Regulators' Forum

Regulatory Innovation

What is regulatory innovation?

Identifying what may constitute regulatory innovation represents a central challenge. Regulatory innovation is characterised by the way we define novel aspects, and may apply to regulatory instruments, regulatory products, processes, and different types of regulatory services. In terms of innovation itself, different degrees of change might be regarded as innovation, ranging from incremental alterations, the utilisation of new technologies to perform existing functions, or a qualitative transformative ('paradigm') change. Innovation may be understood, traditionally, as invention, but is also likely to occur as part of learning.

Variations also exist in terms of innovation to 'whom' - some regulatory innovation might be novel to the particular domain, it might be novel to the particular organisation, or it might be novel in a broader context. Equally, different understandings of 'where' regulatory innovation can be expected exist. Traditional debates point to disagreements as to whether innovation is more likely to occur at the 'core' or at the periphery where different traditions or disciplines intersect or collide. Organisational studies highlight how 'bright new ideas' clash with existing standard operating procedures and organisational cultures (often represented by core functions of an organisation). Innovation might be brought about by individuals, for example, by changes in leadership.

The wider environment matters too - organisations seek to ensure their legitimacy by appearing modern, leading to increasingly homogeneity (e.g., 'institutional isomorphism'). However, there may be a question of 'homogeneity with what' - particular national regulatory arrangements might appear relatively similar, but, in a cross-national perspective, unique. International organisations matter for providing templates. Different regulatory instruments may diffuse, such as regulatory sandboxes. Assessing whether regulatory sandboxes were novel in the current age highlighted the difficulty of defining innovation; it was an experimental technology that had been taken up, in different forms, across different regulatory organisations, across jurisdictions.

To observe regulatory innovation, one could focus on a number of aspects:

- goals and objectives: are changes to the broader goals a prompt for innovation, or are changes in the environment forcing an organisation to reconsider how to achieve its goals?

- regulatory problem definition and framing: are ways in which problems are being identified, in terms of their nature or severity, changing? For example, changes in context may mean that market regulators might increasingly be seen as surveillance and resilience regulators.
- techniques: to what extent can we observe changes to the ways in which regulatory organisations consult, modify their tools to detect and enforce their objectives; how have views changed in terms of incentives?
- rationale for regulatory innovation: in view of the need to sustain reputation for competence in front of different audiences, were regulatory agencies embracing innovation largely for symbolic or performative reasons, or could one detect more far-reaching changes?

The points raised in the previous paragraphs might be regarded as perennial questions in the study of regulatory innovation. Comparing the early 2000s with the mid-2020s, however, highlights a number of changes in the context of regulation:

- The rise of new technologies, especially in terms of the rise of AI, both as a technology to regulate and a concern for regulation. Such questions also relate to, for example, questions of cyber-security.
- The changing geopolitical environment, with the use of regulation as a political tool rather than largely as a tool to smooth market transaction costs.
- The changing political context, with potentially changing understandings as to the appropriate balance between independence and accountability.
- The emergence of new/different players, either because of the rise of technologies (RegTech), changing market conditions leading to changing ownership structures, or the rise of different ways of mobilising public opinion (social media).
- The emergence of different ideas, in the form of the move towards an increasing embrace of the assumptions and techniques of behavioural economics, for example, or changing views as to the nature of the regulated sector, reflected, for example, in the perception of the extensiveness of 'gaming'.

Discussion

It is often suggested that due to inertia, only external pressure encourages organisations to seek innovation. Such crises may relate to external contextual change, a disaster in the sector, or a change in technology that attracts considerable popular attention.

Experience points to a range of contexts for regulatory innovation. They highlight circumstances in which regulatory innovation represents a response to external pressure in contrast to examples where regulatory innovation emerges from self-reflective organisations.

There are the types of external events that regulators had not come across, the implications of a pandemic like Covid-19 being one. Such crises had not featured on organisational radars beforehand. In these cases, there had been subsequent innovation. Resilience and security had become organisational priorities. However, in the other examples, the 'not seeing it coming' was not necessarily an organisation-wide phenomenon. Some attention to a problem may already have been ongoing. However, more extensive action was impeded by, for example, shared competencies across regulators with different regulatory objectives, or the limited interest at the top of the organisation in particular issues. There may also be an underestimation of the salience of the issue and an overconfidence in being able to control the overall narrative. The ability to keep up with public concern was increasingly difficult in view of contemporary political communication. In turn, certain regulatory strategies appear unacceptable in view of popular concerns. Changes in technology or in the character of the regulated industry due to ownership structures require a recalibration of approaches to ensure the same regulatory objectives. In other cases, a disaster in the sector coupled with subsequent supplier failure and further issues with the regulated sector may encourage demands for statutory regulatory responses.

Then there are types of political events involving particular regulators that lead to a seemingly entrenched transformation in the accountability relationship with regulators. Regulators in turn had become ever more attuned to questions of popular perception, engaging in surveying populations about their regulated sector.

A further type of external change reflected on the decreasing legitimacy of a particular organisational form. Particular dominant ideas as to what 'a good regulator looks like' were encouraging organisations to reflect on their overall institutional arrangements, including, for example, also government pressure to engage in particular types of organisational reform. Particular ideas about self-regulation, for example, had become increasingly problematic in terms of general acceptance.

There were, however, also cases of regulatory innovation where this reflected a concerted effort to engage in reflection. In such cases, the academic literature might provide core concepts and illustrations. In such cases, regulators would initiate processes to reflect on the core challenges, generate internal guidance, and encourage greater board-level attention to such issues. The capacity to engage in such a review of one's activities, and possibly become more ambitious, reflected the availability of resources, on the one hand, and, arguably, also a growing confidence in one's own organisational maturity. At the same time, regulatory innovation was also associated with novel regulatory arrangements, where leadership sets the tone regarding being a 'start-up' and therefore seeking to operate in novel ways.

In turn, a lack of capacity might also encourage regulatory innovation in the sense that the lack of financial resources, and a lack of apparently successful performance in fulfilling the regulatory remit, encouraged a process of change. A lack of (perceived) performance may, for example, be a result of a lack of resources, or it may be due to changes in the wider sector that increasingly altered the way in which regulators could engage with regulatees in traditional ways. Especially the pressure to deal with a lack of financial resources could encourage a greater engagement with organising regulatory activities around risk. In such cases, there were also sustained efforts to engage in greater data integration from different regulators.

The lack of capacity to enact regulatory innovation may, however, also relate to the wider authorising environment. For example, political interest may fluctuate and regulators were required to operate within the scope of existing statutory provisions. Similarly, the culture in the regulated sector was important - the more willing a sector was to listen to a regulator, the softer the instruments could be.

Regulatory innovation was also a result of a 'policy as its own cause'. Particular innovation had generated their own side-effects. They might, for example, appear to put an emphasis on particle-based business models and therefore constitute (unwanted) market entry barriers.

The Covid-19 pandemic had, at best, an indirect effect on regulatory innovation. At one level, it had encouraged a quicker take-up of communications technologies in day-to-day business. However, these had not changed the character of regulatory activity as such. Rather, the need to concentrate on certain activities during the pandemic had caused pressure on other areas of regulatory activity, leading to a subsequent need to innovate business processes.

One general challenge for regulators was their ability to highlight the contribution of regulation to the economy. Contemporary debates about burdens were matched with examples of how certain risks were being mitigated. At the same time, the discourse lacked a discussion as to how regulatory activities supported the economy; for example, by the outcomes of inspections leading to increased tax revenue. An essential part of such a conversation was a focus on the underlying purpose rather than the statute. In part, such a perspective would benefit from having resources and authority to embrace changes in regulatory instruments. Having a separate and resourced research function, for example, provided for the opportunity to evaluate and challenge, and to conduct forward-looking policy research. Thus, spending up to 2 per cent of the budget for evaluation might be desirable, but hardly feasible given resource constraints. At the same time, for regulators seeking growing support, regulatory innovation faced the attribution challenge, and how regulatory innovation could be presented. As a result, there was often too much interest in focusing on regulatory innovation in technical terms rather than on focusing on the broader significance of regulatory innovation to support more far-reaching organisational culture change.

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November 2025