Regulatory institutions and practices

Draft Report
Summary version

March 2014

The New Zealand Productivity Commission

Date: March 2014

The Commission – an independent Crown entity – completes in-depth inquiry reports on topics that the Government selects, carries out productivity-related research and promotes understanding of productivity issues. The Commission's work is guided by the New Zealand Productivity Commission Act 2010.

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Terms of reference

IMPROVING THE DESIGN AND OPERATION OF REGULATORY REGIMES

Purpose

1. The purpose of this inquiry is to develop recommendations on how to improve the design of new regulatory regimes and make system-wide improvements to the operation of existing regulatory regimes in New Zealand. The inquiry is not a review of individual regulators, specific regulations or the objectives of regimes.

2. The aim is to improve the design and operation of regulatory regimes over time and ultimately improve regulatory outcomes.

Context

3. This Government is focused on delivering better regulation. We have improved the processes around introducing new regulation, increased our understanding of the stock of existing regulation, and conducted a number of significant regulatory reviews. There is more that can be done to improve the design and operation of regulatory regimes in light of the recent need to develop new or amended regulatory regimes and regulators to manage instances where regulation has not achieved its intended outcomes.

4. The demands on regulatory regimes are often more complex than in the past. The range of regulatory regimes, the nature of the risks involved, the expectations of the community, and the regulatory tools available to achieve regulatory objectives, are wide and varied. It is crucial that government has a good understanding across regulatory regimes of their issues, challenges, similarities and differences and how to improve their design and operation.

Scope

5. Having regard to the above purpose and context, the Commission is requested to undertake an inquiry that addresses the parameters set out below.

An overview of regulatory regimes and their regulators

6. Develop a high-level map of regulatory regimes and regulators across central government, including their organisational form.

7. Develop a set of thematic groupings which can be used to broadly categorise regulatory regimes by their objectives, roles or functions. For example core objectives might include health and safety, environmental protection, or economic efficiency.

Understanding influences and incentives on regulatory regimes

8. Outline and explain key factors which act as incentives or barriers to regulatory regimes and regulators producing the outcomes stated in legislation. For example these factors may include:

- institutional form of the regulator
- quality of the regulatory design and clarity of mandate, functions and duties
- resourcing and funding
- capability
- approach to consultation and engagement with stakeholders
- accountability mechanisms, including the ability to challenge regulatory decisions
- performance measurement and reporting
- external monitoring
- approach to risk management and innovation

9. Undertake a series of case studies to compare and contrast the approaches taken to these factors across different regulatory regimes. A key part of this analysis would be to identify strengths and weaknesses of different approaches taken to these factors to support broader insights into the design and operation of regulatory regimes.

10. This analysis should be undertaken in the context of existing guidance about good practice for the performance of different regulatory functions.

Recommendations

11. Develop guidance that can be used to inform the design and establishment of new regulatory regimes and regulatory institutions, and the allocation of new regulatory functions to existing institutions. The guidance should take into account other existing work in this area to avoid duplication, such as the State Services Commission's *Reviewing the Machinery of Government*.

12. Develop system-wide recommendations on how to improve the operation of regulatory regimes over time. The recommendations may include how to both build on strengths and address weaknesses in current practices and may lead to general comments about key differences between regimes within thematic groupings. The recommendations will not be specific to particular regulations or regulators.

13. The Commission should also specifically consider how improvements can be made to the monitoring of regulator performance across central government.

14. In developing the recommendations, the Commission should take account of any key features or characteristics of New Zealand's regulatory environment that differ from other jurisdictions. For example, these may include differences in scale, resourcing, or the need to coordinate with overseas regulatory regimes.

Other matters

15. The Commission should prioritise its effort by using judgement as to the degree of depth and sophistication of analysis it applies to satisfy each part of the Terms of Reference.

Consultation requirements

16. In undertaking this inquiry the Commission should consult with key interest groups and affected parties, including on the selection of case studies in paragraph 9 above. Consultation should include both regulators and those subject to regulation.

Timeframe

17. The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 30 June 2014.

Referring Ministers

Hon Bill English, Minister of Finance
Hon John Banks, Minister for Regulatory Reform

About the summary version

This "summary version" provides the key points, questions, findings and recommendations from the Productivity Commission's draft report as part of its inquiry into *Regulatory Institutions and Practices*.

The report contains the Commission's draft guidance that can be used to inform the design and establishment of new regulatory regimes and regulators. The report also makes system-wide recommendations on how to improve the operation of regulatory regimes in New Zealand over time. The inquiry is not a review of individual regulators, specific regulations or the objectives of regimes.

The report follows the release of an issues paper in August 2013; consideration of submissions; a large number of meetings with interested parties; and the Commission undertaking its own research and analysis.

The report asks questions and then gives draft findings and recommendations. The Commission welcomes information and comment on any part of the report and on any issues that participants consider relevant to the inquiry's terms of reference.

To see the full version of the draft report - including information on how to make a submission – please visit our website www.productivity.govt.nz.

Key inquiry dates

Submissions due on the draft report	8 May 2014
Engagement with interested parties on the draft report	March – May 2014
Final report to the Government	30 June 2014

Format of the summary version

Key points

- The key points box at the start of each chapter is a summary of the main considerations and findings on each topic.

Q Questions

F Findings

R Recommendations


What do New Zealand regulators regulate?
Electricity industry
(Electricity Authority, Electricity Industry Act 2010)
Competition in markets
(Commerce Commission, Commerce Act 1986)
Telecommunications services
(Commerce Commission, Telecommunications Act 2001)
Conduct and practices in trade
(Commerce Commission, Fair Trading Act 1986)
Offering of securities
(Financial Markets Authority, Securities Act 1978)
Energy use
(Energy Efficiency and Conservation Authority, Energy Efficiency and Conservation Act 2000)
Financial markets
(Financial Markets Authority, Financial Markets Authority Act 2011)
Psychoactive substances
(Ministry of Health, Psychoactive Substances Act 2013)
Insurance sector
(Reserve Bank of New Zealand, Insurance (Prudential Supervision) Act 2010)
Building activity
(Ministry of Business, Innovation, and Employment, Building Act 2004)
Civil aviation
(Civil Aviation Authority, Civil Aviation Act 1990)
Protection from fire
(New Zealand Fire Service Commission, Fire Service Act 1975)
Broadcasting
(Broadcasting Standards Authority, Broadcasting Act 1989)
Use of fisheries
(Ministry for Primary Industries, Fisheries Act 1996)
Health and disability services
(Health and Disability Commission, Health and Disability Commissioner Act 1994)
Maritime transport
(Maritime New Zealand, Maritime Transport Act 1994, Maritime Security Act 2004)
Movement of goods and services across the border
(New Zealand Customs Service, Customs and Excise Act 1996)
Walking access to the outdoors
(New Zealand Walking Access Commission, Walking Access Act 2008)
Hazardous substances and new organisms
(Environmental Protection Authority, Hazardous Substances and New Organisms Act 1996)
Sale of food and wine
(Ministry for Primary Industries, Food Act 1981, Wine Act 2003)
Use of natural and physical resources
(Ministry for the Environment, Resource Management Act 1991; Department of Conservation, Conservation Act 1987)
Greenhouse gas emissions
(Ministry for the Environment, Climate Change Response Act 2002)
Rail transport
(New Zealand Transport Agency, Railways Act 2005)
Land transport
(New Zealand Transport Agency, Land Transport Management Act 2003)
Individual privacy
(Privacy Commission, Privacy Act 1993)
Management of pests and unwanted organisms
(Ministry for Primary Industries, Biosecurity Act 1993)
Films, videos, books, and other publications
(Office of Film and Literature Classification, Films, Videos, and Publications Classification Act 1993)
Education
(Ministry of Education, Education Act 1989)
Animal products
(Ministry for Primary Industries, Animal Products Act 1999)
Medicines, medical devices, and related products
(Ministry of Health, Medicines Act 1981)

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Overview

The Government has asked the Commission to examine how the design and operation of regulatory regimes and their regulators can be improved – ultimately to improve regulatory outcomes. Specifically, the Commission has been asked to develop guidance that can be used to inform the design and establishment of new regulatory regimes and regulators. It has also been asked to develop system-wide recommendations on how to improve the operation of regulatory regimes in New Zealand over time.

Why this inquiry is important

Regulation touches the lives of New Zealanders in many ways. It is indispensable to the proper functioning of economies and societies. Regulation, when implemented well, underpins markets, protects the rights and safety of citizens, and their property, and assists the efficient and equitable delivery of public goods and services (Organisation for Economic Co-operation and Development [OECD], 2011). In this way, regulation is an important tool for preserving and advancing the public interest.

This report demonstrates that New Zealand has a large and complex regulatory sector, comprising as many as 200 regulatory regimes. More than 10,000 people work in regulatory roles. Yet there is surprisingly little information about regulation and its effects or about the wider regulatory system, and its performance (Chapter 3). This is in stark contrast to the voluminous data that is produced, disseminated and scrutinised about New Zealand's fiscal management (taxing and spending).

There is also a question of whether New Zealand's regulatory regimes are unnecessary complex and whether they could be simplified, recognising that capability and expertise, for regulators and regulated alike, is likely to be an ongoing issue. There are limits to how much complexity a small country like New Zealand can sustain.

There has been a growing interest in regulation in New Zealand. This interest stems from a number of important developments:

- individual freedoms and human rights have taken on greater importance in New Zealand society, as signalled by such developments as the passing of a Bill of Rights Act in 1990 and Human Rights Act in 1993;
- there has been a growing awareness of the role that good-quality regulation and institutions can play in promoting economic growth, and that bad regulation can impede productivity and growth;
- reforms over the last quarter of the twentieth century changed the way in which government organises itself, provides services and delivers policy; and
- society is much more diverse, with a broader range of attitudes to risk and expectations about what government can do.

These changes have made regulation a more visible and important government activity. They have also underlined the importance of making sure that the design of regulatory institutions and their operation achieves important public policy goals. If regulation has misplaced objectives, is used when it is not needed, or is poorly designed and executed, then it can fail to achieve policy objectives and have unintended consequences that harm the wellbeing of New Zealanders.

Regulatory failure occurs where regulations fail to improve outcomes, or even make outcomes worse, than if there had been no regulation. The two main ways regulation can fail are failures of design or failures of operation. Poorly conceived and implemented regulatory arrangements can also impose significant costs. Such costs affect business productivity and profitability, and the wealth of individuals and families. Ultimately this will harm the country's economic performance and wellbeing.

Good regulatory design and practice can reduce the likelihood of regulatory failure. The institutional arrangements and regulatory practices that make up the architecture of regulatory regimes shape how

regulators and those regulated behave, the quality of decision making, and ultimately the success of regulatory regimes in achieving the desired outcomes. Indeed, developments in the theoretical literature point to a move "towards a growing emphasis on institutional design and a coupling of this with a more detailed differentiation of motivations and behaviours as these are encountered in the body of politicians, regulators, and the regulated that makes up the regulation community"(Baldwin, Cave & Lodge, 2012, p. 11).

This inquiry seeks to better understand what regulatory institutions and practices look like in New Zealand and how they can be improved. The inquiry examines:

- which organisational forms are best suited to particular circumstances;
- the appropriate level of independence;
- how regulators are governed, held to account, make decisions, engage with industry and the public, and carry out their regulatory practices;
- how regulators are resourced; and
- how regulators develop the capability needed to regulate efficiently and effectively.

Getting these right not only means the objectives of regulation will more likely be achieved but, importantly, it builds legitimacy and trust in the regulator and regulatory regime and, with that, a higher level of trust by society.

Key features of New Zealand regulation

Regulation is the product of an interaction between a number of actors within and outside of government, and can best be thought of as a system. To develop proposals for improving regulation, it is important to understand the features that affect the regulatory system. These features can include constitutional arrangements, history, cultural practices and expectations, geography, levels of national wealth and economic structures. Five main features have a significant impact on how regulation is made and implemented in New Zealand:

- a centralised and statute-driven system, with comparatively few checks and balances;
- resource constraints, driven by New Zealand's small population, distance and relatively low incomes;
- a weak review and evaluation culture;
- the acknowledgement of Māori interests in regulation; and
- the increasing role of international regulatory standards.

These features lead to some system-wide themes in how regulation is developed and implemented in New Zealand.

- A number of important regulatory regimes in New Zealand are young and are still settling down. Electricity and telecommunications are the most prominent examples. This has created perceptions of risk and instability.
- Regulatory regimes in New Zealand can easily become rigid and obsolete. This reflects the strongly statute-driven system in New Zealand and the weakness of review and evaluation systems. As a result, New Zealand regulation can struggle to keep up with changes in technology or public expectations.
- New Zealand has applied different regulatory models across similar issues, rather than applying a coherent and consistent approach. This increases compliance costs on firms operating across multiple regimes, and limits the ability of regulators to learn from each other's experiences.

- Although official recognition of Māori interests in regulation has increased since the 1980s, questions remain over how best to recognise Māori interests and Treaty of Waitangi principles, and mechanisms for ensuring effective participation by Māori in the implementation of regulation are still developing.

New Zealand is notable for having regulatory systems that score highly on numerous international measures of quality, while also being the subject of criticism for instability and inconsistency (Chapter 2).

Better understanding New Zealand's regulatory system

The Commission has found that the lack of regular and detailed reporting about the state of New Zealand regulators and regulation is a key gap in the current regulatory management system. More comprehensive and comparable information about New Zealand regulators should be collected to help offset barriers to identifying and making systemic improvements to regulatory practice. In particular, such information could:

- help designers of regulation compare and contrast regulatory approaches and features;
- help regulators identify better practice among their peers that they might adopt in their own operations;
- be used to identify trends or patterns in implementing regulation or in the performance of regulators; and
- improve knowledge about the scale and scope of regulatory activity in New Zealand and enable more informed debate about regulatory matters.

Standardised reporting requirements should be designed to allow analysis of the structure, scope, efficiency, effectiveness, and responsiveness of regulators, as well as of the burden that regulation imposes on regulated parties. More transparency would increase the accountability of New Zealand regulators. Chapter 3 provides an indicative suite of reporting information – feedback is sought on the type of information that regulators should be required to report.

Standardised reporting on regulatory activity and impacts should be embedded into existing accountability processes, such as agency annual reports. The Treasury and the State Services Commission (SSC), as the central agencies responsible for the public sector accountability framework, should develop standardised reporting requirements for annual reports.

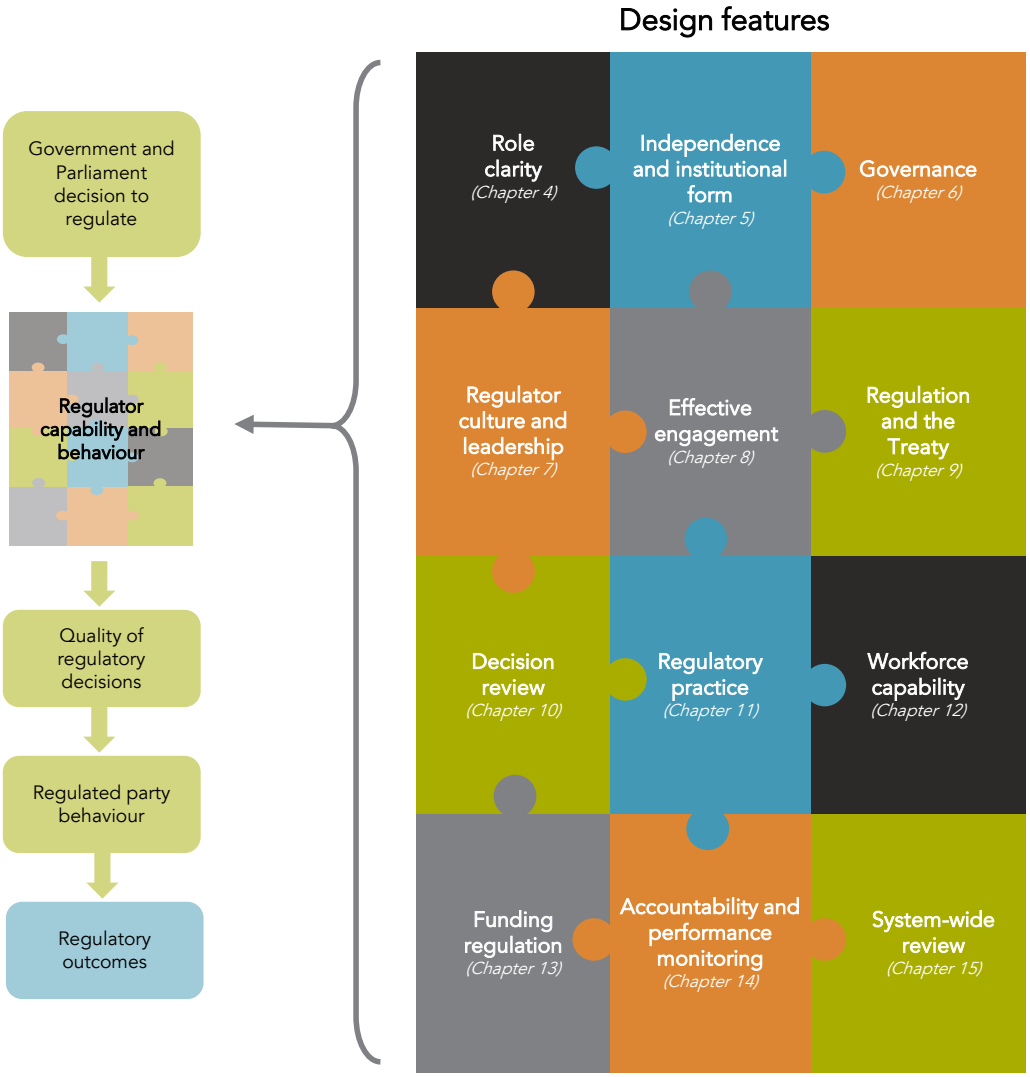
Information from standardised reporting could be formally integrated into the Treasury's regulatory management systems. In particular, it could be used to identify any parts of the regulatory system that need improving, and underpin strategies to make those improvements across the system.

Improving regulatory institutions and practices

The report examines the design features listed in Figure 0.1. Separate chapters consider each feature to determine how they can improve the capability of regulators to make sound decisions that maintain and advance the public interest.

These design features are interconnected, and in a well-designed system will be mutually reinforcing. For example, if roles are clearly defined, this will make it easier for regulators to develop effective cultures and regulatory practice. Likewise, the level of regulatory independence will determine the accountability, performance and monitoring framework that is most appropriate.

Figure 0.1 **The Commission's approach to this inquiry**



Role clarity

Clear regulatory roles and objectives are critical to regulator accountability and focus, compliance by regulated firms, predictable decisions and enforcement, and the legitimacy of the regime. Regulatory regimes with clear objectives are more likely to enjoy high levels of compliance and credibility, and regulators with clear and well-understood roles can more easily be held to account (Chapter 4). But achieving "clarity" is not a simple or straightforward task due to the complex issues regulation often deals with, the multiple stakeholders in any regulatory regime, and the large amount of existing regulation.

Manifestations of poor role clarity include: the expansion of regulatory scope beyond its original mandate; duplicated or contradictory regimes; gaps in regulation, monitoring or enforcement; or inconsistent enforcement. Most businesses that the Commission surveyed found contradictory or incompatible regimes and regulators poorly managing duplicated compliance requirements.

Regulatory regimes may lack clarity because:

- the regulatory standards used (outcome-, principle-, process- or input-based) do not fit the industry or activity being controlled;
- policymakers give insufficient guidance about the desired objectives;
- regulators have functions that create conflicts of interest; and
- little attention was paid (when designing the regulatory regime) to the role of other regulators or the interaction of different regimes on regulated firms.

Actions that can improve the clarity of regulator roles, functions and objectives include:

- ensuring that the regulatory standard used is appropriate;
- applying greater discipline on those who design regulatory regimes;
- avoiding perverse incentives when allocating regulatory functions to agencies; and
- establishing processes to minimise or resolve problems arising from overlapping regimes.

Issues to be considered in selecting the right regulatory standard are the level of harm that would arise from non-compliance, capability levels in the regulator and the regulated industry, and the levels of trust between the industry and regulator.

If a range of capability levels exists within a regulated industry, "deemed-to-comply" models can help to provide flexibility for more capable firms and certainty for less capable organisations. Deemed-to-comply models allow more capable firms to develop their own compliance strategies, while also providing detailed guidance for other firms on how to comply.

Legislative frameworks that minimise the number of objectives and conflicts and provide a clear hierarchy of objectives help to support consistent and predictable decision making by regulators.

Regulatory independence and institutional form

The institutional form of regulators, and the degree of independence with which they are expected to undertake their regulatory functions, are key considerations for designers of regulatory regimes.

There is widespread agreement of the desirability of independent regulators. Independence is multi-faceted and is significantly more than formal legal designation.

Independence supports regulators adopting effective regulatory strategies. It does this because independent regulators generally have more information and are better able to appraise risks than the media or the public. Designers of regulatory regimes need to carefully appraise the arguments for and against regulator independence. Arguments for political control need to be weighed carefully against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.

For most regulatory regimes, the arguments for providing more independent regulation will be stronger than the arguments for less independent regulation. It will usually be appropriate for regulatory powers to be exercised independently of political control so they are not used for partisan purposes.

Regulators often have to work with legislation that is outdated or not fit-for-purpose. Their independence could be enhanced by:

- ensuring greater consistency in the allocation of legislative material between primary legislation and types of secondary legislation;
- looking for opportunities to delegate more rule-making to regulators, particularly in areas with rapid technological change.

If rule-making power is to be further delegated, checks on regulators will need to be strengthened. One key check is the Regulations Review Committee of Parliament, which reviews regulations and can recommend their cancellation, if they are unfair, unusual or onerous. However, this cancellation power is seldom used. The Commission considers that the Committee should play a more active role, and makes some recommendations about what that role should include. The Commission is also seeking public comment on how the Committee's place in the regulatory system could be further strengthened.

Political imperatives will inevitably diverge sometimes from those of independent regulators. While political interference in independent regulatory regimes is undesirable, providing transparent mechanisms for political intervention is preferable to undertaking more fundamental regulatory reform to solve political

imperatives. Providing such mechanisms can actually enhance the independence of regulators. This also allows ministers to be properly held to account for their actions.

Choices about institutional form are in practice more important for what they signal about expected independence, rather than the legal constraints and freedoms associated with particular agency forms. As such, careful attention must be paid to establishing clear expectations, norms and cultures in new independent regulators.

Government has signalled an intention to consider reallocating some functions currently undertaken by Crown entities (which are operationally independent) into a new type of institutional form known as departmental agencies. The Commission has a number of concerns with this proposed new institutional arrangement for regulators (Chapter 5).

Regardless of the advantages or disadvantages of particular institutional forms, the disruptive effect of institutional change on the smooth operation of regulatory functions must be acknowledged. During periods of institutional change, leaders need to have clear strategies for ensuring regulatory functions continue to operate effectively.

Governance, decision rights and discretion

The internal governance of a regulator (the systems of direction and control), where decision rights sit within the organisational structure (who makes decisions and how they are made), and the discretion available to the regulator in making decisions, all affect the quality of decision making and the achievement of regulatory objectives (Chapter 6). Selection of governance structures in regulatory agencies appears in some cases to be ad hoc.

There is evidence of some confusion around the role that some members of Crown entity boards are expected to play. Individuals with expertise in the regulated industries can make a valuable contribution to regulator governance. However, updated guidance and induction material for members of Crown entity boards should make clear that members are not appointed to act as the representative or agent of any external group, and that good practice for managing conflicts of interest apply.

In most cases multi-member decision-making bodies will offer advantages, including the incorporation of different perspectives, better balancing of judgement, and reducing the likelihood of maverick judgments or capture. However:

- regulatory decisions may appropriately be vested in ministers where they involve significant value judgements not amenable to analysis, or have significant fiscal implications;
- day-to-day administrative decisions may be appropriately taken by individual officials (and internal review of these decisions can be a useful quality check).

In any system of authority there is tension between certainty and flexibility: between having definite rules and applying them consistently and even-handedly, and enabling decisions to be made according to the specific circumstances of the case and within a broader framework of goals and values.

The exercise of discretion is constrained by legal and non-legal methods of control, including judicial review and the common law principles of administrative law, cultural and institutional constraints, and transparency.

Regulatory culture and leadership

Organisational culture affects the way that regulatory agencies carry out their functions and is therefore important to regulatory success. Regulator culture refers to the shared norms, values and beliefs that influence the behaviour of the agency staff. These norms, values and beliefs are heavily influenced by:

- the beliefs, values and assumptions of the *founding leaders* of the organisation;
- the *learning experiences* of staff in the performance of their duties; and
- new beliefs, values, and assumptions brought in by *new staff, particularly new leaders.*

It is important to distinguish the impact of culture from the numerous other factors that motivate regulator behaviour. It is often too easy to attribute organisational dysfunction to "culture" issues rather than wider regulatory practices, structures and institutional issues.

Box 0.1 **Inquiry participants' views on what constitutes a good regulatory culture**

Submissions to the inquiry suggested that effective cultures:

- embrace the regulator's role as an educator and facilitator of compliance, as opposed to an enforcer of rules;
- encourage internal debate and robust, evidence-based decision making;
- behave with a high degree of individual accountability;
- encourage the exchange of information in an environment of trust; and
- appropriately match the interface with regulated parties to the type of regulation being implemented.

While generic conclusions are difficult, the Commission's analysis suggests the following.

- There is evidence of risk-averse cultures within New Zealand regulators. This may be appropriate for achieving the regulator's statutory objectives or, alternatively, may have emerged to protect the reputation of the regulatory body.
- Previous restructuring of regulatory organisations has required significant cultural shifts. The new culture has often been pivotal to the success of any structural changes.
- Stakeholders often perceive the quality of engagement as a "window" to the culture of a regulator. In making this connection, it is important to assess whether the regulator's approach to engagement is driven by its values and beliefs, or whether it is driven by some other factor – such as the legislative environment or available resources.
- A common understanding of the purpose and mission of a regulatory body is the first step in developing culture. While the Commission's survey suggests that chief executives believe corporate culture influences the behaviour of front-line staff, other survey evidence indicates that central government regulatory workers in New Zealand do not perceive that top managers communicate a clear organisational mission.

The culture of a new regulatory body can be shaped in a number of ways.

- Government can seed a "desirable" culture by appointing founding leaders with values, beliefs and experiences compatible with those it believes are most conducive to achieving the desired regulatory outcomes. Selecting the "right people" does not guarantee that the "right" culture will emerge, but the actions of founding leaders are key to embedding culture.
- Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.

While legislation can codify certain actions (such as consultation), it does not guarantee that a regulatory body will develop deeply held values around the importance of the behaviours. The culture of the organisation will evolve as its members discover what works and what doesn't work.

Effective consultation and engagement

When implementing regulation, effective engagement can help to reassure stakeholders and the wider community that good regulatory process is being followed, and that the decisions of regulators are robust, well-informed and well-reasoned. This promotes confidence that the decisions of regulators are in the

public interest and that they are evidence-based and impartial. This in turn helps build trust in the regulatory system and in the regulator. It also helps strengthen the legitimacy of the regime and improve the durability of regulator decisions.

Conversely, insufficient engagement can weaken community confidence and trust in both the regulatory regime and the regulator's ability to deliver sound decisions. Low community confidence can undermine the objectives of regulation by deterring compliance or making the decisions of regulators more likely to be challenged.

The choice of engagement mechanism is influenced by the goal of the interaction, and by the relative efficiency of alternative engagement mechanisms. Goals can range from merely *informing* stakeholders of their regulatory obligations, to *involving* them in regulatory decisions, to *empowering* them to make decisions. The strengths and weaknesses of different strategies are examined in Chapter 8.

In general, the greater the level of public participation, the more critical it becomes to ensure a common understanding of the goals of the engagement process. Failure to do so can result in unrealistic expectations around how much participants can affect the decisions of regulators.

When designing a regulatory regime, a key consideration is whether engagement strategies should be left to the discretion of the regulator, or whether statutory provisions are required to promote regulatory objectives of Parliament or protect fundamental principles of natural justice. (Notably, of the more than 50 statutes that the Commission examined, over half contain some form of statutory consultation requirement). This decision should be made in the context of other features of the regulatory regime – particularly the extent of discretionary powers assigned to the regulator, the level of regulator independence, and the strength of accountability mechanisms. The issues to consider when contemplating statutory obligations to consult are set out in Chapter 8.

Inquiry participants have raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement processes with predetermined views, and concerns that some regulators lack the capacity to engage affectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably the New Zealand Transport Agency and the Environmental Protection Authority (EPA).

Inquiry participants also advocated more extensive use of advisory groups and greater involvement of consumers in decision making (that is, through mechanisms such as "constructive engagement" and "negotiated settlements"). Such approaches change the very nature of the regulatory decision-making process and the role of the regulator, and are not without drawbacks. These include that stakeholders can lack the expertise, resources or time to effectively engage in technical decisions, it can be hard to ensure that the views of the broader community are represented, and it can generate unrealistic expectations around the extent to which stakeholders can affect the decisions of regulators.

Regulation and the Treaty of Waitangi

The continuing evolution of the relationship between the Treaty partners, and how the principles of the Treaty are interpreted by the courts, can generate considerable uncertainty for those applying Treaty principles in regulatory regimes where Māori have an interest and where the Crown has a duty of active protection.

References to the principles of the Treaty of Waitangi can be found in statutes where Māori have a relationship with the land, water, important sites, wāhi tapu and other taonga. However, "other taonga" can also encompass te reo, health and history. Most of these statutes contain regulatory provisions and create obligations on a range of parties that are not the Crown.

The inclusion of Treaty clauses can be seen as an insurance policy for both Māori and the Crown. A Treaty clause is a legal acknowledgement of Māori interests and rights, and provides a clearer definition of the Crown's responsibility with respect to those rights (to the extent that the absence of a specific clause might be interpreted more broadly).

Chapter 9 sets out important factors that officials should consider when recommending the inclusion of Treaty clauses in statutes that establish regulatory regimes or regulatory agencies. There is a question as to whether an overarching approach to Treaty principles in legislation would be preferable to the current "case-by-case" approach to the inclusion of Treaty clauses in legislation, with specific Treaty clauses in individual statutes where more guidance is required on how the Treaty principles are to be applied. The question for this inquiry is whether a different approach would improve the quality of regulation.

Excellence in regulatory practice cannot be legislated for. Good practice in upholding Treaty principles of partnership, mutual respect and good faith depends on senior leadership, good internal policies and processes, and guidance for regulatory staff and stakeholders.

The Commission has reviewed 10 examples of guidance from government agencies about how to apply Treaty principles. The overall quality of existing guidance material can be improved. The assessment framework used in reviewing the guidance material could be used as a tool to help regulatory agencies develop their own guidance about the application of Treaty principles.

Sharing good regulatory practice is one way to raise the standard of practice among regulators. Lessons from the experience of the EPA are identified that other regulators can adopt to improve their regulatory practice with respect to the principles of the Treaty of Waitangi. An important lesson for other regulators is that the investment in developing trust through good relationships can pay off in reduced costs and better regulatory decision making.

Decision review

In New Zealand, the courts have a constitutionally important role to supervise the Executive's actions, ensuring that the Executive acts reasonably, fairly, and within the bounds of the laws established by Parliament. Unlike in other countries, New Zealand courts have no role in supervising Parliament. Courts have no ability to strike down or invalidate legislation passed by Parliament.

Judicial scrutiny of the exercise of Executive power is particularly important in the area of regulation, given the coercive nature of those powers. Where Parliament provides for appeals, courts also provide a forum for parties to test that regulators have made "correct" decisions.

Appeals of regulatory decisions involve the courts scrutinising the merits and correctness of those decisions. Judicial review involves the courts scrutinising the process and legality of decision making. These are distinct processes. "Merits reviews" are appeals that look at the correctness of a decision.

Appeal rights of administrative decisions exist only where Parliament expressly provides for them. There is a perception that New Zealand statutes provide limited access to appeal of regulatory decisions, but this is not supported by research undertaken by the Commission. Most regulatory regimes provide for appeals, and only a small minority of regimes provide limited or no access to appeals.

Judicial review is an inherent power of the High Court, and so does not need to be provided for in statute. The Commission has found no evidence that judicial review is ineffective in ensuring the lawfulness and reasonableness of the Executive's actions. Attempts in legislation to exclude judicial review of the Executive are wholly undesirable.

The breadth of judicial review and appeals can vary widely in New Zealand, but in practice significant overlap exists between judicial review and appeal. In New Zealand the scope of judicial review is comparatively broad and can sometimes include scrutinising the substantive merits of the Executive's decisions.

The overlap between judicial review and appeal means that judicial review already adequately provides many of the advantages that submitters to the inquiry ascribed to merits review or appeals. This includes sharpening the incentives on decision makers to come to the correct decisions.

Appeal rights should be provided where the designers of regimes are confident the appeals will improve regulatory outcomes and support the objectives of the regulatory regime. This requires taking into account the costs and uncertainty that appeal rights create.

In deciding whether to provide for appeal rights of complex or highly technical regulatory regimes, designers need to critically assess the institutional capability and expertise of the court or tribunal reviewing the decision, relative to the decision maker at first instance.

A range of mechanisms is available that may support the institutional capability of the court or tribunal reviewing the decision to deal with appeals of complex and highly technical decisions. Two mechanisms are using technical experts as lay judges and providing for more inquisitorial processes.

The Legislation Advisory Committee (LAC) guidelines on review and appeal provide a good list of considerations to take into account when designing review and appeal provisions in regulatory regimes. The LAC notes that appeals:

- scrutinise and correct individual decisions, with the aim of providing redress; and
- maintain a high standard of public administration and public confidence in the legal system.

Even so, the LAC notes that the value of appeals must be balanced against the considerations of cost, delay, significance of the subject matter, competence and expertise of the decision maker at first instance, and the need for finality. It is unclear how much the LAC guidelines influence decisions about provision of appeals in the design or review of regulatory regimes.

Regulatory practice

A central concern in the design of a regulatory regime is ensuring its effective implementation and administration, so that the intent of the regime is met. However, the approach taken to monitoring, enforcement and operational compliance activity is typically left to the expert discretion of the regulator. Successful implementation of regulatory regimes will depend on the strategies, tools and methods regulators deploy.

Regulators around the world, including in New Zealand, have drawn heavily on theory in designing compliance and enforcement strategies, tools and methods. In particular, regulators have tended to adopt:

- Responsive regulation approaches, in which regulators select their compliance tool based on the attitude of regulated firms towards compliance. For firms that are willing to do the right thing, the regulator may select a low-cost tool (such as education); for firms that are unwilling to comply, the regulator may select high-powered tools (such as prosecutions).
- Risk-based approaches, in which regulators focus on identifying and assessing the risk of harm from non-compliance and target their resources towards reducing the greatest harms.

In practice, implementation of either approach has involved considerable challenges, for example:

- regulators can face barriers to using high-powered tools, such as prosecutions; and
- a risk-based approach does not necessarily solve the issue of what risks to prioritise, how to deploy regulator resources, or what enforcement tool to use.

Both risk-based and responsive approaches are evident in New Zealand regulator strategies, although agencies differ in the extent to which they prioritise reducing harm or maximising compliance, and the extent to which the two objectives are integrated or treated separately.

Regulatory scholars Robert Baldwin and Julia Black have developed the concept of r*eally responsive regulation* – a more nuanced institutional approach to regulatory practice and compliance, which sees regulators being attentive and responsive to a broad range of factors in undertaking their regulatory practices.

There is evidence that some New Zealand regulators are demonstrating elements of the really responsive approach. However, evidence also suggests that New Zealand regulators are not paying enough attention to how their regimes perform over time.

Regulating is a deeply challenging task. For regulatory practice in New Zealand to be more effective, and consistently effective, regulators will need to share experience and practice more. Also, more detailed and targeted guidance about regulatory practice is needed. Formal recognition of regulator forums or networks could offset barriers to knowledge sharing through:

- partial government funding of regulator networks, tied to a business case and performance measures;
- the *Cabinet's Expectations for Regulatory Stewardship* being revised to clarify that regulators should seek to raise their own, and the wider sector's, performance by sharing experience; and
- active monitoring by the Treasury and portfolio departments (of Crown entities) of regulator participation in communities of practice.

Workforce capability

Regulators need staff who as a group combine generic and specific competencies, including specific technical expertise, personal competencies such as communication skills, and an understanding of the compliance role and the role of the regulator. As the Ministry of Transport notes, "having an amalgam of very different skill sets can be what matters for regulatory success" (sub, 39. p. 6).

Gaps in these competencies can undermine the credibility of regulation and the achievement of regulatory outcomes. The precise mix of competencies needed is likely to vary between regulators and even within a regulator at different times. It is management's responsibility to identify the required mix and to develop strategies and programmes to deliver it.

It is estimated that more than 10,000 people are employed in regulatory roles in New Zealand. There is limited data about their competencies and any gaps in those competencies.

That said, the Commission's survey of business revealed the business perception of the competency of regulators. Only 23% of the firms surveyed agreed or strongly agreed with the proposition that "regulatory staff are skilled and knowledgeable" and only 25% agreed or strongly agreed that "regulators understand the issues facing your organisation".

The situation was more encouraging regarding communication by regulators. In the last two years, 40% of the businesses surveyed spent significant time and resources on finding out about regulatory requirements and 25% applied for consents and approvals. Of those surveyed, 43% said that interactions with regulatory compliance officers were friendly and non-combative, and 37% agreed with the statement that "regulators communicated well with your organisation".

People who work in regulatory agencies and their chief executives seem to have different views about the adequacy of staff competencies and training. The Commission's survey of 23 chief executives found that only 5 agreed with the statement that there are "significant capability or skill gaps among regulatory staff", while 10 disagreed with the statement, and 7 neither agreed nor disagreed and 1 did not know. However, the Victoria University of Wellington survey of Public Service Association workers found that, compared with local government and district health board regulatory workers, and non-regulatory workers in central government, central government regulatory workers tend to:

- disagree that they are given a real opportunity to improve their skills through training;
- be less likely to perceive that they have sufficient job-related training;
- show lower levels of agreement that their supervisors have helped them get extra job-related training or that they receive ongoing training that helps them do their jobs better;
- be less satisfied with the number and quality of training and development programmes available; and
- disagree that training and educational activities enable them to do their jobs more effectively.

Chapter 12 sets out a number of recommendations that are intended to build on the process of change already underway in developing the capability of the regulatory workforce in New Zealand. These

recommendations are designed to reinforce capability development as a core management responsibility, promote clarity about the roles of those seeking to improve workforce capability, and put greater focus on workforce capability in reviews of regulator performance.

The recommendation and improvements already underway will contribute to the achievement of better regulatory outcomes through:

- a compliance sector that is focused on competency development;
- a well-respected national qualifications framework for regulatory work;
- an effective process for improving the competencies of the existing workforce and for training new people to be effective regulators;
- greater workforce mobility between regulators; and
- more effective collaboration between regulators in relation to competency development.

Funding regulation

Regulators can be funded from various sources, including Crown contributions, levies on the regulated industry, or through fees imposed either on the beneficiaries of regulation or on those who cause the "problem" that needs to be regulated. The way that regulators are funded can affect the efficiency of resource use, equity and the achievement of policy outcomes.

Many countries, including New Zealand, have established frameworks whose purpose is to help those designing and implementing regulation to select the appropriate sources of funds. While in principle there can be benefits from regulators recovering some costs through fees or levies, case-by-case assessment is required to secure these benefits in practice. The framework for choosing between sources of funding needs to encourage this to happen.

The Commission's analysis suggests that while there is no major problem with the approach to funding regulators in New Zealand, and indeed New Zealand's framework for funding regulators has many positive features, there are opportunities to improve it – which would equally apply to new and existing regulators.

In principle, recovering some costs of regulation through fees is beneficial, but poor implementation can undermine the benefits. The Commission's survey of businesses and submissions to the inquiry both reveal concern in the business community about the quality of the consultation before regulatory fees or levies are introduced, weak constraints on the level of charges, and the structure of charges. Other jurisdictions use a variety of approaches to reduce these risks.

Chapter 13 examines what lessons can be learned from the approach to cost recovery used by other jurisdictions. There are examples in other jurisdictions of:

- more rigorous consultation and impact assessment before fees are introduced;
- more detailed advice about how to implement cost recovery;
- stricter requirements for performance standards and reporting against those standards; and
- penalties for failure to achieve the standards.

There is scope to improve New Zealand's approach to cost recovery – to both new and existing regulators – throughstrengthening the governance and accountability framework (Box 0.2).

Box 0.2 **Potential improvements in costs recovery framework**

Improvements in New Zealand's approach to cost recovery can be made through strengthening the governance and accountability framework. In particular:

- publishing the Government's cost recovery policy;
- making portfolio ministers responsible for ensuring that agencies within their portfolio have complied with that policy – also, chief executives of agencies proposing a new or amended fee or levy for regulatory services should be required to certify that their agency has made adequate use of the Treasury Guidelines;
- strengthening performance reporting;
- amending the role of the Regulations Review Committee and increasing the number of audits of cost recovery by the Office of the Auditor-General;
- introducing regular reviews of the cost recovery practices of regulators; and
- improving the implementation of cost recovery by refreshing and rationalising the guidance material, and ensuring adequate departmental advice is available to agencies about how to approach cost recovery.

Accountability and performance

Processes for holding regulators to account for their behaviour help ensure that agencies act efficiently, effectively and lawfully, and can create incentives for regulators to improve their performance.

Existing accountability processes provide multiple avenues to interrogate and challenge regulators about their behaviour, and a range of levers that ministers can pull to influence this behaviour. To influence a regulator in a timely and appropriate fashion, ministers must have a sound understanding of how well the regulatory organisation is performing.

Monitors of regulators have a key role to play in ensuring ministers are well informed about performance and risk levels. Where regulators are Crown entities, the relevant portfolio department acts as monitor. Where the regulator is a department, central agencies (The Treasury and the SSC) have monitoring functions. Effective monitors need good overall sector knowledge, so that they can understand the regulator's operating environment and be independently aware of emerging issues and risks.

Monitoring is both a key link, and the weakest link, in the current accountability system. Some departments appear not to fully understand their monitoring roles and responsibilities, monitoring is not having enough effect on regulatory quality, and incentives on departments to monitor well are not strong enough. The Treasury and SSC are not perceived by regulators' chief executives as playing a significant role in holding agencies to account for their regulatory functions.

Feedback from submitters also suggests that the accountability system may not be giving confidence to regulated parties and the public that regulators are acting lawfully, reasonably, proportionately and effectively.

Performance expectations for monitoring regulators are either too low or unclear, and incentives for effective monitoring could be strengthened. The Commission recommends that:

- more detailed and demanding guidance be prepared for departments and ministers on how to monitor Crown entities;
- the Treasury and the SSC work with departments to develop performance measures that better, and more consistently, reflect good practice in monitoring;
- departments develop and maintain explicit statements of their monitoring roles and responsibilities – in doing so, they should regularly review whether their monitoring approaches are giving ministers sufficient assurance that harm and risks are being effectively managed, permitting accurate performance

assessments, and promoting substantive dialogue with regulators about the fitness-for-purpose of their regimes; and

- the SSC and the Treasury play a more active oversight role for departmental regulators and more tightly integrate their new tools to assess regulatory stewardship performance into existing accountability processes, especially the performance reviews.

System-wide review

New Zealand has a large stock of legislation and regulation that is growing rapidly. Determining whether this stock of legislation and regulation is achieving the outcomes for which it was enacted, and is producing benefits that outweigh the costs, requires a process for evaluation. As the OECD notes, "one of the most important tasks facing governments today is updating of the accumulated regulations and formalities that have gone unexamined over years or decades. National regulatory systems require periodic maintenance. Periodic and systematic review of existing regulations is needed to ensure that outcomes are assessed, unneeded or inefficient rules are weeded out, and needed rules are adapted to new economic and social conditions" (OECD, 1997, p. 224).

The New Zealand Government is implementing a suite of initiatives to improve the management of this stock. It does not use many of the approaches to system-wide evaluation of regulatory regimes that are used in other countries, some of which have been identified as involving low effort and potentially high return in other countries.

To improve the effectiveness of these initiatives, the Government should:

- articulate in more detail its strategy for improving the management of the stock of legislation and regulation, indicating how the initiatives it is implementing fit within the strategy and how success will be measured;
- help departments satisfy the Cabinet's expectations of the responsibilities of departments for keeping current the regulatory regimes that they are responsible for through improved reporting and transparency; and
- require departments to explain their plans for monitoring, evaluation and review in their papers for the Cabinet Legislation Committee and amend the Cabinet Guide to build in this requirement (their plans should be proportional to the significance of the regulation).

Implementation of the Government's initiatives for keeping the stock of legislation and regulation current should be guided by principles, building an approach that:

- ensures that the scale and scope of evaluations is proportionate to the impacts of regulation;
- provides transparent reporting of the Government's strategy, work programme and progress in achieving performance targets;
- clearly defines responsibility for managing the stock of legislation and regulation;
- is based on consultation with those affected by regulation;
- is driven by a need to prioritise effort where the payoff is expected to be largest; and
- is adequately resourced, so that people with the capabilities required to undertake effective evaluations can implement it.

Making it happen

The regulatory management system is a large and important part of New Zealand's policy infrastructure. It should be seen as no less significant than the systems behind taxation and government spending. This report has reviewed the components of the system and has found system-wide deficiencies in each of them. New Zealand's system cannot be described as broken, but it is "muddling through". There is no

government strategy for regulation, no clear programme for its improvement, and no clear "owner" of the system. There is considerable scope to get more, and much better, performance out of the system, with significant benefits for the New Zealand economy and the wellbeing of New Zealanders.

To move the regulatory management system to the next level of performance:

- energetic and focused leadership is required from within the Cabinet, based on the premise that the regulatory management system is a key part of New Zealand's policy infrastructure, combined with more transparent processes from both ministers and agencies;
- effort to improve the system must be focused not only on the front-end of regulation (the decision-making process), but also on organisational design, implementation, monitoring and review;
- regulators need stronger encouragement and support to fulfil their stewardship obligations. The system needs to rely less on goodwill and the sense of professional duty and more on exposing Boards and chief executives to performance expectations and incentives commensurate with the Government's stated objectives;
- departmental monitors of regulators need a better understanding of their role, and the importance attached to the monitoring role needs to be increased; and
- agencies with key roles in ensuring the regulatory management system functions well need to be funded adequately.

Having a minister responsible for the regulatory management system is essential. The minister's responsibilities should include:

- defining the overall objective of the regulatory management system and bringing focus and attention to it;
- strategic prioritisation of effort across the regulatory system;
- specifying and allocating tasks for improving the system; and
- promoting continuous improvement in regulatory design and practice.

The minister needs to be supported by a well-resourced and capable advisory support team. Currently this is located in the Treasury, but the Commission intends to examine other options in more detail in the final report.

Conclusion

This draft report provides guidance that will assist in designing new regulatory regimes and in improving the operation of existing regimes. Attention is focused on the role and contribution of the system to the wellbeing of New Zealanders and ways to encourage a more strategic approach to initiatives aimed at improving it. This means:

- sharpening the accountabilities of those who have important roles to perform in improving the system;
- redirecting effort to improve the system to where it can yield the highest dividends;
- increasing the attention devoted to improving organisational and workforce capability; and
- building mechanisms to encourage continuous improvement ("periodic maintenance") of the system, to keep it current.

New Zealand is not so well off that it can afford to settle for second best in its foundational systems. Indeed, given the disadvantages of small scale and isolation, it needs to excel in such matters if it is to meet its aspiration to deliver first-class living standards to all New Zealanders. Achieving this will require focus, enthusiasm, capability and strong political support.

Summary of questions

Chapter 3 – Understanding the regulatory system

Q3.1 Are there other or different elements of regulator design, practice or impact that should be reported upon?

Q3.2 Are there factors that would make the benefits of reporting at a regime level, rather than an agency level, outweigh the costs of doing so?

Chapter 5 – Regulatory independence and institutional form

Q5.1 How can the role of the Regulations Review Committee be strengthened, if regulators are delegated greater regulation-making powers?

Chapter 7 – Regulator culture and leadership

Q7.1 What factors are contributing to poor communication within regulatory bodies? Are these factors cultural or procedural in nature? What actions or approaches could be put in place to reduce barriers to internal communication?

Chapter 8 – Consultation and engagement

Q8.1 Are there any examples of legislative rigidity that may prevent regulators from using participatory processes and/or making decisions that would benefit both consumers and regulated parties? What evidence is there of this? What lessons could be learnt from these examples?

Q8.2 Are there examples of consultation provisions that are working well, or alternatively, not as well as they should? What factors contribute to a consultation provisions working well/poorly?

Chapter 9 – The Treaty of Waitangi in regulatory design and practice

Q9.1 Would an overarching Treaty clause in an appropriate statute (separate from the jurisdiction the Treaty of Waitangi Act 1975 confers on the Waitangi Tribunal to investigate actions inconsistent with Treaty principles), that signals the Crown's intent with respect to the principles of the Treaty of Waitangi, improve the operation of regulatory regimes in New Zealand?

Chapter 10 – Decision review

Q10.1 What evidence exists for the effectiveness of internal review of regulatory decisions?

Q10.2 How effective are the Legislation Advisory Committee's guidelines on appeal and review in influencing policy-makers in the design of new regulatory regimes?

Q10.3 Is there a need for greater specialisation among the judiciary to hear cases relating to complex areas of regulation? What approaches might be effective to develop greater expertise among the judiciary in these areas?

Q10.4 What benefits and risks are there in providing for alternative dispute resolution mechanisms as a way of reviewing regulatory decisions?

Chapter 11 – Regulator practice

Q11.1 Do recent developments in the theoretical literature, suggesting that in designing and implementing regulatory regimes, there needs to be a focus on:

- the behaviour, attitudes and cultures of regulatory actors, including those of the regulator;
- the dynamics of the regulated environment in which regulated parties and regulator operate, and the institutional setting of the regulatory regime;
- the logics of the regulatory tools and strategies used;
- the performance of the regime over time, and
- changes in each of the above factors;

offer a way forward for improving both the design and operation of New Zealand's regulatory regimes?

Chapter 13 – Funding regulators

Q13.1 Are there clear and legally accepted definitions of fees and levies in New Zealand? If not, does this matter? Are there issues that are specific to either fees or levies that the Commission needs to consider?

Q13.2 Would there be net benefits from imposing a general obligation on regulatory agencies to consult before fees or levies are introduced or amended?

Q13.3 Do surpluses and deficits on memorandum accounts signify a problem? If so, are there worthwhile options to address the problem?

Chapter 14 – Accountability and performance monitoring

Q14.1 Are there other questions or characteristics that a monitoring approach for Crown entity regulators should include?

Chapter 15 – System-wide regulatory review

Q15.1 What would be the advantages and disadvantages of increasing the role of Parliament in scrutinising how the stock of regulation is managed? If Parliament's role should increase, what approach should be used to achieve it?

Chapter 16 – Making it happen

Q16.1 Are there other functions for which a minister responsible for regulatory management would need support?

Q16.2 Which is the best location for a support agency for a minister with responsibility for the regulatory management system?

Findings and recommendations

The full set of findings and recommendations from the report are below.

Chapter 3 – Understanding the regulatory system

Findings

F3.1 Maps and groupings are valuable as a way to understand regulatory regimes and agencies, but mainly as a first step in a more detailed analysis. For most regimes, further disaggregation is likely to be needed to gain a full understanding of their dynamics, relationships and differences.

F3.2 No single set of categories will support all avenues of analysis into how regulatory regimes perform. A range of frameworks can be applied that answer different questions and lead to different combinations of agencies and regimes.

F3.3 The lack of regular and detailed reporting on the state of New Zealand regulators and regulation is a key gap in the current regulatory management system. The lack of data on regulatory activity compares poorly with fiscal management processes. Those processes promote informed and focused public debate on fiscal policy, encourage governments to focus their actions, and enable comparisons between different areas of the public sector.

F3.4 More comprehensive and comparable information should be collected on the activities and impacts of New Zealand regulators. Such information could help offset barriers to identifying and making systemic improvements to regulatory practice. In particular, it could:

- help designers of regulation compare and contrast regulatory approaches and features;
- help regulators identify better practice among their peers that might be adopted in their own operations; and
- be used to identify trends or patterns in implementing regulation or the performance of regulators.

F3.5 The information collected from regulators should allow analysis of the structure, efficiency, effectiveness, responsiveness, scope of activity, burden of activity on regulated parties, and transparency and accountability of New Zealand regulators.

F3.6 Standardised reporting could be formally integrated into Treasury's regulatory management systems. In particular, the results could be used to find any parts of the regulatory system that need improving, and underpin policies to make those improvements.

F3.7 Although reporting at the level of individual regulatory regimes might allow more sophisticated analysis of design and practice features, at this stage the Commission is not convinced that these benefits would outweigh the costs to larger departments of disaggregating performance data down to regime level.

Recommendations

R3.1 Standardised reporting requirements for agency annual reports should be used to collect data on regulator activity. The Treasury and the State Services Commission, as the central agencies responsible for the public sector accountability framework, should be responsible for developing these standardised requirements.

R3.2 At the end of each financial year, the Treasury should collect and analyse performance data from the annual reports of regulators, and produce a public report outlining key features and trends.

R3.3 The Treasury and the State Services Commission should work with relevant departments to ensure that all regulators not captured by the Public Finance or Crown Entities Acts comply with the new standardised reporting requirements for their annual reports.

Chapter 4 – Role clarity

Findings

F4.1 Many firms that the Commission surveyed saw contradictory or incompatible regimes and regulators poorly managing duplicated compliance requirements as issues in New Zealand.

F4.2 "Deemed-to-comply" systems can let regulatory regimes adapt to changes in technology or shocks. They also permit different firms to find the compliance approach that best suits them. This lets regimes more effectively cover industries where the capability varies.

F4.3 Legislative frameworks that keep the number of objectives and conflicts to the lowest possible number and provide a clear hierarchy of objectives help to support regulators in making consistent and predictable decisions.

F4.4 Before new regulatory functions are allocated to an existing agency, policymakers must assess that the mission of the agency is compatible with the objectives of the new regime, and whether the new functions will get sufficient resource and attention.

F4.5 Regulator involvement in providing strategic policy advice is important for effective regulatory outcomes. Strategic policy should be developed so that it taps the experience of regulators and provides a dispassionate assessment of the issue. To ensure this balanced assessment, regulators should not have the sole or main responsibility for reviewing underpinning frameworks.

F4.6 Creating separate bodies so that one body is responsible for making rules and the other for enforcing them can have benefits, such as greater transparency, probity and good decisions. Even so, whether structural separation creates net benefits will depend very much on the details of the regulatory regime. Combinations of other regulatory design options (such as clearer regulatory objectives, stronger reporting and consultation obligations) may provide equivalent benefits, with lower costs and less disruption.

F4.7 Cooperative arrangements like Memoranda of Understanding play an important role in managing regulatory overlaps. To be most effective, they should be reviewed regularly, be publicly available, provide clear guidance to regulated firms and individuals, and be empowered by legislation.

F4.8 Regulatory exemptions can help manage overlaps between regimes, and allow regimes to adapt to changing business practice and circumstances. Principles or criteria guiding the use of exemptions should be included in legislation, and regulators should publish their reasons for granting exemptions.

Recommendations

R4.1 The Cabinet Manual should be amended to set a general expectation that exposure drafts will be published and consulted on before introducing into Parliament legislation that creates new regulatory regimes or significantly amends existing regimes.

R4.2 The next version of the State Services Commission's guidance on machinery of government issues should set an expectation that, where a new regulatory regime is established, the entity responsible for implementing the regime should have a legislative obligation to publish a statement that explains its interpretation of its mandate, to consult on that statement, and keep it up to date.

Chapter 5 – Regulatory independence and institutional form

Findings

F5.1 Designers of regulatory regimes must carefully assess the arguments for and against regulator independence. Arguments for political control must be weighed against the benefits of providing a credible long-term commitment to an impartial and stable regulatory environment.

F5.2 For most regulatory regimes, the arguments for providing more independent regulation will be stronger than the arguments for less independent regulation.

F5.3 To be effective, an expert regulator must operate within institutional arrangements that let it assess risks objectively and manage risks.

F5.4 "Independence" is multi-faceted and covers significantly more than formal legal designation, including:

- the ability to adjust the regulatory settings and rules (regulation independence);
- the ability to undertake functions without interference (operational independence);
- funding arrangements that protect the regulator from external pressure (budgetary independence); and
- formal distance from the executive and security of tenure for governors and senior management (institutional independence).

F5.5 Regulators often have to work with legislative regimes that are outdated or not fit-for-purpose. For example, regulators in transport sectors have to oversee outdated rules due to an inflexible legislative framework.

F5.6 There is inconsistent allocation of legislative provisions between primary legislation and types of secondary legislation in regulatory regimes. There is evidence that existing mechanisms to promote greater consistency are ineffective.

F5.7 There is scope for the greater use of delegating authority to make secondary legislation to regulators, subject to appropriate controls, to ensure regulation can keep pace with technological and other developments. Designers of regulatory regimes need to consider what regulation-making powers can be delegated to the regulator, particularly in areas subject to technological or other changes, in order to future-proof the regime.

F5.8 Political pressures to intervene in the decisions of independent regulators are inevitable from time to time. Providing transparent mechanisms for political intervention in the decisions of independent regulators is preferable to wholesale regulatory reform designed to resolve political frustrations. It can also strengthen a regulator's ability to withstand informal political pressure.

F5.9 Designers need to plan for how to manage the political imperatives to intervene in regulatory decisions. Whether direct powers of intervention are provided or not, designers should seek to ensure:

- intervention is infrequent
- intervention does not set precedents for future intervention
- the regulator's authority is not undermined
- intervention does not encourage regulated parties to work around the regulator
- there is transparency in the intervention.

F5.10 Government has regulatory and funding levers over many public services. Funding arrangements may permit faster enforcement action, but can be less useful for raising performance across the whole system in the absence of substantial failures, or for revealing information to consumers about relative performance. Designers of regulatory regimes to assure quality in public services need to consider how they expect the funding and regulatory levers will be exercised to manage performance issues across the whole system. They also need to ensure that regulatory requirements are appropriate for publicly-funded and privately-funded services.

F5.11 The expectation that departmental agencies will operate with a high degree of autonomy is dependent on agreements between ministers and between chief executives, rather than any legal protections associated with this institutional form.

F5.12 Government has indicated a desire to relocate some regulatory functions from Crown entities to departmental agencies. By itself, this would serve to reduce the formal operational independence with which those functions are undertaken. As a result, government will need to review any functions that are transferred to consider whether they should be undertaken in a statutorily independent way.

F5.13 There is the potential for confusion about the accountability arrangements of departmental agencies, and the respective roles and responsibilities of:

- the minister responsible for the departmental agency;
- the minister responsible for the host department;
- the chief executive of the departmental agency; and
- the chief executive of the host department.

F5.14 The legal differences between the types of Crown entities – the appointment and removal of board members, and ministerial powers of direction – do not in practice differentiate them, because the removal of board members and the issuing of formal ministerial directions to boards has almost never occurred.

F5.15 The choice of institutional form will be important as much in terms of what it signals around expected levels of agency independence, as for the legal protections associated with particular agency forms.

F5.16 Ministers and the founding governors and leaders of new agencies need to pay particular attention to the norms and cultures established around independence, in terms of the relationships between them, and the agency's operations.

F5.17 Regulation designed to prevent low-frequency, high-consequence (catastrophic) events is less likely to suffer from loss of focus or institutional support over time if located in stand-alone agencies.

F5.18 Coherence problems between executive functions cannot be resolved by co-locating those functions alone. Designers of regulatory regimes need to identify what personal and professional relationships are key to the effective operation of a regulatory regime, and assess which of those relationships are best managed within an organisation and which are amenable to management between organisations. This should inform decisions around the location of regulatory functions.

F5.19 While there can be benefits to structural changes in regulatory agencies, they can take time to emerge, and will often be disruptive to the smooth operation of regulatory regimes in the interim.

Recommendations

R5.1 The Ministry of Transport should consider in its review of the Civil Aviation Act 1990 how the legislative regime can be flexible enough to take advantage of ongoing technological developments that could provide safety and efficiency gains. Subsequent reviews by the Ministry of Transport should consider how the other legislative regimes in transport can be made more flexible, taking into account the differences between the transport sectors.

R5.2 The Minister for Regulatory Reform should coordinate a principle-based review of regulatory legislation to ensure greater consistency in allocation of legislation material between primary legislation and types of secondary legislation.

R5.3 The Minister for Regulatory Reform should consider stronger mechanisms to ensure greater consistency in the allocating material between primary legislation and types of secondary legislation, either by elaborating departments' *Disclosure requirements for government legislation*, empowering Parliamentary Counsel to provide stronger guidance, or some other mechanism.

R5.4 The Minister of State Services should review agreements between ministers to establish and allocate functions to departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear.

R5.5 The State Services Commissioner should approve agreements between the chief executives of host departments and departmental agencies to ensure that respective roles, responsibilities and accountabilities are clear, and that there are appropriate formalities in place to preserve the independent exercise of statutorily independent powers.

R5.6 Updated State Services Commission guidance on machinery of government choices should discuss the practical benefits, costs and risks associated with allocating functions to a department or stand-alone agency, as well as the accountability and governance considerations.

R5.7 Plans and strategies for undertaking structural change involving regulatory functions should explicitly discuss how the effective operation of those functions will be maintained during the change.

Chapter 6 – Governance, decision rights and discretion

Findings

F6.1 There is evidence of confusion around the role that some members of Crown entity boards with industry backgrounds are expected to play.

F6.2 There is good SSC guidance on managing conflicts of interest for members of Crown entity boards.

F6.3 Board members of Crown entities should not be appointed to act as representatives of external groups. Regardless of the backgrounds, experiences and prior or ongoing associations that make them valuable as members, their duty should always be to ensure the entity acts in a manner consistent with its statutory objectives and functions, and not as the representative or agent of any external group. The exception is where co-management arrangements are expressly intended.

F6.4 The variety of internal governance arrangements and allocation of decision-making rights in regulators appears to be *ad hoc* rather than based on sound governance principles.

F6.5 Designers of regulatory regimes should avoid allocating regulatory decision-making powers to ministers avoided unless good reasons are established. Decisions where ministerial decision making is likely to be appropriate include decisions with:

- significant value judgements, involving trade-offs that are not readily amenable to analysis
- significant fiscal implications, or which are integral to a government's economic strategy.

F6.6 In practice, the distinction between single-member and multi-member decision making is not always sharp. Colleagues/staff are likely to inform the views of individual decision makers.

F6.7 In designing new regulatory regimes, it is most appropriate to vest significant regulatory decision-making powers in multi-member bodies, unless there are good reasons not to. But a range of day-to-day administrative decisions are more appropriately vested in individuals.

F6.8 Designers of new regulatory regimes need to consider providing for the internal review of day-to-day administrative decisions which are taken by individuals.

F6.9 There is extensive delegation of regulatory decisions within New Zealand regulatory regimes. In practice decisions are taken by a range of compliance staff, managers, chief executives, boards and ministers.

F6.10 Designers of regulatory regimes need to consider the capabilities required to take regulatory decisions in specifying the nature of decisions regulators need to take, assigning decision rights, and providing for delegation.

F6.11 Administrative discretion is a feature of many regulatory regimes. Principle-based or outcome-based regulatory regimes inherently involve the exercise of discretion, as do risk-based approaches to implementing regulation.

F6.12 There is a range of legal constraints on the exercise of discretionary decisions. In particular, there are strong protections where those decisions intrude on the civil and political rights enshrined in the New Zealand Bill of Rights Act 1990. However, New Zealand is unusual in not acknowledging or protecting property rights.

F6.13 Institutional and cultural constraints on the exercise of discretionary power support legal constraints by promoting ethical decision making.

Recommendations

R6.1 The effectiveness of a part-time board comprised of participants in the regulated sector (as in the Financial Markets Authority) should be reviewed by the State Services Commission before its wider application to other sectors of regulation.

R6.2 The State Services Commission's guidance about appointing board members to Crown entities and its induction material for new board members provide good information on the duties of members. But it should update these documents to emphasise that members are not appointed and should not act as the representative or agent of any external group.

R6.3 All regulators should publish and maintain up-to-date information about their regulatory decision making processes, including timelines and the information or principles that inform their regulatory decisions.

Chapter 7 – Regulator culture and leadership

Findings

F7.1 The espoused values of new regulators may be "aspirational" rather than deeply engrained and widely accepted. This means such values may not actually reflect the beliefs of those working within the organisation or be reflected in their actions.

F7.2 The culture that emerges within a new regulatory agency will be influenced by (1) the beliefs, values and assumptions of its founding leaders; (2) the experiences of members of the organisation as it matures; and (3) the injection of new beliefs, values and assumptions through new members.

F7.3 When looking to improve the performance of a regulator, it is vital to understand whether what is required is a *change in regulatory practice within a given culture,* or a change in culture. This requires targeted analysis of the culture within a regulatory agency and the institutional factors that impact the way it operates.

F7.4 Good internal communication is a catalyst for developing a culture of organisational learning. Yet central government regulatory workers are significantly less likely than non-regulatory workers to believe that there is good communication within their organisation.

F7.5 With some exceptions, New Zealand regulators do not appear to have a strong culture of learning from experience.

F7.6 There is evidence of a risk-averse culture within some New Zealand regulators. It is important to understand whether this culture has emerged as an appropriate and efficient response to the nature of the harm being managed or as a means of protecting the reputation of the regulatory body (or its employees).

F7.7 The likelihood that systemic failures in regulatory regimes will go unchecked is higher when regulators have poor internal communication, lack the ability to learn from experience and have professional subcultures that are resistant to change.

F7.8 The way in which a regulator engages with stakeholders is often perceived as a "window" to the organisation's culture. In making such assertions, it is important to assess whether the quality of engagement is driven by the regulator's deeply held values and beliefs, or whether it is driven by some other factor – such as the legislative environment or available resources.

F7.9 A common understanding of the purpose and mission of a group is the first step in developing a common culture. While Chief Executives believe corporate culture is influencing the behaviour of frontline staff, central government regulatory workers do not perceive that senior managers communicate a clear organisational mission.

F7.10 Government can "seed" the culture of a new regulatory agency by appointing founding leaders who have values, beliefs and experiences that are consistent with its vision of the "ideal" culture. However, selecting the "right people" does not guarantee that the "right" culture will emerge – the actions of founding leaders are the key embedding mechanism.

F7.11 When establishing a new regulator, it is important to have founding leaders in place from the start of the organisation. This will provide the leader with the opportunity to influence the cultural foundations of the organisation. The use of "interim leaders" is to be avoided where possible.

F7.12 While legislative provision can codify required actions, they do not guarantee that a regulator will develop deeply held values around the importance of those actions.

F7.13 Monitoring bodies and central agencies can use formal and informal mechanisms to reinforce favourable cultures in new regulatory bodies.

F7.14 There is disagreement in the academic literature around the extent and pace at which embedded cultures can actually change. This debate reaffirms the importance of promoting an "appropriate" culture from the inception of a regulatory body.

Chapter 8 – Consultation and engagement

Findings

F8.1 The "regulatory relationship" is influenced by both the nature of the regulation and the characteristics of regulated parties and beneficiaries. When designing new regulatory regimes, careful thought must be given to the relationships that should exist between the regulator, regulated parties and those who are the beneficiaries of regulation.

F8.2 In general, the greater the level of public participation the more critical it becomes that there is a common understanding of the scope for stakeholders to influence regulatory decisions. Failure to do so can undermine public confidence in engagement processes and in the competence of the regulator.

F8.3 When developing engagement strategies, regulators need to examine both the fairness and proficiency of alternative mechanisms. Both proficiency and fairness are influenced by the manner in which mechanisms are implemented.

F8.4 New Zealand common law, such as case law, contains a number of important principles that affect how and when regulators have an obligation to consult and what constitutes proper consultation.

F8.5 Inquiry participants have raised concerns around the current engagement practices of some New Zealand regulators. These include insufficient time for engagement, a perception that regulators enter engagement with predetermined views and concerns that some regulators lack the capacity to engage affectively. The Commission has also heard positive feedback around the approaches adopted by some regulators – notably NZTA and the EPA.

F8.6 Of the more than 50 Acts examined as part of the Commission's inquiry, over half contain some form of consultation requirement.

F8.7 Statutory consultation requirements are potentially most useful when:

- there is a likelihood that failure to consult would breach natural justice principles – for example regulation involves a significant use of the State's coercive powers that could impair the civil liberty, livelihood or property rights of individuals;
- regulators have wide discretionary rule-making powers that involve making judgements about what is in the public interest;
- there are social equity reasons for specifying the consultation processes that should be followed for a specific group - for example where the affected group may not have the resources or capacity to effectively participate in a conventional consultation process;
- the affected community holds information on trade-offs and technical issues necessary for the regulator to make sound decisions.

Chapter 9 – The Treaty of Waitangi in regulatory design and practice

Findings

F9.1 While a precise definition of the Crown is lacking, it is accepted as being the Executive arm of government.

F9.2 Those involved in designing and implementing regulatory regimes should understand how their actions or inactions are consistent with Treaty principles.

F9.3 The courts interpret references to Treaty principles in legislation in a way that is consistent with the purpose of the relevant Act. In the event of a breach, the courts will likely issue a declaration that the proposed decision or action should be delayed so as to establish a process to respect the relevant Māori interest or right.

F9.4 That Parliament will legislate in accordance with the principles of the Treaty, and will appropriately apply the principles on issues of relevance to Māori, means the courts can, depending on the context, require that an agent of the Crown have regard to the principles of the Treaty, even if there is no specific Treaty clause. The scope and strength of these "statutory interpretation rights" are, however, minimal. The court only takes them into account if the law to be applied in a given situation is ambiguous.

F9.5 The Waitangi Tribunal has a wide mandate to consider any breach by the Crown and its agents. While it does not have decision-making functions with respect to its findings, its opinions carry considerable weight with the courts.

F9.6 References to Treaty principles can be found in statutes in which Māori have strong iwi and hapū relationships. There does not appear to be a consistent description of the application of Treaty principles in statutes. Statutes with references to Treaty principles often contain regulatory provisions and create obligations on a range of parties that are not the Crown.

F9.7 The priority to be given to references to Treaty principles in legislation depends on the wording of the clause and its status in the context of the statute.

F9.8 There are incentives on officials advising on the content of bills and on Māori to include Treaty clauses in legislation, especially where Māori have clear interests, such as in legislation regulating the use of physical resources. Yet the incentives are different. Māori are incentivised because legislative provision is a mechanism they can use to enforce their rights through the courts if needed. Officials are incentivised to set minimum requirements in legislation that define the Crown's obligations.

F9.9 Whether a Treaty clause should be included in legislation requires careful judgement. It requires the careful balancing on a case-by-case basis of key considerations relating to the regulatory area, and the likely impact on Māori, other stakeholders, and the Crown.

F9.10 The quality of guidance to help apply Treaty principles could be improved. None of the guidance reviewed was considered so bad that it would not add value to stakeholders, and overall the guidance promoted best practice over simple legal compliance. Even so, there was a significant difference between the best and worst examples. Only one example had sections specifically targeted to different stakeholder groups. Some guidance was misleading or inaccurate.

F9.11 The framework for assessing guidance material could be used as a tool to help regulatory agencies develop guidance about applying Treaty principles in their area of regulation.

F9.12 The EPA does not limit its role to ensuring that applicants comply with regulatory standards before an application is approved. Applicants are helped in preparing their applications and the EPA also helps those impacted by applications. Conflicts of interest are minimised because the application process is open, transparent and public.

F9.13 The EPA discharges its Treaty responsibilities under its legislation and the Acts it administers within a net-benefit, decision-making approach.

F9.14 Members of the Māori Advisory Committee are the guardians of good process, ensuring Māori have adequate opportunity to contribute their views, and that decision makers can use the consultation process to get the information they need.

F9.15 The permanent and formal structure of the Māori National Network has meant that capability and trust has been built, and this is realising benefits. Te Herenga has increasingly been relied on to accurately and effectively bring the views of Māori to the table on their behalf.

F9.16 Māori have additional steps and costs to incur when developing submissions, but care needs to be taken when considering funding, having regard to the capability of respective stakeholders and the importance of their perspectives, and ensuring funding is directly related to gaining those perspectives. Regulators need to monitor these expenses carefully.

F9.17 Providing guidance for applicants and other stakeholders about navigating the process is considered a core part of the EPA's role as a regulator.

F9.18 Open and timely communication, accessibility, a balanced approach, pro-activity and a culture of respect and understanding must, to a large extent, be credited to the work and attitude of the EPA's staff and its leadership.

F9.19 The arrangements adopted by the EPA are a model that has brought the EPA positive change and support from stakeholders. In designing institutional arrangements, processes and practices to incorporate Treaty principles into their work, regulators should focus on their own regulatory responsibilities and functions, and the capabilities, capacity and incentives of their stakeholders.

F9.20 An important lesson from the EPA's experience for other regulators is that the investment in developing good relationships pays off in the form of reduced cost on all parties involved in the application process, while improving the quality of engagement and the resulting decisions. It has achieved buy-in to the success of the EPA approach and a shared commitment to making it work. When decisions go against stakeholders, those decisions are now more readily accepted and are less likely to be contested.

Chapter 10 – Decision review

Findings

F10.1 In New Zealand there is significant overlap between the scope of judicial review and appeal in practice.

F10.2 Judicial review in New Zealand is much wider in scope than in Australia, and can include greater scrutiny of the merits of decisions.

F10.3 Courts will generally defer to the decisions of expert regulators of highly complex or technical areas. In these areas of regulation, there is still a clear distinction between judicial review and appeals, and judicial review is less likely to scrutinise the substantive merits of decisions.

F10.4 In general, legislation establishing regulatory regimes does provide access to merits review of regulatory decisions.

F10.5 In areas of complex or highly technical regulation, access to merits review or the scope of appeal provided is often limited.

F10.6 It will generally be inappropriate to provide for appeals of ministerial decisions.

F10.7 Access to judicial review should be approached in a non-instrumental way. Judicial review is an important constitutional check on the power of the Executive, and is available to citizens as of right.

F10.8 Access to appeal (or merits review) should be available where it is likely to improve the quality of regulation, in terms of the objectives of the regulatory regime, taking into account the costs of providing it.

F10.9 The Commission has found no evidence to suggest that judicial review is an ineffective method of challenging regulators' decisions, and ensuring they act in proper, lawful, and reasonable ways.

F10.10 An absence of merits review increases the likelihood that aggrieved parties will seek recourse outside the legal system. In particular, it will encourage special pleading to politicians.

F10.11 Merits review does not offer additional safeguards to ensure decision makers followed good processes, beyond those offered by judicial review.

F10.12 The broad scope of judicial review in New Zealand means that the availability of merits review would not provide significantly stronger incentives on regulators to make correct decisions than is provided by access to judicial review alone.

F10.13 Providing access to merits review may not always promote the objectives of a regulatory regime.

F10.14 Designers of new regulatory regimes need to consider whether to provide access to merits review. In areas of highly complex, technical regulation, designers need to critically assess whether the appellate body has the institutional capability, compared to the decision maker at first instance, to improve the quality of decisions in terms of Parliament's objectives for the regulatory regime. They also need to take into account the costs and uncertainty created by providing access to merits review.

F10.15 There is no reason to believe that the incidence or complexity of appeals in areas of highly complex or technical regulation will inevitably decline over time.

F10.16 In appeals of highly complex or technical regulation, providing the court with opportunities to directly question experts, in a non-adversarial setting, can assist in understanding the issues under appeal.

F10.17 Providing courts or tribunals discretion over the admissibility of new evidence is likely to be more efficient than providing for appeals based on a frozen record.

F10.18 Foreign expertise can play a valuable role in bringing expertise to merits review of highly complex and technical regulatory regimes.

Recommendations

R10.1 The Officers of Parliament Committee should review the adequacy of funding for the Office of the Ombudsman to undertake its statutory functions to a high standard.

R10.2 Where courts interpret legislation in ways that significantly alter a regulator's understanding of their mandate, the department responsible for the regime should review that aspect of the legislation. Its review should ascertain whether the courts' interpretation undermines Parliament's objectives in establishing the regulatory regime, and whether legislative amendment is desirable.

Chapter 11 – Regulator practice

Findings

F11.1 Twenty years of *responsive regulation* in practice has demonstrated that institutional impediments have posed enormous challenges to the real-world implementation of the enforcement pyramid.

F11.2 Putting risk-based regulation into practice poses considerable challenges for regulators. Adopting a risk-based approach to regulation requires the regulator to:

- deal with uncertainty about risk;
- operate in a political and public environment where there may be very different perceptions of risk and a poor understanding of what it means for the regulator to take a risk-based approach;
- make risk assessments and decide how to allocate its resources; and
- decide what approach it will take to enforcement once a risk assessment has been made.

F11.3 A risk-based regulatory approach does not necessarily solve the issue of what risks to prioritise, how to deploy regulator resources, or what enforcement strategy to use.

F11.4 Official guidance on regulator practice emphasises risk-based approaches as desirable, but also endorses responsive regulatory strategies.

F11.5 Few of the regulators that responded to the Commission's request for information applied the same level of compliance monitoring to all regulated entities. Most prioritised their efforts in some way, and in many cases regulators applied more than one criterion in judging where and when to monitor.

F11.6 The strategies of the regulatory agencies examined by the Commission consider both the severity of the harm caused by compliance breaches and the attitude/behaviour of those causing breaches when allocating resources and taking action. However, they differ in how far they prioritise reducing harm or maximising compliance, and the extent to which the two objectives are integrated or treated separately.

F11.7 There is evidence that some regulatory agencies are demonstrating elements of the really responsive regulatory approach in their compliance and enforcement strategies, especially the willingness of agencies to consciously consider the behaviour and attitude of regulated parties, institutional settings and the logic of regulatory tools, and changes in these factors, when taking enforcement action.

F11.8 Many of the issues and challenges identified in the literature play out in New Zealand, including:

- 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 change.

In summary, regulators often struggle with putting risk-based approaches to regulation into practice, and there are challenges in applying enforcement tools.

F11.9 The perception that regulators do not take opportunities to improve performance, do not learn from mistakes and successes, and are inflexible in the face of changes in priorities, suggests that New Zealand regulators are insufficiently attentive to two of the five key factors of really responsive regulation – performance over time and response to changes in the regulated environment.

Recommendations

R11.1 Formal recognition of regulator forums or networks could offset the barriers to sharing good practices through:

- partial government funding (for example, 3-5 years) for regulator networks, tied to a business case and performance measures;
- revisions to Cabinet's *Expectations for Regulatory Stewardship*, to clarify that regulatory agencies should seek to raise their own and the sector's performance by sharing experiences and participating in communities of practice; and
- active monitoring by the Treasury and portfolio departments (for Crown entities) of regulator participation in communities of practice and other activities to share experiences.

R11.2 To encourage the production of guidance material of practical use to regulators, one performance measure of the 3-5 year funding contract should be take-up and use of the guidance material produced.

Chapter 12 – Workforce capability

Findings

F12.1 Regulators need staff who, as a group, combine generic and specific competencies, including specific technical expertise, personal competencies such as communication skills, and an understanding of the compliance role and the role of the regulator. Gaps in these competencies can undermine the credibility of regulation and the achievement of regulatory outcomes. The precise mix of competencies needed is likely to vary between regulators and even within a regulator at different times. It is management's responsibility to identify the required mix of competencies and ensure staff have, or can develop, these competencies.

F12.2 There is limited information about qualifications held by the workforce in the compliance sector. The proportion currently enrolled in training for qualifications appears to be small.

F12.3 The approach to developing the competencies of the people who work in regulatory roles is constructive and wide-ranging. However, the approach is evolving and sector participants consider there is room to improve.

Recommendations

R12.1 Regulators should:

- focus on recruiting and retaining staff with the appropriate industry knowledge and mix of enforcement, investigative and communication competencies;
- provide appropriate training and written guidance for staff, and monitor regulator practices for consistency with this guidance;
- facilitate opportunities for staff to improve their understanding of the regulated environment, business practices and the nature and magnitude of the compliance costs their engagement imposes on business; and
- implement cooperative arrangements with other regulators that facilitate the sharing of knowledge and resources.

R12.2 That the Compliance Common Capability Programme uses its review of the organisation's future shape, direction and resourcing to:

- identify gaps in the current organisational framework and explain why it is in the best position to fill some of them;
- set out its specific roles as either a provider of training services or an adviser; and
- explain the issues about which it would provide advice, and how it would ensure that its advice is broadly based from across the regulatory sector.

R12.3 The Skills Organisation should coordinate effort to identify skill levels and gaps across the compliance sector and assess the adequacy of current programmes to fill those gaps.

R12.4 Appropriate groups of regulators should encourage forums aimed at sharing good practice among the regulatory workforce.

R12.5 That The Skills Organisation, as the accreditor of training providers, should seek both to maintain quality and consistent standards of provision, and to promote diversity and competition.

R12.6 Regulators' performance in developing staff should be reviewed, either as part of the Performance Improvement Framework process or through commissioned reviews modelled on that process.

Chapter 13 – Funding regulators

Findings

F13.1 Organisational responsibility for advising, implementing and scrutinising funding arrangements has been established, and guidelines offer regulators and advisors guidance on how to approach funding issues. However, the two sets of guidelines cover similar issues in different ways. There is no general requirement for *ex post* evaluation of the impact of cost recovery and little published evidence about how well funding arrangements are working.

F13.2 While in principle there can be benefits from regulators being at least partially funded through cost recovery, case-by-case assessment is required to secure these benefits in practice.

F13.3 The Commission's survey of businesses, and submissions to the inquiry, indicate concern in the business community about:

- the quality of the consultation that takes place before regulatory fees or levies are introduced;
- weak constraints on the level of charges, including limited transparency about how they are determined; and
- the structure of charges.

F13.4 The funding frameworks in other selected countries are similar to New Zealand in that they:

- set out efficiency and, to a lesser extent, equity as the main objectives of cost recovery;
- require consent, usually of a minister or Parliament, before a fee or levy is introduced;
- are based on a distinction between cost recovery and taxation; and
- provide guidance material.

There are, however, examples in other jurisdictions of:

- more rigorous consultation and impact assessment requirements before fees are introduced;
- stricter requirements for performance standards and reporting against those standards when new fees are introduced;
- penalties for failing to achieve the standards; and
- more detailed advice about how to implement cost recovery.

F13.5 It is desirable that regulators, as they develop improved performance reporting frameworks, use these frameworks to measure the cost of delivering regulatory services and report this information publicly.

Recommendations

R13.1 The Government should publish its cost recovery policy, covering issues such as:

- policy objectives;
- guidance about how to make trade-offs should objectives conflict;
- when cost recovery may be appropriate;
- consultation requirements before implementation;
- how and when arrangements are to be reviewed and by whom; and
- responsibility for ensuring compliance with the policy.

R13.2 Portfolio ministers should be responsible for ensuring that agencies within their portfolio have complied with the Government's cost recovery policy. Chief executives of agencies proposing a new or amended fee or levy for regulatory services should be required to certify through an appropriate mechanism that their agency has made adequate use of the Treasury guidelines.

R13.3 The grounds on which the Regulations Review Committee can disallow a regulation should include that the regulator in developing and implementing a fee or levy has had inadequate regard for the economic framework set out in the Government's guidelines for setting charges in the public sector.

R13.4 The Auditor-General should introduce an enhanced programme of audits of regulators' compliance with Government cost-recovery guidelines.

R13.5 Portfolio reviews undertaken within the Performance Improvement Framework, and/or the Regulatory Systems Reports prepared under the expectations for regulatory stewardship, should review and report on the adequacy of the approaches to cost recovery of regulators within each portfolio.

R13.6 The Government and Auditor-General should review the Treasury's *Guidelines for Setting Charges in the Public Sector* and the Auditor-General's *Charging Fees for public sector goods and services*, to ensure that the guidelines reflect current knowledge about when and how to implement cost recovery.

Users of the guidelines (whether the two sets of guidelines continue or are combined) should:

- only have to go to one place for advice on any issue;
- not receive conflicting advice from the guidelines; and
- be clearly informed about the scope of the entities and charges that the guidelines cover.

R13.7 The Government, when it reviews New Zealand's cost recovery guidelines, should seek to collaborate with the review of the cost recovery guidelines currently being undertaken in Australia.

R13.8 That the Government consider whether those agencies that set or amend fees or levies can access adequate advice and experience from other agencies and departments.

Chapter 14 – Accountability and performance monitoring

Findings

F14.1 Most, but not all, regulators are subject to the Official Information Act.

F14.2 Accountability is a necessary but insufficient condition for better performance.

F14.3 Key tasks for monitors of regulators are:

- providing assurance to ministers that regulators have robust risk identification and assessment processes; and
- assessing the ongoing fitness-for-purpose of regulatory regimes.

F14.4 Regulator chief executives surveyed by the Commission did not consider that central agencies played a significant role in holding their agency's regulatory functions to account.

F14.5 Departmental monitoring of regulators is weak and departments are not contributing enough to regulatory quality and performance.

F14.6 Existing guidance for departments and ministers on monitoring Crown entities underplays the importance of the monitoring relationship and risks sending the signal that a monitoring department does not need to have a detailed understanding of a Crown entity's operations.

Recommendations

R14.1 The State Services Commission and the Treasury should update guidance for ministers and departments on monitoring Crown entities to:

- provide more detail on the issues that monitoring departments and ministers should look for in reviewing the performance of Crown entity regulators;
- clearly express the importance of monitoring departments having the deep sectoral knowledge necessary to understand the regulator's operating environment; and
- place more emphasis on vigilance and free and frank advice from monitoring departments.

R14.2 The Treasury and the State Services Commission should work with monitoring departments to:

- define common and richer performance measures for regulator Crown entity monitoring;
- update performance information in accountability documents around monitoring in time for the 2015/16 financial year; and
- reflect the new measures in the performance agreements and reviews of departmental chief executives.

R14.3 Departments responsible for monitoring regulator Crown entities should develop and maintain explicit statements of their monitoring roles and responsibilities. In doing so, departments should regularly review whether the monitoring relationship:

- gives ministers the assurance they need about risk identification and management;
- allows departments to accurately assess the performance of regulators; and
- promotes substantive dialogue with entities about the fitness-for-purpose of the regime.

R14.4 The performance of departmental regulators should be strengthened by:

- the Treasury publishing the findings from the Regulatory System Report about departmental stewardship activities;
- the State Services Commission (SSC) developing explicit measures for regulatory performance in chief executive performance agreements and annual expectations letters; and
- SSC using PIF and Treasury surveillance information about departmental regulatory performance in reviewing the performance of chief executives.

Chapter 15 – System-wide regulatory review

Findings

F15.1 The New Zealand Government is implementing a suite of initiatives to improve the management of the stock of legislation and regulation. It does not use many of the approaches to system-wide evaluation of regulatory regimes that are used in other countries, some of which have been identified as involving low effort and potentially low/high return in those countries.

Recommendations

R15.1 The Government should publish an overarching strategy that sets out how it will improve the management of the stock of regulation. The strategy should explain how specific initiatives fit within it, and should describe how successful implementation of the strategy will be measured and how it will benefit the community.

R15.2 The performance of departments, in satisfying Cabinet's expectations that they keep current the regulatory regimes they are responsible for, should be strengthened by:

- the Treasury publishing the findings from the Regulatory System Report about departmental stewardship activities;
- the State Services Commission (SSC) developing explicit measures for regulatory performance in chief executive performance agreements and annual expectations letters; and
- the SSC using both the Performance Improvement Framework and Treasury surveillance information about departmental regulatory performance in reviewing how chief executives perform.

R15.3 Departments should explain their plans for monitoring, evaluation and review in their papers for the Cabinet Legislation Committee seeking agreement to introduce new legislation. The Treasury should amend the "Disclosure requirements for government legislation" to make this expectation clear. Departments' plans should be proportional to the significance of the regulation.

R15.4 The Treasury should continue to monitor approaches to evaluation used in other countries, while implementing the current evaluation agenda, building an approach that:

- ensures that the scale and scope of evaluations is proportionate to the monetised impacts of regulation;
- provides transparent reporting of the Government's strategy, work programme and progress in achieving performance targets;
- clearly defines responsibility for managing the stock of regulation;
- is based on consultation with those affected by regulation;
- is driven by a need to prioritise effort where the payoff is expected to be largest; and
- is adequately resourced, so that people with the capabilities to undertake effective evaluations can implement it.

Chapter 16 – Making it happen

Recommendations

R16.1 The Government should publish the responsibilities of the minister responsible for regulatory management. These responsibilities could include:

- defining the overall objective of the regulatory management system;
- prioritising effort across the regulatory system;
- specifying and allocating tasks for improving the system; and
- promoting regulatory policy and the case for continuous improvement in regulatory design and practice.

R16.2 The minister with responsibility for regulatory management should publish a strategy report that sets out the medium-term objectives that the Government is seeking to achieve through the regulatory management system, its strategic prioritisation of effort for achieving these objectives, and its work programme. The minister should report regularly on progress towards delivering this work programme, and update the statement as necessary.