How to Succeed in the Senior Civil Service

Part 7 - An Introduction to Regulation

7.1.1 Introduction[1]

Regulation plays an increasingly important role across government, including in health, education, technology, business, and consumer protection. Many senior civil servants therefore need to think about the design and effectiveness of complex regulatory systems. This can involve difficult compromises.

This advice is designed to help senior officials who are asked to help design a regulatory system in response to a new threat, or to join a regulator's senior team, or to review the performance of a regulator overseen by their department.

Let's start with a little background.

7.1.2 Why regulate?

Regulation - of weights and measures and water quality, for instance - is as old as civilization itself. The Romans imposed heavy penalties, ranging from the equivalent of £10,000-30,000 in today's money, on those who polluted the water, or damaged the supply infrastructure[2]. And whistle blowers were awarded 1/8th of the penalty.

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[1] This is the seventh part of a book (*How to Succeed in the Senior Civil Service*) which might be published in 2025. I am very keen to know what you think of it. Is it clear, helpful? Could the tone be improved? And the contents, of course! Please drop me an email to ukcs68@gmail.com .

[2] https://www.regulation.org.uk/history-1-to_1980.html

Regulation now plays a huge and essential part in modern society and government. Amazing modern technologies empower us to transfer tens of thousands of pounds by clicking a mouse. But will it reach the right person? We can buy and order a rich variety of food, all of which is prepared out of our sight. But will we get food poisoning? Our information, entertainment and energy are supplied by huge corporations whose principal aim is to make money. But are they manipulating us, making excessive profits, or damaging communities and our children? And we have come to expect that many public services, such as health and education, will also be inspected and regulated. Perhaps reluctantly, we have realised that we need 'regulators' to protect us.

But every regulation removes a freedom from an organisation or an individual. It is therefore important that we regulate only when necessary . We should not unnecessarily impose our preferred behaviours on our fellow citizens.

And the modern regulatory state comes with a huge cost. Some costs are direct in the form of regulators' staff and other organisations' administrative and compliance costs. But there are worrying indirect costs. Businesses find it harder to innovate and individuals become less enterprising and more risk-averse within the suffocating comfort of the nanny state. The police, doctors and many others complain that they spend all their time filling in forms rather than collaring criminals or treating people.

And yet our regulatory state has not saved us from numerous regulatory disasters, including the 2008 financial crisis, some dreadful hospital scandals and the Grenfell Tower fire. Put bluntly, many regulators have been too weak and have failed to make full use of the tools at their disposal.

This part of 'How to Succeed ...' offers lessons to be learned from our regulatory experience to date. The over-arching lesson is that we only get good regulation if we get three things right.

- First, politicians, assisted by civil servants, need to transfer their policy decisions into legislation. Lawyers refer to this as *black letter law*. This process is discussed in Part 7.2 below.
    - There are important differences between policy-making in a government department and policy making in a regulator. Departmental officials are constantly considering whether their policies are optimal and, if not, what needs to be done about it. They are very conscious of their ministers' political priorities and often have considerable discretion in grant-giving etc. Regulators (and the courts) look only at the legislation, rather than at any policy decision-making which they're unlikely to be able to second guess. They have considerable discretion about what to prioritise and how to use their enforcement powers (see 7.4 below) but they are otherwise totally constrained by their black letter law. If that law is in any way inadequate, the regulator can do no more than ask their parent department to change it.

- Second, politicians, again assisted by officials, need to ensure that the regulatory system has a strong structure and is well governed. Regulators need to have effective and experienced boards, they need to be an appropriate size and must not be given too many objectives. These issues are discussed at 7.3 and 7.4 below.

- Last, and certainly not least, regulators need to use their powers effectively. They need to withstand political and industry pressure to apply a 'light touch' whilst also avoiding

imposing excessive regulatory burdens on those, including small firms, least able to be able to cope with it. These issues are discussed in Part 6.5 below.

7.2 Whether and How to Regulate

7.2.1 The Fundamental Policy Decisions

Legislators should not impose regulation without first considering whether society or the market will not provide a better outcome if left to its own devices. Society, not legislation, will generally limit (though not eliminate) anti-social behaviour. And it may take a little while, but customers will usually root out inefficient companies with inferior products - especially as those companies' rivals have every incentive to help them do so. As many have commented, no-one organises or needs to regulate the many essential systems that distributes food and other essential goods throughout the UK. The market, through competition, can regulate itself.

Legislators also need to be realistic. They need to work with the grain of the economy and society. They can influence behaviour a bit, but they are unlikely to be able to get them to behave completely differently.

There have been numerous attempts to force larger companies to pay smaller businesses more quickly, but they all *either* rely on SMEs reporting problems (which they seldom do because it antagonises their customers) *or* on 'duty to report' legislation which forces large companies to reveal their payment statistics. This legislation is widely disregarded because there is no effective enforcement mechanism.

And many damaging behaviours are a necessary accompaniment to our modern lives. The role of the regulator is very often to reconcile conflicting uses of the same asset, or reconcile needs that cannot all be filled simultaneously, such as economic growth without environmental damage. The key to good regulatory design, and the key to being a good regulator, is to understand the conflicts within a system and to balance the conflicts by making the judgments that best achieve the regulator's objectives after drawing on the best available evidence.

If a problem appears to need a regulatory solution, policy advisers should therefore approach the design of that solution as they would approach any policy problem. Here are some high level questions that might be asked:-

7.2.2 Initial Questions

First, might there not be a better policy solution than regulation?

- There are often alternative regulatory and non-regulatory options. If we are worried about the cost of energy, for instance, would it not be better to increase the benefits paid to those with low incomes, rather than introduce social energy tariffs, which in effect tax other energy users in a stealthy way? There may also be less intrusive regulatory remedies such as prominent information about the environmental impact of fridges as an alternative to banning fridges with high emissions.
- Be aware, though, that politicians sometimes use regulation as a means of getting out of a fix. They can say "we've asked the regulator to do something" as a way of avoiding grasping a political nettle, which more direct policy tools might require.

If regulation seems to be needed, has something similar been tried before, here or abroad? What works, what doesn't? And try to avoid 'performative' legislation such as introducing new regulations when perfectly adequate existing ones are not properly enforced.

Are those subject to the new regulations likely to choose voluntarily to comply with them? If not, then compliance may need intrusive and expensive enforcement.

- Marcial Boo[3] draws attention to the analogy of the Highway Code. Drivers give way at pedestrian crossings and roundabouts not because they think about the Code, nor from a fear of speed cameras. They do so because they have internalised and choose to comply with agreed standards that they also expect of others. Rules and culture are aligned. When they are not, culture takes precedence. Rules say it is illegal to exceed 70mph on motorways. But culture allows faster driving: many do it, and few are held to account for non-compliance.

Is the legislation sufficiently flexible? Does it encourage regulated entities to respond to changes in society either through deep interaction with the public, or through competitive pressure?

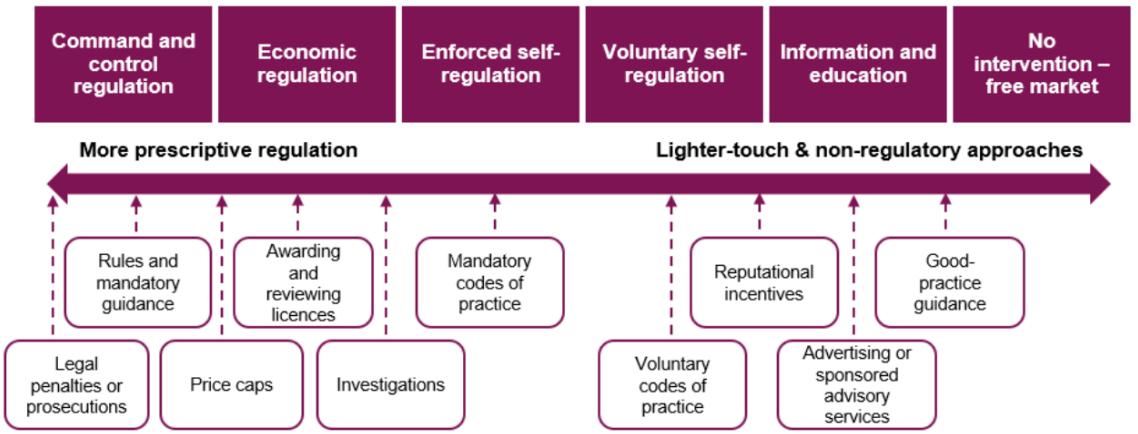
Finally, in this section, do take Regulatory Impact Assessments seriously. They can feel like bureaucratic treacle when you are working for a minister determined to 'do something', but if you approach them sensibly they are a very useful way of highlighting both the strengths and weaknesses of proposed regulations and to assess the costs, benefits, risks and uncertainties associated with different policy options. So do familiarise yourself with the thrust of the advice from the Better Regulation team and try hard to understand and respond to the concerns of the Regulatory Policy Committee.

7.2.3 What Type of Regulation?

Alongside the above policy choices, legislators need to choose from amongst an interesting range of organisational approaches nicely summarised in the following diagram. At one end are essentially unregulated free markets where the courts are the principal arbiter of any disputes. At the other end are areas with particular risks such as the nuclear and pharmaceutical sectors that have more prescriptive rules-based systems of regulation. Between these lies a rich landscape of more principles-based approaches, varying from providing guidance and reputational incentives (such as performance league tables) through various forms of self-regulation and codes of practice to licencing regimes and price regulation.

[3] Marcial Boo (2024) 'The Integrity Mismatch: Public Service Standards in a Political World' (Demos) https://demos.co.uk/research/the-integrity-mismatch/

Figure: Examples of different approaches to regulation



Source: National Audit Office analysis

Pure self-regulation and voluntary codes of practice are unfortunately unlikely to work well unless well accepted within their industry, as with the driving example mentioned above. The Lending Standards Board, for instance, has no formal powers and cannot even 'name and shame'. (One bank reimbursed only 2% of victims.) So victims of fraud lose out. This is why stronger regulatory tools are sometimes necessary.

And some choices are really difficult. Where on the above spectrum would you place the regulation of homeopathy, or second-hand flea markets[4], or cryptocurrency, for instance? Unregulated finance is said to attract only two kinds of people: crooks and suckers. (Guess which kind are billionaires.) Should we spend taxpayer money saving suckers from themselves? There is no obviously right answer to questions such as these - general consumer protection legislation has limitations - so ministers need to make the judgment.

7.2.4 Regulatory Independence

The next policy decision concerns the independence - in effect the power - to be given to the regulator.

The early energy and water regulators were primarily tasked with ensuring that the pipes and wires monopolies could not exploit their monopoly power, most obviously by charging higher prices than could be justified by their costs. But monopolists can exploit their power in other ways. They can lower the quality of their products, offer a reduced range of products and/or provide poorer service. All early price controls therefore also required the regulator to specify numerous non-price minimum standards. This was often a fairly straightforward task.

It was quickly accepted that such economic regulators needed near-total independence from political pressure. That allowed them to take pricing and competition decisions (such as whether to allow mergers) in the long term interest of both companies and their suppliers. It also insulated ministers from blame, for such decisions were certain to annoy somebody!

But modern regulation is all about trade-offs. How much should consumers be asked to pay for clean beaches, fewer leakages and for the initial investment in green energy? How much should current customers and passengers be asked to contribute to the cost of new infrastructure such

[4] It is interesting to note that eBay, the world's biggest second hand market, heavily self-regulates so as to ensure that their marketplace works well.

as the Thames Tideway mega-sewer or a possible third runway at Heathrow? Regulators are not well equipped to make these essentially political decisions - though politicians are also understandably reluctant to make them for fear of annoying their constituents. The best regulators therefore make such decisions very carefully and after considerable consultation, and then explain their decisions transparently and publish the evidence to support their judgments.

And then we get into the regulation of services such as education and health. No politician can be expected to say that they have washed their hands of key decisions affecting services whose delivery is of such direct and personal interest to so many voters. Even regulators such as NICE, which was deliberately set up so as to isolate ministers from some very tricky decisions about the availability of expensive drugs, has to be at least a little bit political. Should it allow terminally ill patients to receive unapproved but promising drugs. And at what cost?

All regulators therefore work in a political context. They may be required to make decisions which are political either because the politicians don't want to, or because speed is of the essence, or because they have the detailed expertise and sectoral knowledge.

So ... there are seldom any obviously correct answers when considering regulatory independence, but there are some obviously incorrect ones. Ministers can hardly be expected to appoint Chairs etc. who are unsympathetic to their broad politics and policy objectives. Ministers can also not be expected to appoint those who are likely to assert great independence from government when taking key decisions in areas such as health and education.

But it is nevertheless vital that arm's length bodies take high quality decisions bearing in mind their statutory duties and the facts and arguments that are brought to their attention. They cannot do this if their Chairs and Chief Executives are concerned about how their decisions might be received by politicians and the media, and/or if they arrive in post with strong biases, prejudices or predispositions. There is a balance to be struck, but it should not be too difficult to identify the correct balance following careful thought.

7.2.5. Accountability

Accountability is the necessary consequence of even partial independence. All regulators are formally accountable to the courts and to their parent departments, and most are directly accountable to Parliament because they are non-ministerial government departments[5] and/or because their Chief Executive is an Accounting Officer[6]. Their Chairs and CEOs can be called at any time to explain their decisions to parliamentary committees.

All regulators are also less formally (but just as importantly) accountable to the public, including through the media. They need strong and effective communications teams who provide relevant facts and interesting analysis - not spin and PR.

But - remember that accountability means being held to account, scrutinised, and being required to give an account or explanation. It does not imply having to accept advice or instruction.

True accountability is nevertheless very powerful because it causes decision makers to think hard about the range of decisions and behaviours that are available to them, and the fairness,

[5] https://www.civilservant.org.uk/information-definitions.html
[6] https://www.civilservant.org.uk/richborne_publishing.html#CSMP

appropriateness and proportionality of each choice. Jonathan Haidt refers to this as *exploratory thought*, and argues (I think correctly) that effective accountability has three vital elements:

- Decision makers learn before forming any opinion that they will be accountable to an audience.
- The audience's views are unknown.
- The decision maker believes that the audience is well informed, and interested in both fairness and accuracy.

Regulators unfortunately learn very quickly that, although they are accountable in many different ways, their audiences (including Parliament) are seldom well informed and interested in both fairness and accuracy. But there remain a good number of specialist journalists who are interested in facts, fairness and accuracy. They are mainly to be found specialist magazines, the mainstream broadcasters and the FT and they are certainly to be cherished and encouraged.

7.2.6 Appeals

The courts and other formal appeal bodies are the best examples of pure accountability. Regulators know when their decisions can be appealed and appeal bodies are (or should be) unbiased and willing to give all parties a fair hearing.

Economic regulation incorporates avenues of appeal to the Competition and Markets Authority and the Competition Appeal Tribunal, and then on to the Court of Appeal if necessary.

Appeals against other regulators' decisions, penalties etc. are mainly by way of judicial review. But recent government s have made it much riskier and more expensive to bring judicial reviews proceedings, thus making it harder for individuals and smaller organisations to mount such challenges.

Appeals processes are also currently taking far too long, for a number of reasons. But there is a particular problem with well-funded appellants such as large corporations for whom the associated legal costs are worthwhile (and relatively miniscule) if there is even a small chance of success. Their lawyers and other advisers are also anxious not to overlook any point or argument that might assist their case which leads to appeals bodies facing extensive documentation and rebuttals from both sides. Tribunals themselves then produce very lengthy and frankly unreadable judgments.

Where possible, advocates, tribunals and courts should be reminded that very senior judges have said that "No court is assisted by the multiplication of arguments regardless of their merit. Nor is a defendant assisted by such an approach, which runs the risk of undermining the stronger points in the defendant's favour."

7.3.1 Systems

Ministers, advised by officials, need to take numerous other decisions concerning the structure, governance and objectives of the regulators that will implement Parliament's decisions. Experience to date suggests that the main dangers are that regulators might become far too large and/or have too many conflicting objectives and/or be asked to work within a confusing regulatory landscape.

Here are some examples.

Ofcom is one of the largest regulators. Its responsibilities include broadband, fixed and mobile telephony, the radio spectrum, broadcasting, online services, newspapers, social media and the postal industry. An argument can be made that these all share common characteristics, but they all also require quite frequent and difficult regulatory decisions to be made. The result is that Ofcom's Board can have only a hazy idea of what is being done in their name by their 1,400 staff. Many consultation documents and decisions will have to be approved by senior staff or else the work would grind to a halt. The result is that Ofcom's work is subject to much less democratic accountability than if the decision-making had remained within government departments. This is not ideal regulation - though it is far from certain that democratic accountability necessarily delivers effective regulation. (The history of the nationalised industries suggests not.)

The Care Quality Commission (CQC) is another organisation with over-wide responsibilities. Its 2,900 staff inspect care homes, hospitals, dentists, family planning and slimming clinics, homecare agencies, GPs, mental health services and community-based health/care services. They may all be in the same sector but the regulatory issues are widely different. It was not surprising (and not entirely its fault) that an external review identified significant failings in 2024 leading to the Health Secretary declaring it to be 'not fit for purpose'.

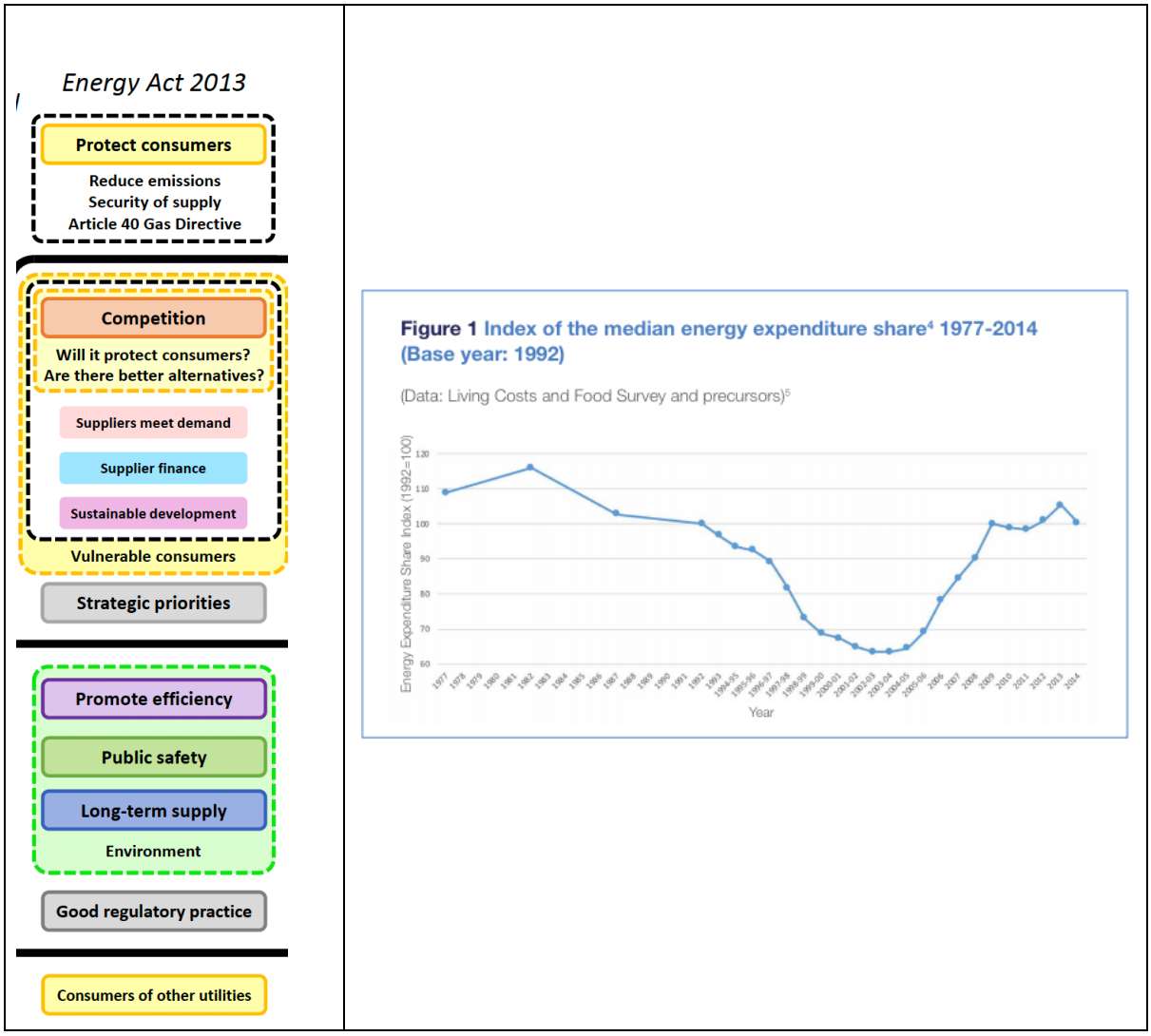
Many apparently well-focussed regulators, such as Ofwat and Ofgem, have nevertheless been asked to assume wider responsibilities, such as helping vulnerable groups or improving the environment. This is unfortunate as it requires them to make trade-offs between their economic and societal objectives, even though these decisions are in principle better left to politicians.

Ofgem, in particular, has long suffered from the trilemma that it is asked to achieve three key outcomes - sustainability, security of supply, and affordability. As each of these pull in different directions, it has become clear that Ofgem cannot avoid being constantly criticised by one stakeholder group or another.

But it hasn't stopped there. The list on the left, below, is of Ofgem's Principal Objective and Primary, Secondary and Tertiary Duties as of 2013[7]. There were only five in 1986 whilst many more have been added since 2013 including new price caps (which Ofgem itself thought anti-competitive) and further responsibility for assisting the industry to achieve 'net zero'. Ofgem is also, like many regulators, now tasked with encouraging growth and/or competitiveness. It is frankly impossible for Ofgem's Board to make a sustained attempt to reconcile all their objectives. They muddle through as best they can, secure in the knowledge that neither ministers nor parliamentarians could do any better.

The dramatic chart, below right, shows what happened to energy prices after Ofgem began to regulate the industry. If you ignore energy costs, there were initially many years of successful price regulation which were undone when Ofgem was forced to add environmental costs (in other words to impose taxes so as to fund low carbon generation) in the early 2000s. But there were also large swings in energy costs so the regulators can't claim all the credit - or all the blame.

[7] Needs updating. Can anyone help?



There was one example of resistance to the addition of unnecessary objectives. A Select Committee chair criticised the Financial Conduct Authority for refusing to start overseeing financial institutions' compliance with the 2010 Equality Act. The regulator politely pointed out that "ensuring compliance with the Equality Act is generally beyond our expertise as a financial services regulator". Indeed, there is already another regulator – the Equality and Human Rights Commission – that is responsible for that job.

Finally, in this section, the regulatory landscape can, over time, become very confusing.

One result is that Ofwat is another regulator that is frequently, but probably unfairly, in the headlines. Is it really Ofwat, or maybe the Environment Agency, or the Office of Environmental Protection, the Marine Management Organisation, or maybe even Natural England, that has overall responsibility for improving the cleanliness of our rivers and beaches? There may be good reasons for creating this plethora of regulators (and I argue above that merging them may not improve things) but there does seem to be confused accountability.

But Ofwat itself has been very keen, over the years, to comment on water companies' corporate structures and executive pay. These interventions were no doubt well-meant but seemed a huge distraction form the regulator's basic job of ensuring water bills were not too large whilst bearing down on problems such as water leakage.

7.3.2 Consumer Representation

Regulators need frequent input from the general public whom they serve. They want to take decisions which properly balance the needs of regulated entities with those of their customers, service users, taxpayers, or other representatives of the wider public. It is however extraordinarily difficult to ensure effective evidence-based consumer or user representation.

The first problem is that it is impossible, without spending huge sums, to get a significant or even representative proportion of the general public to respond to consultation processes. Even when they do respond, most people will say, quite reasonably, that they want high quality, lots of choice, good service - and low taxes/prices. But there are clear trade-offs between these attributes.

It is also near impossible for regulators to get consumers or service users to rank these attributes even when they are faced with hypothetical choices. Focus groups can offer deeper insights, but they are expensive and may not be representative of the wider population. Supposedly representative bodies (including Consumer Councils) also often have too narrow a perspective. And it is even harder when trying to access the views of users of public services, whether primary schools (pupils as well as parents) or housing (residents and potential residents).

This leads to quite a dilemma for regulators. They would generally prefer to act in an even-handed way, receiving contrasting submissions and making quasi-judicial determinations based on those submissions. But this would disadvantage consumers and users, as the regulated industries would have much greater power and influence. The costs of regulation are usually concentrated on a small number of producers whereas the benefits are spread across many consumers, or all society. The former will therefore shout louder and argue more vociferously than the latter.

In practice, therefore, the regulators generally see themselves as representing consumers - or at least the wider public interest - against industry opposition. This is not an ideal place to be, as industry may consider the regulator to be hostile or political. MPs may fear the same. Regulators must therefore take transparent steps to ensure as much impartiality as possible, and always to explain their decisions, to avoid regulatory capture (see below) either by industry and producers or by consumers and service users.

There is further advice in the Consultation Part of 'How to Succeed ...' including reference to the value of *Provisional Findings* and the need to be pretty sceptical about the protestations of senior executives who often haven't a clue what is happening in their organisations - as they will tell you when their staff are caught ignoring environmental regulations or submitting false information to regulators.

7.4.1 Governance

It is vitally important that regulatory bodies are governed effectively by their Boards. Boards need to be strong enough and wise enough to hold the executive team to account. The following advice is based on my eight years' experience as Chief Executive reporting to two regulatory boards, both of which were very well regarded at the time, *plus* observation of many others since I first developed an interest in this subject 26 years ago.

- The Chair must be well regarded within the regulated sector. Otherwise they would not be able to challenge and guide the work of the executive team, nor ensure that the Board takes decisions based on a full appreciation of all the relevant factors.
- As argued in 7.2.4 above, the Chair and other Board members should be politically aware but also well able, when necessary, to take independent and unpopular decisions, and then publicly explain and defend them.
- The board should be around six- to seven-strong. Smaller groups are unlikely to contain sufficient diversity of view and experience, whilst larger groups are too often unable to debate effectively and will likely become dominated by sub-groupings.
- Non-executive Board Members should be appointed on three-four year contracts, renewable once only. This is because it generally takes them a year or two to gain sufficient knowledge and experience to be able to challenge effectively. And it can be difficult/embarrassing to replace them if there is not a firm end date. The initial cohort may, of course need to have staggered lengths of appointment.
- The Chief Executive should be on the Board and other executives and junior staff may attend. But no other executives should have a vote. Rather as with civil service departments and other public sector bodies, the role of the executive is to report to the decision makers appointed by democratically accountable politicians. Executives become too powerful if they both give advice and then take the key decisions based on that advice.
- The Chief Executive needs to be an experienced public servant but does not need to be a sector expert. They will learn quickly enough on the job. The key thing is that they need to be able to create and lead a high performing team, ensure that it provides highly professional advice to the Board, and efficiently and sensitively implements the Board's decisions.
- The Chair should be the person that meets ministers and other key stakeholders and accounts to them for the decisions of their Board. But they should generally be accompanied by their Chief Executive. The two should, in other words, present a united front.
- The Chief Executive should be the person who briefs civil servants, MPs, including the Shadow Cabinet and the media. But the Chair should lead the most important announcements including by appearing on programmes such as *Today*.
    - There are currently (as of August 2024) some very good Chief Executives who are also leading their organisations' communications activities and doing so very well. But it gives the impression that the Chief Exec is responsible for their organisation's policies and that their Boards are irrelevant. This is clearly undesirable.
- Boards should never be asked to take important decisions in a hurry. They should home in on key decisions, including the substance of significant consultation and decision documents, by considering a series of papers over several months and giving a steer to the executive each time. And papers should reach Board members at least 48 hours before their meetings. Good practice is to send papers a week in advance.
    - Some may regard this advice as impractical. They should change their mind. Rushed decisions are always (absent calamitous external events) failures of preparedness and process. Chief Execs should ensure that their Boards (and their parent departments) are never taken by surprise.
- Boards should carry out effectiveness reviews at least once every two years. Some appropriate questions may be found here:-
    https://www.regulation.org.uk/reg_effectiveness-effectiveness_reviews.html

7.4.2 Regulatory Capture

Regulators also need frequent input from their regulated entities and sectors, not least so that they understand the complexities of the system or the sector they are regulating. This will include recruiting staff from the regulated entities. But they face the opposite problem to that of organising consumer representation (see above). It is all too easy for the sector to dominate the provision of information to the regulator as well as its thinking.

It is genuinely hard, and sometimes impossible, for regulators to source relevant information other than direct from the regulated entities - and those entities have every incentive to spin and sometimes outright lie. Regulatory staff and their Boards need to be pretty sceptical, but this is difficult if they have been recruited from the relevant sector, partly because of their sector expertise.

An extreme example, from the other side of the pond, is Boeing. The 737-Max crashes triggered numerous reports of a broken regulatory process that effectively neutered the oversight authority of the safety agency. The FAA boss was an ex-Boeing lobbyist and there were many ex-regulators on Boeing's payroll. Why did this matter? A regulator who anticipated a giant signing bonus from Boeing after their term in office, or an ex-Boeing FAA exec who held millions in Boeing stock, had an irreconcilable conflict of interest that made it very hard – perhaps impossible – for them to hold the company to account when it traded safety for profit. Boeing was in effect allowed to self-certify that its aircraft were safe with consequences which become all too public in the early 2020s - and all too tragic for its passengers.

Most regulators do not risk such extreme regulatory capture. But there are many steps that regulators can take to avoid the risk and the perception of capture, including having strong conflict of interest policies and acting on them, and to be scrupulously transparent in the decisions they take and being even handed in the meetings they have. Being aware of the risk is the first step towards mitigating it.

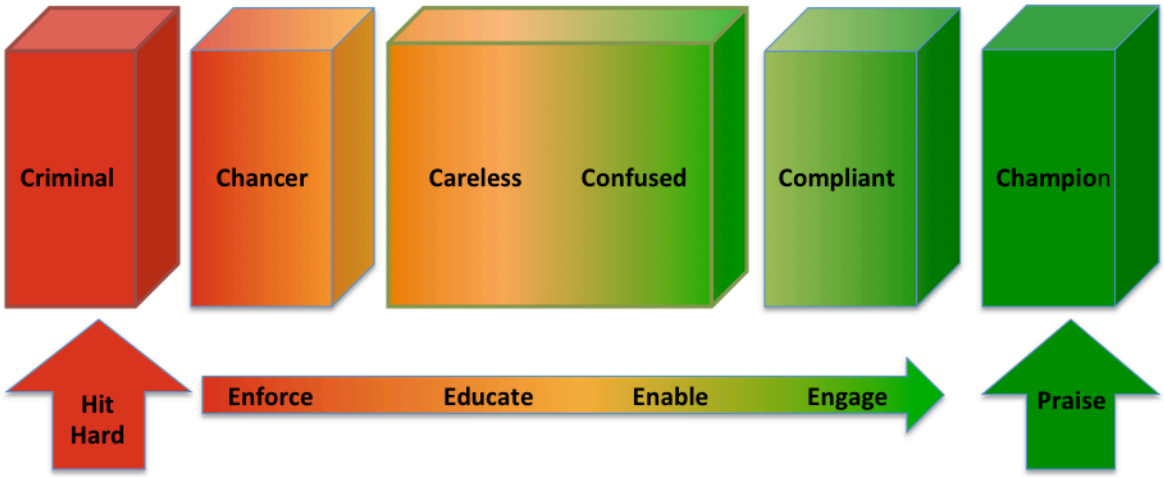
Just occasionally, by the way, a regulator can get itself into a very antagonistic relationship with a regulated entity. This needs to be called out, if necessary.

7.5 Enforcement Strategy

7.5.1 Regulatory Discretion

As mentioned in 7.2 above, regulatory Boards and their staff work within the legislation prepared by Parliament and their parent department. But they do have as good deal of discretion when it comes to the way in which they enforce that legislation.

This diagram, originally prepared by Campbell Gemmell of the Scottish Environment Protection Agency shows how regulators need to vary their approaches according to the character of the regulated entity. Things go wrong when they choose or are persuaded or forced to adopt an inflexible attitude.



If regulators take too hard an approach towards the compliant end of the above spectrum than they tend to run into practical problems. Well behaved and well intentioned organisations will react very strongly to what they will perceive as excessive inspection and unfair regulation. There will in particular be numerous complaints and appeals which usually lead to the regulator learning to behave more sensitively.

One example might be Ofsted whose inspections were literally dreaded by even the very best schools and teachers. Teachers understandably hate to be inspected without notice but pre-notification encourages them to behave unnaturally. One child tweeted that "This week has seen so much drama … we never study like this the whole year like we're going to do this week." Then Ofsted's one word summaries of their inspections often seemed particularly unfair, although this regulatory framework had in fact been mandated by ministers and not Ofsted itself. One such curt summary is alleged to have contributed to the subsequent suicide of a dedicated head teacher.

Professor Lucy Easthope, for instance, argues that Ofsted should encourage teachers to have normal interactions with inspectors. Inspectors should be welcomed into the classroom and senior leaders should be allowed to discuss the findings collaboratively with the inspection team. Emergency planners and safety critical industries seem able to conduct inspection processes that are conducive to getting results but also keep employees emotionally safe.

Another example was the Charity Commission which apologised to Compassion in Care, a tiny charity which had been subjected to a 10 month long "sledgehammer to crack a nut" investigation following a complaint from an organisation which the charity had publicly challenged. The Commission afterwards recognised that its 'unhelpful' correspondence had been seen as aggressive by the trustees and it had not taken into account the distress that the trustees were expressing.

But things go very badly wrong if regulators take too soft an approach towards the left-hand end of the spectrum. The following sections consider examples of 'light touch' regulation, gentle and inefficient enforcement, and failure to intervene before serious harm has already been caused.

7.5.2 Don't Worry About Criticism

Some regulators are too concerned about political and media criticism. Critics should not be ignored, of course - they may be right! - but you often need to analyse their motives.

The media, for instance, like to write about arguments between regulators and large companies. It doesn't help that the latter have large PR budgets and spend much more time briefing the press than can any regulator. American companies, in particular, are often surprised at the speed and power of British regulators when compared with their US cousins.

Norman Blackwell argues that our financial regulators' driving objective is to avoid criticism for regulatory failures, with little incentive to balance that against regulatory costs. Rather than regulating through a small group of senior supervisors, the regulators employ a growing army of less experienced staff who are more likely to stick to a rigid interpretation of the rule book because they do not have the confidence or experience to take responsibility for balanced supervisory judgments. Much the same applies to some non-financial regulators. (See also 6.4.5 below)

All regulators need to ensure that their activities incentivise worthwhile outcomes. Monitoring and inspections are in the armoury of most regulators, but they need to be much more than mere tick-boxing.

Many regulators are also very concerned about losing in court. Lack of resources is one problem. One court, some years ago, noted that the appellant's costs had been around £1.4m. The regulator's had had been £240k. Today's figures would be much higher, although the proportions will not have changed.

This problem is exacerbated by the way (as noted above) that their cost/benefit analysis favours appellants. One company cheerily told a colleague of mine that "Of course we will appeal all the way. We don't think we will win but, given the payoff could be massive, even a 10% chance makes it worth taking the bet given the legal costs are so small."

But regulators must not shrink from testing borderline interpretations of their powers even where legal clarity is needed. The media can be quite vicious when a regulator loses a court battle but regulators should not back off - otherwise the borderline shifts, and then maybe shifts again, always in favour of those regulated entities that don't want the rules to apply to them. Regulators' Boards and their policy opposite numbers in government departments need to be very concerned about this danger. This is easier said than done, however, if you are a medium-sized UK regulator up against a global firm such as Pfizer, Google or Tesla.

Equally, however, regulators do need to respond sensibly when the courts order a rethink. It is often the case that a court will require a regulator to 'go off and do it properly'. This is an opportunity to learn, and try again; not a defeat.

7.5.3 Light Touch Regulation

It is particularly dangerous for regulators to be told to apply a 'light touch' so as to encourage growth, competitiveness etc. The 2008 financial crisis was the most damaging resultant example of this. Prime Minister Tony Blair had previously characterised the activities of the financial services regulator, the FSA, as 'hugely inhibiting of efficient business by perfectly respectable companies that have never defrauded anyone'. The FSA's Chair angrily responded in a letter to the Prime Minister, saying that '[this characterisation] is not one that we recognise or can accept.... 'We are not an enforcement-led regulator'.

Future Prime Minister David Cameron made an equally inappropriate intervention in March 2008 - well after the start of the financial crisis - when he proclaimed that 'As a free-marketeer by conviction, it will not surprise you to hear me say that the problem of the past decade' is 'too much regulation'.

By the end of the financial crisis, UK taxpayer support for the banking sector totalled £850 billion, and the cost of the consequential economic recession was estimated by the Bank of England to be up to £7,400 billion.

Around the same time, the CQC's 'light touch' approach meant that various scandals involving the appalling treatment of the elderly and people with learning disabilities were exposed by the media and other organisations, and not by the CQC. Its Chief Executive resigned in 2011 in advance of a critical Public Accounts Committee report. It was arguable, though, that the CQC was set up to fail. It started life as a very touchy-feely organisation which lacked the hard sceptical edge needed by any effective regulator. And then extra responsibilities were added time after time, so that it became unmanageable. Its senior team were people of integrity, committed to public service, and did not argue when asked to take on yet more and more work. They were probably therefore the wrong people for a perhaps impossible job. Their successors were encouraged to abandon light touch regulation, and the organisation gained some credibility. But it remained over-large and over-stretched and, as we saw above, it ran into another load of critical flak in early 2024, with the departure of another Chief Executive.

Numerous regulatory failings contributed to the Grenfell Tower disaster[8] in which 72 people died but ministers' focus on deregulation certainly made a big contribution. Much fire safety compliance had been outsourced to businesses who were anxious not to upset those whose performance they were meant to be assessing. And departmental officials felt that ministers would be unsympathetic to calls to tighten up regulation in this area.

A more recent 'light touch' disaster was Ofgem's excessive encouragement of competition ('shopping around') as a result of which they allowed several poorly funded entrepreneurs to sell energy to consumers before the spike in energy prices wiped them out. Ofgem ensured that those consumers could continue to buy energy, but it cost the rest of us £94 each.

It is of course extraordinarily hard to get the balance right. Every significant regulatory failure is followed by calls for stronger regulation, but this is inevitably followed, some time later, by equally strident calls for regulators to adopt a lighter touch, and be more "pragmatic". But the catastrophes listed earlier in this note were surely so dreadful that they cannot be characterised as the result of risks which were worth taking.

It will be particularly interesting to track the regulation of semi- and fully-autonomous vehicles. Automation complacency (leading, for instance, to driver inattention on longer journeys) is almost certain to lead to problems.

Over the longer term, it may be possible to see a clearer pattern. First an innovation takes place – a new product, vapes for example, comes to market. But some problems emerge: perhaps fears that the flavours are marketed to children. That leads to regulation, perhaps because something has gone wrong (e.g. a child has died). As the market matures, both producers and consumers know more about the product and which ones are trustworthy. There are calls for reduced

[8] https://www.regulation.org.uk/ob-grenfell_tower.html

regulation, which may then be reasonable. But meanwhile, some producers are tweaking the product and creating new risk and the cycle starts again.

7.5.4 Enforcement Practice

There are regular and frequent complaints that our 'watchdogs' lack teeth, or fail to bare them.

Water pollution is yet again a serious problem. No-one was impressed that the Environment Agency prosecuted only 7% of the 495 serious pollution incidents recommended for prosecution between 2016 and 2020.

It took four years before anyone took effective action to stop criminals dumping stinking waste in Hoad's Wood, a previously beautiful bluebell wood and Site of Special Scientific Interest. 27,000 tonnes of waste had been dumped in those four years.

There are often numerous reasons for failures such as these. Here are the main ones.

Insufficient powers can be a problem. Ofsted, for instance, has pointed out that it cannot inspect or close down unregistered schools even though the Independent Inquiry into Child Sexual Abuse has expressed grave concern about safeguarding issues in such schools.

Weak penalty powers are soon spotted by those tempted to ignore regulatory legislation. The risk of being caught, combined with the punishment that might ensue, almost always appears substantially less than the potential profits from dishonesty. Royal Mail (turnover £7,800m) were hardly likely to be bothered by a £5.6m fine for when it delivered only 82% of fist class mail on time. (Its target was 93%.) South West Water was fined 161 times over 10 years.

Lack of resources is often an even bigger problem, especially following a decade or more of so-called austerity. There can't be many regulators whose resources have not been reduced in real terms, sometimes severely.

But regulators are not powerless. It is very much in own interests, let alone of those who they are protecting, that they make it crystal clear - with reasoning - when they lack the necessary legal powers or resources. They do not need to openly criticise their sponsor department. But the facts should be laid out, clearly and politely, in documents such as Annual Reports as well as when briefing stakeholders and the media. Former Durham Chief Constable Mike Barton used just the right tone when he said that "You can hold me to account on the quality and the efficiency with which we do our work. But you can't hold me to account on the resources that we have. That is decided by others.... There has been a 30% real term cut in police resources since 2010."

There sometimes seem to be **systemic problems**, including very slow legal processes.

Ian Hirst, writing in the FT pointed out that 'FTX was a large international cryptocurrency business with a peak valuation of $32 billion and 130 affiliates. After a one month trial and less than a year after its collapse its CEO was found guilty of one of the largest frauds in American history. The Patisserie Valerie chain of cafes that operate exclusively in the UK collapsed and its Chief Financial Officer was arrested in 2018. Five years later, the Serious Fraud Office announced it had three million documents to assess and a further 2+ years must elapse before the start of a 13 week trial. Something is wrong here!'

Other system weaknesses have clearly been caused by regulators themselves. Ofsted wanted to reduce the inspection burden where they could and so stopped inspecting 'outstanding' schools, half of which needed to be downgraded when eventually re-inspected. It has been reported that other regulators employ call centres (rather than travelling inspectors) to check on compliance by asking tick-box questions over the phone. This undoubtedly helped create impressive management statistics but it does not strike me as likely to identify serious compliance failures.

It is sometimes far from clear who is responsible, especially for enforcing environmental legislation. In the case of Hoad's Bluebell Wood, for instance, (see above) were the Environment Agency to blame for the four year delay, or the local authority or the Police?

7.5.5 Act Quickly

Regulatory enforcement can be 'before the event' (*ex ante)* or 'after the event' (*ex post*).

Examples of regulators that have *ex ante* powers include the CMA, which can prohibit mergers, and local authorities who can force us to leave our homes if they consider them dangerous.

Most regulators have *ex post* powers including the ability to impose penalties, remove licences and so on.

Many regulatory systems contain both sets of powers. *Ex ante* barriers to entry - such as driving tests and professional exams - greatly reduce the likelihood of failure but need to be backed up by *ex post* enforcement when rules are broken. Even if they don't have formal *ex ante* powers, most regulators want to create conditions where people choose to comply - by sharing information or guidance for example.

The obvious problem is that acting after the event can feel pretty pointless. A hospital trust was fined £733,000 following a baby's death. What good did that do anybody? I doubt it had much deterrent effect either in that hospital or elsewhere.

And yet much *ex ante* action is in practice impossible. 'You want to close down that maternity ward? Where else can mothers go?' And *ex ante* action can be resented by the target. 'You are impeding innovation.' 'Why can't I take the risk if I want to?' 'My bank will collapse if you do that, and then every customer will suffer.' As one American mayor ruefully commented after several citizens died following the collapse of a building known to be dangerous: "Ordering people to vacate their homes is a difficult and serious step".

This example underlines the need for regulators to have the power to, and be willing to, take *ex ante* action where there is the possibility of serious damage including serious threats to health and safety. Regulators that have *ex ante* powers need to act as soon as they can reasonably defend their decisions.

This particularly applies to a new regulator. It is much easier (and better) to act tough and back off later once you are convinced that you have got a good understanding of the issues and have identified where you need to focus your enforcement efforts (see 7.4.1 above) and have taken firm action against the worst offenders. Hardly anyone will tell you that you should toughen up again. But if you start by acting softly and letting offenders get away with it then future offenders will claim that you are being unfair. 'You allowed X to do it. Why can't I?' (A new teacher meeting a new class is an obvious analogy.)

Established regulators, too, need to have the courage to act on their concerns. Here are some examples of when regulators appear to have got it badly wrong.

In 2015 *Private Eye* noted there was no reason why tiny incompetent companies should thrive in the ultra-complex energy supply business shortly before the first bankruptcy occurred (GB energy in 2016). The magazine identified from published accounts several dubious practises which should have caused Ofgem to examine more closely the minnows they were so blithely licencing. A later report showed that Ofgem's retail team knew the score by 2019 and took a few belated actions but didn't manage to galvanise the Board itself. But 2019 was anyhow too late the market was already teeming with doomed minnows. There were 73 licensed energy suppliers at its peak, some so small they did not even to publish full accounts. Alarm bells should have rung long before that number was reached. The magazine pointed out how many of them had too little credit standing to obtain the forward contracts needed to hedge their risk price

The FCA had concerns about *Safe Hands* pre-paid funeral plans eight years before it collapsed causing 46,000 customers to lose a total of £60 million.

Then there is the point that Silicon Valley is proud of the fact that its disrupters 'move fast and break things'. This is fine when they are small but behaviour that would be fine in a plucky little start-up eventually becomes a problem. Wider society, too, eventually gets over the novelty of these new toys and starts taking stock of the resultant social, political and economic wreckage. But technology can become so ubiquitous that politicians and courts are rendered essentially impotent.

Examples include the ease with which the far right can use social media to organise its activities, and the widespread harm caused to young people by social media. eScooters - to be found being driven at speed on most city pavements - are another rather lower tech example of this phenomenon.

Legislators and regulators who act quickly to impose sensible regulation on new tech are not prohibiting its use forever. They are simply getting its use and its regulation in the right order, recognising that it can be almost impossible to impose effective regulation once the technology is in wide us. New medicines are a good example. We all want medicines to be safe. So we have a regulator, MHRA, to get the balance right between innovation and safety.

Companies under investigation will complain if they are named, but it is surely worse to let their customers carry on in ignorance of possible problems. It is important, of course, to avoid pre-judging the result of any investigation but it is hard to criticise purely factual briefing.

And many regulators have got it right.

The CMA bravely stood up to Microsoft when it wanted to buy Activision. An angry Microsoft complained that the UK was clearly 'closed to business' but eventually agreed to sell Activision's cloud gaming rights. This was, by the way, a nice example of a regulator having little alternative but to apply its black letter law. If Microsoft's criticism had been correct, the answer would have been for parliament to change the law.

Uber (London) knew of and did nothing to fix a loophole under which uninsured, unauthorised and unscreened drivers could borrow the accounts of other drivers and so appear entirely legitimate to Uber's customers. The regulator, TfL, took a firm line and threatened to remove

Uber's licence. This decision was, of course, made easier by the fact that there were many alternative providers of taxi-like transport in London.

The FCA quite correctly held out for years against issuing a banking licence to Revolut.

7.5.6 Prosecutions

Perhaps unfortunately, criminal prosecutions seldom make sense.

The truth is that no-one seriously thinks about the risk of prosecution when making business decisions, so prosecution cannot act as an effective deterrent to poor decision making.

Then after the event, those who might possibly be blamed for causing a disaster (or their insurers) will always fight hard to clear their name, for the civil and reputational consequences can be severe. Formal inquiries, on the other hand, will most likely discover the truth, and the courts will ascribe civil responsibility on the balance of probabilities.

Prosecutions are altogether a different thing. Juries have to be sure beyond doubt - a much tougher test. And the consequences of a criminal conviction are serious and life-changing. Those charged will therefore fight exceptionally hard to avoid conviction, and prosecutors have to work extra hard, and prepare water-tight evidence and arguments, which takes a long time.

Worse still, non-criminal investigations and inquiries are forced to wait until criminal charges are settled one way or the other, or witnesses will be exceptionally cautious in the way they respond to non-criminal investigators' questions.

The Corporate Homicide Act was watered down by Tony Blair to be more business friendly and is entirely unfit for purpose. Section 18 explicitly prevents any individual - senior manager, director, board member, owner or shareholder - being prosecuted under the Act. Any breaches have to be gross and fall far below what can reasonably be expected.

Prosecutions, especially for corporate manslaughter, are therefore usually very bad news for those mainly interested in understanding the causes of an incident, and avoiding its repetition.

7.5.7 Professionals & The City

It is particularly hard to regulate the behaviour of professionals. There's a lot of self-regulation, for a start, which adds some interesting dynamics. Indeed most professional regulation, whether of barristers, doctors or accountants, started from self-regulation by professional bodies. Another problem is that professionals expect and usually deserve considerable respect from those outside their professions. This from Private Eye's 'MD' gives a feel for the sort of issues that can arise:

> "In an ideal world a wise and competent regulator would quickly weed out the dangerous doctors (e.g. rogue breast surgeon Ian Paterson) while showing understanding and compassion for those who make human errors in inhumane working conditions (e.g. Hadiza Bawa-Garba) or have been vexatiously referred to the GMC for, say, daring to blow the whistle on unsafe care (Raj Mattu) [but] a recent survey by the Medical Protection Society found that nearly a third of those who responded experienced suicidal thoughts during the

investigation. ... Having failed to stop the Bristol heart surgeons ... and waiting until Harold Shipman was incarcerated before striking him off, the GMC has tried to up its game by punishing more minor transgressions."

So it is important to remember that a small proportion of professionals can be just as devious and untrustworthy as anyone else. The 1,100 PwC trainee accountants who were caught cheating (by sharing answers) in their exams were an interesting example of this.

It is even more difficult to regulate the financial services industry (aka 'the City').

One problem is that Ministers and regulators are highly susceptible to lobbying from City grandees. Treasury ministers met financial services business leaders 200 times in 2021 compared with around 10 meetings with consumer organisations. This also reflects the different financial resources available to those on the two sides of their debates.

And then there is unfortunate problem that the whole of the City works on the expectation that 'dog eat dog'. Even Warren Buffett, normally a stickler for corporate ethics, said "If you have to care who's on the other side of the trade, you shouldn't be in the business of insuring bonds" when answering his shareholders' questions about the accusation that Goldman Sachs tricked another large company into insuring sub-prime mortgage securities, despite privately believing them to be a very bad risk.

Harry Markopolos noted that "… the [financial services] industry is based on predator-prey relationships … If you don't know who the predator is then you are the prey." The result is that it has become necessary to construct an enormous regulatory edifice to protect consumers of financial services. There are now four regulators employing around 6,700 staff.

7.7 Concluding Comments

I am conscious that a significant proportion of the above advice consists of examples of regulation that has gone wrong in one way or another. So I do want to stress that the UK has world-leading regulation and regulators as well as a pretty good balance between under- and over-regulation. I could have listed endless examples of excellent regulation and excellent regulatory decision-making. But the document is long enough already so I hope that my focus on lessons-to-be-learned will be forgiven by my ex-colleagues as well as those new to the regulatory profession.

Finally, my initial draft was greatly improved by economists John Davies and Stephen Gibson[9], and by Marcial Boo, Chair of *the Institute of Regulation*[10]. I am hugely grateful to all three of them, and strongly recommend membership of the Institute. The errors that remain, and the occasional strident opinion, are of course mine alone.

[9] SLG Economics and Senior Fellow, Harvard Business School
[10] https://ioregulation.org/