OECD Best Practice Principles for Regulatory Policy

The Governance of Regulators

OECD

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Foreword

A high quality regulatory environment is an essential foundation for all nations to be an enjoyable and prosperous place to live, work, and do business, while protecting the environment and all parts of society. High performing regulators play a key role in achieving these outcomes while also encouraging innovation and fostering productivity and growth.

Over the last decade, OECD countries have strengthened their use of a range of regulatory management tools. There is now a more careful examination of the need for regulation and the available design options (OECD, 2009). Most governments have outlined their policy on improving the design of regulation through regulatory impact analysis and stakeholder engagement mechanisms, often with the support of central scrutiny of proposed new regulation. As well as improving the design of new regulation, nearly all OECD countries have searched for opportunities to remove unnecessary burdens on the business community and citizens.

Good regulatory outcomes depend on more than well-designed rules and regulations. This was recognised in the OECD's *Recommendation of the Council on Regulatory Policy and Governance* (OECD, 2012) which recommended that countries: "Develop a consistent policy covering the role and functions of regulatory agencies in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence." (p. 4)

The *OECD Best Practice Principles for Regulatory Policy: The Governance of Regulators*, is intended to assist countries in developing such a policy. It seeks to construct an overarching framework to support initiatives to drive further performance improvements across regulatory systems in relation to national regulatory bodies or agencies (*regulators*).

Efficient and effective regulators, with good regulatory management and governance practices, are needed to administer and enforce regulations. The comprehensive regulatory reviews of individual policy areas carried out by governments frequently find that there is scope to enhance governance as part of broader initiatives to improve regulatory outcomes [see for example, the Australian Productivity Commission's reports on performance

benchmarking of Australian Business Regulation (www.pc.gov.au/projects/study/regulation-benchmarking), or Maxwell (2004)]. It is clear that appropriate governance arrangements for regulators support improvements in regulatory practice over time, and strengthen the legitimacy of regulation.

Strengthening the governance of regulators will help to maintain the confidence and trust of those being regulated and the broader community (ANAO, 2007). Good regulation helps to make OECD countries healthier, happier, cleaner, more prosperous and safer, while supporting innovative solutions to the challenges faced, and thereby serves the interests of all citizens.

The *OECD Best Practice Principles for Regulatory Policy: The Governance of Regulators* has undergone a rigorous consultation process. The initial draft of the principles was discussed at the *ad hoc* meeting of the Network of Economic Regulators (NER) on 21 November 2012 with key questions and comments from an academic expert. The draft was circulated among NER members and associations for further written comments. A revised version was discussed at the 8th Meeting of the Regulatory Policy Committee (RPC) on 22-23 April 2013, and it was also shared at the NER meeting on 24 April 2014. Incorporating feedback from both meetings, the 3rd draft was released for public consultation for a period of 3 months from June to August 2013. The document was revised absorbing public feedback and a subsequent version was presented and approved at the 9th Meeting of the RPC on 12-13 November 2013 and the NER meeting on 14 November 2013. A preliminary version of the principles was then circulated at the 10th meeting of the RPC on 14-15 April 2014 and the NER meeting on 14 April 2014 before its final publication.

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Preface by the OECD Secretary-General

Can the energy market guarantee safe, secure and affordable energy to citizens and industry? Is the financial sector effectively supervised? Are our natural resources managed in a sustainable fashion? Governments are responsible for the delivery of public policies, but the achievement of many key social, economic and environmental goals is the task of regulatory agencies. These regulators play a crucial role in ensuring that markets function properly and that the public interest is safeguarded.

In the aftermath of regulatory failures linked to the financial crisis, the performance of regulators has come under increasing scrutiny, with calls to strengthen mechanisms to ensure transparency and accountability. Against this background, this seminal set of principles provides governments and regulators with clear and detailed guidance on the establishment and evaluation of regulators. It does not take a one-size-fits-all approach and recognises the need for adaptation and consideration of different political and cultural environments.

The governance arrangements of a regulator are critical. The legal remit of the regulator, the powers it is given, how it is funded and how it is held accountable are all key issues that should be carefully designed if the regulator is to succeed in combining effective regulation with high standards of integrity and trust. Regulators are pivotal in making regulatory regimes work for sustainable growth and equitable societies.

Regulatory agencies are often at the point of interface between regulatory regimes and citizens and businesses. They play a vital role in the delivery of public policy and are responsible for ensuring investment in sectors and industries, as well as for protecting the neutrality of markets. They protect citizens (including workers and consumers) for fairness and safety, and they also protect the environment and manage its future. They ensure the reliability of vital infrastructure. If the lights go out, they are held to account.

This set of principles for the governance of regulators has drawn upon an extensive consultation process that has included the views of regulators from the OECD Network of Economic Regulators, Government delegates

from the OECD Regulatory Policy Committee and other OECD Committees, academic and industry experts. They provide Governments with a guide to consider when establishing or reforming regulatory agencies and regimes, and at the same time they offer regulators advice on how to evaluate and improve the governance arrangements to become more effective. Moreover, the principles also provide a framework for the OECD and other organisations to assess and review the current structure of regulatory agencies and address practical questions on how to deal with different country contexts.

Regulators can have a significant positive impact on society, the environment and the economy, but they work in a complex, high-risk environment at the interface between the public and private sectors. Meeting ever-increasing expectations depends on having the tools and capacity to perform their duties. These OECD principles provide useful guidance in this regard.

Angel Gurría
Secretary-General of the OECD

Acronyms and abbreviations

ACCC	Australian Competition & Consumer Commission
ACM	Authority for Consumers and Markets, Netherlands
AER	Australian Energy Regulator
ARI	Accountability of Regulatory Impact Scheme, United Kingdom
CCA	Competition and Consumer Act, 2010, Australia
CEO	Chief Executive Officer
ICSA	International Council of Securities Associations
IFT	Federal Institute of Telecommunications, Mexico
OFWAT	Water Services Regulation Authority, United Kingdom
RPC	United Kingdom's Regulatory Policy Committee
SCER	Standing Council on Energy and Resources, Australia
SCT	Ministry of Communications and Transport, Mexico
SHCP	Ministry of Finance and Public Credit, Mexico

Executive summary

Regulation is a key tool for achieving the social, economic and environmental policy objectives of governments. Governments have a broad range of regulatory schemes reflecting the complex and diverse needs of their citizens, communities and economy.

However, as Professor Malcolm Sparrow (2000) argues:

"Regulators, under unprecedented pressure, face a range of demands, often contradictory in nature:

be less intrusive – but be more effective;

be kinder and gentler – but don't let the bastards get away with anything;

focus your efforts – but be consistent;

process things quicker – and be more careful next time;

deal with important issues – but do not stray outside your statutory authority;

be more responsive to the regulated community – but do not get captured by industry" (p. 17).

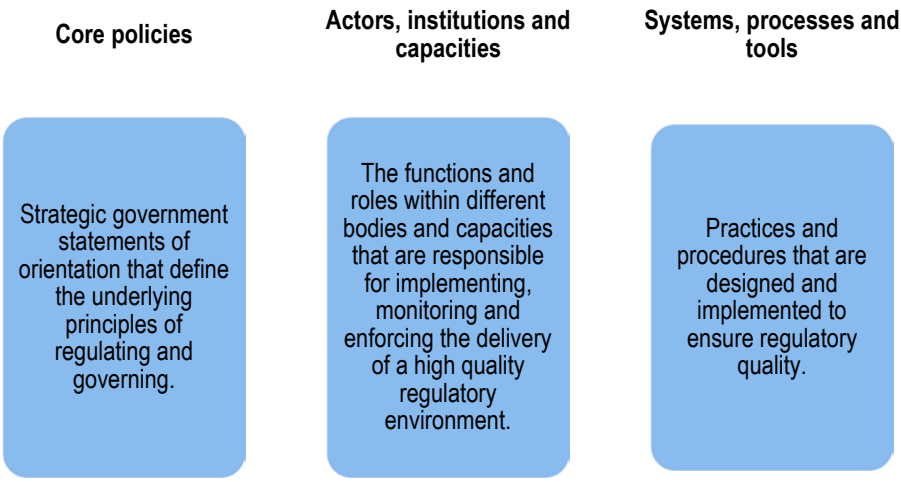
Regulatory activity has become increasingly important in the modern state in both policy formation (regulatory design) as well as in policy execution (regulatory delivery) because regulators have special expertise in drawing on relevant evidence from the natural and social sciences, including economics, finance and behavioural theory (see Lunn, 2014). Regulators are increasingly forward looking and have an advantage in exploring new areas of societal concern.

In addition regulation has become an increasingly important mechanism for managing the space within which society, the economy and environment interact. Most notably it is also the mechanism to manage between the domains of politics and the market. For example under fiscal constraints, governments may turn to regulators to help the private sector provide more in the way of social provision and infrastructure investment. Furthermore

regulators have an advantage over politics and the law in that they can give long term and continuous attention to an area of social and economic concern rather than over shorter horizons or on a case-by-case basis.

Addressing these challenges to achieve better regulatory outcomes requires more than just good governance. It is vital that the full range of necessary and mutually reinforcing regulatory mechanisms and structures are in place, as described by the OECD regulatory policy and governance framework in Figure 0.1.

Figure 0.1. OECD regulatory policy and governance framework



Over the past three decades, the OECD has established itself as a key source of international principles for good regulatory practices. These principles are intended to facilitate better institutional arrangements for the governance of regulators, and consequently it complements documents such as the OECD's *Introductory Handbook for Undertaking Regulatory Impact Analysis (RIA)* (2008), which guides the development of better rules and regulations, the OECD *Best Practice Principles for Regulatory Enforcement and Inspections* (2014) and the OECD's *Recommendation of the Council on Regulatory Policy and Governance* (2012). All of these documents support the work underway across OECD countries to improve the operational processes and practices within regulators and to support regulators' efforts to attract and develop the best people.

These principles are intended for all the key actors in relation to regulators, that is: *i)* the political branch (governments and legislators); *ii)* the judiciary; *iii)* the targets of regulation or regulated entities; *iv)* the public; and *v)* regulators themselves. How a regulator is established, directed, controlled, resourced and held to account — including the nature of the relationships between the regulatory decision maker, political actors, the legislature, the executive administration, judicial processes and regulated entities — *builds trust* in the regulator and is crucial to the overall effectiveness of regulation.

While there are different institutional models for regulators, improving the governance arrangements of regulators can benefit the community by enhancing the effectiveness of regulators and, ultimately, the achievement of important public policy goals.

Achieving good regulatory outcomes is almost always a co-operative effort: by the government, amongst regulators, the regulated, and the broader community. Governance arrangements for regulators can be important to foster such co-operative efforts and build the legitimacy of any necessary, strong enforcement action. For these reasons, governance arrangements require careful consideration to ensure they promote, rather than hinder, the efficient achievement of policy objectives and public confidence in the operations of regulatory agencies.

These principles aim to develop a framework for achieving good governance through outlining general principles that might apply to all regulators. The framework is intended to provide:

- principles for assessing existing governance arrangements and undertaking reviews of regulators and their administration; and
- a guide to the development of governance arrangements for any proposed new regulators.

The principles are set out within seven areas which need to be considered to support good governance of regulators. At the end of each chapter are guiding questions to assist in applying the principles to different contexts and needs.

Regulators are playing an increasingly important role in delivering economic and societal objectives as well as being tasked with *regulating* more complex situations. At the same time the role of regulators is being continuously examined, especially at times of crisis or when issues arise that create public concern. As such regulators are key state actors with responsibilities and therefore are accountable for the delivery of policy outcomes. These principles are designed to assist the institutional structures for regulators to be more effective in the overall regulatory system within which they function.

Box 0.1. **Seven principles for the governance of regulators**

1.	Role clarity
2.	Preventing undue influence and maintaining trust
3.	Decision making and governing body structure for independent regulators
4.	Accountability and transparency
5.	Engagement
6.	Funding
7.	Performance evaluation

Introduction

Setting the scene

Strengthening governance can contribute to improved regulatory outcomes (Meloni, 2010). In particular, better administration, more effective compliance programmes and targeted enforcement of regulation can help to achieve the desired outcomes most efficiently, while minimising the burden on regulated entities. This can also allow more focus on enforcement and other efforts to curb those who deliberately operate at the expense of the community's interests.

Strong governance strengthens the legitimacy and integrity of the regulator, supporting the high level policy objectives of the regulatory scheme and will lead to better outcomes.

Regulation is a key tool for achieving the social, economic and environmental policy objectives of governments that cannot be effectively addressed through voluntary arrangements and other means. Governments have a broad range of regulatory powers reflecting the complex and diverse needs of their citizens, communities and economy.

Regulators are entities authorised by statute to use legal tools to achieve policy objectives, imposing obligations or burdens through functions such as licensing, permitting, accrediting, approvals, inspection and enforcement. Often they will use other complementary tools, such as information campaigns, to achieve the policy objectives, but it is the exercise of control through legal powers that makes the integrity of their decision-making processes, and thus their governance, very important.

Regulators are also important actors in the national governance infrastructure and can help to ensure transparency in the overall regulatory system. Increasingly this includes through providing access to information for regulated entities to make better informed choices. The study of behaviours is also another way for regulators to determine appropriate forms of intervention. The application of behavioural science by regulators has happened for some time and is increasing.

The manner in which the regulator was established; its design, structure, decision making and accountability structures, are all important factors in how effective it will be in delivering the objectives it was intended to deliver. The way that it interacts and communicates with its key stakeholders will be instrumental in the levels of trust it has from them, and in turn then will impact how it will behave in *regulating* its responsibility. The institutional governance arrangements for regulators are critical for assisting or impeding the social, environmental and economic outcomes that it was set up for.

Regulators may take a variety of institutional forms. A regulator may be a unit within a ministry or a separate entity with its own statutory foundation, governing body, staff and executive management. In some cases, a regulatory unit or function will be located within a large, independent service delivery agency; for example, the regulatory responsibilities of a fire service. Regulatory functions may also be discharged at a national or municipal level or by a regional authority body. In some instances a regulator may be independent of national executives and other national institutions and subject to international standard setting entities or supranational bodies, such as independent regulators in the EU.

The external governance principles discussed in this report are relevant to regulators regardless of their institutional form. However, there are many cases where the application of the principles may differ and this may be justified in the particular context, due to the nature of the regulation administered or the circumstances of the regulator.

The principles also set out relevant considerations for when it may be appropriate to maintain regulatory functions within a ministry or Secretariat and when it is appropriate and necessary for the creation of a more autonomous institutional arrangement such as an independent body outside of a ministry. Such a decision will be influenced by the political environment and culture that exists, that may lend towards the need, or not, for independent regulators. Another factor for making such institutional decisions is the type of regulation being considered such as economic regulation which may benefit from separation from the political branch.

This publication provides general governance principles that would be applicable to a wide variety of regulators, whatever the breadth of their responsibilities. Some regulators' mandates relate only to a single industry ("industry-specific regulators"), while others cross several industry sectors and/or public policy agendas ("multi-sector regulators" or "multi-purpose regulators") or the whole economy ("general regulators"). Regulators' responsibilities may be purely economic, purely non-economic (for example, safety-related) or a combination of these or other functions.[1] This

report has been developed with a focus on enhancing the governance of regulators undertaking the regulation of businesses, occupations or professions and not-for-profit organisations.[2]

Regulators could also be viewed as market or non-market regulators depending on whether their decisions will have an economic effect or impact on the market. For instance many safety and environment regulators have an impact on businesses, although they are usually seen as non-economic regulators. And in instances where there is a government-owned entity that operates in the market, then an independent market regulator would be recommended to maintain competitive neutrality, as described in these principles.

The scope of this report

Two broad aspects of governance relevant to regulators can be distinguished:

- external governance (looking out from the regulator) – the roles, relationships and distribution of powers and responsibilities between the legislature, the minister, the ministry, the judiciary, the regulator's governing body and regulated entities; and
- internal governance (looking into the regulator) – the regulator's organisational structures, standards of behaviour and roles and responsibilities, compliance and accountability measures, oversight of business processes, financial reporting and performance management.

The main focus of this report is on external governance arrangements and their effect on the performance of regulators. However, as the two aspects overlap, some issues of internal governance are also addressed where relevant (such as the governing body, funding and performance evaluation of regulators). It is also recognised that a regulator cannot be effective or efficient without clear and well-functioning internal organisation. Internal governance is not only important for instilling public confidence but also is important in the context of judicial and other independent reviews such as external audits.

The nature of an entity's external governance is determined by the arrangements which establish and distribute decision-making power and authority between key decision makers. In government, the main parties involved in these arrangements are the legislature, ministers, the executive heads of ministries, and the governing bodies and executive management of regulators. The judiciary plays an important role particularly for independent

regulators but moreover in maintaining accountability and trust in the regulator. In some cases, such as for regulators in the European Union, the regulators are subject to and accountable to supranational regulatory frameworks and bodies. In the financial services sector there are international standard setting entities such as the Basel Committee on Banking Supervision, G20 Financial Stability Board and International Organization of Securities Commissions that provides standards and guidance on regulatory frameworks that national regulators implement.[3] The generic external governance arrangements between the parties within a regulatory system are depicted in Figure 0.2. Regulators separate from ministries and those located within ministries are portrayed in the diagram, reflecting the diversity in the organisational location of many countries' regulators.

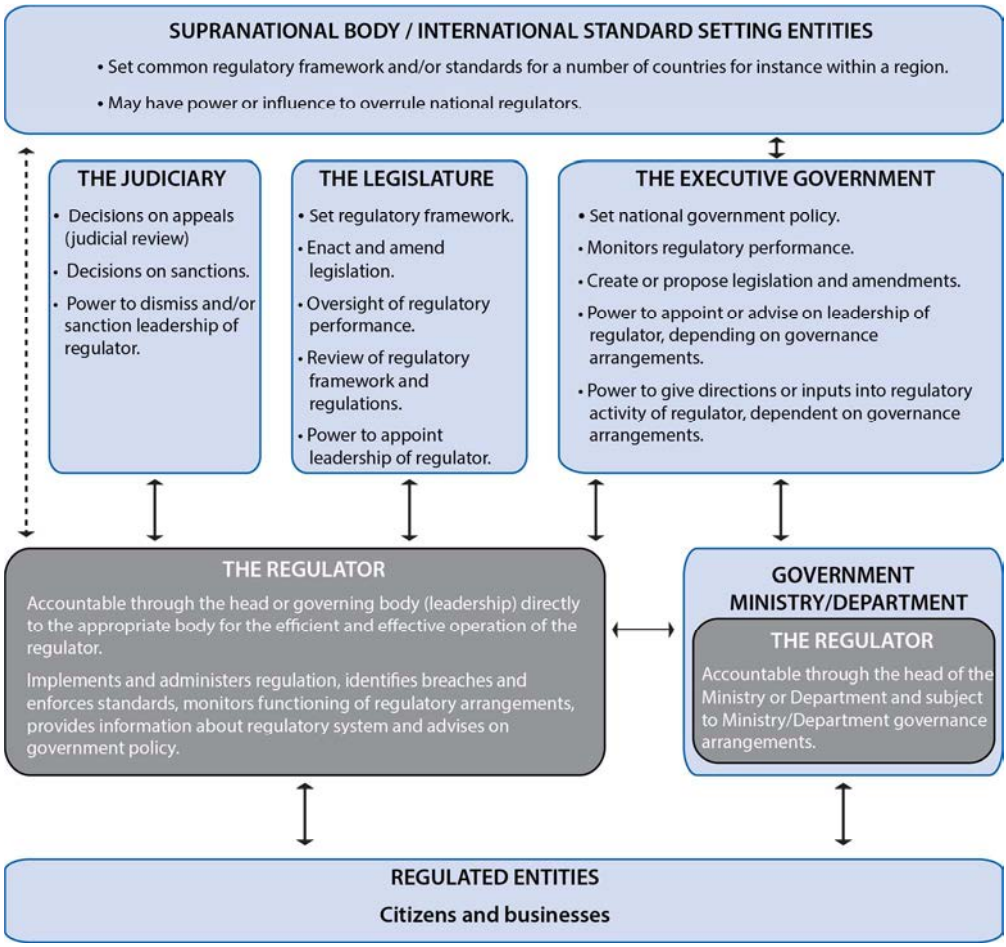
Central to governance arrangements are the institutional forms regulators take. "Institutional form" refers to a regulator's decision-making body and legal form, the degree of organisational separation from ministries, sources of operating funds, employment powers and financial accountability obligations. The relevance of independent regulators versus ministerial regulators is discussed in greater detail in Chapter 2.

In addition to the legislation that determines the institutional form, there are several governance tools, such as statements of expectations, corporate plans, service agreements and protocols, framework agreements and guidance, which can be used to codify and shape the way that governance arrangements work in practice. Governance tools may or may not have the force of law.

Governance arrangements, institutional form and governance tools together comprise the governance framework for an individual regulator. The framework sets out the objectives, powers, functions, limitations and relationships of a regulator.

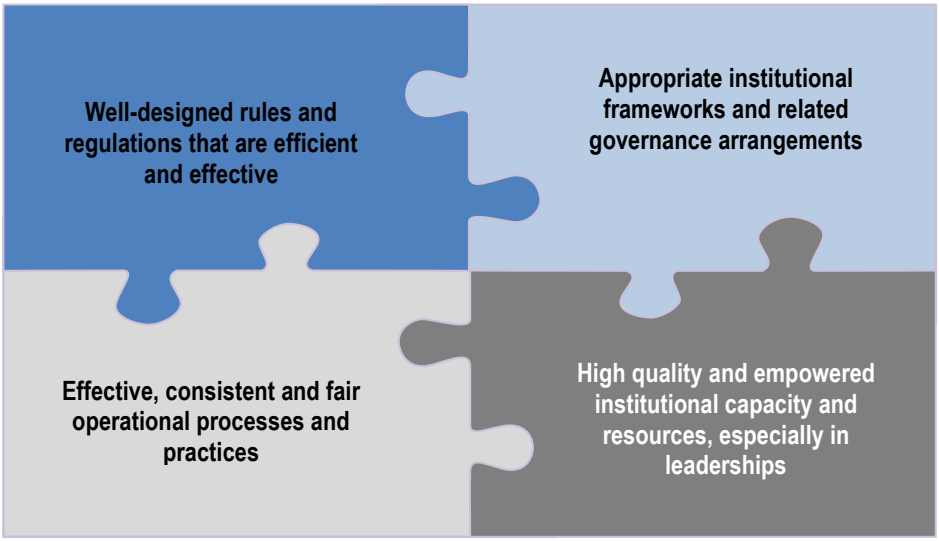
The focus of this report is on external governance, but better internal governance can be a very effective complement to, or in some cases a substitute for, improvements to external arrangements. For example, where it is not practical to create a separate independent regulatory function because of the need to maintain close links with the funding or service delivery functions of the ministry (for example, to share industry knowledge and intelligence or scarce expertise), internal governance mechanisms, such as financial autonomy, internal protocols and reporting arrangements, may achieve some of the benefits of more robust, external arrangements.

Figure 0.2. Governance arrangements of regulators



Achieving better regulatory outcomes obviously requires more than just good governance. In particular, there needs to be four necessary and mutually reinforcing elements, as depicted in Figure 0.3.

Figure 0.3. Necessary elements of better regulatory outcomes



These principles along with other OECD publications mentioned in this report, support OECD countries' governments to improve the institutional arrangements, processes and practices within regulators and support regulators' efforts to build a high level of professional competence and attract, develop and retain the best people to manage regulatory systems.[4] In addition, given the growing importance of ensuring more regulatory delivery and implementation these principles will also be of relevance to non-OECD countries, many of whom are also facing similar challenges in building and maintaining a high-quality enabling and inclusive regulatory environment.

Governance principles are already a familiar concept in monetary, financial and capital market regulation. For example, see the International Monetary Fund (IMF), *Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles* (1999), and the International Organization of Securities Commissions (IOSCO), *Objectives and Principles of Securities Regulation* (2010), which is used by IMF and World Bank assessors in conducting country Financial Sector Assessment Programs.

Improving outcomes through better governance

This report aims to develop a framework for achieving good governance through outlining general principles that might apply to all regulators. The framework is intended to provide:

- principles for assessing existing governance arrangements and undertaking reviews of regulators and their administration; and
- a guide to the development of governance arrangements for any proposed new regulators.

It could also enable more consistent application of other measures that can improve existing governance arrangements, such as guidelines relating to the remuneration of public officials or cost-recovery.

Effective governance structures encourage regulators to improve outcomes for the community honestly, fairly and efficiently, within the boundaries of their legal framework and the objectives outlined by government. Appropriate governance structures support the overarching principles of good regulation. The OECD (2005) recommended that good regulation should support eight key aims as outlined in Table 0.1.

Table 0.1. OECD principles of good regulation

i)	Serve clearly identified policy goals, and be effective in achieving those goals
ii)	Have a sound legal and empirical basis
iii)	Produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account
iv)	Minimise costs and market distortions
v)	Promote innovation through market incentives and goal-based approaches
vi)	Be clear, simple and practical for users
vii)	Be consistent with other regulations and policies
viii)	Be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels

Source: OECD (2005), *OECD Guiding Principles for Regulatory Quality and Performance*, www.oecd.org/fr/reformereg/34976533.pdf, accessed 10 October 2012.

There are strong links between the overarching principles of good regulation and good governance of regulators. Good governance arrangements strengthen the oversight of processes and practices within a regulator. This can contribute to improving the effectiveness of regulatory operations and to promoting compliance by making administration and enforcement more consistent and predictable. It can also promote greater innovation in regulatory practice. Greater scope for regulatory discretion enables regulation to be applied more proportionately and flexibly. This discretion is more likely to be granted by the legislature, politicians and the executive when it is supported by robust accountability and transparency provisions. Effective engagement as part of regulatory operations can enhance the level of co-operation between those being regulated and the regulator.

Over the last decade, many existing regulatory regimes have been reviewed and enhanced. A key aspect of many of these reviews has been how to build on current good practice and ensure that the governance arrangements encourage and support ongoing improvements. While it may not directly achieve regulatory outcomes in itself, improving governance underpins sustained and consistent good regulatory performance.

The diversity of governance arrangements of any jurisdiction's regulators is not necessarily evidence of a problem. Arrangements will often need to differ to reflect different circumstances, but consistent principles will improve coherence and offer the opportunity to apply experience across government to facilitate incremental improvement. While the reviews of regulatory schemes have not identified a standard template for institutional arrangement, some common lessons and approaches can be adopted more widely.

Implementation of the principles

In addition to the high level universal principles, this report also provides guidance on how they might be applied. This may differ, reflecting the fact that the structure, practices and processes of each regulator need to match the nature of the activity, the industry it regulates, and the context in which they were developed over time, as well as the political system of each country. Consequently, the intention is not to develop a "one-size-fits-all" approach to regulator governance, but rather to promote a more consistent and coherent approach in which differences across regulators might reflect the best model for their particular functions, rather than historical circumstances that applied when the regulator was created.

Substantial structural changes that affect the governance arrangements of existing regulators are, in most cases, likely to be best made in conjunction with broader policy reviews of regulatory schemes or reviews of the opportunities to improve operational performance. The most appropriate governance arrangements depend on all aspects of a regulatory scheme, and this targeted approach is likely to yield the highest benefits.

Other enhancements in governance will be achieved through the legislature (parliament or congress) or ministers providing each of their regulators with statements of expectations (see Chapter 4). These statements will address many of the issues of application of the principles that can be achieved without legislative changes.

The principles expressed are intended to be universal, but the approach or process for applying these principles will depend on the context of each regulatory scheme. In some cases, the extent to which it is appropriate to apply some principles will also depend. Where future reviews of a regulatory scheme or regulators are undertaken, the terms of reference could outline an expectation that the review would have regard to the principles that are ultimately developed. Where a review recommends an approach inconsistent with the principles, or an approach that is qualified in some circumstances, the review could be obliged to explain why this is so. This is consistent with the "if not, why not" approach adopted for governance of publicly listed companies by the Australian Securities Exchange Corporate Governance Council (2003).

A focus on the "operate" phase of regulation

The concept of a "cycle" of regulatory activities is a useful aid to understanding in more detail what regulators do day-to-day and, therefore, what particular issues may need to be addressed in designing good governance arrangements. These activities can be grouped into three phases of a regulatory cycle – "Make", "Operate" and "Review" – as detailed in Figure 0.4. In many cases, these phases occur concurrently (Consumer Affairs Victoria, 2008).

Regulators commonly carry out many of the seven generic functions in the "Operate" phase of the regulatory cycle, and it is the governance of regulators which have a core function of delivering the "Operate" phase which is the primary focus of this report.

Figure 0.4. The cycle of regulatory activities

In practice, the imposition of regulatory obligations on businesses or not-for-profit organisations commonly takes the form of:

- requiring licences and permits for entry into specific markets, businesses, occupations or activities, or registering participants in them, setting prices or terms and conditions of access for essential facilities, authorising otherwise unlawful activities, and/or establishing standards and codes of practice relating to the performance of those licences and permits; and

- enforcing the provisions of acts or regulations and other regulatory instruments relating to the conduct of regulated businesses or individuals through conducting inspections or investigations, issuing warnings, directions or penalties to change behaviour and, in some cases, taking court action in response to breaches.

Enforcement is a vital part of ensuring compliance with regulation and therefore obtaining the public benefits that regulation provides. At the same time, a regulator's enforcement activities may lead to the imposition of substantial sanctions against businesses or not-for-profit organisations, with associated damage to reputation and, in extreme cases, business closure or loss of personal livelihood (such as through cancellation of a business or occupational licence). The OECD has also developed *Best Practice Principles for Regulatory Enforcement and Inspections* (OECD, 2014) which provides greater detail on obtaining effective and efficient compliance.

Structure of this report

This report is built around seven principles of good governance:

- role clarity;
- preventing undue influence and maintaining trust;
- decision making and governing body structure for independent regulators;
- accountability and transparency;
- engagement;
- funding; and
- performance evaluation.

Each of the following chapters provide further information about the issues involved with the principle and the implications of applying the governance principles to regulators.

Each chapter ends with a series of questions to guide those seeking to apply the principles to specific cases, either to review existing regulators or in the establishment of new regulatory bodies.

Notes

1. For example, the United Kingdom's Office of Rail Regulation is the rail sector's safety and economic regulator, but it only regulates that single industry. An example of a multi-sector regulator is Bundesnetzagetur, the German Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway. An example of a multi-purpose regulator is the Dutch Authority for Consumers and Markets which is responsible for the economic regulation of water, energy, telecommunication and transport, and competition and customer protection. An example of a general regulator is the Australian Competition and Consumer Commission (ACCC), which promotes competition and fair trade in the market place and regulates national infrastructure industries across a wide range of industries.

2. A business regulator could be defined as: "a government entity that derives from primary or subordinate legislation one or more of the following powers in relation to businesses and occupations: price-setting; market supervision; inspection; regulatory advice to a third party; licensing; accreditation; and enforcement." (derived from Better Regulation Task Force (2003), *Independent Regulators,* London, p. 6).

3. For more information, see OECD (2013b).

4. For example, the United Kingdom's Better Regulation Delivery Office is undertaking a project to establish a common approach to professional competency within its regulators, www.bis.gov.uk/brdo/resources/competency, accessed 7 December 2012.

Chapter 1

Role clarity

An effective regulator must have clear objectives, with clear and linked functions and the mechanisms to co-ordinate with other relevant bodies to achieve the desired regulatory outcomes. This chapter describes how regulators can have a well-defined mission and distinct responsibilities within regulatory schemes.

Principles for role clarity

Objectives

1. The legislation establishing a regulatory scheme or framework should be written so that the purpose of the regulator and the objectives of the regulatory scheme are clear to the regulator's staff, regulated entities and citizens.

Functions

2. The regulatory powers and other functions to be carried out to achieve the regulator's objectives should be clearly specified in the establishing legislation and be appropriate and sufficient to achieving the objectives.
3. Regulators should not be assigned conflicting or competing functions or goals. The assignment of potentially conflicting functions to any regulator should only occur if there is a clear public benefit in combining these functions and the risks of conflict can be managed effectively.
4. Where a regulator is given potentially conflicting or competing functions, there should be a mandatory mechanism whereby conflicts arising are made transparent and processes for resolving such conflicts are specified. There should also be legal ground for co-operation and protocols between relevant regulators or bodies.
5. Where a regulator is assigned competing functions, the legislation should provide a framework to guide the regulator in making trade-offs between the functions, or require the regulator to develop such a framework with the necessary bodies (e.g. legislature, executive, and judiciary).
6. Regulators should operate within the powers attributed to them by the legislature and legislation should provide for judicial review for actions that might be held to be *ultra vires* (beyond the scope of the regulator). At the same time the scope of the regulator should recognise where appropriate discretion is needed in the way that regulatory powers are to be interpreted by the regulator to meet its objectives, without engaging in "mission creep".
7. The responsibility for setting or advising on government policy, particularly relating to the nature and scope of the regulator's powers and functions, should not principally sit only with the regulator even though the regulator has the most up to date knowledge of the issues in the regulated sector. The principal responsibility for assisting the executive to develop government policy should sit with the responsible executive agency and the regulator should have a formal advisory role in this task. In all cases such policy should be advanced in close dialogue with affected regulatory and other agencies, and there should be specified mechanisms for regulators to contribute to the policy-making process.

Co-ordination

8. To reduce overlap and regulatory burden, all regulators should be explicitly empowered and required to co-operate with other bodies (non-government and other levels of government) where this will assist in meeting their common objectives.
9. In the interests of transparency, instruments for co-ordination between entities, such as memoranda of understanding, formal agreements or contracts for service provision, should be published on regulators' websites, subject to the appropriate removal of information (for example, that which is commercial-in-confidence).

Role clarity

Role clarity is essential for a regulator to understand and fulfil its role effectively. The role of the regulator should be clearly defined in terms of its objectives, functions and co-ordination with other entities. These should be clear to the regulator but also to the regulated bodies, citizens and other stakeholders. This is necessary for a well-functioning regulatory framework with different actors knowing their role and purpose that is complimentary and not duplicative or detrimental toward each other.

Objectives

The legislation that grants regulatory authority to a specific body should clearly state the objectives of the legislation and the powers of the authority (OECD, 2012; House of Lords: Select Committee on Regulators, 2007). The objectives should be written in order to identify the ends to be achieved or the expected outcome, rather than specifying the means by which they will be achieved.

Unless clear objectives are specified, the regulator may not have sufficient context to establish priorities, processes and boundaries for its work. In addition, clear objectives are needed so others can hold the regulator accountable for its performance. Regulated entities have a particular right to know the reason their activities may be directed or limited.

The appropriate degree of prescription or detail in legislation is a matter for judgement. Principle-based legislation is likely to be the most appropriate way of meeting policy objectives in complex or rapidly changing fields (see, for example, Haldane, 2012). Where the key principles and objectives are established in legislation, regulators have discretion as to how they are applied, and may choose from a range of regulatory and non-regulatory tools to meet public policy objectives. Achieving compliance with regulation should not be treated as an objective in its own right, but rather as a means to an end.

Where the objectives established in legislation are strategically broad, this will inevitably mean that there will be a greater deal of regulatory discretion for the regulator in interpreting and achieving the objectives. This is often deliberate where there are uncertainties, or the regulated

environment is dynamic and fast-changing, or where there is a lack of information meaning that the regulator is trusted with the "finer detail" in applying the law. Here it is vital that the other principles in this report are strongly institutionalised within the regulator to ensure the competency and structures are in place to manage this discretion.

The objectives of the regulator and any discretion provided to the regulator should not encourage or provide opportunities for "mission creep". The regulator should remain within its scope of activity that is defined by legislation, and monitored through the practice of open, transparent and accountable processes, with the judiciary being able to call the regulator to task for exercising beyond its legitimately intended powers (*ultra vires*).

Competing objectives

Where two objectives could, at least theoretically, be met concurrently, they are defined as competing. Regulators may be given responsibility to make decisions involving the accommodation of two or more competing objectives. The assignment of potentially competing functions can be desirable or necessary; for example, where service delivery functions generate a strong intelligence base that can readily inform regulatory activities and this is most effectively undertaken within an integrated organisation. An example might be fire services that have fire safety regulatory functions. If competing functions are allocated to one entity, it is important that the legislation is clear that the regulator is required to make trade-offs and may make these in the context of a framework of considerations and priorities that is specified in the legislation or developed with the minister (House of Lords: Select Committee on Regulators, 2007). The regulator may either be given scope to decide, or be provided with guidance as to how these issues should be resolved. In either case, the process and the reasoning underlying particular positions adopted by the regulator should be transparent.

Functions

By itself, regulation will rarely be effective in meeting government objectives. All regulators have decision-making functions under statute – that is, they make decisions that may affect people's rights or direct their actions or behaviours, and are subject to judicial review.[1] Generally these are combined with other functions to encourage or discourage certain actions or behaviours, as a means of seeking to reach defined policy objectives.

Consequently, regulators may also have a number of complementary functions which help them to meet their objectives. These could include administration of voluntary or market programmes, education, providing assistance and implementing incentive systems and reward programmes. Where a regulator has the capacity to perform such functions, it is more likely to properly consider alternatives to regulation and only invoke traditional regulation where it is the most effective and efficient means of reaching a particular goal (Coglianese, 2010). Nonetheless this should not be a substitute for regulation in all cases and often the additional programmes are complimentary in addition to regulation.

Moreover regulators should be afforded the appropriate powers to deliver their objectives. The powers should be sufficient and neither stronger nor weaker than necessary for the regulator to be effective. This may relate to not only powers to investigate, enforce and sanction but also may be in relation to information gathering for instance to monitor the performance of the market. The level of these regulatory powers will require the suitable level of accountability mechanisms to ensure proper functioning of the regulatory regime.

Conflicting functions

Where a regulator has a range of functions, it is important that these are complementary and not potentially in conflict. This means that the performance of one function should not limit, or appear to compromise, the regulator's ability to fulfil its other functions (including its core regulatory function).

The assignment to a regulator of both industry development and regulatory functions, such as protecting health or the environment, can reduce the regulator's effectiveness in one or both functions and can also fail to engender public confidence. Such conflicting functions can impair a regulator's clear role and they do not contribute to effective performance. For these reasons, this combination should be avoided.

Multi-agenda or multi-purpose regulators (such as independent multi-sector regulators or regional regulatory authorities with many regulatory priorities) may have conflicting functions such as consumer protection and industry development, and therefore have a more challenging function to fulfil. Such arrangements where a regulator is working on different public interests require good regulatory practices in line with the other principles in this report, as well as regulatory discretion to avoid overall detrimental effects and the ability to select the correct regulatory instrument that meets one conflicting function with another, such as stimulating sustainable energy solutions and oversight in competition. Having institutional arrangements that ensure transparency in decision making, accountability of decisions and actions, and access to provide challenge are crucial.[2]

Box 1.1. **UK growth duty for non-economic regulators**

The UK government is intending to introduce a "growth duty" to ensure non-economic regulators take account of the economic consequences of their actions, specifically having regard to growth in their decision making. The evidence gathered through the Focus on Enforcement Initiative and the Post-Implementation Review of the Regulators' Compliance Code found that in the United Kingdom, regulators can see economic considerations as inconsistent with their existing duties, and in some cases feel constrained from supporting growth when they would wish to do so as they do not have a clear objective in support of growth.

The UK government has expressed its belief that the objectives of securing public protection and economic growth are not incompatible and that the proposed duty will provide a framework for regulators explicitly to consider growth alongside their existing duties to protect, where they have not previously felt able to do so. In considering the "Growth Duty", the government did not wish to detract from nor undermine the core purpose of these regulatory bodies, but to use the resource of these agencies to encourage compliant businesses to grow through proportionate regulatory activity and provision of reliable advice, without compromising the protection of the public. The "Growth Duty" would be complementary to regulators' existing duties and would sit alongside existing responsibilities.

Source: Department for Business, Innovation and Skills (2013), United Kingdom.

In the absence of effective regulatory functions being conducted, a regulator should still analyse the potential divergence between private and social costs. The effective and impartial regulation of an industry in the public interest can increase consumer confidence in that industry and contribute to its long-term development. However, explicitly assigning a function such as development or promotion of an industry to a regulator can generate material conflicts, as has been observed in particular cases.[3] For example, vigorously pursuing non-compliance by some industry participants, and alerting consumers to this non-compliance, can have an adverse effect on the industry's reputation in the short-run, but may be necessary to achieve a consumer safety objective.

Combining the functions of service delivery or the funding of external providers with enforcement of regulatory standards can also present conflicts, particularly when the same staff carry out both functions and report to the same decision maker, and therefore should be avoided. These conflicts may arise because rigorous enforcement of regulatory standards can affect supply of a government service or delivery costs. Where there are

limited suppliers, there may also be pressure to accept lower standards to avoid any service disruption. This can lead to concerns by clients and providers about inconsistent application of standards.

Similarly, providing competitive grants to regulated firms to improve their compliance performance can create perceived or actual conflicts if the regulator subsequently considers enforcement actions against these firms. For example, a review of an Australian environmental regulator found that the regulator had issued an infringement notice to one company, having awarded a grant to fund "beyond compliance" improvements to a related company one week earlier (Krpan, 2011, pp. 279-281). Exacerbating this risk, both the team responsible for administering the grants and the regulatory enforcement team were reporting through the same executive.

Combining functions that manage service delivery or funding to external providers with the work of *setting* (rather than enforcing) regulatory standards that apply to these funded entities does not necessarily present the conflicts outlined above. For example, a telecommunications regulator may be responsible for setting service standards of privately-provided emergency-call taking, and ensuring adequate funding for those services. Combining both functions can assist the making of informed trade-offs between regulatory standards and the implications for service supply and relationships with providers. On the other hand, where regulatory standards apply to both government-funded entities and other organisations that are not government funded, there can be a conflict in combining functions, as the standards that are formulated may be overly onerous or otherwise inappropriate for non-funded entities. In either situation, the risks will in part be mitigated by a high level of transparency and active engagement in the process by which standards are developed and adopted. Public scrutiny should help to ensure that any compromises made between demands are consistent with community priorities.

Structural separation of conflicting functions is generally ideal, but if this is not possible then attention should turn to the separation of teams with these potentially conflicting roles and their reporting lines. Some form of oversight or review of the regulatory activities is also warranted.

There may be limited cases where the assignment of potentially conflicting functions is desirable or necessary; for example, where service delivery functions generate a strong intelligence base that can readily inform regulatory activities and this is most effectively undertaken within an integrated organisation. An example might be farm extension services that also have pest or disease control regulatory functions. However, any combination of potentially conflicting functions needs to be carefully justified on a public benefit basis. In addition, there should be clear

processes for managing the inherent risks, including through sound and robust stakeholder consultation where appropriate, and providing transparency as to how the conflicts are to be navigated.

Competing functions

Given that regulatory agencies have limited staff and financial resources, there will always be competition between various functions for priority. It is important for regulators to ensure their obligations to promote regulatory compliance are given sufficient focus. The rationale and evidence behind regulators' decisions as to the allocation of resources should be clearly set out in the regulator's business plan with demonstrated links to the regulator's objectives.

Combining the functions of service delivery or the funding of external providers with enforcement of regulation also raises the risk that there may not be adequate resources and management attention given to the regulatory task. While separate regulatory units promote the quarantining of resources and a focus of management attention, other mechanisms of internal governance may be able to effectively achieve the same outcome.

While enlightened regulators will seek to help those they regulate to go beyond minimum compliance, this should not be at the expense of work to ensure compliance with regulatory standards. In some cases, recognising the good performance of companies that voluntarily go beyond compliance can free up resources to focus on higher priorities (Hampton, 2005).

For multi-purpose regulators, there is a greater challenge in balancing the competing functions. Not only is there the need to ensure there is sufficient focus on regulatory compliance, but they also need to consider how to allocate resources over the different disciplines in accordance with the calculated risk and outcomes in terms of overall social, economic and environmental welfare.

Box 1.2. A multi-purpose regulator – Netherlands

The Netherlands Consumer Authority, the Netherlands Competition Authority (NMa) and the Netherlands Independent Post and Telecommunications Authority (OPTA) merged on 1 April 2013, creating the Netherlands Authority for Consumers and Markets (ACM). The Netherlands Authority for Consumers and Markets is an independent authority that creates opportunities and options for businesses and consumers alike. The ACM is responsible for the economic regulation of water, energy, telecommunications and transport, and competition and consumer protection.

Source: Authority for Consumers and Markets (2013), Netherlands.

Regulators' policy functions

Policy ideas can arise from a wide range of sources, but policy formulation, in its primary sense, belongs to elected governments. Governments determine the principles, objectives, priorities and approaches they take to governing. These are given effect principally through legislation introduced to the legislature, including through funding for specific programmes.

The role of government ministries and agencies is to advise government on policy and deliver the policies of the government of the day. Under ministerial direction, this may involve:

- clarification and elaboration of the implications of government policy;
- application of policy to specific issues;
- research into particular issues and strategies for addressing them;
- consultation with stakeholders;
- development of legislation and subordinate legislation;
- implementation of legislation;
- advice on delivery of programmes and their costs;
- operational programme or service delivery; and
- review of legislation, organisations and programmes.

Some jurisdictions support the principle that independent regulatory agencies should not have primary responsibility for providing policy advice to ministers, and that this should be the role of the relevant ministry.

However, regulators do undertake important policy functions, by virtue of their familiarity with the regulated sector and responsibility for ultimately carrying out regulatory policy (Meister, 2010). First, they must develop more detailed (but often critical) operational policy that guides the implementation of higher-level policy decisions made by ministers or the legislature. Second, they have to develop and approve some higher-level policy, where their authorising legislation has allocated the regulator greater decision-making powers. Third, if policy formulation by ministers is to be well informed, effectively implemented and responsive to changes in the regulatory environment, it is critical that the relevant regulator is actively involved early in the formulation and subsequent refinement of policy to support the development process led by the ministry.

Furthermore, the experience of regulators in operational rules can prompt ministries to review the policy framework within which the regulators operate. Therefore regulators should have a specific and explicit advisory role on government policy. Alternatively, there should be the opportunity for the regulator to input in developing government policy.

The respective roles of the regulator and the ministry should be clear and agreed. Where the regulator has, for whatever reason, been assigned significant policy activities, their parameters and any channels for communicating advice to the minister or ministry should be formally set out, preferably in legislation. Independent regulators should not be exempted from formal requirements to undertake regulatory impact analysis and related consultation processes when developing new regulation. Equally the regulator when undertaking such formal requirements should be conducting such activities as a state-wide actor, not as a subsidiary of the ministry. The priority placed on policy functions and their interaction with the regulator's other responsibilities should also be clearly articulated.

In addition, regulators should continuously monitor and evaluate the performance of their activities. However, major and periodic policy reviews and evaluation of a regulatory scheme, including the performance of the regulator, should be carried out independently of the regulator. This should be through a transparent process that involves input from the regulator and those affected by its activities.

Co-ordination

The effectiveness and efficiency of a regulatory system depends, in part, on the extent to which potential duplication and gaps[4] between regulators are anticipated and avoided in legislative drafting (Rodrigo et.al, 2009; Meloni, 2010). Regulators often regulate the same businesses but to achieve different policy objectives. Businesses regulated will sometimes see the activities of different regulators as duplication. Targeted co-ordination of activities can provide opportunities to reduce burdens on the regulated while improving compliance (see for example, Hampton, 2005). However, there needs to be clear authority for co-ordination to remove uncertainty about the legality of any arrangements.

For some regulators, the need for co-ordination may extend to federal regulators, sub-national regulators, or municipal/local government.

Regulators should design appropriate co-ordination mechanisms for regulatory policy practices with all levels of government, including through the use of measures to achieve harmonisation, or the use of mutual recognition agreements (OECD, 2012). Formal co-ordination mechanisms to

clarify roles and responsibilities might include agreements detailing respective roles and co-operation with regulators in other jurisdictions and electronic access to information held by other regulators. The effectiveness of such arrangements will depend on the capacity of regulators to identify opportunities and forge effective working relationships.

Legislation should explicitly empower regulators to co-operate with other agencies and bodies in pursuit of the regulator's objectives. This will allow regulators to simplify their dealings with business and other entities through delegation, information sharing, joint regulation, and co-regulation. Specific provisions can be included in legislation for accreditation of other bodies' activities and staff where they are consistent with the standards applied by the regulator. Such provisions will mean that opportunities for improved co-ordination or efficiencies can be easily identified and adopted.

Box 1.3. **Legally defined co-ordination mechanisms for the Federal Institute of Telecommunications (IFT), Mexico**

i. The IFT will co-ordinate with the federal executive to ensure the installation of a shared public telecommunication network that promotes the effective population access to broadband communication and telecommunication services.

ii. The Congress will create an Advisory Council of the IFT, which will be responsible to act as an advisory body.

iii. The IFT must notify the federal executive before proceeding with the revocation of the concession titles, for him to execute, where appropriate, the powers necessary to ensure continuity of service provision.

iv. The IFT may receive non-binding opinions of:

- The Ministry of Communications and Transport (SCT) if granting, revocation and authorisation assignments or changes in the control, ownership or operation of companies related to concessions ;
- The Ministry of Finance and Public Credit (SHCP) for fixing the fees or compensations for the granting of concessions and authorisation of services related to these.

Once constituted the IFT, where it reached agreements with other regulators, these should be published, since in the reform of Article 28, Section IX, the law states that IFT promotes government transparency under the principles of digital government and open data.

Source: "Decreto por el que se reforman y adicionan diversas disposiciones de los artículos 6o., 7o., 27, 28, 73, 78, 94 y 105 de la Constitución Política de los Estados Unidos Mexicanos, en materia de telecomunicaciones" (2013).

An example of the type of co-ordination that can be encouraged by empowering regulators to co-operate is the Primary Authority scheme in the United Kingdom. Under this scheme, a business operating across council boundaries can form a primary authority partnership with a single regulator from one local council. That regulator then becomes the sole regulator in the defined regulatory area for that business, across all the councils in which it operates, and its regulatory decisions are automatically recognised by all other local regulators.

Box 1.4. **Regulatory co-ordination: UK Primary Authority scheme**

Established in 2008, **Primary Authority** drives consistent and proportionate regulation and reduces duplication of paperwork and inspections. Legally binding agreements between local authorities and businesses provide a single point of contact and assured advice for companies operating across authority boundaries. Primary Authority partnerships already cover 807 businesses with 64 000 premises spread over 107 local authorities. The scheme currently operates in relation to environmental health and trading standards legislation, or specific functions such as food safety or petroleum licensing. It is set to be expanded to cover more regulations and extended to businesses within trade associations and franchises in October 2013.

Source: Department for Business, Innovation and Skills (2013), United Kingdom.

Applying the principles – Role clarity

Objectives

- What are the objectives of the legislation?
- To what extent are trade-offs between objectives likely to be necessary?
  - is there a means for the minister to provide direction on priorities; or
  - is there clear guidance in the legislation as to how the regulator should resolve any trade-offs between objectives in any decision?
- How will any trade-offs between objectives in decision making be made explicit? Is this information clear, comprehensible and available to regulated entities?
- Are the objectives clearly defined? Is there the potential for interpretation that could lead to "mission creep"?
- Is regulatory discretion afforded in legislation? If so why? How will this be managed?

Functions

- How is the regulator to meet or contribute to the objectives of the legislation (i.e. what are its duties or functions)?
- Does the legislation provide suitable powers to fulfil these functions and meet the objectives?
- Are these powers proportionate to the scale of risk or hazard with which it will be required to deal?
- Is there a need for regulatory discretion being afforded to the regulator? How will this be managed (i.e. what levels of transparency and accountability will be institutionalised)
- Are there conflicts or potential conflicts between any of the regulator's functions? (Conflicts are most likely between regulatory enforcement and industry development or service provision functions.)
- Are there good policy reasons for keeping conflicting functions together? Do these outweigh the benefits of separating these functions?
- How will any conflicts between functions be managed (e.g. how will any conflicts arising be made transparent, and by what process will any conflicts be resolved)?
- Does legislation allow for a judicial review if the regulator goes beyond the scope and objectives of the legislation?

- Are the respective roles of the minister, ministry and regulator in policy development clearly defined and supported by processes to ensure effective collaboration?
- Is there an explicit advisory role for regulators in policy development?
- What institutionalised processes have been established to ensure close and effective dialogue between the regulator and the relevant ministry in the development of legislation and funding priorities?
- Does the legislation outline the review process to which it and the regulator will be subject (e.g. regular, *ad hoc*, comprehensive, issue-based, etc.)?

Co-ordination

- Have potential overlaps or gaps with other regulators been identified? How will these be handled?
- Does the legislation give the regulator capacity to co-operate with other bodies with shared objectives? These might include capacities to:
  - accredit others' programmes or schemes as contributing to functions under the legislation;
  - authorise others' officers for specific functions (e.g. inspection, compliance);
  - enter into agreements with other bodies; or
  - share relevant and appropriate information with other regulators.
- How will information about shared and co-operative programmes be made available to the regulated entities?

Notes

1. These functions are sometimes described as quasi-judicial.
2. For more information, see Georgosouli (2013a).
3. For example, the National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling (2011) described the combination within the then Mineral Management Service of revenue collection and regulation as "Mixing Oil and Water" (p. 64) and noted that for at least 15 years Directors of the Service focused mostly on royalty issues at the expense of offshore regulatory oversight (p. 76).
4. Changing technologies might lead to unanticipated gaps in regulatory regimes. For example, national or sub-national regulation that previously protected privacy through controls on publications might not be effective in a world where information that is anonymously "published" in another jurisdiction is much more readily available.

Chapter 2

Preventing undue influence and maintaining trust

It is important that regulatory decisions and functions are conducted with the upmost integrity to ensure that there is confidence in the regulatory regime. This is even more important for ensuring the rule of law, encouraging investment and having an enabling environment for inclusive growth built on trust. This chapter explores the ways of protecting regulators from undue influence, including through establishing independent regulators, and the considerations for assuring certainty in the regulatory system.

Principles for preventing undue influence and maintaining trust

Preventing undue influence

1. Independent regulatory decision making at arm's length from the political process, is likely to be appropriate where:
   - there is a need for the regulator to be seen as independent, to maintain public confidence in the objectivity and impartiality of decisions;
   - both government and non-government entities are regulated under the same framework and competitive neutrality is therefore required; or
   - the decisions of the regulator can have a significant impact on particular interests and there is a need to protect its impartiality;
   - the autonomy of regulators (organisational, financial and decision making) situated within a ministry should be safeguarded by provisions in their empowering legislation.
2. All regulators should operate within the power delegated by the legislature and remain subject to long term national policy.
3. New or major policy decisions should be justified by the regulator based on an empirical basis and in the light of evaluation of previous measures, and the reasoning should be made publicly available.
4. Regulators shall conduct horizon scanning of potential major issues and give prior notice to regulated entities and the public of any new major policy initiatives and allow reasonable period for genuine comment by stakeholders, as well as feedback from the regulator.
5. Board members, senior staff and staff on secondment should not be involved (*recused*) in any decisions that affect previous employers.
6. In cases where exceptions are made to a regulated entity, this should be notified to all regulated entities, the public, minister and legislature.

Maintaining trust

7. Where legislation empowers the minister to direct an independent regulator, the limits of the power to direct the regulator should be clearly set out. The legislation should be clear about what can be directed and when. Any direction made by the minister or politicians should be documented and published. In the case of economic regulators, it is preferred that legislation should not permit powers to be directed by ministers.
8. Any communication between the minister, the ministry and an independent regulator should occur in a way that does not compromise the actual or perceived independence of regulatory decision making.
9. The criteria for appointing members of a regulator's governing body, and the grounds and process for terminating their appointments, should be explicitly stated in legislation. The process should involve the legislature or judiciary for greater transparency and accountability.
10. Government and or the legislature (parliament/congress) should establish and publish for each regulator a policy (such as cool-off periods) relating to post-separation employment of senior regulatory staff and members of the regulator's governing body.

Importance of regulatory integrity

A high degree of regulatory integrity helps achieve decision making which is objective, impartial, consistent, and avoids the risks of conflict, bias or improper influence. The nature of some regulatory decisions can at times involve higher risks to the integrity of the regulatory process, for example, due to pressures from the affected interests or the contentious and sometimes politically sensitive nature of the decisions.

Establishing the regulator with a degree of independence (both from those it regulates and from government) can provide greater confidence and trust that regulatory decisions are made with integrity. A high level of integrity improves outcomes of the regulatory decisions. Regulators should have provisions for preventing undue influence of their regulatory decision-making powers and maintaining trust in their competence and delivery.

Independence of regulators

It is important to consider how regulatory integrity will be protected through the external governance arrangements of the regulatory body. All regulators' decisions and activities should be objective, impartial, consistent and expert. There is no generally agreed definition of what characteristics make a regulator "independent". The United Kingdom's Better Regulation Taskforce (2003) developed its own definition of an independent regulator as:

> *A body which has been established by Act of Parliament, but which operates at arm's length from government and which has one or more of the following powers: inspection; referral; advice to a third party; licensing; accreditation; or enforcement (p. 6).*

This raises the question of what is meant by "arm's length", and in these principles this is taken to mean the regulator is not subject to the direction on individual regulatory decisions by executive government, but could be supported by officials who are located within a ministry or have its own staff.

There are also different institutional models of independence and some independent regulators are entirely independent from national governments and ministries. Many sectors in the EU have independent regulators as described in EU law. For instance in the electronic communications sector articles 3.3 and 3.3a of the Framework Directive 2002/21/EC, as amended by Directive 2009/140/EC. Therefore in some jurisdictions the concept of an independent regulator refers to an even higher degree of independence as is described in these principles. The application of these principles should take these different contexts into consideration.

Establishing the regulator with a degree of formal independence both from those it regulates and from government can provide greater confidence that decisions are impartial.

Enshrining a regulator's independence in legislation does not guarantee that the regulator's behaviour and decisions will be independent (Thatcher, 2002; 2005). A culture of independence, strong leadership and an appropriate working relationship with government and other stakeholders are essential to independent regulatory behaviour. The political history and context that regulators operate within may be more culturally attune toward cultural independence, or not as the case may be. Nonetheless, formally protecting the independence of regulators as discussed in this chapter is an important, if not sufficient, element of achieving independence (Gilardi and Maggetti, 2010).

When a separate regulatory function is established, consideration should be given as to whether the regulator is set up under statute outside ministry structures (while still being accountable to a minister) or is set up as an administrative unit of a ministry. In practice, independent regulators need to have the internal capacity to support the governance arrangements needed to guarantee accountability and transparency, and so there should always be consideration as to whether any new regulatory function, or one subject to review, can be better placed with an existing entity.[1]

Any consideration of independence should emphasise that a regulator's "independence" from government can never be absolute, but is a matter of degree and nature. However a regulator's level of autonomy will ultimately assist to maintain the perceived trust by the regulated entities of the regulatory decisions made. A regulator's powers (including the power to raise funds) are always derived from the legislature and are to a greater or lesser extent subject to the direction of ministers. A number of factors can determine the degree and nature of a regulator's independence. These are discussed further in this chapter.

When is an independent regulator most appropriate?

A threshold issue is the question of whether particular regulatory decisions are best made by an independent regulator or by the minister or an officer of the ministry. According to the OECD 2012 *Recommendation of the Council on Regulatory Policy and Governance*, independent regulatory agencies should be considered in situations where:

1. there is a need for the regulator to be seen as independent, to maintain public confidence in the objectivity and impartiality of decisions;
2. both government and non-government entities are regulated under the same framework and competitive neutrality is therefore required; or
3. the decisions of the regulator can have a significant impact on particular interests and there is a need to protect its impartiality.

In these three cases, regulatory integrity is very important and there is likely to be a high level of risk (or perceived risk) to the independent regulator's integrity. Therefore, a substantial degree of independence and distance from executive government is generally warranted.

An independent regulator is important to enhance regulatory certainty and stability. This is more prevalent where the regulator is a *market regulator* as in such cases the government itself may be a stakeholder e.g. as a shareholder or market player, and therefore there is a greater need for an independent regulator.

Box 2.1. **Examples of independent regulators**

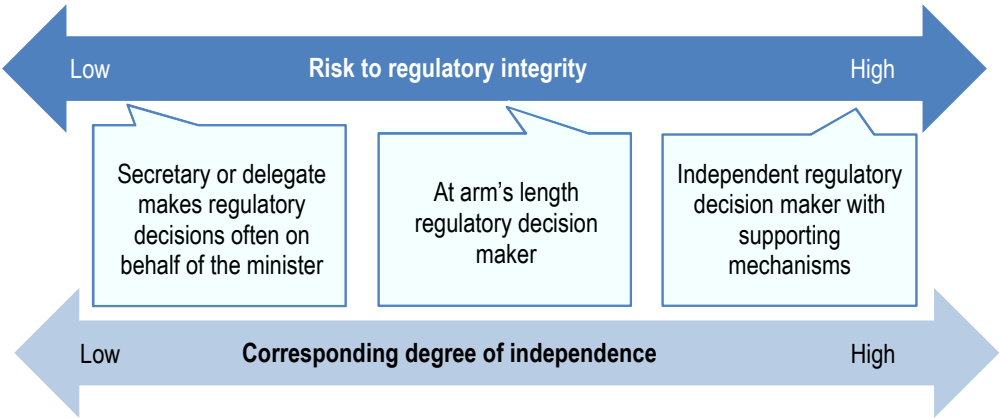
Germany's Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway ("Bundesnetzagentur") is an example of a highly independent regulator for all regulated sectors (cf. also the Regulatory Management of Network Sectors section of the OECD Product Market Survey 2013, which *inter alia* examined the electricity, gas and telecom sectors).

Its independence is stated explicitly in the law (§ 1, *Gesetz über die Bundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und Eisenbahnen*), it has no dominant source of funding, and the regulator cannot receive instructions or guidance from government on its strategy, individual cases or appeals. The regulator's decisions can only be appealed in court in the final instance.

Source: OECD (2013a), "Initial Findings of the Product market Regulation Survey Results for Economic Regulators", unpublished document.

The extent of the risk and the extent of independence required will inform decisions about whether the most appropriate location for the independent regulator's supporting staff is within a ministry or a separate body (see Figure 2.1).

Figure 2.1. Regulatory integrity, independence and the institutional form[1]



1. Supporting mechanisms include: the regulator having direct control of its staff through employment, or alternatively via a Framework Agreement with the head of a Ministry and Minister; provisions that affect the regulator's tenure; explicit restrictions on direction; funding arrangements, etc.

Regulatory integrity is linked to achieving better outcomes. Some regulators who operate in rapidly changing regulatory environments have to be adaptable to responding to the varying situation. This is effectively managed through having the trust of the regulated entities in the decisions and interventions that the regulator makes.

Decisions on the extent of independence required will depend on what is being regulated, judgement about how that is best regulated and whether a particular institutional form best fits the nature of the regulator's activities. For some types of regulatory decisions, the trust of regulated entities and the wider public is best engendered by demonstrating that these decisions are shielded from perceptions of political influence (Christensen and Laegreid, 2006; Meloni, 2010).

In some cases it will be clear that a legally independent and structurally separate regulatory body is needed, while in others it will be a matter of judgement. Factors to consider are set out in Table 2.1.

The assignment by the legislature of powers to independent regulators allows for regulatory decisions to be made independent of political influences, but within the accountability framework established for the regulator.

Table 2.1. Factors to consider in creating an independent and structurally separate regulatory body

Factor	Description
Credible commitments over the long term	Establishing a more independent regulator can send an important message to regulated entities about the commitment of government to objective and transparent administration and enforcement of regulation.
Stability	Greater distance from political influences is more likely to result in consistent and predictable regulatory decision making.[1]
Addressing potential conflicts of interest	Regulatory decisions that have significant flow-on impacts for government, e.g. on budgets or service delivery, or that must be seen to be applied impartially to both government and non-government entities may be better made by entities at arm's length from ministers and ministries.
Development of regulatory expertise	Where there is a need for specialist regulator expertise, which is best maintained in a specialist unit with quarantined resources.

1. More consistent and predictable regulatory decision making can foster investment, particularly for long-lived sunk assets, such as those in utility sectors. See Department for Business Innovation & Skills (2011), "Principles for Economic Regulation", www.bis.gov.uk/assets/biscore/better-regulation/docs/p/11-795-principles-for-economic-regulation, accessed 10 December 2012; Burns, Phil and Christoph Riechmann (2004), "Regulatory Instruments and Their Effects on Investment Behavior", *World Bank Policy Research Working Paper* 3292.

The underlying objective of establishing a regulator as an independent entity is to mitigate and manage any risks or perceived risks to regulatory integrity. A high degree of independence and properly constructed accountability mechanisms are mutually reinforcing. Regulators that are given more power and autonomy in their decisions also need to be more accountable to government and the legislature for the ways in which they have exercised that power. Strong accountability mechanisms for independent regulators, who are neither elected nor directly managed by elected officials, allow their ministers and the legislature to assess whether the objectives set for them are being achieved efficiently and their powers exercised with integrity. These issues are discussed further in Chapter 4.

Box 2.2. **Authority for Consumers and Markets, Netherlands**

The Authority for Consumers and Markets (ACM) in the Netherlands is formally an autonomous administrative authority without legal personality. It operates under the Framework Act for autonomous administrative authorities ("*Kaderwet Zelfstandige Bestuursorganen*"). According to this Act only the Board of ACM is the autonomous administrative authority. The minister provides staff to the autonomous administrative authority. The Framework Act ensures that the staff that is employed by the Board of ACM is empowered only by the Board. The employed staff is only accountable to the Board. The staff is not allowed to seek instructions of the minister; neither can the minister give instructions to the staff employed by the Board of ACM. Crucial conditions for independent staff are therefore guaranteed by law.

Legislation alone is not sufficient to guarantee an independent regulator. Internal governance plays an important role. Therefore ACM regards independence explicitly as one of its three core values. The other core values are openness and professionalism. These core values form the basis of all of ACM's actions.

In practice, the independent position of ACM as an organisation means, on the one hand, taking a critical attitude and exercising independent judgments, and, on the other, maintaining open and constructive relationships with ministries, other regulators and stakeholders.

Source: Authority for Consumers and Markets (2013), Netherlands.

When is a ministerial regulator more appropriate?

Some regulatory decision making will clearly benefit from being undertaken within a structurally separate independent regulator, but in other cases the advantages of such independent decision making are outweighed by the disadvantages of decisions being made outside the ministry.

Regulatory decisions may be better made by the minister, or by ministry officials under the oversight and direction of the minister, where one or more of the following factors set out in Table 2.2 are present (Victorian government, 2010).

Where the regulator is located within a ministry, varying degrees of independence from ministerial direction can be achieved through the design of the regulatory scheme. For example, the legislation may allow the minister and ministry management to have close involvement in operational policy and the regulator's strategy, but contain an explicit provision prohibiting anyone, including the minister, from directing individual ministry decision makers with regard to certain decisions; thereby granting a limited degree of independence.

Table 2.2. Factors to consider in creating a ministerial-based regulatory scheme

Factor	Description
Closely integrated function	The regulatory function must be closely integrated to ministry activity which retains the focus of specialist knowledge and expertise within government
Changing regulatory environment	The environment being regulated is subject to rapid change, with policy still being developed. Regulatory decisions cannot be readily separated from policy choices that are appropriately made by people under the direct control of elected ministers
Minor function	The regulatory function is incidental to non-regulatory ministry activities, such as service delivery. Creating a separate entity to perform the function, or assigning it to an existing independent regulator, is not justifiable

Allocating the power to make regulatory decisions

Some legislation allocates the power to make regulatory decisions to the minister, while other legislation allocates primary decision-making powers to a position defined in statute that may be held by the head of a ministry or another public official within the ministry. In any of these situations the decision maker may have power to delegate his or her decision-making powers, fully or in part.

Where a regulatory decision involves value judgements (that may be informed by independent, expert advice) it may be most appropriate for the decision to be allocated to a minister who is directly accountable to the legislature. For example, controversial planning decisions involving weighing up policy objectives are typically made by elected councillors or by a minister. In contrast, decisions with objective decision criteria, even if they require a degree of judgement, may be most appropriately allocated to a public official. Where technical or legal expertise is needed, and the decision maker is not an expert, it should be provided in the form of advice, and the appropriate institutional mechanisms should be provided to allow for this.

The formal location of the power may have substantive legal consequences. For example, the Australian courts have reviewed ministerial decisions on a different basis from that on which they have approached decisions of public officials.[2] Second, a public official acting under delegated powers would have less formal autonomy in exercising those powers, than if he/she was exercising powers assigned directly to the position he/she held under statute (see next section on delegation).

Consequently, it is important to consider these issues when designing regulatory schemes where the decision makers are expected to sit within ministries.

Preventing undue influence

There are many reasons why different parties may wish to influence the decisions of regulators. Whether the gains are political, financial or any other, regulators will face pressure from those trying to have a more favourable decision, in whatever terms, for their benefit. Even if there has been no influence, if a decision is taken that is unfavourable to a set of stakeholders or regulated entities, then there can still be the perception that a decision has been unduly influenced.

Regulators can avoid actual or perceived influences by simply being more open and transparent about their decisions. Decisions based on empirical evidence or research, post-implementation evaluation and stakeholder input can help build confidence and trust in those decisions. Making such justifications or the reasoning behind the decision open to full public scrutiny is important to achieve not only good regulatory outcomes but also support more fundamental issues such as the rule of law.

In a similar way, regulators often investigate future issues to potentially address through horizon scanning exercises. Sometimes regulators grant special exceptions to regulated entities for good reasons (such as exemptions and grace periods). These should all be communicated along with any new major proposals that will have an impact on regulated entities to the regulated entities, the public, ministers and legislature. These steps will limit the likelihood of regulated entities being surprised by a decision, new regulations or intervention. It can also address potential accusations of decisions being made due to favour of one party over others.

Finally the potential for staff members of regulatory agencies to be influenced or be accused of being influenced should be removed. Recusal or disqualification of members of the board, senior staff and other staff from being involved in decisions that affect previous employers should be introduced. This will further protect regulators from actual or perceived influence that could be unethical and unfair.

Maintaining trust in decision making

Independence exists within the legislative framework provided for the regulator by the legislature and as noted earlier is always a matter of degree. Structural separation is, however, one important way of reducing risks to regulatory integrity.

The most independent regulators are created through the establishment of separate statutory bodies or positions, with a formal and typically public process for appointment of members of the governing body and with specific enabling legislation governing the regulator's objectives, functions, powers and accountability. This limits the extent of ministry and ministerial involvement in day-to-day decision making by the regulator. Independence in decision making can also be fostered by a number of other means including:

- operational clarity (see introduction);
- clear articulation of decision-making power in legislation;
- clarity about requirements for reporting to the minister;
- definition of the minister's power to direct the regulator and transparent processes around the issuing of directions (see Chapter 4);
- an adequate resource base (see Chapter 6);
- staffing flexibility – to attract and retain competent specialised staff for certain regulatory functions;
- transparent processes for appointment to governing bodies and chief executive positions;
- explicit provisions covering performance criteria and review;
- explicit conditions and transparent processes for appointment and termination of appointments, including appeals processes; and
- limitations or restrictions on members of the regulator's governing body accepting employment in the regulated industry after leaving the regulator ("post-separation" activities).

Governance arrangements should ensure that where regulators have a substantial degree of independence they are adequately accountable for their activities (see Chapter 4).

Communication between ministers, ministries, and independent regulators

Defining a regulator's relationship, responsibilities and lines of accountability to the relevant minister, ministry and the legislature is central to both external governance arrangements and independence. A Statement of Expectations from the minister to the regulator is an important mechanism to achieve this (see Chapter 4). If the independent regulator is accountable to the legislature through a minister, the minister needs to be kept informed about the regulator's activities. This may involve routine requests from the minister for information, discussions about the handling of correspondence and the like. However, in handling any such request, the regulator needs to be mindful not to compromise the actual or perceived independence of decision making. Therefore, these requests should occur through defined, systematic channels, which are discussed below.

If the independent regulator reports directly to the legislature then there should be some clear and set procedures and mechanisms for instance periodic published reports and meetings.

Communications between the minister (including his or her office) and an independent regulator with a governing board relating to matters where less frequent communication would be expected, such as the regulator's strategy, enforcement activities or important approval processes, should primarily be via the Chair, whether formally or informally. Communication with the CEO on anything other than routine matters should only be in conjunction with the Chair, in order to both maintain the Board's ability to provide effective management oversight, and protect the actual and perceived independence of decision making.

Transparency in the instructions from ministers to their regulators is highly desirable as public scrutiny acts to protect regulatory integrity. Where a minister is given power under legislation to issue specific directions to a regulator, the limits of the power to direct the regulator should be clearly set out. Any directions issued should be published in a timely manner on the regulator's website or other accessible source, and also in the regulator's annual report.

Independent regulatory decision makers supported by ministry staff

Some independent regulatory decision makers are supported by a secretariat of ministry staff. This can be an efficient and effective means of providing high quality administrative support while allowing the regulator to focus on decision making. It can provide greater independence without constructing a separate statutory body. It can also enable effective information sharing between the regulator's staff and the ministry, while minimising administrative costs.

However, these arrangements may involve a range of potential risks:

- risks to the actual and perceived independence of decision making;
- risks to the quality of decision making due to the quantity and quality of services provided by the ministry or by the constraints on the regulator's ability to fully control the resources at its disposal;
- risks of inappropriate information exchange between the staff working with the regulator and other ministry staff; for example, staff involved in decisions relating to funding of external bodies; and risks that staff may be conflicted by apparent differences in the approach or interests of the minister (or ministry) and those of the regulator.

The appropriate arrangements established to support an independent decision maker within a ministry structure, while managing the risks outlined above, depend on the nature of the work and the degree of independence sought, which in turn relates to the risk to regulatory integrity.

Framework agreement between independent regulatory decision makers and ministry

Preparing and publishing a framework agreement between the independent regulator, the ministry and the minister that outlines the Secretariat arrangements can be one way to manage these risks.[3] This mechanism is highly flexible, but at a minimum the agreement should cover:

- the overall budget of the secretariat;
- whether the secretariat will be physically separate from the ministry;
- whether the regulator has a corporate identity separate from the ministry;
- how many staff will be assigned to the secretariat;
- who selects the secretariat staff;
- how and by whom the secretariat's staff's performance is assessed;
- what information can and cannot be shared between the staff supporting the regulator and other ministry staff;
- what ministry policies cover the operation of the secretariat;

- how broad government requirements, for which ministry heads (Secretary, Permanent Secretary, Secretary-Generals, etc.) are responsible (e.g. administering public records, freedom of information requests, etc.), will be met;
- provision of basic services – legal advice, information technology systems, human resources support, financial management, mail etc.; and
- how the agreement can be amended and how it will be reviewed.

Where it is efficient for the regulator and ministry staff to hold joint meetings with regulated entities, it is important that all participants are clear on respective roles and any protocols about information sharing.

Decisions on any staff movement between the regulator's secretariat and other ministry functions also need to be made mindful of actual and perceived independence.

Box 2.3. **Appointments in the Federal Institute for Telecommunications of Mexico**

Applicants for appointment as commissioners are subject to the compliance requirements of an Evaluation Committee composed of the holders of the Bank of Mexico (Banxico), the National Institute for Educational Evaluation (INEE) and The National Institute of Statistics and Geography (INEGI).

To this end, the Evaluation Committee will convene when each commissioner vacancy takes place and, will decide by majority vote, and will be chaired by the head of the entity with greater seniority who will have the deciding vote.

The Committee will issue a public call to fill the vacancy and, will verify compliance by applicants with the requirements; the applicants that have satisfied these will apply a knowledge test on the subject.

For the theory test, the Evaluation Committee shall consider the opinion of at least two higher education institutions and follow the best practices in the field.

For each vacancy, the Evaluation Committee will send the executive a list with a minimum of three and a maximum of five candidates, who have obtained the highest passing scores. If not completed the minimum number of applicants will be issued a new call. The executive will select from those candidates, the candidate who will be proposed to the Senate for ratification.

Ratification shall be by the vote of two thirds of the Senate present. In case that the Senate reject the candidate proposed by the executive, the president shall submit a new proposal. This procedure will be repeated as many times as necessary. If new rejections happen until only one applicant approved by the Evaluation Committee remarks, the applicant will appointed as commissioner directly by the executive remains.

Box 2.3. **Appointments in the Federal Institute for Telecommunications of Mexico** (*cont.*)

For the first commissioners:

In the event that, within a single vacancy, the Senate does not approve the appointment twice, the Federal Executive, will correspond to appoint commissioner directly, from the list of candidates submitted by the Evaluation Committee.

Transparency designations:

The reform states that the procedure call to select commissioners shall observe the principles of transparency, openness and maximum concurrency.

Among others, the reform provides that the commissioners shall not hold any other employment, business, public or private, except for teaching positions.

It is also stated that the law must punish where commissioners have contact with persons representing the interests of regulated operators, to discuss matters of their competence, except in open court in the presence of other commissioners and as part of the procedures.

Source: "Decreto por el que se reforman y adicionan diversas disposiciones de los artículos 6o., 7o., 27, 28, 73, 78, 94 y 105 de la Constitución Política de los Estados Unidos Mexicanos, en materia de telecomunicaciones" (2013).

Depending on the nature of the regulatory decision making, it may be possible for a regulator to operate through a service agreement with the relevant ministry where the regulator predominately requires only administrative staff support, there are low levels of discretion or judgement required of the staff supporting the regulator, and there is no delegation of powers involved. The staff would remain under the direction of ministry management. The agreement would define the nature, quantity and standard of services the ministry would provide the regulator within a specified budget. It may also specify arrangements for the provision of other services such as independent legal advice.

Regardless of the type of arrangement it may also be useful to set out in an agreement the processes for consultation between the regulator and the ministry, processes for renegotiating resource commitments and service levels, processes for co-ordination of decision making with other regulatory functions conducted by the ministry and procedures for resolving issues that may arise from time to time.

The terms of appointment for board members of independent regulators

An important aspect of institutional arrangements that protect the independence of regulators are the provisions relating to terms of appointment of independent board members.

Terms of appointment that span over an electoral cycle is likely to promote independence from the political process. Procedures regarding re-appointment should be mindful of the need to guard against the perception of "capture" by the (re)appointing authority (Department of Public Enterprise, 2000). Term limits can be useful to guard against perceived capture, but must avoid unnecessarily depriving the regulatory system of the useful expertise and experience built up by a regulator. Overlapping terms of board members can be a useful mechanism to both provide continuity of approach and protect independence.

Termination provisions for independent regulators

The independence of regulatory decision making is protected by a range of factors such as administrative law principles (including procedural fairness), but also by the extent of any constraints on arbitrary termination of appointments or removal from office of regulators.

An important informal constraint will often be political, in that a minister will face the scrutiny of the community and the legislature if he or she terminates an appointment and is unable to effectively justify such a decision.

Clear legislative provisions to protect the integrity of the regulatory agency are also important. These should include outlining what constitutes appropriate grounds for removal and, depending on the nature of the regulator's role, what does not. It should also include the process for removal and any rights of review.

Grounds for termination of members of a regulator's governing body might include:

- bankruptcy;
- conviction of an indictable offence;
- misconduct;
- breach of the Act he or she is responsible for enforcing;
- absence without leave;

- failure to disclose a conflict of interest;
- engagement in paid employment outside the duties of his or her office without the minister's consent;
- physical or mental incapacity;
- refusing or neglecting to perform his or her functions or duties; or
- fitness to continue his or her duties.[4]

The more specific the criteria for removal, the more constrained the ability of the government to terminate an appointment.

In some jurisdictions, the independence of a specific regulator is further protected by the inclusion of formal processes involving the legislature relating to termination from office.[5]

Box 2.4. **Independent regulatory decision making and terminations in legislation**

The Australian Competition & Consumer Commission (ACCC) and the Australian Energy Regulator (AER) are both independent Commonwealth statutory agencies. The Competition and Consumer Act 2010 (the CCA) establishes a Commission and Board as the respective decision-making bodies for the ACCC and AER. The Australian Governor-General may only terminate the appointment of members of the Commission in very limited circumstances, including misbehaviour, physical or mental incapacity (Part II of the CCA). The same criterion applies for the AER (Part IIIAA of the CCA). Commissioners and Board members are initially engaged for five year terms and may seek re-appointment at the conclusion of their terms.

Section 29(1A) of the CCA notes that the relevant Commonwealth minister must not give directions to the ACCC under Part IIIA (Access to services), IV (Restrictive trade practices), VII (Authorisations, notifications and clearances in respect of restrictive trade practices, VIIA (Prices surveillance), X (International liner cargo shipping, XIB (The Telecommunications Industry: Anti-competitive conduct and record-keeping rules) or XIC (Telecommunications access regime). This exclusion covers a significant range of the regulatory activities and responsibilities undertaken by the ACCC.

Source: Australian Competition & Consumer Commission and the Australian Energy Regulator (2013).

Pre-employment and post-separation activities of regulators

Effective management of actual and potential conflicts of interest is particularly important for regulators. The governing body needs to be mindful of the range of risks that might arise and tailor processes and oversight to minimise them.

Many of the staff and members of regulators' governing boards will have backgrounds in the industry they are regulating, and in many cases will return to roles in that industry. These staff movements transfer skills and experience between regulators and industry, and can have benefits in:

- building shared understandings of the context within which each is operating;
- helping regulators stay in touch with current operating processes within the industry;
- improving the industry's understanding and navigation of the regulatory system; and
- improving industry compliance.

Preventing post-employment staff movement to industry can limit regulators' ability to attract the necessary talented staff, as employment by the regulator would narrow potential later career opportunities (OECD, 2003). However, mandatory time gaps or cooling-off periods between leaving a regulator and taking up a position in the regulated industry may be warranted as conditions of employment in some cases, for example:

- where regulated entities are expected or required to reveal commercially sensitive information to the regulator, and would be less open with the regulator if its staff left to join one of its competitors; or
- where departing staff of a regulator would have knowledge that would hinder the regulator's enforcement strategy if held by a regulated firm.[6]

Regulators who are approached to work in an industry they are regulating should disclose this fact to their Boards, ministers or legislature and if necessary step aside from their role to ensure there is no conflict of interest.

Staff movements between the regulator and regulated entities, particularly at senior levels, also carry risks to the actual or perceived integrity of the regulator. In this context, when dealing with former colleagues, regulators and their staff need to be particularly careful to ensure

that they can demonstrate they have acted impartially in regard to decisions and the provision of information.[7] However, it may also be worth considering post-separation employment restrictions for staff movements from regulated entities and regulators as well (Adolph, 2013).[8]

Further detail about requirements and processes to protect the integrity of regulators and their staff can be found in OECD (2003a; 2010a).

While it may not be appropriate to mandate a whole-of-government policy providing specific rules relating to post-separation employment, government should establish and publish such specific rules for each regulator.

Applying the principles – Preventing undue influence and maintaining trust

PREVENTING UNDUE INFLUENCE

Degree of independence

- Can the regulatory function be effectively performed within a normal ministry decision-making structure, or does it require arm's length distance to protect regulatory integrity?
- Is a degree of independence required? Consider whether:
  - there is a need for the regulator to be seen as independent, to maintain public confidence in the objectivity and impartiality of decisions;
  - both government and non-government entities are regulated under the same framework and competitive neutrality is therefore required; or
  - the decisions of the regulator can have a significant impact on particular interests and there is a need to protect its impartiality.

Ministerial regulators

- Regulatory decisions may be formally assigned by legislation to a ministry head (Secretary, Permanent Secretary, Secretary-General, or other specific office holder) or may be formally assigned to the minister and delegated to specified officers of the ministry. Does the legislation clearly specify whether the regulatory decision maker is the minister, the ministry head or a particular ministry officer in each case? Is the rationale for this choice clear?
- Where the minister is the formal decision maker, does the legislation specify which powers officers of the ministry can be delegated or authorised to exercise?

- To what extent is structural separation of the regulator from other ministry functions practical, and what other mechanisms can be put in place to support robust decision making?

Preventing undue influence in regulatory decisions

- Was there an empirical or analytical basis for major decisions? Is the justification publicly available?
- Does the regulator conduct horizon scanning exercises regularly?
- Can the public and regulated entities comment on these? Are they given reasonable time to respond? Is feedback from the regulator provided in response to their comments?
- In the case of exceptional treatment to regulated entities, is this communicated to other regulated entities? If not, why not?
- Is there a recusal clause for all staff and board members being involved in decisions that could be perceived as not being objective?

MAINTAINING TRUST

- Is there a tradition of regulators whose behaviour is independent of the government of the day?
- What structures and processes will be used to protect the actual or perceived independence of the regulatory decision maker from political or other interests?
- Does the minister have power to give the regulator directions on how it should perform its functions? If so, are these directions published and listed in the annual report?
- Is it clear that the minister does not have the power to direct the regulator on individual cases or decisions?
- Is it clear that independent regulators are not subject to the general direction of a ministry head and/or minister?
- If the regulator is supported by a Secretariat of ministry staff, are there protocols established so the regulator can be supported by those staff, without them facing material conflicts of duties in their work, due to the risk of conflicting directions or dual accountabilities?
- Do the legislative conditions covering termination of the regulator's board specify conditions and processes to avoid compromising independent regulatory decisions?
- Are there arrangements in place to manage any risks associated with pre- and post-appointment and employment of members of the governing body or staff of the regulator?

Notes

1. Any scale of economies of combining regulatory functions may differ depending on the nature and extent of the function and the industry being regulated. For example, Clive Briault of the United Kingdom's Financial Services Authority examined the sources of economies of scale and scope from a single industry-wide regulator replacing a multiplicity of separate specialist regulators in *Revisiting the rationale for a single national financial services regulator* (2002) (pp. 16-17).

2. The Australian High Court found that there is a more limited role for the courts in reviewing administrative decisions, where ministers, acting under statutory powers, make decisions on broad policy grounds. Minister for Aboriginal Affairs v Peko Wallsend Ltd (1986), 162 CLR 24 per Brennan, J.).

3. For an example of a framework agreement between an independent agency and a departmental secretariat, see Department of Treasury and Finance and Victorian Competition and Efficiency Commission (2005).

4. For example, appointments of commissioners of the Australian Competition and Consumer Commission *shall* be terminated if they are bankrupt, fail to disclose conflicts of interest, are absent without leave or engage in paid employment outside their duties without the Minister's consent. However, they *may* have their appointment terminated for misbehaviour or physical or mental incapacity.

5. For example, in the Australian state of Victoria, the Chairman of the Essential Services Commission (a utility regulator) and the Director of Transport Safety can only be removed if the relevant minister makes a statement outlining the grounds for removal to each House of Parliament, and both Houses pass resolutions supporting removal.

6. For example guidance, see the New South Wales Independent Commission against Corruption web page on post-separation employment at www.icac.nsw.gov.au/preventing-corruption/knowing-your-risks/post-separation-employment/4301, accessed 18 October 2012.

7. The United States has had legislation relating to post-employment of certain subsequent employment of private employment activities of former federal officers and employees (including regulators) since 1872 (see Congressional Research Service 2012).

8. The prospect of post-separation employment within government induces central bankers to alter their behaviour (Bankers, Bureaucrats, and Central Bank Politics: The Myth of Neutrality, Christopher Adolph, Cambridge Publishing 2013).

Chapter 3

Decision making and governing body structure for independent regulators

Regulators require governance arrangements that ensure their effective functioning, preserve its regulatory integrity and deliver the regulatory objectives of its mandate. This chapter details the structures of governing bodies, the decision making model and their memberships for independent regulators.

Principles for decision making and governing body structure

Decision-making model

1. The governing body structure of a regulator should be determined by the nature of and reason for the regulated activities and the regulation being administered, including its level of risk, degree of discretion, level of strategic oversight required and the importance of consistency over time.

Relationship between the responsible accountable political authority, governing body and the Chief Executive Officer

2. There should be a clear allocation of decision making and other responsibilities between the responsible accountable political authority, the governing body and the Chief Executive Officer (CEO) or individual in charge of the organisation's performance and implementation of decisions.
3. Where a regulator has a multi-member governing body, the CEO or individual responsible for managing the organisation's performance and implementing regulatory decisions should be primarily accountable to the regulator's governing body.

Membership of the governing body

4. To avoid conflicts of interest, where there is a need for formal representation of specific stakeholders in strategic decision making, stakeholder engagement mechanisms such as an advisory or consultative committee should be established, rather than making those stakeholders members of the regulator's governing body.
5. Executive representatives are accountable to the minister, and their presence on the governing body of an independent regulator can create role conflict. They should only participate in meetings of the governing body of independent regulators in a non-voting capacity and only when necessary and by invitation of the regulator.
6. The role of members of the governing body who are appointed for their technical expertise or industry knowledge should clearly be to support robust decision making in the public interest, rather than to represent stakeholder interests.
7. Policies, procedures and criteria for selection and terms of appointment of the governing body should be documented and readily available to aid transparency and attract appropriate candidates.
8. Members of the governing body should be limited to the number of terms of appointment to the Board.

Institutional governance arrangements for decision making

Chapter 2 set out the issues surrounding whether to place a regulatory function within a ministry or in a separate independent entity. If a regulator is established as a unit of the ministry, the decision making and governing body structure will be determined by the ministry's own arrangements, and this chapter is not relevant. However, for independent regulators, there are three main governance structures used (Department of Public Enterprise, 2000):

- Governance board model – the board is primarily responsible for the oversight, strategic guidance and operational policy of the regulator, with regulatory decision making functions largely delegated by the chief executive officer (CEO) and staff – for example, the United Kingdom's OFWAT (Water Services Regulation Authority);
- Commission model – the board itself makes most substantive regulatory decisions – examples include the United States' Federal Trade Commission and the ACCC; and
- Single member regulator – an individual is appointed as regulator and makes most substantive regulatory decisions and delegates other decisions to its staff.

The appropriate governance structure in each case will depend on the nature of the regulatory task and the sectors subject to the regulation, as discussed in the rest of this chapter.

Decision-making model

Where the governance board model is adopted, typically the roles and duties of boards cover strategy, governance and risk management and include matters such as:

- setting strategic direction and developing policy;
- appointing the chief executive;
- monitoring performance; and

- ensuring compliance with the law, the organisation's constitution and polices (OECD, 2004).

The roles and functions have some similarities to the private sector model of corporate governance, but in many ways the board's role and function are substantially different for regulators (Uhrig, 2003). Depending on the nature of the institutional and legislative arrangements, the responsible minister has potential to exert more power than a shareholder over a company. The minister is responsible for many matters which a board would decide in the private sector, such as setting objectives and underlying policies. Public entities often have complex functions, delivering activities on behalf of government and multiple types of stakeholders. The broader accountabilities of regulators – to their responsible minister, to the legislature and to the community more broadly – are key differences to private sector companies.

In some circumstances, a board-like governing body can add significant value to the decision making and oversight of the regulator's operations.

Factors identified in considering the potential value of a multi-member compared with a single-member decision-making model are summarised below. Once an assessment of these factors is made, the basic choice between decision making by an individual or by a collective can be considered and determined. These factors include:

- Potential commercial/safety/social/environmental consequences of regulatory decisions, taking account of the degree of impact of a risk event and the probability of its occurrence – a group of decision makers is less likely to be "captured" than an individual and a group will bring differing perspectives to decisions;
- Diversity of wisdom, experience and perceptions required for informed decision making because of the degree of judgement required (for example, where regulation is principles-based or particularly complex) – collective decision making provides better balancing of judgement factors and minimises the risks of varying judgements;
- Degree of strategic guidance and oversight of delegated regulatory decisions required to achieve regulatory objectives – where the regulator requires significant strategic guidance and oversight to achieve its regulatory objectives, such as in developing compliance or enforcement policies or resource allocation, these functions are better located in a body separate from its day-to-day operations. A multi-member body provides collegiate support for such strategic decision making;

- Difficulty and importance of maintaining regulatory consistency over time – where regulatory decisions require a high degree of judgement, a multi-member decision-making body provides more "corporate memory" over time; and
- Importance of decision-making independence of the regulator – a board will be less susceptible to political or industry influence than a single decision maker.

The OECD's *Making Reform Happen: Lessons from OECD countries* (OECD, 2010b) noted that the great majority of independent regulators in OECD countries have a board (or commission), and that a board is considered more reliable for decision making as collegiality is expected to ensure a greater level of independence and integrity.

Where a multi-member decision-making body is chosen, a further consideration is the appropriate role for the body. In some cases, the multi-member body will be able to adequately make all the substantial regulatory decisions itself. Alternatively, decisions could be divided among decision-making body members (or sub-committees) with particular jurisdictions or specialist expertise, where collegiate decision making is not required. Here the relevant expertise can be leveraged upon through a formal institutional mechanism for technical decisions.

In other cases, the best use of their efforts is on strategic guidance, approval and oversight of operational policy for the regulator, while delegating responsibility for implementation to the CEO and staff (Chartered Secretaries Australia, 2011). This may be the case where the regulator has a high workload of regulatory decisions or otherwise requires significant strategic guidance and oversight. The decision-making body may also need to delegate responsibility for certain time critical decisions, for example, to the Chair, CEO, or sub-committee of the board. Other regulatory decision making may be delegated to inspectors. These individuals may be covered by different employment arrangements and associated legislation. This highlights the importance of thinking about the roles of all of those who are likely to make key decisions when the design of the regulatory scheme and its governance is undertaken. Any limitations on the power of the body to delegate should be made explicit in the establishing legislation.

Where a single-member decision maker is chosen, it is important to consider the interaction between the role of the regulatory decision maker and the role of the CEO (or equivalent). It may be appropriate for the responsibility for implementing the decisions and administering the regulator to be vested in a separate individual, for workload or other reasons. In either case, the justification for the model chosen should be clearly articulated, preferably publicly.

Box 3.1. **Decision making in the Federal Institute of Telecommunications of Mexico**

Decision making is done by a committee, which is comprised of seven commissioners including the commissioner president. These will deliberate in a collective way and will decide their issues by majority vote, its meetings shall be public, except as provided by law.

Source: "Decreto por el que se reforman y adicionan diversas disposiciones de los artículos 6o., 7o., 27, 28, 73, 78, 94 y 105 de la Constitución Política de los Estados Unidos Mexicanos, en materia de telecomunicaciones" (2013).

Relationship between the responsible minister, governing body and CEO

Where a regulator has a separate governing body and chief executive, clearly defining the levels of decision making and their allocation between the body and the chief executive (or management levels) will be important.[1] For example, distinctions can be drawn between broad policy frameworks, key decisions under the enabling legislation, criteria for deciding more routine regulatory matters and the implementation of higher level decisions. The role of the responsible minister with regard to the regulator should be clearly defined. The allocation of roles between these parties should be documented and readily available to all affected parties (Chartered Secretaries Australia, 2011; and Uhrig, 2003).

Where there is a multi-member governing body, the CEO's primary accountability should be to the governing body, in order to safeguard the accountability of the CEO and independence of the regulator. The CEO should be appointed by, or on the recommendation of, the governing body.

Membership of the governing body

In order to support regulatory integrity through objective and impartial decision making, the governing body of a structurally independent regulator must be insulated from inappropriate stakeholder, ministerial or industry influence.

Stakeholder representation

One issue is the potential for confusion between the role of the governing body as a decision-making structure and as a body representing the interests of stakeholders. Even where there is a consultation or nomination process through the relevant sector, the appointee's role on a

regulator's governing body is to bring his or her particular expertise to the governance of the organisation, not to represent the interests of the sector (Pagliari, 2012).

Where industry stakeholders are members of the regulator's governing body, there is a potential for conflicts of interest to arise between the stakeholder's financial or other interests and the policy objectives of the regulator, which can create the appearance of impropriety (Chartered Secretaries Australia, 2011). There is also a risk that members of the governing body, once appointed, may perceive their role as representatives of a group they may have an interest in, rather than independently providing expertise for the governance of the organisation. This risk will be even greater if the regulator has an "industry development" objective. For these reasons, where regulators have a need for representative advice, this is better addressed through the formal establishment of advisory or consultative committees, either on an on-going or ad hoc basis. The Ministry of Employment and Economy in Finland has established a number of consultative or advisory bodies over the past few years as formal stakeholder engagement mechanisms.

In co-regulatory schemes, some form of industry involvement in governance arrangements may be a justifiable quid pro quo for a close relationship between the regulator and the industry, in order to give the regulator a source of effective influence without resorting to enforcement tools. In such cases a protocol for the management of conflicts of interest is essential.

Ministry representation on the governing board

Appointment of members of the ministry on the governing body of an independent regulator has the potential to create role conflict. In some cases, the statute creating an existing regulator requires ministry representation either by the *Secretary* who is the most senior public official in the ministry (i.e. Permanent Secretary, Departmental Secretary, State Secretary, Secretary-General, Deputy Minister, etc.) or his or her delegate, on the governing board. When such regulators are reviewed, the merits of mandating ministry representation need to be carefully considered, in terms of the level of independence of the regulator from government.

Because the duty of ministry staff under the terms of their employment is to the Secretary, and the duty of the Executive to the minister, there is potential for conflict between the role of a ministry staff member as a representative of the ministry and as a member of an independent regulator's governing body. For example, the *Appointment and Remuneration Guidelines of Victorian Government Boards, Statutory Bodies and Advisory*

Committees have noted: "The more a body's operations are designed to be independent of government influence, the less appropriate a non-statutory appointment of a public sector employee is likely to be." These guidelines also require justification of any ministry representation on the governing board not required by statute.

On the other hand, there can be benefits of having ministry representatives participate in the meetings of the governing body, particularly for certain agenda items. The potential benefits include improved information sharing, more informed decision making by both sides and a better relationship between them, although this can also be achieved in other ways.

To capture these benefits without compromising the regulator's independence and conflicting the ministry representative, one option is to allow such representatives to only participate at (non-public) meetings of the governing body of an independent regulator in a non-voting capacity, and at the invitation of the regulator only. This will largely depend on whether their presence at the meeting will unduly influence the proceedings and decisions at the meeting.

Technical expertise or industry knowledge

Where industry or technical experts are required on a governing body for informed and robust decision making, the objective of their appointments should clearly be to contribute independently to decision making in the public interest, rather than as a representative of specific stakeholder interests (Pagliari, 2012). Again, a protocol for the management of conflicts of interest is essential (OECD, 2003).

Selection processes for board members

Where there is to be a multi-member governing body, a diversity of skills and experience tailored to the functions of the regulator will facilitate robust decision making. The appropriate mix will also depend on the precise role of the governing body (for example, in a governance board compared to a commission model). The enabling legislation should identify the skills set and experience relevant to the regulatory functions that need to be represented on the governing body (Department of Public Enterprise, 2000).

Policies, procedures and criteria for selection and terms of appointment of the governing body members must be in line with any guidelines for public entity board appointments,[2] and should be documented and readily available to all affected parties (Chartered Secretaries Australia, 2011).

Governing body appointment policies should include all relevant details, including:

- Who manages the process for appointment of the members of the governing body?
- How are the requirements of the position defined? How are candidates selected?
- Who makes appointments?
- How will the Chair be nominated?
- What is the role of the minister (and the minister's office), the ministry and other advisory structures (if any)?
- How is induction managed?
- How is performance management managed?
- How are conflicts of interest managed?

In some countries the legislature has the formal authority to appoint board members and the CEO of the regulatory agency for greater transparency and accountability of the appointment process.

There should also be a limit to the terms of appointment of the CEO and board members to allow for renewal of the leadership and prevent long appointments. While long term or renewed appointments provide a certain amount of certainty and institutional grounding, they can also be detrimental toward the progress of the regulator and create incentives for career board members.

Applying the principles – Decision making and governing body structure for independent regulators

Decision-making model

- Should the regulatory decision-making powers be vested in a multi-member body or an individual? The following tool is not prescriptive, but is intended to identify the major factors for considering the value a multi-member body would bring, in approximate order of importance. A high overall rating indicates a stronger case for a multi-member decision-making body. Their relative weight will differ from case to case.

Indicators of multi-member decision-making body value (in approximate order of importance)	1 (Low)	2 (Moderate)	3 (High)
1. Potential commercial/safety/social/environmental consequences of regulatory decisions			
2. Diversity of wisdom, experience and perceptions needed for informed decision making because of the degree of judgement required (for example, where regulation is principles-based or particularly complex) or the scope of issues covered			
3. Degree of strategic guidance and oversight of delegated regulatory decisions required to achieve regulatory objectives			
4. Difficulty and importance of maintaining regulatory consistency over time			
5. Importance of decision-making independence			

- Does the legislation clearly establish the roles of the governing body?
- Where a single regulatory decision-maker model is chosen:
  - Should the individual who is responsible for regulatory decision making also have responsibility for the management and administration of the regulator? Why or why not?
  - Should there be any limitations on the ability of the regulatory decision-maker(s) to delegate the power to make regulatory decisions?

Relationship between the responsible minister, governing body and CEO
• Is the allocation of roles and responsibilities between the responsible minister, the governing body and the Chief Executive Officer (or equivalent) documented and available to all affected parties? • Where there is a multi-member governing body: – Does the governing body have the power to appoint and remove the chief executive?
Membership of the governing body
• Are stakeholders separate from the governing body? • In the exceptional case where stakeholders are members of the governing body, what is the justification for this? • How are conflicts of interest managed? • Are ministry staff separate from the governing body? • If ministry representatives are on the governing body, do they participate in a non-voting capacity? • If ministry staff are represented as full voting members, what is the rationale for this, and how are conflicts of interest to be managed? • Are industry or technical experts required on the board for robust regulatory decision-making? • If so, is it clear that the experts are required to contribute to decision-making independently rather than as stakeholder representatives? • How are conflicts of interest to be managed? • Does the legislation clearly specify the skills set and experience relevant to the regulatory functions that need to be represented on the governing body? • Are appointment policies in line with the any government guidelines for public entity board appointments? • Are appointment policies documented and readily available? • Are there limits on the number of terms that a CEO or board member can be appointed for?

Notes

1. For a discussion of this important relationship in the private sector context, see OECD (2004a). The governance relationships in public sector entities are similar to those in the private sector. For example, the economic regulator of the water sector for England and Wales, OFWAT, has a Board structure. The Board comprises a Chair, Chief Executive, executive Board members and non-executive directors. Board members are appointed by the Secretary of State in consultation with the Welsh Government (w.ww.ofwat.gov.uk/aboutofwat/structure/, accessed 10 October 2012).

2. See Board size and effectiveness (2011); and Good Practice in Making council member and chair appointments to regulatory bodies (2012) (www.professionalstandards.org.uk/regulators/overseeing-regulators/appointments-to-councils), Professional Standards Authority, United Kingdom.

Chapter 4

Accountability and transparency

Businesses and citizens expect the delivery of regulatory outcomes from government and regulatory agencies, and the proper use of public authority and resources to achieve them. Regulators are generally accountable to three groups of stakeholders: i) ministers and the legislature; ii) regulated entities; and iii) the public. This chapter provides guidance on the accountability structures and transparency mechanisms that should be in place for effective regulators.

Principles for accountability and transparency

Accountability and transparency to the minister and the legislature

1. The expectations for each regulator should be clearly outlined by the appropriate oversight body. These expectations should be published within the relevant agency's corporate plan.
2. Regulators should report to ministers or legislative oversight committees on all major measures and decisions on a regular basis and as requested.
3. Governments and/or the legislator should monitor and review periodically that the system of regulation is working as intended under the legislation. In order to facilitate such reviews the regulator should develop a comprehensive and meaningful set of performance indicators.

Accountability and transparency to regulated entities

4. Information and access to appeal processes and systems should be made easily available to regulated entities by regulators. Regulators should establish and publish processes for arm's length internal review of significant delegated decisions (such as those made by inspectors).
5. Regulated entities should have the right of appeal of decisions that have a significant impact on them, preferably through a judicial process. Such right of appeal shall be allowable, *inter alia*, on the grounds that the regulator has exceeded the powers attributed to it, insufficiency of consultation, and/or material omissions in the evidence and actions that are disproportionate to the issue being addressed.
6. Regulators may rescind decisions as a result of appeal.

Accountability and transparency to the public

7. Key operational policies and other guidance material, covering matters such as compliance, enforcement and decision review, should be publicly available.
8. The regulator should recognise its special responsibility in ensuring that members of the public have channels of complaint and possible redress in relation both to the actions of a regulated entity and to the actions of the regulator.
9. All major decisions made by the regulator shall be accompanied by publicly stated reasons.
10. The opportunity for independent review of significant regulatory decisions should be available in the absence of strong public policy reasons to the contrary.
11. The right of appeal of decisions by the regulator should be extended to members of the public where their standing is recognised by the judiciary.

Accountability and transparency to ministers and the legislature

Accountability and transparency is the other side of the coin of independence and a balance is required between the two. Comprehensive accountability and transparency measures actively support good behaviour and performance by the regulator, as they allow the regulator's performance to be assessed by the legislature or responsible other authority.

The Australian National Audit Office has also argued that:

> *Increasing the transparency of, and regulated entities' confidence in, the regulatory regime, can be expected to increase the level of voluntary compliance. This has the potential to reduce administrative costs for regulators and compliance costs for regulated entities* (ANAO, 2007, p. 25).

The regulator exists to achieve objectives deemed by government and the legislator to be in the public interest and operates within the powers attributed by the legislature. A regulator is therefore accountable to the legislature, either directly or through its minister, and should report regularly and publicly to the legislature on its objectives and the discharge of its functions, and demonstrate that it is efficiently and effectively discharging its responsibilities with integrity, honesty and objectivity (OECD, 2012; Department of Public Enterprise, 2000). A system of accountability that supports this ideal needs to clearly define what the regulator is to be held accountable for, how it is to conduct itself and how this will be assessed.

The judiciary should help ensure that the regulator operates within the powers attributed to it. The regulator has a responsibility to the regulated entities to exercise its powers in a way that increases confidence in the market, rule of law and in general trust in the state. At the same time the regulator is also answerable to the public for how it makes use of its powers and for the way in which it exercises them and whether it achieves the policy goals it is intended to exist for.

Clear expectations

A good mechanism for ministers and regulators to achieve clear expectations is for ministers to issue a statement of expectations to each of their regulators (both independent and ministerial regulatory units).[1] Each

statement should outline relevant government policies, including the government's current objectives relevant to the regulator, and any expectations on how the regulator should conduct its operations. The statement needs to be consistent with the extent of independence of decision-making enshrined in the regulator's enabling legislation. The regulator should formally respond by outlining how it proposes to meet the expectations of government in its corporate plan or similar document, such as a statement of intent. This document should include key performance indicators agreed with the relevant minister. Where competing priorities exist within a regulator's functions for a given objective, the corporate plan should outline a set of prioritising principles.

The statement of expectations and corporate plan (including key outcomes, outputs, quality and timeliness performance indicators and targets agreed between the minister and the regulator) should be published on the regulator's website. The performance of the regulator should be clearly aligned to the achievement of the government's policy objectives. Through this process, it becomes clear to all stakeholders what the regulator is there to achieve and what it is accountable for. The statement of expectations and corporate plan should be reviewed by the minister and regulator when there is a significant change in government policies or change in the operational environment, or a new minister is appointed.

Involving relevant stakeholders, where appropriate, in defining the expectations will improve the extent of stakeholder buy-in of the regulatory activity and the outcome.

Accountability to the legislature

The legislature confers powers on the regulator and the regulator should report on its activities and outcomes to the legislature (OECD, 2012; Department of Public Enterprise, 2000).[2]

Independent regulators should report on their performance annually to the legislature, such as legislative oversight committees, directly or via their minister, and publish a report. The annual report should primarily report against key agreed outcomes and indicators and include any additional direction from the minister made after the issue of the statement of expectations and the minister's endorsement of the regulator's corporate plan.

Ministerial regulatory units should report on their activities and outcomes either within ministry annual reports or separately. Reporting should be rigorous and provide a level of disclosure to the community similar to that of independent regulators, while reflecting the size and importance of the regulatory unit.

The responsibility for the overall regulatory framework is not with the regulator. This remains with the government and or legislature who should conduct monitoring and periodic reviews of overall regulatory system. Regulators should assist in this important task by having comprehensive and meaningful performance indicators to furnish such oversight activities (see Chapter 7).

Transparency of operational policies

In addition to publishing objectives, clear operational policies covering compliance as well as enforcement and decision reviews should be made publicly available by the regulator, with any necessary guidance material to aid understanding of these matters. All operational policies and guidance materials should be consistent with the outline contained in the statement of expectations of how the regulator is to conduct itself, and explain to stakeholders how the policy contributes to regulatory outcomes. Disclosure by the regulator of these policies and guidance materials should contribute to the public and regulated entities having confidence and understanding of what is expected of them and how their compliance will be monitored, judged and enforced in the event of breaches of the law (Deighton-Smith, 2004).

The regulator should disclose what rules, data and informational inputs will be used to make decisions. However, where such disclosure would likely lead to gaming of the regulatory system by regulated entities, it would be appropriate for the regulator to be permitted to limit such transparency.

Box 4.1. **Limitation to transparency in Netherlands**

Regulators may opt to limit transparency for several reasons. In the Netherlands the Authority for Consumers and Markets may do so:

- when it concerns information that is specifically sensitive to the regulated entities. In those cases, transparency is expected to cause a detriment to the regulated entities. In the Dutch Freedom of Information Act (Wet openbaarheid van bestuur) some exceptions are outlined for the public sharing of governmental information;
- when information sharing can cause have a negative influence on the market; and.
- when the regulated entity is involved in an investigation by the regulator.

Source: Authority for Consumers and Markets (2013).

Transparency in the actions and decisions of regulators is beneficial for preventing reviews of decisions. By being open and providing explanations of decisions regulators can avoid the risk of a large number of appeals to those processes provided the decisions are perceived to be fair and evidence based.

Enforcement actions should also be disclosed in a timely and readily accessible manner. However, limiting transparency may be appropriate where confidentiality is required, for example, in relation to enforcement actions that have not yet been resolved (and where disclosure may prematurely affect the reputation of a regulated entity.)

Accountability to regulated entities and the public

Citizens and businesses that are subject to the decisions of public authorities should have ready access to systems for challenging the exercise of that authority (OECD, 2012). Equally regulators should also recognise its duty to provide avenues for complaint and redress. This is not only in relation to the actions of regulated entities, but also in relation to its' own actions. This demonstrates the regulators' acknowledgement that such corrective procedures are vital in maintaining the trust of stakeholders as well as ensuring the desired outcomes, while limiting unintended consequences.

Such channels should include internal review of delegated decisions, as well as more robust external review by a body such as a court. An important distinction can be made between the principle that specific decisions of a regulator should be subject to judicial review, and the regulator's ultimate accountability for its performance to the legislature and/or minister.

Delegated decisions (such as those of inspectors) can have a material effect on regulated entities and should be subject to a timely and transparent internal review process on request. The regulator should advise the regulated entity of any options for internal review when they are informed of the decision. The internal review process should be published and made accessible to regulated entities. The internal review unit should be as operationally separate from those responsible for the initial decision as practicable. For significant decisions such as those by inspectors, the internal review process should be at arm's length from the regulator. Where the review upholds the original decision, the regulated entity should be given a reason as to why the decision was upheld.

There should also be timely, transparent and robust mechanisms for the external review or appeals of significant regulatory decisions. External reviews or appeals can act as an accountability mechanism and can improve

the quality of the regulator's decision-making and internal review processes. The regulator should outline on its website the process by which regulated entities may seek an external review or appeal. In many cases, such decisions will be able to be reviewed by an Administrative Tribunal or Court. If the appeal is successful then regulators should be able to rescind on those decisions.

Formal complaints can be made about the regulator to an Ombudsman or similar public "watchdog" if the conduct complained of falls within the Ombudsman's jurisdiction and the complaint has not been able to be resolved between the regulator and the complainant. The contact details for the Ombudsman or similar complaints body should be published on the regulator's website.

Box 4.2. **Reviewing regulatory decisions in the United Kingdom**

A common finding in the United Kingdom is that businesses thought that there was a lack of appropriate appeal mechanisms or not enough information about what appeal rights existed or how a regulator's decision could be challenged or a second opinion given. As a result, the UK government launched a specific review of how appeals and complaints mechanisms operate across the range of local and national regulators.[1]

The revised Regulators' Code[2] has clarified the requirements regarding appeals mechanisms. The Code states that regulators should:

1. Provide an impartial and clearly explained route of appeal against a regulatory decision;
2. Provide a timely written explanation of any right to representation or appeal that can be clearly understood; and
3. Clearly set out information on how those they regulate can make a complaint.

1. Further details about the review can be found at: http://discuss.bis.gov.uk/focusonenforcement/closed-focus-areas/regulatory-appeals-mechanisms.

2. The Regulators' Code can be found at www.bis.gov.uk/assets/brdo/docs/publications-2013/13-1016-regulators-code.pdf.

Source: Department of Business (2013), Innovation and Skills, United Kingdom.

The right to appeal is often permissible on the grounds that the regulator has exceeded its own attributed powers, or it did not engage in sufficient consultation before taking a decision, or it made material omissions in the evidence it based its decision on, or the actions taken were disproportionate to the issue being addressed. As good practice, all major decisions taken by regulators should be made publicly available with the justification for those decisions.

Other accountability structures, such as independent reviews of significant regulatory decisions should also be encouraged as a matter of course, not just where an issue has been raised. Such scrutiny bodies may compliment the accountability of regulators to the legislature. The United Kingdom's Regulatory Policy Committee (RPC) is an independent advisory non-departmental (non-governmental) public body tasked with providing independent scrutiny of proposed regulatory measures put forward by the UK government. As of July 2013, the RPC has a new role under the *Accountability of Regulatory Impact* (ARI) scheme. Under the ARI, non-economic regulators, such as the Health and Safety Executive and the Environment Agency, that are planning a significant change in policy or practice will be expected to assess and quantify the impact of that change on business, and share their assessment with businesses affected, and where possible agree it with them. Where an agreement cannot be agreed, the RPC will investigate, assess and determine the best means of resolving the dispute, which may include arbitration.

Box 4.3. **Accountability and transparency practices in Australia**

The Australian Competition and Consumer Commission (ACCC) and Australian Energy Regulator (AER) each maintain websites containing a broad and detailed range of documents to assist stakeholders in understanding the nature of their work. The ACCC and AER provide public versions of all draft and final regulatory determinations on their website. In addition to these transactional documents, the ACCC and AER both produce guidance for stakeholders on operational policies.

The ACCC publishes a Compliance and Enforcement Policy (www.accc.gov.au/publications/compliance-and-enforcement-policy), which sets out the principles adopted by the ACCC to achieve compliance with the law. In addition to this type of guidance, the ACCC provides stakeholders with details on its decision-making processes, including the structure of its specialised committees, and its Code of Conduct for Commission members (www.accc.gov.au/about-us/australian-competition-consumer-commission/decision-making-processes). The AER provides similar information on its governance and decision-making processes on its website (www.aer.gov.au/about-us).

The AER is currently undertaking a Better Regulation reform programme (www.aer.gov.au/Better-regulation-reform-program), which includes the publication of a series of guidelines by 29 November 2013 that set out their approach to regulation under new National Electricity and Gas Rules. The AER has published draft guidelines on its website, which have been the subject of consultation with stakeholders.

Source: Australia Competition and Consumer Commission & Australian Energy Regulator (2013).

Applying the principles – accountability and transparency

Accountability to minister and the legislature

- Has the minister or other appropriate oversight body provided a written statement of expectations to the regulator? If not, how have the expectations of the regulator been provided?
- Does the regulator publish a corporate plan outlining how the regulator intends to meet objectives set by legislation and the minister's or appropriate oversight body's statement of expectations?
- When are the statement of expectations and corporate plan reviewed and revised?
- Is there a legislative requirement for the independent regulator to produce an annual or regular report to the legislature?
- Is there a legislative requirement for all major measures and decisions to be reported to the minister or legislature?
- If the regulator is a ministerial regulator, does it provide the same level of public reporting on its activities and outcomes as would be required if it were an independent regulator?
- Do the agreed performance indicators provide sufficient and clear information to enable meaningful assessment of the regulator's performance across the range of its responsibilities? Do they contribute to government and or legislature's monitoring and periodic reviews of the regulatory framework?
- Have key outcome indicators for publication in the annual report been agreed with/by the minister and/or legislature?

Accountability to regulated entities

- Does the regulator provide easily accessible guidance material on appeals processes and systems to regulated entities?
- What is the regulator's process for internal review of significant delegated regulatory decisions?
- Are regulated entities advised that internal review of significant delegated regulatory decisions is available when they are informed of the outcome of the decision?
- Is the right of appeal through judicial process available for regulated entities? Under what circumstances?
- Can the result of the appeal mean that regulators can rescind the decision?
- Is the process transparent, timely and conducted at arm's length?
- Is the internal review unit as operationally separate from the decision-making body as possible?

Accountability to the public
• Has the regulator published its key operational policies? • Are there good public policy reasons for not publishing some of this information? What are the reasons? • Is the information on reviews and appeals processes easily accessible and communicated in an easy to understand format? • Are all major decisions made by the regulator published? Is the justification published or made public? • Are there any strong public interest reasons why all the significant regulatory decisions should not be able to be subject to both internal review and external appeal? • Can independent external reviews of significant regulatory proposals be conducted? Under what circumstances? Does there need to be strong public interest or concern to conduct it? • What independent bodies can conduct independent external reviews? • What decisions can be appealed by the public? • On what grounds can decisions be appealed by the public? • During the appeals process, are decisions suspended or overturned, or do they remain in force until a decision has been made?

Notes

1. This proposal was introduced in Uhrig, John (2003). The more routine and *ad hoc* communication that can occur between Ministers and regulators is discussed in Section 3.4.1 of this paper.

2. Some implicitly argue that higher accountability requirements imply less independence for a regulator. An index of the independence of regulators created by Gilardi (2002) was used to measure the impact of regulatory independence on investment by Cambini and Rondi (2011). In this index, Gilardi has formulated it so that formal obligations for a regulator to report to the Government or the legislature lead to a lower score for independence. Hanretty, Larouche and Reindl (2013) using similar indices found no such trade-off between regulators' accountability scores and independence scores. This can easily be understood if legislators bestow greater initial independence in other respects if they are assured (or have trust) that the regulator will come back to report to them.

Chapter 5

Engagement

Good regulators have established mechanisms for engagement with stakeholders as part of achieving their objectives. The knowledge of regulated sectors and the businesses and citizens affected by regulatory schemes assists to regulate effectively. This chapter addresses how regulators should interact with stakeholders and the measures to avoid regulatory capture and conflicts of interest.

Principles for engagement

Fit for purpose
1. Regulators should undertake regular and purposeful engagement with regulated entities and other stakeholders focused on improving the operation and outcomes of the regulatory framework or scheme.
2. Procedures and mechanisms for engagement should be institutionalised as consistent transparent practices. There should be a focus on establishing structured and regular consultation mechanisms with regulated entities.
Avoiding capture and conflicts of interest
3. Engagement processes used should protect against potential conflicts of interests of participants and guard against the risk that the regulator may be seen to be captured by special interests.

The relationship between engagement and governance

One objective of good regulator governance is to enhance public and stakeholder confidence in the regulator, its decisions and its actions. Effective engagement with regulated parties and other stakeholders helps achieve this.

The Australian National Audit Office (2003) has described the objective of public sector governance to be:

> *... to ensure that an organisation achieves its overall outcomes in such a way as to enhance confidence in the organisation, its decisions and its actions. Good governance therefore means that the organisation's leadership, its staff, the government, the parliament and the population can rely on the organisation to do its work well and with full probity and accountability* (p. 6).

Effective engagement with regulated parties and other stakeholders is important to inform the policy-making process and the decisions of the regulator. Communication with parties in the formal accountability system, that is, the legislature, ministers and the executive has been dealt with earlier in chapters 2 and 3. This chapter focuses on engagement with other stakeholders.

Depending on the regulator's functions this engagement may relate to:

- matters relating to individual decisions (where information from stakeholders is necessary to inform a regulatory decision);
- the regulator's operational policies (for example, to better understand community expectations relating to regulatory priorities); or
- the potential policy outcomes a regulator might seek to achieve (based on stakeholder input on what might be achievable in different circumstances).
- Moreover engagement between regulators and stakeholders is a way to improve the quality and efficiency of the rules and regulations that are implemented as well as a way to enhance the credibility of the regulatory framework.

Regular, genuine and fit for purpose engagement

The type and level of engagement used for a particular matter should reflect the intended purpose of that engagement. The nature of the legislative scheme and the regulatory style adopted by the regulator will affect the nature of any engagement. For example, more active engagement will be appropriate where the regulation is performance or management based rather than prescriptive, or the regulator is seeking to achieve a more "co-regulatory" approach to improving outcomes.

Advisory bodies

An advisory body may be used to provide insights from industry participants or the community on strategies to influence behaviour, or early warning on developments that may warrant a change in the compliance approach of the regulator. Community or industry engagement may also be useful to inform the development of the corporate plan. This may canvass the scope of the regulator's activities to build greater understanding of the regulator's operations.

Some regulators have formal advisory bodies established in legislation, or an explicit power in legislation enabling the minister or the regulator to create such formal advisory bodies from time to time. In some circumstances, formal and explicit recognition of the important role of effective and structured engagement can be a useful mechanism to build a shared commitment to regulatory objectives (Meloni, 2010). In other cases, the establishment of such bodies has been an important element of a transition to an expertise-based governing board, from a board previously made up largely of representatives of regulated entities.

However, mandating an arrangement in legislation may be unnecessarily rigid or prescriptive. Therefore it is important, when establishing a new body, to determine whether there is a strong case to mandate an advisory body in legislation and, if so, whether a sunset clause should be included. If an existing regulator is being reviewed, the need for an existing advisory body should be assessed. If the industry or other important stakeholders have gained confidence in the expertise-based board, its replacement by more flexible mechanisms may now be appropriate. It may be unnecessary to mandate onerous appointment processes for those in purely advisory roles.

Engagement policies and mechanisms

It is good practice to develop and release a consultation policy so that key stakeholders are aware of the regulator's practices and any expectations that may be placed on stakeholders (OECD, 2012).

Box 5.1. International Council of Securities Associations Best Practices for Regulatory Consultation (2013)

Reflecting the experience of financial services firms and their representatives during a period of intense regulatory activity, the Best Practices document emphasises several key aspects of the consultation process. This includes the need for regulators to ensure that:

1) sufficient time is allocated for the consultation process, particularly for consultations on major reforms;
2) any proposed measures have well designed policy objectives and are written in a clear and precise manner so that stakeholders are able to provide comprehensive comments; and
3) any proposed new regulations are consistent and coherent with the existing regulatory framework.

In addition, we note that impact assessments are an important part of the consultation process. While ICSA members recognise that conducting an impact assessment for a proposed regulation can be a challenging task, we believe such assessments are necessary since the information they provide enables stakeholders to comment in a sufficiently comprehensive manner on any proposed regulation. Impact assessments are also important since they allow regulators and policy makers to better understand the costs of a proposed regulation along with benefits.

Source: International Council of Securities Associations (2013).

Whatever mechanisms are used, engagement with key stakeholders should be institutionally structured to produce concrete, practical opportunities for dialogue based on achieving active participation and, where possible, exchange of empirical data, rather than on a desire to achieve consensus (Deighton-Smith, 2004).

The aim should be better informed, timely decision-making, underpinned by processes that build confidence that decisions are cognisant of the impacts on all affected parties. This is more likely to be achieved if there are structured consultation mechanisms that include a genuine invitation from regulators for comments from market participants and other

stakeholders and appropriate consideration of the comments that have been received.

Avoiding capture and conflicts of interest

While effective engagement is vital to good regulatory outcomes that have the support of the broader community and regulated entities, there are also risks with engagement that need to be managed (Pagliari, 2012). It is crucial that engagement processes do not favour particular interests – for example, some regulated entities over others, or regulated entities in general over the public interest. Even the appearance that engagement has favoured some interests can compromise the regulator's ability to achieve broader outcomes, for example, by affecting the willingness of some regulated entities to support voluntary compliance efforts.

Engagement should be inclusive and transparent unless this would compromise the intended outcome. Inclusive consultation allows any regulated party or member of the public to contribute or comment on proposals, rather than just representative groups, building confidence that all interests are heard.

Transparent engagement involves publicly documenting who has been consulted and what their input has been and the release of the regulator's responses to the main issues (OECD, 2010c). This can protect the regulator from suggestions of capture or failure to listen to the range of views, and also builds confidence in the regulatory process.

Applying the principles - Engagement

Fit for purpose engagement

- What forms of engagement, if any, would benefit from legislative backing, or formal ministerial involvement (for example, in appointing members of a stakeholder advisory group)?
- Are structured engagement mechanisms permitted or encouraged?

Avoiding capture and conflicts of interest

- How do engagement processes address potential conflicts of interests of participants and guard against the risks that the regulator may be seen to be captured by special interests?
- What formal and informal engagement mechanisms are used?
- When are these engagement mechanisms used?
- Is engagement two-way?
- Is there a link between undertaking engagement and the policy cycle?
- Is feedback provided to those engaged on the results of the engagement?

Chapter 6

Funding

The amount and source of funding for a regulator will determine its organisation and operations. It should not influence the regulatory decisions and the regulator should be enabled to be impartial and efficient to achieve its objectives. This chapter raises the key issues for the funding structure of regulators to be effective and efficient.

Principles for funding

Supports outcomes efficiently
1. Funding levels should be adequate to enable the regulator, operating efficiently, to effectively fulfill the objectives set by government, including obligations imposed by other legislation.
2. Funding processes should be transparent, efficient and as simple as possible.
Regulatory cost recovery
3. Regulators should not set the level of their cost recovery fees, or the scope of activities that incur fees, without arm's-length oversight. These fees and the scope of activities subject to fees should be in accordance with the policy objectives and fees guidance set by government or, where these are not in place, the OECD's *Best Practice Guidelines for User Charging for Government Services* (OECD, 1998).
4. Where cost recovery is required, the regulator should not be at risk of setting unnecessary or inefficient administrative burdens or compliance costs on regulated entities.
Litigation and enforcement costs
5. Because of the significant and unpredictable costs involved, regulators should follow a defined process to obtain funding for major unanticipated court actions in the public interest that is consistent with the degree of independence of the regulator.
Funding of external entities by a regulator
6. A regulator should only fund other entities to deliver activities where they are directly related to the regulator's objectives, such as information and education about how to comply with regulation, or research to inform the regulator's priorities. Any funding of representative or policy advocacy organisations should be the responsibility of the relevant ministry, not the regulator.

Supports outcomes efficiently

Clarity about regulators' sources and levels of funding is necessary to protect their independence and objectivity. Transparency about the basis of funding can also enhance confidence that the regulator is efficient, as well as effective.

Regulation is one of many tools to achieve the government's policy objectives. To contribute to these objectives effectively, a regulator's funding should be reflected in the resources required to perform its functions with appropriate use of the resources. In addition to meeting its objectives, a regulator may have a legislative obligation to comply with certain other Acts. Compliance imposes additional costs on the regulator which should be taken into consideration when decisions regarding funding are made.

Funding sources may include budget funding from consolidated revenue, cost-recovery fees from regulated entities, monies from penalties and fines and interest earned on investments and trust funds. This mix of funding sources should be appropriate for the particular circumstances of the regulator. To promote efficiency and equity, it should be made clear who pays for the regulator's operations, how much and why (International Monetary Fund, 1999). A regulator should disclose in its annual report what proportion of its revenue comes from each of these sources.

Regulatory cost recovery

Some forms of regulation require the imposition of fees and charges for regulatory activities such as issuing licences or considering approval applications. The issue of whether regulators should be able to retain the proceeds of any fines or forfeiture is a separate and complex issue that is not examined in this paper.

Cost recovery through fees and charges is most often adopted when government services do not directly benefit all citizens. Many programmes benefit only selected groups in the community (e.g. users of particular services of various professions). In these circumstances, fees on the regulated providers give a mechanism whereby the costs of the regulation are incorporated into the costs of delivering the service.

Where cost-recovery fees contribute to the funding of the regulator, the level of their cost recovery fees, and the scope of activities that incur fees, should be set for a multi-year period by the legislature or the minister in accordance with the policy objectives of the government and any cost recovery guidelines.[1] It may be appropriate for the relevant ministry to develop the proposed fee schedule in consultation with the regulator, regulated entities and other stakeholder groups for the approval of the minister. The anticipated revenues from the proposed fee schedule should be sufficient to allow the regulator, operating efficiently, to fulfil its functions.

When a regulator operates under a cost recovery scheme, care should be given to ensure the scheme does not impose any unnecessary or over burdensome costs on regulated entities or apply significant compliance costs that cannot be justified through a cost benefit analysis. The scheme should be as transparent as possible to demonstrate the fairness of its operation and to build and maintain the trust of the regulated entities.

The proposed expenditure in the corporate plan of the regulator should be submitted to the minister for approval. Some regulators are funded by other means, such as interest earned from investments or specific trust funds. Nevertheless, the power to collect such funding has been granted by the legislature, and the minister remains accountable for its use.

Budget funding

Provided the objectives, scope and performance measures of a regulator are clear, budget funding is an appropriate means to fund general regulators, where it is not efficient to impose user-charges.

The government and the legislature should be able to review an independent regulator's funding levels from time to time. However, secure multi-year funding arrangements can contribute to the independence of a regulator by protecting it from budget cuts motivated by political reaction to unpopular decisions (Kelley and Tenenbaum, 2004).

Financial transparency

The process for determining cost recovery fees (imposed by either independent or ministerial regulators) and how they apply should be clear, understandable, accessible to all stakeholders and, above all, transparent.

Financial transparency in budget funding, cost-recovery fees and other revenue sources can reduce the risks to the regulator's political and administrative independence from government and over-sensitivity to lobbying against the public interest (Kelley and Tenenbaum, 2004). Financial transparency and justification can improve the efficiency of

regulatory operations by providing the information necessary to hold the regulator to account for its activities and expenditures and making any attempt to influence regulatory practice by political or industry interests more apparent (Hüpkes et. al., 2006). This can lead to greater buy-in to the regulatory scheme by regulated entities and may enhance compliance.

Costs of major and unanticipated court actions

Governments provide funding to all agencies that ensures that they discharge their responsibilities effectively. In relation to regulators, this should take into account all necessary enforcement, prosecution and appeal activities likely to arise from its functions. It is recognised however that unanticipated court actions may arise that require significant legal costs that may hinder a regulator's decision to undertake actions.

This presents substantial challenges. On the one hand, given the need for the government to remain accountable for the overall level of expenditure of their regulators, there are issues with a government to providing its regulators with pre-approval of substantial funds for major unanticipated court actions. However, the requirement of an independent regulator to seek ministerial approval for funds to launch a major case would affect its actual and perceived independence.

Funding of external entities by regulators

Some regulators may require services provided by third parties to achieve their objectives. Such transactions could include funding a third party to provide information and education about complying with regulation or programmes that may reduce the demand for regulatory intervention. For example, this may include funding an industry association or union to develop relevant guidance or organise workshops on how to comply with new regulation.[2] All contracts involved should be disclosed and the regulator should be able to demonstrate that all activities funded contribute directly to meeting its policy objectives.

Any funding of representative organisations or policy advocacy groups to contribute to government processes should be the responsibility of the relevant ministry, rather than the ministerial regulatory unit or independent regulator.

Applying the principles – Funding

Supports outcomes efficiently

- How much funding does the (independent or ministerial) regulator require to achieve its objectives?
- How much does it cost to meet the legislative obligations of an independent regulator outside its main functions? e.g. funding of related entities required by legislation, annual reporting, etc.
- Does the independent regulator's annual report (or ministry annual report in the case of a ministerial regulator) disclose the proportion of revenues from budget funding from consolidated revenue, cost-recovery fees from regulated entities, monies from penalties and fines and interest earned on investments and trust funds?

Regulatory cost recovery

- Does the cost recovery scheme impose unnecessary burdens or costs on regulated entities that cannot be justified?
- If fees are charged to the regulated entities to fund the regulator, are they proportional to the costs these entities impose on the regulator?
- Does the annual report of the independent regulator, or the ministry, state the regulator's total expenditure and revenues from budget funding, cost-recovery fees, penalties and fines?
- Is there a clear rationale for this mix of funding sources for the regulator?
- Are the level of cost recovery fees, and the scope of activities subject to fees approved by the minister or legislature, rather than the regulator?
- Where fees are charged to fund the regulator's operations, are they in accordance with the policy objectives and fees guidance set by government or, where these are not in place, the *OECD's Best Practice Guidelines for User Charging for Government Services*.

Litigation and enforcement costs

- Is there a clear process by which the regulator, with the approval of its minister, can apply for funding for major unanticipated litigation?

Funding of external entities by regulators

- Can it be shown that all funding activities contribute directly to the regulator's objectives?
- Does the regulator fund any external entities to contribute to government processes?

Notes

1. In the United Kingdom, cost recovery arrangements are governed by guidance from HM Treasury setting out the approach that should be taken when setting cost recovery fees (www.gov.uk/government/publications/managing-public-money)

2. In contrast, providing competitive grants to regulated firms to improve their performance can create perceived or actual conflicts if the regulator subsequently considers enforcement actions against these firms (this is discussed in Chapter 1). See Krpan (2011), pp. 279-281.

Chapter 7

Performance evaluation

It is important that regulators are aware of the impacts of their regulatory actions and decisions. This helps drive improvements and enhance systems and processes internally. It also demonstrates the effectiveness of the regulator to whom it is accountable and helps to build confidence in the regulatory system. This chapter lays out some of the key considerations in measuring and evaluating the performance of regulators.

Principles for performance evaluation

Identifying the scope

1. Regular independent external reviews of regulators should be arranged by the government, legislature or the regulator itself, in addition to any internal reviews.
2. Regulators should clearly define and agree the scope of their mandate that will be assessed with key stakeholders. This may already be contained within legislation.
3. Regulators should determine which regulatory decisions, actions and interventions will be evaluated in the performance assessment.
4. Regulators should conduct a periodic review of regulations that are put into effect after a number of years of implementation (post-implementation reviews). More broadly; regulators should evaluate their activities and decisions on a continuing basis in the light of their legislative mandate and taking into account the views of outside interested parties.

Developing indicators

5. Regulators should consider which operational indictors can be used to demonstrate the systems, processes and procedures that are applied within the organisation to complete the tasks of the regulator e.g. following published procedures are satisfactory and appropriate.
6. Regulators should consider which outcome indicators can be linked to the actions of the regulator to demonstrate the overall strategic results of regulatory interventions in relation to operations e.g. investment in infrastructure.
7. Comparisons and peer expertise and evaluation should be utilised.

Use of performance evaluation

8. The main purpose of the performance evaluation should be to maintain and drive improvements in the performance of the regulator.
9. The performance evaluation criteria and results should be published.
10. The performance evaluation criteria should be reflected in performance assessments of staff in the regulator, where possible.

Measuring performance

A key underlying reason for implementing good governance arrangements in regulators is to provide the regulator with incentives to improve its performance (Meloni, 2010). Good regulatory performance may include adopting innovative regulatory approaches, making proactive efforts to reduce the regulatory burden and effective use of risk-based regulation.

Measuring performance also communicates and demonstrates to stakeholders and regulated entities the added value of the regulator. The process of defining the performance indicators also helps to manage the expectations of the key stakeholders.

Performance indicators

The regulator should report against a comprehensive set of meaningful performance indicators, set with reference to the goals it is expected to achieve. The regulator's goals should also be linked to the broader policy goals it is expected to achieve. Key performance measures should also be incorporated into planning systems and investigated and acted upon when practice is diverging significantly from established targets. Public reporting improves public confidence in the regulatory system by demonstrating how well regulatory objectives are being met, allows regulators to be assessed and held to account, and provides an incentive for regulators to improve their performance (OECD, 2004).

A regulator's performance measures should incorporate quantifiable aspects of the regulator's activities that provide metrics to assess their performance, as well as the costs they impose. For example, a key metric for many regulators may be processing times for regulatory approvals or other decisions. Undue delays in regulatory processes impose additional costs on business and the community, and so regulators should measure their processing times for key decisions against specified benchmarks (Victorian Competition and Efficiency Commission, 2012).

Investment outcomes are often a key measure for regulators of infrastructure industries. Regulators face the challenge that limiting investment could impede growth, however not managing investments properly could also lead to issues. Therefore the system-wide performance should be part of the assessment framework.

Box 7.1. **Examples of performance measurement**

The Netherlands Competition Authority calculated that in 2011 its enforcement led to a benefit of EUR 36 per household in the Netherlands.

The UK National Audit Office showed that the UK Office for Fair Trade saves consumers GBP 8.60 in financial harm for each GBP 1 it spends on enforcing regulations (December 2012).

Performance evaluations

Regulators should conduct internal performance evaluations as part of good internal governance practices. It is also important to have external performance evaluations that can complement and support the internal reviews. In some jurisdictions these are conducted by audit offices on a regular basis. In the case of the EU this could be the Court of Auditors.

Internal performance evaluations often focus on the systems, processes and procedures and assess the overall operations of the regulator, which are vital for an effective regulator. External reviews should focus on whether the strategic goals of the regulator are being met such as protecting public health or improving reliability in the sector. External reviews can examine particular decisions of the regulator in cases where they have a strategic significance. These should be arranged by the government, legislature or the regulator itself.

As part of the performance assessment, regulators should also conduct periodic post-implementation reviews of new regulations or changes that have been made to the existing regulatory framework. This is especially important during times of major reforms in sectors or changes such as the financial services sector following the international banking crisis.

Regulators often have a number of audiences for their performance evaluation. The bodies that they are accountable to include the legislature or government. Also the regulated entities and citizens or consumers are another audience for their evaluation. It is important that the regulator maintains the main purpose of its evaluation towards self-improvement and accountability.

The approach toward performance evaluation of regulators should be complimented with clear objectives for regulatory officers within the regulator. These personal performance objectives should enable performance towards outcomes rather than outputs. For instance objectives for regulatory officers that relate to the numbers of prosecutions achieved or the number of inspections carried out are, not likely to drive the overall outcome of the regulator.

Box 7.2. **Performance evaluation in the Australian Energy Regulator (AER)**

In July 2013, the AER Strategic priorities and work programme 2013-14 (www.aer.gov.au/node/21203) was released. Outlined in the document were four strategic priorities and five distinct areas of the work programme for the AER over the forthcoming financial year. The AER listed target deliverables and performance indicators for each strategic priority and programme area. This was the first time the AER had published performance indicators in this annual document.

In September 2013, the AER released its inaugural annual report (www.aer.gov.au/publications/aer-annual-report-2012-13). The AER dedicated a chapter of this document to reporting on its performance against similar indicators to those outlined in AER Strategic priorities and work programme 2013-14. The AER has established indicators that cover the breadth of its work. Some of these indicators are objectively quantifiable, while others are quite subjective. Similarly, some indicators are specific deliverables with no measure of quality, while others rely on perceptions of the AER.

In future, the Standing Council on Energy and Resources (SCER), which is comprised of Commonwealth, state and territory ministers with responsibility for energy and resource matters, will issue a Statement of Expectations for the AER. It is currently unknown how regularly the Statement of Expectations will be prepared. This document will sit above a Statement of Intent produced by the AER. The Statement of Intent will be a forward-looking document, which will outline objectives, priorities and performance indicators for the AER. The AER's Statement of Intent is likely to be integrated into the regulator's current performance reporting cycle and processes, with the annual report providing a vehicle to report on the AER's progress against the performance indicators outlined in this document.

Source: Australian Energy Regulator (2013).

Applying the principles – Performance evaluation

Identifying the scope

- What is the mandate of the regulator within legislation?
- What goals or objectives have been set for the regulator in strategic and business plans?
- Which activities of the regulator will be assessed?
- What are new or recent changes in the regulatory framework that should be assessed?
- When and which body should conduct an external evaluation of the regulator?

Developing indicators

- Does the regulatory agency collect the following performance information:
  - a) industry and market performance (e.g. number of network faults);
  - b) operational/service delivery (e.g. number of inspections);
  - c) organisational/corporate governance performance (e.g. number of staff trainings);
  - d) quality of regulatory process (e.g. compliance with regulation and industry standards);
  - e) compliance with legal obligations (e.g. number of successful appeals);
  - f) economic performance (e.g. level of competition);
  - g) financial performance (e.g. direct or indirect cost).

Use of performance evaluation

- Is the performance evaluation published?
- Is the performance evaluation presented to stakeholders or accountable authorities?
- Is the performance evaluation used to plan future strategies, work programme and activities?
- Is the performance evaluation used to determine personal performance assessments of staff in the regulator? Are these outcome-focused rather than output focused?

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Glossary

Business regulator	A government entity that is a state-wide actor, which derives from primary or subordinate legislation one or more of the following powers in relation to businesses and occupations: price-setting; market supervision; inspection; regulatory advice to a third party; licensing; accreditation; and enforcement. Such a body may or may not be involved in the design of regulations or standard-setting.
Charter or code of consultation	A document that lays out a regulator's processes and policies for engaging in consultation with industry or the public.
Competitive neutrality	Ensuring that state-owned and private businesses are able to compete on a level playing field.
Economic regulators	An institution or body that is authorised by law to exercise regulatory powers over the sector for the purpose of setting prices and/or improving the operation of the market so that consumers have access to secure services and service providers receive a reasonable rate of return. Regulators that deal only with health, safety, or environmental issues are not considered economic regulators.
External governance	Governance from the perspective of looking out from the regulator – the roles, relationships and distribution of powers and responsibilities between the legislature, the minister, the ministry, the regulator's governing body and regulated entities.
Framework agreement	An agreement that sets out protocols for the working relationship between a regulator and a ministry that provides them with a secretariat. It will typically include the details of services to be provided and arrangements for the direction of staff.
Government policy	Policy set by ministers, whether individually or collectively by executive government.
Impact assessment guidance	Guidance to assist rule-makers in undertaking regulatory impact analysis of new rules.

Independent regulator	A regulator whose role and powers have been established in legislation and who makes regulatory decisions at arm's length from executive government. An independent regulator is not subject to the direction on individual regulatory decisions by executive government, but could be supported by officials who are located within a ministry.[1]
Internal governance	Governance from the perspective of looking into a regulator — the regulator's organisational structures, standards of behaviour and roles and responsibilities, compliance and accountability measures, oversight of business processes, financial reporting and performance management.
International Standard Setting Entity	An international body that provides guidance and sets standards to be implemented in nation jurisdictions.
Minister	The most senior political role within a portfolio. In Westminster system governments, these are typically styled "ministers", but the title varies.
Ministerial regulator	As opposed to an independent regulator (defined above), a ministerial regulator is part of the organisational structure of a government ministry.
Ministry	Government agency under the direct day-to-day control of a minister.
Operational policy	Policy decisions made by independent regulators or ministries in order to implement government policy.
Regulatory integrity	"Regulatory integrity" is where regulatory administration and decisions are fair, objective, impartial, consistent and expert, without having any conflict of interest or bias, improper influence or improper purpose, or circumstances that reduce the regulator's market credibility, consistency of decision-making, or availability of expertise.
Regulatory plan	A document published by a rule-making agency that outlines planned changes to regulation or new regulations to be implemented over the year.
Secretary	Is the most senior public official in the ministry. These are the names for them: Permanent Secretary, Departmental Secretary, State Secretary, Secretary-General, Deputy Minister, etc.

1. As mentioned in Chapter 2, there is no generally agreed definition of an independent regulator and in some legal frameworks (such as the EU), the understanding goes beyond the definition used in these principles.

Service agreement	An agreement that defines the nature, quantity and standard of services a ministry provides an independent regulator, within a specified budget, where staff supporting the regulator report to ministerial management.
Statement of Expectations	A formal and public statement made by a responsible minister to a regulator outlining relevant government policies, regulatory objectives and government's expectations of how the regulator should conduct its operations.
Statement of Intent	A formal statement by the regulator, in its corporate plan or similar document, outlining its intent to meet the expectations of its responsible minister. The Statement of Intent is made in response to the Statement of Expectations (above).
Sunset clause	A provision within legislation (or regulation) that provides that the law, or parts of it, shall cease to have effect after a specific date, unless further legislative action is taken to extend the law.
Supranational Body	A Supranational body is one such as the European Union who has certain regulatory powers enacted for and over national regulators in accordance with a common framework.

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