THE FUTURE OF INDEPENDENT REGULATION

Is it possible to serve more than one master ? Regulatory issues where there are multiple regulatory mechanisms

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The scheme of allocation of duties in regulated markets in the UK

The topics for consideration in Sessions 1 and 4 are connected. Session 1 is directed to the relationship between Government, the independent regulator and the regulated companies and tests the stability of the "domain" of the independent regulator.

In Session 4 my focus is on the situation in which Parliament has conferred regulatory functions on Government, or Government agencies, and on "independent" regulators. When the statutory objectives are shared, the expectation of regulated companies is that they will not be given alternative and conflicting routes to meet those objectives.

The main characteristic of the regulatory matrices we have put in place for utility regulation is that the principal levers will be through some form of licence enforcement controlled by the regulator.

Regulatory independence is secured, in part, by voluntary acts of the Executive not to interfere with the exercise of those functions. However, markets can change rapidly and may require more or less regulation, matters which can and rightly should engage the interests of Government. Moreover, markets differ in structure and in the need for some or complete State funding in order to meet social as well as economic objectives.

I will argue that, where it is plainly in the public interest, there can be multiple regulatory mechanisms that do not imperil the independence of the regulator. Indeed to achieve the goal of alignment of achievement of shared objectives, protocols or MOUs, Government guidance to independent regulators, once considered by certain regulators as a serious affront to their independence, are often the most transparent and efficient way of advancing what is now generally regarded as the key objective in regulated markets, that of promoting the interests of the consumer, an objective shared by Government and independent regulators. That is not to sacrifice independence but to improve its accountability and avoid the risk of a democratic deficit.

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The regulator's independence derives from statute

In 2007 the House of Lords Select Committee on Economic Regulators concluded that "it was taken as read by the regulators, the regulated and the Government that the regulators are to be fully independent and that no undue influence should be put on them at any point." Indeed the Committee referred specifically to the evidence of Mr Ed Richards of Ofcom who said that "one of the things which I think people underestimate is the extent to which the idea of independent regulation has become almost quasi-constitutional."

You will not find the expression "independence" in any of the so called privatisation statutes - but, from my own experience, the concept was well established in 1993 at the time of the (first) Railways Act. One anecdote will serve to explain the distinction between independence and a Government agency. When restructuring the railways, the Government followed the model adopted in the legislation of the 1980's by establishing a single person to hold the office of regulator, with a range of statutory duties, including the critical "financeability" duty.

The Government also established the office of a Franchising Director. His main duty was to franchise passenger train operations. In order to get the best price from the market the Franchising Director argued that the train company had to have exclusive rights over the franchised area. But the rail regulator had a duty to promote on rail competition. I asked the Government how the regulator was supposed to promote competition when the infrastructure was to be owned and controlled by one owner - now Network Rail - and passenger rail franchisees were to be granted exclusivity. The answer was, in effect, "well, over to you if there is a conflict in the achievement of that and your other statutory objectives, you will have to resolve it as you see fit." When the Franchising Director asked a similar question the reply was "That's simple. You just do as you are told." Thus the difference between the duties on the Rail Regulator "to take account of guidance given by Government" ,and in that case, time limited and the duty on the Franchising Director to "act in accordance with directions from the Government". Each has duties but a duty to take account of guidance ranked as one only of the duties of the regulator. In the event, the Guidance given to me, which I had to take into account, was very prescriptive in terms of seeking to ensure that no action of the Rail Regulator could prejudice one of the statutory aims, namely the privatisation of the State owned railway. Nevertheless, it fell far short of an instruction and Ministers, and the Permanent Secretary in particular, were very clear as to the distance between central Government and the independent regulator.

Checks and balances

The "almost quasi constitutional" position of the regulator does not elevate the office into one in which there are no checks and balances. The regulator is a creature of statute and has to work to promote the objectives set by Parliament - whether they are divided into main or primary duties and then supported by other duties (Water is a case in point, as is the Health and Social Care Act of 2012) or whether they are listed with no hierarchy of importance. The regulator has to work within the four corners of the statute using, and using only, those functions conferred on it by Parliament.

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Mutuality of interest as between Executive and Regulator

The other key characteristic of the privatisation statutes is that the Secretary of State has duties that correspond closely to those of the independent regulator and which are found within the same statute. The quasi constitutional position of the independent regulator is not detached from that of the Secretary of State for the obvious reason that the efficient operation of the regulated markets is vital to the functioning of the modern state and the operation of those markets is largely dependent on whether the governing statute is fit for purpose in achieving those objectives.

Primacy of Parliament

Government, not the regulator, puts Bills before Parliament. And Bills are then debated, the Royal Assent concluding the process of enacting a law that may be materially changed from the original bill, reflecting the concerns of Parliament. In my experience, two of the most controversial of the statutes governing change in rail and health were subject to substantial amendment in their progress through both Houses of Parliament. But if you compare the early privatisation statutes - telecommunications, electricity, gas and water - with those that are now in force or in the form of Bills laid before Parliament the only fair conclusion is that as market conditions change so must the laws, even if that means in some cases the reappraisal of the proper role of the independent regulator.

Dialogue and discussion falls short of undue influence

Thus if the statute through which the regulator derives its legitimacy requires change then the Regulator must work within a new set of rules. There cannot sensibly be a fixed domain for the regulator or a boundary which the Government must never cross. Thus in my view it is entirely reasonable for the t Government to seek a dialogue with the regulator to understand how the regulator's policies are indeed promoting the shared objectives but such conduct should never amount to undue influence. Otherwise, as the title of this session suggests, the regulated will lose confidence in the stability of the regulatory system and will seek to game it through second-guessing what the Government would require from a regulator. Independence is then lost and the constitutional position has changed.

Evolution of markets leads to legislative changes

Moreover, such a distortion of functions would run directly contrary to Parliament's expectations. If the regulator is to be set different priorities the route must be through Parliament, subject always, of course, to some EU obligation on the Government which may have to be discharged through the regulatory functions. Again, one of the features of the evolution of the laws relating to the regulation of utilities is that of regular and at times significant change in those laws as Government looks for different and better ways of securing and sustaining capacity or of introducing and managing competition or both: Water is a prime example of the Government's concerns as to competence of the existing statutory framework to bring about the results that it seeks. But mastery has to be left to Parliament.

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The Health and Social Care Act 2012

We now have a new statute in the Health and Social Care Act 2012, which took effect earlier this month. In the rest of this talk I would like to sketch out how we can see in the legislation a further evolution of the roles of Government, Government agencies and an independent regulator to meet the challenges of an affordable and effective comprehensive health service, funded by the State and incorporating the general rules relating to competition, as well as regulations and licences. The regulatory processes are in the course of development and therefore I cannot say much about where the elements of the regulatory matrix are going to finish up - but my main theme is that Government and Parliament have kept faith with the principles of independent regulation and applied them within the specific and probably unique context of a taxpayer funded health care system.

Regulatory decision making within the new health care market

In the market for NHS funded health services the basic characteristic of the market is the purchaser/provider split. You are either a provider - a GP or acute hospital offering elective and non elective care; or you are a purchaser - a clinical commissioning group or the Commissioning Board , now known as NHS England (but not as the Secretary of State has pointed out to the Chairman of that body) the NHS *in* England. Centralised command and control, the feature of the NHS *in* England is now to be governed by a new regulatory matrix connecting purchasers, providers, regulators and the Secretary of State, all committed to the primary objective of promoting the interests of patients.

Some of the key players

Within the market, excluding the DH itself, there are at least four "players" with regulatory functions. They are the NHS Trust Development Authority, which has oversight of NHS Trusts; Monitor, which has oversight of and regulates NHS Foundation Trusts; the NHS Commissioning Board, now a non departmental public body, responsible for allocating the budget and delivering on objectives set out in a mandate from the Secretary of State; and the Care Quality Commission with a regulatory role in assessing the quality of providers. The expectation of the Government is that there will be an alignment across the system and close and effective joint working between these bodies, through protocols, guidance from the Secretary of State and from Monitor, and MOUs.

Does alignment mean some form of *undue influence* by the Secretary of State over Monitor, the independent regulator, and thus a weakening of the constitutional position? I do not see that as either the purpose or the necessary consequence. The providers and the purchasers will be operating to a set of rules, found in regulations or licences, which will define their rights and their duties. Monitor will review and where necessary enforce those rules but will be following its published guidance in the interpretation of those rules. The fact that Parliament has required that the guidance should have the consent of the Secretary of State is no more than a reflection of the Secretary of State's own critically important role under the statute.

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Key elements of the regulatory matrix

The way the purchaser/provider split hangs together means that there are now specific duties placed on purchasers and providers, through statutory instruments and licences, which are in most cases enforceable by only one of those bodies - which is Monitor, whose powers have been enlarged under the new HSCA 2012 to be the independent regulator.

Monitor's specific statutory duties

Like all independent regulators, Monitor fulfils specific statutory duties. Those duties are now operative but in their current form are largely untested – some elements of the regime only took effect just a few weeks ago. If the experience in other sectors is a guide, these duties will be debated before a stable consensus is reached on what they mean.

Monitor's main duty is "to protect and promote the interests of people who use health care services [whom from here on, I will refer to as 'patients'] by promoting provison of health care services which … is economic, efficient and effective; and … maintains or improves the quality of the services."

Inevitably, there is a range of secondary duties, which I won't discuss in detail but are, in the context of health care, very important for patients and the sector generally (including preventing anti-competitive conduct, enabling the delivery of integrated care and reducing various inequalities in health care delivery). And, a statutory reminder to the regulator, Monitor is to resolve any perceived conflicts between these duties transparently.

The role of the Secretary of State

So far, that looks very much like independent regulation as we know it in other sectors. But the other dimension of health, as we all know, is the role that the State plays in the market. As part of the 2012 reforms, the Secretary of State's overarching duty to promote a comprehensive health service – a defining characteristic of the NHS – was also affirmed, and the Secretary of State retains ministerial responsibility to Parliament (and hence, to the electorate generally) for the provision of health services in England.

The State as commissioner

The peak commissioning body is the statutory body originally known as the NHS Commissioning Board, although it is now known as 'NHS England'. Commissioning occurs through various regional and sub-regional groups, within NHS England and also in the form of 'clinical commissioning groups', or CCGs, composed of groups in an area or region.

NHS England's main duty essentially overlaps – and gives effect to – the duty imposed on the Secretary of State. It is concerned to ensure provision of service, and has the specific function of "arranging for the provision of services for the purposes of" the NHS". The CCGs do not have a duty in the same way, but the regime makes it clear that they have this same function of arranging for health care to be provided.

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And the accountability of NHS England in the commissioning of services is to be secured through Monitor.

The State as provider

As a provider, the state is active on the market through the various organisations that offer health care, from the largest foundation trusts through to local authorities providing, for example, community home nursing. There are also many other forms of ownership and investment in the sector – including private providers, from chains of hospitals through to individuals (think of dentists or GPs).

And the accountability of the state as provider is secured through licence enforcement by Monitor.

The operation of independent regulation in the new environment

So, how does 'independent regulation' operate in such an environment? How does one distinguish between the legitimate – indeed, necessary – role played by the State in influencing regulatory outcomes where it has a legitimate interest, from an illegitimate compromising of a regulator's independence? The answer is: cautiously, carefully, and in ways that seek always to work in the interests of patients; resisting the temptation to be so drawn into regulatory theory that the main objective – a better, safer, higher quality National Health Service – ever risks being lost from view. The right thing to do may involve cooperation between agencies, or between regulators and the regulated, to act in the interests of patients.

Instruments of regulatory dialogue and transparency

One way that these tensions are resolved is through a direct dialogue between the different institutions and stakeholders.

The most important example may be the NHS Constitution, which embeds the core values of the NHS and is intended to govern all of the players in the system – and stands as a direct commitment given to the patients and all citizens about the nature of the NHS. Beyond that, institutions have various arrangements that are enshrined in MOUs (between Monitor and the CQC, for example) and other less formal ways of cooperatively working.

Command and control through contracts and direction and its counterpart -competition in the market

A particular tension that will be visible to this audience is the balance between what in other contexts we might call 'command and control' systems of regulation, and approaches that use de-regulation and competition to provide benefits to users. The role of competition in health care is the subject of community-wide debate. Much of that occurs, rightly, in the political sphere, and isn't the subject of our discussion today. But I would stress that it is a mistake to confuse 'independence' in regulation as avoiding the need to engage with the wider community. So Monitor should do all it can to make the actions it takes and the reasons for them not just transparent, but accessible, explaining why they are

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in the best interests of patients. Indeed the HSCA places a statutory duty on Monitor to provide such Guidance

Cooperation, service rationalisation and competition can work

But my own experience as an independent Panel member, is that the balance of evidence emerging from fixed price competition in acute care in the NHS in recent years seems to be suggesting that, consistent with economic theory, competition in the market does exist and provides an incentive to raise quality. That finding implies that the engine of choice and competition – so effective in other sectors – can have a significant role to play in achieving the statutory objectives in health care. But competition, in the sense of a free for all and a right to be paid for whatever clinical services the provider wishes to offer, may not promote those objectives. In certain cases service rationalisation may be the only means to secure improved services while maintaining sufficient choice. So much depends, as in most things, on the context.

Conclusion

The future of independent regulation has its most secure base in regulatory accountability to Parliament and not direct accountability to the Executive Government - of the day.

But independence is not to be paraded as if it is some badge of office entitling the holder to move outside well defined, by statute, areas of responsibility. The best independent regulator will always seek to provide the reasonable and practicable solution, after transparent processes.

Similarly guidance by Government should not, save where absolutely necessary, go beyond advice which the regulator is to take into account alongside his other duties. Under most circumstances, the values of transparency and openness are best served when the power to issue guidance is governed by processes set in statute – that is, by Parliament.

Regulation will evolve to continue as what is probably a uniquely British brand of pragmatism and principle to secure economic and social benefits for the people of this country. Like many elements of the British constitution independent regulation will adapt to changes in markets as well as influencing the changes themselves. The bell has not tolled.

Thank you.

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Although John Swift has been a member of the Cooperation and Competition Panel since 2009 and was the first Rail Regulator the views expressed herein are his personal views and should not be taken as reflecting the views of Monitor or his former office.

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