Chapter 3

Decision making and governing body structure for independent regulators

Regulators require governance arrangements that ensure their effective functioning, preserve its regulatory integrity and deliver the regulatory objectives of its mandate. This chapter details the structures of governing bodies, the decision making model and their memberships for independent regulators.
Principles for decision making and governing body structure

**Decision-making model**

1. The governing body structure of a regulator should be determined by the nature of and reason for the regulated activities and the regulation being administered, including its level of risk, degree of discretion, level of strategic oversight required and the importance of consistency over time.

**Relationship between the responsible accountable political authority, governing body and the Chief Executive Officer**

2. There should be a clear allocation of decision making and other responsibilities between the responsible accountable political authority, the governing body and the Chief Executive Officer (CEO) or individual in charge of the organisation’s performance and implementation of decisions.

3. Where a regulator has a multi-member governing body, the CEO or individual responsible for managing the organisation’s performance and implementing regulatory decisions should be primarily accountable to the regulator’s governing body.

**Membership of the governing body**

4. To avoid conflicts of interest, where there is a need for formal representation of specific stakeholders in strategic decision making, stakeholder engagement mechanisms such as an advisory or consultative committee should be established, rather than making those stakeholders members of the regulator’s governing body.

5. Executive representatives are accountable to the minister, and their presence on the governing body of an independent regulator can create role conflict. They should only participate in meetings of the governing body of independent regulators in a non-voting capacity and only when necessary and by invitation of the regulator.

6. The role of members of the governing body who are appointed for their technical expertise or industry knowledge should clearly be to support robust decision making in the public interest, rather than to represent stakeholder interests.

7. Policies, procedures and criteria for selection and terms of appointment of the governing body should be documented and readily available to aid transparency and attract appropriate candidates.

8. Members of the governing body should be limited to the number of terms of appointment to the Board.
Institutional governance arrangements for decision making

Chapter 2 set out the issues surrounding whether to place a regulatory function within a ministry or in a separate independent entity. If a regulator is established as a unit of the ministry, the decision making and governing body structure will be determined by the ministry’s own arrangements, and this chapter is not relevant. However, for independent regulators, there are three main governance structures used (Department of Public Enterprise, 2000):

- Governance board model – the board is primarily responsible for the oversight, strategic guidance and operational policy of the regulator, with regulatory decision making functions largely delegated by the chief executive officer (CEO) and staff – for example, the United Kingdom’s OFWAT (Water Services Regulation Authority);
- Commission model – the board itself makes most substantive regulatory decisions – examples include the United States’ Federal Trade Commission and the ACCC; and
- Single member regulator – an individual is appointed as regulator and makes most substantive regulatory decisions and delegates other decisions to its staff.

The appropriate governance structure in each case will depend on the nature of the regulatory task and the sectors subject to the regulation, as discussed in the rest of this chapter.

Decision-making model

Where the governance board model is adopted, typically the roles and duties of boards cover strategy, governance and risk management and include matters such as:

- setting strategic direction and developing policy;
- appointing the chief executive;
- monitoring performance; and
ensuring compliance with the law, the organisation’s constitution and polices (OECD, 2004).

The roles and functions have some similarities to the private sector model of corporate governance, but in many ways the board’s role and function are substantially different for regulators (Uhrig, 2003). Depending on the nature of the institutional and legislative arrangements, the responsible minister has potential to exert more power than a shareholder over a company. The minister is responsible for many matters which a board would decide in the private sector, such as setting objectives and underlying policies. Public entities often have complex functions, delivering activities on behalf of government and multiple types of stakeholders. The broader accountabilities of regulators – to their responsible minister, to the legislature and to the community more broadly – are key differences to private sector companies.

In some circumstances, a board-like governing body can add significant value to the decision making and oversight of the regulator’s operations.

Factors identified in considering the potential value of a multi-member compared with a single-member decision-making model are summarised below. Once an assessment of these factors is made, the basic choice between decision making by an individual or by a collective can be considered and determined. These factors include:

- Potential commercial/safety/social/environmental consequences of regulatory decisions, taking account of the degree of impact of a risk event and the probability of its occurrence – a group of decision makers is less likely to be “captured” than an individual and a group will bring differing perspectives to decisions;

- Diversity of wisdom, experience and perceptions required for informed decision making because of the degree of judgement required (for example, where regulation is principles-based or particularly complex) – collective decision making provides better balancing of judgement factors and minimises the risks of varying judgements;

- Degree of strategic guidance and oversight of delegated regulatory decisions required to achieve regulatory objectives – where the regulator requires significant strategic guidance and oversight to achieve its regulatory objectives, such as in developing compliance or enforcement policies or resource allocation, these functions are better located in a body separate from its day-to-day operations. A multi-member body provides collegiate support for such strategic decision making;
- Difficulty and importance of maintaining regulatory consistency over time – where regulatory decisions require a high degree of judgement, a multi-member decision-making body provides more “corporate memory” over time; and

- Importance of decision-making independence of the regulator – a board will be less susceptible to political or industry influence than a single decision maker.

The OECD’s *Making Reform Happen: Lessons from OECD countries* (OECD, 2010b) noted that the great majority of independent regulators in OECD countries have a board (or commission), and that a board is considered more reliable for decision making as collegiality is expected to ensure a greater level of independence and integrity.

Where a multi-member decision-making body is chosen, a further consideration is the appropriate role for the body. In some cases, the multi-member body will be able to adequately make all the substantial regulatory decisions itself. Alternatively, decisions could be divided among decision-making body members (or sub-committees) with particular jurisdictions or specialist expertise, where collegiate decision making is not required. Here the relevant expertise can be leveraged upon through a formal institutional mechanism for technical decisions.

In other cases, the best use of their efforts is on strategic guidance, approval and oversight of operational policy for the regulator, while delegating responsibility for implementation to the CEO and staff (Chartered Secretaries Australia, 2011). This may be the case where the regulator has a high workload of regulatory decisions or otherwise requires significant strategic guidance and oversight. The decision-making body may also need to delegate responsibility for certain time critical decisions, for example, to the Chair, CEO, or sub-committee of the board. Other regulatory decision making may be delegated to inspectors. These individuals may be covered by different employment arrangements and associated legislation. This highlights the importance of thinking about the roles of all of those who are likely to make key decisions when the design of the regulatory scheme and its governance is undertaken. Any limitations on the power of the body to delegate should be made explicit in the establishing legislation.

Where a single-member decision maker is chosen, it is important to consider the interaction between the role of the regulatory decision maker and the role of the CEO (or equivalent). It may be appropriate for the responsibility for implementing the decisions and administering the regulator to be vested in a separate individual, for workload or other reasons. In either case, the justification for the model chosen should be clearly articulated, preferably publicly.
Box 3.1. Decision making in the Federal Institute of Telecommunications of Mexico

Decision making is done by a committee, which is comprised of seven commissioners including the commissioner president. These will deliberate in a collective way and will decide their issues by majority vote, its meetings shall be public, except as provided by law.

Source: “Decreto por el que se reforman y adicionan diversas disposiciones de los artículos 6o., 7o., 27, 28, 73, 78, 94 y 105 de la Constitución Política de los Estados Unidos Mexicanos, en materia de telecomunicaciones” (2013).

Relationship between the responsible minister, governing body and CEO

Where a regulator has a separate governing body and chief executive, clearly defining the levels of decision making and their allocation between the body and the chief executive (or management levels) will be important. For example, distinctions can be drawn between broad policy frameworks, key decisions under the enabling legislation, criteria for deciding more routine regulatory matters and the implementation of higher level decisions. The role of the responsible minister with regard to the regulator should be clearly defined. The allocation of roles between these parties should be documented and readily available to all affected parties (Chartered Secretaries Australia, 2011; and Uhrig, 2003).

Where there is a multi-member governing body, the CEO’s primary accountability should be to the governing body, in order to safeguard the accountability of the CEO and independence of the regulator. The CEO should be appointed by, or on the recommendation of, the governing body.

Membership of the governing body

In order to support regulatory integrity through objective and impartial decision making, the governing body of a structurally independent regulator must be insulated from inappropriate stakeholder, ministerial or industry influence.

Stakeholder representation

One issue is the potential for confusion between the role of the governing body as a decision-making structure and as a body representing the interests of stakeholders. Even where there is a consultation or nomination process through the relevant sector, the appointee’s role on a
regulator’s governing body is to bring his or her particular expertise to the governance of the organisation, not to represent the interests of the sector (Pagliari, 2012).

Where industry stakeholders are members of the regulator’s governing body, there is a potential for conflicts of interest to arise between the stakeholder’s financial or other interests and the policy objectives of the regulator, which can create the appearance of impropriety (Chartered Secretaries Australia, 2011). There is also a risk that members of the governing body, once appointed, may perceive their role as representatives of a group they may have an interest in, rather than independently providing expertise for the governance of the organisation. This risk will be even greater if the regulator has an “industry development” objective. For these reasons, where regulators have a need for representative advice, this is better addressed through the formal establishment of advisory or consultative committees, either on an on-going or ad hoc basis. The Ministry of Employment and Economy in Finland has established a number of consultative or advisory bodies over the past few years as formal stakeholder engagement mechanisms.

In co-regulatory schemes, some form of industry involvement in governance arrangements may be a justifiable quid pro quo for a close relationship between the regulator and the industry, in order to give the regulator a source of effective influence without resorting to enforcement tools. In such cases a protocol for the management of conflicts of interest is essential.

**Ministry representation on the governing board**

Appointment of members of the ministry on the governing body of an independent regulator has the potential to create role conflict. In some cases, the statute creating an existing regulator requires ministry representation either by the Secretary who is the most senior public official in the ministry (i.e. Permanent Secretary, Departmental Secretary, State Secretary, Secretary-General, Deputy Minister, etc.) or his or her delegate, on the governing board. When such regulators are reviewed, the merits of mandating ministry representation need to be carefully considered, in terms of the level of independence of the regulator from government.

Because the duty of ministry staff under the terms of their employment is to the Secretary, and the duty of the Executive to the minister, there is potential for conflict between the role of a ministry staff member as a representative of the ministry and as a member of an independent regulator’s governing body. For example, the *Appointment and Remuneration Guidelines of Victorian Government Boards, Statutory Bodies and Advisory*
Committees have noted: “The more a body’s operations are designed to be independent of government influence, the less appropriate a non-statutory appointment of a public sector employee is likely to be.” These guidelines also require justification of any ministry representation on the governing board not required by statute.

On the other hand, there can be benefits of having ministry representatives participate in the meetings of the governing body, particularly for certain agenda items. The potential benefits include improved information sharing, more informed decision making by both sides and a better relationship between them, although this can also be achieved in other ways.

To capture these benefits without compromising the regulator’s independence and conflicting the ministry representative, one option is to allow such representatives to only participate at (non-public) meetings of the governing body of an independent regulator in a non-voting capacity, and at the invitation of the regulator only. This will largely depend on whether their presence at the meeting will unduly influence the proceedings and decisions at the meeting.

**Technical expertise or industry knowledge**

Where industry or technical experts are required on a governing body for informed and robust decision making, the objective of their appointments should clearly be to contribute independently to decision making in the public interest, rather than as a representative of specific stakeholder interests (Pagliari, 2012). Again, a protocol for the management of conflicts of interest is essential (OECD, 2003).

**Selection processes for board members**

Where there is to be a multi-member governing body, a diversity of skills and experience tailored to the functions of the regulator will facilitate robust decision making. The appropriate mix will also depend on the precise role of the governing body (for example, in a governance board compared to a commission model). The enabling legislation should identify the skills set and experience relevant to the regulatory functions that need to be represented on the governing body (Department of Public Enterprise, 2000).

Policies, procedures and criteria for selection and terms of appointment of the governing body members must be in line with any guidelines for public entity board appointments, and should be documented and readily available to all affected parties (Chartered Secretaries Australia, 2011).
Governing body appointment policies should include all relevant details, including:

- Who manages the process for appointment of the members of the governing body?
- How are the requirements of the position defined? How are candidates selected?
- Who makes appointments?
- How will the Chair be nominated?
- What is the role of the minister (and the minister’s office), the ministry and other advisory structures (if any)?
- How is induction managed?
- How is performance management managed?
- How are conflicts of interest managed?

In some countries the legislature has the formal authority to appoint board members and the CEO of the regulatory agency for greater transparency and accountability of the appointment process.

There should also be a limit to the terms of appointment of the CEO and board members to allow for renewal of the leadership and prevent long appointments. While long term or renewed appointments provide a certain amount of certainty and institutional grounding, they can also be detrimental toward the progress of the regulator and create incentives for career board members.
Applying the principles – Decision making and governing body structure for independent regulators

Decision-making model

- Should the regulatory decision-making powers be vested in a multi-member body or an individual? The following tool is not prescriptive, but is intended to identify the major factors for considering the value a multi-member body would bring, in approximate order of importance. A high overall rating indicates a stronger case for a multi-member decision-making body. Their relative weight will differ from case to case.

<table>
<thead>
<tr>
<th>Indicators of multi-member decision-making body value (in approximate order of importance)</th>
<th>1 (Low)</th>
<th>2 (Moderate)</th>
<th>3 (High)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Potential commercial/safety/social/environmental consequences of regulatory decisions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Diversity of wisdom, experience and perceptions needed for informed decision making because of the degree of judgement required (for example, where regulation is principles-based or particularly complex) or the scope of issues covered</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Degree of strategic guidance and oversight of delegated regulatory decisions required to achieve regulatory objectives</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Difficulty and importance of maintaining regulatory consistency over time</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Importance of decision-making independence</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Does the legislation clearly establish the roles of the governing body?
- Where a single regulatory decision-maker model is chosen:
  - Should the individual who is responsible for regulatory decision making also have responsibility for the management and administration of the regulator? Why or why not?
  - Should there be any limitations on the ability of the regulatory decision-maker(s) to delegate the power to make regulatory decisions?
### Relationship between the responsible minister, governing body and CEO

- Is the allocation of roles and responsibilities between the responsible minister, the governing body and the Chief Executive Officer (or equivalent) documented and available to all affected parties?
- Where there is a multi-member governing body:
  - Does the governing body have the power to appoint and remove the chief executive?

### Membership of the governing body

- Are stakeholders separate from the governing body?
- In the exceptional case where stakeholders are members of the governing body, what is the justification for this?
- How are conflicts of interest managed?
- Are ministry staff separate from the governing body?
- If ministry representatives are on the governing body, do they participate in a non-voting capacity?
- If ministry staff are represented as full voting members, what is the rationale for this, and how are conflicts of interest to be managed?
- Are industry or technical experts required on the board for robust regulatory decision-making?
- If so, is it clear that the experts are required to contribute to decision-making independently rather than as stakeholder representatives?
- How are conflicts of interest to be managed?
- Does the legislation clearly specify the skills set and experience relevant to the regulatory functions that need to be represented on the governing body?
- Are appointment policies in line with the any government guidelines for public entity board appointments?
- Are appointment policies documented and readily available?
- Are there limits on the number of terms that a CEO or board member can be appointed for?
Notes

1. For a discussion of this important relationship in the private sector context, see OECD (2004a). The governance relationships in public sector entities are similar to those in the private sector. For example, the economic regulator of the water sector for England and Wales, OFWAT, has a Board structure. The Board comprises a Chair, Chief Executive, executive Board members and non-executive directors. Board members are appointed by the Secretary of State in consultation with the Welsh Government (www.ofwat.gov.uk/aboutofwat/structure/, accessed 10 October 2012).

2. See Board size and effectiveness (2011); and Good Practice in Making council member and chair appointments to regulatory bodies (2012) (www.professionalstandards.org.uk/regulators/overseeing-regulators/appointments-to-councils), Professional Standards Authority, United Kingdom.