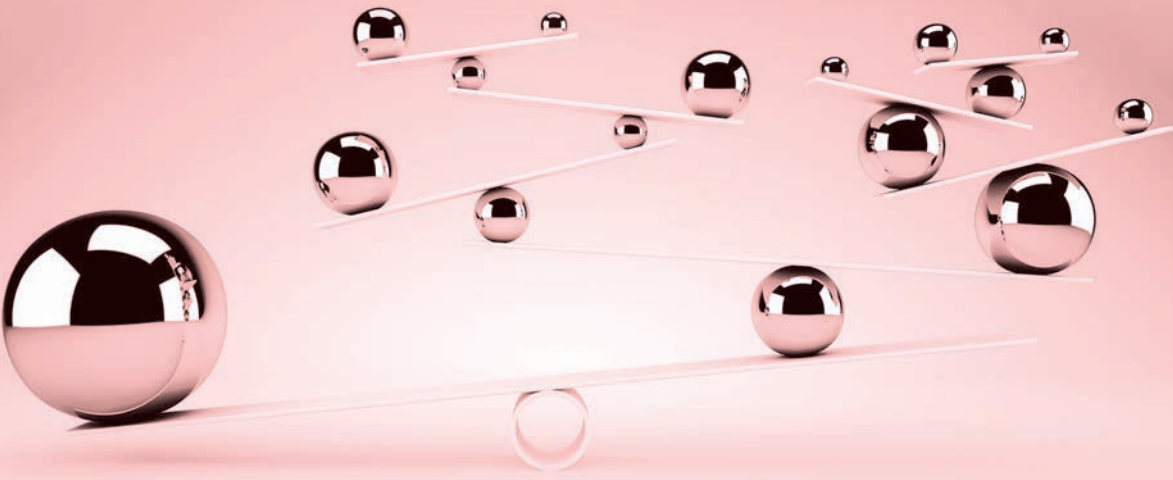




The Governance of Regulators

# Creating a Culture of Independence

PRACTICAL GUIDANCE AGAINST  
UNDUE INFLUENCE





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## Foreword

Regulators oversee the functioning of markets for the improved quality and delivery of public services. In order to fulfil their function, regulators need to make and implement impartial, objective and evidence-based decisions that will inspire trust in public institutions and encourage investment. Undue influence, whether real or perceived, can undermine a regulator’s ability to behave in this way, impinge on its independence, and ultimately, on its performance.

Formal or *de jure* independence of regulators is rarely sufficient to ensure that its day-to-day work embodies this culture of independence, and most regulators need to guard against some form of undue influence that seeks to change their behaviour and the outcomes of their regulatory decisions or activities. This is inevitable, given the interaction and dialogue with stakeholders that regulators must engage in.

To help regulators navigate these challenges and achieve policy goals, this publication provides practical advice on how to address “stress points” throughout the regulator’s life cycle. Presented as a checklist, it sets out necessary institutional measures to bolster independence and proposes other, more aspirational, measures for regulators. It can also help other stakeholders better understand the role of regulators and how to interact with them. This guidance is structured according to five essential dimensions that determine a regulator’s *de facto* independence, namely: role clarity, transparency and accountability, financial independence, independence of leadership, and staff behaviour and culture of independence.

This practical guidance is grounded in the work of the OECD Network of Economic Regulators (NER), which brings together over 80 regulators from across the world and sectors. The NER facilitates peer learning and exchange of experiences, discusses challenges, and identifies innovative solutions that help regulators balance the competing priorities framing the features of a “world class regulator”.

## Acknowledgements

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The guidance is the culmination of the expertise and discussions of the OECD Network of Economic Regulators meetings and activities that were initiated in 2012. The members of the OECD Network of Economic Regulators have provided comments throughout the preparation of the guidance. Thanks are extended to all of them and in particular to Ana Albuquerque, Board Member, Water & Waste Services Regulatory Authority, Portugal, Alberto Biancardi, Commissioner, Regulatory Authority for Electricity, Gas and Water, Italy, Andrew Burgess, Associate Partner, Office of Gas and Electricity Markets, United Kingdom, Luigi Carbone, former Commissioner, Regulatory Authority for Electricity, Gas and Water, Italy, Cristina Cifuentes, Commissioner, Australian Competition and Consumer Commission, Australia, Nicolò Di Gaetano, Senior Advisor, Regulatory Authority for Electricity, Gas and Water, Italy, Annegret Groebel, Head of the International Relations and Postal Regulation Department, Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway, Germany, Richard Home, Executive General Manager, Australian Competition and Consumer Commission, Australia, Lija Makare, Head of External Relations, Public Utilities Commission, Latvia, Jean-Yves Ollier, Director General, Energy Regulatory Commission, France, Montserrat Ramiro Ximenez and Jesus Serrano Landeros, Commissioners, Energy Regulatory Commission, Mexico, Katharina Tappeiner, Senior Policy Officer, International Relations, E-Control, Austria and Josée Touchette, Chief Operating Officer, National Energy Board, Canada. An early draft of the guidance was discussed at a

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## Executive summary

As “market referees”, regulators must take on board the views of legitimate interests as well as protect themselves from inappropriate or undue influence in order to correctly conduct their activities and achieve the right policy outcomes. Independence is a means to this end. Independence from both the government and regulated industry ensures that regulators’ decisions and activities are objective, impartial, consistent and expert. The capacity of regulators to act independently helps implement and refine the policy frameworks developed by government institutions that seek to improve the functioning of markets, sectors and environments through regulation.

However, independence is never a foregone conclusion nor should it be taken for granted; nor is formal (*de jure*) independence sufficient to guarantee the impartiality of a regulator’s daily behaviour and decisions. On the contrary, a regulator’s independence is frequently under stress, particularly at given “pinch points” where there is potential for greater undue influence to be exerted. In order to navigate these challenges, regulatory agencies need to build and sustain a strong and institutionally proactive culture of independence that will bolster their daily practice and behaviour. Certain institutional and practical measures can contribute to such a culture of independence.

The set of guidelines is structured into five sections that reflect dimensions under which these “pinch points” can occur. They cover considerations linked both to the external and internal governance of regulators. These five dimensions include basic and necessary institutional measures to establish and maintain the capacity of regulators to act independently. The guidelines also include a set of aspirational steps that could be taken to further bolster independence and safeguard regulators from undue influence.

### Role clarity and responsibility

Regulators are particularly engaged in policy implementation and, inevitably and desirably, engage with the executive and other stakeholders in their daily work. These actors can have different incentives than

regulators and, in some instances, the lack of clarity on the roles and functions of regulators *vis-à-vis* other stakeholders can open the door to undue influence.

To counter these challenges, legislation should clearly describe the regulator's objectives and how they are to interact with other government actors. Regulators should also be proactive in their outreach to these actors, in bringing to the fore their strategic foresight capacities and in educating stakeholders on their role in the market.

### **Transparency and accountability**

The communications role of a regulator is two-way. In addition to listening to signals from stakeholders when appropriate, a regulatory agency is also responsible for disseminating information about its activities and results in a transparent manner, as well as communicating the key reasons for policy decisions and plans for future interventions to the regulated industry. Regulators should provide timely and relevant information on their performance and the performance of the markets they oversee. There should also be appropriate channels for complaints and appeals against the regulator's decisions.

Regulators could also aspire to implementing ethics codes and principles for transparency and integrity in lobbying.

### **Financial independence**

Appropriate funding is essential for the regulator to carry out its mandate and act independently. Moreover, how funding needs are determined, how the amount of funds is decided and the extent to which the regulator can manage these funds autonomously may be more relevant than the source of funding. These processes should be clearly established, consistent and transparent.

### **Independence of leadership**

The board or agency head of a regulator ultimately takes the decisions for which the regulator will be held accountable, and can be exposed to greater pressures than professional staff. The process for nominating and appointing agency leadership may be an opportunity to exert undue influence, and should therefore be governed by transparent and accountable processes.

Moreover, during their tour of duty, board members and heads inevitably interact with governments and parliament, as well as industry. The impact of these interactions depends on their transparency, the administrative culture in which the regulator and the government operate and the sense of professionalism and objectivity that the regulator as an institution has developed. Clear conflict of interest rules should be put in place to support independent behaviour of leadership while in employment and upon exiting.

## Staff behaviour

The way in which regulators attract, retain and motivate staff is a key determinant of the ability of the regulator to act independently and take decisions that are objective and evidence based. Professional staff are expected to provide the technical and objective advice that help the board or agency head take unbiased decisions. A culture of independence can help foster an environment that helps staff produce unbiased advice and serenely navigate the pinch points of undue influence.

To achieve these goals, recruitment should be based on competence and ethics, and staff should be provided with sufficient incentives and freedom of action to carry out their duties. Regulators may also aspire to have autonomy in setting salary scales and to implement some form of pre- and post-employment restrictions for all staff commensurate to staff's responsibilities.



## Users' guide

This guidance is intended to provide practical guidelines for governments and regulators on how to protect economic regulatory agencies (from here on *regulatory agencies*) from undue influence.\* It also aims at helping the executive, legislature, judiciary, industry, consumers, media and interest groups to better understand and appreciate the role of regulators and how to interact with them. It has an informal status of guidance and can be used by OECD members and non-members to guide their reforms.

Chapters 1 and 2 present an overview of the purpose and rationale of protecting regulatory agencies from undue influence. The guidance is presented in Chapter 3 and is structured as a practical checklist to facilitate behavioural and organisational change. It draws on the OECD report *Being an Independent Regulator* (OECD, 2016), which provides the analytical background of this guidance and should be referred to for more in-depth analysis of the rationale and evidence on the independence of regulators.

The work on the independence of regulators is carried out within the OECD's Network of Economic Regulators (NER). It is framed by the *OECD Best Practice Principles for the Governance of Regulators* (2014) that include the principle of preventing undue influence and maintaining trust, as well as the 2012 *OECD Recommendation of the Council on Regulatory Policy and Governance* and the peer reviews of regulatory agencies that have been conducted applying the OECD's Performance Assessment Framework for Economic Regulators (PAFER) methodology.

\*. This guidance may also be applicable or adaptable to other regulators.





## *Chapter 1*

### **Purpose**

*This chapter discusses why independence matters and how this guidance aims to help regulators and other government actors and stakeholders.*

**“It is important that regulatory decisions and functions are conducted with the upmost integrity to ensure there is confidence in the regulatory regime” (OECD, 2014).**

Objective, impartial and qualified “referees” are fundamental to ensuring that all “players” in any market, sector or environment are treated and behave correctly in accordance with the “rules” for the optimal outcomes. Regulatory agencies often find themselves under various pressures from different stakeholders and interest groups which can subject them to different forms of influence. To ensure they conduct their activities correctly and achieve the right policy outcomes they must take on board legitimate interests and protect themselves from inappropriate or undue influence.

### **How will this guidance help?**

The guidance has been produced to help focus the public discourse of independence towards performance and achieving desired or better results. Independence is a means to an end. It is sought from government and regulated industry to ensure that regulators’ decisions and activities are objective, impartial, consistent and expert. The capacity of regulators to act independently helps implement, improve and refine the policy frameworks developed by government institutions to improve the functioning of markets, sectors and environments through regulation.

The guidance has been developed to help:

- Regulatory agencies to better understand the operational and behavioural implications of being independent and, on this basis, act so as to maintain confidence that regulatory decisions are made on an objective, impartial, and consistent basis, without conflict of interest and bias;
- The legislature and executive to structure and engage with regulatory agencies in a way that embeds a culture and practices aimed at maintaining regulatory integrity;
- Industry and consumers to better understand interactions with regulators and build confidence in the regulatory institutions;
- Media, lobbying groups/lobbyists to appreciate the role and functions of regulators and interact appropriately with them.

## *Chapter 2*

### **Rationale: When and why is independence necessary and why is this guidance needed**

*This chapter provides an overview of when independence may be necessary and factors to consider in creating an independent and structurally separate regulatory body. It also discusses OECD data on the independence of regulators.*

According to the 2012 OECD *Recommendation of the Council on Regulatory Policy and Governance*, independent regulatory agencies should be considered where:

1. there is a need for the regulator to be seen as independent from politicians, government and regulated entities, to maintain public confidence in the objectivity and impartiality of decisions and effective operation for trust in the market;
2. both government and non-government entities are regulated under the same framework and competitive neutrality is therefore required; or
3. the decisions of the regulator can have significant impact on particular interests and there is a need to protect its impartiality.

Table 2.1. **Factors to consider in creating an independent and structurally separate regulatory body**

Factor	Description
Credible commitments over the long term	Establishing a more independent regulator can send an important message to regulated entities about the commitment of government to objective and transparent administration and enforcement of regulation.
Stability	Greater distance from political influences is more likely to result in consistent and predictable regulatory decision-making.
Addressing potential conflicts of interest	Regulatory decisions that have significant flow-on impacts for government, e.g. on budgets or service delivery, or that must be seen to be applied impartially to both government and non-government entities may be better made by entities at arm's length from ministers and ministries.
Development of regulatory expertise	Where there is a need for specialist regulator expertise, which is best maintained in a specialist unit with quarantined resources.

Source: OECD (2014), *The Governance of Regulators*, OECD Best Practice Principles for Regulatory Policy, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264209015-en>.

Other factors to consider in creating an independent regulatory body are summarised in Table 2.1 above, highlighting when and how the creation of an independent regulator presents clear advantages. For example, independence of regulators contributes to the credibility and stability of the regulatory regime. The protection of regulatory decisions from the perception of political influence also enhances trust in the regulator and its decisions. There are different models for independent regulators which could be entirely separate from governments or maintain some institutional

links with a ministry or the executive. These different models can also reflect differences in administrative and institutional contexts. The key determining factor is ultimately the *capacity and capability of the regulator to act independently* within these different models.

### Box 2.1. OECD data and evidence on the independence of regulators

In an effort to better understand what is required for a regulator to be considered independent, the OECD included in 2013 for the first time indicators linked to the independence of regulators in its Product Market Regulation (PMR) database. The PMR Indicators are mostly linked to considerations of *de jure* independence and suggest that there could be some gaps between formal and informal arrangements of independence. The PMR indicators on the management practices will be updated regularly to take into consideration the evolution of the regulators' arrangements and reflect improvements in the methodology. PMR indicators can be accessed at:

[www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm](http://www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm).

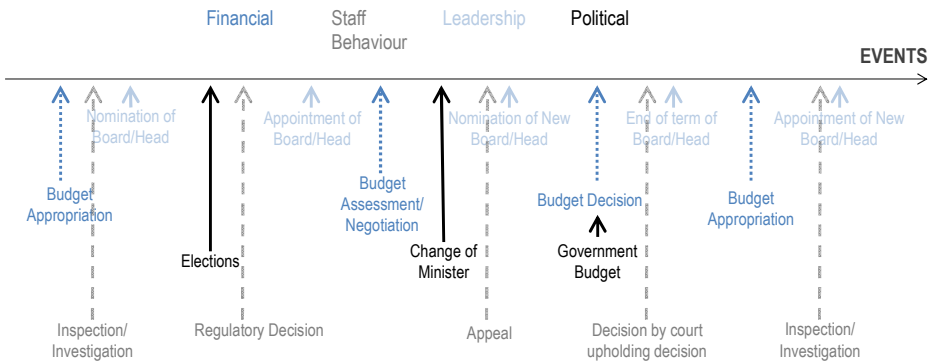
To complement this set of data, further information and experiences have been collected through a survey of 48 regulators across different sectors and 26 countries (OECD and non-OECD), within the work of OECD Network of Economic Regulators (NER). Analysis of the survey data is published in the report *Being an independent regulator* (OECD, 2016a) and provides unique insights into the combined facets of both *de facto* and *de jure* arrangements that impact on the independence of regulatory agencies. For example, the report shows that 88% of the regulators surveyed that receive their funding from the executive are subject to annual rather than multi-annual budget allocations (OECD, 2016a: 79-83). This financial dependence may have an impact on the organisational behaviour and decision making of the regulator.

The report also found that a search committee is used when hiring a new Chair only in the case of eight regulators, with nominations made either by a selection committee composed of the executive, the regulator and experts, or by an external selection panel. In most other cases, the executive nominates the board members. The executive is also ultimately responsible for appointing the board/head for most regulators. In 15% of cases, the appointment is made by parliament (OECD, 2016a: 75-76). Also, almost 50% of the regulators place no restrictions on pre- or post-employment of professional staff. This opens the risk of “revolving doors” and conflicts of interest with industry (OECD, 2016a: 72-73). And only a quarter of the regulators are given a public or formal government statement of expectations, which in addition to a clear definition of regulator role in legislation, can be useful to clarify goals and activities and for accountability and building trust in the regulatory governance of the sector (OECD, 2016a: 53-56).

*Source:* Koske, I. et al. (2016), “Regulatory management practices in OECD countries”, *OECD Economics Department Working Papers*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/5jm0qwm7825h-en>; OECD (2016a), *Being an Independent Regulator*, The Governance of Regulators, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264255401-en>.

How then is this independence established and implemented? *De jure* independence refers to the grounding of a regulator’s independence in law. The extent to which the legislation that establishes and governs the regulator protects its independence is often measured by looking at provisions on budgetary independence, the conditions and process for the appointment and dismissal of the members or head of the regulatory agency, accountability and reporting to the executive, legislature or representatives from regulated industry, as well as whether the executive withholds powers to set tariffs or prices and review or approve contract terms with the regulated entities. These provisions are necessary to formally protect a regulator’s structural independence as they create formal safeguards against undue influence and help prevent attempts to exercise undue control, curtail the roles and responsibilities of the regulator or intervene in exclusive areas of responsibility for the regulator. However, these provisions alone are not sufficient to set up and to preserve safeguards against undue influence in the regulator’s day to day work. The practical implications of formal independence or how it is translated into *de facto* independence in the actions, decisions and behaviour of a regulator are more complex to identify and define.

Figure 2.1. Pinch points: potential entry points for undue influence



Source: Below, B. et al. (2016), “Rara avis? Searching for regulatory independence in its natural habitat”, [www.oecd.org/gov/regulatory-policy/independence-of-regulators.htm](http://www.oecd.org/gov/regulatory-policy/independence-of-regulators.htm) (accessed 21 March 2017).

The task of mapping the different dimensions of independence – and protecting them – is further complicated by the fact that independence is never a foregone conclusion or “done deal”. It is not a static characteristic acquired once and for all, but rather one that is continually under stress. Engagement with stakeholders is an important element of the regulator’s

legitimacy, but it also offers opportunities for undue influence, which evolve along the life of the regulator or throughout the different phases of the regulatory cycle. Some of these “pinch points” where there might be potential for greater undue influence include agency finances, staff behaviour, the appointment and removal of leadership, and how the agency intersects with political cycles (Figure 2.1). In order to navigate these powerful headwinds, regulatory agencies need to build and sustain a strong and institutionally proactive *culture of independence* that will inform their daily practice and behaviour. This guidance points to institutional and practical measures that would contribute to such a culture of independence.





## *Chapter 3*

### **Guidance on creating a culture of independence**

*This chapter presents practical guidance for governments and regulators on how to protect economic regulatory agencies from undue influence and creating a culture of independence. The guidance may be applicable or adaptable also to other regulators. It is structured under five dimensions: role clarity, transparency and accountability, financial independence, independence of leadership and staff behaviour.*

The guidance is structured into five sections (Role clarity; Transparency and accountability; Financial independence; Independence of leadership; and Staff behaviour), developed in response to “pinch points” that can occur throughout the life cycle of a regulator where there is potential for greater undue influence (see above Figure 2.1.) These five dimensions cover issues linked to both external and internal governance of the regulatory agency that are understood as follows:

- External governance: the roles, relationships and distribution of powers and responsibilities between the legislature, the Minister, the Ministry, the regulator’s governing body and regulated entities. The effective management of these relationships is critical to having an independent regulator.
- Internal governance: the regulator’s organisational structures, standards of behaviour, compliance and accountability measures, oversight of business processes, financial reporting and performance management. A key determinant of independence lies in equipping the regulator with adequate resources and processes to carry out its duties.

Each of the five dimensions includes practical guidelines that can be considered as the basic and necessary institutional measures to create a culture of independence which establishes and maintains the capacity of regulators to act independently, based on an analysis of regulators’ institutional processes and practices within the OECD Network of Economic Regulators (NER). The guidelines also include a set of aspirational steps that could be taken to further bolster a culture of independence and safeguarding regulators from undue influence.

These guidelines may also have wider applicability, beyond regulatory agencies. They could be used for the institutional and organisational design of arms-length bodies, corporate governance, anti-corruption and integrity programmes and in any context where the nuances of building trust and managing competing, and sometimes undue, pressures are present.

## 1. Role clarity and responsibility

Regulators are not an island. Rather, they are part of the policy-making process at large and are often particularly engaged in policy implementation. In this context, inevitably and desirably, regulators will engage with the executive and stakeholders in their daily work.

Other public actors, particularly elected officials, can have different incentives than regulators. While elected officials are beholden to short-term election cycles, regulators serve to, among other things, ensure stable and competitive markets over the long-term. The practical implication is that competing interests can sometimes put pressures on regulators and pave the

way for attempts to unduly influence the decisions of regulators by affecting, for example, their capacity and resources to act.

Relevant legislation should clearly set out the roles and responsibilities of the regulator and other relevant public bodies and institutions. However, *in practice*, overlapping and grey areas are inevitable as the regulated sectors are dynamic and circumstances might evolve. It is essential for the executive and regulator to have regular exchanges on identifying possible problematic areas in advance, and to work with the legislative process and parliament to clarify and resolve possible deadlocks, without, however, opening the door to undue interventions.

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#### Guidelines on role clarity

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- 1.1. **Role Clarity.** The legislation should clearly set out the objectives and functions of the regulator. If these objectives and functions need to change over time, modifications should be made in the relevant legislation to avoid mission overload. Regulators should be given a clear mandate and the powers and resources to fulfil it.
  - 1.2. **Relations with the executive and other public bodies.** The role of public actors (including elected officials) in relation to the regulator should be made clear in legislation. Likewise, the role of the regulator should be clearly defined with regard to the executive, legislature and other elected bodies. Directions from government to provide the regulator guidance to clarify its role outside the legislative process should be avoided.
  - 1.3. **Conflict resolution.** While it is impossible to completely eliminate or totally avoid overlaps in functions and activities between different public entities, the negative impact of these overlaps should be minimized by the definition of clear conflict resolution mechanisms should issues arise. When the activities of various entities overlap (e.g. when a regulator makes a proposal to the government or issues an opinion on a government proposal), the rules of procedure should clearly specify which authority has a final say and what are the mechanisms (such as judicial reviews) to resolve a difference of views between these authorities.
  - 1.4. **Outreach.** Regulators should be proactive and heard in relevant institutions. Regulators should welcome appropriate and proportionate opportunities for public hearings with legislatures and systematically present updates on their activities to relevant committees and bodies in the legislature and other relevant bodies such as economic and social councils, committees of the regions etc.
  - 1.5. **Strategic foresight.** Regulators should be proactive in their use of horizon scanning and strategic foresight to anticipate changes and shocks to the socio-political context, especially for catastrophes, crises and extenuating circumstances. In the interest of role clarity, regulators should provide prior notice to the executive and legislature of the findings and the evidence gathered and being mindful of their roles when communicating these findings and evidence externally.
  - 1.6. **Information and understanding.** Regulators should be proactive in informing and promoting better understanding in the executive, legislature and other public and private stakeholders of the role of regulators in the functioning of the regulated market and sector. Exercising this function could include building knowledge in areas where the regulator has most expertise (e.g. explaining how new developments may impact markets and the regulated sector).
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## 2. Transparency and accountability

Transparency and accountability make up the other side of the coin of independence, and are vital to achieve the appropriate balance between them. Importantly, transparency and accountability are not the same and each has its own purpose in the regulatory eco-system.

Transparency is a means that contributes to fostering credibility and trust on the regulator’s decisions and processes, including on operational policies and the way in which the regulator engages with stakeholders. Accountability is the way to ensure checks and balances on the regulators’ actions’ to enable responsible behavior. Transparency can be described as a subset of accountability. Accountability includes the regulator’s reporting requirements to the legislature on the regulator’s effective exercise of powers and responsibilities, activities and outcomes accountability is also strengthened through an adequate appeals mechanism of the regulator’s decisions (OECD, 2014).

A regulator’s legitimacy rests also on its engagement with the industry to exchange information, consult when taking regulatory decisions, ensure compliance and respond to complaints. Public consultations with all stakeholders are the most common formal means of interacting with industry. Regulators will also be inevitably confronted with pressures from industry. Informally, stakeholders can try to influence regulators’ decisions through lobbying and media campaigns. More problematic are cases where stakeholders can exercise pressure on ministers and members of parliament to affect the decisions of regulators. Regulators can use the media to counteract negative campaigns and to go public on issues of transparency and accountability.

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#### Guidelines on transparency and accountability

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- 2.1. **Accountability to public bodies.** Regulators should provide timely and relevant performance information and reporting that demonstrates the link between their internal governance and their outputs and outcomes. This information should be presented to the legislatures and other relevant decision-making bodies, including the executive where relevant, in a transparent manner.
  - 2.2. **Transparency on stakeholder engagement.** Regulators should lay out and make publicly clear what are the ways through which they engage with public and private stakeholders so that opportunities for contributions are clear and accessible. Instructions on how to engage with the regulator should be presented on websites and circulated. Engagement processes should support the perceived and actual integrity, impartiality, competency and objectivity of the regulator.
  - 2.3. **Feedback to stakeholders.** Regulators should justify their key decisions with robust and detailed empirical evidence for the public record. This evidence should be also clearly and briefly summarised and published to the benefit of all stakeholders in a non-technical language, with the exception of commercially sensitive or otherwise protected information.
  - 2.4. **Appeals.** There should be an easy, fair, timely complaints and appeals process for regulators’ decisions, which is also independent and located outside government. Information on the quality and implementation of these processes should be published on accessible platforms.
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### Aspirational measures to bolster transparency and accountability

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- 2.5. **Ethics code.** The *OECD Recommendation of the Council on Public Integrity* (OECD, 2017) recommends that adherents use organisational policies such as codes of conduct or ethics codes to “clarify expectations and serve as a basis for disciplinary, administrative and/or criminal investigation and sanctions”. In line with this recommendation, regulators should seek to establish codes of conduct for the leadership, staff and agency on the engagement with lobbying and interest groups and put in place appropriate mechanisms to enforce them (with sanctions for non-compliance by the agency). Codes of conduct should define the informal and formal means for engagement between public and private stakeholders, including lobbying and interest groups, and any inappropriate interactions that may exert undue influence. These codes of conduct could rely on existing public sector-wide guidance and/or an ethics code and be adapted to the role and functions of the regulator if needed.
- 2.6. **Lobbying.** There should be safeguards for “through the back door” influence through the executive or legislature by interest groups that then exert influence on regulators. Safeguarding regulators against this undue influence should be a key concern for executives and legislatures. In line with the *OECD Principles for Transparency and Integrity in Lobbying* (OECD, 2013), these safeguards would require a clear definition of what constitutes lobbying, notification and disclosure of relevant lobbying activities of interest groups and their interactions with the executive and legislature, particularly in regards to regulators. This could include registration of lobbyists and prompt disclosure of attempts to improper conduct or influence the regulator.
- 2.7. **Media and communication strategy and capability.** Regulators should develop and implement effective media and communications strategies as part of their core functions. Media engagement plans and opportunities should be made public and kept up to date, for instance online and on the regulators’ websites. Reactions to misrepresented views of the regulator or the decisions should be prompts and public so that undue influence via the media could be addressed and minimised. Media and communication strategies should also include the development of tools and capacity within the regulator to effectively use media outlets (print, on-line, social and others) to address potential attempts at exerting undue influence.
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## 3. Financial independence

Appropriate funding is essential to determine the extent to which the regulator can carry out its mandate and act independently. Moreover, the way in which funding needs are determined, funds are decided and the extent to which the regulator can manage these funds autonomously could be more relevant than the source of funding.

In general, regulators’ budgets are approved by the legislature and form part of the national budget, which is a guarantee of transparency and accountability of regulators to citizens, and can strengthen independence. For regulators that are funded through fees, an appropriate cost-recovery mechanism is essential to set the “right” fee and avoid a regulator that is under-funded, captured by industry or undermined by the executive (for example in countries with large regulated state-owned enterprises).

It can be easier to influence a regulator funded through general government revenues by reducing the resources at its disposal. Annual appropriations can make it easier to influence the regulator than multi-annual appropriations that are less contingent to short-term shocks such as political/electoral imperatives. Adequate safeguards can protect the budget process from being used to unduly direct the regulator.

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### Guidelines on financial independence

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- 3.1. **Source of funding.** The source of the financial budget for the regulator should be clearly stated in the establishing framework (e.g. legislation). When identifying funding sources, due consideration should be given to the circumstances that could compromise the integrity of the functions of the regulatory agency (e.g. public ownership of regulated entities, expected market volatility, etc.).
  - 3.2. **Identification of needs.** The regulator should provide adequate information to the legislature or the relevant budget authority on the costs and resources needed to fulfil its mandate prior to setting its next budget cycle. This information should include data on programmes, interventions and resources related to its functions and objectives. Procedures for requesting additional funds from the legislature should be provided in relevant legislation.
  - 3.3. **Length of budget appropriations.** Budgets for regulators should be decided and appropriated on a multi-year basis, for example by negotiating a budget allocation at minimum on a three-year basis to protect regulators' financial independence and avoid continual potential for undue influence from yearly budget negotiations.
  - 3.4. **Budget decision.** The budget decision for the regulatory agency should be transparent with a clearly defined process. The responsible party (legislature, officials, committee/board members) should disclose the budgetary decision along with an explanation for the allocation term (e.g. annual or multi-year budget etc.) and any other conditions.
  - 3.5. **Budget appropriation.** The process for appropriating or transferring the budget allocation to the regulator should be clearly defined and consistent. If the revenue source is from industry then there should be an independent and accountable channel to provide the allocation to the regulator e.g. through a ring-fenced process with the legislature.
  - 3.6. **Financial management.** Regulators should have appropriate and accountable autonomy in spending their budget. They should be able to set their own classification of expenditures within an agreed framework by law. This will be guided by rules of public spending and procurement as well as auditing obligations and good practices. Where the agency has determined its own spending rules there should be accountability measures, such as demonstration of effective and appropriate spending through key performance indicators (KPIs) on the performance of the organisation, the leadership and relevant senior officials.
  - 3.7. **Expenditure controls.** Interference with the regulator's use of the budget, such as spending-caps and political discretion on budget autonomy, should not be allowed so long as the regulator stays within the general rules of orderly budgetary behaviour with legitimate justification. If there is cause to intervene, there should be a transparent and accountable process to determine the necessity of such measures on the agency.
  - 3.8. **Budget re-allocation criteria.** The budget re-allocation or review process for future budgets should be conducted with assessment criteria that are publicly communicated and agreed with the regulator in advance of the start of the review process.
  - 3.9. **External audit.** The external evaluation of the agency's spending should be conducted by an independent body such as a supreme audit institution that is apolitical.
  - 3.10. **Internal audit.** The internal evaluation of the agency's spending should include performance information, the initial regulator budget proposal, and the use of cost recovery mechanisms.
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## 4. Independence of leadership

The board or agency head of a regulator ultimately takes the decisions for which the regulator will be held accountable, and can be exposed to greater pressures than professional staff. As the government (executive and/or parliament) is responsible for the nomination and appointment of board members and agency heads, board members and heads can be closer (or at least have more intense relations with) the nominating and appointing

authority, at least before they start their “tour of duty”. The nomination process is a crucial juncture where the lack of transparency and accountability on the process and criteria leading to a nomination might create strong perceptions of undue proximity.

During their tour of duty, board members and heads inevitably interact with governments and parliament, as well as industry. The impact of these interactions on the decisions can in part depend on the transparency of the relationship between the board/head and the appointing authority, the administrative culture in which the regulator and the government operates and the sense of professionalism and objectivity that the regulator as an institution has developed.

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#### Guidelines on independence of leadership

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- 4.1. **Nomination.** The nomination process for the leadership of the regulatory agency should be transparent and accountable through a specific formal requirement in the legislation or the governing act. Relevant information should be communicated to stakeholders, including the functions to be performed, the skills required for the position, the time frame for nominations, who will officially nominate potential candidates, who will be consulted and whose views will be taken into account in selecting potential candidates, the selection criteria, and any particular considerations in the process (e.g. diversity of expertise in the case of regulators led by a board).
  - 4.2. **Appointment.** The appointment process should also be transparent and accountable with a justification based on the number of candidates considered, selection criteria and consultations that should be publicly available. It should also be clear who specifically has made the final and legal appointment and the terms and conditions of the appointment. This provides greater confidence in the governance of the regulator.
  - 4.3. **Board mandates.** For regulators led by a board, appointments of board members should be staggered to maintain knowledge and expertise in between renewals of appointments. The length of office terms should be designed in a way that ensures that board members' terms cut across electoral cycles, compatible with each country's constitutional arrangements. Mandates should be of at least five years to allow for knowledge and expertise development.
  - 4.4. **Conflict of interest rules.** The professionalism and integrity of the leadership should be protected through measures to avoid perceived or actual undue influence. This may include conflict of interest registers and procedures, declaration of assets/shares/interests in the regulated sector, frameworks for decision-making procedures and publication of the justification of key decisions, continual monitoring in the board composition and interests. However, there must be care to strike an adequate balance by tailoring measures to the gravity of actual and potential risks, to ensure that qualified candidates, with some sector specific skills or experience in the regulated industry as required, are not deterred from working for the regulator or that the regulator is not operationally hindered by these restrictions.
  - 4.5. **Termination.** The grounds and process for terminating appointments should be explicitly stated in legislation, be limited to serious cases of misbehaviour and involve the legislature or judiciary for greater transparency and accountability, and perceived fairness.
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**Aspirational measures to bolster the independence of leadership**

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- 4.6. **Exiting process: conflict of interest.** In line with the *OECD Recommendation on Guidelines for Managing Conflict of Interest in the Public Service* (OECD, 2003), regulators should identify and develop policies for “at-risk” areas for potential conflict of interest situations, which would include negotiation of activity after leaving public office. The exiting process for leadership members should safeguard against decision-biases and protect the integrity of the regulator. This could include disclosure of employment offers to the rest of the leadership and agency administration that can be communicated to the legislature or judiciary if requested and a review of employment offers by ethics committees. Restrictions on post-exit employment should be enforced and supplemented with cooling-off periods that are reasonable and remunerated for a set period of time made clear in relevant legislation. The possibility of legal actions if at a later point the leadership/board position has resulted in unfair or inappropriate financial gain for the leadership member should be made clear in relevant legislation such as anti-bribery laws and clearly stated to the leadership at the beginning of their terms and before exiting.
- 4.7. **Exiting process: wind-down of responsibilities.** Regulators may consider constructing an exit strategy system for leadership members (and for staff members with access to sensitive information) that winds-down responsibilities and access to information nearer the end of the term of appointment to prevent from actual and perceived undue influence at the time when there could be greater potential for it to take effect. There may also be suitable exiting roles within the organisation that will serve the purposes of the regulator better, such as knowledge transferal to incoming members or staff, managing internal organisational issues, etc. to ensure that the regulator remains able to act at all times.
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## 5. Staff behaviour

The way in which regulators attract, retain and motivate staff is ultimately a key determinant of the ability of the regulator to act independently and take decisions that are objective and evidence based. While professional staff are less exposed to pressures from public officials or industry lobbyists, professional staff is nevertheless expected to provide the technical and objective advice that help the board/agency head take unbiased decisions. In this respect, a culture of independence can help foster an environment that helps staff produce the needed unbiased advice and serenely navigate the pinch points of undue influence.

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**Guidelines on staff behaviour**

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- 5.1. **Recruitment. Recruitment of staff should be based on competence and ethics.** A sense of “regulatory stewardship” should be prevalent and accounted for in the recruitment process. Professional staff should be protected from pressures and put in a position to provide objective advice though appropriate safeguards like tenure or other public service safeguards.
- 5.2. **Incentives.** Personalised incentives for staff should be adequate to avoid potential for undue influence. Rewards (including financial incentives, impact of work and personal recognition), opportunities for development (including accreditation and training) and non-monetary incentives (including flexible work arrangements, extra employment benefits, attention to work-life balance and possibility for rapid career growth) are important across the agency.
- 5.3. **Integrity and freedom of action.** Staff should be encouraged and enabled to demonstrate a responsible culture of independence in their daily duties. This may include freedom from political or legal personal retribution, the capability to manage risk, the capacity to act independently, with appropriate internal accountability processes and monitoring linked to the organisational strategic objectives. These freedoms can be enshrined in codes of conduct or guidelines, and reinforced through robust and transparent human resource management (HRM) practices. These should also be reinforced through the support and behaviours of the leadership.
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- 5.4. **Career development.** Regulators should develop career paths for staff that will allow professional and personal growth, mentoring or coaching by the leadership and senior staff, and training to allow mobility within the organisation. Co-operation with partner organisations, both domestic and international, could also provide opportunities for staff exchange programmes. “Regulatory literacy and capacity” training and accreditation should be developed internally or with partners to nurture careers.
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**Aspirational measures to nurture a culture of independence through staff behaviour**

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- 5.5. **Salary scales and benefits.** Regulators should construct salary scales and progression that take into account the regulated industry employing similar staff, taking into consideration wider benefits that are non-financial. This may mean deviating from the public sector norm and having a certain autonomy to adjust public sector salary scales, following the practice of other bodies such as reserve banks.
- 5.6. **Staff objectives.** There should be clear links between the staff objectives and the strategic objectives of the body or agency. This will provide the organisational incentives for individuals and embed checks and balances throughout the organisation for maintaining high levels of integrity.
- 5.7. **Employment restrictions.** In addition to ensuring that staff are rewarded commensurate with the salaries of employees in the regulated industry or are provided with adequate non-financial incentives, some form of post-employment restrictions should exist for all staff and not just the board to prevent the risks of a “revolving door” culture or practices within the regulatory agency or arms-length body. However, these restrictions should be modulated to the roles and responsibilities of staff. Middle and junior staff members should have limited post-employment restrictions to allow for expertise exchanges between industry, the executive and regulators. In these cases, the conduct of former staff should be subject to legal review if ethical rules were breached after leaving the regulatory agency or arms-length body. Post-employment restrictions and rules for senior staff should mirror those as for leadership members such as cooling off periods with remuneration, but on a proportionate basis to their position.
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## *Annex A*

### Methodology

This guidance is based on a body of work developed by the OECD’s Network of Economic Regulators (NER) and the Regulatory Policy Committee (RPC). Discussions first began in the initial meetings of the NER given the increased pressures on regulators in an ever dynamic, complex and challenging climate. “Preventing from undue influence and maintaining trust” is one of the seven principles in the 2014 OECD Best Practice Principles on the “Governance of Regulators” which provided the rationale and considerations for regulators to be and act independently (OECD, 2014).

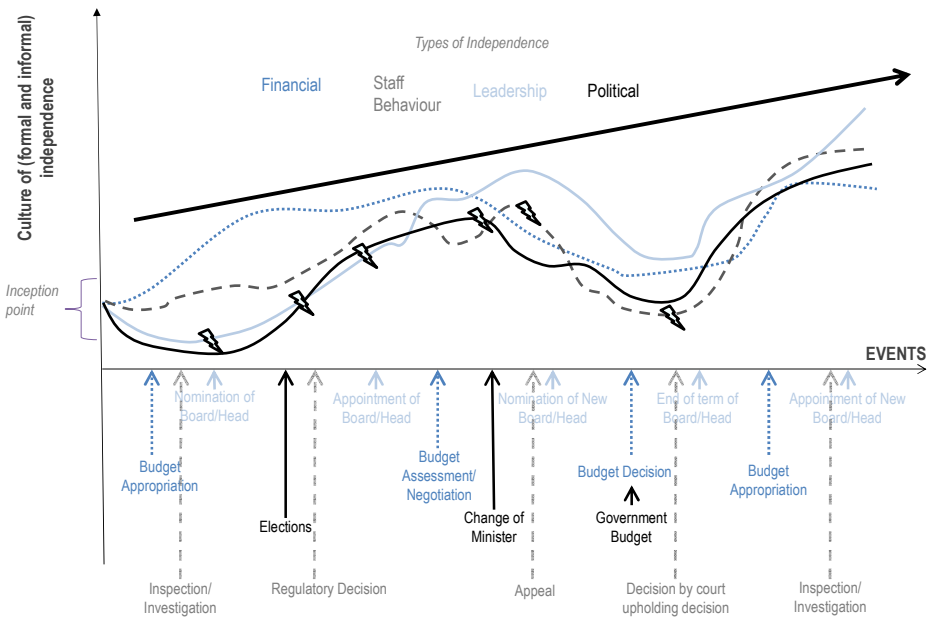
This guidance has been developed as a result of and to complement the 2016 OECD report on “Being an Independent Regulator”. The report is based on a survey of 48 regulators in 26 OECD and partner countries across all economic sectors to identify how independence is translated into practice. The report finds that undue pressure can be exercised at different points in the life of a regulatory agency. Moreover, the institutional arrangements and governance practices within administrations can either hinder or nurture the prevalence of a *culture of independence* (OECD, 2016a).

This work was also informed by the 2013 update of the OECD Product Market Regulation database. The new data captures the independence, accountability and scope of action of economic regulators of network sectors (electricity, gas, telecommunications, railroad transport infrastructure, airports and ports). This update has led to the development of a new set of indicators that map the *de jure* measures supporting independence, accountability and scope of action for network sector regulators across OECD member countries. Key findings from these indicators are presented in the working paper on the “Regulatory management Practices in OECD Countries” by the OECD Economics Department (Koske et al., 2016).

An innovative “pinch-point analysis” has been developed in the course of this work that identifies critical points and junctures in the life of regulatory agencies where there is potential for greater undue influence.

Agency finances, staff behaviour, the appointment and removal of leadership, the way in which agency intersects with political cycles, and the interaction with the various actors in the regulatory sphere are “pinch points” specific to the regulator’s environment. They can be amplified when two or more events occur at the same time. An example might be a political election coinciding with a rise in crude oil prices and a change in the head of the agency. It is at these critical points where opportunities for exercising undue pressure and influence on the regulator can be stronger and therefore action needs to be taken in order to safeguard regulators against such undue pressure and influence. Figure A.1 presents a hypothetical case of how a culture of independence can rise (as shown in the figure) at each of these pressure points if adequate safeguards are in place to enhance such culture of independence. The guidance takes into consideration these “pinch points” and the practical guidelines presented here are meant to help regulators remain on an upward path in terms of developing a culture of independence (Figure A.1).

Figure A.1. Pinch-point analysis of undue influence

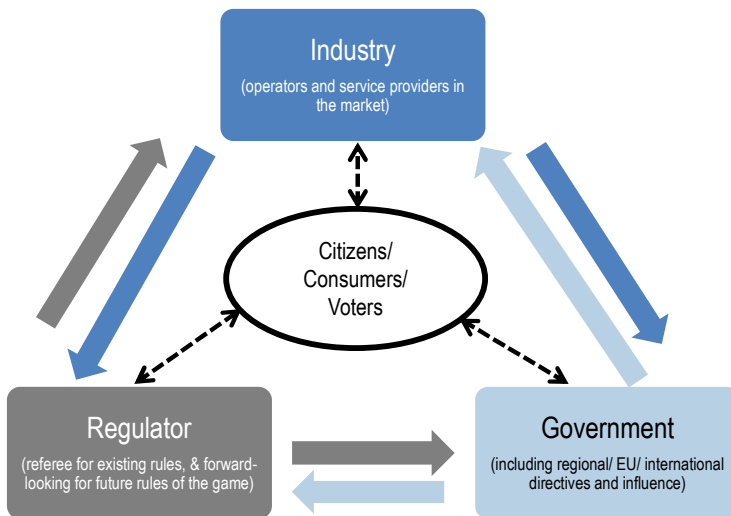


*Note:* The trend of independence can be positive or negative overtime and where there is congruence of events there can be greater avenues for undue influence.

*Source:* Naru, F. and F. Cavassini, OECD, forthcoming.

The “pinch-point analysis” has been further developed through a detailed analysis of the operational and behavioural signals for acting independently, through case studies on the actual practices of regulators in relation to accountability, transparency and co-ordination (OECD, 2016b) and the application of the OECD’s Performance Assessment Framework of Economic Regulators (PAFER) to peer reviews of economic regulators in Colombia, Mexico, Latvia (OECD, 2015; OECD, 2017; OECD, 2016c). This analysis and additional evidence has brought home the complexity and daily interactions and relationships between actors in the regulated market. It has shown the importance of, for instance, considering the financing and staffing of regulatory agencies as well as the information and communication mechanisms between regulators and government and between regulators and industry with the central role of citizens, who are also end-users, that relationship (Figure A.2). In this relationship, the perception of proximity can negatively affect the capacity of the regulator to act independently. For instance, making the nomination process more transparent can help recruit chairs and agency heads who have the necessary technical skills and credibility to enhance the performance of the regulator. These institutional arrangements would not only make the agency or body more effective but also signal the willingness to protect the regulator from undue influence. This signal is the condition for nurturing a culture of independence that enables the regulator to behave and act independently.

Figure A.2. **External governance: Interactions and relationships between actors in the regulated market/sector**



Source: Naru, F. and F. Cavassini, OECD, forthcoming.





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## The Governance of Regulators

# Creating a Culture of Independence

## PRACTICAL GUIDANCE AGAINST UNDUE INFLUENCE

Good regulatory outcomes depend on more than well-designed rules and regulations. They also require bodies to administer these rules to ensure that the right policy outcomes are realised. Regulators are at the delivery end of the policy cycle, where they oversee sectors and markets that provide essential services to citizens. The governance of regulators helps ensure that regulatory decisions are credible and inspire confidence.

Regulators are the “referees” of markets that provide essential services to citizens; they guarantee that all actors respect the rules and work to achieve the best outcomes. This means that their behaviour must be objective, impartial, consistent and free from conflict of interest – in other words, independent. Yet, regulators need to engage with a number of stakeholders, who may also seek to apply pressure and exert undue influence on regulatory outcomes. The independence of regulators is thus constantly under stress. This report provides practical advice on how to address stress points and protect economic regulators from undue influence, drawing on the experience of over 80 regulators that participate in the OECD Network of Economic Regulators (NER). It presents a practical checklist to support behavioural and organisational change, and helps other stakeholders better understand and appreciate the role of regulators and how to interact with them.

[www.oecd.org/gov/regulatory-policy/ner.htm](http://www.oecd.org/gov/regulatory-policy/ner.htm)

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