Of Brexit, regulation, tales and tails

Peter Bonisch and Mustafa Cavus advocate a fundamental rethink of the UK’s regulatory regimes in the wake of Brexit

With Brexit bearing down on us, the issue of the repatriation of regulatory responsibilities from the European Union and European Commission has gained renewed salience. But, is the UK ready for their return? What will be required to rebuild a domestic regulatory capability? And, with a Government commitment to replicate the existing regulatory position – the EU legislative and regulatory status quo ante acquis communautaire – at Brexit via the UK Repeal Bill, what, really, is at stake and over what horizon? Most importantly, who is thinking about the broader issues involved, and how well?

What we can observe gives little cause for optimism as Britain’s regulatory regimes in the wake of Brexit offer an extraordinary opportunity: to reconceptualize regulation as an economic and social phenomenon that is highly contested and not readily understood. Culture is a complex, emerging social phenomenon that is highly contested and not readily operationalized. Any existing psychometric methods are individual but culture is social, individuals’ perceptions can be measured and contrasted but sociometric approaches to culture are problematic at sub-national levels. And few regulators or supervisors have invested in the anthropological or sociological skills or resources necessary to observe and opine meaningfully on culture. It is a difficult area not subject to any regulatory interventions.

Repatriation of regulatory functions as part of Brexit offers a remarkable opportunity to address Britain’s regulatory architecture – both intellectually and organizationally – from first principles. Such an exercise should seek to design and implement a sustained programme to rationalize regulatory rules and to enhance the use of web technologies (usually referred to as ‘RegTech’) in order to reduce the burden on businesses and improve the efficiency of compliance validation and assurance. Doing so will require a recognition of the limits of current regulatory practice, efficacy and capacity and the need for a substantial enhancement of regulatory coordination as well as the economic, technical and analytical skills effective coordination requires. Muddling through the process in superficial ways will only add costs and reduce businesses’ competitiveness.

Too often, regulatory frameworks focus on more routine outcomes, distracting from their real purpose. A recent example is the long overdue initiative in 2014 by the Financial Reporting Council (FRC) to focus corporate attention on risk on potential threats to longer term viability, encouraging firms to adopt scenario-based approaches and stochastic analysis to assess their long-term solvency; such methods have already proved useful in refocusing attention on operational risk in financial services firms. These methods can readily augment (and even substitute for) more traditional and bureaucratic risk register-type approaches, importantly, they have the potential to redirect executive and board attention to where it matters – the tail of the distribution of risks outcomes.

But, as ever, the devil is in the detail. Not only must a regulatory framework accommodate the significance of these tail risks; it should also address what regulation is and does, by whom and to whom (Koop and Lodge, 2017). Conceptually, it should represent (formally or otherwise) a theory of purposeful and goal-directed directed by interests, and their actions and interactions; in Coleman’s (1986) phrase, ‘connecting intentional and purposeful persons with macro-social consequences’. It is also important that whatever approach the regulator adopts should not compound the problem it was designed to solve or create new problems along the way (Stiglitz, 1994). In the terminology of Merton (1949), the regulatory framework will fulfill a combination of manifest functions (intended or recognized impacts) and latent functions (unintended or unanticipated impacts) of regulatory activities will have both positive, some negative (‘dysfunctions’), some irrelevant (‘non-functions’).

A useful regulatory framework requires a set of cognitive or behavioural rules applying to humans and corporate agents (i.e., the subjects of the rules) and the social or organizational and technical rules the subjects must apply to their activities (‘object’). There are (i) the generic ‘constitutive’ rules applicable across all actors and actions (legis, political, social and cultural rules); (ii) the subject and object ‘operational’ rules as well as (iii) ‘mechanism’ rules about how to change frameworks and regulations. Across a range of regulatory contexts (including extensively in financial services and recently at the FRC), considerable effort is being devoted to the vexed issue of culture. It is both right and proper for executives to attend to their organizations’ cultures (plural, note) and how they manifest and interact as well as their latent impacts. Yet, most of this work seems divorced from the rigours of referring to any established discipline or body of knowledge. Executives should attend to the organizational practices (routines and rules, symbols, stories or ‘tales’) and values they demonstrate by their observable actions, that they communicate and then reinforce through pecuniary and non-pecuniary incentives and rewards; these may contrast their espoused values and any gaps their observed behaviours reveal. It is quite another thing for regulators to attempt to intervene therein or to suggest instrumental approaches to culture that will surely be overcome by latent dysfunction (Merton’s, actual term for ‘unintended consequences’).

REFERENCES

AUTHORS
Peter Bonisch is chairman and co-managing partner and Mustafa Cavus is co-managing partner at Kage Strategy.