 pandemic severely impacted economic activity as lockdowns were imposed in many countries.[1] In the UK, economic impact has been severe as output is reduced by at least 20% compared to the same period in the previous year.[2]

The financial implications of economic lockdown in so many sectors were immediate as the corporate sector is heavily financialized.[3] The freezing of business activity has implications for business' cash flow, servicing of debt, potential insolvency and their market valuation and credit rating assessments. Further, the decline of market appetite triggers investors' behavioural bias towards cash (using Lo's adaptive capital markets hypothesis),[4] and adversely affects levels of private investment in the corporate sector.[5] The economic woes for businesses and corporations are inevitably also financial woes. Besides public finance packages for emergency help, such as furloughing,[6] policymakers have turned to private sector finance to alleviate the financial stresses and hardships caused to households and corporations. Private sector finance is being relied on, to a significant extent, but not exclusively, to meet the policy goals of 'relief' and 'rescue' for households and corporations. 'Relief' refers to the policy goal of giving corporations and households temporary release from the pressures of debt which would be exacerbated in the weak economic conditions during the pandemic. 'Rescue' refers to facilitating the access of corporations to finance to keep them afloat in relation to expenses, losses and shoring up for the future.

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[1] https://www.bbc.co.uk/news/world-52103747.

[2] 'UK GDP falls by record 20.4% in April as lockdown paralyses economy' (The Guardian, 12 June 2020), https://www.theguardian.com/business/2020/jun/12/britains-gdp-falls-204-in-april-as-economy-is-paralysed-by-lockdown.

[3] Karen Ho, *Corporate Nostalgia? Managerial Capitalism from a Contemporary Perspective*, in Greg Urban (ed), Corporations and Citizenship (Philadelphia: University of Pennsylvania Press 2014).

[4] Andrew W Lo, *The Adaptive Markets Hypothesis: Market Efficiency from an Evolutionary Perspective*, 30 The Journal of Portfolio Management 15 (2014).

[5] 'Investors pull record €250bn from European funds.' *Financial Times*, April 22, 2020. https://www.ft.com/content/29d69ff6-749b-45dc-b53e-85a236186983; "UK investors flee equity funds on coronavirus fears." *Financial News*, February 27, 2020, https://www.fnlondon.com/articles/uk-investors-flee-equity-funds-on-coronavirus-fears-20200227.

[6] 'Claim for wages through the Coronavirus Job Retention Scheme', https://www.gov.uk/guidance/claim-for-wages-through-the-coronavirus-job-retention-scheme.

These policies are not dissimilar to those undertaken by many countries.[7] In the UK, which is the focus of the article, the policy goals of relief and rescue were carried out by the enactment of emergency legislation[8] as well as by regulatory actions under the leadership of financial regulators, i.e. the Prudential Regulation Authority (PRA)[9] and Financial Conduct Authority (FCA).[10] The PRA and FCA suspended the application of certain regulatory laws and private contractual laws applicable to their regulated entities. Regulatory suspension can be seen as one of the ways the 'elasticity' of law is realized in order to cater for wider political, social and economic needs.[11]

Legal elasticity is treated as a policy instrument, but it has been more fully theorized in Pistor's legal theory of finance.[12] In this theorization, law is central for constructing finance, hence, legal elasticity is resorted to when existing law is no longer able to meet overarching policy goals such as financial stability. This theorization depicts law in an instrumental sense and bound up with power structures that influence legal change, but also treats law in a structural sense.[13] Hence, legal elasticity may not avoid structural effects, such as institutional dissonance and change.

We situate the regulatory suspensions introduced by UK financial regulators during the Covid-19 crisis within the theorization of legal elasticity in Pistor's legal theory of finance. Further, our study, although focused on the UK, offers lessons and insights for developed financial jurisdictions that have also embarked financial regulatory suspensions.[14] We argue that regulatory suspensions should be perceived as going beyond merely being instrumental. It is imperative to explore the nature of regulatory suspensions within the framework of legal elasticity as a fully theorized account so regulators can perceive more fully the implications of their deployment.

Section II explores the concept of legal elasticity as theorized in the wake of the global financial crisis of 2007-09. We argue that this concept can be extended to encompass regulatory suspensions introduced in the Covid-19 crisis, being equally applicable to regulatory suspensions triggered by endogenous financial sector problems or exogenous shocks. Legal elasticity has been deployed as the policy agenda of 'relief and rescue' which represent welfarist and public interest objectives are not easily accommodated in financial regulation, due to the efficiency-dominated paradigm of financial regulation.[15]

However, in its application to credit laws and regulation examined in Section III and capital markets regulation explored in Section IV, legal elasticity challenges the institutional

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[7] IMF, 'Policy Responses to Covid-19', https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.
[8] The UK Corporate Insolvency and Governance Act 2020.
[9] The prudential regulator oversees 2,000+ banks, insurers and systemically important financial institutions.
[10] The conduct regulator oversees all financial institutions, including PRA-authorized institutions in respect of business conduct.
[11] Katharina Pistor, *A Legal Theory of Finance*, 41 Journal of Comparative Economics 315 (2013).
[12] Pistor (2013), 317.
[13] Section II.
[14] Many jurisdictions in Europe have introduced 'relief' measures like debt payment moratoria, supported by prudential regulation suspensions, https://eba.europa.eu/coronavirus; forbearance and moratoria. In the US, see Coronavirus Aid, Relief, and Economic Security Act, (CARES Act), HR 748, March 27, 2020.
[15] FCA, *Economics for Effective Regulation* (2016), https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-13-economics-effective-regulation.

coherence of regulatory regimes and this tension has resulted in a number of unanswered questions and unintended consequences. Sections III and IV examine the hazards such regulatory suspensions could entail to regulators, banks, markets and the intended beneficiaries themselves- i.e. households and corporations.

Section V argues that regulators' deployment of legal elasticity can be better supported by decision-making frameworks that are based on a fully theorized understanding of legal elasticity. We make three proposals for improving regulators' decision-making in deploying legal elasticity. This article does not argue that by more optimally deploying legal elasticity, substantive policy agendas such as 'relief and rescue' would also be optimal. What we argue is that whatever the substantive policies in place, where financial regulatory suspensions are regarded as part of the policy mosaic, the use of legal elasticity should be a fully apprised one and should not add to existing substantive challenges. This is important as for a second time, financial regulators in many jurisdictions have looked to legal elasticity at a significant scale for crisis management, even if this is not a financial sector originated crisis. However, we confine our proposals on the optimal use of legal elasticity in finance, as Section II explains how legal elasticity is anchored in the legal theory of finance. Other regulatory areas may not be susceptible to as much legal construction as in finance. We do not discount the possibility that other regulatory 'enterprises'[16] can benefit from this study but we do not claim direct applicability within the confines of this article. Section VI concludes.

II. LEGAL ELASTICITY IN FINANCIAL REGULATION

Legal elasticity is argued to be a function of the legal theory of finance posited by Pistor.[17] The legal theory of finance frames finance in legal terms, as financial transactions and obligations are constructed as legal structures in order to work as intended. In particular, finance is underpinned by the crucial qualities of certainty and enforceability that law supplies. However, in the global financial crisis, it was observed that the very qualities of certainty and strict enforceability of financial obligations and transactions in various markets would collectively lead to damaging consequences, a manifestation of systemic risk.[18] As such, the solution is also found in law, i.e. to resort to legal elasticity in order to suspend and mitigate the adverse impacts driven by law, in order to meet the needs of crisis management.

In this theoretical framework, legal elasticity served an unwinding purpose- i.e. to unwind the adverse effects caused by its very own legal nature in the first place, when the broader policy goals sought to be achieved are shifted. Elasticity also redeems financial law or regulation and paves the way for law reform. The post-crisis reforms to the banking and financial sector reflected this conceptualization of legal elasticity. For example, where banks had been unable to absorb their losses during the global financial crisis, legal elasticity was applied so that regulatory discipline was not meted out to them for being inadequately capitalized. Instead,

[16] This term refers to different regulatory areas warranting different approaches taken by relevant respective regulatory agencies, Tony Prosser, *Regulatory Enterprises* (Oxford: OUP 2010).
[17] Pistor (2013), 320.
[18] Steven Schwarz, *Systemic Risk*, 97 Georgetown Law Journal 193 (2008).

many jurisdictions bailed out their banks by injecting state capital[19] and then proceeded to reform capital rules to tie banks to higher and more robust levels of capitalization.[20]
The application of legal elasticity by UK policymakers and regulators to credit and capital markets during the Covid-19 crisis seemed arguably not in the same vein, as regulatory suspensions were articulated to be temporary. This near-term perception of regulatory suspensions can be attributed to the sophisticated development of financial regulation after the crisis, which includes inherently flexible regulations.[21] Regulators constructed an increasingly prescriptive regime for prudence[22] and conduct[23] by banks and financial institutions- and also carved out particular measures of inherent flexibility.[24] This juristic development suggests that legal elasticity in finance may have been theoretically enriched by the provision of *ex ante* discretion and flexibility, and not just *ex post* discretion argued in Pistor's legal theory of finance.

However, we observe in Sections III and IV that during the Covid-19 crisis, regulators exhausted inherently flexible measures and moved to relax unexpected regulatory rules, in order to advance the policy demands of relief and rescue. These are framed to be bundled with the inherently flexible rules, arguably showing hesitation and ambivalence in deploying legal elasticity.[25] This *ex post* exercise of legal elasticity raises a new question: can legal elasticity take place within institutional stability? The post-crisis conceptualization of legal elasticity is structural in nature, and a pathway to institutional change. Is legal elasticity during the Covid-19 crisis be temporary?

Figure 1: Spectrum of Regulatory Elasticity- A Hypothesis

[19]'Rescue packages: what governments have offered' (20 October 2008), https://www.telegraph.co.uk/finance/3229434/Rescue-packages-what-governments-have-offered-financial-crisis.html.
[20] Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (2011), http://www.bis.org/publ/bcbs189.pdf; Basel Committee, *Finalising Post-crisis Reforms* (2017), https://www.bis.org/bcbs/publ/d424.pdf. The European Union introduced additional rules in Directive 2013/36/EU (Capital Requirements IV Directive 2013); Regulation (EU) No 575/2013 (Capital Requirements Regulation 2013), amended 2019 by Regulation 2019/876.
[21] 'Embedded flexibility' was mentioned by the European Banking Authority, 'EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector' (12 March 2020), https://eba.europa.eu/sites/default/documents/files/document_library/General%20Pages/Coronavirus/EBA%20Statement%20on%20Coronavirus.pdf.
[22] Iris H-Y Chiu and Joanna Wilson, *Banking Law and Regulation* (Oxford: OUP 2019), chs.8-13; Iris H-Y Chiu, *Rethinking the Law and Economics of Post-Crisis Micro-prudential Regulation- The Need to Invert the Relationship of Law to Economics?*, 38 Review of Banking and Financial Law 639 (2019).
[23] Chiu and Wilson (2019), chs.11-12.
[24] Eg. counter-cyclical buffer in microprudential regulation, Section III.
[25] Sections III and IV.

This question is of importance as regulators wish to avoid an application of legal elasticity whose effects then take them by surprise. However, our examinations in Sections III and IV suggest that signs of unintended *structural* effects are already occurring. Even if legal elasticity encompasses 'degrees' of elasticity, regulators should not assume that no institutional dissonance would result. In this manner, we may be able to add to the conceptualization of legal elasticity in Pistor's legal theory of finance, in hypothesising the structural nature of legal elasticity, beyond merely instrumental. Such a spectrum of structural effects can be dependent on *legal* factors such as how far legal effects are suspended, and for how long, and *other* factors such as the nature of policy rhetoric in which regulatory suspensions are framed. These are issues that can be further explored empirically in future work.

It is fully understandable that the financial regulators in the UK wish to secure institutional consistency despite the application of legal elasticity. The post-crisis financial regulatory reforms have taken more than a decade,[26] and regulators have no appetite for major institutional changes. Further, the Covid-19 crisis is regarded as a crisis exogenous to the financial sector and should not entail existential consequences for the substance of laws/regulations.

Our call to fuller theorization and appraisal of legal elasticity is not intended to 'create more work' for regulators during this stressful time. This exercise would do much to spare regulators from unexpected and longer-term challenges down the road. At a broader level, a fully theorized understanding of legal elasticity allows this regulatory tool to be used more optimally in crisis management. More general application of legal elasticity as a regulatory tool can also be theoretically anchored in responsive regulation.[27] Although Ayres' and Braithwaite's work in 'responsive regulation' was most famous for its enforcement pyramid, it more broadly redefined the nature and directions for modern regulation.[28] It provides a vision of regulatory dynamism for substantive purposes[29] and purposes relating to regulatory participation,[30] processes[31] and implementation.[32] Legal elasticity is more richly based if regarded as an extension of the responsive regulatory paradigm. We turn to examine the use of regulatory suspensions in the credit and capital markets in the UK.

III. REGULATORY SUSPENSIONS IN CREDIT LAWS AND REGULATION: ADVANCING 'RELIEF AND RESCUE'

During the Covid-19 crisis in the UK, a key policy concern is how credit arrangements would affect households and corporations that are in debt and/or need additional financing by debt.

[26] The Basel Committee's reforms between 2009-2017, and the EU's regulatory regime finalised in 2013, amended 2019.

[27] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: OUP 1992).

[28] Christine Parker, *Twenty Years of Responsive Regulation: An Appreciation and Appraisal,* 7 Regulation and Governance 2 (2013).

[29] E.g. Cristie Ford, *Innovation and the State: Finance, Regulation and Justice* (Cambridge: CUP 2017) on regulatory aims to promote innovation.

[30] Eg Julia Black, *Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post-Regulatory' World*, 54 Current Legal Problems 103 (2001).

[31] E.g. meta-regulation, Colin Scott, *Regulating Everything* (2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532865.

[32] Eg Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Cheltenham: Edward Elgar 2011).

Borrowers, both households and corporations, need temporary relief from the pressures of debt while regrouping themselves during the crisis. Second, access to finance and credit to businesses should continue in order to avoid key social losses such as protecting jobs and business suppliers from knock-on effects.[33] In the US, personal finance forbearance is devolved to the private sector,[34] possibly with state regulatory guidance. As the FCA has a consumer protection mandate,[35] measures on personal finance were introduced from the early stages of the pandemic. Relief for corporate borrowers is explicit in both the US[36] and UK.[37]

A. RELIEF FOR BORROWERS

Explicit loan forbearance is introduced in the UK, suspending the operation of contractual obligations for FCA-regulated lenders in consumer credit and household mortgages. As the FCA does not have regulatory perimeter over business lending, an Act of Parliament was passed to give temporary relief for business borrowers.[38]

Regulators require mortgage lenders to grant a payment holiday, originally for three months from March 2020, subsequently extended until end October, to any customer who indicates they potentially experience difficulties.[39] This measure does not affect the accrual of interest on the loan and lenders need not investigate the individual circumstances of each customer who requests for the payment holiday. The balance achieved is that customers are not imposed with burdens to prove that they can afford a payment holiday, but lenders are not asked to forego their expected earnings. Defaulting customers at the commencement of the guidance would enjoy temporary relief from enforcement.

Other consumer credit customers enjoy similar relief in payment holidays, including personal loans and credit cards. Consumers with an arranged overdraft can request an additional interest-free overdraft facility of £500 for a three-month period.[40] High-cost short-term credit

[33] Thomas Huertas, "Here is How Banks Can Help Save the Economy". *Financial Times*, May 11, 2020, https://www.ft.com/content/f02df444-8f78-11ea-bc44-dbf6756c871a.

[34] McKinsey, 'What next for US credit card debt' (May 13, 2020), https://www.mckinsey.com/industries/financial-services/our-insights/what-next-for-us-credit-card-debt#. There seems some forbearance for student debt and mortgage debt underwritten by Fannie Mae and Freddie Mac, 'Personal finance tips: How to pay the bills during the coronavirus pandemic' (March 23, 2020), https://www.usatoday.com/story/money/2020/03/23/mortgage-bills-student-loan-moratorium-covid-19-coronavirus-personal-finance/2894392001/.

[35] Section 1C, UK Financial Services and Markets Act 2000 (amended 2012).

[36] Sections 1102, 1105, CARES Act 2020.

[37] n8.

[38] n8.

[39] FCA, *Mortgages and coronavirus: information for consumers* (20 March 2020), https://www.fca.org.uk/consumers/mortgages-coronavirus-consumers (updated on 19 June 2020).

[40] FCA, *FCA confirms further support for consumer credit customers* (1 July 2020), https://www.fca.org.uk/news/press-releases/fca-confirms-further-support-consumer-credit-customers.

customers,[41] motor finance and 'buy-now-pay-later' or 'rent-to-own' borrowers also benefit from deferred payment requests up to 31 October 2020.[42]

As business lending is not regulated by the FCA, fast-tracked legislation was passed to allow indebted companies to apply for a moratorium. Directors can make such an application if they are of the view that the company is unable to pay its debts. They need to appoint an insolvency practitioner as 'monitor' to verify that rescue for the company is possible.[43] A successful application for moratorium allows the company to enjoy relief, except specified obligations such as rent and employees' wages, for an initial 20 days with a possible extension.[44] During the period of the moratorium, no insolvency proceedings can commence against the company. The company should seek arrangements with its creditors or explore avenues of raising finance during this period.

In order to support loan forbearance, the inherently flexible measures in micro-prudential regulation were deployed. The macro-prudential regulator in the UK, the Bank of England's Financial Policy Committee (FPC), has oversight of the systemic health of the financial system,[45] and is able to exercise an inherently flexible power to adjust a prudential regulatory measure known as the countercyclical buffer (CCyb). The CCyb was introduced in the wake of the global financial crisis to allow the macroprudential regulator to impose capital cost on banks to dampen pro-cyclical creation of debt.[46] Imposing the CCyb moderates financial institutions' behaviour and markets' tendencies towards a cycle of Minskian instability.[47] Prior to the onset of the Covid-19 crisis, the CCyb was set at 1% for UK banks to be elevated to 2% by December 2020 as economic activity looked strong and banks should be prevented from excessive risk-taking. This was abruptly adjusted to 0% during the Covid-19 crisis,[8] freeing up for banks an estimated capital cost of £190bn.[48] As Masur and Posner[49] argue, the CCyb is designed to shape the incentives of financial actors inherently biased towards procyclicality. In downturns, as has been caused by the onset of the Covid-19 crisis, the relaxation of prudential regulation that is inherently adjustable is merely counter-cyclical regulation that counteracts excessively risk-averse behaviour.

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[41] FCA, *Coronavirus: information for consumers on personal loans, credit cards, overdrafts, motor finance and other forms of credit* (3 April 2020), https://www.fca.org.uk/consumers/coronavirus-information-personal-loans-credit-cards-overdrafts; *High-cost short-term credit and coronavirus: temporary guidance for firms* (24 April 2020), https://www.fca.org.uk/publications/finalised-guidance/high-cost-short-term-credit-and-coronavirus-temporary-guidance-firms. This is updated in *High-cost short-term credit and coronavirus: updated temporary guidance for firms* (3 July 2020), https://www.fca.org.uk/publications/guidance-consultations/high-cost-short-term-credit-coronavirus-updated-temporary-guidance-firms.

[42] FCA, *FCA announces proposals to further support motor finance and high cost credit customers* (3 July 2020), https://www.fca.org.uk/news/press-releases/fca-announces-proposals-further-support-motor-finance-high-cost-credit-customers.

[43] S3, 6, 7, Corporate Insolvency and Governance Act 2020.

[44] S9-10, 18, 20, 21, id.

[45] S9Aff, Financial Services and Markets Act 2000.

[46] Art 128(7), Capital Requirements Directive 2013/36/EU.

[47] Hyman P Minsky, *The Financial Instability Hypothesis*. Levy Economics Institute Working Paper, 1992, http://www.levyinstitute.org/pubs/wp74.pdf.

[48] Bank of England, *Bank of England measures to respond to the economic shock from Covid-19* (11 March 2020), https://www.bankofengland.co.uk/news/2020/march/boe-measures-to-respond-to-the-economic-shock-from-covid-19; PRA, *Statement by the PRA accompanying measures announced by the Financial Policy Committee*. (11 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-by-the-pra-accompanying-measures-announced-by-the-fpc.

[49] Jonathan S Masur and Eric A Posner, *Should Regulation be Counter-cyclical?*, 34 *Yale Journal on Regulation* 857 (2017).

Freeing up the cost of capital originally imposed by the CCyb does not automatically result in more lending or forbearance. During the Covid-19 crisis, borrowers' creditworthiness would be difficult to discern. Banks may be behaviourally inclined to refrain from lending due to risk aversion and impediments to efficient markets such as acute information asymmetry, and may hoard capital instead. Hence the PRA and FCA supplemented the inherently flexible measure of the CCyb by suspending other regulations not inherently thought to be flexible, to send stronger incentive-based messages to banks. Such bundling of inherently flexible and unexpected legal elasticity gives rise to more fundamental issues and institutional dissonance. Our analysis is however not to discourage policymakers from deploying legal elasticity, but to encourage towards deeper engagement with its effects.

As loan forbearance creates doubt as to banks' asset quality, banks may choose to conserve capital, or worse, raise capital to shore up against credit risks. In this manner, payment holidays would be contrary to banks' ability to lend or help their borrowers. To steer banks' behaviour towards 'relief and rescue', the PRA clarifies[50] that banks should not treat deferred payments as being in default. Even if deferred payments do not resume promptly, they should not mechanistically be treated as impaired assets. Banks should instead seek to understand individual financial situations. However, permitting ambiguity in whether deferred borrowers are in default poses hazards to regulatory objectives and banks' resilience.

After the global financial crisis, a forward-looking approach[51] to loan loss provision for banks was encouraged. The accounting standard IFRS 9 requires banks to account for debt instruments at fair value[52] and ensure that they have sufficient capital to absorb potential losses. Payment holidays exacerbate information asymmetry in relation to borrowers' creditworthiness and banks may make increased loan loss provisions against these,[53] paddling back against the capital liberation that has been offered. The PRA had to moderate banks' tendencies by encouraging[54] more discretionary assessment on borrowers' credit risks instead of risk aversion across the board. However, banks used to prescriptive numerical prudential regulation would find this expectation difficult to implement in the face of dissonance in changing regulatory objectives. Banks suffer from uncertainty to what extent the boundaries of existing regulations can be pushed.[55] The PRA has in effect 'delegated' to banks the

[50] PRA, *Letter from Sam Woods, Covid-19: IFRS 9, capital requirements and loan covenants* (26 March 2020), https://www.bankofengland.co.uk/prudential-regulation/letter/2020/covid-19-ifrs-9-capital-requirements-and-loan-covenants; PRA, *Statement by the PRA on regulatory capital and IFRS 9 requirements for payment holidays* (22 May 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-on-application-regulatory-capital-ifrs9.

[51] Rosa M. Lastra, *Defining Forward Looking, Judgement-Based Supervision*, 14 Journal of Banking Regulation 222–223 (2013).

[52] Unless they satisfy the contractual cash flow test and business model assessment requirement.

[53] "European bank investors brace for loan-loss provisions." *Financial Times*, April 27, 2020. https://www.ft.com/content/1d9d862a-df05-47c1-8245-cf798127165f; "BoE warns bank loan reserves risk choking business funding." *Financial Times*, 26 April 2020, https://www.ft.com/content/75767049-edfb-4074-942c-f9ce4d07f861; "UK banks' loan loss provisions soar in face of pandemic." *S&P Global Market Intelligence*, 7 May 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/uk-banks-loan-loss-provisions-soar-in-face-of-pandemic-58478176.

[54] PRA, *Statement by the PRA on regulatory capital and IFRS 9 requirements for payment holidays* (22 May 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-on-application-regulatory-capital-ifrs9.

[55] Section V.

implementation of such a balance at the micro level of evaluating their borrowers. European regulators also face this similar difficulty in regulatory objective balancing.[56]

Unintended Adverse Consequences for Markets, Institutional Stability and Distributive Justice

Although well-intentioned, temporary payment holidays are not the same as permanent debt relief. Borrowers benefiting from this may behaviourally postpone their troubles, storing up arrears that may become even more unmanageable in the future.[57] The FCA's Chairman[58] is concerned that customers are incentivized into unsustainable debt levels and future financial fragility.[59] There is a lack of clear guidance to lenders and borrowers on negotiating the exact terms of debt servicing after payment holidays cease. The conduct of debt enforcement down the road is also a matter for concern from the point of view of social justice,[60] as lenders would be anxious to mitigate the impairments to their balance sheets. How will the return of efficiency and contractual discipline affect consumers and are they factoring these into account in their choices under stress during the pandemic? Would and should there be a difference between the treatment of retail and business borrowers, bearing in mind that business borrowers may be responsible for job creation?

Next, regulatory suspension affects market mechanism chains that may in turn adversely affect consumers. This is experienced in the US mortgage markets where securitization is the norm for supporting mortgage underwriting. Underwriters of mortgages seek to bundle mortgages into securitized assets usually after 3 months of such mortgages being written. Payment holidays affects the information quality of such mortgages as no reliable stream of income can be reported for securitized assets sales. This can in turn freeze up mortgage markets, adversely affecting households that need mortgages or refinancing.[61]

Regulators also need to consider the distributive effects of regulatory suspensions. There may be a temporary distributive effect from lenders to borrowers as forbearance is implemented. The optimality of this redistributive effect depends on bank fragility and whether there is an increased chance of use of public funds to recapitalize them.[62] Post-crisis micro-prudential

[56] EBA, *Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis* (2 April 2020, updated June 2020), https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20legislative%20and%20non-legislative%20moratoria%20on%20loan%20repayments%20applied%20in%20the%20light%20of%20the%20COVID-19%20crisis/882537/EBA-GL-2020-02%20Guidelines%20on%20payment%20moratoria.pdf; ECB, *Opinion of 20 May 2020 on amendments to the Union prudential framework in response to the COVID-19 pandemic* (CON/2020/16) 2020/C 180/04.

[57] "Lenders sound warning on mortgage holidays." *Financial Times*, March 25, 2020. https://www.ft.com/content/3a6b82b0-6e77-11ea-89df-41bea055720b.

[58] Charles Randell, 'A financial system to support the recovery' (16 June 2020), https://www.fca.org.uk/news/speeches/financial-system-support-recovery.

[59] Id.

[60] "UK loan freeze plan leaves customers still open to arrears letters." *Financial Times*, April 5, 2020. https://www.ft.com/content/7a533dc5-8cd8-4ef3-9963-d1f43e76ff47.

[61] "Payment holidays are messing with America's $2.2tn mortgage machine." *Financial Times*, April 17, 2020, https://www.ft.com/content/f6c218a1-358e-4564-9919-1a96da91fc94.

[62] Emilios Avgouleas and Charles Goodhart, *Bank Resolution A Decade After the Global Financial Crisis: A Systematic Reappraisal*, in Douglas W. Arner, Emilios Avgouleas, Danny Busch, and Steven L. Schwarcz (eds), Systemic Risk in the Financial Sector: Ten Years after the Great Crash (Ontario: McGill-Queen's University Press

regulatory reforms have made banks more resilient[63] but it remains uncertain how far banks can push their newly-built resilience.[64] Such concerns would shape banks' behaviour in their pursuit of unviable borrowers when relief ceases. Yet the private enforcement paradigm against borrowers would likely be socially scrutinized.

Finally, regulatory suspensions bring about immediate effects of institutional dissonance as their application leaves gaps and creates differences between markets. Regulatory suspensions for consumer and business credit do not apply to peer-to-peer lending arrangements. 'Peer' lenders are not regulated entities and only the platform that facilitates peer-to-peer lending is regulated[65] in respect of their conduct of business vis a vis customers on both sides of the market i.e. the lenders/investors in loans and borrowers. This is a hazard in 'regulatory commons' articulated by Buzbee[66] who cautions against regulatory gaps that may be ideologically anomalous but caused by the drawing of regulatory boundaries.[67] The treatment of borrowers is completely left to the self-regulation of peer-to-peer lending platforms, some of whom allow payment holidays and 'pass the pain' to their lenders/investors by freezing withdrawals or slashing returns.[68]

B. INCREASING CREDIT AVAILABILITY TO BUSINESSES

The PRA has instructed UK banks that all elements of liquidity and capital buffers "exist to be used as necessary to support the economy".[69] This relates to the 'rescue' element of the UK's policy for businesses to access credit during the Covid-19 crisis. This policy pronouncement arguably creates dissonance in relation to regulatory objectives in micro-prudential regulation designed to combat excessive lending and risk-taking[70] in the wake of the global financial crisis. To facilitate the rescue agenda, the PRA introduces a raft of unexpected regulatory suspensions, but expansion of credit is also fiscally supported. Fiscal support for corporate borrowing, trade credit and commercial paper is also introduced in the US,[71] although it is left to state and federal prudential regulators to work out prudential regulatory adjustments.

2019) 31; "Why banks should raise equity to get through this stress." *Financial Times,* May 18, 2020, https://www.ft.com/content/d57f3068-2953-4424-82e1-1ae3db1bc5bf.

[63] "CET1 capital ratios at Europe's largest banks, Q4." *S&P Global Market Intelligence*, March 17, 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/cet1-capital-ratios-at-europe-s-largest-banks-q4-57567429.

[64] 'Are Britain's banks strong enough for coronavirus?' (BBC News, 20 May 2020); Alissa Kleinnijenhuis, Laura Kodres, Thom Wetzer, *Usable Bank Capital* (30 June 2020), https://voxeu.org/article/usable-bank-capital#.XwA9ibxoIRc.twitter; "Banks need to prepare now for Covid-19 losses later." *Financial Times,* July 9, 2020, https://www.ft.com/content/918fe325-8a7f-4646-9031-6e7f2d61b3db.

[65] FCA, *Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules* (June 2019), https://www.fca.org.uk/publication/policy/ps19-14.pdf.

[66] William W Buzbee, *A Theory of Regulatory Gaps,* 89 Iowa Law Review 1 (2003).

[67] Charles AE Goodhart and Rosa M Lastra, *Border Problems,* 13 Journal of International Economic Law 705 (2010) on regulatory boundaries being challenged due to the structural changes that innovation brings to markets.

[68] 'The quandary facing P2P lenders and borrower payment holidays' (25 March 2020), https://www.p2pfinancenews.co.uk/2020/03/25/the-quandary-facing-p2p-lenders-and-borrower-payment-holidays/.

[69] PRA, *Q&A on the usability of liquidity and capital buffers* (20 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda.

[70] FSA, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) http://www.fsa.gov.uk/pubs/other/turner_review.pdf, at 39-42; Howard Davies, *The Financial Crisis: Who is to Blame?* (London: Polity 2010).

[71] CARES Act, Sections 1102, 1105 for small businesses, sect. 3102 for sectors affected severely, with a total cap of $208bn for loan assistance.

UK businesses with turnover of less than £45 million can benefit from the Coronavirus Business Interruption Loan Scheme. Under this Scheme, accredited lenders may provide loans and overdraft facilities of up to £5 million, guaranteed at 80% by the government, to be repaid over up to six years.[72] Smaller UK businesses can borrow from the Bounce Back Loan Scheme that provides loans of up to £50000, guaranteed at 100% by the government to be repaid over up to six years with no payments in the first twelve months.[73] Lenders are expected to assess businesses' credit-worthiness, and eligible borrowers should be healthy ones suffering only short to medium-term revenue loss caused by the lockdown.

Regulatory suspensions to incentivize bank lending, besides the CCyb adjustment, include the use of all regulatory buffers, the liquidity ratio and a generous treatment of leverage ratio constraints. First, regulatory capital buffers such as the capital conservation, systemic risk, PRA buffer and buffers applying to systemically important banks are imposed on banks as risk-constraining measures in post-crisis reforms.[74] Banks may draw down any discretionary buffer[75] they have on top of regulatory ones, and after its exhaustion draw down their regulatory buffers.[76] The PRA and FPC have nevertheless maintained the notional levels of mandatory regulatory buffers (except CCyb), for institutional continuity in capital regulation.[77]

Second, banks are encouraged to allow businesses with credit lines and undrawn credit to draw upon such lines, even if this means banks' liquidity ratios may fall below the mandatory 100% they are supposed to maintain.[78] The liquidity coverage ratio is intended to be maintained at all times at 100% so that banks can meet their cash outflows for a period of 30 days to prevent a liquidity-driven crisis.[79] This unexpected elasticity however raises concerns about the balancing of short-term crisis management objectives against prudential objectives. However, it may be argued banks' risk of depleting their liquidity is mitigated by the Bank of England's new Coronavirus Corporate Financing Facility,[80] designed to help businesses tide over liquidity squeezes through their bank.

At the EU level, a new legislative initiative allows banks not to count certain loans as subject to the prudential measure of the leverage ratio. The leverage ratio limits all leverage created by

[72] Great Britain. Department for Business, Energy and Industrial Strategy, *Coronavirus Business Interruption Loan Scheme* (23 March 2020), https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme.
[73] Great Britain. Business, Energy and Industrial Strategy Dept, *Apply for a coronavirus Bounce Back Loan* (27 April 2020), https://www.gov.uk/guidance/apply-for-a-coronavirus-bounce-back-loan.
[74] Chiu and Wilson (2019), ch.8.
[75] PRA (2020), n69.
[76] Bank of England, *The Financial Policy Committee's Framework for the Systemic Risk Buffer* (May 2016), https://www.bankofengland.co.uk/-/media/boe/files/paper/2016/the-financial-policy-committees-framework-for-the-systemic-risk-buffer.pdf?la=en&hash=B354CE2068CD5B965DA07E15F6F10EFC80668B5F, amended 2018, https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps3218.pdf?la=en&hash=6A70962B5B3893C0F944A61FB3239B4DE71C26A6.
[77] PRA, *PRA decision on Systemic Risk Buffer rates* (9 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-decision-on-srb-rates.
[78] PRA (2020), n69.
[79] Basel Committee, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (2013), https://www.bis.org/publ/bcbs238.pdf, enacted in EU and UK legislation.
[80] BOE, *Covid Corporate Financing Facility (CCFF): information for those seeking to participate in the scheme* (17 March 2020), https://www.bankofengland.co.uk/news/2020/march/the-covid-corporate-financing-facility.

banks to be supported by at least 3% of CET1 capital.[81] This backstops bank lending and compliments other micro-prudential regulation. The new EU Regulation,[82] called the 'CRR Quick Fix' package, introduced temporary flexibility in calculating banks' lending to avoid unnecessary constraint by the leverage ratio.[83] Certain exposures such as guaranteed loans by national governments can be excluded from the ratio.[84] The PRA regards loans made under the Bounce Back Scheme as not counted in the leverage ratio.[85]

In order to precisely steer banks' behaviour towards increased support for the real economy instead of perverse incentives such as rewarding shareholders, the PRA and ECB have discouraged banks from paying dividends or engaging in share buy-backs, as well as paying any cash bonus to certain material categories of staff.[86] This is a different type of 'suspension' as it is a form of intervention that disrupts market participants' expectations, such as those of institutional shareholders. Regulators' power over dividend restrictions is warranted under existing regulation[87] to promote the resilience of banks and financial stability. This use of discretionary power, outside of the original rationale, may however raise long-term problems relating to banks' cost of capital and ability to attract and retain talented staff.

The relaxation of micro-prudential requirements to incentivize lending is complemented by the suspension of externally administered stress testing. The Bank of England (BoE) carries out annual cyclical and biennial exploratory stress tests so that supervisors can understand banks' capital-resilience and potential for continuity in stressful scenarios.[88] The BoE has postponed the 2020 stress test,[89] to reduce pressure on banks and focus them on the relief and rescue agenda.[90] Although the BoE has discretion to determine the timing of stress tests, the drawback of such suspension is that information opacity may be exacerbated at this current time of crisis.[91] Uncertainty over the timeframe for the next stress test makes it hard for banks to plan

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[81] Arts 429, 430, Capital Requirements Regulation 2013. CET1 capital relates to shareholders' equity, regarded as best quality loss absorbing capital.

[82] Regulation (EU) 2020/873, OJ L 204/2020, p. 4.

[83] EBA, *Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis. Final Report* (2 June 2020), https://eba.europa.eu/regulation-and-policy/supervisory-reporting/guidelines-covid-19-measures-reporting-and-disclosure.

[84] Recital 9, Regulation (EU) No 873/2020.

[85] BOE, *Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under the Bounce Back Loan scheme* (4 May 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-statement-on-crm-and-leverage-ratio-loans-under-bbls.

[86] PRA, *PRA statement on deposit takers' approach to dividend payments, share buybacks and cash bonuses in response to Covid-19* (31 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-statement-on-deposit-takers-approach-to-dividend-payments-share-buybacks-and-cash-bonuses; 'ECB extends recommendation not to pay dividends until January 2021' (28 July 2020), https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200728_1~42a74a0b86.en.html.

[87] Art 141, Capital Requirements Directive 2013.

[88] Donald Kohn, *Stress tests: a policymaker's perspective* (5 February 2020), https://www.bankofengland.co.uk/speech/2020/donald-kohn-speech-at-2020-ecb-conference-on-macroprudential-stress-testing.

[89] BOE, *Bank of England announces supervisory and prudential policy measures to address the challenges of Covid-19* (20 March 2020), https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19.

[90] "BoE cancels stress tests to ease pressure on lenders." *Financial Times*, March 20, 2020. https://www.ft.com/content/7433d55c-6a89-11ea-800d-da70cff6e4d3.

[91] Kathryn Judge, *Stress Tests During Times of War*, Columbia Law School Working Paper (2020), https://ssrn.com/abstract=3633310; Dean Buckner and Kevin Dowd, *Can UK Banks Pass the COVID-19 Stress Test?* (2020), 10, https://ssrn.com/abstract=3614865.

in advance[92] and delayed stress tests also mean delayed supervisory guidance on banks' micro-prudential positions.

Unintended Adverse Consequences for Bank Resilience, Regulatory Objectives and Social Justice

Regulators need to consider the longer-term adverse consequences of increased lending, such as the accumulation of nonperforming exposures on banks' balance sheets.[93] This consequence is neither beneficial for banks nor borrowers as banks' regulatory compliance may be jeopardised and their future capacities to support the real economy diminished. Further, balance sheet pressures can also entail enforcement against borrowers, leading to more social frictions between finance and society.

In the UK, and arguably in the US, banks' credit risks are likely exacerbated by fiscal support for government-backed loans. Fiscal guarantees may fuel moral hazard as the urgent demand for loans makes underwriting a pressed process exacerbated by information asymmetry.[94] Banks may minimize diligence standards as they do not have the incentive to price conservatively,[95] relying on the eventuality of fiscal bailout. Commentators already expect at least 40% of Bounce Back loans to default in due course.[96]

The level of loans made in the wake of the Covid-19 crisis that can be expected to be non-performing would likely rise,[97] entailing adverse consequences for bank resilience[98] even if

[92] Robert Weber, *A Theory for Deliberation-Oriented Stress Testing Regulation*, 98 Minnesota Law Review 2236, 2250 (2014).
[93] Henk Jan Reinders, Dirk Schoenmaker and Mathijs van Dijk, *Is COVID-19 a threat to financial stability in Europe?* (2020), 2-3, https://ssrn.com/abstract=3633932.
[94] "CBILS faulty: Sunak's flagship UK lending scheme looks unfit for purpose." *Euromoney*, April 24, 2020, https://www.euromoney.com/article/b1lbgfwrx72nn3/cbils-faulty-sunaks-flagship-uk-lending-scheme-looks-unfit-for-purpose.
[95] Patrizia Baudino, *Public Guarantees for Bank Lending in Response to the Covid-19 Pandemic*, BIS Financial Stability Institute Briefs, 2020, https://www.bis.org/fsi/fsibriefs5.pdf; Pierre Schammo, "Who Knows What Tomorrow Brings? Of Uncertainty in Times of a Pandemic." *Oxford Business Law Blog* (April 28, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/04/who-knows-what-tomorrow-brings-uncertainty-times-pandemic.
[96] "UK banks warn 40%-50% of 'bounce back' borrowers will default". *Financial Times*, May 31, 2020, https://www.ft.com/content/8a551c37-2de8-446b-a8b8-d4a61d33ef73.
[97] Ivan Huljak, Reiner Martin, Diego Moccero and Cosimo Pancaro, *Do Non-Performing Loans Matter for Bank Lending and the Business Cycle in Euro Area Countries?* (May 2020) ECB Working Paper Series No 2411, 2-3, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2411~839bc74726.en.pdf; IMF and World Bank, *COVID-19: The Regulatory and Supervisory Implications for the Banking Sector* (21 May 2020),7, https://www.imf.org/en/Publications/Miscellaneous-Publication-Other/Issues/2020/05/20/COVID-19-The-Regulatory-and-Supervisory-Implications-for-the-Banking-Sector-49452; 'Three US banks set aside record $28bn for loan losses' *Financial Times* (Jul 14, 2020), https://www.ft.com/content/f1bbaf65-7cb7-4855-ba7f-d9bda5f4b053; 'European banks braced for €800bn of loan losses if pandemic worsens' *Financial Times* (Jul 21, 2020), https://www.ft.com/content/1c4faf6c-975c-4566-8e0e-c9cbd613db42.
[98] Anil Ari, Sophia Chen and Lev Ratnovski, *COVID-19 and Non-Performing Loans: Lessons from Past Crises* (27 May 2020), 6-7, https://www.ecb.europa.eu/pub/economic-research/resbull/2020/html/ecb.rb200527~3fe177d27d.en.pdf; Elena Carletti, Stijn Claessens, Antonio Fatás and Xavier Vives, *Introduction*, in Elena Carletti, Stijn Claessens, Antonio Fatás and Xavier Vives (eds), *The Bank Business Model in the Post-Covid-19 World* (CEPR 2020) 19-20, https://cepr.org/content/bank-business-model-post-covid19-world.

banks' current capital positions are relatively strong. Regulators are already concerned[99] but refrain from impeding the policy goals of 'rescue and relief'. We urge contemporaneous engagement with these hazards instead of blithe assumptions that the regulatory framework would simply resume after the cessation of regulatory suspensions.[100] How far can the expected challenges to bank resilience be met by the fiscal backstop for government-guaranteed loans?[101] Further, would a fiscal backstop not create a vicious circle problem for banks, as banks are also funders for sovereigns?

Increased credit is also a snare for borrowers. The Bounce Back Scheme relieves businesses of payments for the first twelve months, but it is uncertain if this would be sufficient for a business to recover. The government guarantee can introduce perverse incentives for banks to accelerate treating recovering Bounce Back borrowers as in default so as to call upon the guarantee, exacerbating the pressure placed on the fiscal backstop. Huertas[102] argues that current loan support measures must be coupled with regulatory thinking about reasonable conduct in treating borrowers in due course.

It may be argued that the hazards of banks in supporting expanded credit are overstated as companies have the option of raising equity, a more stable form of finance, to tide over the crisis. Equity-raising also benefits from regulatory suspension discussed in Section IV. However, investors are risk averse during the Covid-19 crisis and can be highly selective or make equity financing costly, favouring companies that are already financially strong, punishing those that have signals of weakness but are not unviable.[103] Empirical research finds that companies are turning more to debt than equity issuances,[104] and companies' stock market prices are penalized by investors' perceptions such as whether they are affected by trade with China or have healthy leverage and cash levels.[105]

Legal elasticity in facilitating bank lending is an important policy in 'relief and rescue' aims. But such elasticity creates a number of unintended and adverse consequences that policymakers should consider on an *ex ante* basis rather than wait for problems to be manifest *ex post.*[106] Regulators should engage in a fully-theorized understanding of the structural nature of legal elasticity, as follows:

(a) Regulators should consider how they can engage and assist banks in the dynamic landscape of assessing asset quality and banks' resilience and the impact of these upon

[99] *Basel Committee meets; discusses impact of Covid-19; reiterates guidance on buffers* (17 June 2020), https://www.bis.org/press/p200617.htm, reiterating the importance of maintaining the existing regulatory regime.
[100] PRA, *Pillar 2A: Reconciling capital requirements and macroprudential buffers* (July 2020), https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2020/ps1520.pdf?la=en&hash=8FEBCB779D8FE8FB6328AB57AF79AA47B4914614 on a 12-month estimated suspension of the CCyb, while the ECB refers to suspension until end 2021, n86.
[101] 'Coronavirus: UK faces 'explosive' debt levels' *BBCNews,* (Jul 14, 2020), https://www.bbc.com/news/business-53402176.
[102] Huertas (2020).
[103] 'Investors demand companies justify Covid-19 equity raises' (April 2020), https://www.globalcapital.com/article/b1l2knxz0czqhq/investors-demand-companies-justify-covid-19-equity-raises.
[104] Michael Halling, Jin Yu and Josef Zechner, *Bond and Equity Issuance Activity During Covid-19* (May 2020), https://ssrn.com/abstract=3596114.
[105] Stefano Ramelli and Alexander F Wagner, *Feverish Stock Price Reactions to Covid-19* (June 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3550274.
[106] Nicholas Dorn, *Legal 'Elasticity' and 'Sidestepping' in European Crisis Management of Financial Markets*, 21 European Law Journal 802 (2015).

banks' conduct of customers.[107] The supervision of prudential and conduct of business aspects can benefit from integrated conversations between the FCA and PRA,[108] but regulatory coordination may be more challenging in jurisdictions with disparate regulators, such as the US.

(b) Regulators may need to consider safe harbours from capital or liquidity breaches by banks in due course as suspended regulatory requirements resume.

(c) Regulators also have to engage with how to strike a balance between economic welfare/justice and bank resilience, such as considering writing-off for non-performing loans that neither penalize banks nor borrowers in circumstances caused by the onset of the Covid-19 crisis. For example, the US offers loan forgiveness for small businesses for wages incurred by workforce earning under $33,333 in a year.[109] The UK's furlough scheme arguably goes further as government support for 80% of wages is structured as grants not loans. There are policy option mixes involving public and private sector support,[110] debt versus equity,[111] for regrouping corporations as economic engines, to achieve the balance between rescue of the real economy, bank resilience[112] and fiscal implications.

IV. REGULATORY ELASTICITY IN CAPITAL MARKETS REGULATION: CORPORATE FUND-RAISING

As freezes in economic activity during the Covid-19 lockdown threaten corporate revenues, business operational continuity and even survival,[113] regulators have addressed equity fund-raising by companies on an emergency basis. Equity provides a stable pool of capital for companies,[114] and can reinforce a company's financial resilience. Such fund-raising could be pre-emptive as businesses try to safeguard against the depletion of their cash reserves during the lockdown. The building up of companies' capital positions would strengthen their ability to retain employees and maintain investment. Debt on the other hand may be more accessible but can exacerbate financial fragility.[115] However, companies seeking to raise funds could also be in a precarious state, especially if they have high levels of debt and expenses.

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[107] 'EU banks should heed lessons of 2008 crisis', *Financial Times* (Jul 23, 2020), https://www.ft.com/companies/financials.

[108] Sect V.

[109] Sect 1105, CARES Act 2020.

[110] 'UK financiers' flawed call for grants not loans', *Financial Times* (July 23, 2020), https://www.ft.com/content/06281720-80dc-479a-97e5-ca319be74830.

[111] Alex Brazier, 'Protecting economic muscle: Finance and the Covid crisis' (Speech, Bank of England, July 23, 2020), https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/protecting-economic-muscle-finance-and-the-covid-crisis-speech-by-alex-brazier.pdf?la=en&hash=EC45632F7750897CB0C356D076DAB8597A442B90.

[112] Mathias Drehmann, Marc Farag, Nikola Tarashev, and Kostas Tsatsaronis, *Buffering Covid-19 Losses – The Role of Prudential Policy*, 2020, https://www.bis.org/publ/bisbull09.htm.

[113] Luca Enriques, *Pandemic-Resistant Corporate Law: How to Help Companies Cope with Existential Threats and Extreme Uncertainty During the Covid-19 Crisis*, (2020) European Company and Financial Law Review, forthcoming, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3641505.

[114] Discussed in Iris H-Y Chiu, *Can UK Small Businesses Obtain Growth Capital in the Public Equity Markets? – An Overview of the Shortcomings in UK and European Securities Regulation and Considerations for Reform*, 28 Delaware Journal of Corporate Law 933 (2004).

[115] "Corporate debt levels risk amplifying economic fragility, says IMF." *Financial Times*, April 10, 2019, https://www.ft.com/content/9be23506-5b64-11e9-9dde-7aedca0a081a.

The FCA issued a Policy Statement[116] to facilitate corporate fund-raising exceptionally, to last only for the duration of the pandemic. This Policy introduces regulatory suspensions and adjustments to three key aspects of fund-raising: the treatment of pre-emption rights, the general meeting procedures ordinarily needed for shareholder approval of significant transactions in the Listing Rules, and the mandatory disclosure document required for the fund-raising.

A. RELAXATION ON PRE-EMPTION RIGHTS

Shareholders in the UK have a right of first refusal to the company's new offer of shares in proportion to their existing holdings[117] unless pre-emption is exempt.[118] The right of pre-emption seeks to mitigate managerial agency problems as managers may offer new shares cheaply and easily to third parties if left to their own incentives. Shareholders would be adversely impacted in terms of value dilution and the reduction in voting power.[119] In the US, pre-emption rights are the exception and not the rule, particularly for publicly traded companies, as existing shareholders have a choice to purchase shares in the open market if they wish to maintain the level of their shareholdings. Market mechanisms in the US are seen as sufficient to provide shareholder protection needs. The UK, despite similarity with the US in terms of deep and liquid capital markets, has a different balance of flexibility-control in relation to safeguarding the rights of shareholders.[120] There is however the possibility that articles of association can provide for a waiver of pre-emption rights in advance, for a period of up to five years, so that directors can be pre-authorized to an agreed degree of flexibility.[121] The limit is usually set at 5% of the issued share capital for any given year and not more than 7.5% of the share capital over a 3-year period. This best practice is recommended by the Pre-emption Group (PEG) which comprises a range of institutional investors.

The PEG made an extraordinary recommendation to investors that pre-emption rights could be waived for issuances up to 20% of issued share capital during the pandemic. The extended suspension of pre-emption rights is not exactly a regulatory suspension, as it is recommended market practice by the PEG. Its status is more like soft law, with the FCA's endorsement not a form a legalization but a reinforcing signal of legitimacy and a nudge directed to investors.[122]

Although pre-emption rights are an aspect of mandatory 'shareholder protection' in UK company law, their exact implementation is subject to tailoring between companies and their shareholders in relation to pre-authorizations, disapplications and constitutional provisions. This is often regarded as the 'enabling' aspect of company law ideologically supported for its efficiency effects regarding the allocation of governance rights between voluntarily bargaining

[116] FCA, *Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis* (8 April 2020), https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus.
[117] S561, UK Companies Act 2006.
[118] S564-569, id.
[119] Eilis Ferran and Look Chan Ho, *Principles of Corporate Finance Law* (Oxford: OUP 2014), ch.5.
[120] Consistent with EU Second Company Law Directive; Jennifer G Hill, *The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering Combat* (2019) University of Illinois Law Review CHK.
[121] S570-571, UK Companies Act 2006.
[122] Oren Bar-Gill and Omri Ben-Shahar, *Rethinking nudge: an information-costs theory of default rules*, Harvard John M. Olin Discussion Paper (April 2020), https://ssrn.com/abstract=3582129.

parties.[123] In the US, the enabling effects of company law are realized in terms of the doctrine of pre-emption rights itself being up for voluntary adoption. One can argue that the UK's pre-emption rights regime is mandatory and not enabling law. However, there are different shades of enabling law, in terms of the extent of discretion given for private agreements between companies and their shareholders.[124] As the UK allows negotiated exclusion or disapplication of pre-emption rights between shareholders and companies,[125] pre-emption rights can be regarded as a default rule but embedding flexibility.[126] However, in a crisis situation, it is uncertain if shareholders are able to agree on coherent actions, and negotiation costs can be high in the face of uncertainty and different private preferences. In this manner, the role of soft law such as best practices recommended by the PEG provides a benchmark for convergence and efficiency in private decision-making (see Moore,[127] regarding the Corporate Governance Code, another soft law institution). The need for harmonized optimal terms in company law, despite shareholders' theoretical freedoms to bargain with companies, has been theorized by Easterbrook and Fischel.[128]

Although the PEG has shown flexibility in waiving pre-emption rights, it is arguable that suspensions do not go far enough. Commentators have raised the prospect of shortening offer periods as lessons from the emergency fund-raising exercise by banks in the 2007-09 global financial crisis point to disadvantages of a long offer period. Ferran[129] opines that long offer periods allow short-sellers to depress the issuer's share price, adversely impacting uptake of shares.

The FCA has nevertheless introduced unexpected regulatory suspensions complementing the soft law measure above. On the whole, although legal elasticity is deployed beyond what is inherently flexible, it can be argued that these measures build in significant market deference and are not overly interventionist. The bundling of inherent flexibility with unexpected suspensions may have led to a strong marketization character for the *other* regulatory suspensions, thinning out its public interest aspects. Part C in particular discusses this.

[123] Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 Columbia Law Review 1599 (1989); Henry N Butler and Larry E Ribstein, *Opting out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 Washington Law Review 1 (1990); Jonathan R Macey, *Corporate Law and Corporate Governance a Contractual Perspective*, 18 J Corp L 185 (1993); Anita Indira Anand, *An Analysis of Enabling vs. Mandatory Corporate Governance Structures Post-Sarbanes-Oxley*, 31 Del J Corp L 229 (2006).
[124] Eric W Orts, *The Complexity and Legitimacy of Corporate Law*, 50 Wash & Lee L Rev 1565 (1993); Jens Dammann, *The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law*, 65 Hastings Law Journal 441 (2014).
[125] S567-573, Companies Act 2006.
[126] see Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale Law Journal 87 (1989); Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 University of Chicago Law Review 1391 (1992).
[127] Marc T Moore, *Whispering Sweet Nothings": The Limitations of Informal Conformance in UK Corporate Governance*, 9 Journal of Corporate Law Studies 95 (2009).
[128] Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Mass: Harvard University Press, 1991).
[129] Eilis Ferran, *Limits of Private Sector Solutions for Banks: Recent UK Rights Issues* (2008), http://ssrn.com/abstract=1290717.

B. DISPENSATION OF GENERAL MEETINGS

Next, the FCA Policy[130] allows companies to financially re-organize themselves in a less cumbersome manner, by engaging in certain substantial transactions specified in the Listing Rules,[131] relating to significant disposals of assets. It may be imperative for companies to be able to finalize their deals quickly, and such efficacy can be affected by the need for companies to seek general meeting approval stipulated under Listing Rules. Companies can now apply for a dispensation for general meetings, which the FCA grants on a case by case basis. Issuers would have to provide evidence that shareholders would have voted in favour of such a resolution if a general meeting had taken place.

The procedural law of general meetings ensures that all shareholders receive the same information at the same time and are able to participate collectively in decision-making processes. In reality, such procedural fairness has been somewhat undermined as institutional shareholders have begun to be more engaged with their investee companies informally, as part of 'stewardship' (since the Stewardship Code of 2010, amended 2020,[132] and the advent of similar provisions in the European Shareholders' Rights Directive 2017).[133] Policymakers' approve of and encourage institutional investors' monitoring roles.[134] Moreover with the rise of American style hedge fund shareholder activism,[135] the level of voice observed in the institutional shareholder community has risen, both because institutions have worked with hedge funds in joint campaigns[136] and because the corporate sector has attracted negative attention since the global financial crisis and home-grown scandals.[137]

The discretionary dispensation of general meeting procedures for substantial transactions may not be regarded as prejudicial to shareholders. First, its 'bundling' with the relatively more enabling company law discussed above allows shareholders to see the regulatory suspension in more integrated and less unfavourable light. Second, companies are still compelled to engage with shareholders, much in the 'stewardship' ethos of informal engagement 'outside of general

[130] FCA, *Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis* (8 April 2020), https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus.
[131] FCA Handbook Listing Rules 10.5.1.
[132] The UK's Stewardship Code, https://www.frc.org.uk/investors/uk-stewardship-code. It is voluntary and administered by the Financial Reporting Council that oversees the quality of corporate reporting and professional roles of auditors; Iris H-Y Chiu, *Institutional shareholders as Stewards: Towards a New Conception of Corporate Governance?*, 6 Brooklyn Journal of Financial, Corporate and Commercial Law 387 (2012).
[133] Directive (EU) 2017/828, 17 May 2017.
[134] Iris H-Y Chiu, *Turning Institutional Investors into "Stewards"- Exploring the Meaning and Objectives in "Stewardship"*, 66 Current Legal Problems 443 (2013).
[135] John Armour and Brian Cheffins, *The Past, Present and Future of Shareholder Activism by Hedge Funds*, 37 Journal of Corporation Law 51 (2012).
[136] Dionysia Katelouzou, *Worldwide Hedge Fund Activism: Dimensions and Legal Determinants*, 17 University of Pennsylvania Journal of Business Law 789 (2015).
[137] Home-grown scandals include: fraudulent financial reporting, surrounding the collapse of Carillion plc, House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion* (16 May 2018), 51-56, https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf; the bankruptcy of Patisserie Valerie Plc; social irresponsibility scandals at Sports Direct, House of Commons Business, Innovation and Skills Committee, *Employment Practices at Sports Direct* (22 July 2016), https://publications.parliament.uk/pa/cm201617/cmselect/cmbis/219/219.pdf?utm_source=219&utm_medium=module&utm_campaign=modulereports; concerns regarding UK companies' exploitation of global supply chains culminating in Modern Slavery Act 2015.

meetings' to secure sufficient pre-approval. Finally, regulatory discretion in dispensation may be regarded as a gatekeeping device.

Nevertheless, to allow dispensation of general meetings conditioned upon companies securing sufficient written consent of shareholders would mean that companies are likely to engage in selective engagement, with perhaps 'friendly' but significant shareholders to reach the needed majority. In this manner, the underlying principle of fairness amongst treatment of shareholders in the collective decision-making of general meetings is compromised. Further, retail investors are likely to be marginalized.[138] Although stewardship practices already entail differences in the quality of company-investor relationships amongst different investors, allowing companies to selectively 'court' shareholders seems to go a step further and exacerbate the already uneven playing field. Further, even if companies accurately estimate the level of majority support this is not equivalent to a general meeting where the percentage of shareholders dissenting is recorded. The level of dissent is important for signalling the controversiality of company proposals.

The FCA should consider the incentives on the part of affected constituents as a result of regulatory suspension, and the trade-offs made amongst different interest groups affected by the suspensions, especially if trade-offs exacerbate a longer-running issue, such as the relative marginalization of the retail investor, in the stewardship landscape that emphasizes the role of institutional ones. Should shareholder engagement be regarded as part of the enabling character of company law, that facilitates shareholders to tailor-make their monitoring arrangements with companies and or as part of mandatory law that standardizes common expectations of protection and reflects collective values?[139] For the broader purposes of conceptualization in corporate law scholarship, bundling of regulatory suspensions in capital markets regulation with inherently flexible company law aspects raises more questions about the institutional relationship between the perceived 'more enabling' nature of corporate governance and the mandatory aspects. What boundaries are there, if any, between the ideological or jurisdictional separation[140] of corporate law from securities regulation?[141]

On the one hand, the bundling exercise may make porous the boundaries of enabling corporate law and mandatory securities regulation and allow regulators greater freedom to foray into the former.[142] One the other hand, the bundling exercise may also result in the shareholder-centric ideology underpinning enabling aspects of corporate law being extended to the whole package of legal elasticity, therefore thinning out notions of public interest.[143] The longer term impact

[138] "Bypass retail investors at your peril". *Financial Times*, April 24, 2020, https://www.ft.com/content/b9255dab-385d-4182-8c44-200948bfaae2.

[139] Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 Harvard Business Law Review 132 (2018).

[140] James J Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA Law Review 116 (2017).

[141] Robert B Ahdieh, *From 'Federalization' to 'Mixed Governance' in Corporate Law: A Defense of Sarbanes-Oxley*, 53 Buffalo Law Review 721 (2005); Allen Ferrell, *The Case for Mandatory Disclosure in Securities Regulation around the World*, 2 Brook J Corp Fin & Com L 81 (2007).

[142] Criticized in Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale Law Journal (2005), but see Ahdieh (2005).

[143] Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 Colum L Rev 1461 (1989); Jeffrey N Gordon, *The Mandatory Structure of Corporate Law*, 89 Columbia Law Review 1549 (1989); Robert B Thompson, *The Law's Limit on Contracts in a Corporation*, 15 J Corp L 377 (1990); William W Bratton, *Welfare, Dialectic, and Mediation in Corporate Law*, 2 Berkeley Bus LJ 59 (2005).

on the nature of shareholder relations and corporate governance should not be ignored even if there appears to be pressure for quick policy adjustments.[144]

C. RELAXATION OF WORKING CAPITAL DISCLOSURE

The cost of preparing disclosure documents for investors,[145] and how disclosure may affect investors' behavioural biases in times of great uncertainty may be twin obstacles for corporate fund-raising. In such times, investors may greatly discount a company's share price as they are susceptible to risk aversion. The FCA, with the PEG's support, urged companies to utilize the exemption from the EU Prospectus Regulation 2017 with regard to issuances of securities up to 20% of total traded securities so these would not need to be accompanied by a prospectus. Ferran,[146] drawing on lessons from the last emergency fund-raising by banks during the global financial crisis, recommended that suspension of mandatory disclosure in whole could be warranted if issuers are not new to the market and this would save issuers time and cost. However, mandatory disclosure is a cherished tenet in investor protection[147] and suspending this may be counter-productive if companies' cost of capital increases due to investor risk aversion.[148] Hence, the FCA has not chosen to be more radical but rather to adjust mandatory disclosure in a manner that arguably puts issuers in the most favourable light possible.

Companies' annual reporting obligations still stand although filing can be delayed.[149] Investors would likely rely on issuers' disclosure on whether they have working capital for the next 12 months as a going concern, such disclosure to be audited by the company's auditors. The FCA has exceptionally decided to tweak this requirement by allowing companies to provide an unqualified 'clean' working capital declaration as if the company had not been affected by the crisis, and to append disclosure about effects of the crisis in a separate document not requiring formal audit, but only a comfort letter from an auditor in support. This only applies if a company's adverse financial position has been caused by the pandemic and has not entailed from other weaknesses. The FCA requires the additional 'Coronavirus Working Capital Statement' to contain models and assumptions relating to the impact of the pandemic on the company. This tweak is arguably a form of framing that achieves a balance between investors' information rights and issuers' fund-raising interests.

The Coronavirus Working Capital Statement is arguably a form of framing of information that mitigates investors' behavioural biases in the face of negative disclosures. Kahnemann and Tversky's prospect theory[150] shows how the framing of information affects choice, and in

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[144] Luca Enriques, *Regulators' Response to the Current Crisis and the Upcoming Reregulation of Financial Markets: One Reluctant Regulator's View*, 30 University of Pennsylvania International Law Journal 1147 (2009).
[145] Elizabeth Howell, *An Analysis of the Prospectus Regime: The EU Reforms and the 'Brexit' Factor*, 15 European Company and Financial Law Review 69 (2018).
[146] Ferran (2008), n129.
[147] Rafael La Porta, Florencio Lopez-De-Silanes, and Andrei Shleifer, *What Works in Securities Laws*, 61 Journal of Finance 1 (2006).
[148] Brian J Bushee and Christian Leuz, *Economic Consequences of SEC Disclosure Regulation: Evidence From The OTC Bulletin Board*, 39 Journal of Accounting and Economics 233 (2005); John L. Campbell, Hsinchun Chen, Dan S. Dhaliwal, Hsin-min Lu and Logan B. Steele, *The Information Content of Mandatory Risk Factor Disclosures in Corporate Filings*, 19 Review of Accounting Studies 396 (2014).
[149] FCA, *Statement of Policy: Delaying annual company accounts during the coronavirus crisis* (26 March 2020), https://www.fca.org.uk/news/statements/delaying-annual-company-accounts-coronavirus.
[150] Daniel Kahnemann and Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 Econometrica 263 (1979).

particular, O'Clock and Devine[151] show how negatively-framed information by companies affects auditors' opinions (in the same way) and that the opposite produces a salutary effect upon auditor perception. The disaggregation of the 'clean' working capital declaration would help to avoid auditors' biases against negatively-framed information.[152] The confinement of coronavirus-related impact to its own separate statement frames such information as being more contingent, and highlights the exogenous nature of the impact. This may encourage such information to be assessed in more forgiving light and not to preponderantly 'infect' the positive framing within a 'clean' working capital declaration.

A crucial question is whether such framing disrupts the balance of institutional values in securities regulation, i.e. the promotion of rational (as far as possible, despite behavioural biases[153]) investor market discipline for issuers. The rational investor brings about efficient pricing in capital markets,[154] so ultimately, capital is allocated to the most efficient companies resulting in long-term wealth creation for all parties who participate and invest in the corporate economy. It may however be argued that such framing serves as a behavioural antidote to counter sub-optimal investors' behavioural biases, such as excessive risk aversion.

Nevertheless, a more important question is what the FCA seeks to achieve in the regulatory suspensions introduced. If the net effect to facilitate easier equity fund-raising by companies only entails rational, and arguably ruthless market evaluations of companies, selective and costly financing for these companies, the marketization effects of the regulatory suspensions could undermine a pro-social rhetoric in relation to saving companies or jobs. Should we allow the crisis to sift out the most robust companies, albeit bringing about a transitionary period of instability? Left to market forces, commentators[155] find that investors gravitate towards funding companies with less financial fragility during the Covid-19 crisis.[156] This may defeat the broader policy goals of saving companies and jobs, as capital markets can be excessively unforgiving towards companies with some weaknesses. There is a deeper question of whether market discipline should be the optimal channel for selecting corporate survivors as many jobs and near-term economic pain for households are at stake.

The FCA's intervention in framing reflects a hint of public interest in relation to preventing massive destabilization of the corporate economy and capital markets.[157] As the UK Listing Authority, the FCA has an interest in preserving the robustness of London's capital markets.[158] However, are pro-social goals relatively unarticulated and dominated by the private and marketized character of corporate law which the FCA has chosen to rely on? The regulator has refrained from more pronounced interventionist stances, such as stock market closures

[151] Priscilla O'Clock and Kevin Devine, *An Investigation of Framing and Firm Size on the Auditor's Going Concern Decision*, 25 Accounting and Business Research 197 (1995).
[152] Brian, Callaway Daugherty, Carol, Dickins, Denise Dee, and Higgs, Julia, *The Terminology of Going Concern Standards: How Subtle Differences in Wording Can Have a Big Impact*, The CPA Journal 35 (2016).
[153] Robert J Shiller, *Irrational Exuberance* (Princeton: Princeton University Press 2000).
[154] Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 Journal of Finance 383 (1970).
[155] Rüdiger Fahlenbrach, Kevin Rageth, and René M. Stultz, *How Valuable is Financial Flexibility When Revenue Stops? Evidence from the Covid-19 Crisis*, *NBER Working Paper*, 2020, https://www.nber.org/papers/w27106.
[156] "Post-coronavirus growth should be more robust but less optimal". *Financial Times*, April 27, 2020, https://www.ft.com/content/e3c4b133-9aaf-4a32-bc59-03fa5438585a.
[157] Martin Wolf, "Coronavirus crisis lays bare the risks of financial leverage, again." *Financial Times*, April 28, 2020, https://www.ft.com/content/098dcd60-8880-11ea-a01c-a28a3e3fbd33.
[158] Chris Brummer, *Corporate Law Preemption in an Age of Global Capital Markets*, 81 S Cal L Rev 1067 (2008).

proposed by Andhov[159] in order to prevent short-termist value destruction by shareholders or short-sellers. Schammo[160] queries if regulatory choices should be more explicitly 'precautionary' in the public interest.

Although we are sceptical that precautionary tools such as stock market closures are necessarily optimal in achieving a balance between pro-social goals in saving the real economy and investor protection in capital markets, the FCA should consider the substantive effects of regulatory suspensions, and whether more radical options are needed[161] such as:

(a) using public sector vehicles or public-private partnerships to support capital injection into companies alongside private sector fund-raising,[162] in a manner that does not breach state aid rules;[163]

(b) tying down investments made in support of companies during the Covid-19 crisis to duties, measures or restrictions in support of long-termism on the part of investors to help strengthen or rebuild companies, to avoid short-termist behaviour. A form of fiduciary duties imposed on hedge fund activists[164] or controlling shareholders;[165] may be warranted;

(c) requiring companies to make adequate disclosures and continuing transparency regarding the use of funds,[166] especially where investors may have an interest to ensure that companies pursue sustainable behaviour going forward;[167]

(d) instituting a form of prudential regulation[168] for the non-financial corporate sector in order to improve their long-term resilience.

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[159] Alexandra Andhov, "COVID-19 Market Protection: Close Down Stock Exchanges." *The FinReg Blog* (March 25, 2020), https://sites.duke.edu/thefinregblog/2020/03/25/covid-19-market-protection-close-down-stock-exchanges/. See opposite view Luca Enriques and Marco Pagano, 'Emergency Measures for Equity Trading: The Case Against Short-Selling Bans and Stock Exchange Shutdowns' in Christos Gortsos et al (eds). *Pandemic Crisis and Financial Stability* (European Banking Institute, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3607930.

[160] Schammo (2020).

[161] UK Department for Business Innovation and Skills, *The Kay Review of UK Equity Markets and Long-term Decision-making* (2012), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf.

[162] "Investor plans £15bn support for UK companies toiling with crisis loans". *Financial Times*, June 1, 2020, https://www.ft.com/content/e38f23da-4147-4bd3-b613-c7e6f1096cc6.

[163] Communication from the Commission Third amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak 2020/C 218/03, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2020.218.01.0003.01.ENG&toc=OJ:C:2020:218:TOC.

[164] Iman Anabtawi and Lynn A Stout, *Fiduciary Duties for Activist Shareholders*, 60 Stanford Law Review 1255 (2008).

[165] Ernest Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (Cambridge: Cambridge University Press 2019).

[166] For example, investors expressed concerns that corporate bond issuances are unclear as to purposes of proceeds, and this can apply to equity issuances too, "Rise in Covid-19 bond issuance fans fears over 'social washing'." *Financial Times*, June 30, 2020, https://www.ft.com/content/d35d1abc-0a4e-4e09-a776-154a469ef8de.

[167] Sustainable investing is set to surge in the wake of the coronavirus pandemic' (June 7, 2020), https://www.cnbc.com/2020/06/07/sustainable-investing-is-set-to-surge-in-the-wake-of-the-coronavirus-pandemic.html; 'Dutch businesses endorse sustainable Covid-19 recovery' (June 19, 2020), https://www.ing.com/Newsroom/News/Dutch-businesses-endorse-sustainable-Covid-19-recovery.htm.

[168] "Why the real economy needs a prudential authority too". *Financial Times*, April 1, 2020. https://ftalphaville.ft.com/2020/04/01/1585730516000/Why-the-real-economy-needs-a-prudential-authority-too/.

We have explored critically the regulatory objective dilemmas,[169] challenges, unintended consequences, and possible adverse effects entailing from regulatory suspensions in credit and capital markets regulations designed overall to achieve 'relief and rescue' of households and the corporate economy. Even if regulators do not intend to bring permanent adjustments about pro-actively or prematurely, they should engage with deeper and broader considerations in the deployment of legal elasticity, and impact on institutional dissonance. The deployment of legal elasticity can also be regarded as part and parcel of the need for regulators to engage in a broad notion of 'responsiveness',[170] so that dynamism can be brought to substantive policy solutions as well as regulatory processes.

V. DEPLOYING LEGAL ELASTICITY BY FINANCIAL REGULATORS - THE WAY FORWARD

We propose three aspects of a management process for legal elasticity, as empowering measures for regulators rather than to prescribe what substantive solutions may be preferred for combatting the Covid-19 crisis. Different substantive solutions may work to different extents in different jurisdictions, but where legal elasticity is deployed, regulators face similar challenges. The three aspects of regulatory management deal with:

(a) recognizing the potential for institutional dissonance and responsively managing these effects;
(b) actively engaging in multipartite frameworks for crisis management;
(c) pre-crisis preparedness on the part of regulators.

A. MANAGING INSTITUTIONAL DISSONANCE

The reluctance of financial regulators to manage institutional dissonance more explicitly may stem from fears of proactively bringing about institutional instability. However, the cosmetic approach of bundling regulatory suspensions that are inherently flexible with those apparently not does not of itself reinforce institutional stability. Fundamental questions regarding how institutional tenets and values 'encoded' in law or regulation have been rendered imbalanced arise, in relation to moral hazard,[171] or financial institution resilience.[172] Questions abound as to whether longer-term or permanent effects entail from institutional dissonance and pave the way for policy change in due course.[173] As Baldwin et al argue,[174] regulatory stability is not itself a tenet that should be necessarily maintained, but it is important to understand how it should be disturbed.[175]

Pistor's legal theory of finance provides the theoretical basis for conceiving of legal elasticity as structural in nature and inextricably connected with institutional disruption, even if that is a

[169] Armin J Kammel, *Government Versus Markets – A Change in Financial Regulation*, in Friedl Weiss and Armin J Kammel, The Changing Landscape of Global Financial Governance and the Role of Soft Law (Leiden: Brill 2015), ch.1.
[170] Section II.
[171] Kammel (2015), ch.1 and 2.
[172] Viral V Acharya and Matthew Richardson (eds), *Restoring Financial Stability: How to Repair a Failed System*. (New Jersey: New York University Stern School of Business, John Wiley & Sons 2009).
[173] Edward M Iacobucci, *Reflections on Financial Crises, Regulation and Sunsetting*, in Anita Anand (ed), Systemic Risk, Institutional Design, and the Regulation of Financial Markets (Oxford: OUP 2016), ch.5.
[174] Robert Baldwin et al, *Regulatory Stability and the Challenges of Re-Regulating* (2013) https://www.cerre.eu/publications/regulatory-stability-and-challenges-re-regulating.
[175] Id.

matter of degree. However, one may take a more limited reading of the theory. Pistor posits that there is a hierarchy of actors in the financial system, depending on their size and economic power from large systemic banks down to retail investors and borrowers. Legal elasticity is crucially supported by powerful structures, as was the case in the global financial crisis when these needed bail-outs. Elasticity tends to be more accentuated at the top of the system to the benefit of sovereigns and large banks, while those at the bottom are left to face the full rigour of the law. The Covid-19 pandemic is however exogenous to the financial system in the sense that financial firms are not responsible for its occurrence. Hence, powerful structures would unlikely support legal elasticity towards radical institutional change. Elasticity is posited as temporary for welfarist goals.

However, the objective effects observed are that elasticity does bring to fore questions regarding regulatory objective trade-offs, and normative questions regarding what finance's role is and should be. Is it *right* at the end of the Covid-19 crisis for banks simply to return to an 'enforcement' mode against borrowers? Is this issue only a matter of conduct of business?[176] Would consumer protection require more radical distributive treatment such as debt forgiveness? With prolonged economic uncertainty, these questions cannot be answered satisfactorily with simple resumption of regulatory regimes. Power structures alone may not sustain institutional stability, as bottom-up social demands can exert new pressures due to the longer-term effects of institutional dissonance. One of us has argued that social movements have contributed to a gradual institutional change in corporate regulation.[177] Lothian[178] and Arup[179] have also, in the wake of the global financial crisis, called for greater socialization of financial regulation objectives. Such a radical re-orientation is not yet seen in the UK, being dominated by an economic paradigm[180] in financial regulation. Post-crisis reforms have only edged closer to macro-level economic perspectives such as financial stability.[181] However, there is a consistent social cry for financial regulation reform such as in consumer welfare.[182] The undercurrents of dissatisfaction with the myopic paradigms of financial regulation may again be raised in the opportunities provided by institutional dissonance.

Financial regulators should deploy legal elasticity with an understanding of its structural nature in accordance with the fully theorized account of Pistor's theory. It should be recognized that some extent of institutional dissonance *will* result, and regulators should give consideration to monitoring the levels of and managing such dissonance. Keeping an open mind allows regulators more fully to appreciate the risks and opportunities in deploying legal elasticity and

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[176] Such as 'treating customers fairly' under the FCA's Principles for Conduct of Business, FCA Handbook, PRIN ch.2.

[177] Iris H-Y Chiu, *An Institutional Theory of Corporate Regulation*, 71 Current Legal Problems 279 (2018).

[178] Tamara Lothian, *Law and the Wealth of Nations: Finance, Prosperity, and Democracy* (Columbia University Press, 2017) on re-orienting the service of finance to the real productive economy instead of a free-market approach.

[179] Christopher Arup, *The Global Financial Crisis: Learning from Regulatory and Governance Studies*, 32 Law and Policy 363 (2010).

[180] FCA, *Economics for Effective Regulation* (2016), https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-13-economics-effective-regulation.

[181] Mads Andenas and Iris H-Y Chiu, *The Foundations and Future of Financial Regulation* (Oxford: Routledge 2014), ch.2.

[182] Such as the US Consumer Financial Protection Bureau. The UK FCA was compelled to consider reform to customer protection, see 'Duty of Care' inquiry, https://www.fca.org.uk/news/press-releases/financial-conduct-authority-publishes-feedback-statement-duty-of-care.

allows regulators to operate more fully in the intersection between financial regulation and wider public policy goals.

Proposal One: Financial regulators should expect institutional dissonance and focus on how to monitor and manage it in terms of public discourse and policy review. Regulators should factor such effects into their decision-making matrix.

We suggest that financial regulators can benefit from an approach of rational but holistic regulatory decision-making.[183] Such a rational approach can be even more justified in the midst of crisis management where behavioural biases, such as risk aversion and short-termism may dominate perception.

Regulatory decision-making can be grounded in cost-benefit analysis in its broadest terms.[184] This approach allows regulators to anticipate and assess the broadest possible effects of legal elasticity. This approach goes beyond looking to monetary values of benefits and drawbacks in the marketized sense, and seeks to encompass 'hard to value', controversial and subjective evaluations in a holistic way. The evaluative compass is anchored upon the human perspective, including the difficulties in putting a value on social values and preferences.[185] The broad pursuit of such cost-benefit analysis is challenging, as it requires regulators to have a broad scope of information before them[186] and to make dynamic and responsive judgments.

Commentators have criticized regulatory implementation of cost-benefit approaches in regular times as being flawed as they have become narrowly defined,[187] avoiding hard questions,[188] and highly proceduralized.[189] However, as Wiener[190] argues, cost-benefit analysis need not be practised in narrow, formalistic and meaningless terms.

We encourage regulators to consider broadly and holistically near and longer-term effects and implications when deploying legal elasticity. Opportunities for law reform should not be ruled out. Where regulatory suspensions have mobilized a suite of laws and regulations not inherently thought to be flexible, regulators can consider if more flexibility needs to be built into regulatory systems.[191] The evaluative approach also provides a more robust basis for regulatory accountability.[192]

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183 Cass R Sunstein, *Valuing Life: Humanizing the Regulatory State* (Chicago: University of Chicago Press 2014).
184 Cass R Sunstein and Robert W. Hahn, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis*, John M. Olin Law and Economics Working Paper, 2002, https://chicagounbound.uchicago.edu/law_and_economics/10/.
185 Cass R Sunstein, *The Limits of Quantification*, 102 California Law Review 1369 (2014).
186 Jonathan Wiener, *Better Regulation in Europe*, Duke Law School Working Paper, 2006, http://www.osservatorioair.it/wp-content/uploads/2009/08/wiener2006.pdf
187 Mark Harrison, *Assessing the Impact of Regulatory Impact Assessments*, 16 Agenda 41 (2009), http://ssrn.com/abstract=1906482.
188 Julie Froud and Anthony Ogus, *Rational Social Regulation and Compliance Cost Assessment*, 74 Public Administration 221 (1996).
189 Christopher Carrigan and Stuart Shapiro, *What's Wrong with the Back of the Envelope? A Call for Simple (And Timely) Benefit–Cost Analysis*, Regulation and Governance 1 (2016).
190 Wiener (2006).
191 Heikki Marjosola, *Regulating Financial Markets Under Uncertainty: The EU Approach*, 39 European Law Review 338 (2014).
192 Cass R Sunstein, *The Cost-Benefit State* (Coase-Sandor Institute Working Paper, 1996).

This leads us to the second proposal, intricately linked to Proposal One. Financial regulators have communicated at great length to their regulated entities to carry out regulatory suspensions and to adhere to the institutional framework, especially in micro-prudential regulation and corporate transparency in capital markets regulation. Such communications give the impression that, because financial regulators firmly believe in their assumption of institutional stability, the management of institutional dissonance is merely an implementational matter for the regulated entities. In this manner, institutional dissonance can become externalized or 'delegated' to their regulated entities. This leads to hazards in terms of unexpected behaviour on the part of regulated entities and social justice consequences. We argue that regulatory leadership is necessary for managing such 'delegated implementation'.

B. DELEGATED IMPLEMENTATION BY REGULATED ENTITIES IN MANAGING INSTITUTIONAL DISSONANCE

Balancing the policy of relief and rescue, and adherence with existing regulations[193] is challenging. How should banks exercise the discretion to be able to draw down capital and liquidity buffers, not being certain where the bottom-line is, or to make less loan loss provisions, not being certain how much to provision for? The exercise of discretion by banks can become a burden, not a freedom.

At a broader level, this is an archetypical problem of modern regulatory approaches such as meta-regulation[194] where regulators' broad principles and open-ended frameworks are by necessity realized through implementation by firms. Firms cannot be overly prescribed as regulators cannot micro-manage regulatory compliance. However, the breadth of discretion in implementation can lead to firms' cosmetic compliance[195] if firms are not committed to the underlying policy. Firms can also be left to a form of self-regulation if regulators fail to supervise meaningfully.[196] In the deployment of legal elasticity in credit and capital markets regulation, regulators have tended towards a *greater degree* of leaving to regulated entities and markets to implement legal elasticity. The more regulators assume that institutional stability is not affected by temporary legal elasticity, the more likely a 'delegated' approach will ensue, in the meta-regulatory outworking of legal elasticity. Regulated entities, in managing the uncertainties of institutional dissonance, can engage in undesirable behavioural responses.

One, regulated entities can become excessively risk averse, mindful of the possible boomerang effect of compliance once elasticity recedes. This can explain why the Coronavirus business interruption loan scheme discussed in Section III did not result in much lending. Second, delegated implementation by the regulated sector can give rise to perverse behaviour to exploit opportunities.[197] It was reported in the UK that private-equity owned companies that were already debt-laden sought to increase debt by turning to government-backed loans. This caused

[193] PRA, *Letter from Sam Woods, Covid-19: IFRS 9 and capital requirements – Further guidance on initial and further payment deferrals* (4 June 2020), https://www.bankofengland.co.uk/prudential-regulation/letter/2020/covid-19-ifrs-9-capital-requirements-further-guidance.

[194] Christine Parker, *The Open Corporation* (Cambridge: CUP 2002); Colin Scott, *Regulating Everything: From Mega- To Meta-Regulation*, 60 Administration 61 (2012).

[195] Kimberly Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 Washington University Law Quarterly 487 (2003).

[196] Cristie Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 American Business Law Journal 1 (2008).

[197] "Coronavirus: private equity's bailout moment." *Financial Times*, April 24, 2020. https://www.ft.com/content/f7cc82d7-70b9-40c3-b4a0-815ebc5d99d5.

public outcry as private equity backers are seen as exploitative and unwilling to capitalize companies in a manner that may help them become more resilient in the future.[198] These companies would also be competing with others for loan finance, and could unduly deprive other companies from accessing such finance. Third, delegated implementation can also entail behavioural sub-optimality on the part of regulators. Regulators place blame on the regulated sector[199] if social sentiment is unfavourable to their actions.[200]

Legal elasticity often results in reallocations of burden and benefit. The dangers of delegated implementation for distributive consequences are: (a) welfare outcomes may be attributed to regulated entities' actions, putting them in a difficult position in balancing their private decision-making, the needs for regulatory compliance and the part they play in the public policy of 'relief and rescue'; and (b) the roles of regulators and policymakers may become ambiguous even though welfare outcomes that result are essentially matters of public interest.

Distributive judgments implicate private capacities[201] as well as public institutional structures, in relation to the nature of the Lockean social contract in politics. The rise of the risk society[202] and welfare state in Western developed countries,[203] poses the question whether consumers should be favoured in terms of protection, relief and welfare, and under what circumstances should the operation of market forces be regarded as optimal.[204] Even in an institutional context, there can be redistributive consequences. The adjustments to mandatory disclosure for securities offerings in emergency fund-raising by corporations discussed in Section IV have redistributive consequences in terms of reducing cost for companies, but potentially increasing opacity cost for investors.

Financial regulators should engage continuously with the regulated sector carrying out the delegated implementation of legal elasticity. Further, supervisory steering is needed in light of behavioural developments that may be unexpected. Policy steering would be needed for broader implications of welfare outcomes that are mixed matters of private and public interest. Legal elasticity has to be managed *relationally*, with those tasked to implement it, as well as those likely to be affected by or interested in the outcomes of implementing legal elasticity.

Proposal Two: Consistent with a pro-active approach to monitoring and managing institutional dissonance entailing from legal elasticity, regulators should engage in

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[198] 'Should the world worry about America's corporate-debt mountain?' (14 March 2019), https://www.economist.com/briefing/2019/03/14/should-the-world-worry-about-americas-corporate-debt-mountain.

[199] Bridget M Hutter and Sally Lloyd-Bostock, *Risk Regulation and High-Profile Disasters Regulatory Crisis as a Distinct Phenomenon*, in Bridget M Hutter and Sally Lloyd-Bostock, Regulatory Crisis: Negotiating the Consequences of Risk, Disasters and Crises (Cambridge: CUP 2017), ch.1.

[200] Elke U Weber, *Understanding Public Risk Perception and Responses to Changes in Perceived Risk* and Thomas A. Birkland and Megan K. Warnement, *Focusing Events, Risk, and Regulation*, in Edward J. Balleisen, Lori S. Bennear, Kimberly D. Krawiec, and Jonathan B. Wiener (eds), Policy Shock (Cambridge: CUP 2017), chs.4 and 5.

[201] Bolton and Rosenthal (CHK); Sebastián Fleitas, Price Fishback, and Kenneth Snowden, *Forbearance by Contract: How Building and Loans Mitigated the Mortgage Crisis of the 1930s* (NBER Working Paper 2015), http://www.nber.org/papers/w21786.

[202] Ulrich Beck, *Risk Society: Towards a New Modernity* (London: Sage Publishing 1992).

[203] Richard Rose and Rei Shiratori (eds), *The Welfare State: East and West* (Oxford: Oxford University Press, 1987); Claus Offe, *Modernity and the State: East, West* (Cambridge MA: Polity Press 1996).

[204] Fleitas, Fishback and Snowden (2015).

relational frameworks, proactively with their regulated entities, also extending to other agencies and stakeholders.

The relational management aspects of legal elasticity include:

(a) The relationships amongst financial regulators, relevant agencies and policymakers;[205]
(b) The relationships between regulated entities and regulators;
(c) The relational dimension between regulators, policymakers, stakeholders or society more broadly, as crisis management benefits from multi-stakeholder participation and drawing together of resources,[206] social mobilisation and solidarity.

One of the lessons from the global financial crisis for financial regulators was the need to coordinate amongst each other. In the UK, crisis management must be coordinated between the Treasury, BoE and PRA in respect of financial stability and public interest needs.[207] As the reform was inspired by the last crisis relating to financial instability, the FCA was excluded due to a lack of perception of business conduct as being contributory to these objectives.[208] However, the global financial crisis was quickly followed by business conduct scandals in the banking industry.[209] In practice, the PRA and FCA closely coordinate policies and actions, such as in the management of the Covid-19 crisis.

Although the regulated-regulator relationship is fraught with lobbying, informal 'capture or sympathy'[210] or excessive trust (especially before the global financial crisis),[211] it remains imperative that regulators maintain informational and supervisory proximity to the regulated. Omarova[212] argued, in the wake of the global financial crisis, that a system of tripartite financial regulation should be introduced where 'bankers' and 'bureaucrats' would enrol 'guardians' who are stakeholders representing public interest to co-govern in financial regulation. Such a multipartite form of networked governance has always been envisaged in regulatory theory.[213] Perhaps there is fear that diverse demands from multiple stakeholders may confuse the policy agenda. However, excluding voice or dialogue at a time of crisis-management does not necessarily lead to more effective policy decisions. In Section IV, the FCA and the PEG legitimized the waiver of pre-emption rights for capital-raising by companies, showing the importance of catalysing influence on the part of non-public sector stakeholders. However,

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205 Charles Baubion, *Strategic Crisis Management* (OECD, 2013), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwigmoGZ8LzqAhUNbn0KHVShAWgQFjAKegQICBAB&url=https%3A%2F%2Fwww.mmc.com%2Fcontent%2Fdam%2Fmmc-web%2FFiles%2FStrategic-Crisis-Management-paper-July2013.pdf&usg=AOvVaw0pf8cG8D9qlRntNMBYRKzBEg.

206 Black (2001).

207 S64-5, Financial Services Act 2012.

208 Niamh Moloney, *The Legacy Effects of the Financial Crisis on Regulatory Design in the EU*, in Eilís Ferran, Jennifer Hill, Niamh Moloney, and John C. Coffee (eds), *The Regulatory Aftermath of the Global Financial Crisis*, 111–202 (Cambridge: Cambridge University Press 2012).

209 the LIBOR manipulation scandal and mis-selling scandals such as the UK London and Capital Finance unregulated product mis-selling scandal.

210 Edward Baxter, *Capture in Financial Regulation: Can We Channel It Toward the Common Good?*, 21 Cornell Journal of Law and Public Policy 3 (2011).

211 FSA, *The Turner Review* (2009), ch. 1.4, http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf.

212 Saule T. Omarova. *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 Journal of Corporation Law (2012).

213 Black (2001); Julia Black, *Mapping the Contours of Contemporary Financial Services Regulation*, 2 Journal of Corporate Law Studies 253 (2002).

there may be an issue regarding how stakeholders are selectively engaged by regulators for the purposes of crisis management. An example of a more open multistakeholder dialogue during the Covid-19 crisis is the UK Business, Energy and Industrial Strategy Committee's (BEIS) channel for feedback[214] from the business sector in relation to impact and needs. Such a channel is open to the public although the Committee may engage in further dialogue with selective respondents.

C. PREPARATION FOR CRISIS MANAGEMENT AND LEGAL ELASTICITY

Finally, if legal elasticity is to become a staple part of crisis management for financial regulators, regulators need to engage with it in an *ex ante* and sustained manner. Regulators should have a pre-crisis framework for thinking about the scope of and possibilities relating to legal elasticity.

Proposal Three: Financial regulators should have a pre-crisis framework for crisis management, including deploying legal elasticity, as this goes some way towards the ex post management of institutional dissonance.

Regulators should have a dedicated outfit for pre-crisis preparation, and wisdom may be borrowed from scenario planning literature in business management. Oliver and Parrett[215] argue that the more dynamic and unpredictable a business environment may be, the more a business needs to engage in scenario planning. Scenario planning allows business leaders to take stock of information and possibilities in a holistic manner, and consider the existing suite of tools in imagining responses.

In a similar vein, pre-crisis preparation on the part of regulators can incorporate useful elements from scenario planning. Regulators already have access to significant amounts of market and regulated information,[216] a development since the global financial crisis.[217] Such information should also be regularly shared amongst networked regulators and policymakers discussed in Proposal Two.[218]

Next, regulators should model deploying crisis management tools and legal elasticity. Maymin[219] argues that regulators need to be aware that the timing and duration of their interventions can promote regularization of dysfunctional markets but can also distort markets. Regulators should enhance their preparedness in considering scenarios where legal elasticity

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[214] Great Britain, Parliament, House of Commons, *The impact of coronavirus on businesses and workers. Inquiry*. London: Business, Energy and Industrial Strategy Committee 2020, https://committees.parliament.uk/work/178/the-impact-of-coronavirus-on-businesses-and-workers/.
[215] John J Oliver and Emma Parrett, *Managing Future Uncertainty: Reevaluating the Role of Scenario Planning*, 61 Business Horizons 339 (2018).
[216] Iris H-Y Chiu, *Transparency Regulation in Financial Markets- Moving into the Surveillance Age?*, 3 European Journal of Risk and Regulation 303 (2011).
[217] Stijn Claessens and Laura Kodres, *The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions*, in Edward J. Balleisen, Lori S. Bennear, Kimberly D. Krawiec, and Jonathan B. Wiener (eds), Policy Shock (Cambridge: CUP 2017), ch.16.
[218] Thomas H Stanton, *Why Some Firms Thrive While Others Fail: Governance and Management Lessons from the Crisis* (Oxford: OUP 2012), ch.3.
[219] Philip Maymin, *Regulation Simulation*, 2 European Journal of Finance and Banking Research (2009).

may be needed. Crawford[220] argues that although regulators cannot prepare for the exact types and extents of crises that occur, training intuitive judgment by a 'wargaming' approach is beneficial. This is similar to stress-testing that regulators carry out for systemically important banks and financial institutions.[221]

VI. CONCLUSION

The Covid-19 crisis has severely impacted economic activities globally, entailing wide-ranging policy responses. A crucial piece of the mosaic in the policy response comes from financial regulation, as financial regulators adjust regulatory rules in order to allow the financial sector to meet the policy goals of 'rescue and relief'. By studying the UK's policies and experience, we argue that regulatory suspensions introduced by financial regulators obscure hazards to regulators, regulated financial entities, households and corporations and may fall short of the welfarist goals desired. This is because such regulatory suspensions affect institutional stability to different extents. We situate the deployment of regulatory suspensions within the theoretical framework for legal elasticity developed in Pistor's legal theory of finance, and argue that the very legal nature of elasticity is structural in nature. Regulators need to confront the structural nature of legal elasticity to avoid greater hazards to legal certainty, institutional stability and ultimately policy outcomes.

We make a series of recommendations to improve financial regulators' decision-making processes. First, we propose that regulators should anticipate that institutional dissonance follows from deploying regulatory suspensions and should proactively seek to evaluate all relevant aspects pertaining to institutional stability and change. Second, regulators should engage constructively in relational paradigms with relevant public sector agencies, regulated entities, and broader stakeholders in order to monitor and supervise the outworking of legal elasticity. Third, regulators should put in place *ex ante* frameworks for preparing for crisis management and the potential use of legal elasticity.

[220] John Crawford, *Wargaming Financial Crises: The Problem of (In)Experience and Regulator Expertise*, 34 Review of Banking and Financial Law 115 (2014-15).

[221] Basel Committee, *Principles for Sound Stress-testing Practices and Supervision* (May 2009), http://www.bis.org/publ/bcbs155.pdf; Mario Quagliariello (ed), *Stress-testing the Banking System: Methodologies and Applications* (Cambridge: Cambridge University Press 2011).