

## **Regulators' Forum 1st meeting**

### **Inspection & Compliance**

*Enforcement is a challenge for all regulatory bodies. Challenges emerge from bringing together responsive and risk-based enforcement styles, especially in an age of austerity. Regulatory decision-making takes place in the context of available resources, risk profiles and reputational concerns. How can one deal with these challenges?*

*How do regulators deal with the challenges of reconciling risk-based and responsive systems of inspection?*

One of the defining characteristics was the diverse nature of regulatory experiences. One key difference involved the role of inspection itself. Some regulators were almost solely dependent on the information gathered by inspectors themselves rather than on third parties or whistleblowers. This placed a premium on close and continuous oversight, the development of trust between the regulated institutions and the inspectors, as well as on developing self-reporting relationships. Other regulators were faced with large numbers of regulated institutions, ranging from about 45 firms to one inspector to approx 500 firms per inspector. This required a strategy that identified systemically relevant firms, with other firms being visited less frequently.

A similar risk-based approach was adopted by those regulators that relied on other organisations to perform their inspection activities. This had led to a shift towards those organisations that were identified as high risk/low compliance organisations. Similarly, there was a move towards 'earned recognition' across different regulatory bodies. However, there were always concerns about potential 'nasty surprises' that could be generated by those organisations that had been identified as having 'earned recognition'.

Other regulators had faced greater difficulties with a risk-based approach, especially in the context of incidents. However, simply increasing inspection activity was problematic given a lack of resources. Other regulators relied mostly on a data tracking approach that looked at various financial and quality indicators. There was then an issue about the data itself, especially when this data was collected by other organisations and represented historical rather than real time developments. The challenge was to assess the capability of regulated organisations.

Further differences in approach involved complaints. Some regulators faced hardly any complaints, others received a large amount of complaints that were very difficult to evaluate. The primary source for assessing compliance was incident self-reporting, others could rely on developing the role of customers in reporting incidents.

New risks presented a common challenge. These were almost always seen as a potential problem, and there was a bias towards being sceptical about new ways of doing things, thereby potentially biasing inspections towards accepting older, possibly riskier, activities. In general, this raised

issues about moving risk-based regulation towards a future-focused perspective that explored emerging themes.

A further discussion point was whether visibility of regulatory activities was desirable. For some, being outside the headlines was important, others saw it as an important tool to legitimise their activities. It was important to show regulated industries that one was involving all parties, especially including consumers, in campaigns to show that the regulatory burden was spread across different stakeholders.

*Inspection styles vary significantly, ranging from the announced inspection to the so-called 'dawn raid'. What are the determinants of an effective inspection?*

Regulators built on varied approaches towards enforcement. Some offered firms a time window during which an inspection would take place, but without indicating the exact date and time. This also gave the inspector some flexibility. However, while unpredictability was therefore an element, it was not seen as always being effective. Appearing unannounced might mean that essential counterparts were not present (for valid reasons).

Regulators noted that they relied on three approaches, announced, unannounced and thematic inspections. Regulatees wanted to speak to inspectors and develop an understanding of what the 'science' was. The thematic inspection was particularly helpful here as it concentrated on one particular aspect and therefore facilitated learning. A thematic approach could be used to champion an improvement of practice. There was the impression that regulated parties wanted inspectors to visit more often. Other regulators distinguished between pro-active inspections (that were announced), reactive inspections (that were incident-driven or where the data was suggesting problems and where inspections may be unannounced) and themed inspections.

There was agreement that the role of inspection had an advisory function. An unannounced inspection was not necessarily seen as a helpful device to develop advisory relationships. Regulators reported that surveys also suggested that inspections were welcomed and that businesses generally reported that they benefitted from an inspection. This was also helpful when the evidence base was informed by self-reporting.

Prosecution was an important part of regulation. But it was not necessarily a success factor. The act of having to resort to prosecution was seen as a result of failure and was therefore rarely used. A rare use of prosecutions was seen as a success. For some, the legal framework placed limitations on the way in which inspection and prosecution could be pursued; for others, there was a problem that consistency in decision-making meant that cases were more or less automatically treated in similar ways, meaning that some types of behaviours were always leading to a revocation of licences, others not. This was potentially sending a problematic signal.

Agreement existed about the role of inspection. For some, appearing on a site to find that nothing was wrong represented an error, as this was a waste of resources. Mostly, however, inspections had regulatory and advisory functions. The challenge, for those regulators with a highly diverse set of regulated business, was to target those firms that were unlikely to comply.

Introducing more discretionary, outcome-based regimes represented a challenge. Regulators had moved, or were moving towards a more outcome-based approach that was replacing a more prescriptive approach. This proved challenging for both inspectors and inspected. Both of them

wanted certainty and had become used to the existing approaches. Requiring inspectors to make judgments, and dealing with firms that demanded certainty in what they were supposed to do in order to be deemed safe, was a particular challenge.

Differences in professional background and the kind of activities that were being regulated represented a further challenge. Some inspection activities did not lend themselves to a risk-based framework, others did - and sometimes these activities fell within the sphere of one regulator. The challenge therefore was to find ways to get at the 'organisational culture' of the regulated organisation. This required highly qualified and experienced inspectors that could rely both on data and the intangible experience of an inspection. One could get to this culture by exploring certain themes during an announced inspection where one suggested exploring other areas as well - thereby adding a degree of unpredictability to the inspection. This was often reflected in the requirement to assess 'confidence in management'. Another approach was to use the 'mystery shopper' device. However, even if there was an insight into organisational cultures, the challenge was how to improve it. One way of improving safety cultures was to rely on off-line conversations.

There was a further challenge in mixing the 'tough' and the 'tender' in inspections. Continued interactions between inspectors and regulated parties could lead to a degree of slippage in that small deviations would go unnoticed over time. Inspectors needed to develop a degree of collegiality with the regulated businesses, and this would become strained if they had to exercise draconian sanctions. One device was to rely on regularly rotating inspectors. Another approach was to rely on particular individuals who would take on the responsibility for being 'tough', thereby protecting inspectors' long-term relationships somewhat.

*What are the challenges of the age of austerity for regulatory enforcement?*

Some regulators suggested that reduced resources meant that certain risks had to be tolerated more. There had to be clear understanding and communication. Similarly, austerity and financial problems were also evident in the way in which regulated companies were delaying maintenance. There was a wider issue about how one could deal with the new objective of having to regard the impact of regulatory decisions on economic growth. This was sometimes problematic as it conflicted with international obligations.

The key issue was seen to lie in issues of recruitment and reward, on the one hand, and on understanding the capacities of those bodies that were doing inspections on behalf of regulators.

Finally, austerity also meant that business models were changing, and this also affected the way in which inspections could be pursued, and in which regulatory objectives had to be adjusted to reflect particular concerns.

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