CIVIL JUSTICE SYSTEMS

ETHICAL BUSINESS PRACTICE AND REGULATION

A Behavioural and Values-Based Approach to Compliance and Enforcement

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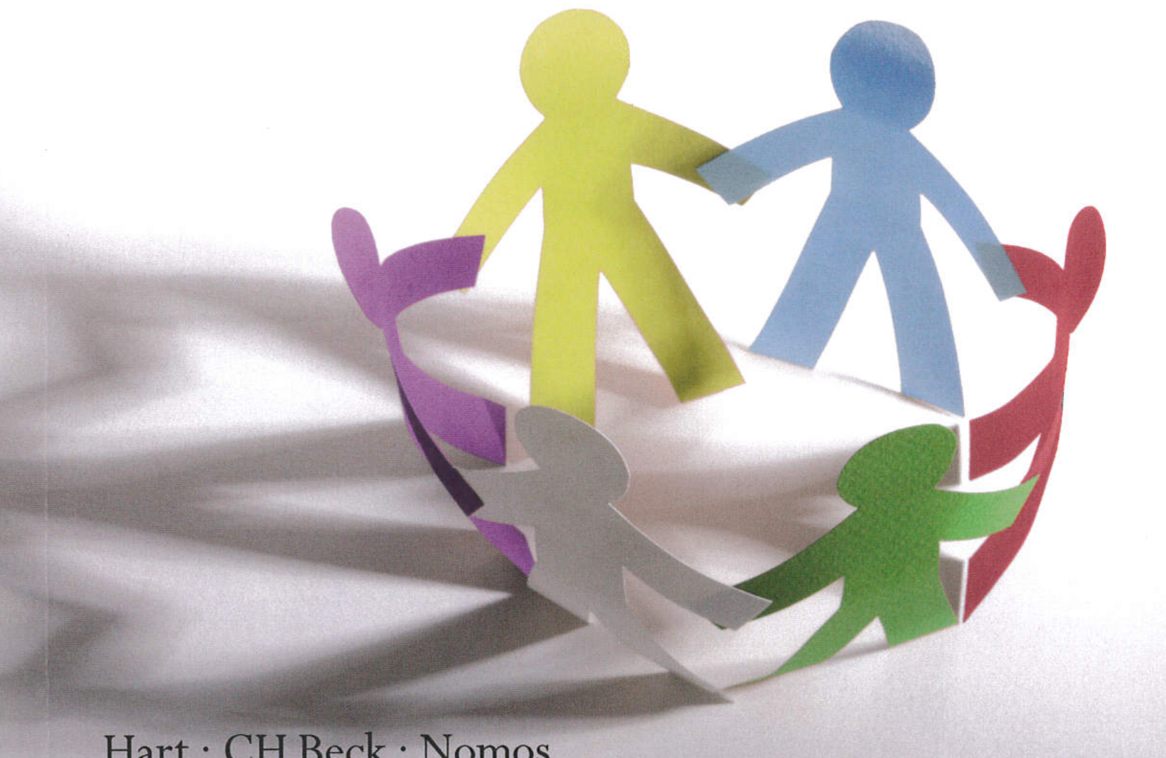

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Ethical Business Regulation

Part III of this book puts all the evidence in Part I to work, in the practical context of business regulation as identified in Part II. How should we design and operate a system for the regulation of business activities based on what we know about how people make decisions and behave, both individually and in groups? How should the regulatory and enforcement system work? What should the relationship be between businesses and regulators, and vice versa, and everyone else?

The basic proposition, as we have discussed, is that the system should be based on expecting businesses to adopt EBP, and thus to do the right thing, and should assist and support them to do that. Each business must strive to behave ethically and show that it does. Where evidence of such commitment to ethical behaviour can be seen, businesses should be treated as adult members of society by equally adult public bodies. Businesses should know that where the evidence of their ethical behaviour is less convincing, the level of trust and of response by regulators will reflect this situation. Where a business demonstrates that it cannot be trusted or is a straightforwardly criminal enterprise, it will be treated accordingly. So, the essential choice rests with businesses and the people who work in them, but the attitude of public bodies and their staff is equally important.

Thus, Ethical Business Regulation (EBR) is an open relationship of trust between businesses and regulators built on evidence that both sides can be trusted and that each will, unless evidence to the contrary occurs, treat each other with respect in openly and fully cooperating to regulate risk and commercial behaviour in accordance with the fair rules of their society. This adult–adult relationship is based on the scientific knowledge set out earlier on how to support human behaviour in constantly monitoring and improving performance.

The design and operation of a regulatory system will be most effective where it adopts the following principles:

1. *A policy of supporting ethical behaviour*. The regulatory system will be most effective in affecting the behaviour of individuals where it *supports ethical and fair behaviour*.
2. *Ethical regulators*. Regulators should—self-evidently—adopt unimpeachable, consistent and transparent ethical practice.
3. *Ethical businesses*. Businesses should be capable of demonstrating constant and satisfactory evidence of their *commitment to fair and ethical behaviour*

that will support the *trust* of regulators and enforcers, as well as of employees, customers, suppliers and other stakeholders.

4. *A learning culture.* A blame culture will inhibit learning and an ethical culture, so businesses and regulators should encourage and support an essentially *open* collaborative 'no-blame' culture, save where wrongdoing is intentionally or clearly unethical.
5. *A collaborative culture.* Regulatory systems need to be based on collaboration if they are to support an ethical regime and to *maximise performance*, compliance and innovation.
6. *Proportionate responses.* Where people break rules or behave immorally, people expect to see a *proportionate response.*

Establishing EBR

People and organisations that demonstrate that they can be trusted on a consistent basis deserve the response of being trusted. One of the objectives of EBR is to support commercial activities by providing ongoing and consistent evidence that businesses can be trusted because they behave ethically in all that they do. Having a reputation not just for delivering good service and products but also for respecting customers, staff, suppliers, investors, neighbours, local communities and the society within which one operates should be good for commercial results. But, in addition, it should be good for the outcomes that public regulators and enforcers and internal management and compliance officers aim to produce. A further objective is to enable both business and regulators to benefit from a relationship based upon mutual trust. The regulator will benefit by having a cooperative and trustworthy partner and therefore being able to devote its resources to businesses that are at greater risk of non-compliance. Business will benefit by devoting time and resource to activities that will also enhance its commercial success. Thus, regulators should *enable* firms to enter into EBR arrangements and should *remove barriers* to them doing so, but should not require this: consumers, society and the market should drive the spread of EBR. One would hope that businesses would see the benefit and would encourage their regulators to consider an EBR approach.

The aim in the regulatory context is to do this by a business establishing a body of convincing evidence that it can be trusted to observe regulatory rules, to strive to exceed the standards that they set, to identify the root causes of problems as soon as possible and to take steps to rectify them. It will do this by nurturing an internal culture of doing the right thing and speaking up—an ethical culture. The evidence will be reliable, verifiable, transparent, consistent and constantly produced.

In an ethical business culture, the objectives of internal compliance and external regulation are the same. Accordingly, they should operate together by being integrated and fused, delivering not only effectiveness but also efficiency.

Measures of EBP

A regulator will ask: 'How can I tell if a business is being ethical—if it practises ethical business or not?' Traditional compliance and regulatory systems are based on systems that measure and produce metrics, so we understand that some form of quantification will be desirable. Although measuring culture may combine elements of art as well as science, useful tools are available and have been used to do so for the past 20 years in thousands of organisations. We do not agree with the following conclusion by leading City of London bodies:

> The conclusion that culture matters is a problematic one for regulators because it involves a qualitative approach. They cannot force companies to have a 'good' culture because they cannot define exactly what that means and measure compliance on an objective basis.[1]

Instead, we agree wholeheartedly with the second part of the assertion that: 'Good company culture does not lend itself to easy measurement and cannot be enforced via a tick box exercise.'[2] The components of good company culture can increasingly be measured and described based upon empirical research as the presence of certain characteristics and the absence of others, despite there not being only one combination of these characteristics that produces good outcomes.[3] For an individual business, it is a question of the accumulation of different pieces of evidence, ideally over time. It will by necessity involve examining a range of indicators, both quantitative and qualitative, rather than focusing on one 'objective' standard.

We still must be careful not to approach culture by means of a 'tick-box' approach with one list of requirements, such as might be included in an 'international standard on culture'. Ethical cultures do not all share the same exact characteristics; each business has a unique culture and its own values based, as we have seen, on many factors. Even organisations in the same industry sector will have their own personality and despite this may all be ethical. It is not possible to try to score businesses' 'comparative ethicalness'. In practice, one might say, in general terms, that a business is more ethical in its decisions on some subjects than others (such as staff safety or treating customers fairly) or that some businesses are more ethical overall than others, but these are value judgements and do not lead to a 'one-size-fits-all' definition of 'good' culture.

We suggest that evidence of a 'good' culture can be seen from the existence of systems that encourage certain behaviours and discourage others. There are many indicators and sources of information about culture, including leadership behaviour and communications, cultural values assessments, internal audit reports, anti-corruption risk assessments, employee and customer surveys, exit interviews, turnover rates, performance management discussions, etc. Looking at the number and type of staff, customer or supplier complaints or feedback of any kind can tell you a lot about the extent to which a business is respecting and respected by those groups. The state of an organisation's culture and parts thereof can be measured by established cultural assessment tools that survey employee values and the views of employees and other stakeholders on the values lived in the culture and on managerial behaviour.

In addition to specific cultural values assessment tools, there are other ways that one can collect information about the culture of an organisation, though we believe cultural assessments based upon measuring values are a powerful way to turn qualitative input into quantitative data. No one source of information will be adequate, so it is wise to look at all possibilities. For example, the FRC's 2016 report contains a series of questions and actions for board members to use to identify the culture of their organisation.[4] In addition to a list of questions to ask management, the report suggests board members should get a real feel by talking to the 'front line'. Board members, including non-executive directors, have a role to play in raising the tone of an organisation and their knowledge of the organisation should extend beyond the balance sheet. Therefore, these questions relate to the alignment of human resources processes such as performance reviews and incentives, as well as the risks that the corporate culture may create for the organisation and the ethics and compliance programme. The FRC report notes the employee engagement survey as a very widely used human resources tool for gauging culture. While employee surveys can be useful in this regard, they do not tell the whole story and can be complicated to interpret.

New cultural measuring tools for use in this area are being developed in response to the need to gain specific insights into the so-called compliance culture of an organisation as well. Increasingly, companies are communicating with the public about their values, their aspirations with respect to ethical behaviour and the means that they use to accomplish their goals. The Sustainability Reporting Standards of the Global Reporting Initiative (GRI) are an example of this trend. The GRI was created to promote transparency and drive concerns regarding sustainability into the decision-making processes of organisations globally. Although the standards cover a broad range of topics, they include numerous topics relevant to an organisation's commitment to behaving ethically. The point is that companies are generally becoming more willing to open themselves up to scrutiny in this regard. This is a trend that will facilitate the adoption of EBP.

As mentioned earlier, we do believe that it is possible to identify the general elements of the systemic adoption of EBP by a business. We set out some of our own ideas in chapters 13 and 14. Evidence of EBP could be indicated by external bodies such as the Good Corporation, Investors in People, or British Standards Institute or ISO certifications, but could also be through arrangements with regulatory bodies on the Primary Authority model. However, we emphasise that it is critical to avoid falling into the trap of specifying one rigid description or certification standard of or for EBP and insisting that all companies that aspire to it look alike. This is tick-box compliance by the back door. That is why we advocate a smorgasbord of indicators from which a company can choose those that best fit their culture and risk profile.

The evidence that will be necessary to establish ongoing trust may differ depending on the particular sector, type and size of business, and stage of development of both individual businesses and regulators. Hence, approaches will both differ and develop. In accepting that a business is trying to behave ethically, or to improve its behaviour, the judgement is one of whether the regulator—or any other observer—ultimately trusts that the business is genuinely making a serious and competent effort. Such trust should ideally be based on a relevant spread of evidence of different metrics, outcomes, experience and behaviours, including adherence to the items mentioned in the frameworks set out in chapters 13 and 14, and in whether there is a formalised relationship between the business and the regulator, such as under a Primary Authority-type model in which responsibilities and sources of evidence will be set out.

An EBP approach should start from basic ethical values that govern all actions, decisions and behaviour. In this respect, it equates to a regulatory regime comprising a tiered structure that has basic principles at the top, with secondary principles underneath, followed by rules that have greater granularity. This is the system proposed by Ofgem in 2016. The result should be that the complexity of a regulatory system can be reduced or avoided. The basic principles (do the right thing, check, ask, speak up) should guide conduct in unfamiliar situations. A large body of rules should be avoided, possibly replaced to a considerable extent by less formal guidance on what to do in certain situations (similar to the Primary Authority scheme's 'assured advice' arrangement explained in chapter 5 above, and the Bribery Act's 'adequate procedures' to prevent bribery approach, which will be discussed in chapter 12).

We wish to emphasise that adopting EBP is a voluntary choice by businesses. Regulators cannot require it; adoption should be consciously chosen by individual firms and individually demonstrated. Small or entrepreneurial businesses that are testing concepts or innovations might not be expected to be able to adopt complete ethical systems or frameworks, although mechanisms to ensure compliance with legal requirements would be required. Proportionality is key: are the values, norms and policies adequate in proportion to the risks the organisation is facing? Thus, the steps required to achieve EBP might not be universal, and it may take time for them to spread to some sectors. But it should be possible for those outside a business to be able to identify where a firm stands in relation to ethical practice. The Corporate Governance Code requires a board to establish the business' ethical values, and both these and the extent to which they are achieved should be transparent. We should be able to choose whether we want to work in, with or invest in a business based on its ethical track record. To do so, we need evidence.

EBP should be recognised by enforcers without a formal arrangement necessarily being in place. However, an EBR arrangement can go further than just providing information. It should ideally be a cooperative co-regulatory agreement aimed at delivering the shared outcomes of compliant and constantly improved performance. It should also do the following:

1. Identify who is going to perform which *tasks* in relation to the monitoring and improvement of regulation functions, such as checking, educating, evaluating, feeding back, producing change and so on. The objective is to produce an integrated and efficient system, avoiding unnecessary duplication but providing verification. The delineation of responsibility for specific tasks should be established.
2. Identify what type of *evidence* is going to be produced that will demonstrate not just compliance and performance but also ethical culture.
3. Agree a joint *commitment* to ethical practice to include openly discussing issues that arise and responses to them.

The existing Primary Authority scheme involves constructive, legally recognised partnerships between a business and a nominated local authority, enabling the provision of reliable advice to business and arrangements for coordinated and consistent enforcement.[5] Some Primary Authority arrangements are now being extended to include other regulators and trade associations or others.

The objective will be to find a way to balance conflicting needs: regulators and society want to know who to trust, and companies must be involved in a genuine attempt to express their best ethical culture.

Appendices 1 and 2 contain various lists of actions for businesses, regulators and governments that would support the adoption and spread of EBP and EBR. These lists are intentionally generalised, so they can be applied in differing specific contexts. Making EBR work starts with a state of mind. The objective is to incentivise entities to adopt ways of being and doing that create the conditions for ethical decision-making and behaviour to thrive.

While we must emphasise that there is no one way for an organisation to be ethical or to arrive at ethical business practice, we have set out in chapters 13 and 14 our ideas in the form of a cultural and leadership framework and a values-oriented ethics and compliance framework that, if adopted, we believe would allow an organisation to create, assemble and share relevant evidence with its regulator(s).

The EBR Relationship

The essence of EBR is the *relationship* between a business and a regulator. It is a relationship within which both business and regulator are incentivised to do the right thing and behave openly and fairly because trust takes time to build, but only moments to destroy. It must be adult, open, ethical and just. The Civil Aviation Authority refers to an *adult* conversation between airlines and others and itself, based on mutual respect, in which relevant information is openly shared,

discussed and recorded. The parties would usually agree on action to be taken, but can disagree, and recording this usually assists in resolution. A straightforward example of this relationship approach is that of Revenue Scotland, which begins its 'standards and values' with the simple statements set out in Case Study 21. The first requirements on both sides are to be, and to be treated, honestly.

Evidence of trust has to flow from both sides—it is axiomatic that a body and its officials who represent the public should behave ethically. It is necessary to devote enough resources to having this type of relationship and conversation. It is axiomatic that all regulators need to ensure that they themselves demonstrably and consistently adopt the highest ethical standards. This follows inevitably from the well-established criteria of integrity and independence that are essential to maintain the legitimacy of their mandate. Public authorities represent the state and the public. A society that claims to be based on ethical principles should be able to trust that its agents act in accordance with its values.[6] Therefore, it also follows that the higher their standards, the better able public officials should be to encourage businesses to embrace ethical conduct as a route to compliance, and the greater the perception of acceptability of their regulatory and enforcement actions. In other words, if the reputation of a regulator falls below acceptable standards, there is far less hope that businesses will take seriously either the authority of that regulator or ethical conduct in general.

The requirement for regulators to be accountable leads to the need for them to welcome feedback and complaints to help them improve. This means that robust mechanisms need to be in place in relation to how to build trust and listen to feedback, and businesses need to trust that they can use them. Further, applying the concept of fairness to a system of risk-based regulation requires that a regulator should focus its efforts on those who deserve it.

An EBR relationship involves a culture of sharing full information and not hiding or delaying it. The ideal is a relationship jointly focused on achieving the shared ends. It will involve understanding the other's position and priorities. It will involve respect for the unique positions of each side: the regulator represents the public interest (rather than that the regulator is able to exercise power) and the business represents the interests of all its stakeholders and customers.

A regulator will need to adopt a basis and culture of distinguishing between ethical and unethical businesses and responding to each accordingly. A regulator should respond to a business that is ethical and deserves the regulator's trust by adopting a supportive approach. Precisely this distinction is at the heart of the approach to citizens of Revenue Scotland and the Scottish Environmental Protection Agency (see Case Study 21). It is striking how Revenue Scotland's basic covenant is: 'We will treat you as honest, and we expect you to be honest.'

In the context of a relationship between a business and a regulator, the point is that issues should be discussed between them rather than hidden. The EBR relationship should expect openness on both sides. This is the basis of the relationships in the civil aviation sector and the Primary Authority scheme outlined in chapters 5 and 12. If a business is unsure about how to interpret and apply legislation, the 'assured advice' mechanism in the Primary Authority scheme provides a mechanism for it to ask the regulator for a view on which the business may rely. Crucially, making such a request will be highly unlikely to trigger enforcement action.

Case Study 21: Revenue Scotland's Standards and Values[7]

Revenue Scotland will:

- Treat you as honest (unless there is reason to believe otherwise).
- Bring to account those who act dishonestly and try to evade paying tax, and challenge those who seek to avoid paying tax.
- Treat you courteously and with respect.
- Recognise your right to confidentiality and keep your data secure.
- Act with integrity and fairness, comply with relevant laws and regulations, and provide a prompt, accurate and professional service.
- Use our powers reasonably, consistently and proportionately.
- Provide you with guidance and support, helping to make it easy for you to comply with your obligations, pay the right amount of tax and claim reliefs to which you may be entitled.
- Work with you to minimise your costs in dealing with us, respond promptly and conclude matters as quickly as possible.
- Respect your right to complain if you are unhappy with our service, and your right to appeal if you disagree with a decision we have made on tax liability.
- Respect your right to be represented by someone.

Taxpayers and their agents and representatives (paid or unpaid) will:

- Be honest, cooperate fully and take reasonable care to ensure you provide all relevant information.
- Accept the responsibility to understand your tax compliance duties and seek assistance where necessary.
- Respect our staff and treat them courteously.
- Keep accurate records of all activities that may be taxable.
- Make accurate returns and claims with care and on time, to the best of your ability, knowledge and belief.
- Let us know promptly if you think you have made a mistake.
- Let us know promptly if you might have difficulty making a payment.

Responding to Adverse Events: Resisting the Impulse to Blame

When adverse events occur, the temptation to default to a blame culture must be resisted if learning and improvement are to occur. A natural response to problems (but one that Laloux would say comes from an earlier stage of development) is to

ask 'Who's to blame?' rather than taking care to find out what the real cause of the problem is—and hence what the real solution is—and then reducing the risk that the problem recurs.

This is not to say that appropriately strong sanctions and responses should not be applied to those individuals who deliberately or recklessly break the law. It is important that proportionate consequences are applied to morally anti-social behaviour. The key issue here is the intention of the individuals: was it ethical or not? Were they wilfully ethically blind? Did the organisation take steps to minimise the risk of ethical blindness? Those with disciplinary and enforcement powers should distinguish between people who are intrinsically legal or illegal, responding to criminals with strong enforcement and supporting learning and improvement by those who were unfortunate or just unintentionally got things wrong. However, even for the latter, their response to having caused harm should be to apologise, explain and repair.

But the EBP and EBR paradigm is to support an open and just culture of sharing information. Adopting a punitive response for people who did not intend to cause harm will destroy that. The enforcement strategies and practices of legislators, regulators, prosecutors and courts—as well as businesses internally—should promote and recognise business commitment to an ethical approach. A considerable amount of work has been done on furthering this approach in various contexts, as we will note in chapter 12.[8]

The paradigm also involves a business doing the right thing by proactively seeking to prevent problems from arising, seeking to identify problems as soon as they arise, disclosing the problem, investigating the problem and identifying its root cause, analysing the means of reducing reoccurrence, making changes so as to reduce the risk of it happening again, putting right any damage caused and continuing to monitor the situation. Enforcement policies should incentivise this behaviour. The approach of the Bribery Act 2010 (see chapter 12 below) to exonerating companies that have adequate procedures in place is on the right track. Enforcement policies that are based on taking into account aggravating and mitigating factors are also on the right track, but they may take into account factors that are irrelevant to the essential issue of whether the perpetrator was behaving ethically or unethically. They are not acceptable if they still impose a high penalty in response to people or organisations that have tried to do the right thing. EBP should also be recognised and supported irrespective of whether a formal arrangement is in place between regulator and business.

If the 'blame game' is not going to be pursued, it will be necessary for people to know that this is the case and that the reason for this is that trying to blame someone for events prevents learning, improvement and prevention of reoccurrence. This will need a clear and consistent public statement of the policy, and political leadership over its adoption. The importance of this cannot be overstated. Both business and regulators will be concerned not to be seen to be adopting a self-serving shift in policy, and the public must therefore understand how they will benefit and how companies will be held accountable for improvements and mitigation of the risk of reoccurrence.

'Deterrence' as a term should be dropped. It involves connotations that are ineffective and describes an earlier style of society that believed that fear and punishment produced good behaviour. We should talk instead about 'affecting future behaviour'. Influencing future behaviour has to be addressed specifically and separately from responding to historical behaviour

The scientific evidence is that 'deterrence' has at best a limited effect on future behaviour in many circumstances. It is possible to influence the brain by reminders not to do something. But constant surveillance of every activity by others is not possible or affordable. A society based on mutual surveillance and accusation is unattractive and constitutionally unacceptable. In contrast to the deterrent approach to *enforcement*, there is now a significant body of evidence that influencing behaviour by maximising actors' internal controls can be highly effective, can apply to multiple behaviours/actions and can be efficient. Further, enforcers in a wide range of regulated environments seek to maximise *compliance and performance* based on supporting rather than blaming. An unfair 'deterrent' response will prevent the voluntary flow of information, prevent learning and undermine an ethical culture.

The basic question in investigations and deciding on sanctions is to identify whether the people who caused the offence were intending to act ethically or not. Are these people and organisations ones that you can trust consistently or ones that do things for unethical motives, such as making money illegally? The Anderson review divided people who break laws into a typology of five clusters of people: prepared and established; guilty procrastinators; capable but unconcerned; conscientious but challenged; and blind-eye turners.[9] A similar segmentation approach has been used by HMRC and the Scottish Environmental Protection Agency, whose model is given in Figure 11.1.

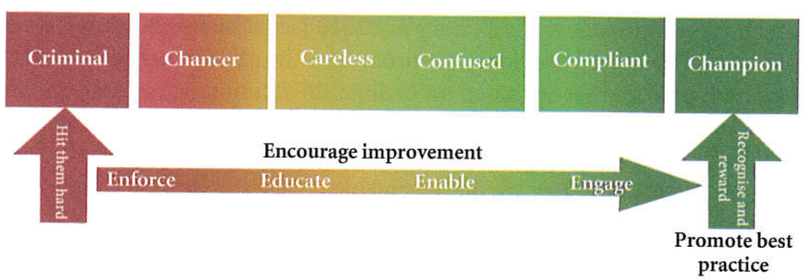

Figure 11.1: Segmentation of offenders: the Scottish Environmental Protection Agency's spectrum of compliance

Case Study 22: Relations between a US Regulator and a Major Company

In the mid-1990s, Hodges attended a large internal conference in an American drug company, at which one of the speakers was a senior official of the Federal Drug

Administration (FDA). He began his remarks by congratulating the company on its close working relationship with the FDA. At that point, an in-house lawyer leant over and said: 'We escort them onto the campus and we escort them off. They only get to see and discuss what is agreed in advance. We don't share things with them unless we have to.' This approach contrasts with what Hodges had observed in numerous different contexts of the relationship between the UK regulator (now the Medicines and Healthcare products Regulatory Authority (MHRA)) and firms in the UK (even the same firm as that just mentioned in its US context). The relationship was based on professional respect and trust, since most of those taking part on both sides were qualified in medicine or pharmacy. They had no difficulty in sharing and openly discussing the technical information, and agreeing the right course of action. The problem that both sides faced was more to do with the inexpert attitudes of politicians and the media, and how best to explain their technical decisions to such non-experts. The first question that these interlocutors would ask was: 'Who is to blame?' To those who were grappling with complex technical issues, lack of complete data, and a serious gap in comprehension and communication, a simplistic framing of an issue in terms of blame was simply irrelevant and did nothing to aid public understanding, reassurance or protection.

There must be better ways than this!

Conclusions: Reasons to Adopt EBR

There are various reasons that support adoption of EBR. For government, the major considerations are:

— to implement economic policy based on both promoting business by reducing burdens whilst also improving outcomes;
— to save public resources in stretched public authorities by extending greater self- and co-regulation that has a significantly higher likelihood of avoiding the historical problems of less than ideal compliance and behaviour associated with self-regulation, by supporting business;
— to seek shared outcomes, growth and innovation;
— to reduce 'compliance' and 'enforcement' activity and to make it more effective, given the growing realisation of the drawbacks of enforcement based on economic or individual deterrence rather than on behavioural science and thus maximising the outputs through motivating and encouraging voluntary ethical practice. This allows enforcers to concentrate resources and hard enforcement on high-risk and criminal activities.

For business, the advantages are:

— to achieve increased performance in terms of compliance and risk reduction, since this supports profitability and innovation;
— to improve relationships with some regulators and enforcers, since an open relationship is more productive in terms of achieving desired outcomes than an adversarial one;

— to address a lack of consistency between different enforcers now that some widely different approaches have become apparent. Inconsistency of approach applies not just within countries but also between states. The different culture of regulators raises challenges and costs for businesses;
— to reduce uninformed political influence on balanced and fair regulatory decisions. This is seen as a real problem in responding in a logical way to reducing risk, especially in responding to a crisis. It distracts from addressing the real issues. The over-reaction of asking 'who's to blame?' leads to a witch-hunt and the imposition of excessive and irrelevant extra regulatory burdens;
— to reduce the level and imposition of fines and to divert expenditure to remediation, although this involves spending on ethical culture and putting things right;
— to benefit from the likely strengthening of the company culture and hence financial performance.

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Developing Examples of Ethical Regulation

The nature of regulation differs depending on its context and the nature of what is being regulated (safety, prices, standards and so on), and the practice of regulation has also evolved at different speeds and ways in every context. Developing EBP and EBR is a journey, and will differ depending on the sector and context. We look here at some examples of developments that can be seen as supporting EBR (or not). We have already seen in chapter 5 examples of regulatory cooperation, in the pharmacovigilance system (and similar product safety systems), civil aviation safety, the Primary Authority scheme and workplace health and safety. When one starts to look, one can find many diverse examples of current practice that adopt aspects of EBR.

Civil Aviation

A strong illustration of the flexibility and collaboration that is possible within the new approach is that of the Civil Aviation Authority, which has for some years adopted an open approach with most major airlines (but reserves deterrence for some other operators or situations). Figure 12.1 shows that its direction of approach starts with 'collaboration and facilitation', moving to 'advice' and ending with an escalating series of formal enforcement tools.

The Primary Authority Scheme

The coordinated approach of the Primary Authority scheme has been hugely successful in delivering assured advice to support consistent good practice. For trusted businesses, it reduces the need for inspections or enforcement action and instead supports communication within an established relationship so as to identify and swiftly resolve issues as they arise. It has spread quickly, and now involves 10,000 businesses, 90% of which are small. Most of the benefits of Primary Authority for a business have come from the ability to talk to a regulator (paying for the

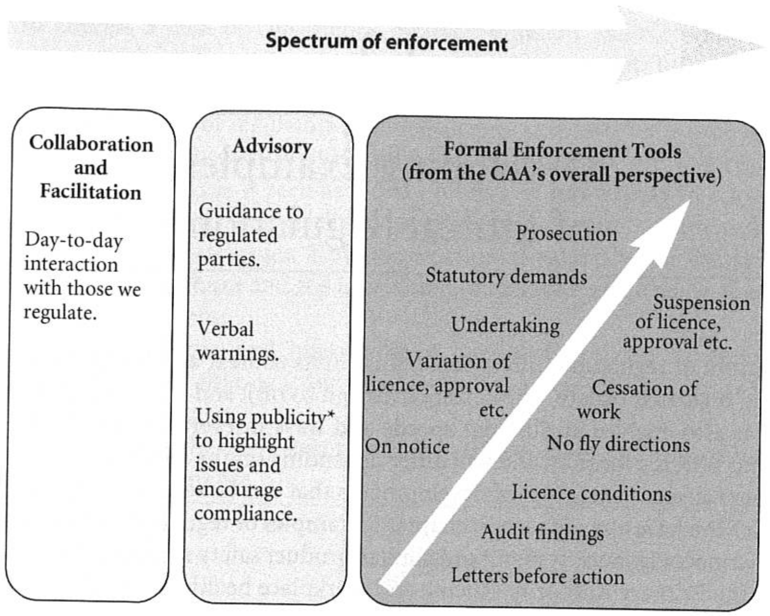

Figure 12.1: ***Civil Aviation Authority Regulatory Enforcement Policy*** **(2012)**[1]

consultancy time). There has only been one dispute to resolve in 8 years, whereas there have been many previously.

Some success stories from the Primary Authority scheme are as follows:

— At a Northamptonshire local authority, savings to businesses in 2014–15 were estimated to be £80,000, with improvements in business compliance and satisfaction.
— Imperial Cars' partnership with Portsmouth City Council reduced complaints to Trading Standards by half and increased turnover by £27 million.
— A care home group (HC-One) made savings of £1 million as a result of agreeing single best practice that was applied consistently across its multiple homes in different geographical areas across the country.[2]

From 2016, the Primary Authority architecture has been extended in two directions: vertically to include trade associations within the relationship structure and horizontally to be able to include some national regulatory authorities.[3] From October 2017, 'every UK business can access advice they can trust from one place'.[4]

The government's Regulatory Delivery Directorate published its service standards in 2017 on what businesses can expect of it, which emphasise that it carries out all its activities 'in a way that supports those we regulate to comply and grow' and includes the following statements (which, it will be seen, are a long way from an approach based on deterrence):

> *Helping you to get it right*
>
> We want to work with you to help your business to be compliant and successful and it is important to us that you feel able to come to us for advice when you need it. We won't take enforcement action just because you ask us a question or tell us that you have a problem …
>
> *Responding to non-compliance*
>
> Our aim, when dealing with non-compliance, is to deliver fair and objective enforcement in a manner consistent with the intentions of the legislation and the necessity of delivering a robust and credible enforcement regime. Where we identify any failure to meet legal obligations, we will respond proportionately, taking account of the nature, seriousness and circumstances of the offence, including taking firm enforcement action when necessary.[5]

As can be seen from the discussion in chapter 5, the architecture of the Primary Authority scheme, as extended in 2017, is expressly designed so as to enable trade associations and other bodies to be able to influence—and partly regulate—their members. Other stakeholders such as NGOs can also have a huge potential to influence organisational behaviour.[6] Historically, it has proved difficult for external stakeholders to influence, or be interested in influencing, SMEs.[7] Similarly, we noted in chapter 9 concern by investors that they are not able to exert adequate pressure on behaviour. SMEs, by definition, are small groups of people and are more likely to be influenced by the ethics of their owner-managers, which are in turn influenced by market values and revenue-based activities.[8] Equally, there is plenty of evidence that SMEs can be responsive to advice, education and 'rehabilitative' approaches.[9] The Primary Authority scheme has been successfully built on that premise and there are signs of new feedback mechanisms emerging that may assist the responsiveness of SMEs towards customers and wider agendas.

Food Standards

The Food Standards Agency (FSA) has adopted a strategic goal of 'Food We Can Trust' and published the following five principles that form the core of discussions with stakeholders in 2016:

1. *Businesses are responsible* for producing food that is safe and what it says it is, and should be able to demonstrate that they do so. Consumers have a right to information to help them make informed choices about the food they buy—businesses have a responsibility to be transparent and honest in their provision of that information.
2. FSA and regulatory partners' decisions should be tailored, proportionate and based on a clear picture of UK food businesses.
3. The regulator should take into account all available sources of information.
4. *Businesses doing the right thing for consumers should be recognised*; action will be taken against those that do not.

5. Businesses should meet the costs of regulation, which should be no more than they need to be. (Emphasis added)[10]

The FSA's 'Regulating Our Future' policy[11] adopted an 'open policy-making' approach that involves multiple stakeholders: expert advisory groups from industry and from professions, a consumer panel, 'hot house' groups to resolve particular issues (such as national inspection strategies), tailored stakeholder engagement, feasibility studies and pathfinder trials. Potential assurance streams that are anticipated for the future include: audit by independent accredited third parties, internal checks by first and second parties, official controls by a competent authority, and certified regulatory audits, the last introducing competence assessment.

Studies published in 2017 that compared the approaches to assessing compliance and scoring of the public authorities and of two major businesses showed consistent similarities. This supported the policy that audit data collected by food businesses could be used by local authorities to check food hygiene standards and decide ratings.[12] Hence, the authorities could rely on businesses that they trusted. This approach was seen to be logical when it was realised that a major supermarket employed 800 people collating and scrutinising supply chain data.

A programme involving the FSA working *with* the major retailers and processing plants in relation to the incidence of campylobacter on chickens led to a 17% decline in the number of laboratory reports of the bacteria—the most common cause of food poisoning—in 2016, which was estimated to have led to 100,000 fewer human cases of campylobacter, with a direct saving to the economy of over £13 million in terms of the cost of days off work and NHS costs.[13]

Workplace Health and Safety

The good work of the HSE in relation to improving the safety of construction work has been referred to in chapter 5 above. In 2011, the Institute of Directors and the HSE published advice that the basic principles in maintaining health and safety in workplaces were:

1. Strong and active leadership from the top:
   a. visible, active commitment from the board;
   b. establishing effective 'downward' communication systems and management structures;
   c. integration of good health and safety management with business decisions.
2. Worker involvement:
   a. engaging the workforce in the promotion and achievement of safe and healthy conditions;
   b. effective 'upward' communication;
   c. providing high-quality training.
3. Assessment and review:
   a. identifying and managing health and safety risks;

   b. accessing (and following) competent advice;
   c. monitoring, reporting and reviewing performance.[14]

The advice stated that company boards typically fall short in not leading effectively on health and safety management; they should all consider the following issues: competent advice, training and supervision, monitoring and risk assessment.

A 2012 meta-review of 40 papers, of which 35 were quantitative studies and 5 were qualitative studies, found the following consistent associations between specific leadership styles and safety outcomes:

— *Transformational leadership* (e.g. acting as a role model, inspiring and motivating employees to work safely and showing concern for employees' welfare) enhances a number of safety outcomes including fostering perceptions of a positive safety climate, promoting higher levels of employee participation in safety activities, compliance with safety rules and procedures and safety citizenship behaviours (e.g. participation in safety committees, looking out for workmates' safety).
— *Transactional (contingent reward) leadership* (e.g. clarifying performance expectations, monitoring and rewarding performance) is associated with perceptions of a positive safety climate, positive safety behaviours and reduced accident rates.
— *Passive leadership* (i.e. turning a blind eye to safety) is associated with lower levels of safety consciousness, negative perceptions of safety climate and an increase in safety-related events and injuries.
— The effects of transformational and transactional leadership are both direct and indirect. In the latter case, positive effects are achieved through the promotion of a positive safety climate. In addition, transformational leaders can influence safety by enhancing employees' levels safety consciousness (i.e. knowledge).
— The benefits of transactional leadership are enhanced when safety is valued across different levels of management. Transformational leadership styles combined with trusting relationships between management and employees enhance employee safety performance such as safety citizenship behaviours.
— *Trust in management* influences perceptions of safety climate as well as accident involvement. Behavioural consistency, honesty and integrity, sharing and delegation of control, openness and accuracy of communication, and demonstration of concern are qualities that influence the development of trust in leaders.
— The quality of relationships between employees and management, particularly supervisors, impacts on safety. *High quality leader-member exchanges, characterised by mutual trust, and openness* are associated with higher levels of upward safety communications, safety citizenship behaviours and reduced levels of safety-related events. Safety citizenship behaviours in particular, are pronounced when, in addition to high quality leader-member exchanges, leaders emphasize the value of safety and promote a positive safety climate.[15]

The review noted that those studies that focused on specific safety management attitudes, behaviours and practices (and all of these things could be said of ethics) have consistently shown that:

— *Management commitment to safety* is associated with a reduction in risk-taking behaviours and violations, lower levels of self-report incidents and higher levels of learning from safety events.

- *Perceptions that safety policies and procedures are enforced* and consistently implemented are associated with lower levels of incident under-reporting, self-report injury incident and higher levels of satisfaction with the organisation.
- *Leader support for safety and openness to safety suggestions* is associated with higher levels of employee willingness to raise safety issues, lower levels of self-report injuries, higher levels of satisfaction with the organisation and can lead to a long-term improvement in safe working practices.
- *Safety communication* between management and the workforce is associated with a reduction in the levels of risk-taking behaviours, promotion of positive safety behaviours and reduced levels of self-report work-related pain.
- *Active involvement in safety* helps promote perceptions of a positive safety climate and fosters increased levels of employee accountability and responsibility for safety.

In fact, one of the salient points we have observed is that effective approaches to safety and ethics are remarkably similar.

Case Study 23: Ethics as Analogous to Safety[16]

While reviewing the Borealis Code of Ethics and 'ethics excellence programme', we learned many lessons from the step change in safety that was ongoing at the same time. Messages such as 'you are looking at the person responsible for your safety' posted on the mirrors in the lavatories equated to our mantra 'ethics is everyone's responsibility'. Also, by discussing the relationship between the two concepts, we found it easier to gain employees' attention and commitment to ethics. Safety was more intimately associated with the well-being of the average employee, and it was a not difficult to show how ethics and integrity could affect them in similar ways. This analogy is useful in manufacturing companies that can relate to safety concepts but have not yet matured in their approach to ethics.

Energy

Ofgem, originally created as an economic regulator, broadened its approach and introduced Standards of Conduct (SoCs) in 2014. A principal objective was to produce supply licences that were much shorter, more accessible and clearer about what is expected of suppliers.[17] One of the main objectives was emphasis on a culture of 'treating customers fairly':

> Under this proposed new regulatory approach, there will be a much greater onus on suppliers, right up to board level, to work out what's right and fair for consumers rather than following a list of prescriptions from Ofgem. This requires a significant culture change where suppliers place consumers at the heart of their business, watch carefully for any areas where they may not be getting things right for consumers and, if this happens, put things right quickly. Suppliers who do this will face fewer burdens and have flexibility and space to innovate. Those suppliers who do not take this seriously will have a much more difficult time.

The objective is to 'put responsibility on suppliers to deliver good consumer outcomes'.[18] The Standards of Conduct require suppliers (amongst other things) to:

1. ensure that they behave in a fair, honest, transparent, appropriate and professional manner (SLC25C.4(a));
2. provide information that is complete and accurate and not misleading and provide information which is otherwise fair both in terms of content and in terms of how it is presented (SLC25C.4(b)(i) and (iv)); and
3. act promptly and courteously to put things right when suppliers make a mistake and otherwise ensure that customer service arrangements and processes are complete, thorough, fit for purpose and transparent (SLC25C.4 (c)(ii)–(iii)).

This broadening of focus raised the challenge of how to enforce the SoCs. It has started to engage in dialogue with operators in a Challenge Panel, which is making progress, and is pursuing an initiative on Future Retail Regulation that aligns closely with ethical retail principles, outcomes and conduct.

The change in Ofgem's approach to sanctions is truly dramatic. Its enforcement notices typically set out detailed arrangements on what businesses are going to do in generating change in their behaviour, usually with specific targets, which can be monitored. There has also been a transformative shift between imposing fines to overseeing payment of redress from 2010 to 2015, as shown in Figure 12.2.[19] In 2014/15, redress represented 92.5% of the volume of remedies imposed, with £26.4 million being paid or made available to customers, £15 million in penalties and £19.3 million in payments to charities or other third sector organisations in lieu of financial penalties.[20]

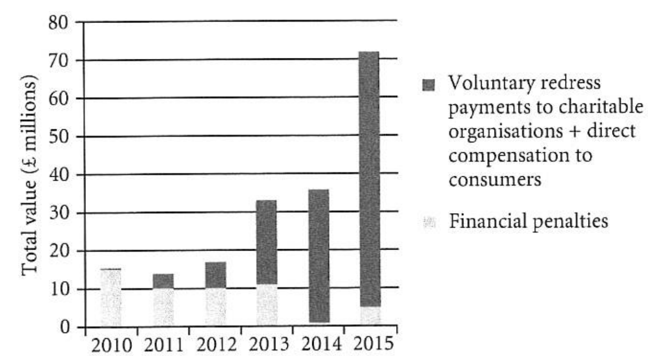

Figure 12.2: Financial penalties and voluntary redress resulting from enforcement actions by Ofgem 2010–15

Equality and Human Rights

The Equality and Human Rights Commission identified extensive legal infringements in the meat and poultry processing sector after an inquiry commenced in

2008. The sector employed 67,500 people. The Commission had a choice between adopting traditional 'hard' enforcement, prosecuting some offending companies, or a 'softer' approach aimed at achieving more widespread and permanent change across the sector. It chose the latter. Reviewing results in 2012, it reported significant progress:

> Rather than taking expensive and confrontational enforcement action, we decided to work with, and support, the industry to improve their recruitment and employment practices. We began by writing to processing firms setting out the main findings of the inquiry, relevant recommendations and encouraging them to draw up an action plan to tackle the challenges the industry faced. We also set up a representative industry taskforce chaired by the Ethical Trading Initiative. The aim of the taskforce was for the industry to take the lead and work together to tackle the challenges it faced, supported by the Commission. The solutions for business came from business.
>
> The supermarkets and industry bodies identified and agreed management practices and key performance indicators (KPIs) to deal with many of the problems identified in our inquiry. These have already been adopted by meat and poultry processing firms supplying most of the major supermarkets.[21]

The Commission continued to work with the industry to embed good practice. As with the similar approach adopted by the HSE, a sea change in attitudes occurred across the sector. Supermarkets and other major influencers were enlisted to support and procure good practice. The Commission has adopted the same approach in relation to other issues, such as employers' attitudes to maternity rights. The basic approach is to work *with* people rather than *against* them.

Water in Scotland: Prices and Wider Issues

In Scotland, both the water regulator, the Water Industry Commission for Scotland (the Commission), and the sole undertaking, Scottish Water, are publicly owned. The principal focus of the regulatory function is to control prices and levels of service for customers. In setting out its methodology for the next regulatory control period in 2021–27,[22] the Commission expressly accepted the principles of EBR set out in *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance and Ethics.*

The regulatory philosophy of the Commission is that Scottish Water should 'Seek Trust But Expect Verification' and that 'the onus is on Scottish Water to demonstrate both now and on an on-going basis that its customers and other stakeholders should trust it to deliver the right levels of service for an appropriate price'. The Commission said:

> We were very encouraged to learn of the work of Christopher Hodges, Professor of Justice Systems at the University of Oxford. His work on ethical business regulation appears to be closely aligned with the practical steps that we are taking. For example, we agree strongly with his conclusions that a constructive relationship—backed by strong incentives to 'do the right thing'—will maximise performance, compliance and innovation.
>
> The Scottish Government has adopted the work of Professor Hodges as the basis for their thinking of how best to use their new consumer powers and, more generally, how regulation should work in the interests of customers.
>
> There appear to be several steps required to reduce the potential for information asymmetry, ensure there is no regulatory capture and empower customers and communities to the maximum extent possible. These steps seem to us to include:
>
> Engagement
>
> — Greater trust and openness between regulators and the regulated, which will act as a catalyst for a far more productive relationship and the ability to take forward joint solutions to address the challenges ahead;
> — Direct engagement between the regulated company and its customers to agree a detailed business plan that will meet the needs of the full range of its customers;
>
> Managing risk
>
> — An opportunity to agree how uncertainty and risk should be handled: helping drive improved performance and greater innovation;
> — An opportunity to provide revenue certainty beyond a particular regulatory control period if this could reduce costs or improve levels of service;
>
> Monitoring and reporting
>
> — Fully transparent reporting of performance—with appropriate evidence—and progress towards meeting agreed service levels and other targets by the company—with further detail being available to those who wish it;
> — A mechanism to monitor financial performance and ensure that returns are fair and not excessive but also that a company is insulated from unexpected costs;
>
> Governance
>
> — An expectation that a regulated company will identify the extent of out-performance and discuss how to share the benefits with its owner and other stakeholders (including the scope for immediate improvements or by putting the money away for the proverbial rainy day);
> — Scottish Water to take full responsibility for its capital expenditure and be directly accountable to its customers and to the Quality Regulators. It should be able to evidence why it has taken the steps that it has; and
> — A strong regulatory body that is able to comment authoritatively on performance. The regulator would produce a high quality and accessible monitoring report—with further detail being available to those who wish it. This would include an expectation that negative comments from the regulator should have a material impact on the management of the regulated company and its reputation.

The Commission proceeded to address 'what needs to change' under this approach of 'Collaboration: Seek Trust But Expect Verification'. It started by accepting that *all* key stakeholders—owner, company and regulator—would be required to change. The owner (the government) would need to 'think long term and recognise that maintaining the legitimacy of water charges in the eyes of customers is the critical challenge'. The company would need to 'demonstrate how and why it is acting in the best interests of its customers—both now and into the future. It has to recognise that its approach will be subject to detailed scrutiny and comment and that its customers will, in future, have ever higher expectations'. The economic regulator would need different skills to focus 'less on econometric modelling and the design of incentives and more on scrutiny of analysis, forensic questioning and rigorous performance monitoring'.

The Commission also accepted that 'embedding trust among stakeholders will be a key enabler to improving the quality of decisions taken in the Scottish water industry and driving benefits for customers', as this is the 'principal foundation' of the concept of EBR.

In relation to the risk of 'regulatory capture', the Commission said:

> There is the potential for 'regulatory capture' when the regulator becomes unable to make appropriately independent judgments about a regulated company. The Commission's experience suggests that it has to be alert to any such accusation. The political process is quick to spot and seek to criticize any failures of governance or performance of a publicly owned company or its regulator.
>
> Regulators should therefore be cautious about working with a regulated company. It is right and proper that economic regulators guard their ability to make independent judgments and avoid being pulled unnecessarily into management detail. It is not surprising that economic regulators generally prefer market solutions—effective markets do, after all, empower customers.
>
> The Commission's experience is somewhat different. It designed and implemented the first 'in the market' framework for competition in the water industry. To ensure that this framework was successful, the Commission understood that it would need to have an understanding of the costs, capital requirements and risks of the business activity that was to be made competitive. It worked, therefore, with Scottish Water and potential new entrants to ensure that non-household wholesale prices and retail margins were appropriate such that an efficient entrant would find it attractive to enter the non-household retail market. This joint working was, in our view, essential to the success of the non-household retail market opening. It largely eliminated the potential impact of information asymmetry. Doubtless prior to that experience, the Commission would have seen collaboration as inimical to effective regulation. It is not. Better information and improved understanding actually significantly reduce the risk of capture.

Nuisance Calls in Scotland[23]

A consistent body of research shows that people in Scotland are disproportionately affected by nuisance calls compared to people elsewhere in the UK. For example, an analysis of 9 million calls received over a 3-year period conducted by the consumer group Which? and call-blocking technology provider trueCall[24] concluded that 3 of the top 5 cities receiving the highest volumes of nuisance calls were Scottish. While for some these calls are simply an annoyance, for others whose circumstances make them particularly vulnerable, they can act as a gateway for unscrupulous actors to cause substantial emotional or financial distress.

The Scottish government does not have devolved powers to regulate this area, but recognises that the principles of EBP and EBR could still be used to take action. In fact, the lack of regulatory power makes it an ideal opportunity to increase collaboration and work to change business behaviour by raising standards and, in so doing, to make it easier for enforcement agencies, regulators and those receiving calls to identify and tackle the worst offenders.

Key to this work is bringing regulators, consumer groups, businesses and academics together to develop a joint programme of work with three linked but distinct strands: empowering those who can to protect themselves; improving business behaviour by emphasising best practice; and encouraging partnership working actively to protect those who are at most risk from serious harm.

All of this rests on the knowledge that there will always be a need to tackle bad actors who prey on vulnerable citizens, but that the vast majority of businesses want to do the right thing and are themselves harmed by abusive practices. Successfully identifying and tackling these actors requires a flexible approach that targets resources where they are needed most and supports businesses that make mistakes rather than intentionally doing wrong to improve and raise standards.

By placing a strong emphasis on collaboration, the Scottish government and its partners are developing a holistic strategy that combines protection, prevention and behavioural improvement. In particular, this will focus on improving business behaviour by developing best practice principles and a forum for shared learning, especially as it relates to identifying and protecting vulnerable customers, and creating mechanisms to ensure that a wide range of organisations, for example, social workers and healthcare practitioners, are linked with enforcement agencies to better identify both those who may need extra support to stay safe and the offenders who seek to exploit their vulnerability.

Bribery and 'Adequate Procedures' to Prevent it

The UK Bribery Act 2010 departed from previous anti-bribery legislation and, among other provisions, established a new corporate offence of 'failure to prevent bribery by associated persons'. It came into force in 2011 and has already motivated many companies doing business in the UK to rethink their approach to compliance. It is a strict liability offence and there is no need to prove that the company intended to commit the bribery. All that is required is that an employee or other 'associated person', basically anyone doing business on behalf of the company, commits active bribery. However, the 'adequate procedures' defence was provided—if an organisation can prove that it had adequate procedures for preventing bribery by associated persons, it may escape liability under the corporate offence.

Although there is no one definition of 'adequate procedures', the UK Ministry of Justice did publish guidance at the time that the Act came into force.[25] During the lengthy consultation period, many people argued for a focus on culture and values and a move away from a tick-box compliance approach. The Six Principles set out in the guidance clearly point to the importance of culture, particularly in Principle 2, Top-Level Commitment, which says: 'Those at the top of an organisation are in the best position to foster a culture of integrity where bribery is unacceptable.' Therefore, top-level management must be committed to preventing bribery and must foster a culture in which bribery is never acceptable.

In addition, the other Principles encourage a thoughtful, tailored approach for each organisation subject to the Act:

(a) *Proportionate Anti-bribery Procedures*; meaning policies and procedures proportionate to the risks that the organisation faces, that are effectively implemented.
(b) *Periodic, Informed and Documented Bribery Risk Assessments*. In addition to assessing the external risks to which an organisation might be exposed, the Guidance recognized that the risks might come from within.
(c) ... a bribery risk assessment should also examine the extent to which internal structures or procedures may themselves add to the level of risk. Commonly encountered internal factors may include:
  A. deficiencies in employee training, skills and knowledge
  B. bonus culture that rewards excessive risk taking
  C. lack of clarity in the organisation's policies on, and procedures for, hospitality and promotional expenditure, and political or charitable contributions
  D. lack of clear financial controls
  E. lack of a clear anti-bribery message from the top-level management.
(d) *Due Diligence* proportionate to the identified risk, acknowledging that third parties operating on behalf of an organisation pose a high risk of corrupt behaviour.
(e) *Communication*, including training about relevant policies and procedures but also conveying the 'tone at the top'. Included in this concept was the need for 'a secure, confidential and accessible means for internal or external parties to raise concerns about bribery on the part of associated persons, to provide suggestions for improvement of bribery prevention procedures and controls and for requesting advice.' To be considered effective, there needs to be protection from reprisals for reporting concerns.
(f) *Monitoring and Review*: Since corruption risk will change over time as the business evolves, it is important for organisations to monitor and evaluate the effectiveness of their procedures and ensure that they remain fit for purpose.

The tone and content of this Guidance makes it clear that organisations are responsible for having a clear understanding of their business and culture, and of that of their business partners in order to design procedures that are adequate and effective for them.

There is no 'one-size-fits-all' or tick-box solution. There are suggestions and principles that serve as guidance. We believe that this approach encourages companies to think more deeply about all aspects of their culture and continually review their progress.

Product Manufacturers

The importance of balancing economic, technical and ethical considerations was highlighted in a survey of those involved in European product safety and surveillance, published by the European Commission in 2017.[26] Respondents comprised manufacturers (49%), importers/distributors (21%), users (8%), conformity assessment bodies (5%), online intermediaries (1%) and others (16%). No less than 89% of respondents considered that their products were affected by non-compliance with EU product legislative requirements. Of the businesses, 80% thought that non-compliance has a negative effect of sales and/or market shares. Of all respondents, 33.47% thought that the most important reason for non-compliance was a *deliberate* choice to exploit market opportunities at the lowest cost, followed by a lack of knowledge (26.78%), a technical or other type of inability to comply with the rules (10.88%), ambiguity in the rules (10.46%) and carelessness (9.62%).

Financial Services: Regulation Will Be Inadequate Without an Ethical Culture

> The regulatory response to the crash of 2008 has been to fight the symptoms instead of the cause.
>
> Joris Luydendijk[27]

By way of contrast with the sectors noted above, in which elements of an ethical behavioural approach have been adopted with success, it is instructive to consider examples of sectors where establishing behaviour based on ethical values has been identified as important, but has proved to be a challenge. The closed world of competition enforcement has been noted in chapter 3 above. Here we look briefly at the financial services sector. The focus on imposing rules, compliance and legal accountability seems to have crowded out understanding on how to support the spread of ethical behaviour.

Before the 'Big Bang' expansion of the City of London in 1986, informal rules were applied through 'club regulation', gentlemen's agreements based on the principle that 'my word is my bond', self-policed by social responses and ultimately by exclusion.

The financial sector has experienced a series of crises:

— The collapse of significant institutions, such as secondary banking crisis in the 1970s, BCCI in 1991,[28] Barings in 1995[29] and Equitable Life.[30]
— Repeated cycles of mis-selling consumer products and persistent failures to comply with suitability rules,[31] such as pension transfers and opt-outs,[32] PPI[33] and endowment mortgages with interest-only loans.[34] PPI products were mis-sold to over 12 million consumers, and firms paid over £22 billion in compensation between April 2011 and May 2016. This was mirrored in the EU context, where a 2011 trawl of 1,200 mystery shoppers conducted across 27 EU Member States found that only 43% of retail investment products were deemed to be broadly 'suitable' under a relatively simple rubric (i.e. they basically fulfil shoppers' needs in terms of investment liquidity and risk level), while the remaining 57% were assessed as broadly 'unsuitable'.[35]
— Mis-selling of interest rate hedging products, especially to businesses and particularly SMEs.[36]
— Systemic manipulation by banks of the London Interbank Offered Rate (LIBOR).[37]
— General business practices (various banks, including Barclays),[38] such as allegations of intentionally putting business customers into default so as to reap increased fees (RBS).[39]
— The payment of excessive remuneration to employees, especially through bonuses or selling incentives.[40]

One striking feature of this long series of serious failures is why lessons were not learned and changes made earlier. As a result of the emergence of this succession of failures, general confidence in this vital industry fell to an extremely low level, and remained so,[41] fuelled by popular perception that bankers continued to fail to grasp the public's lack of trust in them, as evidenced by the continuing award and receipt of large bonuses, often against overall loss-making results.

Political responses to the financial crisis focused on introducing a massive increase in rules and attempts to impose 'accountability' on individuals in the financial industry, in the belief that would control future behaviour. In contrast, one imaginative academic proposal was to incentivise self-regulation of the financial sector to prevention of systemic risks by relying on meaningful incentives for firms:

— establishing a separate regulatory regime for financial institutions that deal and trade in complex instruments of risk transfer;
— eliminating those institutions' access to federal deposit insurance and other forms of public subsidy;
— mandating mutual self-insurance against the systemic risk which these institutions' activities create.[42]

The proposal was based on the idea that the nuclear industry's self-regulatory response to the disaster at Three Mile Island through the Institute of Nuclear

Power Operations (INPO) and the chemical industry's response to the Bhopal disaster through its Responsible Care programme were based on a 'community of fate'.[43]

Over and above various mechanistic explanations for the series of major failures in this sector, such as a regulatory system that contained numerous technical gaps, and a politically inspired policy of leaving the banks alone ('light-touch regulation'), all major reports on the financial crash emphasised the crucial importance of addressing culture. In other words, the issue raised was the absence of self-regulatory value-based control on behaviour.[44] Three fundamental aspects of the prevailing culture have been identified:

— Maximisation of shareholder value: exposure to short-term value extraction by takeover and asset stripping; focus on short-term performance fuelling spiralling remuneration.
— Incentives: maximisation of personal gain and business profits; bonuses, macho culture, sales targets.
— No other-regarding ethic: pure selfishness.[45]

These aspects have been discussed in chapter 9. For now, we should note some comments on culture. In relation to PPI, the House of Commons Committee of Public Accounts has said:

> The cultures of firms and the nature of their sales incentives have been identified as key factors behind mis-selling. The FCA has taken some action to deal with these root causes, for instance by promoting changes to firms' incentive structures and better training of financial advisers. The Senior Managers Regime, which the Government is introducing for banks from 2016, aims to get senior people to take greater responsibility for the actions of those they manage. But the risks of mis-selling remain, for example pensions freedoms reforms are a potential trigger for future mass mis-selling. Middle managers in financial services firms were often promoted on the basis of achieving sales targets, making it hard to embed more customer-focused approaches.[46]

Statements by the FCA from the same time also emphasised the fundamental importance of a firm's culture.[47] Clive Adamson, the Director of Supervision at the FCA, noted that it was difficult to set criteria for an acceptable culture, but it was possible to observe outcomes and actions that indicated this, and to identify the key drivers of culture at a firm, which include:

— setting the tone from the top;
— translating this into easily understood business practices; and
— supporting the right behaviours through performance management, employee development and reinforcing through reward programmes.[48]

A 2013 report by Anthony Salz into the business practices of a major bank, in the light of the emergence of ongoing scandals, noted that:

> A bank's licence to operate is built on the trust of customers and of other stakeholders, such as its staff, regulators and the public as a whole. Trust is built from experience of reasonable expectations being fulfilled—a confidence that an organisation will behave

fairly. Successful banks acquire a reputation for being trustworthy. This can take decades to build. Yet it can be destroyed quickly and, in global organisations, by events almost anywhere in the world. Some companies have greater reputational resilience than others. They get the benefit of the doubt when things go wrong—partly because of the far greater number of things that go right and partly because of the way they respond to problems. Public opinion also tends to be more generous to those organisations that seem to be trying to do the right thing, or that have an appreciable social purpose.[49]

The bank had itself noted that trust in banks had been 'decimated and needs to be rebuilt' and that its own behaviours had elicited significant criticism.[50] The bank's culture had favoured 'transactions over relationships, the short term over sustainability, and financial over other business purposes'.[51] Salz found that that culture had predominantly shaped the unacceptable business practices. He laid the responsibility for leading a transformation in culture with the Board and the Group Chief Executive.[52] He recommended that the design and operation of the ways in which the bank managed and developed its people was crucial to supporting a desirable culture, and that the human resources function should be given sufficient status to stand up to the business units on a variety of people issues, including pay. Pay had been seen as the primary tool to shape behaviour, and insufficient attention had been given to personal development and leadership skills (as opposed to technical training).[53] Salz said that the bank must improve its openness and transparency in order to facilitate trust, but this would involve a fundamental change in attitude and mindsets rather than mere reporting[54] Fundamental change was also in relationships with key stakeholders, including moving from a confrontational approach with regulators to one that is more open and cooperative.[55]

Leading scholars also noted a shift in the analysis of financial markets from economics to a social conception.[56] This would necessitate a shift in the style of regulation from rules to a social dimension. A major group of investment firms noted:

> The Group is unanimously and firmly of the view that beyond our formal recommendations, the greatest need is for deep cultural change.[57]

A group of interested parties issued a report in late 2014 that identified culture as the cause and solution of problems for retail banking.[58] It stated that an aggressive sales culture was a major driver of bank failure, that policy interventions addressed structural issues but left culture change to the banks and that all banks had some kind of culture change process under way, but that change remained fragile and many expected bad practices to continue. Culture was said to be better in the new, smaller challenger banks. It called on banks to commit themselves to continuous and consistent delivery of culture change.

In 2016, the incoming head of the FCA identified culture as a key concern:

> There is a reasonable debate about what is culture, but that is not a debate about whether it is important. In my view, culture is a product of a wide range of contributory forces: the stance and effectiveness of management and governance, including that well used phrase 'the tone from the top'; the structure of remuneration and the incentives it creates; the quality and effectiveness of risk management; and as important as tone from the top, the willingness of people throughout the organisation to enthusiastically adopt and adhere to that tone. Out of this comes an overall culture. It is not something that has a tangible form. As supervisors, we cannot go into a firm and say 'show us your culture'. But we can, and do, tackle firms on all the elements that contribute to defining culture, and from that we build a picture of the culture and its determinants.
>
> Culture has a major influence on the outcomes that matter to us as regulators. My assessment of recent history is that there has not been a case of a major prudential or conduct failing in a firm which did not have among its root causes a failure of culture as manifested in governance, remuneration, risk management or tone from the top ... As regulators, we are not able, and should not try, to determine the culture of firms. We cannot write a regulatory rule that settles culture. Rather, it is the product of many things, which regulators can influence, but much more directly which firms themselves can shape.[59]

Individual Accountability: The Dead End of a Legal Approach

In 2013, the UK's Parliamentary Commission on Banking Standards considered that a key problem lay with a lack of individual responsibility of bankers and that the answer lay in punitive accountability:

> *The problem*
>
> Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility. Top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making. They then faced little realistic prospect of financial penalties or more serious sanctions commensurate with the severity of the failures with which they were associated. Individual incentives have not been consistent with high collective standards, often the opposite.[60]

In order to improve standards across the banking sector, the Parliamentary Commission inspired a package of legislative reforms 'intended to create a new framework to encourage individuals to take greater responsibility for their actions, and [would] make it easier for both firms and regulators to hold individuals to account':[61]

1. A new 'Senior Managers Regime' (SMR) for individuals, who are subject to regulatory approval, requiring firms to allocate a range of responsibilities to these individuals and to regularly vet their fitness and propriety. The intention was that the most important responsibilities within banks should be assigned to specific, senior individuals[62] so they could be held accountable.
2. A 'Certification Regime' requires relevant firms to assess the fitness and propriety of all employees who could pose a risk of significant harm to the firm or any of its customers.
3. A new set of 'Conduct Rules', with far wider application than previously, sets expectations about standards of behaviour, so as to provide a framework for regulators to make judgements. The key new rules are 4 and 5 in Table 12.1.

4. A new criminal offence for senior managers of reckless misconduct in the management of a bank.[63]

Table 12.1: FCA conduct rules

First tier—individual conduct rules	
Rule 1	You must act with integrity.
Rule 2	You must act with due skill, care and diligence.
Rule 3	You must be open and cooperative with the FCA, the Prudential Regulatory Authority (PRA) and other regulators.
Rule 4	You must pay due regard to the interests of customers and treat them fairly.
Rule 5	You must observe proper standards of market conduct.
Second tier—senior manager conduct rules	
SM1	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
SM2	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.
SM3	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
SM4	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

The Parliamentary Commission's approach of increasing accountability by creating criminal offences for individuals was supported by the PRA and the FCA.[64] The FCA wanted to identify who was 'responsible' for what actions, but was unable to be clear about which senior managers held which responsibilities. The FCA therefore supported making banks identify this so that individuals could then be prosecuted for the deeds of people for whom they were 'responsible'. The FCA also felt it was responding to public anger towards those the public felt 'got away with it'.[65]

Practitioner lawyers criticised the notion of sanctioning senior managers of failed banks on the basis that it failed to address two key problems: a lack of clarity about who was responsible for failure; and the absence of an agreed standard to which key roles should be performed.[66] They criticised the criminalisation of individual conduct when key decisions are usually taken on a collective basis (board responsibility) and they argued that it was unjust to reverse the burden of proof, if a regulator could not satisfy a court that an individual had broken the rules, by making an individual prove the opposite.

Will this attempt to hold some senior people criminally responsible for the behaviour of others supposedly under their control affect the behaviour of the latter? Is it fair?

Case Study 24: The Culture of a Global Industry

The well-known story of the financial services industry over the past decade needs little elaboration. Many have questioned how a whole industry can lose contact with the morality of the society in which it is embedded, such that so much everyday practice (systematic behaviour, such as lending mortgages that could never realistically be repaid, then selling and buying such worthless securities; selling payment protection insurance products to those who did not need them; fixing foreign exchange and other dealing rates; claiming that culture had been 'fixed' when it had not and serious infringements were still being carried on) that was internally regarded as normal and laudable was what external society viewed as being blatantly immoral. Further, how did such practice escape both internal and external attention, and add up to behaviour that was so risky as to endanger the integrity of the global financial system?

The response has to include strengthening the regulatory system, but that is not enough to affect the day-to-day behaviour of so many workers in an entire industry. How can regulators or others affect mass behaviour? Will it be adequate for global regulatory bodies or an impressively large group of judges[67] to insist that bankers adopt an ethical culture? Will preaching at bankers be enough? Will establishing a professional institute for bankers be enough? Will the morale of those involved in the industry be undermined by an extended period of public vilification, such that the quantity and quality of recruitment will suffer, and bankers will drown under a regulatory burden and prefer to take the low-risk option of not lending? There are signs that all these problems remain unresolved in the financial services sector.

Case Study 25: UBS Rogue Trader[68]

Kweku Adoboli booked fictitious trades to cover up gambles and set up secret funds. At one stage, possible losses were $10.6 billion, which would probably have brought down his employer, UBS. When he was caught, he lost UBS $1.4 billion. He was sentenced to seven years in prison. After his release, he gave an interview to the BBC's Economics Editor. He unreservedly apologised for what happened, admitted he had failed, had been dishonest and had made mistakes. He did not think of himself as a criminal and thought that his 'intentions were always in the right place'. He claimed that others at the bank knew of his actions, although UBS denied this and no other charges were brought against others. He said that: 'People are required to take risk to generate profit, because yields in the industry are consistently compressed.' If investment banks continue to push for the same level of profitability as in the past, he expected that traders would continue to be pushed to make profits 'no matter what' and that it could 'absolutely happen again'.

Case Study 26: The Amoral Financial Sector

The journalist Joris Luyendijk interviewed approximately 200 financial services personnel working in the City of London and concluded that the entire system was based on a culture in which amorality was endemic and unavoidable by individuals.[69] Everyone was focused on business ('revenue responsibility') and on making their allocated budget so as to keep their job. Bonuses could be large, but were entirely based on financial results. The traders whose revenue figures were lowest were regularly 'let go' ('a brutal hire-and-fire culture') and individuals' figures could even be publicised daily. Managers were equally focused on their figures and had no time or incentive to consider any long-term or ethical issues. Traders were not immoral; they had no time or opportunity to be either moral or immoral in daily behaviour, as the system unavoidably required them to act amorally in order to make money.

Bankers were quoted as saying: 'I know banks where admitting you got things wrong is not a smart thing to do.' 'The trouble is', he said with a perfectly calm smile, 'a bank's internal management often don't know what's going on themselves because banks today are so vast and hugely complex.' Such organisations 'continue to be governed by a system of incentives that seem almost designed to encourage short-termism'.

Luydendijk concluded that the City was a 'heartless place' that is out of control ('an empty cockpit') and where the culture is incapable of producing ethical behaviour without fundamental changes in how targets, remuneration and careers operate.

Success in Delivering Redress

One area in which the FCA—and various other regulators—has achieved a significant shift concerns the delivery of redress to customers. The traditional approach is that there is a clear distinction between public and private law and actors: public officials deal with regulation, ultimately relying on fines and convictions, whereas private actors must use other intermediaries (lawyers, litigation funders and civil courts) to seek damages. However, regulators have realised that it is part of their job to see that firms treat their customers fairly, that markets that are unbalanced by illegal activity are rebalanced, that illicit gains are not retained by those who have broken rules, and hence that consumers and customers are paid the redress they are due. Thus, regulators in some countries have been given powers to see that redress is paid. These 'regulatory redress' powers form one element in their enforcement toolbox. These redress powers have been used highly effectively by the consumer authority in Denmark (called the Consumer Ombudsman) and various sectoral regulators in the UK. The result is often that businesses' agreement to pay redress is agreed as part of a wider and comprehensive settlement of all regulatory infringement matters. Hence, payment of redress is achieved very swiftly and efficiently, and far more so than if those who have lost out had to instruct lawyers and sue, perhaps in lengthy and costly collective litigation.

The FCA has a number of powers to secure redress to consumers and has been increasingly active in doing so since 2000.[70] Between April 2014 and November 2015, the FCA established 21 informal redress schemes, which it estimates have provided £131 million in compensation to consumers.[71]

The Financial Sector in 2017

From 2014, the Banking Standards Board (BSB) set out to examine how far a firm demonstrates characteristics that it expects to be associated with any good culture in banking, namely, honesty, respect, openness, accountability, competence, reliability, responsiveness, personal and organisational resilience and shared purpose. The BSB's first report in 2017, from the views of 28,000 staff in 22 UK banks and building societies, found 'many examples of good practice', but also identified 'areas where change is needed, and where deep-rooted attitudes and behaviour detrimental to the interests of customers and clients' as well as workers.[72] It highlighted that 'responsiveness, accountability, personal resilience and openness are all areas where … progress needs to be made'.

In a perspicacious speech in 2016, Minouche Shafik, then Deputy Governor of the Bank of England, analysed five factors that had driven misconduct in the sector and led to fines and redress costs paid by UK banks since 2009 of almost £35 billion:

> A combination of factors caused 'ethical drift' across the industry where bad behaviour went unchecked, and became progressively more widespread and accepted as the norm. Market structures (such as poorly designed benchmarks, unmanaged conflicts of interest, and possibilities for collusion) presented opportunities for abuse. Systems of governance and control focused on second and third lines of defence that were weaker than highly profitable and powerful trading desks. Weak market discipline, particularly from the buy side, meant that poor market practices were allowed to continue. Remuneration and incentive schemes stressed short term returns over longer term value enhancement. And finally, a culture of impunity was prevalent because of a perception that the likelihood of being caught was low.[73]

Emerging Collaboration

We have been critical of both industry and regulators in the financial services sector. We do not believe that an ethical culture can be imposed on people or organisations, whether by regulators or employers.[74] But there is recent evidence of adoption of more collaborative approaches, which are proving to be effective. First, the existence of the BSB itself is something to be encouraged. Second, leading financial regulators around the world are experimenting with a 'regulatory sandbox', which permits banks to test innovative products, services, business models and delivery mechanisms.[75] The technique appears to be successful. The Dutch Financial Regulator DNB has been focused on behaviour and culture for over five years, and although its approach is based upon inspection, it is informed by the conviction that these aspects are key to successful regulation.[76]

Third, the FCA has quietly taken a notably fresh approach to regulating the credit sector, which comprises over half of the firms that the FCA regulates, moving away from the traditional approach of simply imposing rules. The change in style was first seen in relation to credit cards (a sector worth £68 billion), where a market study took an unusually soft approach.[77] It gave examples of good practice, areas of concern and key risks to consumers, and noted that the FCA had worked with industry in developing agreed new approaches. The FCA did not use its enforcement powers, nor did it proceed by proposing a lot of new rules, which would have taken years to introduce. The discursive and consensual approach delivered effective change swiftly. The approach involves transparency, dealing with problems and low key reporting. The same approach is now apparent in relation to the motor finance sector (worth £53 billion). In 2017, the FCA announced a review (not a Review).[78] The Finance and Leasing Association (FLA) responded by contacting the FCA to confirm that it was already working on various initiatives, such as on improving training and competence, and the outcome was that the FCA joined the FLA working group.

Fourth, a partnership between central banks and market participants has produced a Global Code of good practice in the foreign exchange market in 2017.[79] This Global Code is organised around six leading principles (see Figure 12.3), the first of which is 'ethics'.

- *Ethics*: market participants are expected to behave in an ethical and professional manner to promote the fairness and integrity of the FX Market.
- *Governance*: market participants are expected to have a sound and effective governance framework to provide for clear responsibility for and comprehensive oversight of their FX Market activity and to promote responsible engagement in the FX Market.
- *Execution*: market participants are expected to exercise care when negotiating and executing transactions in order to promote a robust, fair, open, liquid and appropriately transparent FX Market.
- *Information sharing*: market participants are expected to be clear and accurate in their communications and to protect confidential information to promote effective communication that supports a robust, fair, open, liquid and appropriately transparent FX Market.
- *Risk management and compliance*: market participants are expected to promote and maintain a robust control and compliance environment to effectively identify, manage and report on the risks associated with their engagement in the FX Market.
- *Confirmation and settlement processes*: market participants are expected to put in place robust, efficient, transparent and risk-mitigating post-trade processes to promote the predictable, smooth and timely settlement of transactions in the FX Market.

Figure 12.3: The FX Global Code: Guiding Principles

Conclusions from the Evidence across Different Sectors

The main themes that emerge from this brief review, which is limited to just a few sectors and some recent developments, are as follows. First, there has been a shift in the goals and rhetoric—and in some cases the practice—of regulators in relation to how they see their roles and what they expect from businesses. Second, those authorities that have widened their approach are increasingly engaging with the *what* and *how* of actions that businesses are planning to take to improve their performance and to reduce the risk of future infringement. To do this, an authority has to shift from operating remotely at a desk, assuming that a monetary penalty will magically induce all desired changes, and engage with how businesses actually operate on the ground, in order to understand what changes can and will be made, and in what sequence, when and by whom. This extra level of understanding necessarily requires the authority to get closer to business practice (through visits and discussions, rather like how a non-executive director should operate in getting around and talking to people). Equally, it requires an open and transparent response to the authority by the business at all levels. This means that the two need to have a *relationship*, and one of trust, based on an open, full and frank basis.

Third, there has been a significant shift by some regulators in the practice of how they respond to businesses who break the rules—in other words, their enforcement practice. A striking example of this is the shift made by Ofgem in the past five years, reducing fines significantly whilst promoting a huge increase in redress paid by infringing companies to consumers, trade customers and charitable causes. (Ofgem is not alone amongst authorities in this shift in emphasis, and various others can be applauded for similar actions, such as the many charitable payments produced by the Environment Agency under its civil sanctions powers.)[80]

We do not suggest that all the sectors or authorities in the following examples have achieved the ultimate vision that we advocate, but we commend them as examples of a significant shift in approach in the right direction. We add a contrasting example of financial services, where some of the rhetoric on culture fully accords with our vision, but much of the practice does not, and seems unable to shift away from a traditional policy of credible deterrence. Therefore, the final point that these examples illustrate is that all authorities and sectors exist largely in their own silos, do not communicate with each other and have not realised what a transformative shift is quietly occurring or that it is one that they could achieve.

The financial services sector stands out in this review by seeming to demonstrate a schizophrenic nature (although the sectors reviewed are selective, and financial services are not completely alone in this, even if they seem now to be in a minority). The BSB pursues the laudable aim of assisting the industry to 'demonstrate to … customers and to others that it is trustworthy'.[81] Meanwhile, leading regulators make statements about the importance of culture in banks, but these statements are then undermined by inconsistent messages over the approach to compliance being based roundly on 'credible deterrence' and the introduction of a criminal regime for senior managers who are to be held 'responsible' for things that might occur in their divisions. This approach is simply not going to work. It is not credible and scandals will continue. The deterrence policy can only go in the direction of increasing penalties, whether on firms or individuals, which will ultimately be seen as unfair and ineffective in achieving behavioural change in behaviours. Customers may receive redress through the welcome intervention of regulators, and the Treasury may benefit from the large fines, but such costs merely serve to increase customers' costs and reduce employees' and investors' benefits, without affecting behaviour for the better. There appears to be no evidence of a holistic relationship of trust, and an absence of blame, between industry and the regulatory community.

In contrast, the energy regulator has made a dramatic switch from imposing fines to starting to address behaviour directly. Authorities dealing with civil aviation, workplace health and safety, trading standards, gambling, equality and human rights, and various others have been moving in this direction for some time.

Harnessing Self-Regulation

The idea that people will change how they behave if someone they respect suggests how they should do things differently, noted in research in how people follow others and in how SMEs need and react to advice, has driven the extension of the Primary Authority scheme to include company headquarters and trade associations as intermediate tiers in the vertical hierarchy. This is merely the old idea of self-regulation in a new guise.[82] But the problem with self-regulation is that people cannot be trusted to act altruistically all the time. The current economic climate of stringency of public resources has also driven the return of interest in self- and co-regulatory structures, as can be seen in the identification of 'earned recognition' and 'regulated self-assurance' in the *Regulatory Futures Review*. This model opens the door to social groups such as colleagues and customers supporting 'doing the right thing' through collective engagement and maintaining individual and collective reputations for ethical behaviour.

EBR offers the answer to this conundrum. It examines the circumstances in which an actor may be trusted by society (and regulators), because he produces constant evidence that supports placing trust in him. Hence, if businesses can be trusted, regulation may be complemented—or might even be replaced in some situations—by actors' commitment to doing the right thing. This was in fact what OECD said in 2011:

> Develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate.[83]

In regulatory terms, the trick is for the regulatory system to harness businesses' wish to 'do the right thing' and their actions in doing so, and regard suitable

evidence of that as being an integral part of the regulatory, surveillance and enforcement system. The UK government adopted exactly that policy in 2017 for future regulation.

After the publication of *Law and Corporate Behaviour* in late 2015, what is now the Regulatory Delivery (RD) Directorate of the UK Department for Business Energy and Industrial Strategy published a paper summarising the evidence for EBR.[84] These two publications were noted by the European Commission as supporting its strategy for innovation.[85] The Scottish government indicated its intention to include EBR as a consistent core policy in delivering its political goal of a fair Scotland[86] and held a series of meetings with regulators on implementation of this approach. The approach was noted and approved of in the draft *Manual on Consumer Protection* by the United Nations Commission for Trade and Development (UNCTAD).[87] In September 2016, a slightly longer version of the RD paper was commissioned by the UK's Committee on Standards in Public Life as an annex to its report on ethics in regulatory bodies, in which it examined how the seven (Nolan) principles of public life applied to a range of such bodies.[88] This paper set out a number of actions that could be taken by businesses, regulators and government to encourage and support an ethical approach to commerce and regulation, which have been incorporated into this book. The Committee's report concluded that, in accordance with the principle of providing external leadership, 'regulators should actively engage with those they regulate and take a leadership role by encouraging positive attitudes towards compliance'. The Committee recommended that such promotion of an ethical approach to compliance would be supported by a suitable amendment to the Regulators' Code.

The 2017 policy statement by the UK government on 'Future Regulation' recommended that all regulators should aim to move towards a model of 'regulated self-assurance' and 'earned recognition'. This policy statement supported and built on the EBR ideas of an open, no-blame relationship between regulator and business, in which business was supported by assurances from its staff, suppliers, customers, investors and professional auditing and accreditation bodies and personnel.[89] This policy document adopted the proposition that regulators should allow other stakeholders to hold organisations accountable. It expressly extended the regulatory model to encompass a potentially wide range of stakeholders, since they can provide evidence of ethical or unethical behaviour by businesses. It is recognition that regulators are not the only people who represent the public interest.

But more is changing here than just a regulatory structure, from a binary regulatory–regulatee relationship to a 'regulated self-assurance' model involving potentially multiple actors. The implicit acceptance is that rules and models cannot guarantee behaviour. Hence, *ethical* business practice has to be a requirement and cannot be ignored. The government said:

> In practice this means that businesses who 'do the right thing' should be regulated with a very light touch. As part of this, regulators should encourage more ethical business practices. However, where regulated entities do not 'do the right thing' and do not follow ethical business practices, redress should be sought.

What is needed now is a very strong focus on demonstrating the absolute non-negotiability of ethical values in conduct. Thus, fairness—ethics—is inescapably at the centre of both a fair society and of the maximisation of all social (and hence commercial) interactions. Accordingly, the next steps in both corporate culture and regulatory relationships should be towards a norm of ethical behaviour.[90]

Conclusions

1. Cooperative frameworks, relationships and structures, as well as reliance on ethical values, can be seen developing in regulatory regimes across a wide range of sectors. The shift to EBR would be merely a formality in many instances. Elements that can be relied on in EBR regimes can be cross-fertilised from good practice in diverse sectors.
2. The UK government's high-level policy of 'regulated self-assurance' provides a framework within which to embed EBP and EBR. Indeed, the framework may well not work effectively without these ethical and behavioural elements.