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HOW IT MATTERS WHO MAKES CORPORATE RULES

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Abstract — Corporate rules are often analysed without attending to the strengths and limitations of the body making, monitoring, or implementing those rules. However, corporate rule-making and implementation bodies (RMIBs) over which policymakers have the most influence—legislatures and public regulatory agencies, stock exchanges, and private/professional bodies with a degree of self-regulatory autonomy—have an important bearing on the effectiveness of rules. This Article advances a framework to understand how RMIBs influence the effectiveness of corporate rules by critically examining five core features of RMIBs: (a) their incentives for making and implementing the rules; (b) the nature and extent of regulatory competition; (c) available and relative resources; (d) rule-making speed and the certainty of those decisions; and (e) their legitimacy in the eyes of the regulated parties and relevant stakeholders. To illustrate the framework concretely, this Article conducts case studies exploring how it matters who makes the rules on climate-related risks disclosure and in the UK's recently enacted Financial Services and Markets Act 2023.

Keywords — corporate governance; corporate law; regulation; self-regulation; stock exchanges; incentives; regulatory competition; legitimacy; FSMA 2023; climate disclosure

JEL Codes – G18, G30, G38, K20, K22

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I. INTRODUCTION

There is extensive literature on the rationales, contents and structures of corporate rules.[1] For example, companies are increasingly required or urged to disclose climate-related risks and diversity policies and practices in their public filings. Regulatory agencies,[2] legislatures,[3] stock exchanges,[4] and private bodies[5] in different jurisdictions have also issued or proposed rules concerning the responsibilities of companies and financial institutions to disclose and address climate-related risks. Rules requiring boards of listed companies to have a certain number of female directors have been issued by either legislatures,[6] regulatory agencies,[7] or stock exchanges[8] depending on the jurisdiction. The requirement for independent directors has been laid down by

[1] *Corporate* rules are used here to refer to the sub-set of norms, standards, and principles that 'govern the relationship between a company's managers and investors' or that 'regulate corporate action' more broadly. See Black (1990), p. 546-547. These rules can include norms, standards, and principles, as well as both hard law and soft law. See e.g. Black (2002); Kaplow (1992).

[2] See e.g. Financial Conduct Authority (2021a).

[3] See e.g. UK Department for Business, Energy & Industrial Strategy (2022).

[4] See e.g. the Hong Kong Stock Exchange (HKSE) listing rule, which came into effect in July 2020, that requires its listed issuers to report on climate-related risks on a comply or explain basis. See HKSE (2023), Appendix 27: A27-7.

[5] See e.g. the Task Force on Climate-related Financial Disclosures (TCFD) created by the Financial Stability Board to develop a set of voluntary and consistent climate-related financial disclosures. See TCFD (2017).

[6] See e.g. California Corporations Code, s. 301.3; India Companies Act 2013, s. 149.

[7] See e.g. Financial Conduct Authority (2022).

[8] See e.g. Nasdaq (2021).

legislatures,[9] administrative agencies,[10] and stock exchanges.[11] However, it is unsatisfactory that the debate over proposed and actual corporate rules often occurs without a careful analysis of the strengths and limitations of the body making, monitoring, or implementing the rules.

The Article's basic objective is to analyse how corporate rule-making and implementation bodies (RMIBs) through whom policymakers can choose to initiate new rules[12]—legislatures and public regulatory agencies, stock exchanges, and private/professional bodies with a degree of self-regulatory autonomy—have an important bearing on the effectiveness of corporate rules. The underlying intuition is that the effectiveness of corporate rules—which can be understood as compliance with the rules' prescribed contents, coupled with advancement of the rules' objectives (if articulated)[13]—is also function of their source, which implies that corporate rules should not be designed in a manner that is 'source neutral' or non-cognisant of how an RMIB itself influences the rules it promulgates and enforces.

[9] See e.g. India Companies Act 2013, ss. 149-150.

[10] See e.g. Financial Reporting Council (2018), provisions 9-11.

[11] See e.g. NYSE (2021), s. 303A.00.; NASDAQ 'The NASDAQ Stock Market LLC Rules', 5615(a)(5).

[12] Courts are not considered RMIBs because their primary function is not to create or implement rules, unlike the legislature (which creates rules that are implemented by the executive). Rather, courts exercise a rule adjudication function and exercise supervisory powers over how legislatures and public regulatory agencies, stock exchanges, and professional bodies create and implement rules. While judge-made law often constitutes a source of corporate rules, policymakers cannot instruct courts on what rules to make, and far from being overlooked, courts feature in this Article's analysis in the ways that they interact with the three core RMIBs identified above.

[13] 'Effectiveness' is commonly understood as rule or norm observance. See Moreso and Navarro (2005). This Article assumes that the objective or goal of the corporate rule in question is worthy of pursuit. It is beyond the aim and scope of this Article to examine what criteria or approaches should be used to determine the worthiness of a corporate objective or goal. One suggested approach is cost-benefit analysis that seeks to promote overall well-being rather than merely economic efficiency: see Adler and Posner (2006).

To develop this contention in more detail and explain how an RMIB influences rule-making, implementation, and enforcement in the corporate law and governance context, we aim to develop an analytical framework that critically examines an RMIB's core features. In our framework, these features consist of: (a) an RMIB's incentives for making and implementing the rules; (b) the extent of regulatory competition; (c) the available and relative resources of an RMIB, particularly relating to enforcement; (d) how quickly an RMIB makes and implements the rules and the certainty of its decisions; and (e) the RMIB's legitimacy in the eyes of regulated parties, market participants, and relevant stakeholders. We do not claim that this categorisation is the only way to break down analytically the larger issues in order to advance our main objective of analysing how it matters who makes corporate rules; rather, our aim is to generate clarity by bringing together the myriad issues discussed in existing but often disparate strands of literature, and our method is to categorise salient RMIB features in a manner that preserves necessary detail, avoids unnecessarily overlap, and remains accessible to policymakers and rule appraisers.

Accordingly, this Article has two main contributions. First, it seeks to help re-orient discussion in the corporate law and governance literature towards the ways that an RMIB influences the effectiveness of corporate rules, given a tendency to propose or critique rules without due regard to their source. Second, by setting out an analytical framework, this Article provides and explains a set of factors for rule-makers, appraisers, and stakeholders to critically reflect upon, in order to arrive at more considered views as to which RMIB should make or implement a particular rule within their jurisdiction, or how rules could be better tailored to the strengths and limitations of the existing RMIB.[14] We suggest that the characteristics of RMIBs are important to consider even when only one RMIB can implement a particular rule, because rule-making is most effective when the contents of rules are designed to leverage the strengths and minimise the limitations surrounding their implementation and enforcement.

The Article is structured as follows. Part II sets out the analytical framework, comprising five core features. An RMIB's features interact with each other in ways that can be cross-cutting: e.g., a large for-profit stock exchange might have strong incentives to create investor protecting rules, as well as ample resources to monitor and low procedural burdens allowing for quick revision, but competitive pressures may discourage strict enforcement, and it may lack legitimacy with market participants and stakeholders when the subject matter of the rule has important social consequences (like board gender or racial diversity). Since an RMIB's strength in one area can be a weakness in another, this Article does not endorse a prescriptive and definitive weighting of the five features advanced. Arguing for universally prescriptive rule-making based on an RMIB's features would unduly constrain policymakers' judgment and not sufficiently allow for contextual considerations. However, the framework still allows for concrete application to be made and lessons to be drawn, which is undertaken with two case studies in Part III.

Part III uses climate-related risks disclosure as the first case study to analyse which RMIB should make which type of rules, and suggests that given salient issues bearing on the effectiveness

[14] Given this goal, the Article will not explore the theoretical implications of decentred or polycentric conceptions of regulation on RMIBs. For a discussion on decentred regulation, see Black (2002), pp. 2-7. See also Black (2008), p. 140.

of climate-related risks disclosure, the legislature should make and implement the rules in conjunction with a public regulatory agency, stock exchange, or private/professional body. This is because certain features in these RMIBs enable them to: address the problem of lack of consistent and comparable disclosure standards; undertake a comprehensive analysis of the costs and benefits of the rules; to quickly and flexibly make and amend the rules in light of changing scientific developments and market conditions; or to address objections based on democratic legitimacy. Part III then considers another case study: the UK's recently enacted Financial Services and Markets Act 2023 (FSMA 2023), which will over time move large swaths of corporate/financial rules from legislation to regulators' rulebooks. Since policy decisions to delegate enormous rule-making responsibilities to the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) have already been made, the case study employs the framework to identify issues relevant to the effectiveness of the new regime. It suggests that the policy debate surrounding the FSMA 2023's predecessor bill, the Financial Services and Markets (FSM) Bill, focused on increasing regulatory competition and justified the changes based on Parliamentary resource limitations and rule-making speed and adaptability constraints, but devoted insufficient attention to: incentive compatibility issues stemming from delegated rule-making, and the risk of eroding legitimacy if the regulators are not held sufficiently accountable or if they exercise their greater discretion in a manner that increases uncertainty for regulated parties and stakeholders. Part IV concludes by drawing out potential lessons from the case studies.

II. ANALYTICAL FRAMEWORK

A. Incentives

Incentives matter because they affect what types of rules are made and how those rules are enforced. Legislatures can face conflicts of interest to make rules in line with voters' preferences, but possess fewer conflicts of interest surrounding adjudication and enforcement, which are primarily left to judges and public regulatory agencies. However, while, stock exchanges' commercial interests provide strong incentives to create rules that respond to market participants' needs, exchanges face much stronger conflicts of interest to enforce these rules. And private bodies with self-regulatory responsibilities or regulatory autonomy have incentives to make and enforce rules in ways that benefit their members, constrained primarily by the threat of government intervention should their rule-making stray too far from the public interest.

1. Legislatures and regulatory agencies

Legislatures are incentivised to make rules concerning politically salient issues. An issue's political salience connotes 'its importance to the average voter, relative to other political issues.'[15] Legislators depend on their electorate to remain in office, and although legislatures comprise individuals with heterogenous interests, public choice theory suggests that individual legislators have strong incentives to make rules on highly salient issues.[16] However, legislators have weaker

[15] Culpepper (2011), p. 4.

[16] Buchanan (1984).

incentives to deal with less politically salient, more technocratically complex issues, allowing lobbyists and interest groups to more readily influence legislative rule-making in these areas with less media scrutiny.[17] Corporate governance rules are typically of low political salience, apart from in the wake of financial crises or headline events when the political salience of corporate governance experiences a short-lived but significant increase due to increased media coverage and public interest.[18]

Legislatures (and regulators), unlike stock exchanges, can impose criminal sanctions for non-compliance, and thus arguably possess the strongest disciplinary deterrent.[19] Since judges or government agencies govern rule adjudication and enforcement, legislatures do not possess strong conflicting incentives between creating appropriate disciplinary mechanisms and enforcing those mechanisms. For legislatures, the most significant conflict of interest arises at the rule-making rather than enforcement stage, when lawmakers do not make rules in line with the preferences of the voters who elected them.[20] Legislatures may also make rules that benefit interest groups instead of the general public, which is also known as regulatory capture.[21]

[17] Culpepper (n 15) 8.

[18] Coffee (2010), p. 13.

[19] cf Schell-Busey et al. (2016), pp. 388-91.

[20] Buchanan (n 16) 19.

[21] Mitnick (2013), pp. 35-36. Regulatory capture theories have been extensively debated and it is outside the scope of this Article to cover them. For a summary of the debates, see Dal Bo (2006). For criticisms of regulatory capture, see Croley (2013), pp. 52-56.

As for public regulatory agencies such as the FCA or the US Securities and Exchange Commission (SEC), while they too may be at risk of being pressured or captured by interest groups, they can and have been independent on the whole, and they have incentives to retain their rule-making authority by maintaining effective rule-making and enforcement.[22] Since their regulatory authority has been delegated to them by the state,[23] there is a risk that if they do not exercise their authority properly or sufficiently, it may be taken away or challenged in court. An example of this is the UK Financial Reporting Council (FRC), a quasi-public body regulating in the areas of corporate governance, reporting, and audit.[24] Sir John Kingman's independent review of the FRC highlighted a number of criticisms and weaknesses, comparing the FRC to a home that 'leaks and creaks' and needed to be rebuilt.[25] Sir Kingman recommended that the FRC be replaced with a new, significantly overhauled independent regulator called the Audit, Reporting and Governance Authority (ARGA), which the UK government endorsed but has not yet delivered on by enacting the necessary legislation to create ARGA.[26] Pertaining to incentives, Sir Kingman identified concerns of 'excessive closeness to those it regulates' and 'an inconsistent and incomplete approach to managing conflicts of interest', strongly influenced by the revolving door between

[22] Gilardi and Maggetti (2013), pp. 201-4; Gilardi (2002). See also Heese et al. (2017), p. 100, who find that 'SEC capture, if it exists, may be less blatant or pronounced than previously thought.'

[23] The FCA's powers are conferred pursuant to the FSMA 2000, and the SEC's powers are conferred pursuant to the Securities Exchange Act of 1934.

[24] The UK FRC has been described as 'quasi-governmental' because while it is 'formally a private entity' (a company limited by guarantee), it has governmentally appointed directors, fulfils statutory functions, and has delegated governmental powers. See Cheffins and Reddy (2022); Sir Kingman Independent Review (2018), p. 8. The UK government delegated authority to the FRC to make binding regulations via The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012.

[25] Sir Kingman Independent Review (2018), pp. 5-11.

[26] Ibid; Financial Reporting Council: 3-Year Plan (2023), p. 1.

industry and the FRC, as well as a funding model that is dependent on voluntary contributions from the same companies and audit firms it regulates, which 'creates a clear danger of blunting the FRC's incentive to bite the hand that feeds.'[27]

It is possible that should regulatory agencies exercise the powers conferred on them too zealously or in a manner that directly competes with the state, their powers could be usurped by the state if it is sufficiently threatened.[28] Independent regulatory agencies may also be more impervious to short term pressures of political salience than legislators who face the pressures of election cycles, in many circumstances allowing them to prioritise longer term goals,[29] however the pressure imposed by the government and industry on the FCA to rapidly reform the listing rules demonstrates that this is not always the case.[30]

2. *Stock exchanges*

Stock exchanges' core function is to provide a public listing and trading venue for companies, but business models have shifted considerably due to the information revolution and most exchanges earn a significant proportion of revenues through the sale of data and processing of information, in addition to listing and trading fees or providing post-trade services.[31] Exchanges

[27] Sir Kingman Independent Review (2018), pp. 5-8.

[28] Roe (2003).

[29] Seligman (2020), pp. 1134-35.

[30] See discussion of the government commissioned Lord Hill Listings Review in Section II(B)(1); for discussion of industry pressure, see Noonan (2023).

[31] An Oxera study found average data revenues amongst leading European stock exchanges (Euronext, LSE, Deutsche Börse, BME [Madrid], SIX Swiss Exchange, Nasdaq [Nordics & Baltics], Wiener Börse, Oslo Børs,

are incentivised to make quality listing and trading rules and prioritise market integrity firstly to support listing and trading revenue, and secondly because the value of the data that stock exchanges sell is dependent on liquidity, trading volume, and price accuracy and informativeness.[32] This is because when stock exchanges advance the regulatory objectives of investor protection and market efficiency by making quality investor-protection listing rules, this will attract well-capitalised companies to exchanges, which will in turn result in high trading volumes with accurate and informative market data that is useful to the market participants purchasing the data.

However, exchanges' enforcement incentives are weaker than their rule-making incentives because exchanges' commercial interests do not align as closely with strict enforcement. Exchanges face a tension between publicising companies' wrongdoing and disciplinary actions, and the risk that significant publicised disciplinary activity may lead to the perception that the market is failing to achieve its regulatory objectives. Because more enforcement 'increases the likelihood of detecting violations', which harms stock exchanges' reputation, exchanges may be incentivised not to detect misconduct.[33] The most severe enforcement tools that exchanges possess

Budapest SE) to be 30% in 2015, 31% in 2018, and 24% in 2021. See Oxera (2019), p.71-72; Oxera (2022), p. 3-4. Data revenues for individual exchanges varied from 14 to 49% in 2021. The LSE Group plc is an outlier with a very high proportion of revenue coming from data and analytics, which ranged from percentages in the mid-40s and high-30s from 2012-18, and the mid-60s since 2020 following the acquisition of Refinitiv. In 2022, 67% of the London Stock Exchange Group pro-forma income belonged to the revenue stream 'Data & Analytics'. See London Stock Exchange Group (2022), p. 3.

[32] Fox et al. describe liquidity and price accuracy as 'a stock market's two most important characteristics'. Liquidity relates not only to trading volume but the price and time to execute trades. See Fox et al. (2018), pp. 82-84.

[33] Kahan (1997), p. 1518.

are relatively heavy handed – suspending trading or de-listing a stock – and both of these actions reduce trading and data revenues for the exchange.[34]

Thus, exchanges face conflicts of interest in strictly enforcing the rules against the companies upon which they rely for business. However, this conflict of interest is alleviated to a degree by their strong incentives to generate listing and trading revenue and to sell market data whose quality is dependent on effective monitoring of market abuse, since demand would be reduced for lower quality data.

3. Private/professional bodies

Private (or quasi-private)[35] bodies' rule-making incentives are less dependent on the alignment of their regulatory objectives with commercial objectives, since unlike stock exchanges these bodies are not typically for-profit corporations. Private bodies' rule-making and enforcement incentives depend on the membership composition of the organisation, which could lead to conflicts of interest when a private body is tasked with policing market participants upon whom they rely for business. Thus, there is a risk that private bodies may under-regulate, engage in

[34] Some studies have shown that the two main stock exchanges in the US rarely de-list firms for rule violations. See Macey et al. (2008).

[35] 'Quasi-private' bodies may be composed of private members and represent industry self-regulation, while having (often much later acquired) a statutory footing or degree of statutory empowerment.

'greenwashing'[36] or 'social washing',[37] or make rules that primarily benefit the members of the body at the expense of other relevant stakeholders.

For example, the UK Takeover Panel is the body responsible for writing, administering, and adjudicating the rules contained in the City Code on Takeovers and Mergers. It became a quasi-private body in 2006 after obtaining formal statutory footing in the Companies Act 2006, which includes statutory duties concerning rule-making, appeals, among others.[38] Its membership has consisted of London-based institutional investors, banks, and other finance industry associations since its establishment in 1968.[39] Unsurprisingly, UK takeover rules favour institutional investor interests and are generally pro-shareholder because 'institutional investors were involved at every stage of the drafting of the [Takeover] Code', as well as enforcing the Code, and given the incentives of Takeover Panel members writing and enforcing the rules.[40]

Despite these concerns, private and quasi-private bodies may be incentivised to regulate properly in order to pre-empt regulation by the state. After all, private bodies must show that their self-regulatory arrangements are more effective than those of the state and the market in order to justify their continued regulatory authority. Private bodies have partly restrained incentives to act

[36] See e.g. River (2021).

[37] See e.g. Marsh (2020).

[38] Companies Act 2006, ss. 942-965.

[39] The Takeover Panel (2021a).

[40] Armour and Skeel (2006), p. 1771.

in a purely self-serving way, which would only undermine their interests once rule-making autonomy is retracted.[41]

B. Competition

Regulatory competition refers to the availability of rival regulatory regimes. The greater competitive pressure a rule-making body faces to attract participants to its regulatory regime, the stronger its incentives to respond to participants' regulatory needs.[42] Market participants will exit regulatory regimes with costs that are excessive or unjustified relative to the benefits, and competition incentivises regulators to be responsive and innovative to meet participants' needs in order to retain market participants.[43] Private rule-makers have particularly accentuated competition incentives because they 'are able to capture a much greater proportion of the economic benefits of marginal revenues generated by "users" of their laws than do public legislatures.'[44]

[41] e.g., the Takeover Panel instituted reforms in its first year following threats by the UK government to introduce legislation that would decrease the Panel's regulatory autonomy. Reforms included procedural protections (e.g., an Appeal Committee) and a commitment to more strongly enforce sanctions on Code violators. Armour and Skeel (2006), pp. 1761-62.

[42] While regulatory competition also relates to the first feature, incentives, we choose to categorise competition as a discrete feature because of the pre-conditions that differ from analysing RMIB incentives more generally. Analysis of competitive pressure is built upon the pre-conditions that firms are able to choose regulatory regimes (i.e., no excessively deterrent switching costs) and do so based on anticipated costs and benefits, and that jurisdictions have high enough payoffs from increased entry to tailor rule-making to attract entrants. Armour (2005), pp. 8-9.

[43] Romano (2005), pp. 215-16.

[44] Armour (2005), p. 32.

1. Legislatures and regulatory agencies

Legislatures typically face less regulatory competition than private bodies and stock exchanges given the latter's greater availability of substitute markets.[45] The absence of competition, such as in the US where the federal government has a monopoly on the provision of securities regulation, may reduce public incentives to supply ideal regulation.[46]

This does not imply that legislatures' corporate rule-making cannot be strongly influenced by competitive pressures. Apart from the well-worn debates surrounding inter-state competition for corporate charters,[47] there is a host of recent evidence in the UK attesting to the strong influence of regulatory competition on public rule-making. The UK government commissioned a review of the listing rules (and prospectus regime), written by Lord Hill and published in 2021.[48] The report mentions phrases such as the UK's 'competitiveness', 'competitors', 'competitive position', and the like 20 times.[49] Lord Hill recommended that the government consider adopting 'growth' or 'competitiveness' as a statutory objective for the FCA.[50] The FCA has actioned many of the

[45] On the different dynamics of regulatory competition for firms and legislatures, see Hadfield and Talley (2006).

[46] See e.g. Romano (1998).

[47] See e.g. Kahan and Kamar (2002); LoPucki (2018), pp. 2106-2108.

[48] Lord Hill (2021).

[49] Ibid.

[50] Ibid, p. 18.

report's recommendations,[51] and the FSMA 2023 expressly prescribes 'competitiveness and growth' as a new secondary objective for the FCA and PRA.[52] This competitiveness objective could influence the FCA's rule-making, supervision, and enforcement functions with the risk of 'opening the door to an excessively deregulatory agenda'.[53]

In other contexts however, for example, where EU directives enable regulatory competition amongst member states that are 'accompanied by the implementation of procedural safeguards', competition can improve rule-making by inducing jurisdictions to compete in providing value-enhancing company laws.[54] In the EU one can incorporate under the company law regime of another EU country, and regulatory competition has arguably produced positive, more entrepreneur-friendly rule-making on the whole, such as EU member states lowering minimum capital requirements and shortening incorporation times to remain competitive.[55] Overall, then, regulatory competition can pressure legislatures to adopt more business friendly rule-making to attract companies to their regime, resulting in more economically efficient rules or laxer regulatory standards following de-regulatory pressures.

[51] e.g., the FCA revised the listing rules in 2022 to allow for a limited form of dual class share structures on the premium list, and easing some of the restrictions governing special purpose acquisition companies (SPACs). See Cheffins and Reddy (2023), p. 191; Financial Conduct Authority (2021c).

[52] Financial Service and Markets Act 2023, s. 25.

[53] Ferran (2022), pp. 1, 33, 38.

[54] Armour (2005), p. 3. argued that 'regulatory competition is likely to be both a significant and a beneficial mechanism for the development of European company law' by inducing EU member states to compete in providing value-enhancing company laws.

[55] Ringe (2013), p. 267.

2. *Stock exchanges*

Stock exchanges face even greater competition than legislatures. Exchanges face greater competition than ever before from other venues to facilitate the purchase and sale of securities.[56] For example, there are 127 public trading venues ('regulated markets') in Europe alone.[57] In fact, exchanges face greater competitive pressure in all of their economic functions, not only in providing liquidity. Other institutions compete to provide reputational signals of company quality (e.g., investment banks), provide a set of standard form contracts or standardised rules for trade (e.g., regulators), and monitor markets to police wrongdoing (e.g., securities litigation plaintiffs).[58] The effect of increasing competition for reputational signalling mechanisms strengthens exchanges' incentives to maintain reputational capital by implementing and maintaining high quality regulation.

However, the effects of regulatory competition are not always positive, as the perennial race to the top or bottom debate suggests.[59] Competitive pressures with other trading venues may weaken exchanges' incentives to enforce rules in the public interest.[60] The risk of losing market

[56] For an example of greater competition, consider that in 2015 more than two-thirds of the trading volume in NYSE-listed shares occurred on trading venues other than the NYSE itself. See OECD (2016), p. 125.

[57] European Securities and Markets Authority (2021).

[58] Macey and O'Hara (1999), pp. 37-42.

[59] See e.g. Revesz (1992).

[60] Macey (2008), p. 112. See also Macey and O'Hara (2005), p. 580.

share to competing trading venues may also weaken stock exchanges' enforcement incentives, as disciplined companies may exit the market.

3. Private/professional bodies

Regulatory competition can also cut both ways for private bodies, where low competition can lead to less responsive regulation to market needs, but high competition can result in multiple regulatory standards which struggle to influence the market and suffer from a lack of widespread adoption and network benefits. For example, the Financial Accounting Standards Board (FASB) has a regulatory monopoly for setting US accounting standards, and commentators have argued that regulatory competition would improve corporate governance and rule-making, resulting in a lower cost of capital for reporting companies.[61] But the multitude of ESG reporting standard setters that has resulted from high regulatory competition has created challenges of 'coherence and consistency' for market participants,[62] suggesting that a risk of regulatory competition for regulatory agencies and private bodies is having too many rule-makers occupying the same regulatory space.[63] However, the multiplicity of private bodies in the same regulatory space becomes less problematic when a public RMIB or a stock exchange adopts one of the private

[61] Sunder (2002), p. 232.

[62] 'There are many existing reporting standards (e.g., GRI, SASB, TCFD, CDP, ISO, IIRC and many others), which cover a number of investors' needs, but the market is calling for greater coherence and consistency between frameworks.' Principles for Responsible Investment (2019).

[63] Probert (2021).

bodies' rules or standards, forcing more widespread implementation and reducing regulatory plurality.

Private bodies with self-regulatory autonomy also face regulatory 'competition' from the state.[64] Private bodies that fail to implement and enforce effective rules face the risk of government removing their private regulatory autonomy, and the more credible the threat of government intervention, the stronger incentives the private body has to avoid publicised regulatory failures.[65] Private bodies' 'competition' with government moderates, but does not eradicate, their incentives to make and enforce rules in their members' interest rather than the public interest.

C. Resources

This section outlines how the more regulatory resources at an RMIB's disposal – which include human capital (with the right expertise), financial capital, and other crucial assets such as data – contribute to more effective rule-making, monitoring, and enforcement.

1. Legislatures and regulatory agencies

Many commentators have focused on the importance of regulatory resources in the context of public enforcement of securities regulation.[66] Public securities regulators' budgets and personnel counts reflect public agencies' capacity for market surveillance, investigation and

[64] Roe (2003).

[65] See note 41.

[66] The adequacy of funding models is also relevant; the SEC must submit annual Congressional Budget Justifications to secure government funding, and the FCA is wholly funded by industry (fees from regulated firms).

monitoring of wrongdoing, initiating enforcement actions, and writing and revising 'more sophisticated regulatory rules'.[67] Similarly, a lack of regulatory resources can cause public enforcement agencies to be 'reactive' in their prosecution of financial crime and enforcement of investor protecting rules, whereas increased resources allows for more 'proactive' market monitoring and surveillance and contributes to the prevention of corporate misconduct ex ante.[68] Public RMIBs like the FCA are statutorily required to use their resources 'in the most efficient and economic way', acknowledging the importance of stewarding precious regulatory resources.[69]

Several empirical studies examining the relationship between regulatory resources and regulatory compliance or enforcement suggest that resource constraints can significantly undermine firm compliance and RMIB enforcement activity.[70] Many of these studies rely on publicly available data disclosed by the SEC, and provide compelling evidence for the crucial importance of human and financial capital to the effectiveness of RMIBs' rule-making, monitoring, and enforcement activity.[71] For example, one study finds that firms with headquarters that are geographically closer to SEC offices have lower financial statement misreporting deviations, supporting the 'constrained cop' hypothesis whereby a regulator is more likely to

[67] Jackson and Roe (2009), p. 209.

[68] Anand (2018), p.17.

[69] FSMA 2000, s. 3B(a).

[70] One study, for example, finds that positive budget shocks (i.e., more funding) cause higher levels of firm compliance and lead to short term increases in the number of SEC investigations. See Lohse et al. (2014).

[71] See Gunny and Hermis (2020); Ege et al. (2020).

undertake local investigations because of time and financial resource constraints, since local investigations are cheaper to conduct.[72]

However, more human and financial capital only aids in more effective rule-making and enforcement up to a point, but more is not always better. Merely possessing regulatory resources does not guarantee their good use.[73] This is because more human capital improves monitoring and enforcement when personnel have the necessary expertise, which is not always the case given the highly specialised nature of monitoring financial markets and corporate activity.[74] RMIBs possessing fewer resources must implicitly rely more on gatekeepers or regulatory intermediaries to make up for the shortfall (e.g., an RMIB with minimal accounting expertise must rely heavily on assessments from third party accountants).[75] Attention must also be paid to the source of funding, so that it does not create conflicts of interest or weaken enforcement incentives. Sir Kingman's review of the FRC emphasised that its funding model, which relies to a large extent on voluntary monetary contributions from the same companies and audit firms that the FRC is tasked to regulate, is 'seriously inappropriate' given that it could weaken the FRC's enforcement

[72] Kedia and Rajgopal (2011), pp. 260-61.

[73] Jackson and Roe (2009), p. 211.

[74] See e.g. Kubic (2020), p. 314. Kubic finds that a one-person staff increase in the SEC Division of Corporate Finance review team increases the relative probability of detection for financial statement misreporting by 24.3% only if the additional person is an accountant; the likelihood of financial misreporting detection does not increase at all when the one-person staff increase is a lawyer.

[75] Abbott et al. (2017), pp. 19-20; Kraakman (1986), pp. 53-54.

incentives.[76] Consequently, Sir Kingman's review recommended that the new body to be created, ARGA, be funded by a mandatory statutory levy.[77]

2. Stock exchanges

The vast majority of stock exchanges are 'demutualised', meaning that they are for-profit, shareholder owned corporations, rather than non-profit, member owned organisations.[78] For-profit exchanges with comfortable profit margins like the LSE plc, whose corporate parent (LSEG) reported operating profits exceeding £1.4 billion in 2022, will often be less constrained by resource shortages compared to the taxpayer financed budgets of public RMIBs.[79] The *relative* resources of an RMIB compared to others is salient when there is a degree of choice over whom should implement a set of rules; e.g., if a public regulatory agency is more well-resourced than an exchange in a particular jurisdiction, this feature would weigh in favour of the regulatory agency. Demutualised stock exchanges tend to possess significant financial capital which may enable them to hire more employees when needed, and provide stronger monetary compensation and performance incentives than public RMIBs or other private rule-making bodies in the jurisdiction.[80]

[76] Sir Kingman Independent Review (2018), p. 9.

[77] Ibid, pp. 59-60.

[78] Gadinis and Jackson (2007), p. 1257.

[79] London Stock Exchange Group (2022), p. 42.

[80] For a list of large demutualised exchanges, see Gadinis and Jackson (2007)

However, exchanges have varying degrees of jurisdiction to make rules, depending on the authority conferred on stock exchanges by government. The FCA is tasked with rule-making and enforcement on the LSE Main Market, but the LSE plc (as a regulated market operator) has parallel responsibilities (e.g., monitoring and detecting market abuse) that often require cooperation with the FCA, meaning that resource strengths and limitations of the stock exchange and regulatory agency must be taken into account together.[81]

Stock exchanges' greatest resource advantage may be having the fastest access to real time market information and data of any RMIB. Data is one of the primary resources that stock exchanges sell. Stock exchanges and private rule-making bodies possess better information about their activities and the particular needs of the market than public regulators, who rely on reporting by market participants and data provided by stock exchanges themselves. Data allows for faster detection of market abuse, and more (and faster) data allows for more effective monitoring and market surveillance by RMIBs.

3. *Private/professional bodies*

There is less evidence to date on private bodies regarding the relationship between available resources and rule-making. This is partly because private bodies, such as the Global Reporting Initiative (GRI) or the Task Force on Climate-related Financial Disclosures (TCFD)

[81] See *Burford Capital Limited v London Stock Exchange Group plc* [2020] EWHC 1183 (Comm), [139], [150], [180].

(established by the Financial Stability Board), disclose minimal funding details.[82] The lack of transparency may stem from private bodies' reliance on their members for funding, since members may prefer less funding disclosure given that perceived conflicts of interest may arise.

Private bodies established or supported by international organisations, industry, or the state can be well-resourced – e.g., the Takeover Panel generated a surplus in excess of £2.5 million in 2020-21 from document charges and the trading levy.[83] To be clear, the 'rules' made by these bodies do not necessarily mean legally binding prescriptions that are backed by sanctions, whether formal or informal. Rather the 'rules' made by these private bodies include norms or standards that have been adopted or have influenced the adoption of rules in the jurisdictions concerned. For example, the GRI (an international independent body) issued the GRI Standards, a sustainability reporting framework, which has been extensively adopted by stock exchanges around the world.[84] The recommendations issued by the TCFD, a private sector industry body, have also been adopted or influenced the making of climate-related disclosures in at least nine jurisdictions.[85]

[82] The GRI discloses that 'around 40%' of funding comes from 'governments and foundations', with the majority coming from 'commercial services, events, corporate engagements and memberships.' See GRI (2022). The TCFD does not disclose how it is funded, and the FSB's financial statements do not provide further insight on TCFD resources. The majority of the FSB's funding and services come from the Bank for International Settlements. See FSB (2021).

[83] See The Takeover Panel (2021b), p. 17. The Panel receives income for the mandatory review of takeover offer documents, a levy (£1 as of 2023) that investors pay when trading shares with a value greater than £10,000 (subject to some exceptions), and for the review of certain groups possessing exempt or recognised intermediary status.

[84] Of the stock exchanges globally that issue guidance on ESG reporting to their listed companies, 91% cite frameworks by the GRI. See UN Sustainable Stock Exchanges (SSE) (2021) p. 2.

[85] TCFD (2021).

D. Speed and Certainty

1. The advantages of speed and certainty

Rule-making speed or adaptability refers to how long an RMIB takes to create or revise new rules. It includes the time from awareness or detection of a deficiency in the existing rules, continues through any rule consultation processes, and culminates in formal additions or revisions to the rulebook or legislation. Speed is important — in the context of corporate law and governance, market circumstances can change rapidly and undermine the effectiveness of rule-making that does not adapt to the immediate context and market developments. Faster is not always better – clearly, poorly considered or hasty rule-making is undesirable – but all things equal, speed is a regulatory advantage because it provides the RMIB with more adaptability and responsiveness.

Speed is a feature that is largely internal to the RMIB, influenced by regulatory resources such as staffing and market awareness, as well as voluntary internal procedures governing rule-making. However, speed interacts with certainty (described below) in an important and often over-looked way, as speed and adaptability can also be influenced by factors that are external to the RMIB, such as legislative frameworks that provide for mandatory consultation periods or allow for external challenges to rule-making.

Rule-making certainty refers to the clarity and predictability of a rule's content and enforcement, which is influenced by the nature of the rule-maker and how susceptible a rule is to challenge that could result in the content or application of the rule being changed. Certainty is important in the context of financial regulation because predictability always has value – rule-makers and regulated participants alike can make more informed ex ante decisions and more effectively plan for compliance. Rule certainty helps regulated participants re-allocate resources to be able to comply with additional regulatory requirements. Certainty is a feature that can be determined by internal characteristics such as the extent (and consistency) of rule-makers' permitted discretion, as well as features external to or independent of the RMIB, such as the legislative or regulatory framework within which the RMIB finds itself, the availability of judicial review, the motivation and capacity for interested parties to challenge the validity of the rule, and whether the RMIB is engaged in public or private rule-making and enforcement activity.

2. *'Internal' and 'external' determinants of speed*

Regulatory resources such as budget size and employee headcount, as discussed previously, are the primary internal determinants of rule-making and enforcement speed. Possessing more staff with the necessary skills, expertise, equipment, and time to carry out their roles allows RMIBs to engage in careful, quicker rule-making and enforcement.

Public RMIBs can be subject to statutory notice or consultation requirements, creating lengthier rule-making timelines. The FCA, for example, has extensive public consultation duties under the Financial Services and Markets Act 2000 (FSMA 2000). Core elements of the FCA's consultation duties include publishing drafts of proposed rules that contain a cost benefit analysis, describing how the proposed rule-making is compatible with its strategic objective of ensuring the well-functioning of markets, and explaining how the proposed rules advance its operational objectives such as market integrity or consumer protection.[86] The FCA must specify the consultation period timeline and, prior to confirming any draft rules, must consider any representations made by stakeholders about the draft rules and provide its response in general terms.[87]

One rule-making speed advantage that stock exchanges and private bodies frequently possess over public bodies is that they are less often constrained by time consuming requirements to produce cost benefit analysis (CBA).[88] Stock exchanges conduct in-house research and, similar to public RMIBs, issue rule consultation proposals to ascertain market feedback and create tailored rules.[89] It is significant that exchanges and private bodies are not subject to the same procedural requirements to justify their rule-making as public RMIBs. The CBA contained in an FCA consultation paper on climate-related disclosures included granular compliance costs such as the number of additional employee hours (and estimated salary) each aspect of compliance would take.[90] Regardless of whether quantitative CBA in financial regulation is beneficial on the whole,

[86] FSMA 2000, ss. 1(B)-(E), 138I(1)-(2).

[87] FSMA 2000, s. 138I(2)-(3).

[88] Even incremental rule-making in climate-related disclosure can take at least six months at a public RMIB like the FCA. For example, in June 2021 the FCA published further rule-making proposals to extend the scope of climate-related disclosure beyond premium-listed companies to standard listed companies, anticipating that the final rules could be implemented by the end of 2021. In contrast, consequential amendments in 2018 to the AIM company rules, nominated adviser rules, and Disciplinary Procedures and Appeals Handbook initiated by the London Stock Exchange plc were implemented in less than 3 months, including the consultation period and feedback statements. See FCA (2021b), p. 8. See also LSE (2018).

[89] In fact, the FCA relied significantly on unpublished research by the LSE assessing how many premium-listed companies disclosed climate-related matters in order to estimate the number of companies affected by individual costs stemming from its proposed rule-making. See FCA (2020), p. 39.

[90] Ibid, pp. 46-50.

statutory procedural requirements to produce CBA reduce the speed of public rule-making relative to nimbler private bodies or stock exchanges. Commentators have noted that rules made by the Takeover Panel 'are capable of being continuously updated in response to developments in the market' and therefore have adaptability advantages over company law legislation.[91]

3. *'External' determinants of certainty*

Rule-making certainty of public RMIBs can be undermined by external factors such as judicial review of the constitutionality of rule-making. For example, an SEC rule on proxy access that allowed certain significant shareholders to submit information on dissident director nominees, which the company must then include in its proxy materials sent to shareholders to vote in absentia, was struck down by the US Court of Appeals (DC Circuit) in 2011 because the SEC's CBA failed to adequately set out the economic costs and benefits.[92] Further, from 2005 to 2011, the DC Circuit struck down five SEC rules, one rule exemption, and one SEC enforcement action, leading one commentator to note that the proportion of SEC rules that were vacated on judicial review 'represent[ed] one in seven of the SEC's major rules over that period'.[93]

Nevertheless, in the US, independent agencies like the SEC or CFTC are subject to less strenuous CBA requirements than executive agencies, and the precise scope for quantified CBA

[91] Armour (2005), p. 23.

[92] *Business Roundtable v SEC* 647 F 3d 1144 (DC Cir 2011), [18]-[20]. For criticisms, see Coates (2015), pp. 917-20.

[93] Coates (2015), pp. 915-16.

in financial regulation has developed hazily through judicial review cases in the DC Circuit.[94] In the UK, the PRA and FCA have statutory requirements to conduct quantified CBA, unless they can provide an explanation of why the costs or benefits 'cannot reasonably be estimated' or why 'it is not reasonably practicable to produce an estimate'.[95]

Despite mandatory CBA in UK financial regulation and the resulting potential for rule-making to be challenged in court, there have been no judicial challenges solely on this basis, and no FCA or PRA rule-making has been overturned on the basis of inadequate CBA. This reflects a fundamental difference in the nature of judicial review in the US and UK: American judicial review concerns challenges to the constitutionality of rule-making, reducing the certainty of a rule's continued existence, whereas English judicial review concerns challenges to the lawfulness of a particular exercise of public power, reducing the certainty of a private RMIB's contractual discretion. It is our view that rule-*making* certainty is higher for public RMIBs in the UK than in the US, given the paucity of judicial review precedent for FCA or PRA rule-making. However, rule-*enforcement* certainty is not necessarily higher in the UK than in the US, as English judicial review (like US judicial review of administrative agency action) will void exercises of discretion by public RMIBs that breach procedural or substantive fairness.

[94] Ibid, pp. 909-12.

[95] FSMA 2000, ss 138I-J. However, the FCA only needs to show proportionality between burdens and benefits, not a mathematical calculation that the benefits exceed the costs. See Financial Conduct Authority (2018b), p. 4. The FSMA 2023 requires the creation of a statutory CBA panel to either support (pre-rule-making) or review the regulators' CBA. Financial Conduct Authority (2023).

Stock exchanges and private bodies can also be subject to legal challenges to their rule-making, enforcement, or exercise of discretion in applying the rules. Under English law they may face private law claims for breaching contractual duties,[96] and will be subject to administrative law duties of procedural fairness if, upon judicial review, the private body is found to be exercising power that is public in nature.[97] In theory, therefore, rule-making or enforcement by private bodies such as the LSE plc could be overturned by a successful judicial review if the rule-making or implementation activity was held to be public in nature.[98] In practice, this is unlikely to be the case in the majority of instances, because judicial review of stock exchanges and private self-regulatory bodies in the corporate law context has been infrequent by English courts over the past few decades.[99] This suggests that in addition to differences in judicial review between the UK and US, higher rule-making certainty in the UK may also result from a less litigious environment overall.[100] Moreover, the doctrinal tests in English law outlining when a private body is exercising public power are notoriously unclear, rendering it difficult for claimants and rule-makers alike to know whether public law procedural fairness duties are owed (such as consultation or the right to

[96] e.g., a company might ambitiously claim for an implied duty of good faith in the exercise of contractual discretion by the stock exchange or private body.

[97] *R v Panel on Takeovers and Mergers Ex p. Datafin Plc* [1987] QB 815, [1987] 2 WLR 699, 847.

[98] See e.g. *R (United Company Rusal plc) v The London Metal Exchange* [2014] EWHC 890 (Admin), [2014] ACD 87, where the court quashed a decision by the London Metal Exchange (LME) on the grounds of procedural unfairness. This was overturned on appeal by Lady Justice Arden, who found that the judge of first instance over-extended the public law duty of fairness. See *R (United Company Rusal plc) v The London Metal Exchange* [2014] EWCA Civ 1271, [2015] 1 WLR 1375.

[99] Commenting on CBA, an FCA official noted that judicial review is 'rare' but that 'we certainly take that possibility incredibly seriously'. See House of Commons Treasury Committee (2022), para 109.

[100] Ramseyer and Rasmusen (2010), p. 5.

reasons).[101] Finally, since stock exchanges and private bodies do not typically engage in public rule-making and enforcement activity, their private regulatory activity is less likely to be challenged than public RMIBs, resulting in higher external rule-making certainty.

E. Legitimacy

Legitimacy, understood empirically, refers to 'the belief that one ought to obey the law', regardless of personal benefit or detriment, because the legal authority 'has the right to dictate behavior'.[102] It can be associated with people or institutions.[103] This section argues that in the corporate rule-making context legislatures and regulatory agencies derive *democratic-based* legitimacy from procedural fairness and public accountability, whereas stock exchanges and private bodies derive *market-based* legitimacy from the rule-makers' reputational capital, technocratic expertise, and market participants' voluntary consent to the economic regime.[104] Legitimacy is empirically important because it is positively associated with voluntary compliance, suggesting that an RMIB's legitimacy is relevant to its effectiveness. Individuals who perceive legal authorities as

[101] See Chan (2021), pp. 241-43.

[102] Tyler (2006), pp. 4, 27, 161. We adopt an attitudinal conception focusing on the empirical significance of legitimacy (i.e., regulatory compliance), instead of conducting philosophical and moral reasoning to normatively justify whether a rule ought to be obeyed. This should not be taken to imply that the latter concerns are less important. For a discussion of the different conceptions of legitimacy, see Stryber (2001), p. 8701; Tucker (2018), pp. 148-52.

[103] Tyler (2006), p. 29.

[104] See Moore's discussion of 'market-*invoking* regulation' and public (democratic) acceptability in Moore (2013), p. 170-72. See also Baldwin's discussion of legitimacy resting upon claims relating to legislative mandate, democratic accountability, due process, expertise, and efficiency in Baldwin (1995). Finally, see also Black's discussion of pragmatically based (i.e., self-interest based), cognitively based (i.e., the organization is perceived to be necessary/inevitable), and morally based legitimacy in Black J (2008), pp. 144-45.

possessing more legitimacy are more likely to voluntarily comply with the law.[105] RMIBs require legitimacy to exercise discretionary power effectively.[106] Rather than attempting to secure participants' compliance through incentives alone, by trying to optimally calibrate costs and benefits – an impossible task – voluntary compliance can result through greater legitimacy in the eyes of the public or regulated participants.

1. *Procedural fairness increases the legitimacy of legislature and regulatory agency rule-making and implementation*

Procedural justice is a crucial factor influencing legitimacy, and individuals who feel they have been able to participate in the decision-making process, such as by making submissions and being heard, have higher assessments of procedural justice and are more likely to perceive the rule-making body as legitimate.[107] Public RMIBs have traditionally relied upon democratic legitimacy, accrued through procedural fairness and public accountability. They owe public law duties of procedural fairness, which can include the right to notice, a duty to provide reasons, and an absence of bias. Clear statutory mandates are important to ensuring public accountability; Sir Kingman's review of the UK FRC, a quasi-public corporate governance, reporting, and audit regulator, noted

[105] Tyler (2006), p. 57; Black J (2008), pp. 148-9.

[106] Tyler (2006), p. 161.

[107] Tyler (2006), pp. 163, 172.

that the 'absence of clear statutory duties' and 'lack of a clear statutory base' undermines 'how it can be properly held to account by Parliament and others.'[108]

Public law duties of procedural fairness do not imply that legislatures and regulatory agencies will always be more procedurally fair than stock exchanges and private bodies, particularly because the latter groups often involve their members in rule consultation and listen to their views, whereas legislatures do not always provide individuals with formal consultation rights prior to the enactment of legislation.[109] However, it does imply that stock exchanges and private bodies have leeway to make and enforce less procedurally fair rules than governmental bodies, which would detract from their legitimacy if it were democratically based. Instead, stock exchanges and private bodies have traditionally derived market-based legitimacy from the reputational capital of their members and voluntary participation of individuals in the market.

2. *Legitimacy stemming from reputation and technocratic expertise strengthens stock exchanges' and private bodies' non-binding rule-making and implementation*

Legitimacy is important to stock exchanges and private bodies because participants are more likely to comply with RMIBs' discretionary exercises of power when viewed as legitimate. Legitimacy is crucial to the effectiveness of the voluntary guidance that stock exchanges routinely publish. For example, although at present only the largest 100 listed companies in India are

[108] Sir Kingman Independent Review (2018), p. 19. Sir Kingman notes that the FRC 'relies on a blend of statutory functions and limited delegated powers (mainly in relation to audit) and voluntary agreements', and recommends that the new regulator, ARGA, have clearly defined statutory powers in order to increase public accountability.

[109] The UK government often consults on legislation, but individuals do not possess formal consultation rights. See Craig (2016), ss. 12-001(i).

required by the public regulator to publish a 'Business Responsibility Report', the National Stock Exchange of India (NSE) and BSE (formerly Bombay Stock Exchange) issued guidance encouraging other companies to follow suit.[110] Stock exchanges rely on soft law and discretionary exercises of power to a high degree, and if the NSE and BSE lacked legitimacy with market participants, their non-binding guidance for companies to publish Business Responsibility Reports would have little to no effect.

Private bodies derive part of their market-based legitimacy from the composition and buy-in of their members, who participate in the rule-making and implementation process and who are also the regulated parties. Private bodies also gain legitimacy in the markets in which they seek to expand their regulatory influence by borrowing the reputational capital of their members. For example, the reputational capital of the TCFD's members lends legitimacy to the private body, which helps it to attract more companies to voluntarily opt-in to its standards.[111] The TCFD publishes on its website an up-to-date list of organisations who are formal 'TCFD supporters', speaking to the importance of peer-to-peer legitimacy.[112] By framing their activity as predominantly economic and apolitical, private bodies base their legitimacy upon the voluntary participation of market actors and 'neutral-technocratic' assumptions whereby rule-making

[110] UN Sustainable Stock Exchanges (SSE) (2021), p. 14. The Securities and Exchange Board of India has made publication of Business Responsibility Report mandatory beginning in 2022-23.

[111] The TCFD was created in 2015 by another private body of international renown, the Financial Stability Board, under the leadership of Mark Carney. As of May 2023, it is chaired by Michael Bloomberg, and its 34 members consisting of individuals who represent leading investment banks, companies, asset managers, accounting firms, rating agencies and other leading international financial institutions.

[112] TCFD (2023). As of May 2023, there were 4000 supporters in 101 jurisdictions.

authority should lie solely in technical expertise.[113] Another example is the UK Takeover Code, which has claimed to reflect market 'best practice' instead of acknowledging 'any socially determinative effect in their own right'.[114]

3. *Market-based legitimacy may be insufficient for stock exchange and private body rule-making that is important to the general public for non-economic reasons*

The corporate rules made by legislatures, stock exchanges, and private bodies may impose significant externalities and have profound social consequences on the wider public. Examples of corporate rule-making by exchanges and private bodies with far-reaching social consequences include the rules requiring corporate climate-related risks disclosure which affect a jurisdiction's transition to a net zero emissions economy. On ESG disclosure rule-making, for example, the SEC Commissioner Peirce suggested that legislatures have the democratic-based legitimacy and public accountability to make rules concerning 'politically and socially sensitive subject matters', but that '[s]erious democratic legitimacy concerns arise' when independent regulatory agencies go beyond their statutory mandate or delegate rule-making to 'unaccountable third-party standard-setters'.[115] Legislatures have a measure of democratic-based legitimacy and public accountability that is entirely absent from stock exchanges and private bodies. Not only could compliance decrease should market participants perceive stock exchanges and private bodies to be making rules beyond their expertise, but democratic-based legitimacy could be seen as providing a more compelling

[113] Moore (2013), pp. 170-71.

[114] Moore (2013), pp. 170-72.

[115] Peirce (2021).

justification for corporate rule-making that is important to the general public because of the significant economic externalities or social consequences imposed, as compared to less inclusive market-based legitimacy.

III. TWO CASE STUDIES

Having analysed the different features of RMIBs and their strengths and limitations, this Part applies the analytical framework in Part II. Climate-related risks disclosure is selected as a case study because of its topicality and salience in practice and in the corporate governance scholarship, and because the rules governing this subject have been issued by different RMIBs. Given salient issues relevant to the effectiveness of climate-related risks disclosure, this Part suggests that the legislature should make and implement the rules in conjunction with a public regulatory agency or a stock exchange, considering the RMIB features of incentives, competition, resources, speed, and legitimacy. The FSMA 2023 is selected as a case study because of its monumental importance as 'a once-in-a-generation opportunity' for the UK government to re-tailor its financial services regulation.[116] Since policy decisions have been made to move the bulk of financial rule-making from the Parliament to the regulators (FCA and PRA), rather than critiquing whether other RMIBs (such as stock exchanges or private bodies) should have been involved, the case study aims to use

[116] HM Treasury (2021), p. 2.

the framework to shed light on issues that are relevant to the effectiveness of the regime going forward.[117]

A. Climate-related risks disclosure

The question of which RMIB should issue and implement which type of rules has to be examined in light of the specific issues influencing the effectiveness of those rules. The first predominant issue is a lack of comparable, consistent and reliable disclosures.[118] Different RMIBs in different jurisdictions have issued or proposed different types of inconsistent disclosure standards and formats on climate-related risks. There are, for example, the TCFD recommendations,[119] the proposed SEC rules,[120] the reporting standards proposed by the European Financial Reporting Advisory Group,[121] and the International Sustainability Standards Board.[122] Second, the scientific developments underpinning climate-related risks are rapidly evolving, which impact the appropriate methodologies and metrics that the rules ought to require companies to furnish in their disclosures.[123] Third, without widespread adoption of climate-related risk disclosure rules (e.g.,

[117] Nevertheless, the FSMA 2023 (and prior FSM Bill) case study is not a conventional illustration of how the framework could be applied because it does not concern one discrete set of rules but thousands of pages of rule-making covering diverse areas of financial services. Additionally, rule-making will move not from a public RMIB to a stock exchange or private/professional body, but between public RMIBs, from the legislature to regulatory agencies.

[118] Ameli et al. (2021), p. 917; BlackRock Policy Spotlight (2022).

[119] See e.g. TCFD (2017).

[120] SEC (2022).

[121] European Financial Reporting Advisory Group (2022).

[122] International Sustainability Standards Board (2022).

[123] Adrian et al. (2022); Basel Committee on Banking Supervision (2021); Fiedler et al. (2021), p. 91.

including large private companies), there are the risks of regulatory arbitrage, the transfer of 'dirty assets' to private companies, and failure to target the most polluting firms.[124] The final issue concerns legitimacy, where legislators in some jurisdictions have argued that climate-related risk disclosure rules, which pertain to climate change policies of major economic and social importance, should be made by the legislature and not by an independent regulatory agency.[125]

1. Lack of comparable and consistent disclosures

Given the proliferation of competing and even conflicting standards and requirements, it would be advisable for the legislature to make rules in conjunction with a regulatory agency, stock exchange or private/professional body, to come up with a clear and consistent set of disclosure requirements. This would address the problem of high competition among RMIBs which can result in multiple regulatory standards, and ensure the most widespread adoption of the rules.

The UK is a good example of this joint rule-making approach.[126] The FCA, a public regulatory agency, amended the listing rules to require listed companies to make disclosures against the TCFD recommendations.[127] Parliament amended the Companies Act 2006 to require large private companies to furnish climate-related disclosures as part of their non-financial and

[124] Gözlügöl and Ringe (2022).

[125] Budd et al. (2022).

[126] HM Treasury (2020).

[127] The FCA amended the listing rules to companies with a premium or standard listing to make disclosures against the TCFD recommendations on a 'comply or explain' basis. See LR 9.8.6(8) R, 14.3.27 R, and 18.4.3 R.

sustainability information statement in their annual strategic report.[128] The statutory climate-related disclosure requirements are aligned with the TCFD recommendations, and although in-scope companies must comply with both the FCA listing rules and the Companies Act 2006, there is a high degree of consistency with only relatively minor differences.[129] Another good example of a joint rule-making approach can be found in the EU Corporate Sustainability Reporting Directive (CSRD), which came into force in January 2023 and will phase in sustainability reporting requirements for the 2024 financial year onwards (meaning the first set of applicable companies will report in 2025).[130] The CSRD is drafted at a general level, and enables the European Commission to adopt delegated regulation specifying how national competent authorities and in-scope companies must comply with the directive. The details of the specific reporting standards are being fleshed out by the European Financial Reporting Advisory Group (EFRAG), a non-profit private advisory group with technocratic expertise and stakeholder representation drawn from the private sector, industry bodies, civil society groups, consumer and trade unions groups, and academics.[131] The European Commission has adopted EFRAG's draft standards – the European Sustainability Reporting Standards (ESRS) – as delegated regulation, making the Commission and

[128] UK Public Interest Entities and AIM companies with more than 500 employees are also in scope. See Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 which amended ss. 414C, 414CA and 414CB of the Companies Act 2006.

[129] The same disclosure will satisfy both requirements, unless a company frequently chooses to 'explain' rather than 'comply'. See Department for Business, Energy & Industrial Strategy (2022), pp. 19-20.

[130] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[131] EFRAG is a private association that receives both public (EU) and private (member organisation) funding. EFRAG defines its mission as 'to serve the European public interest in both financial and sustainability reporting by developing and promoting European views in the field of corporate reporting.' See EFRAG (2023).

EFRAG in effect joint rule-making bodies.[132] The CSRD contains a broad outline of the reporting obligations with which EU and non-EU companies have to comply in relation to how material environmental (which include climate change), social and governance impacts, risks and opportunities are identified, managed and integrated into their business operations and financial conditions. EFRAG is responsible for coming up with detailed and precise disclosure requirements such as the definition of materiality, and how and what kind of ESG information (including scope 1, 2 and 3 emissions) should be disclosed pertaining to companies' upstream and downstream value chains.[133] Compliance with the EFRAG's general and environmental standards should ensure compliance with the TCFD recommendations.[134]

By contrast, in the US, there is uncertainty among companies as to whether they should disclose climate-related risks, and if so, which standards or format they should adopt. After all, no rules on climate-related risk disclosure have been issued by Congress, state authorities, or stock exchanges. Rather, only the SEC has proposed rules on climate risk disclosures, but these proposals have not been passed and have been criticised.[135]

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[132] European Commission (2023a). The CSRD itself is passed by the European Parliament, jointly with the Council of the European Union.

[133] See e.g. Draft European Sustainability Reporting Standards, ESRS E1 Climate Change (EFRAG, Nov 2022); for the adopted delegated regulation (ESRS), see European Commission (2023b).

[134] Skadden, Arps, Slate, Meagher & Flom LLP (2023).

[135] For a good summary, see Vallette and Gray (2022).

2. Evolving evidence and impact on methodologies and metrics

Because the science underlying climate-related risks is rapidly evolving, disclosure requirements related to methodologies and metrics should not be cast in stone and have to evolve accordingly.[136] This requires continual monitoring, flexibility and responsiveness, implicating RMIB features related to incentives, resources, and speed.

Because climate-related risk disclosure requirements are stipulated in the Companies Act 2006 and listing rules, Parliament and the FCA can continue to study and modify the rules in light of scientific developments, and the FCA and the LSE plc can monitor the quality of the disclosures made by companies. This combined approach helps ameliorate the aforementioned speed and responsiveness challenges (e.g., due to CBA) faced by the FCA, and minimises the resource limitations that may hamper any singular RMIB. The LSE plc has incentives to monitor disclosure quality because its revenue depends to a significant extent on the sale of data and processing of information, which would include that of climate-related risks disclosures.[137] Further, the FCA is incentivised to ensure the effectiveness of its climate-related risk disclosure rules because of their influence on its operational objective of protecting the stability of UK markets, since there is a strong correlation between climate-related risks and the financial risks faced by companies,[138] and because the FSMA 2023 adds a new regulatory principle of achieving the UK's net zero emissions

[136] Adrian et al. (2022).

[137] See Part II(A)(1).

[138] Emambakhsh et al. (2022).

target that the FCA and PRA must consider.[139] Moreover, from the competition perspective, the FCA and a stock exchange such as the LSE plc are likely to be responsive to market demands in this context, since leading asset managers and asset owners have been pushing for climate-related risk disclosure.[140]

3. *The need for widespread adoption*

It is important for both public and large private, listed and large unlisted companies to be subject to climate-related risks disclosure requirements (although the extent and quality of the disclosures would necessarily vary) for the rules to achieve their objectives and ultimately reduce greenhouse gas emissions.[141] Unlike the UK, private companies in other leading global financial centres such as Singapore and Hong Kong are not required to disclose climate-related risks because no such requirement has been provided for by the legislature.[142] Both the legislature and the regulatory agency (as in the UK and India for example) or the legislature and the stock exchange (as in Singapore and Hong Kong for example) should make and implement climate-disclosure rules for a variety of reasons. The first is to prevent regulatory arbitrage, as large private companies may have stronger incentives not to become public so as to avoid being subjected to more onerous disclosure requirements. The second is to address the problem of private companies buying carbon-intensive assets from public companies as a result of the latter's attempt to meet their

[139] Financial Service and Markets Act 2023, s. 27.

[140] See e.g. Espiner (2022); Bussiere et al. (2021); Climate Action 100+ (2022).

[141] Gözlügöl and Ringe (2022).

[142] HKEX (2023); SGX (2022).

disclosure requirements, which has been described as 'climate-driven asset partitioning' of dirty assets.[143] Finally, once the legislature enacts rules requiring certain private companies to disclose their climate risks, public companies will be better equipped to disclose information concerning their Scope 3 emissions because public companies' supply chain business partners are likely to include private companies and the latter's GHG emissions.[144]

4. Legitimacy

Climate-related risks disclosure rules have been criticised on the basis that, among others, the RMIB proposing or making the rules lacks democratic legitimacy or is doing the bidding of non-investor stakeholders.[145]

Climate risks disclosure rules are likely to have a significant effect on a jurisdiction's transition to net zero transmission, resulting in substantial economic externalities and social consequences. Furthermore, the perceived legitimacy of the rules can influence companies' compliance, thereby advancing or undermining their effectiveness. Because legislatures have democratic-based legitimacy unlike regulatory agencies or stock exchanges, a strong argument can be made for the legislature, as a publicly accountable RMIB, to make climate-related risks disclosure rules. However, where after extensive consultation with the public and relevant

[143] Armour et al. (2022).

[144] The US Environmental Protection Agency defines Scope 3 emissions as 'the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain'. EPA (2022).

[145] Peirce (2022).

stakeholders, there is evidence that all relevant views are properly considered, a regulatory agency can issue the rules (consistent with its statutory mandate) before the legislature does so. For example, climate-related risk disclosures rules were first issued in the UK by the FCA via the listing rules (contained in the FCA Handbook), followed by the responsible Secretary of State via the Companies Act 2006.

Although the FCA's climate-related disclosure rule-making took two years, its rule-making process appeared to be deliberative, inclusive and rigorous, which addressed democratic legitimacy concerns.[146]

In 2021, after the FCA issued the rules, the government issued a consultation paper on introducing climate-related disclosure obligations aligned with the TCFD recommendations in the UK Companies Act 2006.[147] In 2022, the Secretary of State then enacted the statutory rules on climate-related risks reporting.[148] This suggests that the rules issued by the FCA already had substantial buy-in from the stakeholders. In other words, the rule-making process concerning climate-related risks disclosures in the UK had both market-based and democratic-based legitimacy because these rules were made by both the regulatory agency and legislature. After all, the rules made by the FCA and the responsible Secretary of State were part of the concerted actions

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[146] The FCA published a discussion paper in 2018 on the proposed climate-related risks disclosures, solicited feedback, and in 2019 published a paper addressing the feedback. Subsequently, the FCA worked with the government on green financing and climate-related risks disclosures. In 2020 the FCA published a consultation paper with additional proposals, and only confirmed and issued the rules in 2020. See FCA (2018a), pp. 15-16; FCA (2019), pp. 4-6; FCA (2020b), pp. 6-7.

[147] Department for Business, Energy & Industrial Energy (2021).

[148] The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022.

by the government and regulators to mandate TCFD-aligned climate-related financial disclosures.[149]

By contrast, in the US, the SEC has been criticised for not having the requisite legitimacy and for exceeding its authority to make climate-related disclosure rules.[150] In jurisdictions such as the US where serious legitimacy concerns have been expressed with regard to the SEC rule-making in this context, caution should be exercised for the regulatory agency alone to make such rules, unless there is clear evidence that the rule-making process has been highly deliberative and consultative with buy-in from relevant stakeholders, akin to the FCA rule-making process.

In sum, after considering the RMIB features relating to competition, resources, speed, incentives and legitimacy, and having regard to specific issues on the effectiveness of climate-related risk disclosures, it is suggested that the legislature should make climate-related risk disclosure rules in conjunction with a regulatory agency, stock exchange, or private/professional body.

B. Financial Services and Markets Act 2023 (FSMA 2023)

The FSMA 2023 is predicated upon the model of financial regulation created by the FSMA 2000, whereby policy frameworks are implemented via legislation and the bulk of substantive rule-

[149] HM Treasury (2020).

[150] Peirce (2022); Manchin III (2022); Budd et al. (2022).

making is delegated to the FCA and PRA as independent regulators.[151] The UK's former membership in the European Union necessarily meant that EU directives and legislation (both EU and national implementing legislation) were the source of large portions of financial rule-making. Following Brexit, EU legislation was temporarily transferred to UK statute books ('retained EU law'), leaving a 'complicated' regulatory structure with many sources of corporate/financial rule-making: retained EU law and technical standards, UK primary and secondary legislation, and regulatory rules.[152] The FSM Bill, now having received Royal Assent as the FSMA 2023, will repeal retained EU law on financial services and place responsibility for new rule-making with the FCA and PRA, providing these regulators with 'an unprecedented degree of authority'.[153]

It is unfeasible in this Article to consider all of the implications of moving large swaths of corporate/financial services regulation from legislation to regulators' rulebooks, partially because of the size and scope of the reform (millions of rules across areas as different as banking and insurance to securities offerings), and also because the new delegated rule-making has not yet been made. Instead, the more limited aim of this section is to initiate discussion on the implications of uprooting the source of large swaths of corporate rules from legislation to regulators' rulebooks under the FSMA 2023, and to analyse relevant RMIB features in order to shed light on issues that

[151] HM Treasury (2022), p. 9. For a helpful visualisation of the move from EU legislation to regulatory rulebooks, see Reynolds (2022), pp. 34-36.

[152] HM Treasury (2022), p. 22.

[153] Reynolds (2022), p. 36.

could advance or impede the effectiveness of the new regime (an aim which differs from analysing all of the changes to substantive rule-making content).

1. Incentives

Much emphasis has focused on how the move away from retained EU law provides freedom for UK RMIBs to pursue different policy priorities. From the UK government's perspective, EU rules 'constrained regulators' ability to determine the most appropriate regulatory requirements for UK markets'.[154] However, insufficient attention has been paid to incentive compatibility issues *between* RMIBs under the FSMA 2000 regulatory model – i.e., how aligned are the FCA and PRA's incentives, as operationally independent regulators, with those of Parliament (which prescribed the regulators' statutory objectives in the FSMA 2000) and the government (which will designate activities for the regulators to make rules on)?

Incentive compatibility issues manifest in the Hansard legislative debates concerning regulators' independence and accountability to Parliament (and also give rise to legitimacy issues, discussed below). Given government powers under the FSMA 2023 to 'require a regulator to carry out a review of specified rules' if considered in the public interest,[155] some MPs expressed concern that governmental rule review powers could 'risk giving the impression that regulation in this country is not independent and can be overridden when that suits a Government…'.[156] And on the

[154] HM Treasury (2022) p. 9.

[155] Financial Service and Markets Act 2023, s. 29.

[156] Dame Eagle (2022).

other hand, given the vast powers regulators will be afforded to make rules in activities 'designated' by government and then review these rules themselves, many other lawmakers expressed concerns over a lack of accountability, with regulators 'in essence, marking their own homework'.[157] On their own, issues of potentially compromised independence or unaccountability to Parliament do not imply that regulators should or should not be given greater rule-making responsibilities.[158] However, these issues are relevant to the effectiveness of regulatory rule-making and a reminder that changing the source of rules, in this case from the legislature to regulatory agencies, may entail problematic consequences. For example, one might expect the FCA and PRA to less aggressively pursue the FSMA 2023's 'competitiveness and growth objective' than the government might hope, given that the regulators deal with the immediate consequences of firm failings or scandals under their rules, and the government can more readily pass off blame for delegated rule-making by regulators rather than its own legislation.

2. *Regulatory competition*

Given the importance of regulatory competition to rule-making discussed in Part II(b), the new 'competitiveness and growth' secondary objective for the FCA and PRA contained in the FSMA 2023 has, unsurprisingly, been one of the government's most contentious policy decisions. The FSMA 2023 amends the FSMA 2000 to require, in addition to the regulators' current statutory

[157] See Baroness Bowles (2023). See also Dame Eagle (2022).

[158] The Treasury Select Committee has written that 'The Treasury should respect the principle of regulatory independence, and must not pressure the regulators to weaken or water down regulatory standards…' House of Commons Treasury Committee (2022), paras 3, 32-33.

objectives,[159] a secondary objective of facilitating the UK economy's 'international competitiveness' and 'its growth in the medium to long term'.[160] This would allow, for example, the FCA to now make rules that improve competitiveness without advancing other existing primary objectives (e.g., consumer protection, market integrity, competition).[161]

The Treasury Select Committee has emphasised that competitiveness should not come at the expense of 'weakening the UK's strong regulatory standards', and that 'pressure on regulators to trade off competitiveness against resilience' would undermine regulatory functions.[162] However, the real concern with a statutory competitiveness mandate is that pursuing competitiveness may not be possible without generating excessive risk-taking and deregulatory pressures.[163] The government was consulting (as of May 2023) on what metrics the regulators should publish to implement the new competitiveness and growth objectives, which ought to carefully account for the risks mentioned above.[164]

3. *Resources, speed, and certainty*

The government's predominant justification for placing more financial rule-making with regulators rather than Parliament under the FSMA 2023 was based upon a combination of resource

[159] House of Commons Treasury Committee (2022), para 20.

[160] Financial Service and Markets Act 2023, s. 25.

[161] House of Commons Treasury Committee (2022), para 22.

[162] Ibid, para 4.

[163] Admati et al. (2022). See also Ferran (2023).

[164] Chan (2023).

constraints and greater speed and adaptability, two of the core features in the analytical framework. Policy documents emphasised that 'The effect of having these regulatory requirements in legislation is that it is difficult and time-consuming to update, and places substantial resource pressures on Parliament which is asked to consider a large volume of technical provisions.'[165] Furthermore, the government argued that 'Keeping rules in statute could require Parliament to amend or pass new legislation every time that the regulators wish to make changes to them. This would be resource-intensive and impractical.'[166] In addition to time and personnel shortages, the government referred to constantly evolving financial markets to justify the need for speed and adaptability: 'It [the FSMA model] also provides flexibility for the regulators to update standards efficiently in response to changing market conditions and emerging risks'.[167]

These justifications are rightly raised and largely sound, though reasonable views will differ on the impracticality of Parliament amending financial legislation, and the speed advantages of the FCA and PRA. For example, it is open to query whether implementing secondary legislation (e.g., statutory instruments) is always slower than regulatory rule-making, given the lengthy public consultation, feedback, and CBA duties of the FCA.[168] Furthermore, the Treasury Select Committee raised concerns relating to the regulators' speed, meaning that the anticipated

[165] HM Treasury (2022), p. 9.

[166] House of Commons Treasury Committee (2021), para 27. See also House of Commons Treasury Committee (2022), para 94.

[167] HM Treasury (2021), para 4. To take a specific example, 'Providing the FCA with powers to set the detailed requirements on prospectuses will allow it to put in place a more effective regime, which can [be] more readily adapted as needed.' HM Treasury (2022), para 15.

[168] See Part II(D)(3). See also House of Commons Treasury Committee (2021), para 27.

advantages may be over-estimated in certain rule-making areas.[169] Given the government's proposed powers to direct the regulators to review their rules when it is in the public interest, additional concerns were raised that 'there is a risk that the collective impact could be excessive in its impact on regulators' resourcing, as well as their ability to make decisions quickly where needed.'[170] Finally, policy documents noted that regulatory staff were perceived to have significant technical expertise, but problems of high staff turnover to the private sector posed concerns over 'depth of expertise'.[171] Thus, the view that independent regulators possess resource advantages relative to Parliament that should generally result in more readily adaptable rules seems correct on the whole, but is predicated on aforementioned assumptions about regulatory resources and speed that may not hold under all conditions.

It is also important to consider certainty, which in the FSMA 2023 context relates to how the clarity and predictability of rule-making and enforcement will be affected by internal characteristics of the RMIB (given the minimised role in the UK of external certainty/judicial review discussed in Part II(D)(3)). From the government's perspective, 'they [independent regulators] are likely to deliver more predictable and stable regulatory approaches over time.'[172] However, from at least one prominent practitioner's perspective (whose views feature in reports

[169] The Treasury Select Committee noted that 'how it [the FCA] is performing against its service standards shows a deteriorating picture. The FCA has a reputation for being too slow in its authorisation work…'. House of Commons Treasury Committee (2022), para 38.

[170] Ibid, para 5.

[171] Ibid, para 36.

[172] HM Treasury (2021), para 5.

by the Treasury Select Committee), the FCA and PRA apply principles in a way which has led to 'individual, discretionary rulings of whoever may be employed by the regulators from time to time' and creates 'considerable uncertainty'.[173] The result of high regulatory discretion is now that 'firms regard their personal relationship with the regulator as being their main focus.'[174] Since under the FSMA 2023, regulators will be afforded even more rule-making authority and discretion, the issue of unpredictability must be considered when evaluating the effectiveness of the proposed regime changes. Suggestions to bolster certainty and reduce problematic exercises of discretion include a revamped appeals procedure to challenge regulatory decisions on the merits, given the 'hollow basis' of judicial review which is infrequently employed.[175]

A countervailing factor that could enhance, rather than undermine certainty is that the FSMA 2023 could remedy the problem of excess regulatory complexity by creating a simpler regime that is easier for firms to understand and comply with.[176] As one policy document notes, on-shoring EU law onto UK statute books for the Bank of England alone required 'lawyers and specialist teams […] working through 10,000 pages of rules and another 6,000 of technical standards.'[177] MiFID II, only one piece of EU financial regulation, comprises 1.7 million rules

[173] Reynolds (2022), p. 13. Reynolds leads Shearman & Sterling LLP's global financial institutions practice.

[174] Ibid, p. 15.

[175] Ibid, pp. 22-23.

[176] House of Commons Treasury Committee (2022), paras 13-14.

[177] House of Commons Treasury Committee (2021), para 9.

alone.[178] Regulatory simplification could increase certainty and comprehension of the rules, thereby improving compliance. The FSMA 2023 itself refers to the Treasury's power to modify legislation for 'the purpose of making the law clearer or more accessible'.[179] Clearly though, the benefit of increased clarity in this instance comes at the risk of compromising substance or omitting pertinent details, if relevant provisions of the masses of retained EU law are overlooked or not adequately replicated in the regulators' rulebooks. As the FCA noted, 'It is important that however the transfer of responsibility is achieved [from retained EU law and Treasury legislation to the regulators], it is not left incomplete, as this will impact the coherence of the regime.'[180]

4. Legitimacy

Unlike in the context of private RMIBs, it is not under question whether the FCA and PRA have the requisite democratic-based legitimacy to make rules important to the general public – Parliament has delegated responsibility to the independent regulators and is responsible for their oversight, along with HM Treasury. Legitimacy is still relevant, though, because of the aforementioned risk of unaccountability; deviation from the regulators' statutory objectives or unpredictable rule-making and enforcement would erode the regulators' public legitimacy, resulting in potentially weakening compliance by regulated parties.

[178] Reynolds (2022), p. 8.

[179] Financial Service and Markets Act 2023, ss. 4(2), 5(2).

[180] Financial Conduct Authority (2021d).

The regulators are subject to a number of existing accountability mechanisms,[181] and the FSMA 2023 includes further accountability mechanisms such as the power given to the government to direct the FCA and PRA to review specified rules.[182] In the months leading up to enactment of the FSMA 2023, the government also consulted on the appropriateness of then FSM Bill clause 37 (now FSMA 2023 section 39), which empowers the Treasury to require the regulators to publish reports with information that is 'reasonably necessary for the purpose of reviewing and scrutinising the discharge of the [FCA/PRA]'s functions', when other information is insufficient for this purpose.[183] While this provision is beneficial on the whole for increasing accountability, section 39 also permits the FCA and PRA to refuse to publish information when 'publication would be against the public interest'.[184] In this particular instance, regulatory accountability could have been strengthened by requiring the FCA and PRA to state their reasons for declining to publish information, which would increase accountability to affected stakeholders and better enable judicial review.[185]

[181] These include: Treasury appointees on the FCA Board and Prudential Regulation Committee; statutory consultation duties; publishing CBA; reporting to the Treasury Select Committee; and publishing annual reports on matters including the advancement of their objectives, to name a few. FSMA 2000, sch 1ZA para 11; sch 1ZB para 19. For a more comprehensive list of FCA accountability mechanisms, see the FCA's discussion of how it 'contribute[s] to ensuring accountability and democratic input'. FCA (2021d).

[182] FSMA 2023, s. 29; House of Commons Treasury Committee (2022), paras 32-33.

[183] This information includes, but is not limited to, matters in the annual report. Financial Service and Markets Act 2023, s. 39; HM Treasury (2023), pp. 14-15.

[184] Financial Service and Markets Act 2023, s. 39(2).

[185] See Chan (2023), para C.7.

It is worth highlighting that under the FSMA model of regulation, the risk of eroding legitimacy increases in line with the amount of power the rule-making body is delegated.[186] The FCA and PRA have been given 'significant new rulemaking responsibilities', which as the government acknowledges 'must be balanced with clear accountability, appropriate democratic input, and transparent oversight'.[187] This balance should not be determined by focusing on trade-offs between resource and speed advantages against increased accountability; rather, lawmakers should first consider the requisite (baseline) amount of accountability and oversight mechanisms necessary to safeguard the regulators' legitimacy over time as they exercise their expansive new rule-making responsibilities. Legitimacy lost with the public cannot necessarily be regained, as arguably demonstrated following the financial crisis by the new coalition government's decision in 2010 to abolish the Financial Services Authority.[188] Once confident that a baseline of sufficient accountability and oversight mechanisms is in place to safeguard the regulators' legitimacy and prevent the risk of legitimacy erosion, policy discussions could then focus on trade-offs against other features such as resource constraints and adaptability.

To summarise, the effectiveness of the UK's new financial services regime will not only depend on the substantive rules made, but on salient characteristics of the RMIBs. The FSM Bill

[186] Under the FSMA model, Parliament establishes a framework via primary legislation (e.g., FSMA 2000) that governs regulators' operational conduct (e.g., their objectives, consultation duties, etc.). HM Treasury determines the scope of regulated activities via secondary legislation, creating a 'regulatory perimeter', but does not prescribe detailed rule-making contents. Finally, the relevant regulator exercises its delegated authority to create the rules applying to firms and individuals carrying out 'regulated' or 'designated' activities. See HM Treasury (2021), para 13.

[187] HM Treasury (2023), paras 1.8-1.9.

[188] For an argument that this political decision was not inevitable, see Ferran (2011).

and FSMA 2023 policy discussion has focused on some of the features in the Part II framework – notably, a decision to allow competitiveness to influence rule-making (for better or worse), and the potential benefits of delegating monumental rule-making responsibilities to the FCA and PRA, which include overcoming Parliamentary resource limitations and increased rule-making speed and adaptability. This case study has suggested that the resource and speed benefits are largely sound, though they may be over-estimated in certain circumstances. However, the analysis has also suggested that other crucial features in the framework have not been paid sufficient attention. Greater delegation is only effective to the degree that the regulators are held accountable for their advancement of statutory objectives and use of empowered rule-making and enforcement discretion, which brings incentive and rule-making certainty issues to the fore. This is particularly important because of the risk of a loss of legitimacy and credibility if the regulators are not held sufficiently accountable to Parliament and the Treasury, which would weaken compliance and undermine the entire FSMA regulatory model.

IV. CONCLUSION

Several potential lessons may be drawn from the case studies. First, where widespread adoption is crucial for effectiveness, and both large private and publicly listed companies should be subject to the rules (as has been argued for climate-related risks disclosures, for example), the legislature and the body responsible for making listing rules (either the stock exchange or regulatory agency) ought to issue the rules. Second, where rule-making can result in far reaching economic externalities or have important social consequences and is likely to attract legal challenges based on democratic legitimacy, as well as compliance being undermined due to a perceived lack of legitimacy, an independent regulatory agency should not by itself issue such rules unless there is widespread buy-in from investors, stakeholders and the public. Third, where there is a need to subsequently or continuously amend the rules in light of evolving circumstances and evidence, it may be preferable to involve an RMIB in the jurisdiction with advantages in speed and responsiveness to issue and amend the rules. Finally, where rule-making and implementation power has been transferred from one body to another, more readily observable speed and resource advantages must be carefully balanced against potential incentive and legitimacy risks, with the preservation of legitimacy taking on heightened importance when a legislature ceases to make the rules in certain areas (as in the FSMA 2023, for example).

It is also important to note that the weighing and balancing of the features in the analytical framework also depend on the specific political, social and economic contexts within which RMIBs in any jurisdiction are situated. Although this Article has largely drawn from examples in the Anglo-American context, to illustrate how the features could be weighed differently elsewhere, consider the many jurisdictions that are characterised by concentrated ownership where the state is both the controlling shareholder of many significant listed companies and the regulator of those companies and stock exchanges.[189] In political and economic systems where the state controls stock exchanges and regulatory agencies, both RMIBs may be biased in their enforcement of the rules against state-owned companies for fear of reprisal from the state.

It is our hope that policymakers, appraisers, and scholars should devote more attention to the question of why and how the source of corporate rules matter. Since rules are not 'source

[189] Lim (2021).

neutral', identical rules that are implemented and enforced by different RMIBs will lead to different levels of compliance and advancement of regulatory objectives. Our proposed analytical framework helps enable critical evaluation of how corporate rule-makers' characteristics bear upon the effectiveness of their rules, and therefore why it matters who makes corporate rules. It is hoped that these considerations can, in turn, inform context-specific debates on which bodies should make the rules.

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