BGP Report: Political and Regulatory Risk

Summary introduction

Consideration of political risk – uncertainty arising from actions or the structure of policy or regulatory processes – is topical at a time when considerable attention is being paid to risk assessment and management as an integral part of directors' and financiers' duties.

Following discussions with Whitehall departments, we were prompted to consider three questions:

- Does the policy process create political and regulatory risk?
- If so, how does that risk affect corporate strategy and business investment?
- Is that risk avoidable? If not, how can it be mitigated?

We assembled a group of politicians, former officials and Special Advisers, and corporate and City specialists to work with us in assessing the evidence. There was common agreement on four points:

- That risk is largely a function of the level of external confidence in the reliability of the policy process.
- That actual or perceived uncertainty over the governance and outcome of that process is high.
- That, while some witnesses may perhaps have overstated their concerns, such uncertainty has materially reduced corporate efficiency and inhibited or increased the cost of investment.
- And that the scope exists to improve confidence and reduce uncertainty.

Most of the 40 recommendations (which, while focusing on the UK, are in the main equally applicable to EU institutions) we make to address those conclusions have been designed with both business and to the wider public in mind since greater transparency and accountability is of broad benefit. They cover three broad areas:

- Stronger and clearer governance protocols to apply to political, administrative and regulatory decision making
- Greater delegation of decisions to expert bodies
- Processes should seek to provide clearer and longer-term signals covering their direction, content and decision-making criteria

Summary of findings and recommendations

How great a problem is it?

- 63 per cent of survey respondents believed that political/regulatory risk considerations had inhibited their investment decisions or forecasts, 48 per cent that they had increased the cost of capital or influenced the structure of corporate finance packages, and 69 per cent that such considerations had inhibited corporate strategy decisions (9).

- The most significant risk factors were regarded as uncertainty over the criteria to be taken into account in making policy/regulatory decisions, uncertainty as to the outcome of policy processes, concern that costs and benefits will not be fairly calculated/balanced, and uncertainty as to whether politicians or regulators will intervene (9).

Limits on the ability to reduce risk

- Although political control is considered important in order to retain democratic accountability, the way it is exercised should perhaps be reconsidered if confidence in politicians is low. (23).

Candidates for political withdrawal/improved impact assessment

- Political involvement in the policy process does not necessarily increase risk, but because Whitehall and Brussels at present do little to explain how they will reach or have reached decisions, concerns over the way evidence is balanced are greater than they might be, and the perception of risk is therefore higher than it might be (26). Government has acknowledged that this can be a problem in certain areas by delegating responsibility for monetary policy and for most competition and many other regulatory decisions to apolitical expert bodies subject to policy frameworks set by Ministers (27).

- Candidates for political withdrawal should be drawn up in areas involving price or standard-based regulation, where determination can be left to expert bodies working within ministerially-set parameters (29).

- Stricter timetabling, consistent with the practice followed by several regulators, and horizon-setting (creating a reasonable expectation that policy frameworks will not be significantly amended for a declared period) should be introduced (29). Timetabling should be tested through three pilots spread over different Departments and involving a major policy development exercise, a policy review, and a Bill. It should only apply to the parliamentary stage of the process in extremis (33-34).

- Ministers should determine whether the public interest requires them to be the ultimate decision maker and should be prepared to justify that role. (30).

- There should be a presumption in favour of the publication of research, internal analysis or external advice and that it should be incumbent on the system to explain any departure from it (32).

- Government should produce regularly updated three year or full-Parliament legislative programmes as a development of existing departmental five-year plans (35).

- UK and EU bodies should adopt the Scottish Executive's practice of posting on its website a forward consultation schedule (35).

- Ministers will have to decide whether giving greater structure to the process is an acceptable price to play for an increase in faith in that process and therefore a reduction in perceived and actual risk. Our proposals seek to raise trust in political decision-making to the same level as that enjoyed by the judiciary (36).

- Whitehall and Brussels should borrow from DG Competition's Best Practice Guidelines for mergers, where State of Play meetings are offered to discuss the development of thinking on cases, allowing assumptions on outcomes to be steadily built up rather than sprung upon affected sectors and their financiers (37).

- One option to encourage greater use of horizon-setting could be the seeking of views on reasonable investment/certainty horizons as part of initial consultation. Policy or regulation could then be set on a detailed framework basis. The State of Play review would also include ex-post assessment of actual compared with forecast costs and benefits, with the option of subsequent consultation on amendment, strengthening, or relaxation (38).

- Regulatory Impact Assessment could more effectively be used to make the system more punctilious about Evidence Based Decision Making. One option is to give independent status to the Better Regulation Executive, which could be empowered to undertake RIA independently and require that a proposal failing should, if necessary, fall or its owner renew it with a public explanation (39-40). An alternative would maintain the BRE's role during the drafting process but empower the NAO to review all RIAs between ministerial sign-off and Council political agreement or, for UK-originating measures, implementation of the policy in question or the parliamentary stages of legislation. In practice, this would involve auditing the governance of the RIA process, assessing compliance against a set of tests (41).

- The RIA process should either become statutory, allowing ministerial proportionality decisions to be judicially reviewed, or a Regulatory Appeals Tribunal should be established to cover all cases which do not currently fall under the jurisdiction of the Competition Commission (43). At the very least, it could be progressively introduced through incorporating in new legislation an RIA requirement in respect of decisions made under that Act (Note 14).

- A closer relationship between the Public Accounts Committee and the Better Regulation Commission and Executive, possibly taking the form of an annual performance review, would be welcome (44).

- As an interim measure, around 20% of Assessments should be examined against the proposed tests, with a smaller number being subjected to the current depth of review (46).

- The Conciliation stage of the EU legislative process currently operates behind closed doors and is exempt from Impact Assessment requirements. Compromises are produced with little explanation and no analysis of costs and benefits. Clarity and accountability are as important at that stage as at any other (48).

Transposition risk

- Common Position should not be reached until draft implementation plans have been submitted to the Council Bureau and posted on line. Initial consultation on transposition should become part of the RIA process, with views on costs, benefits and implementation options being invited while proposals are at Working Group stage (53-54).

- Widespread introduction of automatic notification of material produced by the system would make an appreciable contribution to the reduction of risk by limiting one of its factors – imperfect communication (54).

- Transposing Directives verbatim is not an effective remedy. Thin or unclear legislation only creates a demand for detailed guidance notes, in the absence of which the apparent reduction in Red Tape would in most cases be offset by an increase in risk (55).

Enforcement and interpretation

- If the Environment Agency had the autonomy of other agencies such as the Health and Safety Executive and the Food Standards Agency it could take total responsibility for regulatory policy and implementation, enabling more independent and holistic approaches to regulation and offering greater clarity about responsibility and communication (59).

- Regulatory responsibilities could be transferred from local authorities to the relevant central government agencies (62).

- HSE and EA are seeking greater inter-agency co-operation but are hampered by different legislative and institutional regimes. This suggests the more radical solutions flagged by the Hampton Review, namely greater consolidation of regulatory activities (63).

- HSE, for example, publishes its guidance to inspectors, much of it on the web. This practice is to be encouraged (63).

- Greater co-operation is needed between business, government and worker/ environmental representatives at the drafting stages of legislation. This would involve fora where these groups could focus on practical implications (63).

- Greater co-operation is needed between stakeholders about compliance solutions. It is possible, for example, that two track compliance schemes should be given greater attention (63).

Planning

- Local Plans should be monitored on a rolling annual basis, with the possibility of a fast track process. Plans should set out areas where capacity is coming on stream and then establish a simplified planning system within those zones (66).

- Local Development Plans could be shorter if a clear national standards book was produced and much of the detail was moved to local technical manuals. These manuals would also set out s.106 criteria, possibly moving to a tariff basis to reduce uncertainty (67).

- The burden on applicants and planning officers could be reduced through expanding Deemed Consent (67).

- An authority's unreasonable behaviour or failure to produce evidence should be subject to stricter censure. In order to encourage more careful debate on applications, ODPM should review the procedure for awards where appeals or Local Government Ombudsman determinations not only overturn decisions or censure procedures but award costs against the planning authority. An audit trail should be established to show

how Councillors voted on planning matters and whether they were acting against officers' advice, with the information published annually as part of the Council's audit report (67).

- Where Committees endorse officers' advice and a cost award is made on appeal, such costs should be deducted from any Planning Delivery Grant made to the Authority or from its own resources in the absence of Grant. All planning officers should have performance assessments based on their delivery of advice to Committee, so where a refusal recommendation is overturned on appeal with or without costs, such matters should be subject to the officer's performance review. Where officers consistently perform at a high level they should be eligible for a bonus payment from the Planning Delivery Grant, which should be ring-fenced for this purpose (67).

- Public consultation should be focused on Community Plans. Consultation on Local Development Frameworks should be restricted to spatial planning issues such as land use – in other words, non-planning items should be excluded from the planning process (67).

- Greater scope should be offered for the option of dispute resolution ahead of/after the inspector's hearing in order to streamline hearings and reduce the need to appeal. Appeal costs should be loaded as an incentive to settle earlier but Government guidance would be needed on award discretion in order to avoid undue disincentive to appeal (67).

- Call-In should be limited to genuine national projects (67).

- Training should be compulsory for all planning committee members (68).

- Applicants could take steps to reduce risk through embracing community consultation (70).

Other

- Despite the many controls that already exist, policy decisions emerge from a system that can be undisciplined: statements creating expectations can be reversed; judgements about the relative weight of public versus business interests can be unpredictable; timetables are frequently overrun (or not even set), and so on. Should we regard the risk that this creates as an acceptable price to be paid? (81).

- Many sector regulators regard the giving of clear signals to markets and operating on a "reasonable expectations" basis as fundamental to the reduction of risk. Whitehall and the European Commission have no such culture or protocols. Why? (81).

- Why have some Departments and bodies found it so easy to introduce systems that reduce uncertainty by easing and widening access to information and why have so many others been sluggish or resistant? (81).

- Given that public confidence in the policy process and the role of decision makers is generally low, why has the system, both here and in Brussels, only taken isolated steps to improve faith in its governance? (81).

- A realistic explanation of the process, perhaps following the example set by the "Approach Documents" produced by some regulators, should be an integral and initial consideration in any consultation exercise, with approaches or methodologies being

agreed with stakeholders early in the process. Similarly, where they are foreseeable, decision parameters should be set out at an early stage in the process (85).

- There should be a presumption in favour of publishing information on evolving thinking on the application and enforcement of regulatory rules. Decisions on the application of such rules should be shared with all market participants to avoid information asymmetries (p.8)

- Company directors and financial institutions need to embrace the monitoring and assessment of political risk and accept that this is an integral governance requirement under the Combined Code and other corporate governance requirements. Improving risk management may reduce actual risk by developing more accurate perceptions of the policy process (87).

- Few senior officials have had experience of working within, let alone running, the types of organisations to whom they seek to apply policy or regulation. Greater exposure to contextual training is needed if policy makers are to develop an ingrained culture of appreciation of the factors that contribute to risk (88).

RISK COMMISSION STRUCTURE

The following participated in the work of the Commission. Positions are those held during the term of the Commission's work

Bob Armitage (Director, Merck)

Henry Bellingham MP (Conservative employment spokesman)

Edward Blades (DTI observer)

Michael Chambers (Director of Policy, Royal Institute of Chartered Surveyors)

Tony Collins (Partner, Atis Real Weatheralls)

Dr Dan Corry (Director, New Local Government Network; former DTI Special Adviser)

Jitesh Gadhia (Managing Director, Corporate Finance, ABN AMRO)

Ian Gregory (DTI observer)

Brian Harte (Director, Group Head of Compliance and Regulatory Affairs, Barclays plc)

Lord Haskins (former Chairman, Better Regulation Task Force)

Simon Holmes (partner, S J Berwin)

Prof. Bridget Hutter (Director, Centre for Analysis of Risk and Regulation, London School of Economics)

Sharmin Joarder (Better Regulation Executive observer)

Alan Kemp (Director, Haymarket plc; former Special Adviser, DTI and DoE)

James King (Policy Adviser, Regulation and Strategy Team, Association of British Insurers)

Rt Hon Francis Maude MP (former DTI, Treasury and Foreign Office Minister)

Charles Miller (Regulatory Policy Institute)

Huw Morris (Editor, *Planning*)

Simon Oates (DTI observer)

Craig Pickering (consultant and former Head of Asset Finance, Finance and Leasing Association; former Head of Industry Division, H M Treasury)

Hilary Plattern (Director of Public Affairs, Clifford Chance)

Stephen Rea (Government Affairs, Shell UK)

John Rhys (Managing Director, NERA)

Richard Ritchie (Director, UK Government Affairs, BP)

Sue Slipman (Chairman, Financial Ombudsman Service)

Warwick Smith (Secretary, British Generic Manufacturers Association; Chairman, Citigate Public Affairs; former Departments of Environment and Transport official)

Iain Taylor (Director of Regulation, Centrica)

James Walsh (Policy Unit, Institute of Directors)

Sir Steve Robson (former H M Treasury official; Director Cazenove, XStrata and Royal Bank of Scotland) and John Denham MP (Chairman, Home Affairs Select Committee; former DSS, Department of Health and Home Office Minister) also contributed to the Commission's work, but not to the final report