

Gaye Searancke, Peter Mumford,
Karl Simpson and Mark Steel

Governing the Regulators – applying experience

It is tempting to characterise changes in the regulatory landscape in response to regulatory failure, such as leaky buildings, failed finance companies, and the Pike River disaster, as a reversion to state control and the triumph of prescription over principles and performance requirements. If judged by the quantum of law as measured by the increase in the number of clauses in relevant statutes, or the size of regulators' budgets, one might be excused for drawing this conclusion. For example, the Building Act 1991 had 93 clauses, but its successor, the Building Act 2004, has some 451. The building regulator's budget was \$3.5 million in 2002, increasing to \$16 million in 2011, with the security regulator's budget increasing from a similar base and by a similar amount over the same period.

In reality the emphasis has been on more effective law rather than more law, and in this context much more attention has been paid to the role of regulators. This reflects the fact that we know more now about the critical role of the regulator in delivering regulatory outcomes, although not through the traditional approach of administering command and control regulatory regimes based on prescriptive rules and heavy-handed enforcement, but rather something quite different.

We also have a better appreciation of the attributes of effective regulation, such as the importance of regulatory certainty, and the reality that there is not one regulatory approach which fits all businesses. For example, larger and more sophisticated businesses may be able to work with principles-based regulation in a way that small businesses cannot.¹

Finally, we have a better appreciation of what is required to ensure that regulation is effective in a New Zealand context. For example, New Zealand has relatively limited competition in many markets

Gaye Searancke, Peter Mumford, Karl Simpson and Mark Steel are all members of the Labour and Commercial Environment Group in the Ministry of Business, Innovation and Employment.

and lack of depth or capability among expert professions and advisers. This increases the risks for us that regulatory systems which rely for their effectiveness on vigorous competitive disciplines, well-developed markets for information and readily available specialised expertise may not be effective, or as effective, in New Zealand.

Using building controls, financial markets regulation and occupational health and safety as examples, we will present here our analysis of the changes to the regulatory landscape, and in particular the role of regulators as a particular facet of regulatory design. The change process is ongoing. In the workplace health and safety area we will draw on the 2013 report of the Independent Taskforce on Workplace Health and Safety,² and in the financial markets area we will draw on both the Financial Markets Authority Act 2011 and the Financial Markets Conduct Act 2013.

Drivers of change

The impetus for recent changes to the regulatory landscape has been significant adverse events that have been seen as failures of existing law. In this respect law reform is following historical patterns. For example, the building control regime introduced in 1991 was in response to perceptions of regulatory failure, although in this case the overriding concern was with law that was excessively burdensome rather than ineffective (Mumford, 2011). Successive financial markets law reform in New Zealand over the past 30 years has typically been a reaction to financial failures and concerns that these have resulted from weak law (see, for example, Fitzsimons (1994) on the impetus for securities law reform in the 1970s and 1980s).

The impetus for change is not, however, the same as the drivers of the changes we have seen in these statutes or recommended by the workplace health and safety taskforce. Regulatory failure can explain why there was change, but not what changed. The latter can generally be explained by reference to four drivers: (1) best practice legislative design and implementation; (2) modernisation; (3) shifts in the fundamental regulatory

approach; and (4) either shifts in societal expectations or a better appreciation of those expectations. For example, the workplace health and safety taskforce is proposing to broaden the definition of primary duty holders in relation to duties to deliver health and safety outcomes. This is an example of modernisation of the law, as it reflects modern workplace practices, rather than a fundamental shift in regulatory approach. An example of a fundamental shift is the change of approach from prescriptive to performance-based regulation in a number of regimes, including building and occupational health and safety, in the 1990s.

Modern statutes convey much more information to regulators than in the past about their role and how they should perform it. In effect, regulators have always been able to exercise discretion.

Conceptualising the regulator

Arguably, the one fundamental shift in regulatory approach common to building and securities markets and envisaged by the workplace health and safety taskforce is in the role of the regulator. Experience, common sense and theory have combined to build a picture of a new sort of regulator, better equipped to deliver regulatory outcomes envisaged by Parliament in a complex and dynamic environment.

The theoretical foundations can be found in the writings of academics such as Ayres and Braithwaite's *Responsive Regulation* (1992) and Baldwin and Black's 'Really responsive regulation' (2008), both cited in the workplace health and safety taskforce report. The Capital Market Development Taskforce drew on Bhattacharya and Daouk (2009), who argued that regulation that is not enforced can be worse than having no regulation at all to support the case for a proactive regulator that educated and informed, but also provided a 'visible deterrent' which enhanced its overall credibility and hence effectiveness.

Current thinking locates the regulator at the pivot of a complex system that requires many actors in many different roles to all play their part. The regulator needs to be clear about the objectives of the law and its specific role, relative to others, in achieving them. The regulator must also develop a deep understanding of the system and the opportunities and challenges it offers with respect to legal compliance; have available to it and effectively deploy a range of tools for achieving compliance in a range of situations; and be willing and able to evolve its approach in response to new information on how the law is working in practice and what future demands will be placed on it. It must also carry out its role

transparently and with regard to the costs as well as benefits of regulatory action.

Modern statutes convey much more information to regulators than in the past about their role and how they should perform it. In effect, regulators have always been able to exercise discretion. Modern statutes still provide for discretion, but are more informative in terms of how that discretion should be exercised. Discretion continues to be important, as the modern regulator needs to choose the most appropriate type of intervention (e.g. informing versus sanctioning) given the particular circumstances and based on evidence. This is not necessarily clear at the time a new regulatory regime is put in place or a new regulator is established. This is not just an issue of flexibility for the regulator. If implemented well, it should lead to the most effective and lowest (social) cost solution for the regulated.

We illustrate this conceptualisation of the modern regulator and how it is being reflected in law with reference to the Building Act 2004, Financial

Markets Authority Act 2011, Financial Markets Conduct Act 2013, and the recommendations of the workplace health and safety taskforce, under headings that mirror what is found in statute: purpose and principles, functions and duties, and powers.

Purpose and principles

The purpose statements in statutes are an expression of the outcomes expected by Parliament, and principles are typically matters that must be taken into account by those who have a statutory obligation in relation to producing those outcomes.³ Both the Building Act 2004 and Financial

health and safety taskforce has signalled a more proactive regulatory approach. Coupled with the principle in the model law that ‘workers and other persons should be given the highest level of protection against harm ... as is reasonably practicable’, also recommended by the workplace health and safety taskforce, this signals a high bar in terms of the levels of health and safety sought.

The Securities Act 1978 did not have a purpose statement and the Securities Commission developed its own, which, in 2007, was to ‘strengthen investor confidence and foster capital investment in New Zealand by promoting the

the Securities Act 1978 and there are four ‘additional purposes’ in the act of 2013), and recommendations of the workplace health and safety taskforce (an increase from eight in the Health and Safety in Employment Act 1992 to 11 recommended by the taskforce).

Two key objectives underpin this preference for more principles:

- to clarify what the regulator is expected to take into account in undertaking what might be described as its core regulatory functions: i.e. those associated with achieving the primary purposes of the statute;
- to codify other policy objectives that the regulator should contribute to when carrying out its functions: e.g. the innovation principle in the Building Act 2004 and the additional purpose of ‘promote innovation and flexibility in the financial markets’ in the Financial Markets Conduct Act 2013.

Functions and duties

The shift in the direction of greater specification in statute of matters that have a bearing on the role of the regulator is also evident in relation to functions and duties. The workplace health and safety and financial markets areas are exceptional in so far as the primary legislation did not specify any general functions or duties for the regulator. This reflects the age of the statutes, and best practice today is that functions would be specified. What is notable is that the workplace health and safety taskforce recommended 17 general functions of the regulator and three general duties,⁵ and the Financial Markets Authority Act 2011 specifies a main objective for the Financial Markets Authority (FMA) and six functions (with an additional four sub-clauses that spell out in more detail what is expected of the regulator).

The Building Act 2004 demonstrates a similar emphasis, specifying 19 roles of the chief executive and around four general duties, compared with nine functions given to the Building Industry Authority in the Building Act 1991 and no general duties.

This again is evidence of an intention to be much more specific in statute in

The shift in the direction of greater specification in statute of matters that have a bearing on the role of the regulator is also evident in relation to functions and duties.

Markets Conduct Act 2013 illustrate how societal expectations, resulting from or clarified through a crisis, have been transmitted through new purpose statements, and the workplace health and safety taskforce has recommended a new purpose for a new workplace health and safety act that is similarly illustrative.

The purpose of the Building Act 2004 extended the scope of the building control regime from a primary focus on safe and healthy buildings to include, among other things, a broader focus on the well-being of the people who use them. This reflected an appreciation, born out of the dramatic effects on people’s lives of leaking and rotting buildings, that dwellings, in particular, contributed to the social fabric of society and the concept of well-being captured important building attributes that safety and health missed.

In proposing that the current purpose of the Health and Safety in Employment Act 1992 of promoting the prevention of harm be replaced with the Australian model law – national model workplace health and safety law – formulation which is to secure the health and safety of workers and workplaces, the workplace

efficiency, integrity and cost-effective regulation of our securities markets.’⁴ The Financial Markets Conduct Act does contain a purpose statement, which is ‘to promote and facilitate the development of fair, efficient, transparent financial markets and to promote the confident and informed participation of businesses, investors, and consumers in the financial markets’.

In addition to what is signalled through the statutory purpose, these recent statutes (and recommendations in relation to workplace health and safety) also aim to provide more comprehensive and explicit guidance on what needs to be taken into account by the regulator in carrying out its role. This is done through the inclusion or extension of statutory principles. The building case illustrates this most graphically. The Building Act 1991 had six principles. Its successor, the Building Act 2004, has 17 principles, ranging from facilitating the preservation of buildings of significant cultural, historical or heritage value to allowing for innovation. This construct is shared with the Financial Markets Conduct Act 2013 (there were no principles in

terms of what is expected of the law and the role of the regulator in delivering these outcomes. This not only clarifies and strengthens the mandate of the regulator, and incidentally make it easier to monitor its performance, but also improves the understanding of all those involved in the regulatory system of what they can reasonably expect from the regulator.

The breadth of these functions and duties also illustrate the concept of a responsive regulator described earlier. For example:

- The modern regulator *should develop a deep understanding of the system and the opportunities and challenges it offers with respect to legal compliance.* This is illustrated by the difficulties New Zealand has experienced in building, and that the entire world has experienced in financial markets, where regulators did not have a sufficiently strong understanding of the risks being taken; although, to be fair to them, neither did most of the participants, commentators and researchers. This new emphasis on understanding the system can be seen in the duty of the chief executive responsible for administering the Building Act to monitor current and emerging trends in building design, building technologies, and other factors that may affect the building code and compliance documents, and report annually to the minister. It can also be seen in the recommendation of the workplace health and safety taskforce⁶ that the new workplace health and safety regulator has a function of monitoring and reporting on how the health and safety system is working in practice, and making recommendations for improvement.
- The modern regulator *should have available to it and effectively deploy a range of tools for achieving compliance in a range of situations.* This is reflected in the functions provided for (in the building area) or recommended (in the workplace health and safety area), which range from developing technical regulations and guidance and providing authoritative advice, to promoting and supporting education

and training and access to competent advice, to traditional enforcement action. We can also see it in the additional powers given to regulators, which will be discussed below.

- The modern regulator *must also carry out its role transparently and with regard to the costs as well as benefits of regulatory action.* This is reflected in the procedural requirements in the Building Act 2004 in relation to compliance documents, warnings and bans, whereby the chief executive must seek to identify all reasonably practicable options for achieving the

should have available to it and effectively deploy a range of tools for achieving compliance in a range of situations. This principle is reflected in the increase in the number and type of powers given to the regulator.

The building control regime, involving multi-level governance, has some distinctive features as the nature of the new powers given to the regulator reflects what we now know about the challenges of multi-level governance. The Building Industry Authority had a limited set of powers, reflecting a view at the time that the substantive building regulators were

Work undertaken by Treasury suggests that the combined effect of regulatory failure and the desire by both regulated entities and regulators for greater regulatory certainty is a shift in the direction of more prescriptive or measurable regulatory standards.

objective of the document, warning or ban, and assess the benefits and costs of each option and the extent to which the objective would be promoted or achieved by each option, and must consult on this analysis. It is also reflected in recommendations of the workplace health and safety taskforce that the regulator should publish its compliance strategy to make clear how it will strike the balance between information/guidance and enforcement, and how it will achieve certainty without being over-prescriptive or overly complicated. The FMA has a function of issuing guidance and publishes its enforcement policy. These documents are guided by the purposes of the statute, including the additional purposes of promoting innovation and avoiding unnecessary compliance costs.

Powers

We have noted that the modern regulator

the territorial authorities. The Building Act 2004 represented a significant shift in approach, with the establishment of the Department of Building and Housing (now the Ministry of Business, Innovation and Employment) as the central coordinating and control authority (Mumford, 2011). There was a commensurate increase in the range of powers given to the regulator, including an ability to initiate the process of determining whether an alternative solution meets the requirements of the Building Code,⁷ and an ability to issue warnings and bans and mandate compliance documents.

In addition, the regulator is able to take enforcement action (including taking proceedings for offences under this act) if the chief executive considers that it is desirable to do so to establish or clarify any matter of principle relating to building or the interpretation of the act, or in cases where one or more territorial authorities are unwilling or unable to take enforcement action.

Workplace health and safety and financial markets for the most part involve a single central regulator, and the increase and configuration of powers either in place or proposed have the effect of increasing the range of tools in the regulator's tool box, drawing on New Zealand and overseas experience of what seems to work best in certain situations. For example, the workplace health and safety taskforce recommended that the new regulator have, among other things, the ability to accept enforceable undertakings, and the FMA already has such powers. This is consistent with recent Australian research on the merits of this approach to compliance (Johnstone and King, 2009).

Conclusion

Work undertaken by Treasury suggests that the combined effect of regulatory failure and the desire by both regulated entities and regulators for greater regulatory certainty is a shift in the direction of more

prescriptive or measurable regulatory standards. For the most part this can be seen as a desirable part of the learning process. In effect we know more about how performance- and principles-based regulation works in practice, and this is being reflected back into the design and implementation of regulatory regimes.

In relation to regulatory design, some of the biggest shifts are in relation to how statute law mandates, guides, directs and empowers the regulator. We observe much more specific and comprehensive statutory provisions in the areas of purpose and principles, functions and duties, and powers. Underlying this approach is the philosophy that visible and proactive regulators can be critical to the effective operation of some regulatory regimes, and certainly those that have been the focus of this article. This does not, however, signal a heavy regulatory hand. Rather, what we see in statute, and in the recommendations of the workplace health and safety taskforce,

is the concept of a responsive, or 'really responsive', regulator that understands the regulatory environment and applies a range of fit-for-purpose strategies for achieving desirable regulatory outcomes efficiently and effectively.

- 1 This of course requires a sufficiently sophisticated understanding of the industries and markets regulators regulate given the information disadvantages they face as institutions. There is a high premium on developing effective working relationships with the sectors being regulated.
- 2 The government has largely accepted this taskforce's recommendations. Worksafe New Zealand has been established through the Workplace New Zealand Act 2013 and a new Health and Safety Reform Bill is now in progress. See www.mbie.nz/what-we-do/workplace-health-and-safety-reform.
- 3 While the term 'principles' has been used, this is the construct in the Building Act 2004. The Financial Markets Conduct Bill uses 'Main Purposes' and 'Additional Purposes', and the Health and Safety in Employment Act 1992 has a single 'Object of Act' clause, with a statement of 'Object' and a list of ways in which the Object will be achieved.
- 4 Securities Commission of New Zealand annual report, 2007.
- 5 Worksafe has a main objective and 13 general functions under the Worksafe Act 2013.
- 6 This recommendation is reflected in the functions of Worksafe.
- 7 See section 181 of the Building Act 2004.

References

- Ayres, I. and J. Braithwaite (1992) *Responsive Regulation: transcending the deregulation debate*, Oxford: Oxford University Press
- Baldwin, R. and J. Black (2008) 'Really responsive regulation', *Modern Law Review*, 71 (1), pp.59-94
- Bhattacharya, U. and H. Daouk (2009) 'When no law is better than a good law', *Review of Finance*, 13 (April), pp.577-627
- Fitzsimons, P. (1994) 'The New Zealand Securities Commission: the rise and fall of a law reform body', *Waikato Law Review*, 2
- Johnstone, R. and M. King (2009) 'A responsive sanction to promote systematic compliance? Enforceable undertakings in occupational health and safety regulation', *Australian Journal of Labour Law*, 21, pp.280-315
- Mumford, P. (2011) *Enhancing Performance-based Regulation: lessons for New Zealand's building control system*, Wellington: Institute of Policy Studies