

# Executive Summary

1. Almost all products, services and activities in the United Kingdom are regulated in one way or another. From the environment to finance, education to healthcare, and transport to energy, regulation plays a key role in public life and impacts significantly on markets, services and professional careers. Regulation contributes to a thriving, safe and fair society.
2. Given the distinctive and powerful role which bodies performing a regulatory function play in public life, the Committee undertook a review of the extent to which they uphold the Seven Principles. This Review is not intended as a commentary on the need or otherwise for regulation, or its effectiveness in particular situations. These are important issues which receive substantial, and sometimes controversial, attention elsewhere. The review does, however, reflect our fundamental belief that a regulatory body should conduct itself in ways which are – and are seen to be – ethically acceptable. This is an important aspect of its overall effectiveness.
3. We undertook the review by surveying a range of regulators, conducting interviews with selected bodies, holding roundtables with academics, regulators and stakeholders, and commissioning four pieces of academic research. We owe our thanks to all those who gave their time so generously.
4. The Committee has been struck by the complexity and disparity of the regulatory landscape, driven by historical and political contexts. Regulators comprise a patchwork of large and small bodies across sectors. They also have a variety of statutory powers, functions, governance and staffing arrangements, as well as standards of practice. Although we do not directly consider self-regulatory regimes as part of this review, much of the best practice identified here will be applicable to those regulators.
5. The commonality they share though is the need to maintain their integrity through independence – both from government and those they regulate – avoiding undue influence and ensuring the decisions they make are fair, well-reasoned and evidence-based. It is a complex space to negotiate and a difficult path to tread.
6. In light of the result of the June 2016 referendum in which the British people voted to leave the European Union (EU), the UK's regulatory landscape is likely to be substantially restructured in the coming years. Given the importance of supranational legislation for the UK's regulatory environment, domestic regulatory bodies are likely to become all the more important as the UK withdraws from the EU's legal framework. In this context, the Committee believes that maintaining the highest ethical standards within regulatory bodies continues to be of the utmost importance.
7. This review was intended as a 'health check' of an important and distinctive slice of public life which the Committee has not previously examined in detail. It was not prompted by any particular trigger event. During the course of the review, however, we came across variances in ethical standards which cause us some concern. Recognising the breadth and range of regulatory bodies, we do not envisage a 'one size fits all' approach. But across all regulators, we believe strongly that the adoption of good practice identified by the Committee would enhance ethical standards of regulators which, in turn, would have a significant impact on regulatory effectiveness.
8. The Committee has grouped this best practice into six key areas, so that all regulatory bodies can check the approach of their own organisation to the ethical standards they should be upholding. We believe that, as far as possible, these can be achieved without the need for statutory changes.

## Our Recommendations for Best Practice

### Governance

9. Leadership in ethical standards is determined, in part, by the governance arrangements of the regulatory body. These governance arrangements are critical in helping to set an ethical tone. Regulators' governance should promote collective decision making to help the organisation exercise fair and balanced judgement. The Committee's review has shown that the upholding of the Seven Principles of Public Life in regulatory bodies is dependent on the organisation's leadership, and their efforts to prioritise and promote these standards.
10. Regulatory boards need to recognise the importance of maintaining the highest behavioural standards and to encourage the same behaviour by their staff, so as to promote trust from the public, those they regulate and the government. Boards should therefore have processes in place to ensure that high standards of ethical behaviour run throughout the body.

**Best Practice: The board is responsible for providing leadership and setting standards on ethical behaviour within the organisation. The board should seek regular evidence-based assurance that the highest ethical standards are being upheld.**

11. Governance structures should ensure that power is not overly concentrated in one individual. This can help mitigate the risks that individuals might act for private gain or pursue their own agenda in regulation.
12. Non-executive or lay board members provide an important external perspective, bringing independent judgement and a challenge function, which is vital when the organisation experiences inappropriate pressure from the government or from those being regulated.

**Best Practice: Non-executive and lay members of boards – whether statutory or advisory – have an important role to play in ensuring that the regulatory body is beyond reproach in following the Principles of Public Life. All board members have a responsibility to ensure that adequate discussion of issues occurs before decisions are made.**

**Best Practice: Corporate governance arrangements should minimise the risk of conflicts of interest and individuals acting for private gain.**

13. On-going scrutiny of standards of behaviour in organisations – including openness and transparency – is key to ensuring that regulatory bodies are able to manage ethical challenges. Yet, the Committee has found that publicly-accessible registers of meetings, conflicts of interest and gifts and hospitality are not always maintained by regulatory bodies. In some instances these records are published in formats which prevent the public from easily holding the regulator to account. It is the responsibility of accounting officers or their equivalent to ensure that ethical practices are upheld throughout the organisation.

**Best Practice: Compliance with ethical standards of conduct should be confirmed in the published annual certification by accounting officers. Regular, published information should include up-to-date registers of meetings, conflicts of interest and gifts and hospitality. These should be publicly accessible.**

## Codes of Conduct

14. The Committee welcomes the evidence that codes of conduct setting out standards of expected behaviour are widespread across regulatory bodies. However, the extent to which these codes are embedded in the day-to-day practice of the regulators was varied and of uneven quality, sometimes within the same organisation. The Committee saw evidence of cases where staff working alongside each other, with the same access to highly sensitive information, were not covered by the same code of conduct.
15. The Committee is concerned about this inconsistency and the apparent lack of clarity and knowledge within some regulatory bodies about application of their code(s) of conduct to their staff and non-executive members. It is reasonable to expect that a code of conduct should cover all personnel.

**Best Practice: At least one code of conduct should cover all personnel. This includes executive and non-executive board members, employees, secondees, consultants, and contractors.**

**Best Practice: A regulatory body's code of conduct should be at least equivalent to the Civil Service Code, and reflect the ethical risks faced by the regulatory body.**

16. For a code of conduct to have an impact on individuals' behaviour, it is essential that the standards established in the code are embedded within the culture and processes of the organisation.

**Best Practice: The standards established in the code of conduct should be evident in the recruitment and appraisal processes of the organisation. Staff should be made aware of the importance and significance of upholding these standards at their induction and through regular training processes.**

## Revolving Door

17. Whilst the 'revolving door' of staff moving between regulatory bodies and the regulated entities or profession can bring benefits in terms of technical knowledge to the regulator and promote compliance within the regulated entities, it brings its own risks. Neither the appointment of individuals from the regulated sector, nor their movement to it, need be problematic. But, if not properly managed with adequate safeguards, the revolving door can be a serious threat to the regulator's essential integrity and independence.
18. This is not only true for board members and senior executives, but also for operational staff at lower levels of the organisation who may have more detailed knowledge about competitors' confidential information or regulatory intentions than those at the top. In order to ensure that these moves are conducted with integrity, and to promote trust in the regulatory body, regulators should be clear to their staff when they join the organisation about the post-employment procedures for all board members and key staff.
19. A mixed picture has emerged in the policies and procedures for managing the propriety issues around movement of personnel. Of the regulators we surveyed, under a third had policies on managing the movement of staff to those they regulate. Even fewer had policies on the recruitment of staff from the organisation or profession they regulate. The Committee is concerned that, where these moves remain unmanaged, regulatory independence is under threat.

**Best Practice: Policies and procedures should be in place to manage 'revolving door' situations where individuals come from, or go to, the regulated sector. These should apply to all individuals at any level of the organisation.**

**Best Practice: Where board members and staff are recruited from the regulated sector, relevant safeguards should be considered, such as isolation from the regulation of recent employers or exclusion from key meetings.**

**Best Practice: At every board meeting, members should be asked to declare any actual or potential conflict of interest and these should be publicly recorded. Where the board agrees that a conflict is inappropriate, the member should be recused from both the discussion and decision making.**

**Best Practice: The process for departing board members and senior executives should be in line with arrangements for ministers and senior civil servants as determined by the Advisory Committee on Business Appointments. In order to ensure that such moves are conducted with integrity, and to promote trust in the regulatory body, regulators should be entirely transparent about post-employment destinations and restrictions.**

**Best Practice: Additional safeguards should be considered for anyone who leaves the regulatory body. These include explicit prohibitions on disclosing confidential information, restrictions on contact with the regulator, and gardening leave requirements.**

**Best Practice: All individuals taking up positions subject to pre- and post-employment rules should be made aware of them at their appointment.**

20. In the regulatory world, non-executive and lay board members are likely to hold a portfolio of positions which may lead to conflicts of interest between the activities of the regulator and those of regulated entities; these portfolios could compromise the independent judgement of non-executive and lay board members.

**Best Practice: Particular care should be taken where non-executive board members have a live, concurrent post which could give rise to conflicts of interest. Any conflict of interest for non-executives should be established at the start of the selection process and actively managed to ensure there are no material factors impeding independence of judgement.**

## Independence

21. The Committee recognises the immense challenges that regulators face in striking the balance between competing pressures from the government and regulated sector.
22. On the one hand, visible independence is vital to ensure that there is neither short-term political interference nor any sort of bias or favouritism towards or against particular players. This freedom of action is needed to reassure investors, competitors, consumers, and employees. A number of regulatory leaders told the Committee that the imperatives of independence are now less well-understood, and given less weight, than during the major privatisation exercises of the 1980s and 1990s.
23. On the other hand, the Committee recognises that there is a spectrum of independence. There cannot be total independence from government, especially where ministers make appointments, provide funding and have made clear their own priorities. Absolute independence can also lead to regulators operating in a vacuum, isolated from the opinions and actions of those they regulate or those they protect.
24. The government has a legitimate, democratic interest in the strategic direction of a regulatory body and in its efficiency and overall effectiveness. However, governments must not be involved in the operational decisions of regulators as this would influence and undermine their judgement and their authority. Clarity and transparency about the interaction between regulatory bodies and the government can go a long way to allay fears of misplaced interference.

**Best Practice: The operational independence of regulators must be upheld. Ministerial guidance on operational aspects may be transparently considered, but should not be treated as binding, unless there are statutory provisions for such guidance.**

**Best Practice: Any ministerial guidance to a regulatory body on its strategic direction should be published online by the regulator.**

25. Ministerial appointments may have a material impact on the strategic direction and independence of the regulatory body. It is essential therefore that appointments to regulatory bodies follow proper process.

**Recommendation: Ministerial appointments must be made, in a timely and transparent manner, on merit, without patronage and with proper regard to the needs of the organisation.**

**Recommendation: Unless expressly authorised in the statutory foundation of the regulator, ministers should not have the power to hire or fire the Chief Executive or any other operational staff.**

26. While some significant ministerial appointments are subject to pre-appointment scrutiny hearings with relevant select committees, others are not. The Committee views these hearings as an important mechanism to check the suitability of the preferred candidate and ensure that there has been propriety in the appointment process. However, there is lack of clarity over which positions or bodies are subject to scrutiny and which are not.

**Recommendation: Each government department should publish a list of the appointments that are subject to pre-appointment scrutiny hearings, and the justification for those decisions.**

27. Regulators should actively engage with the regulated sector or profession to build knowledge and expertise about their environment, activities, plans, concerns and to promote compliance. They also need to be alive to the risks of being improperly influenced by partial information or lobbying from the sector as a whole or from particular organisations or individuals.

**Best Practice: While constructively engaging with the regulated sector, regulators should guard against the dangers of 'regulatory capture'. Regulators should seek to ensure that staff at all levels are clearly aware of conflicts of interest and are explicitly advised about the risks of bias in decision making.**

28. Regulators may seek to diversify their income streams. However, some funding arrangements have the potential to compromise a regulator's independence by enabling undue influence from those who fund regulation and increase the risk of decisions being based on financial, rather than impartial judgement. Risk-based selection can help to ensure that regulators are not 'leant on' by ministers or other political influences, but remain neutral when selecting targets for regulation.

**Best Practice: Regulators should regularly publish full and accessible information on their sources of funding and, specifically, any restrictions proposed by those who provide their funding. Regulatory bodies should demonstrate that funding mechanisms do not have an impact on their independence and integrity.**

## Transparency

29. Regulators should exercise their judgement in balancing the demands of their role and protecting sensitive information whilst also seeking to be as transparent as possible by not withholding information from the public. This can be managed through publishing publicly-accessible transparency data on the functioning of the regulator, and ensuring that any pertinent information on regulated entities is published once it is no longer sensitive.

**Best Practice: Regulators should publish and update their corporate governance documents. These should include minutes of meetings, registers of interests, annual reports, their rules and guidance and their decision making processes.**

**Best Practice: Any body with regulatory functions not designated a 'public authority' under the Freedom of Information Act 2000, should have a publication scheme in line with the best practice established by the Information Commissioner's Office.**

## External Leadership

30. Although the focus of the Committee's review has been on standards of conduct within regulatory bodies, regulators are well placed to support a wider ethical environment. There has been much comment in recent years about the damage caused by poor ethical standards in some parts of the commercial world. The unique influence possessed by regulatory bodies gives rise to a leadership opportunity, and responsibility, to promote ethical standards, especially in terms of positive approaches to compliance. There is growing evidence that regulatory effectiveness is maximised by a collaborative approach that actively promotes compliance as enlightened self-interest rather than a reliance upon deterrence and punishment.

**Best Practice: Regulators should actively engage with those they regulate and take a leadership role by encouraging positive attitudes towards compliance.**

**Recommendation: Such promotion of an ethical approach to compliance would be supported by a suitable amendment to the Regulators' Code.**

## Conclusion

31. Overall, the Committee has been reassured by the level of awareness and consideration of ethical issues by the regulators we reviewed. We found that they generally do understand the importance of supporting and maintaining ethical standards and have succeeded in establishing acceptable standards in their organisations. However, practice varies, and we did come across examples of *ad hoc* or retrospective action to deal with issues as they emerged. Whilst welcoming good practice, we would warn against complacency.