

# Regulating Really Responsively

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Public lecture co-hosted with GEN and MBIE

Thursday 27<sup>th</sup> March 2014, Wellington

# Outline

- Preface – the regulatory challenges
- Really responsive regulation (RRR) – key elements
- Applications and extensions of RRR
  - RBR
  - Analyses of markets
- RRR and the NZ Productivity Commission's review
- RRR - challenges and potential

# Preface

- Regulators face some key functional challenges
  - Scale
  - Variety
  - Legibility (knowing what they are regulating, and rendering it knowable)
  - Governing at a distance in time and space from those they are attempting to govern
  - Contradictory combination of dependence on and inherent ungovernability and dynamic properties of people and things
  - Managing themselves and maintaining legitimacy
- RRR is an attempt to tease apart the complexity of the regulatory task and the context in which it has to be performed to enable regulators to analyse and to respond to these challenges

# RRR – key elements

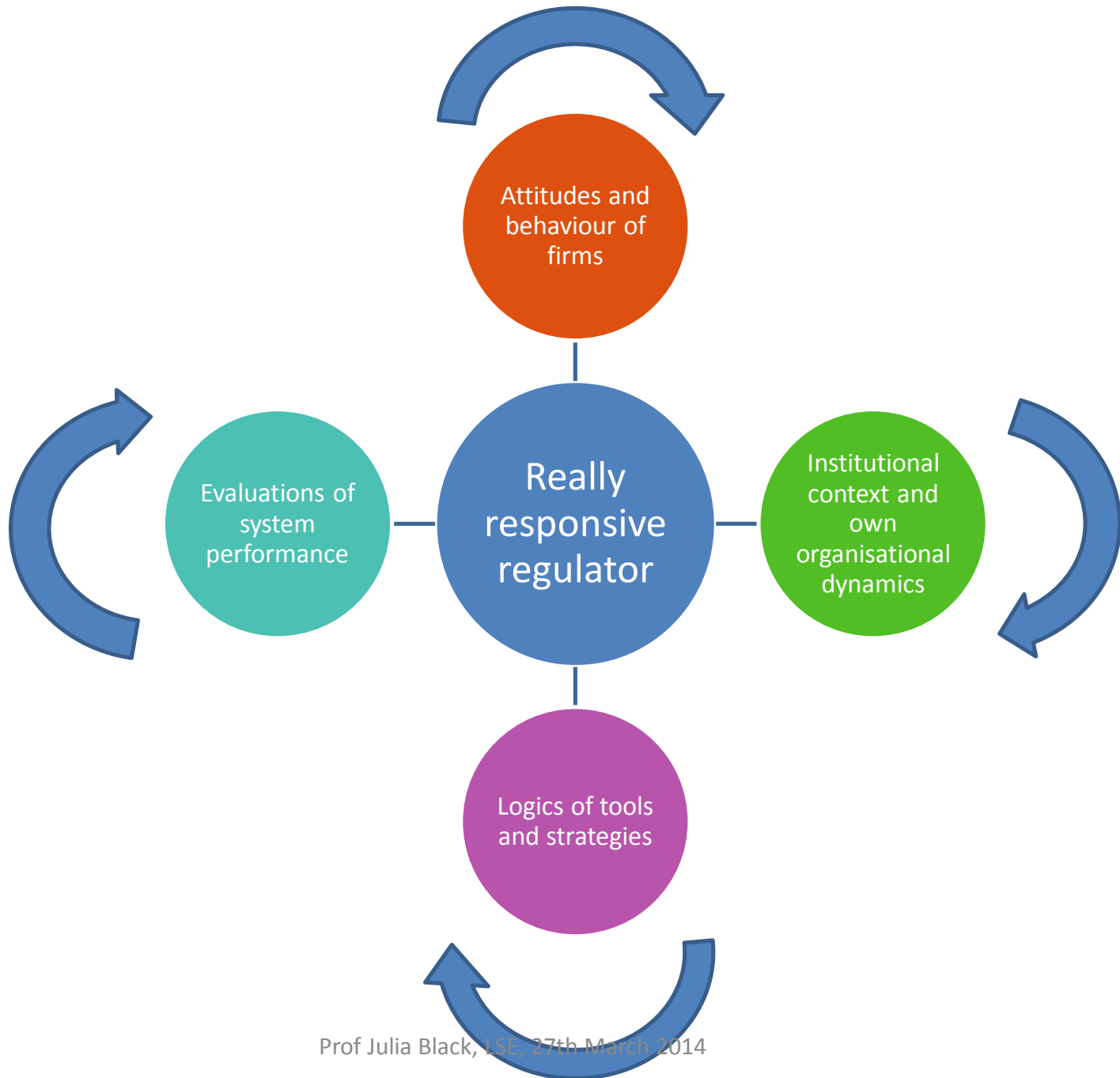
- Responsive vs ‘really’ responsive regulation
  - Ayres and Braitwaite’s ‘responsive regulation’
    - Enforcement pyramid + ‘tit for tat’ strategy
    - Influential, though subsequently modified to combine ‘targetted’ sanctions when escalation not appropriate
    - Modified by the ‘smart’ regulatory pyramid which goes beyond enforcement context to focus more broadly on regulatory strategies

# RRR – key elements cont.

- ‘RRR’ developed with Prof Rob Baldwin
- Expands on RR in two key ways
  - (i) RR assumes that the only factor that will, and should, influence how a regulator interacts with a regulatee, and decides which enforcement tools to use, is the attitude and behaviour of the regulatee – the ‘tit for tat’ approach.

In contrast, RRR argues that how a regulator interacts with a regulatee will, and should be influenced by 5 key factors

- the *behaviour, attitudes and cultures* of regulatory actors;
- the *organisational dynamics and institutional setting* of the regulator within the regulatory regime;
- the *different logics of regulatory tools and strategies (and how these interact)*;
- the *regime’s own performance* over time; and finally,
- *changes* in each of these elements



# RRR – key elements cont.

(ii) RR applies to enforcement activities whereas RRR applies to all regulatory activities:

- Framing agendas and setting objectives / goals
- Formulating rules / norms
- Developing and implementing regulatory strategies
- Monitoring risks and behaviour
- Gaining compliance and taking enforcement action
- Evaluating performance and providing feedback

# Applying RRR in different ways: (i) to risk based regulation

- Risk based regulation (RBR)
  - The development and use of *systematised* decision making frameworks to prioritise regulatory activities and deploy resources based on an assessment of the risks that regulated firms pose to the regulator's objectives
    - Prioritisation decisions are systematised, and brought 'into' the centre and driven 'up' the organisation
- Initially: focused on inspection and enforcement activities (eg focus of UK Hampton Report 2005)
  - Though note that decisions on whether to pursue enforcement action often have a separate set of criteria
- More recently – RBR is being 'mainstreamed' across all policy making decisions, including whether or not to regulate at all
  - Eg UK Legal Services Board & Solicitors Regulation Authority



# Really Responsive Risk Based Regulation (RRBR) (Black and Baldwin)

- RBR should
  - (i) Incorporate risk assessments AND attitudes and compliance behaviours in the risk assessments (see GRID below)
  - (ii) Be responsive to the institutional and market environment
    - Systemic risks
    - Be aware of their own organisational capacities
    - Be aware that politicians, the public, regulated firms and other regulators in its regulatory 'network' may all have different assessments of the same 'risks' (ie of the priority they should have)

# RRBR cont.

- RBR should
  - (iii) Recognise that regulatory tools can have conflicting logics
    - Eg that the logic of RBR is one of risks and outcomes, and can conflict with a compliance logic which is one of rule following and approaching enforcement ‘from the court-room back’
    - Conflicting logics can be imposed on regulators
      - The accountability criteria imposed on regulators may conflict with the RBR approach
      - The business model imposed through cost recovery models can contradict the RBR approach

# RRBR cont.

- RBR should
  - (iv) Be sensitive to its own performance
    - Need more sophisticated strategies and understandings of the regulatory task and of evaluation
      - In managing risks, difficult to say why a risk has not crystallised – but maintaining the status quo can be hard work
      - When managing uncertainty, even harder
    - Be wary of self-referentiality by evaluating the system just by assessing movements within or between risk categories
    - Need a more nuanced political conversation about what constitutes ‘failure’ in a risk based system
  - (v) Be able to respond to change
    - Often difficult to shift resources as risks change
    - Be aware of problems of ‘model myopia’

# Integration of RRR and RBR in B&Bs Good Regulatory Intervention Design (GRID) (Baldwin & Black)

- Argued that there is a strategic and operational gap between risk based scoring systems and compliance and enforcement policies
- Neither gives any help to regulators in trying to decide which regulatory strategies to adopt (as opposed to what compliance or enforcement activities to undertake - eg educate, give a notice, prosecute)
- Response: GRID
  - Decision matrix accompanied by an Intervention Guide listing 23 different regulatory strategies

	Nature of the low-risk site/activity				Options for Regulatory Activity & Intensity
	<i>Inherent low-risk – stable</i>	<i>Net low-risk – stable</i>	<i>Inherent low-risk – but may change or accumulate</i>	<i>Net low-risk – but may change or accumulate</i>	
<i>Regulatees are well motivated with high capacity to comply</i>					<i>Screening</i>
					<i>Monitoring</i>
					<i>Engagement &amp; incentives</i>
	Low	Low	Low	Low	<i>Regulatory intensity</i>
<i>Regulatees are well motivated with low capacity to comply</i>					<i>Screening</i>
					<i>Monitoring</i>
					<i>Engagement &amp; incentives</i>
	Low	Low	Low	Low	<i>Regulatory intensity</i>
<i>Regulatees are less motivated with high capacity to comply</i>					<i>Screening</i>
					<i>Monitoring</i>
					<i>Engagement &amp; incentives</i>
	Medium	Medium	Medium	High	<i>Regulatory intensity</i>
<i>Regulatees are less motivated with low capacity to comply</i>					<i>Screening</i>
					<i>Monitoring</i>
					<i>Engagement &amp; incentives</i>
	Medium	Medium	High	High	<i>Regulatory intensity</i>

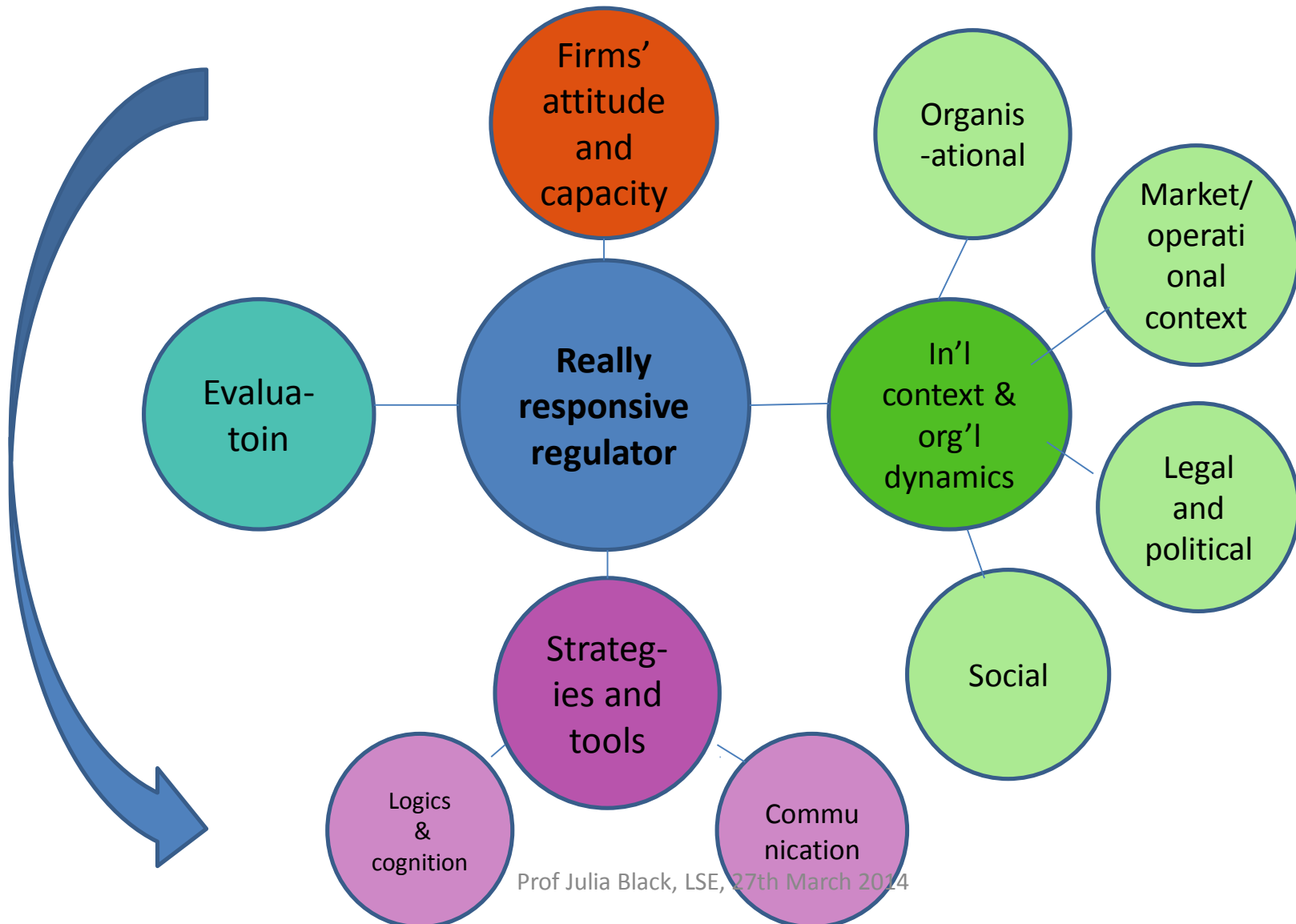
# Further extensions: RRR approach to regulating financial markets (Black)

- Attitudes and behaviours of regulated firms, including
  - their organisational dynamics and governance capacities
  - their interactions with other market actors
- Institutional context of the regulator
  - Regulators' own organisational governance, capacities and dynamics
  - Political and legal / soft law infrastructure
  - Nature of financial markets (which embraces sociological understandings), including
    - their functions and institutional structures
    - the role of law and regulation in their constitution
    - the role of social interactions in their operation
  - Fundamental conflicts of interest within the broader political institutional context – states are interested parties, eg in sovereign debt markets
  - Political and social expectations

# Further extensions: RRR approach to regulating financial markets (Black)

- Strategies and techniques
  - In particular the logic of calculative technologies and their role both in markets and in regulation
  - Importance of knowledge, understandings and assumptions in how problems are identified, understood and addressed
- Evaluation
  - Need to recognise unintended consequences, in particular unintended incentive effects regulation can have on market behaviour
  - Need to be aware of interaction with other regulatory regimes on the ground
- Dynamism
  - The nature of markets as dynamic, complex and adaptive systems which can change and can interact with regulation in unpredictable ways

# Disaggregating the elements of RRR





# RRR and the NZ Productivity Commission Report

- Gratifying!
- Examples of how an RRR approach can be used in regulatory decision making and to develop regulatory strategies
  - Taking a prosecution
  - Regulating low risks - pest management under the NZ Biosecurity Act 1993: GRID
  - Regulating in the particular institutional context of NZ: acknowledging Maori interests in the regulatory management system and upholding the Treaty of Waitangi

# RRR – Challenges and Potential

- NZ Productivity Commission report found some examples of regulators being attentive to some of the elements of RRR
- But that most still faced significant challenges
  - difficulties assessing and targeting risk;
  - conflicting compliance approaches;
  - insufficient or inappropriate enforcement tools;
  - the costs and timeliness of prosecutions; and
  - the ability of regulators to learn from experience and respond to changes in the regulated environment challenges

# Summary and Conclusions

- Regulation is never easy, but significant improvements can still be made
- Critical to facilitating change are
  - Capacities, capabilities and cultures of regulatory organisations and regulatory practitioners
    - Communities of practitioners is a good place to start
    - Greater attention needed to internal governance of regulators
    - Training of both regulatory practitioners and board members needs to improve
  - Coherent regulatory regime with
    - Minimal underlaps and co-ordinated overlaps
    - Clear objectives and bases for making trade-offs
    - Avoiding or effective management of conflicts of interest
  - Effective evaluation
    - Including an understanding of legislators and executive overseers of the nature and challenges of the regulatory task, and of the regulatory system that they have created piece by piece
  - Engagement of duty holders and civil society in the regulatory project
- Just because it's difficult doesn't mean we shouldn't do it!