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1 Foreword

Regulatory creep is the 'hidden menace' of the red tape burden. Regulatory creep arises when the rules are unclear - when there is confusion about the standards, guidance and regulation. People are left not knowing what is expected of them, what constitutes compliance with the law. But what is very clear is that the penalty will be high if they fail to do the right thing. It is also clear that though hidden, the 'menace' is real - uncertainty creates additional burden and cost. Compliance with rules and regulations depends on clear parameters and our report finds evidence of failure here.

From the outset of this study it was clear that the term regulatory creep means different things to different people. We have chosen to define regulatory creep as the process by which regulation is developed or enforced in a less than transparent fashion and not in accordance with our five Principles of Good Regulation.

Stakeholders told us that on one level the development of regulation in the UK is the best in Europe. Strong tools and mechanisms for better regulation have been in place for some time and the Government is getting better at using them. The Government's compliance with its Code of Practice on Consultation is improving and its current compliance rate on producing Regulatory Impact Assessments for proposals that impact on businesses, charities and the voluntary sector is 96%.

However, this study shows that there is less evidence of good practice when it comes to developing guidance or informing enforcement policy and practice. And it is this that allows regulatory creep to take place.

The examples of regulatory creep we considered had in common an underlying lack of transparency. For instance we encountered examples where there was a lack of transparency about the intention of the regulation. We also considered examples where a lack of transparency about the purpose of guidance had led to regulatory creep.

In order to minimise the effects of regulatory creep, the Government must be far clearer about its objectives when developing regulatory proposals and consider at the outset how those being regulated will demonstrate compliance in practice. It needs to embed better the Principles of Good Regulation into the development of enforcement policy and guidance. And it needs to spread good regulatory practice beyond Whitehall to its independent regulators. It has already begun to do this by implementing the recommendations in our report on Independent Regulators. But there is still more work to do.

We are grateful to all those who contributed to this study and would like to extend particular thanks to the Centre for Analysis of Risk and Regulation at the London School of Economics for their help and support.

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2 Introduction

2.1 What the review considers

Regulatory creep takes many forms and our discussions with stakeholders highlighted that it means different things to different people. For the purpose of this study the Task Force has defined regulatory creep as the process by which regulation is developed or enforced in a less than transparent fashion and not in accordance with the Principles of Good Regulation. This may not be deliberate and may not always be the result of actions by government and regulators. Those who are being regulated can also help extend the scope and impact of regulation far beyond what is originally intended by over-zealous interpretation of regulation and guidance.

During our discussions stakeholders put forward many examples of regulatory creep. Some organisations thought that framework legislation giving the Government wide powers to make significant regulatory changes via secondary legislation amounted to regulatory creep. Others suggested that the introduction of skeleton bills with the detail being filled in by Government sponsored amendments constituted regulatory creep. Others pointed to case law, tribunal rulings and ombudsmen's rulings as sources of regulatory creep. And some pointed to the role of insurers and consultants in "gold-plating" regulatory requirements.

We have concentrated here on how regulation might be developed or embellished by non-statutory means, particularly in relation to compliance and enforcement. So we have identified a set of regulatory problems that together we have examined as examples of regulatory creep.

Principally these are how:

- a lack of clarity about the intention of regulation, particularly goal-based regulation, both on the part of regulators and those being regulated, can lead to unnecessary compliance burdens;
- guidance - its status, how it is developed and used can influence enforcement activity and compliance, again leading to unnecessary burdens that bring little benefit to those the original regulation was designed to protect;
- enforcement activity can induce over compliance in those being regulated; and
- ombudsmen's rulings can have wider regulatory implications.

These problems all have one factor in common – a lack of transparency. The original intention of the regulation may be unclear and can become more so as it is embellished or interpreted by regulators, industry bodies and by those being regulated. Most importantly, we have regulation that is not being developed in accordance with our Principles of Good Regulation. The end result is greater burden for those being regulated for little, if any, increased benefit.

2.2 Key themes emerging from the review

The reasons why regulatory creep occurs can be complex and may often be due to a combination of circumstances. But one of our key findings is that goal-setting regulations, while having advantages, can lead to regulatory creep. This is because there

is often a need for guidance to explain to those being regulated how they can comply, and the guidance can stray beyond the requirements and indeed the intention of the legislation.

But part of the attraction of goal-setting regulation is its flexibility and we do not want to discourage this. Nor do we want to discourage the use of guidance as a useful alternative to regulation for driving up standards. But where does guidance as a useful alternative in driving up standards end, and regulatory creep begin? It is often how enforcers use guidance that is the determining factor.

The Task Force's Principles of Good Regulation are now widely applied, but only in relation to preparing regulation. We believe that they need to be applied throughout the regulatory process, including in the formation of guidance.

We said in our report on Independent Regulators that the Government should think carefully before creating new regulators. In this study we have found that the way a regulator is set up can influence whether regulatory creep might occur. The founding statutes of some regulators, particularly those set up more recently, contain more checks and balances in relation to regulatory burden than others. This can be an important factor in reducing regulatory creep.

Finally, the quality of the dialogue that the regulator has with those it regulates and with enforcers has an effect on regulatory creep. Poor or non-existent dialogue means that those on the receiving end of regulation are far less likely to be clear about what they need to do to comply. As one regulator remarked:

"*…when we have got it wrong it is generally when, for whatever reason, we haven't had a strong dialogue with stakeholders.*"

2.3 Our approach

We focused on areas that were initially suggested to us by stakeholders. Top of many stakeholders' concerns, both businesses and consumers, were the identification requirements of the anti-money laundering regime. Food regulation and health and safety regulation were also highlighted as areas for consideration. We have also referred to other examples that we came across during the course of our work, including ombudsmen's rulings. During the study we gathered a great deal of information from many sources. We spoke to:

- businesses and their representative organisations;
- government departments;
- independent regulators;
- academics;
- consumer bodies; and
- enforcement agencies.

Annex B gives a list of those who contributed to the report. We are grateful to them for their input.

The report draws on a series of specific examples and makes generic recommendations on how to reduce regulatory creep. In addition we make some specific suggestions to encourage a more proportionate and risk-based anti-money laundering regime.

The report is divided into 6 main sections that cover:

- goal-setting regulation;
- guidance;
- enforcement activity;
- penalties;
- overlapping regulatory regimes; and
- ombudsmen's rulings.

Each section of the report is illustrated by examples.

3 Full list of recommendations

Recommendation 1

The Task Force recommends that when considering options for achieving the policy objective, policy makers should consider what scope there is for a set a of measurable minimum standards for compliance that can operate alongside a goal-based approach.

Recommendation 2

The Task Force recommends that policy makers should involve those being regulated and enforcers in the early stage of policy development, so all parties involved share a common understanding of what demonstrating compliance will mean in practice. This advice should be included in the Cabinet Office's guidance on consultation.

Recommendation 3

The Task Force recommends that policy makers should include in the Regulatory Impact Assessment consideration of how those being regulated will be expected to demonstrate compliance, paying particular attention not to generate unnecessary paperwork burdens. The guidance "Better Policy Making: A Guide to Regulatory Impact Assessment" should be amended to reflect this by the end of 2004.

Recommendation 4

The Task Force recommends that the Government and regulators should include clear statements in their guidance documents setting out their purpose and legal status.

The Regulatory Impact Unit, working with the Small Business Service, should revise current advice to policy makers on developing guidance. The guidance should be published by spring 2005.

This advice should:

- include the need for a clear statement of the purpose and status of guidance;
- stress the importance of applying the Principles of Good Regulation to the development of guidance;

- encourage those who draft guidance to take into account the projected costs and benefits of the original regulatory proposal to make sure that the guidance does not stray beyond the original intention; and

- encourage those who draft guidance to involve those being regulated and enforcers in the development of the guidance.

Recommendation 5

The Task Force recommends that in applying the openness principle of good enforcement policy that sponsoring Departments should ensure that enforcement agencies publish their enforcement policies and guidance to inspectors on what constitutes compliance on their websites.

Recommendation 6

The Task Force recommends that the Government should consider the scope for creating further sector specific industry/cross government forums. The terms of reference for new and existing forums should include a clear steer that they should:

- consider at an early stage compliance issues associated with emerging regulatory proposals so all parties share a common understanding of what compliance will mean in practice; and

- have an input into the development of guidance.

Recommendation 7

The Task Force recommends that the Financial Services Authority together with the financial services sector should develop a robust system for passporting ID checks between institutions that has the full confidence of the sector, by spring 2005.

We look to the Treasury, as the lead Department for the anti-money laundering regime, with the help of the Financial Services Authority, to disseminate the lessons learnt from the financial services sector's work on simplifying ID checks and to facilitate the development of a system for passporting ID checks across all sectors subject to the Money Laundering Regulations by the end of 2005.

Recommendation 8

The Task Force recommends that when creating new regulators the Government should include appropriate checks and balances in the founding statute to minimise the risk of regulatory creep. In particular the Government should include a duty on regulators to review and report annually on the regulatory burden they impose and the steps they have taken to reduce it.

For existing regulators the Government should include in their management statements a duty to review and report annually on the regulatory burden they impose and the steps they have taken to reduce it.

Recommendation 9

The Task Force recommends that the Government should consult on how it might introduce a more proportionate and targeted system for suspicious activity reporting within the anti-money laundering regime by spring 2005.

Recommendation 10

The Task Force recommends that when creating statutory ombudsmen to work alongside regulators the Government should consider whether it needs to develop a mechanism for dealing with cases that have wider regulatory implications. This should ensure that proper consultation and impact assessment may take place. Cabinet Office guidance to departments on setting up ombudsmen services should be amended to reflect this by spring 2005.

4 Goal-setting regulation

Goal-based regulation sets broad objectives leaving those who are being regulated to decide how to meet them. We have found it can lead to regulatory creep. There are two principal reasons for this:

1) High level goal-setting objectives may need further clarification. Goal-setting regulation can leave a vacuum that Government, regulators and industry will seek to fill with guidance. The guidance may stray beyond the original intention and/or it may be applied prescriptively by regulators and those being regulated.
2) Insufficient thought is given at the outset to how those being regulated will demonstrate compliance with regulation – what compliance will mean in practice. Regulators argue that it is their job to prove non-compliance and that there is no legal requirement for duty holders to demonstrate compliance. However, compliance should not be a guessing game. Those being regulated do need to understand what is required of them in practice.

4.1 Goal-setting regulation and guidance

Effective goal-setting regulation requires clearly defined objectives. But, even if the objectives are clearly defined, industry will often seek further clarification on how to comply.

The Better Regulation Task Force supports goal-setting regulation because it allows for flexibility in implementation. But we are aware that there are some businesses, particularly smaller businesses, that prefer the certainty that classic regulation and prescriptive rules can give. They prefer to be told exactly what they have to do in order to comply with the law. This was apparent during many of our discussions with businesses – where there was often a split between those who wanted greater certainty and prescription and those who preferred to take advantage of the flexibility that goal-based regulation can offer. It is a difficult challenge for Government and regulators to provide sufficient clarity without taking an overly-prescriptive approach.

In the case of the anti-money laundering regime, the Financial Services Authority requires the firms it regulates to have in place systems and procedures to prevent money laundering. Its rules follow the Treasury's Money Laundering Regulations, which in turn implement EU and international obligations. On customer identification the rules require that firms take reasonable steps to ensure that they are satisfied that customers are who they say they are. These objectives seem fairly clear, but nonetheless the sector feels the need for additional guidance on how to comply with the rules.

The Joint Money Laundering Steering Group (JMLSG) is the industry body responsible for guidance on anti-money laundering procedures. Its guidance sets out the types of identification documents the sector should check and gives examples. However, firms seem to apply the guidance in a rather rigid fashion to all their customers rather than taking a risk-based approach. They seem to place undue emphasis on the process of customer identification with the result that the sector loses sight of the desired

outcome – to detect and prevent money laundering. And as the Financial Services Authority has said:

"Our experience is that far too many firms do anti-money laundering not because they understand and support its rationale, but simply because they are required to do it, initially by the law and now also by their regulator. And many find it easiest to follow the JMSLG Guidance Notes by rote, treating them as prescriptive obligation".[1]

The Financial Services Authority is working with the sector and other stakeholders to develop a more risk-based, proportionate approach to identification verification. The sector is also working on a more risk-based revision of the Joint Money Laundering Steering Group's Guidance Notes. We welcome these initiatives as an important contribution to reducing regulatory creep in the sector.

4.2 Thinking about compliance

Often the primary focus of Government is to get the legislation onto the statute book within a fixed and often tight timetable. There is often insufficient consideration of compliance issues right at the start of the process and as we said in our report, "Environmental Regulation: Getting the Message Across", insufficient thought given to implementation.

The Construction Design and Management Regulations 1995 are an example of goal-setting regulations, which have resulted in regulatory creep.

The Construction Design and Management Regulations 1995

The Construction Design and Management Regulations placed a duty for the first time on clients who commission building work to ensure that the designer or planning supervisor they employ is competent. To demonstrate compliance, clients ask designers and planning supervisors to complete unnecessarily long and complicated questionnaires. The Health and Safety Executive (HSE) is currently reviewing the regulations.

Here greater consideration at the outset of how those being regulated might demonstrate compliance could have avoided or reduced a bureaucratic paperchase that does little to improve health and safety in the construction sector.

4.3 Defining compliance clearly at the outset

To avoid regulatory creep, all parties - the policy makers, the enforcers and those being regulated – need to share a common understanding of what compliance means in practice.

"Better Policy Making: A Guide to Regulatory Impact Assessment" (Cabinet Office guidance to departments on carrying out Regulatory Impact Assessments)[2], asks policy makers to consider compliance. But the emphasis is on avoiding the creation of new regulation simply because compliance levels with current

[1] Philip Robinson Financial Services Authority, Sector Leader, Financial Crime, 21 April 2004
[2] Better Policy Making: A Guide to Regulatory Impact Assessment.
http://www.cabinetoffice.gov.uk/regulation/docs/ria/pdf/ria-guidance.pdf

regulations are low. The guide does not explicitly ask policy makers to consider what "compliance will look like".

In our report "Imaginative thinking for Better Regulation", we recommended that the Code of Practice on Consultation should emphasise the need to encourage stakeholders to identify all possible alternative approaches to implementing policy. We would like to add to this by suggesting that policy makers should also explicitly consider during consultation how they would expect those being regulated to demonstrate compliance.

Similarly in our report, "Environmental Regulation: Getting the Message Across", we said that from the earliest stage of implementing new legislation, the Government should draw on the advice of a range of experts from outside Government. We now echo this in relation to regulatory creep. We believe that policy makers need to involve enforcers and those being regulated in the early development of new policy, particularly in relation to compliance issues. The fundamental questions – what will compliance look like? how will those who are being regulated be able to demonstrate compliance? what will inspectors be looking for? – need to be asked and examined right at the outset with those who will be affected by the regulation.

Since publication of that report the Government has set up a number of industry/cross government forums on policy and regulatory development to give early warning of, and to allow industry to express its views on, emerging policy and regulatory proposals. Forums have been established for the vehicle, construction, chemical and retail sectors. The Government should consider how it could use these forums to explore compliance issues so that all those involved share a common understanding of what compliance will mean in practice. (See recommendation 6)

Policy makers and enforcers should take care not to place undue emphasis on record keeping and monitoring as this can lead the focus of those being regulated to become skewed towards processes rather than focusing on the desired outcome.

As part of their better regulation agendas both the Netherlands and the USA pay more attention to addressing the paperwork burdens and business reporting costs. For instance the Dutch Government has made a commitment to reduce total administrative burdens on businesses by 25% by 2007. In our annual report this year we suggested that it might be time for the UK to concentrate more on reducing paperwork burdens by adopting a UK version of the Dutch approach. This could be built into the Regulatory Impact Assessment (RIA) as part of the process of establishing what compliance will mean in practice.

4.4 The best of both worlds?

We came across one example of regulation, proposed by the Food Standards Agency, that encompassed both the goal setting and prescriptive approaches.

Although this will shortly be overridden by new EU requirements we thought it was an interesting approach, which may offer the best of both worlds – the

prescriptive approach for those who prefer certainty and a goal-based approach for those who prefer greater flexibility, provided of course the enforcing authority does not lean too much towards the prescriptive option.

The Licensing of Butchers Shops Regulations

The Licensing of Butchers Shops Regulations in Scotland contain two options for butchers to follow in order to obtain a licence. The first route is through the adoption of a risk-based food safety management system tailored to the business, or alternatively butchers can choose to comply with a set of prescriptive requirements.

When considering options for achieving the policy objective, we suggest that policy makers consider what scope there is for a set of measurable minimum standards that can operate alongside a goal-based approach.

4.5 Ill-defined scope leads to regulatory creep

It is not only goal-setting regulation that can lead to regulatory creep. A lack of clarity about the scope of any type of regulation can lead to regulatory creep. This seems to have been the case with the Private Security Industry Act 2001, which established the Security Industry Authority to regulate the private security industry. The Act provided for the regulation of a number of sectors in the private security industry, including the licensing of all individuals engaging in licensable activity, in six industry sectors; door supervisors; wheel clampers; security guards; key holders; security consultants and private investigators.

The scope of those activities to be licensed in relation to door supervisors has not been defined clearly enough. In fact it has been drawn so widely that everyone who performs the duties of door supervisors (as defined in the Act) in licensed premises is included, unless specifically excluded. Drawing legislation this widely may mean that it will catch some sectors which it was never the intention to regulate.

Security Industry Authority proposals to licence door supervisors

The Security Industry Authority recently consulted on arrangements to licence door supervisors. During the consultation it became apparent that some football stewards will, in the course of their duties, perform some of the activities of door supervisors as defined as licensable under the Private Security Industry Act. Therefore individuals that perform those duties ought to be licensed.

However, it is far from clear that the original intention of the act was to regulate football stewards. Football stewards are already subject to training and supervision requirements by other bodies. They are not generally considered to be part of the private security industry.

During the initial consultation on the licensing of door supervisors, and in the accompanying RIA it was not made explicit that the proposals would apply in the case of football (and in other sports) nor were representative bodies on the consultation lists. This seems to suggest that sporting events were not intended to come within the scope of the Act.

There seems to be a similar lack of clarity about the Government's draft legislation to create a UK ID card scheme. This is a recipe for regulatory creep, as even at the outset, the objective of the proposal is not clear. The consultation on the draft legislation has not been accompanied by a Regulatory Impact Assessment (RIA) and states that the impact of creating the scheme will depend on how the ID card is to be used, indicating that at this stage the Government doesn't have a very clear idea of the purpose and extent of the scheme. The House of Commons Home Affairs Select Committee has said:

"We express concern about the Government's lack of clarity about the [identity card] scheme's scope and practical operation..."[3]

[3] House of Commons Home Affairs Committee report on identity cards (Fourth Report of Session 2003-04)

Recommendation 1

The Task Force recommends that when considering options for achieving the policy objective, policy makers should consider what scope there is for a set a of measurable minimum standards for compliance that can operate alongside a goal-based approach.

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5 Guidance

The way in which guidance is developed and used can play a significant part in encouraging regulatory creep. It is important here to draw a distinction between best practice guidance and guidance that is intended to help those being regulated comply with their obligations.

Best practice guidance can be a useful alternative to prescriptive regulation as a means of raising standards and is therefore likely to go beyond regulatory requirements. But it must be clearly labelled as such. Often the Government, regulators and industry will prepare guidance notes that encompass both advice on complying with regulatory requirements and best practice advice. It may be more helpful for businesses to have both sets of guidance in one volume, but it can also lead to confusion over what constitutes best practice and what is required by law.

Guidance can also have the force of law as the courts may take into consideration the extent to which guidance has been followed. For example, the Gambling Bill specifically states that guidance issued by the Gaming Commission may be taken into consideration by the courts when determining whether an offence has been committed.

We came across many terms for guidance and the box below gives some examples. Stakeholders were often confused about the status of some of this guidance and whether what they were reading was guidance on compliance with regulations or advice on best practice.

Examples of different terms for guidance

Guidance
Guidelines
Advice
Voluntary Codes of Practice
Approved Codes of Practice
Best practice guidance
Good practice guidance
Guidance on complying with regulatory requirements
Criteria
Guidance Notes
Approved Documents
Principles

The language used in guidance can also add to the confusion. Frequent use of the word “should” tends to make those using guidance feel that they have no choice but to follow it to the letter.

5.1 Best practice or regulatory requirement?

As we have already mentioned in section 4.1 in the anti-money laundering regime, an industry body, the Joint Money Laundering Steering Group, is

responsible for providing guidance on both best practice and regulatory requirements. The guidance has grown over the years and is now subject to many influences. It is a mixture of best practice and guidance on complying with regulatory requirements and does not, in our view, differentiate clearly between the two.

Joint Money Laundering Steering Group guidance

Originally the Joint Money Laundering Steering Group guidance was drafted to help banks implement the international Financial Action Task Force (FATF) recommendations. It has since been widened to include guidance on compliance with the Money Laundering Regulations 2003 (which replaced the 1993 Money Laundering Regulations), the Financial Services Authority's anti-money laundering rules and the Proceeds of Crime Act 2002. It therefore now applies to all the sectors regulated by the Financial Services Authority. The guidance has been added to over the years, but it has never been substantially revised.

However, the Joint Money Laundering Steering Group is now in the process of overhauling the guidance. This is a welcome move that we expect will help to reduce regulatory creep in the sector.

We also found the status of some of the guidance on food regulation unclear. For instance, the Food Standards Agency guidance, "Criteria for the use of the marketing terms fresh, pure, traditional etc" is a mix of best practice guidance and guidance on complying with regulations. But this is not clear from the way the guidance is presented. It begins with a summary of regulatory requirements, which suggests that it is guidance on complying with regulations. There is nothing to indicate that some aspects are best practice guidance. However, the Food Standards Agency is currently revising the guidance to distinguish more clearly between best practice and regulatory requirement.

Criteria for the use of the marketing terms fresh, pure, traditional etc

In at least one case a trading standards officer had threatened to take a retailer to court for not following the best practice elements of the guidance on the use of the marketing terms fresh pure, traditional etc. The guidance says that the term traditional "should demonstrably be used to describe a recipe, fundamental formulation or processing method for a product that has existed for a significant period. The ingredients and process used should have been available, substantially unchanged for that period. As a general rule this should be taken to be of the order of 2 generations, 50 years." This business could only produce 34 years worth of records. So rather than face court action it had to bear the cost and inconvenience of changing its label. It now uses the term "classic" as a substitute for the term "traditional". It is difficult to see how this benefits the consumer.

5.2 Industry specific guidance

Industry specific guidance on compliance with regulation tends by its nature to be more detailed. The greater the detail the greater the risk that the regulation could be embellished beyond its original intention. Businesses are often keen to have industry specific guidance, but care needs to be taken that the guidance does remain consistent with the original intention of the regulation.

Guidance on training for food handlers was singled out by both business and enforcers as an example of regulatory creep.

Guidance on training for food handlers

The guidance has its origins in an EC Directive which states that;

"Food business operators shall ensure that food handlers are supervised and instructed and/or trained in food hygiene matters commensurate with their work activities."

However, guidance published by the Department of Health (prior to the creation of the Food Standards Agency), implies that training is a requirement and furthermore should be followed up by refresher training.

In addition, industry guides to good hygiene practice were developed by representatives of the food industry in liaison with the Department of Health (and more recently the Food Standards Agency) LACORS (Local Authorities Coordinators of Regulatory Service), to advise and educate food businesses in compliance with the regulations. While the regulations cover a whole range of food businesses, the guidance notes are more specific.

Although the guides state that it would be possible for a food business to demonstrate to enforcers that it had achieved the objectives identified in the regulations in other ways. The prolific use of words, such as 'must' in relation to formal training, reinforce the perception that formal training and refresher training are legal requirements.

Here, as well as language being the issue, the guidance has embellished the original intention.

5.3 The influence of trade associations

Regulatory creep is not necessarily the result of the action of Government or regulators. It can also be encouraged by trade and professional associations and by those being regulated.

Another example is guidance on health and safety in swimming pools by the Institute of Sport and Recreation Management. This hit the headlines earlier this year.

Institute of Sport and Recreation Management guidance on child/adult ratios in swimming pools

The purpose of the Institute is to promote for the public benefit the provision of facilities for recreation or other leisure time occupation in the interest of health and social welfare and to provide opportunities to encourage participation in sport and other recreational activities. The Institute has no statutory authority, but the press reported that its advisory guidelines on adult to child ratios in swimming pools were being implemented by many pools leading to complaints from parents.

The guidance suggests a standard ratio for a traditional 25 metre swimming pool with a deep and shallow area. It states that for such pools children under the age of four should be accompanied on a one to one basis, and that four to seven year olds should be accompanied on a ratio of two children to one adult. It also states that any deviation in this policy should be justified in the pool's written procedures.

When we talked to local authorities about how they used this guidance, they were all very clear that they did not enforce against the guidance, though some told us that some pools complied with the ratios out of fear of civil litigation. As one Environmental Health Officer commented about pool operators:

"if they choose something else (other than the advisory ratios) and get it wrong and an incident results then they will have to justify it to the courts. The courts have consistently shown that they like people to follow the guidance when it exists."

We also heard of at least one case where the ratios were included in the contract between a private pool operator and a local authority.

5.4 Clarifying the status of guidance

We have explored, via a number of specific examples, how guidance may give rise to regulatory creep. We believe that some of this can be avoided by better consultation during the development of guidance, by applying the Principles of Good Regulation and by being clearer about the status of guidance.

The Health and Safety Commission/ Executive have addressed this issue about the clarity of the status of guidance by including status paragraphs in their guidance and Approved Codes of Practice, so those reading the publications are clear about their purpose and status. For instance, Health and Safety Commission Approved Codes of Practice have a special legal status and this is spelt out in the status paragraph.

Health and Safety Commission status paragraphs

For use in Approved Codes of Practice
This Code has been approved by the Health and Safety Commission, with the consent of the Secretary of State. It gives practical advice on how to comply with the law. If you follow the advice you will be doing enough to comply with the law in respect of those matters on which the code gives advice. You may use alternative methods to those set out in the code in order to comply with the law.

However, the code has a special legal status. If you are prosecuted for breach of health and safety law, and it is proved that you did not follow the relevant provisions of the code, you will need to show that you have complied with the law in some other way or a Court will find you at fault.

For use in Health and Safety Commission Guidance
This guidance is issued by the Health and Safety Commission/Executive. Following the guidance is not compulsory and you are free to take other action. But if you do follow the guidance you will normally be doing enough to comply with the law. Health and safety inspectors seek to secure compliance with the law and may refer to this guidance as illustrating good practice.

In addition the Health and Safety Commission/Executive supply clear guidelines to those in their organisation responsible for drafting Approved Codes of Practice and guidance. We commend this good practice.

Extracts from the Health and Safety Commission's/Executive's publication guide

HSE operates under the law: principally the Health and Safety at Work etc Act 1974 (HSW Act), which is based on 'reasonable practicability'. HSW Act and associated regulations frequently set goals. Approved Codes and guidance can advise on how to meet these goals. Approved Codes have a special status in criminal proceedings.

In publishing guidance, HSE's principal job is to illustrate practices that will secure legal compliance. In cases where 'best practice' - a standard better than the legal minimum - is being promoted, the guidance must make that clear.

The Food Standards Agency provided us with a good example of how to ensure clarity when guidance gives both best practice advice and advice on complying with regulation in a single volume. Its guidance on country of origin labelling makes a clear distinction between the legislation on origin labelling and best practice advice on what additional voluntary

information producers could provide to help consumers. The Food Standards Agency has said that it intends to use this model in the future. This is a welcome move.

5.5 Improving the development of guidance

Better consultation during the development of guidance and greater consideration of its potential impact will help to reduce regulatory creep.

Guidance is usually consulted on in draft before it is published. But its potential impact receives scant attention and there is little consideration of how it matches up to the Principles of Good Regulation. Some would argue that this is perfectly reasonable given that guidance is not mandatory. However, guidance is often the first port of call for those being regulated and in the event of a prosecution the courts can take into account whether a defendant has followed any relevant guidance. So it would be a pity if the Government's good work on consultation and Regulatory Impact Assessment were then undone by guidance that goes beyond the original intention of the legislation.

"Better Policy Making: A Guide to Regulatory Impact Assessment" advises that guidance on complying with regulations should be published 12 weeks before the regulations come into force. Where this is the case then its impact should have been captured in the RIA for the regulations.

However, where guidance on complying with regulation is produced after the introduction of regulation and where the regulation is broadly defined, policy makers should ensure that the guidance does not result in additional compliance burdens.

We said in recommendation 2 that it is important to involve those likely to be affected by regulation in its development. It is just as important to involve stakeholders in the development of guidance. Departments often consult formally on guidance, but we would like to see more informal consultation and a real dialogue established between the regulator and those being regulated at an early stage in the development of guidance. This is happening between the Financial Services Authority and the financial services sector as they try to establish in guidance a more risk-based approach to customer identification procedures required by anti-money laundering regulations. We suggest that the Government should make use of the industry forums it has set up to consult informally on guidance as well as on new regulatory proposals. (See recommendation 6)

The Small Business Service (SBS) has published advice to policy makers on how to make guidance relevant to small businesses. This guidance could be amended to address the problems we have identified in relation to guidance and regulatory creep. The current guidance is not very well known and not easily accessible. We had difficulty tracking it down on the SBS website, so it would need to be relaunched and widely publicised.

However, the problems we have identified in relation to guidance and regulatory creep are not just pertinent to small businesses. We would like the

Regulatory Impact Unit to take the lead on issuing new advice to policy makers on developing guidance with input from the SBS to take account of the needs of small firms.

Recommendation 4

The Task Force recommends that the Government and regulators should include clear statements in their guidance documents setting out their purpose and legal status.

The Regulatory Impact Unit, working with the Small Business Service, should revise current advice to policy makers on developing guidance. The guidance should be published by spring 2005.

This advice should:

- include the need for a clear statement of the purpose and status of guidance;
- stress the importance of applying the Principles of Good Regulation to the development of guidance;
- encourage those who draft guidance to take into account the projected costs and benefits of the original regulatory proposal to make sure that the guidance does not stray beyond the original intention; and
- encourage those who draft guidance to involve those being regulated and enforcers in the development of the guidance.

Although our recommendations are made to Government, in this study we have found that guidance prepared by trade associations and industry bodies can also encourage regulatory creep. We would urge anyone who develops guidance to:

- consult informally as well as formally on its content;
- develop it in accordance with the Principles of Good Regulation; and
- be absolutely clear about its status.

6 Enforcement activity

In the previous section we looked at how confusion about the status of guidance and its over-prescriptive application can lead to regulatory creep. But it is how guidance is used by enforcers that is often the determining factor that encourages regulatory creep. We came across a number of examples where enforcement activity led to what effectively amounts to the enforcement of guidance. For instance, naming and shaming companies who do not "comply" with good practice guidelines, or enforcers and inspectors taking best practice guidance as their benchmark in judging compliance. In this section of the report we also look at the part enforcement initiatives and inconsistent enforcement practices can play in encouraging regulatory creep.

6.1 "Enforcing" the guidance

We mentioned in the last section the Food Standards Agency guidance on the use of certain marketing terms. The Food Standards Agency has acknowledged that the guidance is a mix between best practice guidance and guidance on complying with regulation, but nonetheless it asked local authorities to carry out a survey to check the extent to which the guidance was being followed. Its findings were published in a report in February and included a list of those products sampled that were found to be "non-compliant". The Food Standards Agency regards this as part of its duty to provide information to consumers to help them make informed choices. Consumer groups have welcomed the surveys. However, we do not believe that companies should be named and shamed for not following best practice guidance.

Our most recent report, "Bridging the Gap; Participation in social care regulation", identified that the introduction of National Minimum Standards on care has led to regulatory creep. Care home providers put a great deal of time and effort into being able to demonstrate they comply with rigid standards, despite the fact that they are not legally enforceable.

National minimum standards for social care

Under the Care Standards Act the Secretary of State for Health has powers to publish statements of National Minimum Standards. In assessing whether a care home conforms to the Care Homes Regulations 2001, which are mandatory, the Commission for Social Care Inspection must take the standards into account.

Compliance with the minimum standards is not itself enforceable, but compliance with regulations is enforceable subject to national standards being taken into account. In our report on user participation in social care we recommended that the Department of Health and the Commission for Social Care Inspection should work together to achieve a flexible risk-based approach to the interpretation of the National Minimum Standards.

As a broad principle we would prefer to see policy makers and regulators consider the extent to which standards may be flexible or adapted to specific circumstances, rather than being applied rigidly across the board.

In contrast we also came across cases where the enforcing authority had used its discretion and had taken a pragmatic approach to enforcement, rather than enforce according to the strict letter of the law. These were generally cases where technological developments had overtaken the law. The Environment Agency provides an example of this in the box below.

Negative Creep - regulation of biodiesel and waste management licensing

Biodiesel produced from waste cooking oil, can be used instead of ordinary diesel in cars. There are a number of good reasons to encourage this. Biodiesel can cut emissions of carbon dioxide and it is readily biodegradable. Biodiesel also provides a recycling route for waste cooking oils. However, the use of waste derived biodiesel in motor vehicles is (in theory) subject to waste management controls which means that the Environment Agency should require individuals to hold specific permits for its supply and use.

The Environment Agency does not consider that requiring individual permits for the supply and use of waste derived biodiesel is in the public interest. Its main priority is the regulation of large or commercial scale biodiesel processing or purification activities that have the greatest potential to cause pollution or harm to health. The Agency is therefore working with Government to develop a more proportionate regulatory framework that does not require permitting of individual users of biodiesel. In the meantime it has issued guidance to inspectors to promote a risk-based approach to the enforcement of the current regime.

6.2 Enforcement initiatives

Regulators may decide that an enforcement initiative is desirable, sometimes because there is poor compliance or in order to raise standards. While this may be a worthwhile objective, introducing an enforcement initiative without proper consideration and/or consultation may result in regulatory creep.

Enforcement initiatives need to be carefully presented and where they effectively amount to a change in policy, stakeholders should be consulted.

Health and Safety initiative to eliminate manual kerb laying

In January 2004 the Health and Safety Executive wrote to all local authorities to alert them that inspectors would be taking action to secure a transition from the manual handling of kerb laying to mechanical methods. This was a joint initiative with the construction industry.

The construction sector has set itself challenging targets for improving its record in the field of health and safety. Both the Health and Safety Executive and the construction sector have, therefore, targeted this as an area that needs further attention. During 2003 HSE discussed informally with a number of bodies how it could encourage the use of mechanical handling aids when laying or repairing kerbs. It then called a stakeholder forum in December 2003 to develop a way forward. However, only one local authority was represented. And it is local authorities that commission the vast majority of kerb laying.

One of the results of this forum was a letter alerting all local authorities that HSE inspectors would be taking action to promote mechanical methods of kerb laying. Subsequently, the Health and Safety Executive did discuss its approach with local authorities. But it has remained firm in its view that "only rarely" should it be necessary to handle kerbs manually. This seems to go beyond the regulatory requirement that employers should “so far as is reasonably practicable, avoid the need for employees to undertake any manual handling operations at work which involve a risk of their being injured”.

Local authorities have told us that to comply they will have to close narrow and steep roads to carry out repairs. This may result in increased congestion and a greater risk of road accidents. It is understandable that the Health and Safety Executive is keen to take action to reduce the injuries caused by manual handling, but initially it appears to have approached this exercise without discussing the feasibility of what it was proposing with a key stakeholder group and underestimated the circumstances where road closure may displace the risk elsewhere.

6.3 Inconsistent enforcement

Patchy enforcement was cited to us by business organisations as a cause of regulatory creep. One example that was brought to our attention was auditing of the Packaging Waste Regulations by Environment Agency inspectors.

The Packaging Waste Regulations

The Packaging Waste Regulations require the data used to calculate a business's recycling obligations to be as accurate as is reasonably possible. However in some instances the Environment Agency's focus seems to be on absolute accuracy.

For instance, we heard of a company that was not permitted to give the amount of cardboard it bought in as the basis for the calculation for its recycling obligation. The Environment Agency expected it to be able to demonstrate how much it uses for each product line by having weighed the cardboard. This seems to go beyond the requirements of the regulations.

However, the Environment Agency has told us that an inspector would go down this detailed route only if they thought there was a particular problem.

One way of tackling inconsistent enforcement practices would be for regulators to publish their guidance to inspectors on their websites. The Environment Agency will produce its audit protocol on the packaging waste regulations on request, but we recommend it should be displayed on its website alongside other information about the regulations. Businesses would then know what to expect from a visit and could challenge enforcement practice that seemed inconsistent with the protocol.

Recommendation 5

The Task Force recommends that in applying the openness principle of good enforcement policy that sponsoring Departments should ensure that enforcement agencies publish their enforcement policies and guidance to inspectors on what constitutes compliance on their websites.

6.4 Adopting a more co-operative approach

Some of the complaints about regulatory creep that we have heard have been fuelled by tensions between the enforcer and industry. This seems to be the case with the Food Standards Agency with regard to certain areas of its work and parts of the food industry. There seems to be particular tensions around labelling issues. However, in other areas of the Food Standards Agency's work, such as food safety, the Agency and the food sector seem to adopt a more co-operative approach. Strictly speaking the Food Standards Agency is not an enforcer. Local authorities enforce on its behalf. The Food Standards Agency does, however, set policy, issue guidance and direct enforcement practice.

We have already discussed naming and shaming in the previous section. While "naming and shaming" those who fail to comply with regulation may be a

useful enforcement strategy, we would ask regulators to consider carefully how they go about this. Some regulators issue press releases naming and shaming those who have been prosecuted and quite often these do not tell the full story. For instance a common complaint is that they often omit any mitigating circumstance.

We do not believe that it is appropriate to name and shame in relation to guidelines. There is no right of appeal and once a firm is named in the press the damage is done, even if later the results turn out to be invalid. It doesn't help form constructive relationships, and so is unlikely to lead to better protection for those the regulation is intended to help. We urge the Food Standards Agency to consider how it might move away from its practice of naming and shaming against guidance towards naming and praising.

Other regulators have said that in order to regulate effectively they need the support and co-operation of those they regulate. They say they achieve more by working co-operatively with those they regulate and that this approach leads to greater protection and benefits for those the regulation is intended to help or protect. But we recognise that by adopting this approach regulators may leave themselves open to the accusation that their relationship with industry is too cosy. It is a difficult balance. And it is possibly more difficult for the Food Standards Agency than other regulators given that it was set up to champion the consumer. However, we believe that greater co-operation between the food sector and the Food Standards Agency on labelling issues would offer consumers more effective protection.

Some regulators such as the Health and Safety Executive and the Financial Services Authority have set up industry advisory committees and working groups to help inform the development of policy, guidance and enforcement. And we have already mentioned the industry/cross-government forums that the Government has set up for particular sectors to allow industry to express its views on emerging policy and regulatory proposals. This is good practice and will help avoid regulatory creep.

The Food Standards Agency has recently set up stakeholder forums with industry, consumers and enforcers. We welcome this and hope that it will lead to a more constructive relationship between the food sector and the Agency on labelling issues. We would urge the Food Standards Agency to use this forum as a platform to discuss emerging proposals at an early stage and work with industry to deliver better consumer protection.

We would also ask industry to play its part to develop a more constructive relationship, particularly in relation to helping establish the impact of regulatory proposals. We hear all too often, and this is by no means unique to the food industry, that when Departments and regulators go out to industry for information on the likely costs and benefits of proposals, they are often met with silence. In order to influence regulation and guidance, industry needs to engage with Departments and regulators. We believe that this will lead to better quality regulation that is less susceptible to regulatory creep.

Recommendation 6

The Task Force recommends that the Government should consider the scope for creating further sector specific industry/cross government forums. The terms of reference for new and existing forums should include a clear steer that they should:

- consider at an early stage compliance issues associated with emerging regulatory proposals so all parties share a common understanding of what compliance will mean in practice; and

- have an input into the development of guidance.

6.5 Plugging regulatory gaps

There is always the possibility when creating a new regulator that it will look for gaps in compliance and this may result in regulatory creep. We found that this was one of the factors that helped encourage regulatory creep in the anti-money laundering regime.

Before the creation of the Financial Services Authority there was patchy compliance with and virtually no enforcement of the 1993 Money Laundering Regulations. The Financial Services Authority has a statutory objective to reduce financial crime, so it is not surprising that it set about remedying this lack of compliance. The Abacha affair (when the ex Nigerian President, his family and close associates were found to be laundering vast sums of money through City of London banks) and the events of September 11 helped to focus attention on the UK's anti-money laundering regime.

Each year the Financial Services Authority sets out the areas it identifies as a priority for action. It calls these its regulatory themes. In July 2001 the Financial Services Authority published a document setting out the details of its Money Laundering Theme. The main aim of the Money Laundering Theme was to:

- assess the level of industry compliance with the Money Laundering Regulations 1993 to determine the strength of firms money laundering systems and controls;
- identify which financial activities and sectors are subject to the greatest money laundering risks; and
- raise the profile of money laundering within the financial sector and emphasise to firms the consequences of failing to meet the requirements set out in the Financial Services Authority's Money Laundering Rules.

The Financial Services Authority's Money Laundering Theme

The Financial Services Authority found patchy compliance with the 1993 Money Laundering Regulations and set about reviewing anti-money laundering controls in each of the sectors that it had identified as vulnerable. In August 2002 it published the findings of its review into domestic banking.

It stated that all retail banks "need to ensure that they have robust and effective controls from a Know Your Customer perspective if they are to meet the operational standards, which the Financial Services Authority expects". After discussions with the Financial Services Authority the six major high street banks started checking the identities of existing customers.

The Financial Services Authority wrote to the Chief Executives of all the UK banks and building societies to highlight the findings of its review and in certain cases to point out where action was needed. All firms were expected to assess where they stood in relation to the findings and, where necessary, to deal with any shortcomings. In particular the Financial Services Authority stated that it "will be important for all firms and the financial sector more generally to follow the major banks' example on reconfirming customer identity".

The Financial Services Authority subsequently consulted about introducing a regulatory rule on reconfirming customer identity, but decided on the basis of a cost benefit analysis not to proceed. However, it did announce that it would expect individual firms "to consider the risks posed by existing customers who have not been properly identified and to put in place appropriate measures to mitigate these risks. This might include carrying out a review similar to that being undertaken by the six largest retail banks and others".

Where there are serious shortcomings, as in the implementation by the financial sector of the Money Laundering Regulations, then it may be necessary to plug a regulatory gap. But it should be approached in a risk based and proportionate fashion.

The pressure placed on banks to reconfirm existing customers' identities, among other contributory factors, seems to have also led to firms rechecking existing customers' identities when they apply to open a new account or buy a financial product even when they have done business with a firm for many years. We accept that there may be the need for a firm to recheck an existing customer's identity if they are buying a product or setting up an account that is likely to carry a high money laundering risk. But for some firms it seems to be the norm regardless of the risk of the product or the account.

6.6 Duplicate ID checking

Duplicate ID checking was highlighted as a problem by both consumers and the regulated sector. Customers are being asked to produce their ID more than once by the existing service providers and when they become a customer of another financial firm.

The Financial Services Authority is now working with the industry and other stakeholders to simplify the ID checking regime. We believe that there is scope here to reduce the amount of duplicate ID checking, and suggest that this work should include significantly extending the practice of passporting ID checks between firms (that is, the ability of one firm to rely on the identification checks that another firm has already done).

There are already signs that those sectors (accountants, solicitors, casinos, estate agents and dealers in high value goods) that were brought within the anti-money laundering regulations in March this year may start to overdo ID checking in the same way as the financial services sector has in the past.

"I went to my solicitor to change my will. The only financial transaction that took place was me paying a fee to my solicitor. But I was still required to provide evidence of my ID and was told that those are the money laundering rules."

We would encourage other sectors to learn from the financial services' sector work on simplifying ID checks.

We would hope that once a system of passporting ID checks in the financial services sector is up and running that it could be extended to other sectors. And although these sectors are not regulated by the Financial Services Authority we would hope that it would be able to disseminate the lessons learned from its recent work with the financial services sector on simplifying ID verification procedures to other sectors to so that they can adopt similar practices. Ideally what we would like to see eventually is a single system for passporting ID checks across all sectors subject to the Money Laundering Regulations.

Recommendation 7

The Task Force recommends that the Financial Services Authority together with the financial services sector should develop a robust system for passporting ID checks between institutions that has the full confidence of the sector, by spring 2005.

We look to the Treasury, as the lead Department for the anti-money laundering regime, with the help of the Financial Services Authority, to disseminate the lessons learnt from the financial services sector's work on simplifying ID checks and to facilitate the development of a system for passporting ID checks across all sectors subject to the Money Laundering Regulations by the end of 2005.

6.7 Checks and balances on regulatory intervention

There has been a move in recent years to place checks and balances on regulators' regulatory interventions in their founding statutes. For instance, the Financial Services Authority is required by statute to consult and carry out cost benefit analyses on changes to its rules. This is an important safeguard. But is it enough?

In our report, "Independent Regulators", we recommended that all independent regulators should:

- follow the Principles of Good Regulation; and
- consult and prepare RIAs on all major policy proposals.

In this report it has become evident that even with these safeguards regulatory creep cannot always be avoided and that newly established regulators may be tempted to plug regulatory gaps.

The newly created Ofcom has a duty to review annually the regulatory burdens it imposes with a view to either removing or reducing them. It also has a duty to promote self-regulation. We think this is an important additional safeguard that could help prevent regulatory creep.

In last year's Pre-Budget Report the Chancellor announced that Government Departments should account for their regulatory performance in their annual reports and that this would help inform their spending settlements. We believe it is time to extend this requirement to independent regulators. Requiring independent regulators to review and report on their regulatory performance would go some way to preventing regulatory creep.

Recommendation 8

The Task Force recommends that when creating new regulators the Government should include appropriate checks and balances in the founding statute to minimise the risk of regulatory creep. In particular the Government should include a duty on regulators to review and report annually on the regulatory burden they impose and the steps they have taken to reduce it.

For existing regulators the Government should include in their management statements a duty to review and report annually on the regulatory burden they impose and the steps they have taken to reduce it.

7 Penalties

Stiff penalties can encourage over-compliance. They can create "a fear factor" that leads industry to do more than is necessary to comply. Their influence can lead firms to focus on getting the processes and the paper work right in case an inspector calls, rather than focusing on the outcome.

We found this particularly when we looked at the anti-money laundering regime, both in relation to the civil penalties imposed by the Financial Services Authority and to the criminal sanctions in the Proceeds of Crime Act.

7.1 Fines

High fines are a useful enforcement tool and need to be high enough to deter non-compliance, but regulators need to be aware that in a particular context they may encourage regulatory creep. One way to mitigate any over-reaction on the part of industry is to be absolutely clear about the failures that led to the imposition of a particular penalty, as the Financial Services Authority did in the examples we mention above, though in this instance the sector still succumbed to the “fear factor”.

High profile fines

The Financial Services Authority has this year fined the Royal Bank of Scotland £1.75m for having inadequate anti-money laundering procedures in place. Last year it fined Abbey National £2.3m. It said that these fines were for repeated and significant breaches of its money laundering rules. The fines, alongside other contributory factors, seemed to have played a part in creating what the sector refers to as the “fear factor”, which in turn has contributed to the over-zealous identity checking that has taken place recently.

7.2 The Proceeds of Crime Act

The Proceeds of Crime Act 2002 (PoCA), which came into force in February 2003, carries various penalties for the failure to report suspicious transactions to the National Criminal Intelligence Service (NCIS). A lack of clarity about what constitutes “reasonable ground to suspect” that someone is engaged in money laundering combined with a 5 year prison sentence for failure to report this suspicion seems to have contributed, together with other factors, to the over-zealous application of customer identity checks.

It has also led to what is known as “defensive reporting”, where those regulated submit reports to cover their backs, just in case, as opposed to when there is a genuine suspicion.

Suspicious activity reporting

Under PoCA persons within the regulated sector are required to report when they know or suspect or have reasonable grounds to know or suspect that somebody is engaged in money laundering. Failure to do so is punishable by up to five years' imprisonment. Firms say they fear that this means the courts could ask in hindsight what they should have been doing to prevent money laundering more generally. And many in the sector point to this as a further contributory factor in the over-zealous application of customer identity checks.

The Financial Intelligence Division of the National Criminal Intelligence Service (NCIS) is responsible for receiving and analysing Suspicious Activity Reports (SARs) and for disseminating targeted intelligence to law enforcement and revenue agencies for investigation. A proportion of SARs are retained on the NCIS database but are accessible to be searched against for future cases. In 2003, NCIS received approximately 95,000 suspicious activity reports from the regulated and non-regulated sector; it expects to receive around 150,000 suspicious activity reports during 2004. There is little information available on how useful the SARs that are passed to law enforcement agencies are at tracking down money launderers.

KPMG estimated in its, "Review of the Regime for Handling Suspicious Activity Reports", published in July 2003[4] that compliance costs for the regulated sector were in the region of £90m each year – and this was before the widening of the regulated sector to include lawyers and accountants. By comparison NCIS and the law enforcement agencies costs in processing and following up the reports were estimated to be around £11m. Although these figures should be viewed with caution, KPMG believes that they indicate the order of magnitude of the difference between the cost between the regulated sector and law enforcement.

Although the effectiveness of the suspicious activity reporting regime has been improved over the last year and measures have been introduced to reduce the burden of reporting requirements, there is still a big question mark over its cost in relation to the contribution it makes to combating crime.

The Financial Services Authority is working with its regulated sector to develop a more proportionate risk-based regime in relation to customer identification. We believe this will reduce regulatory creep in the sector. The requirements of PoCA to report all suspicious transactions do not sit well with the proportionate and risk-based approach the Financial Services Authority is pursuing.

We would therefore encourage the Government to explore with stakeholders how it might also introduce a more proportionate and targeted regime for suspicious activity reporting.

[4] Review of the regime for handling Suspicious Activity Reports, KPMG, July 2003

Recommendation 9

The Task Force recommends that the Government should consult on how it might introduce a more proportionate and targeted system for suspicious activity reporting within the anti-money laundering regime by spring 2005.

8 Overlapping regulatory regimes

Regulatory regimes that involve several bodies can become confused and lack a clear strategic direction. This can lead to regulatory creep as each body pursues different objectives and takes a different focus. Those being regulated find themselves responding to competing or confusing demands.

This seems to have been the case in the rail industry. Here an end-to-end review of rail transport identified significant regulatory overlaps and duplication particularly in relation to safety standards. The White Paper, "The Future of Rail", identified eight different bodies that all played a role in rail safety. The report noted that this led to a lack of accountability and a clear strategic direction.

The White Paper noted that there was an over-emphasis on basing safety procedures on railway industry standards. These procedures tended to be based on a huge number of rigid standards, rather than on a careful analysis of risk and the report noted that unquestioning compliance with safety standards could sometimes add to costs or harm performance, without significantly improving safety. The aim now is to move to a more risk based approach.

In the White Paper the Government has said that it will streamline the regulatory system by bringing all aspects of rail regulation under a single public regulator. This will reduce overlap and duplication.

We found in our money laundering case study that in the eyes of many stakeholders there was a lack of coherence about the regime as a whole. There are a lot of players involved and all with a slightly different focus and objectives. Some of the key players said they were even confused about the roles and responsibilities of the other players. We believe this lack of clarity encourages regulatory creep. Information on these bodies and their roles can be found in Annex A.

Where there are overlaps and confusion, the Government should consider how it might use end-to-end reviews to achieve more effective, proportionate and joined up regulatory regimes. The Hampton review of regulatory inspection and enforcement, currently underway, is considering areas of regulation where enforcement responsibilities are unclear or contradictory. We have suggested that the review should consider recommending end-to-end reviews in areas where enforcement or inspection arrangements are very complex.

The Efficiency Review's work on policy, funding and regulation identified that departments, in general, have an insufficient understanding of the efficiency and effectiveness of key delivery chains. It recommended that departments should undertake reviews of priority delivery chains where either delivery of key outcomes are not meeting targets or the costs of the chain are disproportionately high compared to the value added.

However, we do not believe that it would be helpful or productive for the Government to undertake an end-to-end review of the money laundering regime at this time, as the regime is currently undergoing significant changes, many of which are identified in this report. But it would be useful for the Government to draw together these

changes in a published strategy document that clarifies the roles and responsibilities of key players.

We understand that the Treasury is already drawing up an anti-money laundering strategy. We welcome this move and would suggest that the strategy should:

- clarify the roles and responsibilities of key players;
- identify and remove blockages, bottlenecks and gaps;
- identify and remove duplication or fragmentation in processes and systems; and
- identify and remove unnecessary/unproductive activities.

We believe a strategy of this kind will result in a more proportionate, risk based, and effective regime that is less susceptible to regulatory creep.

9 Ombudsmen's rulings

Decisions by Ombudsmen were suggested to us as a possible cause of regulatory creep. However, we only found evidence of this in the financial services sector. Nonetheless we thought it worthwhile to include this example as there are some wider lessons that the Government may wish to bear in mind when setting up statutory ombudsmen to work alongside regulators, or new regulators to work alongside ombudsmen.

As we pointed out in our report, "Better Routes to Redress", published earlier this year, ombudsmen provide a valuable dispute resolution service that is quicker and less adversarial than using the courts. This gives consumers better access to justice but by the same token exposes regulated bodies to more claims and decisions than they would receive through the court process. In a regulated environment firms develop a natural assumption that they can look to the regulator alone for clear guidance on what is expected of them. An ombudsman can complicate the picture.

Ombudsmen are all set up slightly differently and have different remits. For instance the remits of the Local Government and the Parliamentary Ombudsmen relate to complaints about maldadministration. This may be why we found little evidence that ombudsmen's rulings lead to regulatory creep.

9.1 The Financial Ombudsman Service

The Financial Ombudsman Service (FOS) was set up by the Financial Services and Market Act 2000 (FSMA), in order to settle individual disputes between consumers and financial firms. It replaced six previous financial sector ombudsman schemes and maintained the dispute resolution model that had been voluntarily adopted by the industry in those schemes.

The FOS is composed of a panel of 23 Ombudsmen, who are appointed by the board of directors who are themselves appointed by the Financial Services Authority, though the Financial Ombudsman's Service operates entirely independently of the Financial Services Authority.

The FOS does not punish firms or issue fines. It settles disputes between individual consumers and financial firms. An Independent Assessor deals with complaints about the service provided and publishes a report in its annual review along with key statistics such as complaint type and an overview of complaint trends. The FOS also publishes a monthly newsletter containing case studies.

The FOS handles around 100,000 cases a year of which 1/3 are found in favour of consumers. 40% of cases are resolved by mediation, a further 49% are resolved by adjudication, where the case is resolved to the satisfaction of both parties. Only around 10% of cases go to a final decision and each party has the opportunity to see drafts of the ruling and to make further representations based on the draft ruling. It is only a small proportion of these rulings that give rise to wider regulatory concerns.

9.2 Sector concerns

The Financial Services Practitioners Panel (an advisory committee to the Financial Services Authority) has long

been concerned that the FOS's rulings are creating 'effective regulatory change' without proper consultation. According to its survey of regulated firms in 2002 around 75% of practitioners are unclear about the boundaries between the Financial Services Authority's policy and the handling of complaints by the FOS.

Stakeholders we spoke to gave us a number of examples that they argued forced them to change industry practice and were therefore effectively new rules. The FOS is clear that its rulings apply only to the circumstances of a particular case, but the sector is expected to learn lessons from the work of the ombudsman. Both individual decisions and case examples published in the FOS newsletter encourage this. Consumer organisations tend to take the view that FOS decisions have been effective in changing the commercial practices of the sector for the better.

Examples of FOS rulings that have had wider implications

In one case firms argued that a FOS decision to uphold a complaint against a firm that destroyed its records after the expiry date set for preservation by the regulator had wider implications. Although the FOS has stressed that this was one ruling arrived at in particular circumstances, firms have interpreted it to mean that they must keep their records for longer than is required by the regulator, because it lessens their risk of being found at fault in cases where there is uncertainty.

Another controversial ruling involved a claim against a buildings insurer after a storm damaged a policy holder's roof. The FOS decided that in this case the buildings insurance should cover replacing a damaged TV aerial as part of the roof repair even though it was normal industry practice to include TV aerials in contents insurance, rather than buildings insurance. The insurance industry interpreted this ruling to mean that it had to change its practice of including TV aerials within contents insurance.

Perhaps the ruling that has had the greatest impact on firms was on the issue of dual standard rate variable mortgages. Here the FOS was faced with complaints that a number of mortgage lenders had overcharged certain borrowers when, having introduced an additional variable mortgage rate, they unfairly applied the wrong rate to the borrowers. When the FOS upheld some of the complaints the lenders reacted quickly and withdrew the additional rates. The lenders interpreted the decisions to mean that in no circumstances could they offer two different standard variable rates.

9.3 The two year review of the Financial Services and Markets Act 2000

The Government committed itself to reviewing the Financial Services and Markets Act (FSMA), which created the Financial Services Authority and the FOS, two years after it came into force. As part of the review the Financial Secretary to the Treasury has asked the Financial Services Authority and the FOS to review the circumstances in which the Financial Services Authority takes regulatory action, instead of individual cases being determined by the FOS.

The FOS and the Financial Services Authority issued a joint consultation document in July. In particular they are considering how they might handle more effectively cases with wider implications. Both the FOS and the Financial Services Authority accept that there is currently a lack of transparency about how they deal with cases with wider implications. There is already a memorandum of understanding between the two bodies which allows the FOS to pass a case to the Financial Services Authority so it can consider whether regulatory action or further guidance is necessary. However there are no clear criteria for deciding when a case has wider implications and should be referred to the Financial Services Authority. The current consultation aims to make the process for dealing with cases with wider implications more transparent.

9.4 Creating new ombudsmen

As ombudsmen all have slightly different remits and work within different regulatory frameworks, the extent to which rulings could give rise to wider regulatory implications will vary. For most it will probably not be an issue at all. However, when the Government is considering introducing a dispute-resolution mechanism in a sector that is or will be regulated, it should at least ask the question – are cases of wider regulatory implications likely to occur?

Following consultation, the Government has announced that the FOS will act as the dispute-resolution mechanism for consumer credit complaints. The outcome of the FSMA review will therefore need to be taken into account when the FOS and the relevant government departments consider what mechanisms might need to be put in place to seek input from stakeholders should cases of wider regulatory implications occur in this area.

Recommendation 10

The Task Force recommends that when creating statutory ombudsmen to work alongside regulators the Government should consider whether it needs to develop a mechanism for dealing with cases that have wider regulatory implications. This should ensure that proper consultation and impact assessment may take place. Cabinet Office guidance to departments on setting up ombudsmen services should be amended to reflect this by spring 2005.

10 Conclusion

Throughout this report we have examined a number of examples of regulatory creep. We have structured the report around what we have found to be the key components of regulatory creep. Principally these are:

- a lack of clarity about the intention of regulation, both on the part of regulators and those being regulated;
- a lack of clarity about the status of guidance, when best practice is seen as required practice; and
- enforcement activity that can lead to a fear factor that induces over compliance in those being regulated.

Regulatory creep can occur if only one of these factors is present. Where more than one of these factors are present, the risk of regulatory creep is magnified.

For instance with regard to the ID checking requirements of the anti-money laundering regime we have concluded that a number of factors led to regulatory creep. Here we have a complex regulatory regime involving a number of key players all with a slightly different focus, guidance that does not distinguish clearly between best practice and legal and regulatory requirements and a regulator seeking improved compliance and imposing stiff penalties for non-compliance. All these factors have led to the financial services sector placing undue emphasis on customer identification procedures, which are only one element of the anti-money laundering regime.

In our food labelling example we saw that a lack of clarity about the status of guidance on the use of marketing terms led to enforcement against best practice guidelines. This was compounded by the Food Standards Agency's survey of "compliance" with the guidelines. This has tended to focus the food industry on complying with detailed labelling "requirements" rather than on the wider duty not to mislead consumers.

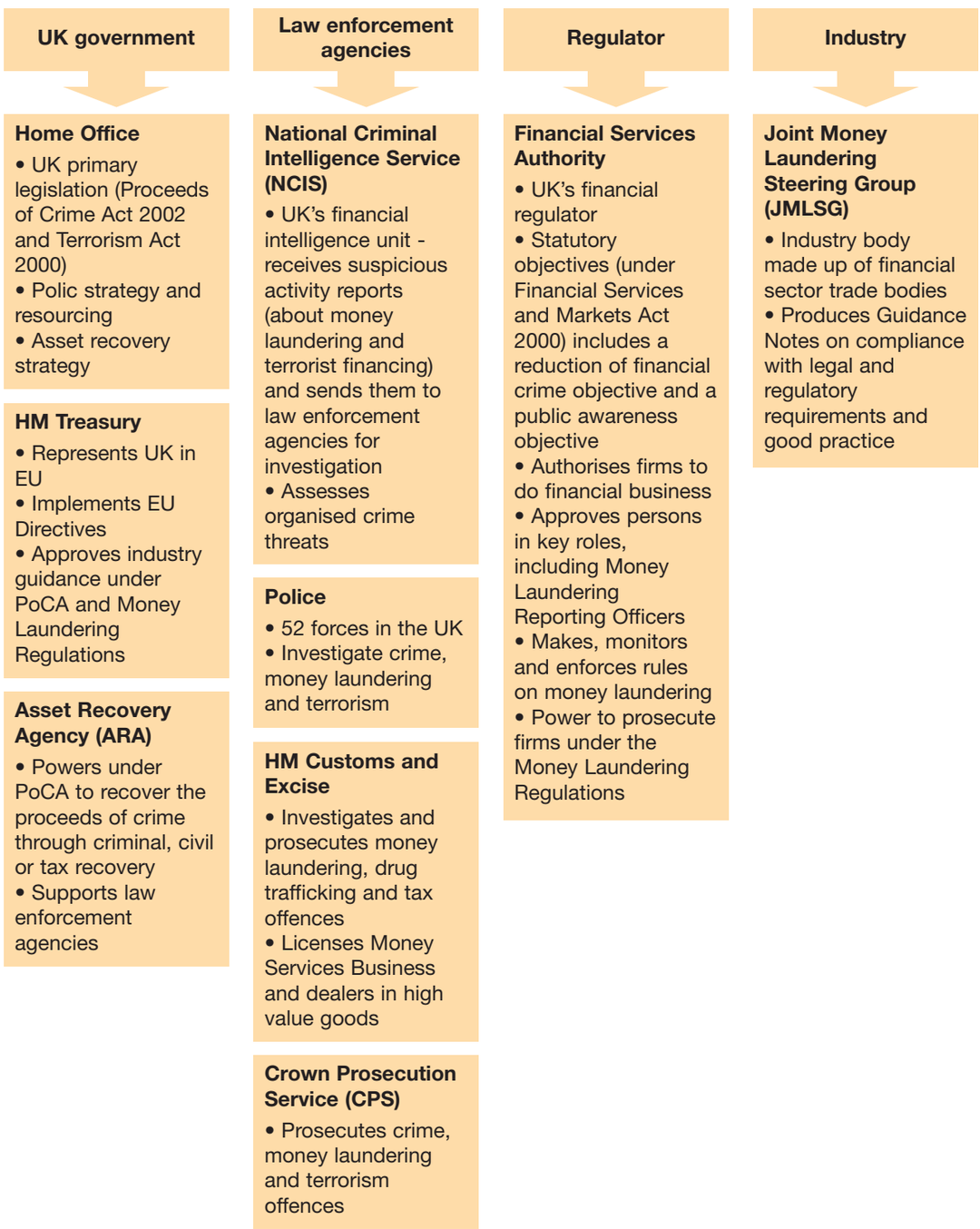
Regulatory creep can skew the focus of those being regulated away from the key objective of the regulation and encourage them to concentrate on the process for demonstrating compliance rather than on the outcome, delivering little, if any, additional benefit.

In order to minimise the effects of regulatory creep the Government needs to embed better the Principles of Good Regulation into the development of guidance. It needs to spread good regulatory practice beyond Whitehall to its independent regulators. And it needs to be far clearer about its objectives when developing regulatory proposals.

Regulatory creep is not necessarily the result of the actions of Government or regulators. Industry bodies can encourage a culture of over-compliance in their members. We would urge these bodies to consider how the recommendations we have made to the Government in this report can be applied to their work.

Annex A
The UK anti-money laundering regulatory framework

This diagram summarises the regulatory framework for anti-money laundering in the UK. (Taken from the Financial Services Authority discussion document Reducing the Money Laundering Risk - Know Your Customer and Anti-Money Laundering Monitoring)



Annex B
Contributors to the review

ASDA Wal-Mart
Association of British Insurers
Association of Independent Financial Advisers
Association of Investment Trust Companies
Barclays
The Biscuit, Cake, Chocolate and Confectionery Association
Benjys Group Limited
British Bankers Association
British Chamber of Commerce
British Retail Consortium
Buckinghamshire County Council
Centre for Analysis of Risk and Regulation
Charcol Holden Meehan
Charted Institute of Accountants
Charted Institute of Environmental Health
Construction Industry Federation
Consumer Association
Coutts
EEF, the manufacturers' organisation
Environment Agency
Federation of Small Businesses
Financial Ombudsman Service
Financial Services Authority
Financial Services Consumer Panel
Financial Services Practitioners Panel
Fiona Price Partners Ltd
Food & Drink Federation
Food Standards Agency
Food Standards Agency Consumer Committee
Health & Safety Commission/Executive
HM Treasury
Home Office
Institute of Directors
Institute of Sport & Recreation Management
Joint Money Laundering Steering Group
Jupiter Asset Management
Kings Centre for Risk Management
Local Authorities Coordinators of Regulatory Services
Law Society
Liberty
Lloyds TSB
Marks & Spencer
National Consumer Council
National Criminal Intelligence Service
National Federation of Master Bakers
Association of Private Client Investment Managers and Stockbrokers
Royal Bank of Scotland Group

Royal Borough of Kensington and Chelsea
Royal Borough of Windsor and Maidenhead
Scottish Federation of Meat Traders
Security Industry Authority
Small Business Service
Smith and Willamson
Social Market Foundation Institute for Economic Affairs
Southwark Council
Swimming Pool Federation
Trading Standards Office
Tesco
Threadneedle Asset Management
Trade Union Congress
Warwick District Council
West LB

Annex C
Membership and ways of working

The Better Regulation Task Force is an independent advisory group established in 1997. Members are appointed by the Minister for the Cabinet Office, Ruth Kelly. Appointments are for two years in the first instance and are unpaid. Members come from a variety of backgrounds – from large and small businesses, citizen and consumer groups, unions, the public sector, non-for-profit and voluntary groups and those responsible for enforcing regulations. All have experience of regulatory issues in the UK.

The Chair is David Arculus. He was appointed for a three year period from 1 April 2002.

Terms of Reference and how we work

The Task Force terms of reference are:

"To advise Government on action to ensure that regulation and its enforcement are transparent, accountable, proportionate, consistent and targeted."

When we comment on the quality of existing or proposed regulation, we test it against our five principles of good regulation (see Annex 3), asking ourselves a number of questions:

- Is the regulation necessary?
- Is it fair?
- Is it simple to understand and easy to administer?
- Is it affordable?
- Is it effective?
- Does it command public support?

We carry out studies of particular regulatory issues. These reviews are taken forward by sub-groups of Task Force members who set their own working methods. All sub-groups discuss their proposals with key organisations and individuals, as well as with Ministers and Government Departments. We work through consensus – all reports are endorsed by the full Task Force before being sent to the relevant Ministers for their response. The Prime Minister has asked Ministers to respond to Task Force reports within 60 days of publication.

We also respond to consultation exercises on regulatory proposals; we comment on live regulatory issues; and the Chair of the Task Force attends meetings of the Panel for Regulatory Accountability, a Cabinet Committee which meets regularly to address regulatory concerns with Departmental Ministers.

Resources

In addition to the valuable time of its Chair and members, which is freely given, the Task Force is supported by a team of 13 staff, part of the Cabinet Office Regulatory Impact Unit. The budget of the Task Force support team is £0.55m in 2003/4.

Members of the Task Force from April 2004

David Arculus – *Chair*, Severn Trent plc
Teresa Graham OBE – *Deputy Chair*, Baker Tilly
Jean Coussins, Portman Group
Michael Gibbons, Consultant: utility sector
Kevin Hawkins OBE, British Retail Consortium
Dame Deirdre Hutton, National Consumer Council
Kirit Patel, Day Lewis Group
Dr Ian Peters, EEF
Dr Penelope Rowlatt, Independent Economist
Janet Russell, Kirklees Metropolitan Council
Eve Salomon, Consultant: communications
Sukhvinder Stubbs, Barrow Cadbury Trust
Tim Sweeney, Consultant: financial services
Rex Symons CBE,
Bournemouth Primary Care NHS Trust
Sarah Veale, Trades Union Congress
Victoria Younghusband, Lawrence Graham LLB

Members of the Task Force who stood down on 31 March 2004

Matti Alderson, FireHorses
Stephen Falder, HMG Paints
Simon Petch, CONNECT (retired May 2003)
Simon Ward, Consultant: hospitality industry

A Register of Members' Interests has been drawn up and is on the Task Force website: www.brtf.gov.uk or is available on request.

Annex D
Sub-group members

Ian Peters (Chair) is Director of External Affairs and Marketing at EEF, the manufacturers' organisation. He was previously Deputy Director General of the British Chambers of Commerce and Deputy Director and Head of SME Policy at the CBI.

Stephen Falder is Marketing Director of HMG Paints Ltd, a medium-sized manufacturer of industrial surface coatings. He is a CBI Regional Councillor and a member of the CBI SME Council.

Kevin Hawkins is Director General of the British Retail Consortium. He was previously Director of Communications at Safeway Stores plc.

Eve Salomon is a freelance legal and policy consultant, specialising in broadcasting-related matters both domestically and internationally. She is also a member of the Gaming Board of Great Britain and a Commissioner for the Press Complaints Commission.

Annex E
Principles of Good Regulation

Proportionality	*Regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.* • Policy solutions must be proportionate to the perceived problem or risk and justify the compliance costs imposed – don't use a sledgehammer to crack a nut. • All the options for achieving policy objectives must be considered – not just prescriptive regulation. Alternatives may be more effective and cheaper to apply. • "Think small first". Regulation can have a disproportionate impact on small businesses, which account for 99.8% of UK businesses. • EC Directives should be transposed without gold plating. • Enforcement regimes should be proportionate to the risk posed. • Enforcers should consider an educational, rather than a punitive approach where possible.
Accountability	*Regulators must be able to justify decisions, and be subject to public scrutiny.* • Proposals should be published and all those affected consulted before decisions are taken. • Regulators should clearly explain how and why final decisions have been reached. • Regulators and enforcers should establish clear standards and criteria against which they can be judged. • There should be well-publicised, accessible, fair and effective complaints and appeals procedures. • Regulators and enforcers should have clear lines of accountability to Ministers; Parliaments and assemblies; and the public.
Consistency	*Government rules and standards must be joined up and implemented fairly.* • Regulators should be consistent with each other, and work together in a joined-up way. • New regulations should take account of other existing or proposed regulations, whether of domestic, EU or international origin. • Regulation should be predictable in order to give stability and certainty to those being regulated. • Enforcement agencies should apply regulations consistently across the country.

Transparency	*Regulators should be open, and keep regulations simple and user-friendly.* • Policy objectives, including the need for regulation, should be clearly defined and effectively communicated to all interested parties. • Effective consultation must take place before proposals are developed, to ensure that stakeholders' views and expertise are taken into account. • Stakeholders should be given at least 12 weeks, and sufficient information, to respond to consultation documents. • Regulations should be clear and simple, and guidance, in plain language, should be issued 12 weeks before the regulations take effect. • Those being regulated should be made aware of their obligations, with law and best practice clearly distinguished. • Those being regulated should be given the time and support to comply. It may be helpful to supply examples of methods of compliance. • The consequences of non-compliance should be made clear.
Targeting	*Regulation should be focused on the problem, and minimise side effects.* • Regulations should focus on the problem, and avoid a scattergun approach. • Where appropriate, regulators should adopt a "goals-based" approach, with enforcers and those being regulated given flexibility in deciding how to meet clear, unambiguous targets. • Guidance and support should be adapted to the needs of different groups. • Enforcers should focus primarily on those whose activities give rise to the most serious risks. • Regulations should be systematically reviewed to test whether they are still necessary and effective. If not, they should be modified or eliminated.

Annex F
Task Force publications

The Better Regulation Task Force has produced the following reports that are all available free on request by:

- writing to: Better Regulation Task Force secretariat, 5th Floor, 22 Whitehall, London SW1A 2WH
- telephoning: 020 7276 2142
- emailing: taskforce@cabinet-office.x.gsi.gov.uk
- visiting our website at www.brtf.gov.uk

Bridging the Gap – Participation in social care regulation	September 04
Annual Report 2003/04	June 04
Better Routes to Redress	May 04
The Regulation of Child Employment	February 04
Alternatives to State Regulation leaflet	January 04
Independent Regulators	October 03
Imaginative Thinking for Better Regulation	September 03
Environmental Regulation: Getting the Message Across	July 03
Government: Supporter and Customer?	May 03
Annual Report 2001/02	February 03
Revised Principles of Good Regulation	February 03
Scientific Research: Innovation with Controls	January 03
Higher Education	July 02
Local Delivery of Central Policy	July 02
Employment Regulation: striking a balance	May 02
Annual Report 2000/01	October 01
Housing Benefit: a case study of lone parents	September 01
Economic Regulators	July 01
Local Shops: a progress report on small firms regulation	July 01
Regulating Cyberspace: Better Regulation for e-commerce	December 00
Environmental Regulation and Farmers	Nov 00
Annual Report 1999/00	October 00
Revised Principles of Better Regulation	October 00
Protecting Vulnerable People	September 00
Alternatives to State Regulation	July 00
Tackling the Impact of Increasing Regulation – a case study of Hotels and Restaurants	June 00
Helping Small Firms Cope with Regulations – Exemptions and other Approaches	April 00
Red Tape Affecting Head Teachers	April 00
Payroll Review	March 00

Self-regulation interim report	October 99
Annual Report 1998/99	September 99
Regulation and Small Firms: a progress report	July 99
Fit Person's Criteria: a review of the criteria used to judge people's suitability for certain occupations	May 99
Anti-discrimination legislation	May 99
Enforcement	April 99
Annual Report 1997/98	September 98
Early Education and Day Care	July 98
Access to Government Funding for the Voluntary Sector	July 98
Licensing Legislation	July 98
Packaging Waste	June 98
Long-term care	May 98
Consumer Affairs	May 98
Principles of Good Regulation	December 97