

## 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.<sup>1</sup> 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.<sup>2</sup>

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

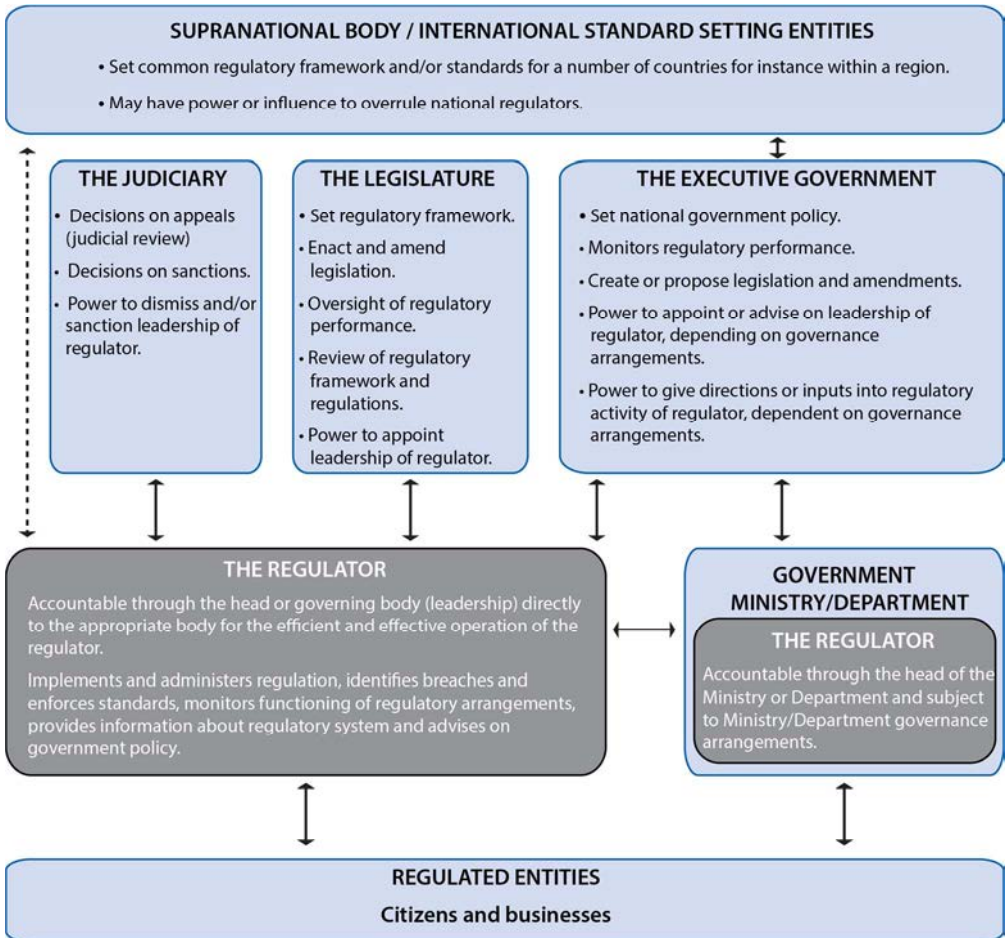
regulators but moreover in maintaining accountability and trust in the regulator. In some cases, such as for regulators in the European Union, the regulators are subject to and accountable to supranational regulatory frameworks and bodies. In the financial services sector there are international standard 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.<sup>3</sup> 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.

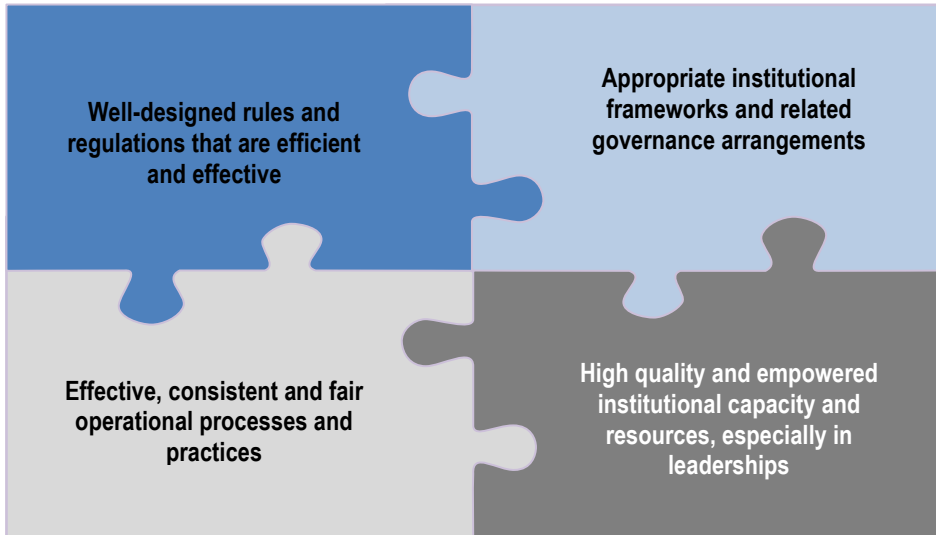
In addition to the legislation that determines the institutional form, there are several governance tools, such as statements of expectations, corporate plans, service agreements and protocols, framework agreements and guidance, which can be used to codify and shape the way that governance arrangements 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.<sup>4</sup> 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/ft/reformereg/34976533.pdf](http://www.oecd.org/ft/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 Bundesnetzagentur, 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](http://www.bis.gov.uk/brdo/resources/competency), accessed 7 December 2012.



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