The Pandemic Response in the UK in the context of corporate and financial law – within and without Law

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Abstract

This short paper focuses on the response to the pandemic in corporate law and capital markets regulation and the role that the law played in it.

First, the pandemic has brought the interests of stakeholders into more direct focus in corporate governance than was previously the case. But questions remain as to whether this represents only a temporary adjustment in response to the crisis or, alternatively, a more enduring trend. And if the latter, it prompts consideration of the appropriate techniques for stakeholder engagement and participation in corporate governance.

Second, the pandemic has disrupted the relationship between financial firms and their customers and the operation of capital markets. Conduct regulators have responded with a series of interventions. We examine whether those interventions are ad hoc or, alternatively, if they can be linked to key regulatory trends that emerged in the wake of the 2008 global financial crisis. This approach provides a basis for assessing the implications of the pandemic for the future trajectory of conduct regulation.

Conclusions are then drawn on the way forward and the likely role that the law will play.

1. Introduction

The Covid-19 pandemic has prompted a wide range of responses from governments, central banks and regulatory agencies around the world as well as driving adaptations to corporate governance practices to cope with the new situation. In this paper, derived from contributions to a webinar[1] hosted by the universities of Edinburgh and Glasgow on 12 June, we focus on the response in the UK. Specifically, we focus on stakeholder interests in board decision-making and regulatory interventions in the framework of conduct of business regulation applicable to licensed financial firms. We observe two distinct trends within the responses. The first, evident in board decision-making, has been adaptation of practice and focus within the scope of the law to elevate the significance of stakeholder interests. The context for that outcome is a legal regime for directors' duties which permits a spectrum of practice linked to a rule that consideration must be given to stakeholder interests. The second trend, evident in

[1] See https://www.gla.ac.uk/schools/law/research/groups/corporate-and-financial/news/headline_727032_en.html. This paper is based on two presentations: Iain MacNeil, 'Conduct of Business Regulation: Past, Present and Future'; and Irene-marie Esser, 'The Position of Stakeholders during a time of Crisis: The New Normal?'.

the case of conduct of business regulation for capital markets, has been a series of interventions that are not based on formal legal powers. The context for that outcome is a system of regulation in which principles and guidance facilitates intervention by the regulator without reference to formal rule-making powers. The outcome in both instances is that significant change has occurred without changes to legal rules, albeit there are some other examples of interventions where that has been the case.[2] We first discuss the two responses and then attempt to evaluate their longer-term significance.

2. Within Law – Stakeholder Interests in Board Decision Making

2.1 Context

Globally, and in the UK, there have been ongoing debates about the position of stakeholders and to what extent their interests should be considered during board decision-making. In the UK the duty of a director to promote the success of the company for the benefit of its members as a whole, but with reference to other factors embedding some form of stakeholder protection, is codified in section 172, Companies Act 2006. Even so, the UK corporate governance system is one characterised by shareholder primacy and the shareholders are the ultimate beneficiaries of directors' duties.[3] The consideration of non-shareholders' interests is of secondary importance and is subordinated to the interests of shareholders – confirming the supremacy of shareholders' interests. Stakeholders have some protection through disclosure and reporting requirements and the latest Corporate Governance Code (CGC)[4] makes provision for various stakeholder engagement mechanisms.[5] It is well-known that s 172 attracted, and still attracts, a lot of criticism mainly as it does not adequately provide for some form of stakeholder protection.[6] It is pertinent to note that consideration of other factors (as

[2] In particular, changes to insolvency law permitting a new form of debt moratorium and changes to corporate law to facilitate online meetings of shareholders – see the Corporate Insolvency and Governance Bill 2019-21 at https://services.parliament.uk/bills/2019-21/corporateinsolvencyandgovernance.html.

[3] David Cabrelli and Irene-marie Esser, Chapter 12 in Mathias M. Siems and David A. Cabrelli, *Comparative Company Law: A Case-Based Approach* (2nd edn, Oxford, Hart Publishing, 2018).

[4] See https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code.

[5] Based on Provision 5 of the 2018 UK Corporate Governance Code the board will be obliged to understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in s 172 have been considered in board discussions and decision-making

[6] See, for example, Elaine Lynch, 'Section 172: A Ground-breaking Reform of Director's Duties, or the Emperor's New Clothes?' 33(7) *Company Lawyer* 196, 202 (2012), Andrew Keay, 'Moving Towards Stakeholderism? Enlightened Shareholder Value, Constituency Statutes and More: Much Ado About Little?' 22 (1) *European Business Law Review* 1, 33-36 (2011). See also a short blogpost by Martin Petrin, 'Is Stakeholderism bad for stakeholders? Some Counterarguments' at https://clsbluesky.law.columbia.edu/2020/05/21/is-stakeholderism-bad-for-stakeholders/.

listed in s 172) is even more problematic, since the appropriate scheme for analysing these factors has neither been established nor considered in any detail by the courts.[7]

In the context of the role of stakeholders, the consideration of ESG issues and sustainability, typical questions and issues usually relate to whether or not directors should have a legal duty to consider the interests of stakeholders alongside those of shareholders. If so, how would they balance the various, competing interests, bearing in mind that stakeholders' interests are not always aligned? A related issue is whether reporting and disclosure requirements represent an effective strategy for engaging stakeholders in the decision-making process of boards of directors. Reporting and disclosure are usually seen as effective ways to provide stakeholders with information, but this is often after decisions have been taken.[8] Stakeholders can only really get involved in decision-making through some structured form of stakeholder participation or engagement. That could be in the form of hard law or soft law, the UK CGC being the primary example of soft law. We have previously argued that disclosure plays a crucial role, but on its own it is not enough to improve stakeholder participation. For stakeholders to be fully engaged they need adequate information, in the form of disclosure, but they also need mechanisms to facilitate participation from their side.

The role of stakeholders has been on the corporate governance agenda for a long time. During 2019 181 CEO's signed a new 'Statement on the Purpose of the Corporation' making five commitments to stakeholders.[9] Whether this adds anything new is debateable, but it does show, at least, reflection and engagement with the topic. It was also one of three issues considered during the latest UK corporate governance review (together with remuneration and the position of large, private companies).

[7] *Richmond Pharmacology Ltd v. Chester Overseas Ltd* [2014] EWHC 2692 (Ch) paras 66-68 (Stephen Jourdan QC); *Re Southern Countries Fresh Foods Ltd* [2008] EWHC 2810 (Ch) para. 53 (Mr Justice Warren). See also: *Deirdre Ahern, Directors' Duties, Dry Ink and the Accessibility Agenda* 128 (Jan) Law Quarterly Review 114, 132 (2012). Referring to *Re West Coast Capital (Lios) Ltd* [2008] CSOH 72, Lynch doubts whether s 172 CA will be discussed in courts: 'it seems that s.172 really is nothing more than a restatement of the previous law, and deserves the almost dismissive judicial treatment that it has received': Elaine Lynch, note 6 above.

[8] See Irene-marie Esser et al., 'Engaging Stakeholders in Corporate Decision-Making through Strategic Reporting: An Empirical Study of FTSE 100 Companies' 29(5) *European Business Law Review* 729 (2018). This article provides empirical evidence on compliance with the relevant statutory provisions. It sheds light on the manner in which companies consider environmental, social and governance (ESG) issues in decision-making and the extent to which disclosure represents an effective strategy for engaging stakeholders in that process. In Part 2 (*European Business Law Review*, 31(2), pp. 209-242.) they assess the impact of strategic reporting on stakeholders focusing in particular on the link between strategic reporting and engagement by stakeholders in board decision-making by conducting a series of interviews.

[9] https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans. See on this, L Enriques, 'The Business Roundtable CEOs' Statement: Same old, same old', 12 September 2019, OBLB.

So, when considering the role of stakeholders, the main issue is how can we ensure, through the law, that directors focus on long-term interests, act in a sustainable manner and not merely focus on short-term goals and profit maximisation.

The recent pandemic puts this into perspective and brings stakeholder interests into direct focus.[10] This crisis demonstrates which companies have truly embodied the 'stakeholder model' and which ones have only paid 'lip-service' to it. In recent months we have seen companies engaging in various activities and initiatives to try to deal with the devastating impact of the virus. Some have acted contrary to the 'normal' way, where a focus on profitmaking and the interests of shareholders is paramount, by focusing on the interests of other stakeholders and putting their needs above those of the shareholders. Many companies have also suspended share buybacks, scrapped dividends and executives agreed on pay reductions (for example, Rolls Royce, Marriott, Goldman Sachs, Delta, Kenya Airways, to name a few).[11]

2.2 A legal response?

The motivation behind these initiatives and actions is no doubt diverse, perhaps companies really do care, or, and this is more realistic, they realise that once the crisis submerges, they will be judged on how they dealt with it, i.e. it will have a lasting impact on their reputation. The question we need to ask, especially from a legal perspective, is whether this is 'the new normal', will most companies continue to act in this way, or will we see a move back to shareholder primacy and profit maximisation once the crisis settles down? This is important as it determines how we address the stakeholder issues, mentioned before, for future purposes.

There are potentially three responses to this question:

1. The current legal position on stakeholder protection is sufficient. When it was needed, in a crisis, directors did consider the interests of stakeholders. The crisis showed us that companies will step up if it is urgent and required. When

[10] See A Kamalnath, 'Shareholder Primacy in the time of Coronavirus', OBLB, 7 April 2020 as well as 'Corporate Social Responsibility in the times of Covid', 12 May 2020. See also Cheema-Fox et al, 'Corporate Resilience and the Response during COVID-19', April 2020, Harvard Business School Working Paper, No. 20-108; R Bains, 'Emerging corporate governance considerations for the post-COVID-19 world', 12 May 2020, OBLB and a blogpost by R Barker, 'The new stakeholder governance – how coronavirus is changing things for ever' at https://www.iod.com/news/good-governance-debate/article/the-corporate-governance-of-coronavirus---stakeholders-centre-stage.

[11] But see also 'Bumper CEO stock awards dwarf salary sacrifice', Financial Times 10 June 2020 at https://on.ft.com/37nH2f1.

it is *really* needed directors will focus on the long-term, on sustainability. The counter argument for this is that the actions of companies are not purely 'their own', they are backed by Government actions. For example, the UK Government's Self-Employment Income Support Scheme and Coronavirus Job Retention Scheme as well as various loan schemes for business.

2. The law has its place, but it is really 'collective social action'[12] that is the driver that brought stakeholder interests into clear focus. Companies responded to that pressure, as the cost for not doing this will be too high, especially from a reputational perspective. In the end social and market forces, and 'collective social action' played a key role. This is a valid argument, but one that will only work in the context of a crisis, where urgent measures are needed. The evidence shows us that companies who followed some kind of stakeholder model before the crisis were better equipped to deal with the crisis, e.g., Unilever as well as the shipping company Maersk are often mentioned as a good examples in this case.[13] Companies who already have a business model in place where they consider stakeholders, where they look after their employees and consumers, for example, are in a better position to continue to do that, compared to those who do not have this in place pre-crisis.
3. Stakeholder interests were brought to the fore during this time of a pandemic, but it is hard to imagine that it will stay this way. Companies did not change overnight and they will potentially go back to focus on shareholder maximisation and shorter term issues. It can even be argued that it will be more so, after the crisis than pre-crisis. It will be much harder to focus on the long-term and be sustainable after a devastating period, financially and with potentially much less support from Governments.

Point 3 is the most convincing response and the best approach to follow. We need to be ready…. someone recently said 'there will be a vaccine for COVID-19, but there is not one for climate change.[14] It is of utmost importance that we continue to look at the protection available to stakeholders. We should sufficiently regulate these issues nationally to be able to respond globally. We return to this issue in more detail in section 4 below.

3. Without Law – Conduct Regulation in Financial Markets

[12] See also here S Gomtsian, 'When businesses can do good: Lessons from the Coronavirus crisis for promoting responsible business practices', 6 May 2020, OBLB.

[13] See https://www.weforum.org/agenda/2020/03/covid-19-is-a-litmus-test-for-stakeholder-capitalism/

[14] See https://impactalpha.com/corporate-sustainability-and-covid-19-three-signs-of-hope-for-a-brighter-future/.

3.1 Context

The definition of conduct regulation given by the International Organisation of Securities Commissioners (IOSCO) provides a useful starting point to delineate the scope of conduct regulation:

'Those principles of conduct which should govern the activities of financial services firms in protecting the interests of their customers and the integrity of the market'.[15]

Conduct regulation differs from prudential regulation in that the focus is on relationships with individual customers.[16] The market integrity objective is focused on ensuring confidence in the operation of markets, encompassing in particular freedom from market manipulation and insider trading. In some systems, such as the so-called 'twin peaks' system in the UK, conduct regulation is undertaken by a separate regulator, whereas in others a single or multiple regulator may be involved. And the regulatory remit may extend beyond the IOSCO definition by including additional objectives, such as the promotion of competition in the UK system.[17]

3.2 EU dimensions

The EU framework for conduct regulation has been the key driver of the evolution of conduct regulation in the UK in recent times and that influence will persist even after Brexit, as EU law will be preserved when the transitional period linked to the UK's withdrawal ends on the 31st December 2020.[18] Thus, the UK regime can only be understood by reference to some key aspects of the EU framework.

Harmonization

The framework for conduct regulation in the EU has been the subject of considerable harmonization over time, with the result that there is a substantial body of common rules operating across the EU. In some instances (e.g. insurance) the process has been in the form of minimum harmonization (leaving member states the option of imposing higher standards through 'gold-plating'), whereas in others (e.g. the MiFID regime for investment services[19]) the process has been one of maximum harmonization, leaving member states with little or no scope to adjust or expand the EU rules.

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[15] See IOSCO, International Conduct of Business Principles (1990) at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD8.pdf.
[16] For a general overview see Andrew F. Tuch, Conduct of Business Regulation, Chapter 18 in N. Moloney, E. Ferran and J. Payne (eds) *The Oxford Handbook of Financial Regulation* (OUP 2015).
[17] For the statutory objectives of the UK conduct regulator, the Financial Conduct Authority (FCA), see The Financial Services and Markets Act 2000 (c. 8) s1B-s1E.
[18] See further House of Lords, EU Financial Affairs Sub-Committee, Corrected Oral Evidence: Financial Services After Brexit, Witnesses Prof Niamh Moloney, London School of Economics, Prof David Miles, Imperial College London, available at https://committees.parliament.uk/oralevidence/64/pdf/.
[19] See for a general overview https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir.

Sectoral regimes

There is no single regime for conduct regulation across financial services in the EU. Instead there are a number of regimes which cover sectors, and in some cases just a single financial product (e.g. mortgages or payments). And while there are similarities between these regimes, there are also important differences, with the result that financial products with similar functions can be subject to different conduct regimes.[20]

ESAs and 'single rule book'

The establishment of three sectoral European Supervisory Authorities (ESAs) in 2011 was intended to facilitate a more consistent approach to supervision of financial firms through the creation of a so-called 'single rule book', combining the different levels of regulatory rules with guidance from the ESAs.[21] But, in contrast with the banking sector, there was no significant shift of supervision from national authorities to the ESAs in the case of investment and insurance.

Enforcement and NCAs

Moreover, even with the introduction of the ESAs, enforcement of conduct regulation remained the responsibility of the national competent authorities (NCAs) of the member states in which business in conducted.[22] Thus, in contrast with prudential supervision, where financial firms would typically be supervised by a single regulator, there may be many different NCAs involved in conduct regulation.

3.3 Emerging Trends in Conduct Regulation

In order to understand the context of the regulatory response to the pandemic and to evaluate its potential influence for the future, it is useful to identify some of the key trends that have been evident in conduct regulation since the global financial crisis (GFC) of 2008.

Principles vs rules

[20] See further V. Colaert, D. Busch and T. Incalza, *European Financial Regulation, Levelling the Cross-Sectoral Playing Field* (Hart Publishing 2019).
[21] See further Iain MacNeil, 'All Change in Europe', Editorial, 5(2) *Law and Financial Markets Review* (March 2011).
[22] See further Iain MacNeil, Enforcement and Sanctioning, chapter 10 (part 4) in N. Moloney et al (eds) (n16).

The issue of principles vs rules is something of an old chestnut in regulatory discourse.[23] But is has retained its relevance in the post-GFC world, in particular in the UK. The more assertive enforcement stance adopted by the FCA following the GFC relied substantially on the capacity of principles to be enforced independently, without reliance on underlying rules.[24] That enabled principles to be used to mitigate the inherently more limited scope of detailed rules and to trump the sort of 'box-ticking' compliance often associated with such rules.

Culture and Ethics

One of the key developments in the wake of the GFC was a realization that more regulatory rules would not necessarily provide a good solution, especially as the sharp rise in misconduct claims and penalties indicated that the existing rules were not very effective. And while the rate of production of conduct regulation has not declined since the GFC (more likely the opposite), it is noticeable that regulators (both prudential and conduct) have focused on the importance of culture and ethics as drivers of good conduct.[25] That change in approach can be interpreted in different ways, but it is at least credible to suggest that it may be linked with a recognition that there are limits to what can be achieved through regulatory rules, with the result that some experimentation with alternative techniques is required. Linked to that is the possibility that the focus on culture and ethics may represent a simplification strategy for a system that has become overly complex, by providing a proxy for organizational values and practices that lead to good outcomes.

Expanding disclosure

Disclosure is widely regarded as a *sine qua non* for informed decision-making by investors, thereby supporting the price formation and capital allocation functions of markets and providing effective protection for consumers. But the process of setting appropriate disclosure standards remains largely trial and error, especially in the case of retail investors where the national contexts and market practices may vary considerably. Post-GFC, it seems that there has been expansion in disclosure obligations, especially in the context of investment services provided to retail clients, but also in the context of stock exchanges, where non-financial

[23] Principles-based regulation had risen in prominence and prestige before the GFC, largely as a result of its adoption in the UK. See further Julia Black, Martyn Hopper and Christa Bland, 'Making a Success of Principles Based Regulation', 1(3) *Law and Financial Markets Review* 191-206 (May 2007).

[24] This approach has been endorsed by the courts – see *R (ex parte British Bankers Association) v FSA* [2011] EWHC 999 (Admin) at para 161 (Ousely J). That decision underpinned the FSA's requirement for firms to compensate customers for the mis-selling of payment protection insurance (PPI).

[25] See e.g. FCA DP 20/1, Transforming culture in financial services – driving purposeful cultures (5th March 2020), available at https://www.fca.org.uk/publications/discussion-papers/dp20-1-transforming-culture-financial-services-driving-purposeful-cultures.

information linked to environmental, social and governance issues has come to the fore.[26] What is less clear, especially in the retail sector, is whether expanding disclosure has or can deliver better decision-making and outcomes.

3.4 The Pandemic Response – Interventions

There have been a wide range of interventions at the EU and UK level in response to the pandemic. We focus on the most significant, encompassing both the professional and retail markets.

Mortgages

The FCA issued guidance in March instructing mortgage lenders to provide a 3-month payment holiday where a customer is experiencing or reasonably expects to experience payment difficulties as a result of circumstances relating to coronavirus.[27] The guidance was updated in May[28], providing that where a customer indicates they cannot immediately resume full payments, firms should offer them a further full or partial payment deferral for 3 monthly payments, based on what the customer considers they can currently afford to repay.

The European Banking Authority also issued a statement[29], in less explicit terms than the FCA, calling on lenders to act in the interests of consumers, and regulators in various EU countries have followed up with more specific measures.

Pre-emption rights

Pre-emption rights ensure that equity shareholders are protected against dilution of their proportionate shareholding when new share issues take place. The principle is a key element of UK and EU corporate law, albeit that other capital markets (such as the US) seem to operate quite well without it. The FCA Policy Statement follows that of the Pre-Emption Group, which

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[26] See generally Esser et al (n8).

[27] See FCA, Mortgages and coronavirus: our guidance for firms (20th March 2020), available at https://www.fca.org.uk/firms/mortgages-coronavirus-guidance-firms.

[28] See FCA, Mortgages and coronavirus: updated guidance for firms (22nd May 2020), available at https://www.fca.org.uk/publications/guidance-consultations/mortgages-coronavirus-updated-draft-guidance-firms.

[29] See EBA, Statement on consumer and payment issues in light of COVID 19 (25th March 2020), available at https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framework-light-covid-19-measures.

recommends that shareholders support share issues without pre-emption rights up to 20% of share capital (compared with the standard authorisation of only 5%).[30]

Disclosure

The FCA relaxation[31] in the UK relates to the requirement to publish a statement of working capital in connection with capital raising via a prospectus. It allows issuers to disclose in an unqualified working capital statement their key assumptions in relation to business disruption during the coronavirus crisis underpinning the 'reasonable worst-case scenario' that must be modelled in support of the working capital statement. The revised approach permits such assumptions to be disclosed without requiring the inclusion of a qualified working capital statement.

Financial Reports and General Meetings of Shareholders

The FCA has temporarily relaxed the normal rules on publication of annual and interim reports and the holding of general meetings of shareholders, both of which are fundamental aspects of the accountability regime for boards of directors.[32]

In the case of annual reports, listed companies are permitted 6 months (instead of 4) from their financial year end to publish the report. For interim reports the permitted deferral is one month. A similar approach has been adopted by ESMA at the EU level.

Shareholder approval is required under the UK Listing Rules for Class 1 transactions (major transactions) and related party transactions. Normally, a shareholders meeting is required to give approval, but that requirement can now be the subject of an individual dispensation from the FCA if the issuer can show that they would have the support of the relevant proportion of shareholders. This is in addition to the proposed relaxation of company law permitting online rather than in-person general meetings.[33]

3.5 Rationale and legal basis

While the rationale for all these interventions can be linked to the need to respond to the crisis, the legal basis for FCA action provides an illuminating perspective. None of the actions

[30] See FCA, Listed companies and recapitalisation issues during the coronavirus crisis (8th April 2020), available at https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus.
[31] Ibid.
[32] Ibid.
[33] See the Corporate Insolvency and Governance Bill 2019-21 at https://services.parliament.uk/bills/2019-21/corporateinsolvencyandgovernance.html.

represent a formal exercise of rule-making powers. The mortgage intervention takes the form of guidance, which cannot impose obligations, but may be relevant for the regulator deciding to take enforcement action and for the interpretation of principles if such action is taken. Moreover, and contrary to normal practice, the guidance has the effect of disrupting private law obligations. The pre-emption statement is really just endorsement of the recommendation of an influential shareholder body. In the case of annual reports and general meetings, the intervention is in the form of a Statement of Practice, which in effect provides a safe-harbour to firms from enforcement action.

In contrast with prudential regulation (where the counter cyclical buffer is designed to be adjustable by the Financial Policy Committee), conduct regulation lacks explicit provision for general adjustment of rules by reference to changes in market context (waivers of rules are possible only for firms on application). Thus, interventions are *ad hoc*, and are framed without the benefit of an *ex ante* framework for crisis management. While some commentators see that as problematic in terms both of the nature of interventions and the process for agreeing action between multiple regulators,[34] others point to the need to subordinate considerations of formal legal process and accountability in crisis situations.[35]

4 Evaluation

We conclude by evaluating what these different outcomes tell us about the future trajectory of development and the role of law.

4.1 Stakeholder Interests

The adaptation in corporate governance practice evident during the pandemic to elevate stakeholder interests suggest that instead of trying to reform the law we should focus on options already in place. These include section 172, which enables directors to perform a balancing act between long-term interests and short-term considerations, detailed non-financial reporting requirements and, finally, mechanisms to ensure stakeholder participation and engagement. It is perhaps the last where we can do more and ensure that stakeholders are not merely informed, but engaged in the decision-making process, on board level. In

[34] See Chiu, Iris H-Y and Kokkinis, Andreas and Miglionico, Andrea, 'Regulatory Suspensions in Times of Crisis: The Challenges of Covid-19 and Thoughts for the Future' (May 19, 2020) *European Corporate Governance Institute* - Law Working Paper No. 517/2020. Available at SSRN: https://ssrn.com/abstract=3605423 or http://dx.doi.org/10.2139/ssrn.3605423.

[35] See Wolf-Georg Ringe, Covid-19, No Time for Lawyers, OBLB Blogpost 22nd May 2020, available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/05/covid-19-no-time-lawyers.

previous research[36] we have suggested combining an advisory stakeholder panel (including representation of the workforce, as recommended in the CGC) and a designated non-executive director (NED) representing all stakeholders.[37] The stakeholder panel could meet outside the board and report to the board through a designated NED. The biggest challenge with regard to the suggested stakeholder panel concerns setting out an effective mechanism to determine the composition of the panel and the representation of the interests of all stakeholders. The South African social and ethics committee (SEC) can be used as an example in this context. It creates a statutory solution and could be applied with adjustments to the UK. In brief, based on s 72 of the South African Companies Act 2008 (read with Companies Regulation 43) every state owned company, every listed public company and any other company that has, in any two of the previous five years, had a public interest score of at least 500 points (the number of employees and the turnover are some of the factors that will determine if a company is obliged to have such a committee) must appoint an SEC. The aim of this Committee is to draw certain matters to the attention of the board and to then report to the shareholders. These matters include social and economic development, good corporate citizenship, the environment, health and public safety, consumer relationships, labour and employment. This committee is dealt with in legislation in South Africa, but a similar committee could be provided for in the UK Companies Act as part of the current section 414. It would make sense if this committee is mandatory. The same sample of companies that have to produce a strategic report should also have such a committee in place. The UK is characterised by a flexible system that operates on a “comply or explain” basis but we are of the view that this would not be sufficient in this context. We argued before that there is no mechanism for market discipline available to stakeholders analogous to the selling option available to shareholders. A mandatory committee, considering ESG issues, will provide a level-playing field for stakeholder engagement.

A recent study[38] on this committee, in South Africa, revealed that most companies that took part in the study admit that their social and ethics committees are in the early stages of

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[36] Esser, I.-M. and MacNeil I, ‘Disclosure and engagement: stakeholder participation mechanisms’. *European Business Law Review,* 30(2), pp. 201-221.

[37] Libson underlines the role of a designated board sub-committee in pursuing ESG goals. He states that a corporation’s decisions that have a significant impact on social matters, such as environmental implications, should be delegated to shareholders to approve. Importantly, one of the options for achieving this goal is the top-down form that establishes an independent sub-committee on the board that identifies significant social issues and delegates decisions on such issues to shareholders. Adi Libson, Taking shareholders’ social preferences seriously: Confronting a new agency problem Bar Ilan University Faculty of Law Research paper no 18-18 (2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3226767.

[38] See the EY survey on the impact of the social and ethics committee, 3 years after its incorporation in its Trialogue Annual Sustainability Review available at https://www.ey.com/Publication/vwLUAssets/EY-the-status-of-social-and-ethics-committees-a-

development and they expect their mandates to be refined; to develop a deeper understanding of the issues and their strategic importance and to have the composition adjusted, with a greater focus on independence. Respondents also expressed interest in strengthening their management systems with improved performance dashboards and data quality. These are factors to keep in mind when considering a similar structure. However, the committee is uniquely placed, with direct access to the main board and a mandate to reach into the depths of the business. As a result, it is capable of having a strong influence on the way a company heads down the path of sustained value creation.[39]

4.2 Conduct of business regulation

What do the pandemic interventions tell us about the future of conduct regulation? In order to make that assessment, let's return to the three emerging trends in conduct regulation identified earlier.

Principles vs rules

Tolerance for *ad hoc* interventions, based on high level principles, may indicate better acceptance of principles by regulated firms, investors and consumers. The complexity of the conduct regulation system has been driven in part by firms calling for more legal certainty and a perception that more granular rules deliver better consumer protection. A less complex system would be a step forward.[40]

Culture and Ethics

Interventions have not relied on the formal legal process associated with regulatory rule-making (which would trigger consultation and cost-benefit analysis). This may be linked with the idea that legal techniques have reached their limit in terms of driving higher standards of conduct. There is some evidence that ethical standards have been mobilised by the crisis, moving from the poor relation of hard regulatory rules to play a more instrumental role in

trialogue-ey-survey/$FILE/EY-the-status-of-social-and-ethics-committees-a-trialogue-ey-survey.pdf. The study looked at 12 listed companies, employing around 14 000 employees. Challenges include clarifying the committee mandate, securing top-level buy-in, ensuring strategic alignment and navigating a challenging and diverse set of issues. Successes include raising the profile of sustainability issues and ensuring decision makers appreciate their strategic value and identifying critical non-financial issues and formalising a response.

[39] See IM Esser, Chapter 4: 'Regulating ESG Issues: A comparison of South Africa and the United Kingdom' in Hermie Coetzee and Carika Fritz (eds), De Serie Legenda, Developments in Commercial Law, Entrepreneurial Law (Volume III), LexisNexis, Durban (2019).

[40] See further I MacNeil, 'Rethinking Conduct Regulation', 30 (7) *Butterworths Journal of International Banking and Financial Law* (2015) 413-420.

conduct regulation.[41] That may well encourage regulators to continue with their initiative to position culture and ethics more centrally in the framework of conduct regulation.

Expanding disclosure

While regulators have been keen to stress that disclosure obligations generally remain in place during the crisis, the interventions serve as a reminder that disclosure and transparency are not unqualified public goods. There are trade-offs to be considered in terms of the costs and benefits of disclosure, including behavioural limitations on informed decision-making. Moreover, if it is true that ethical standards are now more prominent, there is a case for reconsidering the protective role of disclosure for consumers as part of the consultation on MiFID II that is currently underway in the EU.[42]

From a broader perspective, setting an appropriate framework for conduct regulation will be a key factor for re-invigorating the stalled Capital Markets Union project in Europe[43], particularly after the departure of the UK, where market-based finance has been more prominent. This is relevant both for issuers and investors and encompasses the design and distribution of potential new financial instruments that could respond to the pandemic.[44]

5 Conclusions

We note that formal legal change has not featured prominently in the UK response to the pandemic albeit that some interventions (such as mortgage holidays) have de facto adjusted pre-existing legal rights and duties. The reasons for this outcome differ between the two scenarios that we investigated. In the case of stakeholders' interests, the flexible nature of the legal standard represented by directors' duties facilitated an elevation in the significance of stakeholders' interests in response to social pressure. Nevertheless, we conclude that without

[41] This is implicit in the reliance of the FCA pandemic response in the UK on high-level principles which are linked much more closely to ethical principles than detailed rules. See further MacNeil (n40) at 417.
[42] See EU Commission, Review of the regulatory framework for investment firms and market operators, (February 2020), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12167-Review-of-the-regulatory-framework-for-investment-firms-and-market-operators-MiFID-2-1-/public-consultation.
[43] See e.g. Ecofin Discussion Paper, Capital markets union – reboot: a policy discussion on the future of the capital markets union, (September 2019) available at https://eu2019.fi/documents/11707387/15400298/CMU+Reboot+Informal+ECOFIN+final+Issues+Note+2019-09-09_S4.pdf/05142af6-25f0-74d0-7d2a-7eb68a2bcb39/CMU+Reboot+Informal+ECOFIN+final+Issues+Note+2019-09-09_S4.pdf.
[44] See Anne Richards, CEO Fidelity International, Public equity markets are flagging when we need them most, Financial Times, June 3 2020, available at https://www.ft.com/content/1a9dddc1-d52b-4fc0-afef-01bbc3b55195.

more effective progress on an effective mechanism to integrate stakeholder interests into board decision-making, the pandemic response is unlikely to have lasting impact. Moreover, we are sceptical with regard to the use of the 'comply or explain' technique for any such mechanism as the conditions that make the technique effective in the context of corporate governance codes would be absent. In the case of conduct of business regulation, the structure of regulation in the UK facilitated a response largely without resort to formal rule-making. We surmise that this outcome can be read, at least in part, as linked to an emerging trend away from detailed rules in favour of alternative metrics of good conduct, which might also justify a less prominent role for disclosure as a form of consumer protection.