

Chapter 4. Improving the governance of regulators and regulatory enforcement

Ensuring effective compliance with and implementation of rules and regulations is an important factor in creating a well-functioning society and trust in government. Developing and applying regulatory delivery policies, tools and institutions that help achieve the best possible outcomes through the highest possible levels of compliance, while keeping the costs and burden as low as possible, should therefore be an important part of governments' regulatory policies. This chapter discusses regulatory delivery, concentrating on regulatory and enforcement agencies that oversee the implementation of regulation, promote compliance and, in some cases, design secondary regulations. It proposes a way forward for the better regulation agenda to include cross-governmental considerations linked to improved delivery of regulations, better co-ordination, governance and performance of bodies involved in regulatory delivery, improved targeting of regulatory enforcement activities and improving regulatory compliance.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Key findings

An increasing number of OECD countries recognise the importance of the implementation phase of the regulatory governance cycle in ensuring the quality and effectiveness of regulatory policy and meeting the goals of regulations. Regulatory delivery also represents an important opportunity to reduce the overall level of regulatory burdens imposed on businesses and citizens while saving public resources and protecting health and security of citizens as well as the environment.

For many stakeholders, the manner in which laws and regulations are implemented and delivered is at least as important as the quality of their design. Organisational culture and behaviours of inspection agencies together with a governance framework that support accountability, a focus on potential and actual risks and output and outcome measurements are key for the effectiveness of inspection authorities.

Regulators and inspection authorities hold unique insights into the performance, successes and failures of policies and their implementation. Governments should create genuine opportunities for regulators and inspection authorities to feed their knowledge back into the review and design of policies and regulations. This feedback could contribute significantly to the overall effectiveness of state action.

Sound governance structures are necessary to support regulators and inspection authorities in the effective delivery of their functions. This includes considerations such as the agency's legal remit, goals and powers, how it is funded and held to account, and how it co-ordinates and communicates with stakeholders. A transparent, predictable and well-functioning regulator-legislature accountability relationship builds overall confidence in democratic institutions and raises the profile of the regulator as an independent and accountable agency.

The context of rapidly evolving and changing markets, new technologies and uncertainty directly and significantly affects regulators' objectives, functions, powers and capacities, creating a need for flexible and autonomous operating models. This includes funding and human resource strategies that respond to needs, perhaps going beyond regular government schemes, as well as new policy tools for more effective intervention such as the use of behavioural insights.

There is a need for effective co-ordination and collaboration between different agencies. Avoiding the proliferation of different institutions responsible for implementing and enforcing regulations, ensuring clarity and coherence, preventing the emergence of areas of conflicting competence are essential.

Regulatory agencies need to build and sustain a strong and institutionally proactive culture of independence that will inform their daily practice and behaviour. Independence comes in two forms: *de jure* independence refers to the formal independence granted by law, whereas *de facto* independence promotes practical independence as shown by actions, decisions and behaviours. Sustaining both forms is crucial.

The resource frameworks of regulators and inspection agencies are instrumental in defining their autonomy and flexibility. Much of the financing for regulators and inspection authorities still comes from the state budget, although some of the bodies gradually move towards obtaining necessary funding from regulated subjects, based on cost recovery principles. Financing of inspection authorities should not depend on the number of violations nor the levels of fines.

Appropriate capacity for data management and analysis is key. How data is analysed and turned into evidence and information that is in turn used to inform decisions and communicate on performance are crucial questions. Technological advancements and the use of big data have the potential to change the way regulations are being enforced, making regulatory delivery more risk-based, predicting potential threats in real time and preventing them more effectively.

A good inspection and enforcement system should simultaneously aim at delivering the best possible outcomes in terms of risk prevention or mitigation and public welfare, without exceedingly increasing costs for the state and burden for duty holders. Alternatives to state-led enforcement should be considered as part of these processes. To target enforcement activities effectively, they must be based on risk assessment and risk management. Enforcement should be based on “responsive regulation” principles – where the culture is based on promoting compliance and not on finding violations and punishment. Regulatory enforcement agencies should engage with regulated entities and strive whenever possible and appropriate to establish a co-operative approach. To implement such changes, governments need to have an official vision, strategy and/or legal framework for regulatory delivery, setting goals and objectives for the reform.

Introduction

The 2015 *Regulatory Policy Outlook* identifies regulatory delivery as the weakest link in regulatory governance and underlines that “focusing on increasing compliance with regulations would help to improve the effectiveness of regulation at achieving its goals and, ultimately, would strengthen the case for regulatory quality”. In response to this challenge, this chapter discusses the policies, tools and institutions responsible for regulatory delivery, essentially concentrating on regulatory and enforcement agencies that oversee the implementation of regulation, promote compliance and, in some cases, design secondary regulations. It proposes a way forward for the better regulation agenda to include cross-governmental considerations linked to improved delivery of regulations, better co-ordination, governance and performance of bodies involved in regulatory delivery, improved targeting of regulatory enforcement activities and improving regulatory compliance.

The analysis builds on a series of work carried out by the OECD Regulatory Policy Committee (RPC) and its subsidiary body, the Network of Economic Regulators (NER), established in 2013. This work draws from the seminal publication of:

- *OECD Best Practice Principles on Regulatory Policy: the Governance of Regulators* (OECD, 2014_[1]) that identifies seven main principles for the governance of regulators produced with the inputs and based on the experiences of regulators in OECD and non OECD countries; and
- *OECD Best Practice Principles on Regulatory Enforcement and Inspections* (OECD, 2014_[2]), which address the design of the policies, institutions and tools to promote effective compliance – and the process of reforming inspection services to achieve results.

Further work was carried out by the NER on the independence of regulators, through the implementation of a survey seeking to better understand the practical implications of independence in the (OECD, 2017_[3]) day to day work of regulators. The results of the survey were published in the report *Being an Independent Regulator* (OECD, 2016_[4]) and some of the data is cited in this chapter. Survey findings guided the formulation of

Creating a Culture of Independence: Practical Guidance against Undue Influence (OECD, 2017^[5]), that lays out a practical checklist for basic and aspirational characteristics and governance arrangements for independent regulators. NER delegates also responded to a survey on the role of economic regulators in the governance of infrastructure, the results of which were published in 2016 (OECD, 2017^[6]). Finally, the seven principles of the governance of regulators informed the creation of a comprehensive governance framework supporting the organisational performance of regulators (Performance Assessment Framework of Economic Regulators, PAFER) that has been used to carry out peer reviews of economic and technical regulatory agencies since 2015. Qualitative evidence from these reviews has also informed the analysis in this chapter.¹ Based on this body of work, carried out with over 60 economic and technical regulators, including some with inspection functions, this chapter puts forward areas that have been identified as drivers of performance of regulatory agencies. Some of these lessons learnt in terms of organisational governance, performance and behaviour could be applied more largely to other government agencies such as those with enforcement but no regulatory powers (inspection agencies), as well as other public bodies.

The analysis in this chapter also builds on the results of the OECD Conference on Regulatory Enforcement and Inspections organised in Paris on 9 November² gathering policy makers and experts responsible for the “better regulation” agenda with practitioners involved in regulatory enforcement and inspections and enabling the exchange of experience among them to share approaches to inspections and their reforms. One of the outcomes of the conference will also be the publication of the *OECD Toolkit on Regulatory Enforcement and Inspections*.

While recognising the specificity of economic and technical regulators and inspection authorities, this chapter highlights the common challenges that they often face and the importance of governance and organisational behaviour for the effective delivery of regulation.

Regulatory delivery is a crucial element of regulatory policy

Ensuring effective compliance with and implementation of rules and regulations is an important factor in creating a well-functioning society and trust in government. Developing and applying regulatory delivery policies, tools and institutions that help achieve the best possible outcomes through the highest possible levels of compliance, while keeping the costs and burden as low as possible, should therefore be an important part of governments' regulatory policies. An increasing number of OECD countries recognise the importance of the implementation phase of the regulatory governance cycle in ensuring the quality and effectiveness of regulatory policy. It also represents an important opportunity to reduce the overall level of regulatory burdens imposed on businesses and citizens while saving public resources and protecting health and security of citizens as well as the environment.

For many stakeholders, the way laws and regulations are implemented and delivered is at least as important as their quality itself. As one of the entrepreneurs in the United Kingdom put it, “As a small retailer I have to comply with thousands of regulations across a dozen themes. Scrapping two or three burdensome regulations here and there is great, but it does not make a great difference to me. What makes a difference is the attitude of inspectors. Being able to sleep at night because I know I have got it right and don't fear an inspector knocking on the door”.³ Organisational culture and behaviours of inspection agencies together with a governance framework that support accountability, a

focus on potential and actual risks and output and outcome measurements are key for the effectiveness of inspection authorities (see the example of the Brazilian Electricity Regulatory Agency in Box 4.1).

Box 4.1. Enforcement Reforms at the Brazilian Electricity Regulatory Agency – ANEEL

ANEEL redesigned its enforcement strategy based on the OECD Best Practice Principles on Enforcement and Inspections in 2014-17. ANEEL built an enforcement framework based on four pillars: “detect, prevent, promote and act”.

A mix between preventive actions, such as posting of guidelines on the Agency’s website, alerts sent by email, reports to the market, and hotline support has increased by 20% the success ratio of on time and on format information reported to the Agency among generation companies in 2017. In the same period, traditional tools, like notifications and fines were responsible for an increase of only 4% in the same type of information delivery.

From 2014 to 2016, improvement plans signed by the ANEEL enforcement staff and 64 transmission companies were responsible for a 41% decrease in faults from unknown causes in the transmission system as a whole.

Improvement plans were also used to increase the quality of service offered by distribution companies to consumers. As an example, we can point to the performances delivered by two companies, one being a private distribution company and the other being state owned. The private company increased the quality of its service (in terms of frequency and duration of interruptions) in 20%, and the state-owned company achieved a gain of 24%.

Source: www.linkedin.com/pulse/enforcement-reforms-brazilian-electricity-regulatory-agency-rossi/.

Having effective and efficient enforcement systems can also contribute significantly to the reduction of regulatory burdens. Evidence shows that most burdensome inspections are often the least effective (Blanc, 2018^[7]). Experience has shown that it is possible to significantly reduce administrative burdens by 25% or more (Lithuania, the Netherlands) without worsening regulatory outcomes and increasing risks, sometimes while actually improving them.

Regulators and inspection authorities are ideally positioned to close the regulatory policy cycle

Regulators and inspection authorities hold unique insights into policy delivery with the potential for closing the regulatory policy cycle. Indeed, the activity of regulatory agencies and inspection authorities mostly takes place in the implementation and enforcement stage of the regulatory cycle (Table 4.1). These activities, including those of agencies that are arms-length and independent, take place in a policy framework set by the government, via one or several line ministries, depending on the authority’s sectoral responsibilities. Some economic and technical regulators are entrusted in law with advisory functions whereby they can be requested on an *ad hoc* basis or as part of a continuous conversation to provide inputs to policy formulation, but this may not always be the case.

Table 4.1. The reported actors at each stage of the regulatory cycle

	Number of countries reporting involvement of actors at the following stages			
	Stage 1: Set policy	Stage 2: Design	Stage 3: Implement/enforce	Stage 4: Evaluate
Parliament	7	6	2	4
Government collectively (e.g. Cabinet or President)	19	6	4	6
Government collectively (e.g. Cabinet or President)	19	6	4	6
Individual ministries acting within their policy areas	15	20	14	15
National government body co-ordinating or overseeing regulatory proposals	17	20	6	10
Regulators	3	9	17	9
Supreme Audit Institutions	0	0	0	5
Other (sub-national) tiers of government	4	7	7	5
Civil society (business, citizens, etc.)	3	8	0	3

Notes: The 24 respondents included Australia, Austria, Brazil, Chile, Denmark, Estonia, the European Commission, Germany, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, New Zealand, Norway, Poland, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom.

Source: (OECD, 2015^[8]), *OECD Regulatory Policy Outlook 2015*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264238770-en>.

Given their active position on the forefront of policy implementation, regulators and inspection authorities withhold unique insights into the performance and successes and failures of policies and their implementation. This is particularly true if the regulators implement systematic *ex post* evaluation of their regulatory activities and when they count with robust performance assessment mechanisms that include indicators to track results and impact on the sector/market (for the latter, see for example Box 4.2).

Regulators also receive and analyse unique data on market performance and trends, which can allow them to fulfil a unique strategic foresight function for market evolutions. Some of them are also responsible for carrying out inspections and designing and enforcing safety regulation in the sectors they oversee. The creation of legitimate opportunities for regulators and other government entities involved in the implementation of policy to feed their knowledge of policy implementation, compliance and sector evolutions back into the review and design of policies could contribute to the overall effectiveness of government action.

In addition to building adequate feedback loops from implementation into policy evaluation and design, the “how” of regulatory delivery deserves to be fully examined in the phase of developing regulations, ideally as part of regulatory impact assessment and through stakeholder engagement. It needs to be decided already at that stage which institution(s) will be responsible for enforcing regulations with what kind of competences and resources. This is especially relevant in cases where sub-national levels of government are responsible for enforcing regulations. Many state/local-level governments complain about an increasing number of responsibilities while the resources for executing these powers are in fact decreasing.

Box 4.2. Performance Assessment: the Outputs Monitoring Group of the Scottish government

The Outputs Monitoring Group (OMG) is chaired by the Scottish government and comprises senior (executive level) representatives from the Drinking Water Quality Regulator, the Scottish Environmental Protection Agency, the Water Industry Commission (the economic regulator), Consumer Futures Unit (the customer representative body) and Scottish Water.

The primary function of the group, which meets quarterly, is to oversee the delivery of the investment objectives set by Scottish Ministers for the regulatory period. These objectives set out high-level outcomes for the industry: such as meeting defined drinking water quality standards, environmental performance targets and customer service standards.

As part of the regulatory process, these high-level objectives have been translated, prior to the start of the regulatory period, into an agreed set of programme outputs; for example, the ‘number of water treatment works to be improved’ or ‘environmental performance assessments to be carried out’. In turn, these output programmes are linked to an agreed list of projects – termed ‘the Technical Expression’ – which details the investment works and studies that will deliver the output programmes. This provides the OMG with clarity on the projects that will deliver the output programmes and the ministerial objectives.

Going into the regulatory period, Scottish Water provide a baseline delivery plan for the regulatory period, which details the expected profile of completion of these output programmes. This then allows the OMG to monitor output delivery performance against Scottish Waters’ planned delivery profile.

The OMG owns and maintains this agreed baseline of outputs: ensuring that any changes arising from study outputs or new information during the period are incorporated into the baseline in a controlled and transparent way. This is achieved through a well-defined change mechanism, which requires regulatory sign-off of changes.

The preparation of reports and information for the OMG is carried out by the OMG working group (OMGWG), which comprises senior representatives from the same set of stakeholders as OMG. The OMGWG also meets quarterly, a month ahead of the OMG meeting, and focusses on the preparation of accurate reports for the OMG, as well as overseeing the change mechanism.

At the OMG meetings, based on the information provided by the OMGWG, output delivery progress across the investment programme is discussed and any shortfalls against the targets are highlighted. The OMG reviews progress at five key delivery milestones – such as ‘financial approval’ and “regulatory sign-off of output delivery”. Scottish Water is required to provide explanations in respect of any shortfall against a milestone target: highlighting what corrective action is underway. This provides a high degree of transparency in respect of the delivery of the outputs for which customers have paid.

The OMG produces a quarterly report on progress which is published on the Scottish Government web-site. At the end of the regulatory control period, the group also provides a final report that details progress with the delivery of the agreed set of outputs and the Ministerial Objectives.

Source: (OECD, 2017^[9]), *Driving Performance of Mexico's Energy Regulators*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264267848-en>. Based on information provided by the Water Industry Commission of Scotland in October 2016.

The importance of sound governance structures

Economic and technical regulators protect market neutrality, foster competition, and help ensure access to, quality and safety of public utilities. They are at the point of interface between regulatory regimes and citizens and businesses. To fulfil their functions, regulators need to make and implement impartial, objective and evidence-based decisions that will provide predictability to the regulatory regime, inspire trust in public institutions and encourage investment. Sound governance structures are therefore necessary to support regulators and inspection authorities in the effective delivery of their functions.

As highlighted in the 2012 Recommendation and the subsequent OECD Best Practice Principles on the Governance of Regulators (OECD, 2014_[1]) and on Regulatory Inspections and Enforcement (OECD, 2014_[2]), the governance arrangements of a regulator as well as of an inspection authority are critical to the delivery of its functions and its performance. This includes considerations such as the agency's legal remit, goals and powers, how it is funded and held to account, and how it co-ordinates and communicates with stakeholders; these considerations and more can be understood under the dimensions of an agency's internal and external governance (Table 4.2).

Table 4.2. Internal and external governance of regulators

External governance (looking out from the government agency)	Internal governance (looking into the government agency)
The roles, relationships and distribution of powers and responsibilities between the legislature, the Minister, the Ministry, other sector regulators, the agency's governing body and supervised entities.	The agency's organisational structures, standards of behaviour and roles and responsibilities, compliance and accountability measures, oversight of business processes, financial reporting and performance management.

Source: Based on (OECD, 2014_[1]), *The Governance of Regulators*, OECD Best Practice Principles for Regulatory Policy, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264209015-en>.

Even though the seven best practice principles for the governance of regulators (Box 4.3) were developed specifically for economic regulators, most of them can be, with modifications, applied also to enforcement and inspections authorities.

Box 4.3. Seven OECD Best Practice Principles for the Governance of Regulators

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 desired regulatory outcomes.
2. **Preventing undue influence and maintaining trust.** Regulatory decisions and functions must be conducted with the upmost integrity to ensure that there is confidence in the regulatory regime. There need to be safeguards to protect regulators from undue influence.
3. **Decision making and governing body structure.** Regulators require governance and decision making mechanisms that ensure their effective functioning, preserve their regulatory integrity and deliver the regulatory objectives of their mandate.

4. **Accountability and transparency.** Business 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.
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.
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 carry out its work.
7. **Performance assessment.** 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 build confidence in the regulatory system.

Source: (OECD, 2014^[11]), *The Governance of Regulators, Best Practice Principles for Regulatory Policy*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264209015-en>.

The need for flexibility in a changing context

The agencies responsible for regulatory delivery increasingly face rapidly evolving and changing markets, new technologies and uncertainty, which directly and significantly affect their objectives, functions, powers and capacities. For example, disruptive technologies are breaking down barriers between traditional sectors, or they are blurring the line between producers and consumers. Likewise, of the 64 sectors surveyed, 63% respondents to the OECD Network of Economic Regulators Survey on the Governance of Infrastructure indicated that their role with regard to the governance of infrastructure has changed over the past five years (88% in communications, 79% in energy, 47% in transport, and 100% in water). Common sources of this change were the impact of technological change on scope of the required regulatory role in some sectors, and new functions and responsibilities placed on economic regulators by governments (OECD, 2017^[6]).

In this context, there is a need for flexible and autonomous functioning and management, including for funding and human resource strategies that respond to needs as well as new tools for more effective intervention. Forms should follow functions and the objectives that the agency or authority is expected to deliver for citizens. In the same spirit, enforcement and compliance methodologies should increasingly put users at the centre, be they individuals or organisations. These methods would for example include the use of new approaches to the design and implementation of regulation, such as using behavioural insights to achieve regulatory goals and increasing compliance that would factor in behavioural barriers to compliance (see Chapter 5).

Co-ordination among regulatory delivery institutions

Avoiding the proliferation of different institutions responsible for implementing and enforcing regulations, ensuring clarity and coherence, preventing the emergence of areas of conflicting competence are all essential. Duplication of functions should be avoided and mandates and responsibilities clear (between different institutions and also between national and local levels). Different implementation and enforcement structures share information and records, participate in joint alert systems, co-ordinate “on the ground” – particularly in related regulatory areas.

The policy context in which regulators and inspection agencies operate, makes the need for effective co-ordination between different agencies more acute today. For example, this is the case across different regulatory authorities including economic, technical and competition authorities that intervene in markets that are becoming increasingly interconnected or are overlapping.

Co-ordination among agencies might take different forms from more formalised ones (see the example of Mexico, Box 4.4), to informal ones, such as the Inspection Council in the Netherlands.

Box 4.4. The establishment of an integrated system of energy regulators in Mexico

Mexico’s energy reform (2013-14) that opened the oil and gas sector to private investment also enhanced the institutional set-up of the existing sector regulators: the upstream regulator, the National Commission for Hydrocarbons (*Comisión Nacional de Hidrocarburos*, CNH) and the downstream regulator, the Commission for Energy Regulation (*Comisión Reguladora de Energía*, CRE). The reform also created a new cross-cutting technical regulator to oversee safety and environmental protection throughout the whole hydrocarbon value chain: the Agency for Safety, Energy and Environment (*Agencia de Seguridad, Energía y Ambiente*, ASEA).

In September 2017, the three regulators joined forces, and via a formal Co-operation Agreement created the System of Energy Regulators that aims to regulate and supervise sector activities in a reliable and co-ordinated manner in order to promote productive investments and the energy sector’s efficient and sustainable performance for the benefit of Mexico. The Group structures its work around four main objectives:

1. Planning: to share a common vision of the future and plan accordingly
2. Operational co-ordination: to address operating priorities in a timely manner
3. Resources: to address common necessities concerning talent attraction and retention and financial autonomy
4. Conflict resolution: to address and resolve conflicts between regulators.

A number of joint initiatives, including the opening of the one-stop-shop Coordinated Assistance Office of the Energy Sector (ODAC) that provides information to sector stakeholders in areas that involve more than one regulator in February 2018, have already been carried out by the co-ordination body.

Source: <https://cnh.gob.mx/Informacion/> (accessed 21 March 2018).

Relationship with the legislature and trust

Arms-length regulatory agencies are generally accountable to the legislature, both with regard to their regulatory activities (in general, standing parliamentary committees for the sector(s) that the regulator oversees) and their finances (in general, the finance or budget parliamentary committee that will review financial reporting). However, the relationship with parliament on the regulator's substantive work is rarely perceived as optimal by either party. While regulators submit their annual reports to parliament, there is no structured or systematic discussion around the results of their activities and sector performance on this occasion; instead, representatives may be summoned to appear on an ad hoc basis and in response to problematic situations.

There may be scope to stabilise this relationship by building in scheduled meetings around specific moments in the regulator's planning and reporting lifecycle, such as the finalisation of its strategic plan and its annual work plans (which could be presented to parliament to raise awareness of the regulator's objectives and activities) and annual reports (to discuss results of activities). This could contribute to instating the regulator as a trusted go-to partner for technical expertise rather than just an entity to be summoned in crisis situations. A transparent, predictable and well-functioning regulator-parliament accountability relationship would build overall confidence in democratic institutions and raise the profile of the regulator as an independent but accountable arms-length agency.

Creating a culture of independence

The opening of key markets to competition in many countries has led to the creation of independent arms-length regulatory agencies that oversee markets in a manner that is deemed more objective and impartial. *De jure* independence refers to the grounding of a regulator's independence in law and is necessary to formally protect regulator's structural independence against undue influence. It can be expressed for example by provisions on budgetary independence, the conditions and process for the appointment and dismissal of the members or head of the regulatory agency, as well as whether the executive withholds powers to set tariffs or prices and review or approve contract terms with the regulated entities. However, this formal independence needs to be accompanied by *de facto* independence in the regulator's day to day work, which is more difficult to map out.

Practical independence is not a static characteristic acquired once and for all, but rather one that is frequently under stress as the regulator engages with stakeholders throughout the different phases of the regulatory cycle. This engagement presents "pinch points" where there might be potential for greater undue influence include agency finances, staff behaviour, the appointment and removal of leadership, and how the agency intersects with political cycles. For example, in the case of regulators that answered the OECD Survey on Being an Independent Regulator, the executive nominates and appoints the board/head of the regulatory agency, rather than the process taking place through mixed selection committees or with the participation of the legislature (Figure 4.2 and Figure 4.3).

In order to navigate these powerful headwinds, regulatory agencies need to build and sustain a strong and institutionally proactive *culture of independence* that will inform their daily practice and behaviour. The OECD has published practical guidelines to support regulatory agencies in this quest (Box 4.5) that may also be applicable to other public entities.

Box 4.5. Creating a culture of independence: Practical guidance against undue influence

OECD (2017) explores how to establish and implement independence with regulators. Independence comes in two forms: de jure independence refers to the formal independence granted by law, whereas de facto independence promotes practical independence as shown by actions, decisions and behaviours.

The guidance is structured into five sections (see below Five dimensions of independence) developed in response to “pinch points” that can occur throughout the life cycle of a regulator where there is potential for greater undue influence. These dimensions cover issues linked to external and internal governance of the regulatory agency that are understood as:

- External governance: the roles, relationships and distribution of powers and responsibilities between the legislature, the Minister, the Ministry, the regulator’s governing body and regulated entities. The effective management of these relationships is critical to having an independent regulator.
- Internal governance: the regulator’s organisational structures, standards of behaviour, compliance and accountability measures, oversight of business processes, financial reporting and performance management. A key determinant of independence lies in equipping the regulator with adequate resources and processes to carry out its duties.

Figure 4.1. Five dimensions of independence

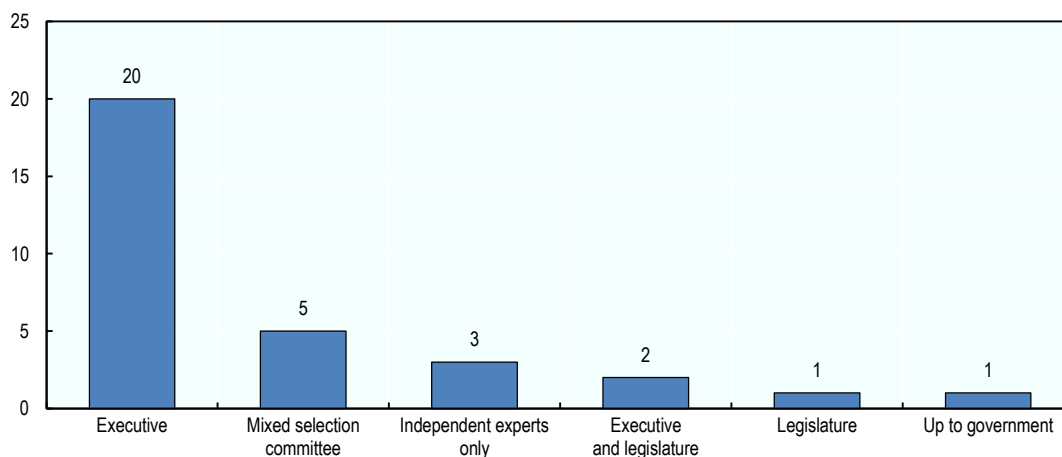


Source: OECD, www.oecd.org/gov/regulatory-policy/independence-of-regulators.htm.

Each of the five dimensions includes practical guidelines that can be considered as the basic and necessary institutional measures to create a culture of independence which establishes and maintains the capacity of regulators to act independently, based on an analysis of regulators’ institutional processes and practices within the OECD Network of Economic Regulators (NER). The guidelines also include a set of aspirational steps that could be taken to bolster a culture of independence and safeguarding regulators from undue influence.

These guidelines may also have wider applicability. They could be used for the institutional and organisational design of arms-length bodies, corporate governance, anti-corruption and integrity programmes and in any context where the nuances of building trust and managing competing, and sometimes undue, pressures are present.

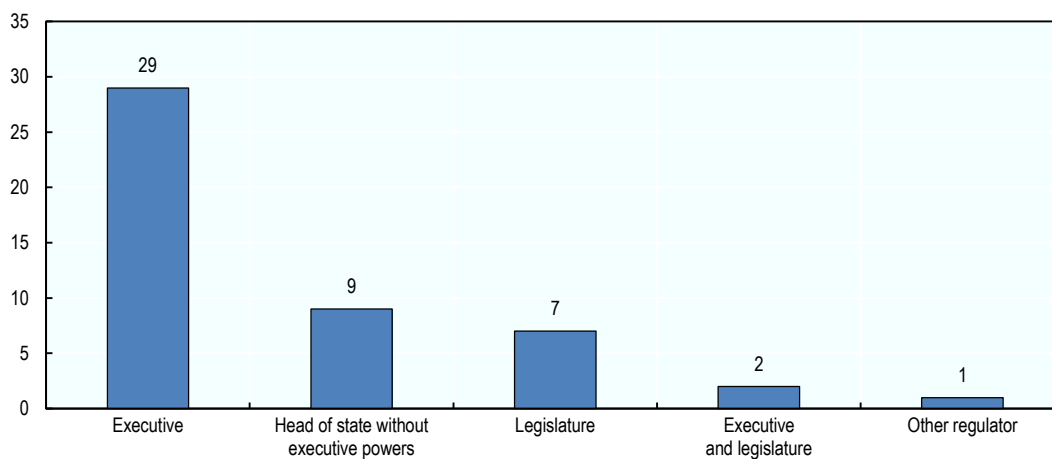
Source: (OECD, 2017^[5]), *Creating a Culture of Independence: Practical Guidance against Undue Influence*; (OECD, 2014^[1]), *The Governance of Regulators*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264274198-en>.

Figure 4.2. Authority nominating the regulator board/head

Notes: No information was received on the nominating authority for 13 regulators; for two regulators the nomination of some board members is made by the executive and some by the legislature.

Source: (OECD, 2016_[4]), *Being an Independent Regulator*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264255401-en>.

StatLink  <https://doi.org/10.1787/888933814996>

Figure 4.3. Authority appointing the regulator board/head

Source: (OECD, 2016_[4]), *Being an Independent Regulator*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264255401-en>.

StatLink  <https://doi.org/10.1787/888933815015>

Autonomous resource frameworks

The resource frameworks of regulators and inspection agencies are instrumental in defining their autonomy and flexibility. Most of the financing for regulators and inspection authorities still comes from the state budget, although some of the bodies gradually move towards obtaining necessary funding from regulated subjects, based on costs recovery principles. Regarding regulatory enforcement, financing of inspection authorities should not depend on the number of violations nor the levels of fines. This could certainly provide perverse incentives for regulators to focus on looking for violations rather than promoting compliance. Instead, governments should consider differentiation of the charges for regulated subjects to make them more risk-based (i.e. regulatees presenting higher risks would contribute more), compliance-based (i.e. regulatees with a record of compliance would contribute less) and complexity-based (i.e. regulators would be compensated for more complex or repeated inspections) (OECD, 2018_[10]; UK Government Office, 2017_[11]).

Given their role overseeing key sectors of the economy, regulators are expected to carry out their functions with high level of technical expertise and professionalism. They need to attract the best available human resources to carry out these functions. Yet, regulators compete directly with regulated entities, many of whom include leading global firms, for qualified human resources. A common challenge highlighted by regulators is the ability to attract and retain staff at all professional levels, when competing with the private sector and at the same time being bound by government frameworks, such as salary scales, levels at appointment, rigid performance-related or other bonus-type schemes, etc. Similar challenges can exist with regard to the management of financial resources, from caps from the executive on annual budgets, although in some jurisdictions economic regulators enjoy full autonomy in terms of setting their annual budgets, securing funding for the budget from regulated entities, and managing their financial resources.

In this context, there is a need for flexible and autonomous management, including for setting human resource strategies that respond to needs and in certain cases go beyond regular government schemes.

Governance structures and human resources policies for regulatory enforcement should support transparency, professionalism, and results-oriented management. This means not only technical competence in the fields relevant to the type(s) of risk(s) addressed, but also generic inspection skills (or “core inspection skills”) relating to how to conduct inspections effectively and promote compliance, ethical standards of behaviour, risk management, inter agency co-operation – and operational management. Performance management policies for staff need to reflect the overall aims of enforcement activities and the specific goals of each agency, and in particular the performance indicators for the agency.

Appropriate capacity for data management and analysis

Appropriate capacity for data management and analysis is key for regulators and inspection authorities to achieve their potential for policy delivery. Economic regulators and inspections generally hold powers to request a variety of information and data from the industry on sector performance. This provides them with the opportunity to bridge information asymmetries, while presenting the challenge of managing a wealth of data. How data is analysed and turned into evidence and information that is in turn used to inform decisions and communicate on performance are key questions.

Data collection, management and analysis also highlight an opportunity for collaboration with other regulators or enforcement agencies intervening in the same sector(s). Working with other government agencies can help streamline data management systems, alleviate burden on the regulated industry, and pool resources and capacity for data analysis.

Digital registration of individual decisions concerning a regulatee is of particular importance, to make inspection and enforcement actions more predictable and the application of regulatory frameworks more legally certain. Businesses then would be able to compare decisions taken in their particular case to decisions taken in similar cases and to question differences.

The technological advancements and use of big data might change the way regulations are being enforced, making regulatory delivery more risk-based, predicting potential threats in real time and preventing them more effectively. This is still an understudied area and OECD plans to investigate the issue more in the next biennium.

Changing the way of enforcing regulations and promoting compliance

A good inspection and enforcement system should simultaneously aim at delivering the best possible outcomes in terms of risk prevention or mitigation and public welfare, without exceedingly increasing costs for the state and burden for duty holders. It should ensure trust and satisfaction from different stakeholders, whose perspectives are often conflicting (businesses, civil society organisations etc.). The main elements of a modern regulatory enforcement and inspection regime are summarised in the OECD Best Practice Principles (Box 4.6) as well as in the *OECD Regulatory Enforcement and Inspections Toolkit* (OECD, 2018_[10]).

To create a culture of effective enforcement, enforcement and inspection aspects must be taken into account when developing new regulations using regulatory impact assessment and effective stakeholder engagement as well as during *ex post* reviews of regulations. Alternatives to state-led enforcement should be considered as part of these processes. To target enforcement activities effectively, they must be based on risk assessment and risk management. Enforcement should be based on “responsive regulation” principles – the culture has to change from finding violation and punishment to promoting compliance. To do this, governments should engage in providing assistance, advice and guidance to the regulated subjects which, however, must not diverge from the path set out by the overlaying regulatory framework. Guidance, toolkits and check-lists must not constitute over-implementation (gold-plating) of the overlaying regulatory framework.

Evidence shows that deterrence does not, in most cases, drive behaviour of regulated subjects. Understanding their motivation and reasons for non-compliance using behavioural insights is an area to be further explored (Hodges, 2016_[12]).

An overly strict regulatory environment can signal distrust, crowd out intrinsic motivation and open the door for unethical behaviour. In turn, balanced and proportionate regulations supporting goals and individual responsibility strengthen ethical decision making. Overcomplicated or unnecessary rules may also undermine the ethical compass of individuals, creating frustration and incentives to cut corners. Regulations may also need to clearly assign responsibility and liability, as unclear or shared responsibility can lead to diffusion of responsibility, leaving the door open for unethical behaviour (OECD, 2018_[13]).

To implement such changes, governments need to have an official vision, strategy and/or legal framework for regulatory delivery, setting goals and objectives for the reform. Some countries (Lithuania, Netherlands, United Kingdom) have adopted such strategies but in most countries regulatory delivery is still not a firm part of the cross-cutting regulatory policy.

Regulatory enforcement agencies should engage with regulatees and strive whenever possible and appropriate to establish a co-operative approach, because only stakeholders themselves can ensure consistent, sustained compliance in their operations (see (OECD, Forthcoming^[14]). Nonetheless, regulatory “capture” can also be a real danger, whereby some agencies become exceedingly close to regulated business operators, and end up being too lenient in the face of major violations or hazards, or possibly create an uneven playing field in favour of some operators. To avoid such problems, governments should make sure that governance systems for regulatory enforcement agencies ensure that stakeholders that stand to benefit from the regulation (e.g. workers, consumers etc.) are also represented, and that performance targets are strictly set and monitored that ensure that “regulatory capture”, if it were to happen, would be promptly identified and addressed.

Box 4.6. OECD Best Practice Principles on Regulatory Enforcement and Inspections

1. **Evidence-based enforcement.** Regulatory enforcement and inspections should be evidence-based and measurement-based: deciding what to inspect and how should be grounded on data and evidence, and results should be evaluated regularly.
2. **Selectivity.** Promoting compliance and enforcing rules should be left to market forces, private sector and civil society actions wherever possible: inspections and enforcement cannot be everywhere and address everything, and there are many other ways to achieve regulatory objectives.
3. **Risk focus and proportionality.** Enforcement needs to be risk-based and proportionate: the frequency of inspections and the resources employed should be proportional to the level of risk and enforcement actions should be aiming at reducing the actual risk posed by infractions.
4. **Responsive regulation.** Enforcement should be based on “responsive regulation” principles: inspection enforcement actions should be modulated depending on the profile and behaviour of specific businesses.
5. **Long term vision.** Governments should adopt policies and institutional mechanisms on regulatory enforcement and inspections with clear objectives and a long-term road-map.
6. **Co-ordination and consolidation.** Inspection functions should be co-ordinated and, where needed, consolidated: less duplication and overlaps will ensure better use of public resources, minimise burden on regulated subjects, and maximise effectiveness.
7. **Transparent governance.** Governance structures and human resources policies for regulatory enforcement should support transparency, professionalism, and results-oriented management. Execution of regulatory enforcement should be

independent from political influence, and compliance promotion efforts should be rewarded.

8. **Information integration.** Information and communication technologies should be used to maximise risk-focus, co-ordination and information-sharing – as well as optimal use of resources.
9. **Clear and fair process.** Governments should ensure clarity of rules and process for enforcement and inspections: coherent legislation to organise inspections and enforcement needs to be adopted and published, and clearly articulate rights and obligations of officials and of businesses.
10. **Compliance promotion.** Transparency and compliance should be promoted through the use of appropriate instruments such as guidance, toolkits and checklists.
11. **Professionalism.** Inspectors should be trained and managed to ensure professionalism, integrity, consistency and transparency: this requires substantial training focusing not only on technical but also on generic inspection skills, and official guidelines for inspectors to help ensure consistency and fairness.

Source: (OECD, 2014_[21]), *Regulatory Enforcement and Inspections*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264208117-en>.

Notes

¹ As at November 2017, PAFER reviews of the following regulators have been carried out: Colombia's Communications Regulator (OECD, 2015_[15]), Latvia's Public Utilities Commission (OECD, 2016_[16]), Mexico's Agency for Safety, Energy and Environment (OECD, 2017_[17]), Mexico's National Hydrocarbons Commission (OECD, 2017_[3]), Mexico's Energy Regulatory Commission (OECD, 2017_[18]), and Ireland's Commission for the Regulation of Utilities (OECD, 2018_[19]).

² www.oecd.org/gov/regulatory-policy/oecd-conference-on-enforcement-and-inspections.htm.

³ Presentation of Graham Russell at the OECD Regulatory Enforcement and Inspections Conference, 9 November 2017.

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