THE BETTER REGULATION/GOVERNANCE NEXUS: A Discussion

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Abstract: *This paper proposes a reviewing discussion of the linkages between the concepts of better regulation and organisational governance. Both are considered in a context of the former having become an attempt (some would posit it as an exclusively EU—inspired one) to transcend many of the negative attributes of all other regulatory paradigms. After initially considering the general contextual ambient for all regulation, we then discuss the issue of to what extent should the state regulate, some aspects of the macroeconomic impact, and the regulatory components analysis which builds a causal chain in governance processes. We also consider some corporates' behaviour in the general area of the regulation/governance nexus.*

1. Introduction

Good regulation/bad regulation, overregulation/under-regulation, regulation-deregulation-reregulation, old style / new style regulation, rules- based/ incident-based,….the list and the permutations are indeed endless. Endless too are the contexts, cultural, economic, social, historic, political, whatever, within which the whole discipline of regulation lives and subsists.

In whatever context from the above, or even in whatever specific event context that one chooses to think and research about regulation, it has become almost impossible to sever the concept from a specific economic sector within which one would be analysing that regulation. This writer is conditioned by a lifelong background within the financial services sector, and it is acknowledged that seeking to be theoretically generic, and all- encompassing, about regulation thinking of just the financial services sector, is not at all either wise or easy. Whatever the historical evolution of all forms and contexts for regulation may have been, it has certainly always been evolutionary different, whether in the worlds of health services, energy policies and implementation, medical care, public transport, environmental planning, or indeed financial services, or, in fact, regulation of anything and in any society.

For one thing, the cultural, political, and societal contexts within which any type of regulation evolves, these are always naturally highly determining, over time, of the design and effectiveness of the eventual overall regulatory picture or structure, in any society and at any time. Working within this paradigm Michael Moran (1986) had seminally built up his theoretical framework for all regulatory theory, placing all theories (perhaps too generically?) into the groupings of teleological (i.e. those where the underpinning is the communal imperative), instrumental (mainly in terms of sociological ideals or class impacted), cultural (time and place impact), and administrative (tools used, intelligence gathering, etc.).[1]

It is against such a background, admittedly and conceptually quite complicated, that the issue of search for a compromising and absolutely general approach to the whole issue of regulation, thought of in terms of each, or all, of the general descriptions stated in our introductory paragraph, that one "solution" type of regulation has come to be born; and described, — simplistically, or far too easily and naively? — as the ever-present need for "Better Regulation".

Whilst what justifies the need for general better regulation can be easily synthesised — improved living standards improved competitiveness, environmental protection, facilitating of market openness, in such or different preferential orders - any a posteriori viewing of a regulatory situation will inevitably encase it into any of the situational/descriptive categories already mentioned.

Governments, judicial and legal practitioners (the latter even when engaged in soft law), and regulators generally, are all constantly presumed as seeking to ensure the public interest, i.e. the greater interests and benefits of the majority of a population. Two possible approaches try to ensure that firms too take into account this public interest. One is termed "regulation" and comprises telling firms (bossing them around?!) what must be achieved, what can and/or cannot be done, telling them the processes to follow, or all at once. The other is termed "governance", and — besides the usual "basically good management" definition, also often involves arranging both disciplining and incentive structures so that firms find it in their interest to achieve what good government desires.

So far a discourse in this sense can be considered as anything but conflictual. Indeed it runs diametrically opposite to what George Stigler had in mind in 1975 when he defined regulation as "the exercise of coercive government power" [2]. Governments can, and often will, act to get organisations to do what they (the governments) think is in the public interest. This can mean outcome or process, or even both together, and both are forms of regulation. If, rather than a process of issuing instructions, orders, laws, regulations, or whatever, a process is put in place that organises incentive structures, such that rational individuals and firms, out of their own self-interest, do what a government wishes, this latter course can then best be described as governance.

This is conceptually the point where governance and better regulation come closest. The six EU White Paper Principles of Better Regulation (2004), viz necessity, proportionality, transparency, accountability, consistency, and effectiveness, all indeed also feature as motivations of good corporate governance in the eyes of the European Union. The EU's Corporate Governance Action Plan (CGAP), submitted by the EU Commission in 2003, is clear on several fronts. These include:

- Ensuring that the regulatory environment is simple and of high quality;
- Ensuring that regulation is used only when and where necessary;
- Ensuring that the burdens which the regulatory environment imposesare proportionate to its aim/s.

The tools for better regulation are such that no corporate governance actions by firms can exclude them. The main one is having integrated impact assessment systems in place. These will of course include analysis of the economic, social, and environmental impacts of legislative proposals; clear, consistent and transparent consultation roles; and a slim simplification programme establishing criteria for systematic assessment of existing legislation, and preventing it from becoming obsolete in its implementation.[3]

In discussions of regulatory policy certain general propositions appear consistently. And, as Parker and Kirkpatrick (2012) do when dealing with the uneasy task of measuring regulatory performance, it warrants summarising some of them:

> "1. Regulation can be supportive of market transactions and may result in significant economic social and environmental benefits. At the same time, ill-designed regulation (the "bad" regulation which anthitesises

"better" regulation!) can have appreciable economic costs, leading to the concept of the "regulatory burden".

2. In particular, regulation can cause serious economic distortions that lower economic growth or GDP, damage investment and competitiveness, and reduce entrepreneurship.

3. Regulatory costs may act as a barrier to entry into industry in the form of one-off set-up costs (e.g. installing equipment to meet health and safety laws) and on-going annual costs (e.g. preparing returns and facilitating inspections).

4. Regulation can be unduly costly to comply with, administer and enforce.

5. Regulatory simplification can reduce the regulatory burden."[4]

On market transactions, on economic distortions lowering GDP growth, on liberal entry into industry, on costliness and simplification, in some form or other in all of these the automatic linking of better regulation with better governance runs a real risk of both (i.e. both governance and regulation) being also criticised as furtherance of what some have described as "the nanny state".

A regulating, or a 'nanny' state

There is here a fundamental regulatory dilemma faced by practically all regulators. Should regulators protect decision-makers or operators from taking risky decisions? Or should the regulator limit himself to ensuring there is a proper framework to enable reasonable market operators to make informed choices about risks and rewards?

One position is to hold that regulators should not be functionally saddled with responsibility for precluding an operator from making risky decisions, but, yes, that it factually is the role of a regulator to enable an operator to make an informed decision. In financial services, for example, it is possibly more than the EU's 2003 Prospectus Directive and its later versions [5], more than data from national Companies Registries, more than the EU's latest Marketing in Financial Instruments Directive (MIFID |I)(6), and so on, that will all be needed to protect against the buying of securities that are not listed on an exchange. It all boils down to a reality where operators are aware of the risks involved and that such risks are properly disclosed.

The most often quoted articulation of this argument is that "sunlight is said to be the best of disinfectants, and electric light is the most efficient policeman". So one could here be considered as arguing that both better regulation and good governance should never be built up to be the two sides of nanny regulation, protecting people from taking riskier investment decisions.

Macroeconomic impact

There is no lack of studies on the impact of regulatory policy and governance on macroeconomic performance, and, more specifically, on welfare outcomes. The more notable amongst these use various proxies for regulatory governance, and cover a range of regulatory policies and economic effects. They suggest that there is evidence of a statistically significant and positive relationship between regulatory policy, governance, and economic growth, while regulatory governance and a country's institutional framework can mitigate the damaging impacts of particular regulatory policies (e.g. product and labour market regulation) on economic growth. Gorgens et al (2003) for example estimate that a heavily regulated economy might grow on average by between 2% to 3% p.a. less than a less heavily regulated economy; but this effect is predominantly only in terms of comparisons between moderately and highly regulated countries. [7]

There have indeed been other studies, i.e. besides Gorgens et al's, that have empirically examined this issue of impact of regulatory policy and governance on macroeconomic performance. In 2004 Loayza et al estimated the impact of regulatory policy on GDP growth and volatility in a large sample of developed and developing countries. They drew on a range of data sources to create a set of indicators capturing entry/exit regulation, international trade, fiscal burdens, contract enforcement, labour and financial markets. In summary they find:

- A negative causal relationship between economic growth and overall regulation and, separately, product market and labour regulation;
- No significant link between an index of fiscal burden with economic growth;
- Results for labour and product market regulation become small as a country's overall quality of institutional framework improves, suggesting that better institutions help mitigate, and may even eliminate, the adverse impact of regulation on macroeconomic performance; and, overall most importantly,

that "If the quality of governance is sufficiently high, an increase in [the overall index of] regulation can have a positive impact on growth".[8]

Similar to Loayza et al, two years later in 2006 in their studies Djankov et al made use of the World Bank's Doing Business index (which covers some 183 countries), plus indices from the Fraser Institute of Canada, and the Heritage Foundation (US) databases relating to the labour market, corporate tax rates, and international country risk. Their sample covered up to 76 countries during the late 1990S, and they aimed to establish the relationship between the burden of business regulations and economic growth. Their overall findings suggest that moving from the worst to the best quartile of business regulation (i.e. the best or better "quality" regulation), implies a 2.3 percentage increase in average annual economic growth.

Another important empirical analysis of the relationship between regulatory policy and governance was that carried out by Jacobzone et al in 2010. Here the relationship is mostly based on a very expansive OECD definition. It is an approach that includes both economic and non-economic regulation, and covers regulation policies, regulatory institutions, regulatory procedures, and regulatory tools.

Components analysis

This is indeed an impressive study. It includes consideration of many elements, such as: oversight bodies and ministerial responsibility for regulatory policy, governance structures for regulators, tools for improving the quality of new regulations such as regulatory impact assessments, systematic procedures to consider alternatives to regulation, consultation on draft regulation, risk- based approaches to the design of regulation and compliance strategies, transparency in communication and access to regulation, and programmes for improving the quality of existing regulations such as administrative simplification strategies, burden reduction, and ex post regulatory review and evaluation.

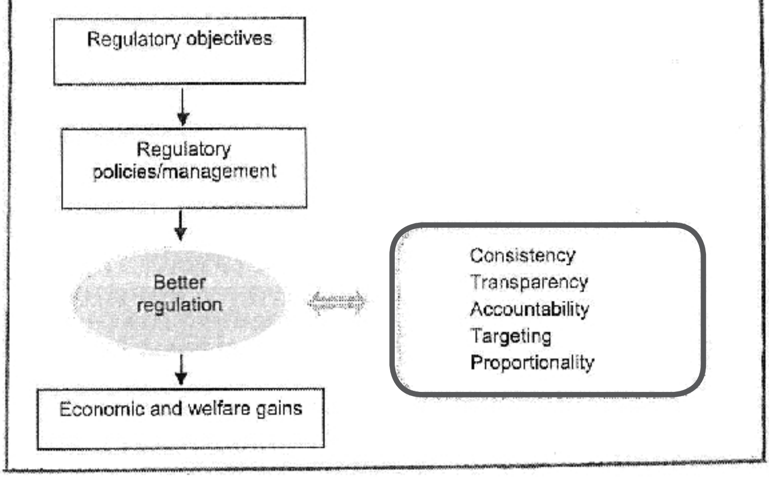
Jacobzone et al's study is indeed important and provides formidable elements coverage, even if not totally flawless. The analytical approach is that of principal components analysis. It converts extensive quantitative information from OECD surveys (between 1998 and 2005) on the quality of OECD countries' regulatory management systems.[9] Regression analysis is used to convert the quantitative information on the quality of countries' regulatory management systems, and then assessing the relationship between these systems and indicators of economic outcomes. A possible criticism of this study may lie in the small sample size used, and possibly a lack of time series data used for the regression analysis. But, nevertheless, the results indicate a significant and positive impact on employment, GDP, and labour productivity as response to improvements in regulatory management systems.

Parker and Kirkpatrick (2012) have, as part of their exercise on measuring regulatory performance[10], laid emphasis on the empirical method/evidence-based multiple regression analysis approach, extensively used in research by both individuals and various important bodies. The latter included the CPB Netherlands Bureau for Economic Policy Analysis (2004), the Swedish Agency for Growth Policy Analysis (2010), the Australian Government Productivity Commission (2006), and the Ministry oflustice of Vietnam (2008).

The causal chain

Any policy initiative to introduce “better regulation” cannot do without analysis of the causal chain for explaining the way in which regulatory intervention results in an economic impact. By helping to understand the ”how” and ”why” questions which surround regulatory impact, causal chain analysis can provide policy makers with relevant information on the consequences of policy decisions. A very basic causal chain can be illustrated as follows:

Figure 1. The causal chain

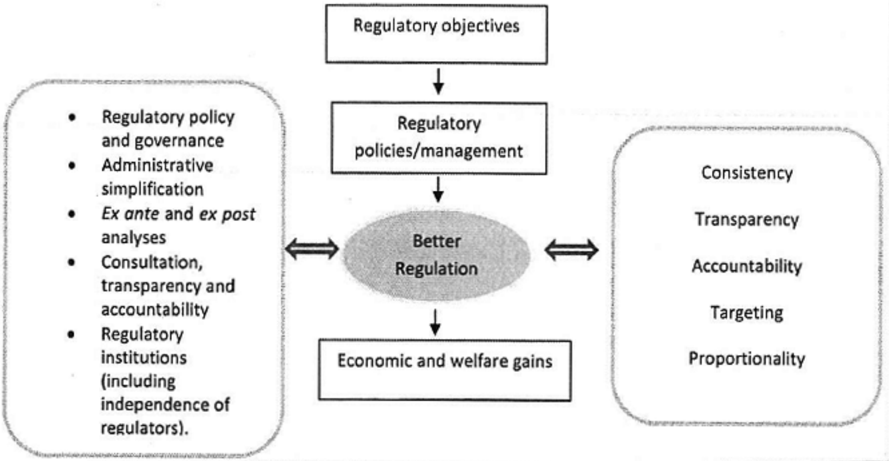

Regulatory objectives
Regulatory policies/management
Better regulation
Economic and welfare gains
Consistency
Transparency
Accountability
Targeting
Proportionality

The bulk of research and empirical literature on how the causal chain moves suggests a rigid categorisation into five groupings. These are:

- Regulatory policy and governance in general;
- Administrative simplification, (e.g., one-stop shops, time reduction for setting up a business);
- *Ex ante* and *ex post* analyses of regulations (e.g., for oversight bodies or institutions);
- Consultation, transparency, and accountability; and
- The regulatory institutions (including regulators' independence).

We can posit that, together, these groupings constitute the expansion of the above shown causal chain into the following manner:

Figure 2. The causal chain and specific regulatory policies


Regulatory objectives
Regulatory policies/management
Better Regulation
Economic and welfare gains
• Regulatory policy and governance
• Administrative simplification
• *Ex ante* and *ex post* analyses
• Consultation, transparency and accountability
• Regulatory institutions (including independence of regulators).
Consistency
Transparency
Accountability
Targeting
Proportionality

Corporate behaviour

The above shown causal chain elements and related regulatory policies are not far from the action plan on "Modernising Company Law and Enhancing Corporate Governance in the EU — A Plan to move Forward", which the European

Commission submitted in 2003. This was initially looked upon as setting forth a benchmark for improving the convergence of European regulations in the fields of company law and corporate governance. In its strong favour is the fact that it was not developed as a static instrument.

When one examines Paras 4-5 (on the guiding political criteria) of the formal EU Communication announcing it[11], it emerges as resoundingly clear that the whole Plan was built under a Better Regulation mantle. The latest developments in European Corporate Governance in the light of better regulation efforts have been studied in depth by Weber-Rey (2007) who has carried out an in-depth review exercise of efforts pursued at a European level in the field of this linkage between this Plan and Better Regulation.[12]

The better regulation approach to corporate governance simply cannot ignore that at every stage of the abovementioned causal chain the almost automatic linkage with specific regulatory policies brings to the fore the necessity of corporations regularly reviewing their governance processes and practices to make sure that these effectively oversee management, and indeed to ensure that their governance frameworks meet regulatory requirements and reflect evolving best practices. It may be useful to look at how some key organisations declare in their regular reporting their factual and operative respect for this "regulation-governance" nexus.

Sun Life Financial Inc. of Canada, the sister finance arm of the internationally famous Sun Life Insurance Co of Canada, makes it clear[13] that all its practices and processes are consistent with the corporate governance guidelines of a number of bodies. These include the Insurance Companies Act (Canada), the Canadian Securities Administrators guidelines, the Office of the Superintendent of Financial Institutions (OSFI) of Canada, , and then also the New York Stock Exchange (NYSE), and the Philippine Stock Exchange. Ethical behaviour, the essential basic company mandate, key officers' and board members' roles, responsibilities, independence, skills (including CPE), experience, tenure periods, diversity and inclusion, plus also the important link with risk management policies and structures, all of these elements feature in the manner that the corporation pursues all of its actions in the context of a perceived automatic, indeed inseparable, linkage between regulation and governance.

Another important insurance operator Mapfre Middlesea, (based in Malta but part of the large Spanish International Mapfre Group), is guided in its governance policies and actions by the fact that, with its shares listed on the Malta Stock Exchange, it is subject to governance requirements as laid out by the main financial regulator of the country, the Malta Financial Services Authority (MFSA). The MFSA's Code of Principles of Good Corporate Governance (the Code) features in the MFSA's Listing Rules, and this therefore can be considered as a coerced linkage of governance to regulatory imposition.[14]

Both here and elsewhere regulations generally require publication of statements of compliance. Interestingly Mapfre Middlesea's 2015 compliance statement is structured to deal with both areas where the corporation is in compliance with the Code, and where it isn't. The board, the chairman and the CEO, the company's audit committee, risk management, money laundering, the company's investments and remuneration committees, conflicts of interest, corporate social responsibility (CSR), AGM's, are all matters where the company declares "compliance with" the Code. How the company's directors are selected, evaluation of the board's performance, and certain aspects regarding board responsibilities and remuneration, feature amongst a few matters where there is "non-compliance with the Code".[15]

The highly prominent HSBC Group (banking) seeks to apply in all of its subsidiary and associate banks in many parts of the world what it describes as "the HSBC global values of dependability, openness to different ideas and cultures, and connection with customers, communities, regulators and each other." The Malta subsidiary of the Bank is, here again, subjected to the MFSA Listing Rules' requirements on corporate governance, and in its published statements the Bank here too follows the required praxis of outlining both where it is in compliance with the Listing Rules's requirements, and where it is not, in the latter case duly giving clear explanation why.(16)

There is a somewhat strange approach to the abovementioned Listing Rules's requirements in the position which is taken by Malita Investments, which is a public properties owning corporation in Malta, where the shareholding is both by state and private shareholders. Its 2015 Annual Report and Financial Statements include a Corporate Governance Statement which in part states (p.12) that "the Code (the MFSA Listing Rules requirements) does not dictate or prescribe mandatory rules, but recommends principles of good practice". This is a strange stance, but then perhaps again easily surmounted by the content of what is reported in the Statement where the coverage extends to practically all the same areas of governance and regulation as outlined in the other examples above.[17]

Conclusions

Efficiency, stability, and integrity are elements which underpin both regulation and governance. In a perhaps generalising approach it can be said that there are two ways for governments to do what they think is best in the public interest. One is telling the regulated (often also described as the regulatees) what to do. This can mean prescribing a wanted outcome, prescribing wanted process, or even both together, and both being in fact forms of regulation.

The other is governance. It is of course explicit recognition that organisations are run by people. In our times we perhaps exaggerate a sort of automata waiting passively to be told what to do. Recognising this suggests that, rather than simple issuing of instructions, one should organise incentive structures such that rational individuals, out of their own self-interest, do what the government wishes. But, as has also been hinted at above, regulation can freeze practice where evolution is desired. That is one side of the debate: the other is to what extent can disciplining change corporate behaviour. In November 2013 the Financial Times reported that regulators had in then recent years fined companies to the tune of more than Stg 500 m, but that approach was failing to have an effect on governance behaviour.

In the financial world historical modernity seems to have come about from a very distinct and precise point in time: post September 2008 and Lehman. From then onwards, both the didactic literature on regulation and governance, as well as the legal outputs at every state's level as well as within the EU, have indeed been endless and enormous. Should this imply that we have no choice but to be pessimistic? Should we write off all hopes of modernity being such where individual organisations, as well as markets, can reach what - to vary in some manner Kane's constant re-regulation theory[18] - be the permanent- equilibrium regulatory context status that Hegel conceived to stop what he saw as the thesis/antithesis conundrum, i.e. his vision of permanent peaceful synthesis?

We think not. A permanent, and positively operating, regulation/governance nexus and equilibrium is not only possible (even accepting permanent re-regulation as a perhaps inevitable reality) but can indeed serve to bring nations and peoples closer in their day to day operations and affairs. It simply does not pay to be negative about both regulation and governance.

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9. Vide OECD (2010) — indicators of Regulatory Management Systems — (January, Paris).

10. Parker & Kirkpatrick, Op cit (2012), pp 25-27.

11. Communication from the Commission to the Council and to the European Parliament, Brussels, COM(2003)284 of 21 May 2003 (CGAP).

12. Weber-Rey Daniela (2007) — "Latest Developments in European Corporate Governance in Light of Better Regulation Efforts" (pp 247- 269) in "Better regulation", Weatherill S.(ed), Hart Publishing, Portland, Oregon.

13. Vide e.g. Sun Life Financial Inc., Management Information Circular 2016, pp 16-27.

14. The Code features in Appendix 5.1 of Chapter 5 of the currently applicable MFSA Listing Rules, and in terms of Listing Rule 5.94 the company is obliged to prepare a report explaining its compliance with the provisions of the Code.

15. Mapfre Middlesea Insurance plc, Malta, Annual Report and Financial Statements 2015, pp 17-26.

16. HSBC Bank Malta plc, Annual Report and Accounts 2015, pp 27-36.

17. Malita Investments plc., Malta, Annual Report & Financial Statements, 2015, pp 12-19.

18. The Edward J. Kane model, known as the "regulatory dialectic" or "struggle model" is discussed in detail in his 1977, 1981, 1983, 1984 and 1986 papers, particularly (1981) "Accelerating inflation, Technological innovation, and the Decreasing Effectiveness of Banking Regulation" (Journal of Finance, May, pp 355-367), and (1986) "Competitive Financial Re-regulation: an International Perspective (1986 Conference of the International Centre for Monetary and Banking Studies, August).