



What Makes a Regulator Excellent?

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Question posed: what makes a regulator excellent? Could be two distinct questions: what makes a regulatory organization excellent and what makes an individual regulator, working within a regulatory organization, excellent?

Because people ultimately determine what an organization does, this outline focuses primarily on effective individual regulators. In doing that, it also touches on issues of organizational culture.

Start with a quick overview of knowledge, skills, and traits of excellent regulators, then consider questions of culture and law. Finally, take a slightly deeper dive on knowledge and skills required.

Knowledge

Knowledge in five key areas is necessary to be an effective regulator. You must:

- Understand your agency's core mission and its specific legislated objectives
- Know where you stand today internally within your organization and externally with respect to your regulated sector
- Understand likely root causes of the problems, their import, and their susceptibility to influence
- Understand your ability to drive the necessary change (theory of change; evidence of the impact of past actions in similar or analogous situations)
- Knowledge of past problems how they were resolved, both trends and recent results

Skills and Traits

Knowledge alone is likely not enough. Also need right set of skills, and perhaps a special mindset.

- Be comfortable taking bold (yet informed) action in the face of harsh criticism
- Seek multiple perspectives
- Have ability to see both the forest and the trees
- Be flexible, creative and swift in problem-solving
- Be comfortable with criticism
 - Understand that you will be criticized by trade associations, members of Congress, and others for the tough decisions you make
 - Understand that your successor will receive the credit for the tough decisions you make today

In short, be a smart, effective and strong manager/leader in your organization. Timidity usually does not work, particularly where there are known problems that require time sensitive solutions.

Organizational Culture

- Tone at the top matters: to change culture, need to drive change from the top. Unfortunately, you cannot legislate good leaders so this is up to the person running the agency
- Cultural problems at regulatory agencies often go very deep and take years to cement. Unless there is a strong message from the top, nothing will change.
- Engage with industry to understand their business model (how they make money and where their risks are) and facilitate their business where appropriate and in keeping with the core mission of the agency.
- Give horizontal guidance and perspective to industry to allow them to see where they stand relative to their peers to drive change (for example, cybersecurity/anti-money laundering efforts)
- Recognize good people (people will do more if they feel they are being noticed and appreciated). Little things matter
- Value well-informed, well-considered regulatory flexibility in responding fairly and encourage regulated entities to go beyond regulated compliance

Laws

- Clear about objectives
- Mandate frequent measurement to gauge progress on objectives
- Mandate data transparency except where confidential business information will be disclosed
- Afford regulators flexibility in means of regulation
- Afford regulators flexible penalty authority that allows them to respond fairly but persuasively to non-compliance situations

Core mission and regulatory objectives

- Mission-focused objectives. There are many different types of regulatory agencies with varying missions. E.g.,
 - Financial regulation: Safety and soundness or solvency of institutions; consumer/investor protection and market integrity; financial system stability
 - Environmental regulation: improve human, animal, plant, and ecosystem health and reduce the frequency, severity, and consequence of environmental stressors such as chemical or oil spills and permit exceedances
- Sometimes regulators forget their core missions or sometimes this mission may not be clear, so resources can be expended on activities that are not germane to the core mission. This can result from: the prioritization of specific requirements and activities that do not actually reflect organization mission; changes in what is regulated with lagging regulations and laws; debate about objectives; conflicting

objectives; activity-focused, rather than risk or condition-focused, performance metrics, E.g.,

- Financial regulation: did the Fed have a financial stability mandate before the crisis; does/should the SEC have a financial stability mandate; was the OTS's desire to enhance the thrift charter part of its mission; is the facilitation of business part of being a regulator; if so, where are the boundaries?
- Environmental regulation: inspection findings rather than water and air quality, risks, or harmful incidents, especially when inspecting small percentage of permit holders or when permit holders are only a small percentage of the problem
- General regulatory objectives:
 - End outcome objectives: lawfulness (compliance), fairness and perceptions of fairness, minimal economic impact.
 - Intermediate outcome objectives: awareness of regulatory requirements and reasons they have been established, understanding, acceptance, behavior change
 - Process objectives: higher return on taxpayer dollar, high quality interaction with government officials; government accountability to the public (that the public understands what government organizations are trying to accomplish, why, how, progress on objectives, adjustments made to announced strategies and tactics, and why those adjustments were made. It also means that the public can constructively provide feedback and engage on all of the above)

Understand where you stand today

- The problem and opportunities: The threats or risks you are trying to reduce or prevent, including their frequency and consequence, and the conditions you are trying to improve
- Regulated party characteristics: Characteristics of those being regulated, such as their size, the market forces affecting them, common or unique problems, such as problems at regulated entities on a horizontal basis (if virtually everyone has money laundering issues, that's a problem that a regulator should be focused on; the state of cybersecurity vulnerability at banks, insurers raises public policy issues)
- **Regulator characteristics/regulatory adequacy:** Criteria for assessing regulatory demand and regulator supply -- where do you stand today, internally and externally? Each agency is different, but once you have a clear understanding of your core mission, you can develop criteria tailored to your agency that effectively track your agency's current ability and capacity relative to regulatory needs (resources, authorities, tools, skills to influence those being regulated to accomplish core mission)
- **Impact:** What's working and what's not working in terms of: (1) end outcomes; (2): non-compliance patterns, compliance, and beyond compliance behaviors; (3) intermediate outcomes (awareness, understanding, and acceptance of need for regulation); and (4) process fairness (timing and decision predictability, civility)

- **Regulatory process efficiencies (timeliness and cost):** e.g., time and cost for various types of applications (license, registration, business combination) needing approval and time and knowledge required for approval, both averages and distribution; length of time institutions require to remediate problems; length of time on rulemaking for matters known to be high risk (subprime lending)

Root Causes of Regulated Party Problems

Regulatory excellence, and the ability to influence regulatory compliance and outcomes, requires an understanding of the reason for non-compliance or harm-creating behavior.

- Lack of awareness of regulatory requirements
- Misunderstanding of or confusion about regulatory requirements
- Disagreement with regulatory requirements and perception that will not get caught and penalized
- Competitive pressures
 - Sense that competitors are non-compliant and that they have an economic advantage
 - More money is better than less, regardless of competitive position, and regulatory compliance is a cost
- Cost of regulatory requirements exceeds business ability to pay the cost and still exist (marginal operations)

Regulator Vulnerabilities

Knowing vulnerabilities and working to prevent them is critically important. Some examples include:

- Problem: Inadequate number of skilled or experienced employees
 - Root causes could include: (1) inability to recruit talented people due to lack of funding, poor recruiting strategy, political pressure to keep growth down, lack of a qualified applicant pool; (2) inability to retain skilled or experienced individuals due to revolving door, older workforce approaching retirement age, lack of a career path, or poor compensation; (3) inadequate training due to lack of funds, lack of effectively tailored program, poor employee participation; (4) poor deployment of resources due to legislative requirements or poor management
- Problem: Poor Decision-making
 - Root cause could include political or outside influence, regulatory capture, disorganized process, lack of accountability and responsibility for poor decisions or inefficiencies in the decision-making process; competition with other agencies
- Problem: Morale
 - Workforce not empowered to challenge or raise questions
 - Workforce not empowered to address problems, only spot them
 - All of the above

Tools for Reducing Problems

- Differentiate between those who complain about culture and those who actually change it
- Allocate resources better internally (understand civil service laws and collective bargaining agreements as a both a vehicle and an obstacle). Legislative approval for additional resources in budget? (lobby Legislature/Executive)
- Where there is particularly widespread bad behavior, and if appropriate, shine light on certain practices to drive industry change
- Focus on outcomes and what changes them, and risks and who and what causes them.
- Monitor progress using inspection findings, counts of unwanted incidents and their characteristics, conditions of interest frequently; share and discuss the data with managers, field, stakeholders to find ways to improve; to enlist and engage ideas/assistance; to motivate internally and externally