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Bell Gully submission to Productivity Commission – Issues Paper on Regulatory Institutions and Practices

1. Bell Gully is a leading New Zealand law firm, advising major New Zealand and overseas clients on all aspects of commercial law (including securities, competition, and regulatory law). We frequently advise both corporate and individual clients in relation to a range of regulatory matters.

2. We are grateful for this opportunity to submit on the Productivity Commission's Issues Paper on Regulatory Institutions and Practices. Rather than try to address the Issues Paper in full in this submission, we make some discrete points in connection with compliance monitoring, investigation, and enforcement.

3. We would be happy to discuss our views further with the Commission. Please contact:

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Compliance monitoring

4. We agree with the Commission that effective compliance monitoring is an integral part of a successful regulatory regime. However, it is important to bear in mind that it is neither feasible nor socially optimal for a regulatory regime to exclude all risk of non-compliance. Especially in a small economy like New Zealand, scarce monitoring resources must be deployed efficiently. Regulators should adopt a risk-based approach to this aspect of their work, focusing their monitoring and investigation efforts on those activities and organisations which present a real prospect of harm to desired regulatory outcomes.[1] With reference to the Commission's Q44, we acknowledge that it may sometimes be difficult to identify in advance which activities or organisations present the greatest risk to the desired outcome. However, we consider that in most contexts it is possible to develop a view on that issue over time, by reference to both past experience in New Zealand (including past monitoring work and past compliance) and emerging trends overseas. For example, where an organisation conducts itself well over an extended period it may be appropriate for a regulator to accord it a degree of 'earned autonomy' whereby it is subject to less burdensome monitoring or reporting obligations.[2]

5. Policy-makers and regulators must remember that compliance monitoring work can impose very significant burdens on regulated parties. Even collating and providing information on a periodic basis, or responding to a letter from a regulator, can impose material costs in terms of lost management time; the costs associated with accommodating inspections or responding to more in-depth audits can be considerably greater. Such private costs are not always overtly acknowledged within a given regulatory regime. For example, section 9(1)(c) of the Financial Markets Authority Act 2011 states that one of the functions of the FMA is to monitor compliance with financial markets legislation. Section 25(1)(a) provides that the FMA may issue a notice requiring a person to supply it with any specific information if it "considers it necessary or desirable for the purposes of performing or exercising its functions". In other words, the FMA could compel an organisation to expend considerable effort in responding to a section 25 notice without having any express regard to the costs such a notice would impose on that organisation. With reference to the Commission's Q39, we consider that social efficiency requires that regulators should be obliged to take such private costs into

[1] The FMA indicates in its *Compliance Focus for 2013* that it pursuses a "risk-based approach to our monitoring and surveillance activities". Available at http://www.fma.govt.nz/media/1513558/fma_s_compliance_focus_for_2013.pdf (accessed 24 October 2013), at p12.
[2] Sir Philip Hampton, HM Treasury (2005). *Reducing administrative burdens: effective inspection and enforcement*, available at http://www.bis.gov.uk/files/file22988.pdf (accessed 24 October 2013), at 2.24.

account when considering how best to monitor compliance with the relevant legislation. One simple option might be to include in new regimes a requirement that a regulator consider its chosen monitoring tool to be an "efficient" way of performing its compliance function before utilising that tool.

Investigation

6. We see compliance monitoring and investigation as distinct parts of the regulatory life-cycle, as is apparent in sections 3 to 4 of the Electricity Authority's Prosecution Policy.[3] The Authority applies an 'initial screen', such that a matter will not be subject to formal investigation if it falls more properly within the jurisdiction of another agency, does not constitute a prima facie case of an alleged breach, or does not warrant any further action. We consider that other regulators should be encouraged to expressly adopt a similar approach, to avoid incurring investigation expense unduly.[4]

7. Similarly, we have some concerns about the risk of multiple regulators pursuing concurrent investigations in relation to a single set of circumstances. For example, clause 5.2 of the Memorandum of Understanding between the Financial Markets Authority and the Serious Fraud Office indicates that the parties may agree to undertake a joint investigation into a particular matter, but clause 5.3 states that a matter may still be separately investigated "where the parties determine".[5] Concurrent investigations inevitably result in extra costs from both a public and private perspective (and there can be significant legal complications in terms of fairness, the use of evidence, and the risk of double jeopardy). That duplication may be justified in some cases by the different policy goals underlying different regulatory regimes. In general, however, efficiency and fairness demand that regulators should be discouraged from pursuing investigations in parallel with other agencies. This could be achieved through clear delineation of regulatory objectives, and inter-agency arrangements.

8. There may also be social savings to be made by recognising that an organisation's activities will usually be best understood by the organisation itself. In some cases, regulators resort to reviewing documents or speaking with third parties instead of simply discussing the underlying matter with the organisation concerned. In our experience, engaging with that organisation is usually the most efficient way of enabling the regulator to learn about a particular set of circumstances. It allows that organisation to explain its conduct directly to the regulator and to provide important context that might otherwise be lacking, and to understand the regulator's needs. For that reason, we consider that regulators should place special emphasis on continuing to engage with a regulated party during the investigation phase. Many of New Zealand's commercial regulators already take that approach.

9. It is important that investigations are progressed quickly and completed within reasonable timeframes. For example, we sometimes find that it takes regulators several months to respond to a single letter. During that time, the investigation continues to hang over the regulated party; such investigations can have important, long-term reputational and commercial implications. Some investigations will of course take longer than others. Nevertheless, we suggest that there may be advantage in encouraging regulators to complete their investigatory work within reasonable timeframes. One easy solution would be for regulators to commit in their enforcement policies to complete all but truly exceptional investigations within finite timeframes.

[3] Available at http://www.ea.govt.nz/act-code-regs/compliance/prosecution-policy/ (accessed 24 October 2013). A similar approach is reflected in paragraph 8 of the Commerce Commission's Enforcement Response Guidelines, available at http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/ (accessed 24 October 2013).

[4] The Australian Securities and Investments Commission applies a similar initial screen, stating in its enforcement policy that "We consider a range of factors when deciding whether to investigate and possibly take enforcement action, to ensure that we direct our finite resources appropriately". Available at http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+approach+to+enforcement?openDocument (accessed 24 October 2013), p3.

[5] Available at http://www.fma.govt.nz/media/1242962/mou_serious_fraud_office_-_sfo.pdf (accessed 24 October 2013).

Enforcement

Approach

10. New Zealand is a small economy, dominated by small to medium enterprises. Most organisations have a genuine desire to comply with the law; it is very rare for organisations to deliberately flout the law. In such an environment, it is not usually appropriate to rely upon a heavy-handed deterrence model to motivate compliance. A compliance model that is more focused on promoting education and facilitating compliance will offer 'better social value', in terms of achieving regulatory outcomes without incurring undue (public or private) cost. In our view, the following statement from the Companies Office Enforcement Policy Guidelines sets out a good approach:[6]

> The Companies Office enforcement strategy is underpinned by the philosophy that as far as possible, it aims to assist its customers and users to achieve compliance with their statutory obligations, rather than seeking to penalise them for any and every breach. It recognises that the majority of customers and users wish to and do comply with their obligations, and seeks to overcome any obvious barriers to compliance.

11. Organisations should be able to understand in advance their obligations, the possible implications of non-compliance, and the approach that the regulator will take in addressing non-compliance. In our view, regulators should therefore be encouraged to publish (and adhere to) guidelines fully explaining their enforcement policy and detailing how they will exercise any discretion in terms of an appropriate enforcement response. With reference to the Commission's Q41, publicly committing to approach enforcement issues in a rigorous and balanced way is the best means of ensuring that regulatory discretion is not abused. The Commerce Commission's Enforcement Response Guidelines may provide a good example of the level of detail which should be provided.[7]

Enforcement tools

12. We agree with the Commission that regulators should utilise an enforcement pyramid with a hierarchy of graduated responses to non-compliance.[8] Such an approach is explicit in some enforcement policies (such as the Commerce Commission's Enforcement Response Guidelines), but less fully articulated in others (such as the FMA's Enforcement Policy[9]). It would be helpful to make the pyramid approach explicit in all cases, and explain in advance how any residual discretion will be exercised.

13. The enforcement pyramid implies that less intrusive responses will be used more often, which is fitting in a small economy like New Zealand. It is on that part of the enforcement toolkit that the real focus should lie. Especially in a commercial or regulatory context, it is not proportionate to resort to the use of heavy-handed, expensive criminal tools. Even if such tools are reserved for the most serious cases, they can present citizens with "undue disincentives to participate".[10] We therefore take the view that regulators should be able to exercise a range of 'low-impact' enforcement tools to educate organisations and facilitate compliance. Tools such as informational campaigns, advisory letters or warning letters should always be available, with the most extreme enforcement options being used only in the most extreme cases.

Settlement

14. Equally, settlement should always be available as a means of resolving a regulatory disagreement. Just as with private litigation, there should be minimal impediment to the

[6] Available at http://www.business.govt.nz/companies/about-us/enforcement/policy-guidelines (accessed 24 October 2013).
[7] Available at http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/ (accessed 24 October 2013).
[8] Productivity Commission (2013). *Towards better local regulation*. Wellington: Productivity Commission (at p196).
[9] Available at http://www.fma.govt.nz/laws-we-enforce/enforcement/fma-enforcement-policy/ (accessed 24 October 2013).
[10] FMA Enforcement Policy.

parties reaching an agreement at any point prior to a court making a final decision – such agreements have the ability to look both backward and into the future, with an organisation committing to change its conduct going forward. We have some concerns, therefore, about statements in enforcement policies indicating that the prospect of settlement is reduced once a regulator has determined to pursue an enforcement case.

15. The implication is that once the FMA has invested time and effort in preparing an enforcement case, the prospect of settlement is reduced. That may give organisations an artificial incentive to settle early, before the factual and legal position is fully apparent.

16. Other factors may also inhibit socially optimal settlement. For example, an organisation may be discouraged from settling by the regulator's refusal to discuss the possibility of a joint media announcement, or insistence that the organisation make public admissions of liability.[11] Especially where there is the prospect of 'follow-on' litigation against the organisation by other parties, it may be difficult for an organisation to agree to make such admissions – it may be forced instead to take the matter to trial, at cost to both itself and the regulator.

Engagement during enforcement

17. It goes without saying that we consider it vital for regulators to continue to engage with organisations during the enforcement phase. Refusing to engage with an organisation that is the subject of possible enforcement action will prevent the regulator from learning about the underlying matter, increase the chances of the regulator selecting the wrong enforcement tool, and limit the prospect of settlement in more serious cases.

Oversight

18. Regulators have limited resources, and usually have limited familiarity with the underlying circumstances. Some risk of regulatory error will always remain during the enforcement phase. Especially where such error results in over-enforcement, there is the risk of undue cost (both public and private). It may be preferable for there to be some central authority responsible for the oversight of regulators (subject to preserving the regulators' independence from political interference).

Concluding comment

19. In its Q2, the Commission asked what type of guidelines it should produce in order to assist in the design of regulatory regimes. One option might be for the Commission to circulate Best Practice Guidelines[12] for policy-makers to adhere to when developing new regulatory regimes, or assessing the performance of existing regimes.

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[11] Such requirements are apparent, for example, in the Commerce Commission's Enforcement Policy Guidelines (para 71), and in the FMA's Enforcement Policy.
[12] Such guidelines could update and refine the Code of Good Regulatory Practice (1997). Available at http://www.med.govt.nz/business/better-public-services/regulatory-reform/information-for-policy-makers/code-of-good-regulatory-practice (accessed 24 October 2013).