Corporate Purpose – The Future of Regulation and Governance

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2020 bought unprecedented disruption from a global pandemic, Brexit, global political movements and an even stronger spotlight on climate change. This has bought wider societal and global pressures into sharper focus for many businesses. The events of 2020, in conjunction with calls for greater transparency of ESG issues, mean that corporate governance failures and public discourse retain their position at the top of the policy agenda.

We bring you a keynote address from Lord Callanan, Minister for Climate Change and Sustainability on the future of regulation in a post-Brexit, post-pandemic landscape. This will be followed by an analysis of the regulatory landscape from our panel of governance experts: Matthew Kirk, senior advisor at Squire Patton Boggs and former external affairs director at Vodafone; Rosie Donachie, Group head of Government Relations and Regulatory Strategy at London Stock Exchange Group; and Hannah Kendrick, Corporate Partner and Governance lead at Squire Patton Boggs.

The Regulatory Landscape

The UK is in a unique position of possessing a newfound regulatory autonomy following its departure from the EU, but this is not the only motive for a renewed interest in regulation. The two key drivers of regulatory reform are, in fact, globalisation and technology.

1. Globalisation

In recent years, the world has grown ever more connected. As a result, key policy issues transcend international borders and regulation has been necessary to protect both businesses and citizens while enabling us to compete at a global scale, and tackle major challenges. For example, climate change will require a global effort to reduce our carbon emissions, and regulatory harmony will help our financial markets to recover and stabilise in the wake of the pandemic.

2. Technology

The rapid and unrelenting evolution of technology exceeds the rate at which our regulation can adapt. The benefits of these innovations are vast, but without supportive regulation, innovators are facing unnecessary obstacles and failing to reach their full potential. As a result, we are missing opportunities to use technology to tackle some of the world's biggest problems, such as climate change and medical advances.

It is these two connected issues – globalisation and technology – that are defining the future of regulation.

What Does This Mean for the UK?

The UK has long been recognised as one of the best places in the world to do business because of its prioritisation of effective and necessary regulations. We are at a critical junction for the country, as our new found regulatory autonomy provides us with the ability to take a new approach, develop smarter regulation and facilitate innovation, investment and support international trade.

International Trade

As a standalone nation, the UK is poised to deepen its trading relationships with a range of partners across the globe, and developing a new approach to international regulatory cooperation will be key to delivering on the vision of a global Britain.

Regulatory cooperation has previously been seen as a competence of the EU; hence, it is imperative that we engage in this ourselves to facilitate future trading relationships, not just with the EU, but globally. The forthcoming International Regulatory Strategy sets out plans to reform the policy-making process in a way that will require government and regulators to consider their proposals and implications from an international perspective. This will entail harmonisation or equivalence in regulatory standards to enable opportunities for bilateral cooperation with UK leadership in shaping our global interests.

Rest assured, such regulatory reforms will not compromise our reasons for leaving the EU. Regulatory cooperation does not have to mean adhering to identical laws and regulations. It could be achieved through creating more interoperable frameworks that recognise different rules, processes and standards that can create similar outcomes.

Regulatory Diplomacy

In order the secure the UK's position as a world leader in effective regulation, the government is working on a more coordinated approach to international influencing abroad, in what is known as regulatory diplomacy. The intention is for the government to collaborate with other UK bodies to leverage a collective influence and deliver impactful engagement with priority countries, as well as secure the UK's place in the key forums that establish regulatory rulebooks.

The Significance of Climate Change

Already, the UK has taken steps to establish its sincerity in being a responsible global player by promoting the response to tackle climate change.

Firstly, the UK is the first global economy to legislate for net-zero as a means of tackling climate change, and we are now legally obligate to deliver net-zero.

Secondly, by endorsing recommendations from the Task Force on Climate-related Financial Disclosures (TCFD) and making these disclosures mandatory by 2022. This is an important piece of legislation because high-quality disclosures enable the management of opportunity and risk for investors. It will improve transparency, there will be better informed capital allocation, and, as a result, over time, TCFD will help support investment decisions that are aligned with the transition to a low carbon economy.

Such bold measures are supported by a series of announcements from the Chancellor of the Exchequer in 2020 that recognised the importance of financial services as a critical enabler in mobilising investment at the pace and scale required, and aim to cement the UK's position as a hub for green investment.

The UK is leading an international response to climate change and the COP26 presidency will demonstrate what effective regulatory cooperation should look like. Through the international regulatory cooperation strategy, the government is going to look at what systematic changes can be made for a more global approach to regulation for climate change among wider issues.

Thus, paramount to tackling climate change are climate-related financial disclosures and technological advances in green-tech. In order to maximise their utilisation and scale markets, we need common rules and regulation to ensure they are made to the highest grade, deployed most effectively and are readily tradeable.

The Significance of Technology

Our traditional understanding of regulation as being a barrier to growth is evolving. We now recognise that it can be a powerful enabler if done right, creating the certainties for businesses, investors and consumers, which new markets need in order to grow. Autonomous vehicles, fusion energy, new medicines and medical breakthroughs will not happen in the absence of regulation, as it is essential to ensure safety, trust and widespread adoption.

The Regulatory Horizons Council

A key aspect of UK regulatory reform that will enable the rapid yet safe adoption of new technologies is a more anticipatory approach to facilitate rather than restrict innovation. Hence, the Regulatory Horizons Council was formed last year with the aim of identifying technologies that will have the greatest impact on our economies, society and the environment.

The pace and complexity of changes in emerging technology has demonstrated that a prescriptive command and control type regulation is not effective. Instead, we need outcome-focused tech-neutral legislation with a focus on the achievement of real world outcomes for citizens. Lord Callanan is working to encourage this type of flexible approach across the government, by requiring all new regulatory proposals to be assessed against an innovation test as part of the impact assessment and review process.

Regulatory Sandboxes

Regulatory reform needs to incorporate more room for experimentation of new technology innovations under regulatory support to stimulate the safe breakthrough of new technologies. The UK's financial conduct authority seized the opportunity to adopt the world's first sandbox – a space where firms could work with regulators to trial their innovations without having to meet all of the usual requirements for compliance, while allowing regulators to anticipate their response to such products.

Emerging technologies are global in scale and comparison with regulation requiring international cooperation to create effective protections for consumers and to enable innovators to buy and sell in a global market. The UK is now championing this style of regulatory reform globally, encouraging other countries to move away from traditional and prescriptive approaches that lock out innovation.

Therefore, in December 2020, the Agile Nations Initiative was launched by Lord Callanan. This is a cooperation network consisting of six countries, with the aim of collaborating on regulatory experimentation and enabling the rapid adoption of new technology. Such activities include coordinating anticipatory regulatory initiatives in different countries to create a shared understanding and approach to future regulation of technology, identifying where divergence in regulation occurs, or developing a global sandbox that enables innovators to test their products in several markets simultaneously. Ultimately, the goal is to set a global precedent in regulation of innovations, align regulatory approaches and enable innovators to scale their products across international markets.

Striking the Right Balance

There is a balance to be struck between enhancing accountability and presenting the UK as an attractive destination to do business. At present, the government is determined to support the economy and build back stronger. Success in this area is reliant on private investment, which, in turn, relies on frank and reliable information to provide certainty and manage risk. Thus, the existing measures and pending reforms are about maintaining the high standards of corporate governance and fairness that underpin financial markets.

Market Impact

The Prominence of Corporate Purpose

Of late, attention has been shifting from a focus on financial results to a focus on corporate behaviour, with corporates beginning to look inwards at their governance structures, and focussing on risk response, resilience, HR and human capital management, and their corporate culture. This change in regulation has been anticipated for some time, and boards have been motivated to get their affairs in order for when this occurs.

In part, the prevalence of corporate purpose has been driven by investors, who for many years have been critical to diverting funds in a manner that has brought ESG reporting to the fore. Ultimately, the key driver for this change has been accountability. The public, the media, and shareholders, etc. are increasingly holding large corporations to a higher standard of behaviour. The pandemic has only accelerated this trend, by spotlighting the way in which businesses have managed their response. For example, the Job Retention Scheme that was made available to support employer-employee relations and enable a stronger recovery post-pandemic engendered public criticism for large corporations that were deemed to not need the support, as well as public praise for those companies who re-paid their debts early.

Corporate purpose is loosely defined in terms of outlook for customers, employees, society and future generations while, at the centre, being a successful business. In the future, we can expect the list of directors' duties to evolve, and corporations to be seen doing more for both the society and environment. Aptly, businesses will likely have an important role to play in the Build Back Better strategy, as well as tackling climate change, although their role will become clearer in due course.

The Impact of Mandatory Reporting

Previously, businesses were only required to demonstrate compliance to their stakeholders, but today, businesses are encouraged to actively promote their ESG capabilities. The implementation of mandatory reporting has proven beneficial in the past, for example, gender pay gap reporting. Arguably, any measure that encourages companies to change their behaviour for the better will help to build transparency and trust, foster employee engagement and improve public standing. However, the force of accountability means that for some time, companies have effectively been disclosing on a voluntary basis.

In addition, ethical investment done right has a competitive advantage for businesses. The data is starting to demonstrate a positive correlation between strong ESG practices and financial performance. Businesses with robust governance frameworks are able to manage their environmental and social factors and can better mitigate risks and increase productivity. The consequences for a lack of robust compliance programmes are very real, including unlimited fines, loss of operating licences and damage to the business' reputation.

ESG-conscious companies with sound governance and solid relationships with their suppliers, employees and stakeholders have been able to better account for long-term risks, shown greater resilience and outperformed during this period of intense volatility.

The Future of Regulation and Governance

Corporate purpose will retain its place at the top of the board agendas for a long time to come, and businesses would be wise to adapt their behaviours and business strategies accordingly – if not to help the UK build back better post-pandemic, then to reap the rewards of a competitive advantage.

The UK's regulatory future remains largely uncertain, but it is recognised that there are no advantages to regulatory divergence from the EU among other key trade partners, and that existing regulation can create obstacles to innovation. Therefore, we can expect a less restrictive approach and a more international mindset, as regulation is reformed to enable innovation and globalisation.

Contact

Hannah Kendrick
Partner, Leeds
T +44 113 284 7620
E hannah.kendrick@squirepb.com

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