ETHICS IN BUSINESS PRACTICE AND REGULATION

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Executive Summary

This paper explains how empirical evidence from behavioural psychology and responsive regulatory practice have identified the importance of ethics in regulatory activities—on the part of both regulators and businesses—and what steps should logically be taken by government, regulatory bodies, businesses and others to adopt, support and incentivise ethical approaches to a regulatory system that is founded on ethical values. It draws on the author's recent extensive analysis in this field.[2]

Why regulatory compliance is supported by encouraging people to behave ethically

Research into behavioural psychology has identified a number of important findings on why people observe or break rules. We now know many reasons why people may fail to observe a rule, notably because of inertia, procrastination, the influence of others especially social groups, mis-framing of issues, mistakes in assessing probability, not knowing exactly what to do, and so on.[3]

Decisions are made by people rather than by organisations, although the structures, systems, objectives, culture and incentives that operate within organisations can affect the decisions made by the people who work in them. The focus of achieving compliance with laws should, therefore, be on affecting both the behaviour of individuals and the organisational environment.

The essential findings of the behavioural research are that people obey rules where:[4]
    a. The rule corresponds to their internal moral value system;
    b. The rule has been made fairly; and
    c. The rule is applied fairly.[5]

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[2] CJS Hodges, *Law and Corporate Behaviour*: *Integrating Theories of Regulation and Enforcement* (Hart Publishing, 2015). See also C Hodges, *Ethical Business Practice: Understanding the Evidence* (Better Regulation Delivery Office, 2016). The author is grateful for comments on a draft by Graham Russell, Helen Kirkman, Ruth Steinholtz and Richard Thomas CBE.

[3] See generally T Gilovich, D Griffin, and D Kahneman (eds), *Heuristics and Biases: The Psychology of Intuitive Judgment* (Cambridge University Press, 2002); D Kahneman and A Tversky (eds), *Choices, Values, and Frames* (Cambridge University Press, 2000).

[4] L Friedman, *The Legal System: A Social Science Perspective* (Russell Sage Foundation, 1975), 105-13; RA Kagan, N Gunningham and D Thornton, 'Fear, duty, and regulatory compliance: lessons from three research projects' in C Parker and VL Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2012).

Each one of these findings is based on the concept of *fairness*. In other words, ethics is central to people's observance of rules, and an advanced contemporary society that seeks to maximise compliance with its rules cannot avoid basing both the substance of its rules and the way they are made and applied on the sound ethical principles that are followed by that society. Basing regulatory and compliance systems on ethical norms and practice will, therefore, be essential for success. Equally, where actions are driven by dishonest, unscrupulous or wilful motives, the identification of such actions and the imposition of meaningful and proportionate sanctions is required.

Thus, it will be important to align the ethical values of individuals, work groups and businesses with those of the wider society in which they exist. Reaching and maintaining consensus on what the society regards as ethical gives rise to a need for ethical education, and ongoing discussions, reminders, and checks. The substance of the 'rules of the game' should be agreed as being fair, expressing the essential values of the society. Making rules by a fair procedure will mean requiring fully enfranchised involvement, open and predictable processes, full notice of proposals, and adequate opportunities for public consultation, analysis and debate before decisions are made. Applying rules fairly will mean ensuring that that wrongdoing is identified, and that responses to wrongdoing are applied proportionately, fairly, and consistently.

It follows that the design and operation of a regulatory system will be most effective where it adopts the following principles:

1. **A policy of supporting ethical behaviour.** The regulatory system will be most effective in affecting the behaviour of individuals where it *supports ethical and fair behaviour*.

2. **Ethical regulators.** Regulators should—self-evidently—adopt unimpeachable, consistent and transparent ethical practice.

3. **Ethical businesses.** Businesses should be capable of demonstrating constant and satisfactory evidence of their *commitment to fair and ethical behaviour* that will support the *trust* of regulators and enforcers, as well as of employees, customers, suppliers and other stakeholders.

4. **A learning culture.** A blame culture will inhibit learning and an ethical culture, so businesses and regulators should encourage and support an essentially *open* collaborative '*no blame*' culture, save where wrongdoing is intentionally or clearly unethical.

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[5] J Darley, TR Tyler and K Bilz, 'Enacting justice: the interplay of individual and institutional perspectives,' in M Hogg and J Cooper (eds), *The SAGE Handbook of Social Psychology* (Sage, 2003); JT Jost and B Major (eds), *The Psychology of Legitimacy* (Cambridge University Press, 2001); TR Tyler, *Why People Obey the Law* (Yale University Press, 2006); TR Tyler and SL Blader, *Cooperation in Groups: Procedural Justice, Social Identity, and Behavioral Engagement* (Psychology Press, 2000); TR Tyler and SL Blader, 'Can businesses effectively regulate employee conduct? The antecedents of rule following in work settings' (2005) 48 *Academy of Management Journal* 1143; J Jackson, B Bradford, M Hough, A Myhill, P Quinton and TR Tyler, 'Why Do People Comply with the Law? Legitimacy and the Influence of Legal Institutions' (manuscript, 2013).

5. **A collaborative culture.** Regulatory systems need to be based on collaboration if they are to support an ethical regime, and to *maximise performance*, compliance, and innovation.

6. **Proportionate responses.** Where people break rules or behave immorally, people expect to see a *proportionate response*.

We will now examine how each of these points could be realised in practice. Each point in fact links with all of the others, so the approach needs to comprise all of them if it is to be successful.

1. A policy of supporting ethical behaviour

A regulatory *system* should encourage and support ethical behaviour by all participants—regulators, traders, customers, scrutineers and stakeholders. It should adopt the right culture, incentives and actions that support, and do not hinder, efforts by individuals and organisations to behave ethically. For example, the enforcement strategies and practices of legislators, regulators, prosecutors and courts—as well as businesses internally—should promote and recognise business commitment to an ethical approach. A considerable amount of work has been done on furthering this approach in various contexts.[6]

Imposing a punitive response to non-compliance that arises despite ethical behaviour would be counter-productive. An example of an agreement between regulators and businesses that could be extended to include ethical aspects is the Primary Authority scheme, which involves constructive, legally-recognised partnerships between a business and a nominated local authority, enabling the provision of reliable advice to business and arrangements for coordinated and consistent enforcement.[7]

It will be important to influence both individual and group behaviour. The culture of an organisation is a vital component. Many reports following the financial services crisis in 2008 noted the inadequacy of responding by imposing a multitude of rules whilst ignoring the need to create and nurture an ethical culture within banks.[8] Since then, however, the extensive

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[6] Recent examples include the Food Standards Agency's 'Food We Can Trust' initiative, which includes the principle that 'Businesses doing the right thing for consumers should be recognised; action will be taken against those that do not'; and OFGEM's emphasis on a culture of treating customers fairly: see *Consultation: The future of retail market regulation* (OFGEM, 2015).

[7] The primary authority scheme was created under the Regulatory Enforcement and Sanctions Act 2008, and amended by the Enterprise and Regulatory Reform Act 2013, s 67. It commenced on 6 April 2009 under the Regulatory Enforcement and Sanctions Act 2008 (Commencement No 1) Order 2008, SI 2371/2008. The primary focus is on provision of advice and guidance to businesses. Inspection plans may also be developed by the primary authority, which is required to consult the business, and the plan takes effect after it is approved by the Better Regulation Delivery Office, under the Enterprise and Regulatory Reform Act 2013, ss 67, 68. Trade associations can provide assistance to their members, thereby playing significant self-regulatory roles in the architecture of the scheme: see Enterprise Bill.

[8] *Toward Effective Governance of Financial Institutions* (Group of 30, 2012); *Investing in Integrity. The Lord Mayor's Conference on Trust and Values* (City Values Forum, 2012); *A New Paradigm. Financial Institution Boards and Supervisors* (Group of 30, 2013); *The FCA's approach to advancing its objectives* (FCA, 2013); *The*

imposition of new regulation has prompted a demand for increased certainty through *more* rules and prescription, reducing the ability of individuals on the front line to think for themselves and diminishing their power and responsibility to act responsibly.

2. Ethical Regulators

It is axiomatic that all regulators need to ensure that they are themselves demonstrably and consistently adopting the highest ethical standards. This follows inevitably from the well-established criteria of integrity and independence that are essential to maintain the legitimacy of their mandate. Public authorities represent the state and the public. A society that claims to be based on ethical principles should be able to trust that its agents act in accordance with its values.[9] It also, therefore, follows that the higher their standards, the better able public officials should be to encourage businesses to embrace ethical conduct as a route to compliance, and the greater the perception of acceptability of their regulatory and enforcement actions. Put another away, if the reputation of a regulator falls below acceptable standards, there is far less hope that businesses will take seriously either the authority of that regulator or ethical conduct in general.

The requirement for regulators to be accountable leads to the need for them to welcome feedback and complaints to help them improve. This means robust mechanisms need to be in place in relation to how to build trust and listen to feedback, and businesses need to trust that they can use them. Further, applying the concept of fairness to a system of risk-based regulation requires that a regulator should focus effort on those who deserve it.

3. Ethical Business

A business that behaves ethically will adopt ethical business practices in everything that is done throughout the organisation.[10] Codes on individual aspects, such as marketing and grading (treating customers fairly), production, waste, or social responsibility, are not enough: the approach has to be holistic. It has to be led from the top, but also to exist in practice at every level of the organisation and in its multiple social groups. Studies on the causes of sustained long-term business success have concluded that it is critical to establish clear *core values*, which are shared by *all* members of the workforce, and form an ideology that is enduring and able to be applied consistently in different trading and geographical circumstances, whilst operational goals are constantly examined and developed.[11] This type of culture will generate ideas for improvement (innovation), in which complaints are treated

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Salz Review of Barclays' Business Practices report to the Board of Barclays PLC. (2013), para 2.4; *A report on the culture of British retail banking* (New City Agenda and Cass Business School, 2014).

[9] *OECD Best Practice Principles for the Governance of Regulators* (OECD, 2013).

[10] C Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation and Enforcement* (Hart Publishing, 2015).

[11] J Collins and JI Porras, *Built to Last: Successful Habits of Visionary Companies* (12th ed, HarperCollins, 2005); R Barrett, *The Values-Driven Organization* (Routledge, 2014); J Mackey and R Sisoda, *Conscious Capitalism: Liberating the Heroic Spirit of Business* (Harvard Business Review Press, 2014); F Laloux, *Reinventing Organizations* (Nelson Parker, 2014).

as welcome feedback or gifts,[12] lessons are applied, and things put right when they have gone wrong.

Philosophers[13] and business scholars[14] have emphasised the critical importance of trust, and the need to construct mechanisms by which an independent judgment may be made of whether an expectation of ethical behaviour can apply to counter-parties, regulatory scrutiny, stakeholder expectations, and organisations' internal arrangements. It has long been said that trust has to be based on *ethical* values.[15] There is ample evidence that behaving ethically is not inconsistent with making profits: and there are many recent examples where questionable activities have damaged reputation (recently, for example, VW and fraud in emissions, Tesco and late farmers' payments, various multinationals and fair tax payments, FIFA and IAAF and bribery, and banks and mis-selling and LIBOR). But ethical behaviour does require a particular approach to how commercial activities are undertaken. Achieving that approach may require particular structures to support ethical decisions and culture.

It is essential to provide ongoing *evidence of trust* that an organisation operates on ethical values, to support independent judgment on whether an expectation of ethical behaviour is warranted.[16] Mere claims by an organisation that it can be trusted will clearly not suffice. Mechanisms should be designed to produce reliable evidence of trust. This may include aspects such as: a deep and consistent adherence to ethical principles; a high proportion of satisfied customers; consistent application of compliance systems and audits; transparency; ethical governance structures; belonging to an external professional structure that has high ethical principles and provides ongoing training, help lines, auditing and sanctions; obtaining feedback such as through staff and customer mechanisms or ombudsmen; effective use of internal Ethics Ambassadors;[17] and structures enabling decisions to be debated to test ethical compliance, evaluated against external views, and made transparent. These sources of evidence will be mutually reinforcing, so as to provide density.[18]

It is a requirement for placing trust that a business is not seen to place the self-interest of any of its shareholders, directors or staff above any of other group, or of customers, suppliers or society. The approach is a development of Corporate Social Responsibility, which has itself

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[12] K Evans, *"Using the Gift of Complaints": A Review of Concerns (Complaints) Handling in NHS Wales* (Welsh Government, 2014).

[13] O O'Neill, 'Trust, Trustworthiness, and Accountability' in N Morris and D Vines (eds), *Capital Failure; Rebuilding Trust in Financial Services* (Oxford University Press, 2014), 178.

[14] TM Jones, 'Ethical Decision Making by Individuals in Organizations: An Issue-Contingent Model' (1991) 16(2) *Academy of Management Review* 366.

[15] Aristotle, *Nicomachean Ethics, Book I* trans JAK Thompson (Penguin Books, 1978), 90; A MacIntyre, *After Virtue* (Gerald Duckworth & Co, 1981); S Hauerwas, *A Community of Character: Towards a Constructive Christian Social Ethic* (University of Notre Dame Press, 1981).

[16] O O'Neill, 'Trust, Trustworthiness, and Accountability' in N Morris and D Vines (eds), *Capital Failure; Rebuilding Trust in Financial Services* (Oxford University Press, 2014), 178; TM Jones, 'Ethical Decision Making by Individuals in Organizations: An Issue-Contingent Model' (1991) 16(2) *Academy of Management Review* 366.

[17] R Steinholtz, 'Ethics Ambassadors: Getting under the skin of the business' (2014) *Business Compliance* 16.

[18] CA Heimer, 'Explaining variation in the impact of law: organizations, institutions, and professions' (1996) 15 *Studies in Law, Politics and Society* 29, 37.

developed from the need of businesses to engage with internal and external stakeholders.[19] The UK government launched a wider initiative on social responsibility in 2014.[20] Enlightened financial regulators across the world have accepted that external regulation cannot be relied on to affect all behaviour, and that what is more important is the personal and group values of the human actors and the ethical culture of their organisational groups.[21] The goal of 'maximising shareholder value', which has permitted some managers and shareholders to hold other stakeholders to ransom,[22] has to be balanced with other social values, given firms' social licence to operate.[23] Mayer points out that shareholder value is an outcome, not an objective, and calls for a shift in general corporate organisation to enshrine a business' ethical values in its operations, guarded by a board of trustees that can overrule managers, such as on the German model.[24]

4. A Learning Culture

The regulatory systems in which learning and maintenance of performance is critically important—such as civil aviation,[25] pharmacovigilance, workplace health and safety—approach 'regulation' as a behavioural system to support people making the right decisions through constant feedback and learning. The approach is based on the recognition

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[19] Communication *A renewed EU strategy 2011-14 for Corporate Social Responsibility* COM(2011) 681, 25.10.2011. J Ruggie, *The Special Representative of the Secretary-General, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational business corporations and other business enterprises, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, A/HRC/17/31, 21 March 2011. See JL Campbell, 'Why would corporations behave in socially responsible ways? An institutional theory of corporate social responsibility' (2007) 32(2) *Academy of Management Review* 946; J Eijsbouts, *Corporate responsibility, beyond voluntarism. Regulatory options to reinforce the licence to operate' Inaugural lecture* (Maastricht University, 2011).

[20] *Corporate responsibility. Good for business and society: government response to call for views on corporate responsibility* (Department for Business Innovation & Skills, 2014).

[21] *Toward Effective Governance of Financial Institutions* (Group of 30, 2012); *Investing in Integrity. The Lord Mayor's Conference on Trust and Values*, City Values Forum, October 2012; *A New Paradigm. Financial Institution Boards and Supervisors* (Group of 30, 2013); C Adamson, 'The importance of culture in driving behaviours of firms and how the FCA will assess this', speech by Director of Supervision at the CFA Society UK Professionalism Conference, 19 April 2013; *The Salz Review of Barclays' Business Practices report to the Board of Barclays PLC* (2013), para 2.4; *A report on the culture of British retail banking* (New City Agenda and Cass Business School, 2014); M Carney, Speech 'The future of financial reform', 2014 Monetary Authority of Singapore Lecture, 17 November 2014; J Shipton, *Integrity in Financial Markets – Challenges from Asia*, Speech to the FCA International Regulators' Seminar, London, 24 November 2014.

[22] L Stout, *The Shareholder Value Myth* (Berrett-Koehler Publishers, 2012); C Mayer, *Firm Commitment* (Oxford University Press, 2012).

[23] T Donaldson, *Corporations and Morality* (New Jersey, 1982). See also SC de Hoo, *In pursuit of corporate sustainability and responsibility: past cracking perceptions and creating codes* Inaugural Lecture Maastricht University, 2011, 11, referring to the principle of reciprocity, also a corporate social contracts based approach.

[24] C Mayer, *Firm Commitment: Why the corporation is failing us and how to restore trust in it* (Oxford University Press, 2013), 167.

[25] *The transformation to performance-based regulation* (Civil Aviation Authority, 2014), 1.

that both human error and system error are unavoidable,[26] that multiple descriptions of events are plausible, so that finding truth so as to make changes in how things are done requires multiple inputs.[27]

A critical issue is to identify *why* a hazard occurred, what factors (environmental, organisational, human, cultural etc.) were potential causative factors, and how the risk of a similar event occurring again can be reduced. If one human acted in a way that produces an adverse consequence, how could the risk that others in a similar situation would make the same mistake be reduced or avoided? This recognises that no system will be able to prevent every adverse event from occurring. The focus should be on constant monitoring and learning from events so as to improve performance and reduce risk.

However, individuals will not volunteer information if they fear attracting criticism or blame.[28] So it is essential—in the absence of serious wrongdoing—to encourage an 'open culture' of sharing and questioning, rather than a 'blame culture'.[29] There is an increasing public emphasis on 'manifestation of a more open culture.'[30] Put simply, in a blame culture we are not learning to improve. If we want to learn and improve, the default approach has to eradicate blame and substitute open sharing of all relevant information. Such an approach could have been applied in financial services by triggering review of simple questions such as 'Is this practice ethical?', 'Is this product in the best interests of the customer?' or 'Does this customer need this product?' It is an approach that could transform the NHS. However, if a no blame culture is to be successful, blame has to be removed from *all* of the relevant contexts within which people work: regulation (of entities, systems and professionals), employment, liability and social. Essentially, blame is replaced by a collaborative approach to problem-solving, rather than an adversarial relationship between individuals in the organisation as well as with regulators. Individual accountability is not removed but means a responsibility constantly and openly to share all relevant information. Where that sharing ethic exists, failure to share is a serious social transgression, 'enforced' socially.

An approach based on learning and improvement supports a coordinated intra-company and external-regulatory response to problems that—instead of blaming—proceeds through the following steps: openly clarifying all the facts; full investigation to identify what went wrong and how to reduce the risk that any human in a similar situation would repeat the undesired behaviour; implementing such responsive measures by all relevant actors; redressing any

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[26] D McCune, C Lewis and D Arendt, 'Safety Culture in Your Safety Management System' in AJ Stolzer, CD Halford and JJ Goglia (eds), *Implementing Safety Management Systems in Aviation* (Ashgate, 2011), 138.

[27] S Dekker, *Just Culture. Balancing Safety and Accountability* (Ashgate Publishing, 2007), ix.

[28] For recent assertions on this point in the HGS see *Building a culture of candour: A review of the threshold for the duty of candour and of the incentives for care organisations to be candid* (Royal College of Surgeons of London, 2014); *A review into the quality of NHS complaints investigations where serious or avoidable harm has been alleged* (Parliamentary and Health Service Ombudsman, December 2015).

[29] Regulation (EU) No 996/2010. See RL Helmreich, 'Building safety on the three cultures of aviation' in *Proceedings if the IATA Human Factors Seminar* (Bankkok, 1999), 39; D McCune, C Lewis and D Arendt, 'Safety Culture in Your Safety Management System' in AJ Stolzer, CD Halford and JJ Goglia (eds), *Implementing Safety Management Systems in Aviation* (Ashgate, 2011).

[30] Committee on Standards of Public Life, 'Getting the balance right: implementing standards in public life', Tenth Report of the Committee on Standards in Public Life, 2005, para 4.31.

harm caused; imposing professional, employment and public sanctions that respond to the degree of moral fairness. Transparency is one of the features of ethical environments.

5. A collaborative culture

In order to learn and trust, it is important that regulators and businesses *collaborate*, rather than having an adversarial and distanced relationship. The approach should be 'Business plus regulator against the problem' as opposed to 'Regulator v business **is** the problem'. Such collaboration needs to be transparent to outsiders, who should see that lessons are constantly being learned, as a result of openly sharing and evaluating information and applying the conclusions.

The starting point is for regulators and businesses to agree on what compliance looks like. For example, if there is no shared understanding on interpretation of the rules, they are not capable of being applied fairly. This may involve agreeing guidance. It would be necessary to make sure that all those subject to the rules are aware of them and understand them. This may involve agreeing how that is to be done.

Both systems for business management, compliance and risk,[31] and for regulation, involve essential mechanisms based on circulation of information so as to monitor performance, identify risks and make improvements. Examples of regulatory information systems are the pharmacovigilance system from medicines,[32] the RAPEX system for general product safety,[33] the 'safeguard procedure'[34] and post-marketing surveillance system for engineered products,[35] and 'RIDDOR' legislation for workplace health and safety.[36] European Commission's 2013 'Effective Open Voluntarism' initiative frames effective voluntary multi-

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[31] BJ Schoordijk , 'Risk management alshoeksteen van corporate governance' in SHA Dumoulinea (ed), *Tussen Themis en Mercurius*, BedrijfsjuridischebijdragenaaneenEuropesebeleidsconcurrentie, LustrumuitgaveNederlandsGenootschap van Bedrijfsjuristen (Kluwer, 2005), 309-329; DAMHW Strik, 'Deel II – Aansprakelijkheidvoorfalendrisicomanagement', in *Ondernemingsbestuur en risicobeheersing op de drempel van eennieuw decennium: eenondernemingsrechtelijkeanalyse*, Preadvies van de Vereeniging 'Handelsrecht' 2009 (Kluwer, 2009); J Eijsbouts, *Corporate responsibility, beyond voluntarism. Regulatory options to reinforce the licence to operate* (Inaugural lecture, Maastricht University, 2011).

[32] Directive 2001/83/EC on the Community code relating to medicinal products for human use. Extensive guidelines see are at Volume 9A of the Rules Governing Medicinal Products in the European Union: Guidelines on Pharmacovigilance for Medicinal Products for Human Use, which includes guidelines for competent authorities and the EMEA at Part II.

[33] Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93.

[34] Decision No 768/2008/EC, Annex I, art R32.

[35] Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the implementation of Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93, COM(2013) 77, 13.2.2013, para 2.3.

[36] The Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013, SI 2013/1471.

stakeholder action, in the context of a wide range of voluntary and self- and co-regulation processes, and 'profound world-wide patterns of change'.[37]

The objective here should be to improve outputs through combining public regulatory and business compliance systems in structured, supervised co-regulatory structures. Many examples of co-regulation already exist in the UK, such as in advertising, pharmaceutical promotion, financial lenders, franchising, and the business codes of many sectors.[38] In respect of local authority regulation, the Primary Authority scheme embeds collaboration through individual agreements within which the separate and complementary efforts of business and regulator are recognised.

Such co-regulatory structures can be developed to include commitment to ethical behaviour and mechanisms that generate the evidence to support a relationship of trust. Agreements can include commitments by businesses or their representatives to shoulder responsibility for significant elements of inspection and education, whilst sharing information, so that the regulator is better informed and may act in a supervisory and strategic oversight, whilst retaining the ability to intervene where necessary, backed by the ability to impose behavioural controls and sanctions where necessary. The existence and operation of the collaborative relationship must be fully transparent, allowing workers, customers, suppliers and others to see evidence of how the system operates, to monitor the accurate and reliable performance of each task, and to support earned recognition and hence trust.

6. Fair and proportionate responses

An ethical and fair culture, whether within an organisation or in a regulatory regime, has to be seen to respond to problems and wrongdoing by distinguishing between people who are basically trying to do the right thing and those who are not—essentially an issue of motivating intention. It is important that enforcement responses should be *fair and proportionate*. Part of this is ensuring that the responsibility is attributed to the highest relevant level of management within an organisation, rather than the foot soldier who may be a victim of the system or of wilfully blind or 'immoral' management. This approach accords with the concept of 'responsive regulation'.[39] Further, if people engage in criminal activity, people expect to see the law upheld and for there to be a proportionate response. Serious wrongdoing deserves a serious response to protect society and to uphold its values. But where people have been trying to do the right thing, or have been generally, but not wilfully,

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[37] DG INFSO *Consultation about a Code for Effective Open Voluntarism* (2012)

[38] The Advertising Standards Authority and its Advertising Codes; Code of Practice for the Pharmaceutical Industry; the Lending Standards Board; the Lending Standards Board; Consumer Codes Approval Scheme: Core Criteria and Guidance, at http://www.tradingstandards.gov.uk/advice/ConsumerCodes.cfm.

[39] I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992); N Gunningham and P Grabosky, *Smart Regulation: Designing Environmental Policy* (Oxford University Press, 1998); see also N Gunningham, 'Enforcement and Compliance Strategies' in M Cave, R Baldwin, M Lodge (eds), The Oxford Handbook of Regulation (Oxford University Press, 2010); J Black, '*Critical reflections on regulation*,' (2002) 27 *Australian Journal of Legal Philosophy* 1; C Parker, *The Open Corporation: Effective Self-regulation and Democracy* (Cambridge University Press, 2002); J Black and R Baldwin, 'Really Responsive Regulation' (2008) 71(1) *Modern Law Review* 59.

ignorant about how to do things, adopting a punitive response would be seen as unfair, and hence would undermine general willingness to comply.

The limited effectiveness of deterrence

The supportive approach contrasts with the traditional idea that the rationale and purpose of enforcement is deterrence. The basic idea of deterrence that is a person will obey the law because of fear that a breach will be punished, so it is better to conform than suffer. A variation of deterrence in economic theory is the assumption that all decisions are taken on the basis that deciders calculate (objectively, rationally and amorally)[40] the costs and benefits of all their actions,[41] and will therefore be incentivised to take decisions on the basis that the external adverse costs of harm that flow from a decision will be internalised through legal processes,[42] so that the rational calculation will be that it is cheaper to comply than to infringe.[43]

Empirical evidence and behavioural psychology have strongly challenged the theories outlined above that deterrence and economic rational action in fact produce significant effect on behaviour, whether of individuals or organisations. For example, as noted above, individuals are not skilled at assessing risk, and do not make every decision on the basis of maximising personal net gain.

Behavioural psychology supports two key findings here. First, increasing the severity or certainty of punishment alone in fact results in only modest, if any, increases in deterrence.[44] In the criminal sphere, social control strategies based exclusively on a rational choice and deterrence model have had at best limited success,[45] and leading criminologists stress the

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[40] R Kagan and J Scholz, 'The 'Criminology of the Corporation' and Regulatory Enforcement Styles' in K Hawkins and J Thomas (eds), *Enforcing Regulation* (Kluwer-Nijhoff, 1984), 67-95.

[41] M Allingham, *Rational Choice* (St. Martin's Press Inc., 1999); MS Archer and JQ Tritter, *Rational Choice Theory: Resisting Colonization* (Routledge, 2001).

[42] AC Pigou, *The Economics of Welfare* (Macmillan, 1920), 168-71.

[43] G Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economy* 169; GJ Stigler, 'The Theory of Economic Regulation' (1971) 2 *Bell Journal of Economics and Management Science* 3; M Faure, A Ogus and N Philipsen, 'Curbing consumer financial losses: the economics of regulatory enforcement' (2009) 31 *Law & Policy* 161.

[44] LS Beres & TD Griffith, 'Habitual Offender Statutes and Criminal Deterrence' (2001) 34 *Connecticut Law Review* 55, 59; see I Ehrlich, 'Crime, Punishment, and the Market for Offenses' (1996) 10 *Journal of Economic Perspectives* 43, 55-63 (surveying the research on the question); PW Greenwood et al., *Three Strikes and You're Out: Estimated Benefit and Cost of California's Mandatory New Sentencing Laws* (RAND Corporation, 1994) 16. But see D Kessler & SD Levitt, 'Using Sentence Enhancements to Distinguish Between Deterrence and Incapacitation' (1999) 42 *Journal of Law & Economics* 343. **Association studies:** DP Farrington, PA Langan and P-O Wikström, 'Changes in Crime and Punishment in America, England and Sweden between the 1980s and 1990s' (1994) 3 *Studies in Crime and Crime Prevention* 104; D Nagin, 'Criminal Deterrence Research at the Outset of the Twenty-first Century' in M Tonry (ed), *Crime and Justice: A Review of Research* (University of Chicago Press, 1998). **Meta-analysis**: TC Pratt, FT Cullen, KR Blevins, LE Daigle and TD Madensen, 'The Empirical Status of Deterrence Theory: a Meta-analysis', in FT Cullen, JP Wright and KR Blevins (eds), *Taking Stock: The Status of Criminological Theory* (Transaction Publishers, 2006).

[45] See generally T Brooks (ed), *Deterrence* (Ashgate, 2014) (debates continue over whether it is even possible); DS Nagin, 'Criminal Deterrence Research at the Outset of the Twentieth Century' (1998) 23 *Crime and Justice*

'importance of linking the deterrence (or rational choice) perspective with theories that rely on other types of control mechanisms' in society (especially normative attachments).[46]

Second, the idea that a person will obey a rule out of fear of being punished has been shown to be effective only where an individual *perceives* there to be a *high risk that he will be identified*, from which he will suffer embarrassment and loss of reputational esteem.[47] That perception can apply in some situations (where there is high surveillance, such as international nuclear strikes, where average speed limits are visibly measured by digital cameras, or where effective anti-plagiarism software is known to be used). However, achieving that perception consistently in relation to all human—or just commercial—activities, and also assembling necessary evidence, would be prohibitively expensive.

Further, the fundamental cultural values of Anglo-Saxon and European democratic states are based on respect for individuals and social solidarity. Those values should be supported by state officers as an approach to behaviour, whether in business, public or social life. Accordingly, ruling by fear in a modern democracy is an unacceptable and arguably unconstitutional policy. Continuous surveillance of behaviour and enforcement by authoritarian regimes tends to be accusatory, confrontational, punitive and coercive and produces a culture of mistrust and resentment.[48] There is overwhelming evidence from Cold War Communist states of cultures involving entire populations living in constant fear of

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1 (review of the literature); M Tonry, 'Learning from the Limitations of Deterrence Research' (2008) 37 *Crime & Justice* 279.

[46] TC Pratt, FT Cullen, KR Blevins, LE Daigle and TD Madensen, 'The Empirical Status of Deterrence Theory: A Meta-analysis' in FT Cullen, JP Wright and KR Blevins (eds), *Taking Stock: The Status of Criminological Theory* (Transaction Publishers, 2006), 385. See P-O Wikström, 'Deterrence and Deterrent Experiences: Preventing Crime Through the Threat of Punishment' in SG Shoham, O Beck and M Kett (eds), *International Handbook of Penology and Criminal Justice* (CRC Press, 2008); M Tonry, 'Learning from the Limitations of Deterrence Research' in M Tonry (ed), *Crime and Justice: A Review of Research* (University of Chicago Press, 2009) 37, 279.

[47] A recent overview is A Bottoms and A von Hirsch, 'The Crime-Preventive Impact of Penal Sanctions' in P Cane and HM Kritzer, *The Oxford Handbook of Empirical Legal Research* (Oxford University Press, 2010), 104. FH Easterbrook, 'Criminal Procedure as a Market System' (1983) 12 *Journal of Legal Studies* 289, 295 and n7; R MacCoun, 'Drugs and the law: a psychological analysis of drug prohibition' (1993) 113 *Psychological Bulletin* 497; DP Farrington, PA Langan and P-O Wikström, 'Changes in Crime and Punishment in America, England and Sweden between the 1980s and 1990s' (1994) 3 *Studies in Crime and Crime Prevention* 104; PH Robinson and J Darley, *Justice, Liability and Blame* (Westview, 1995); PH Robinson and J Darley, 'The utility of desert' (1997) 91 *Northwestern University Law Review* 453; D Nagin, 'Criminal Deterrence Research at the Outset of the Twenty-first Century' in M Tonry (ed), *Crime and Justice: A Review of Research* (University of Chicago Press, 1998); PA Langan and DP Farrington, *Crime and Justice in the United States and England and Wales, 1981-96* (Bureau of Justice Statistics, 1998); HL Ross, *Deterring the Drinking Driver* (Lexington Books, 1982); PH Robinson and JM Darley, 'The Role of Deterrence in the Formulation of Criminal Law Rules: At Its Worst when Doing Its Best' (2003) 91 *Georgetown Law Journal* 949, 953-56; A Blumstein, 'Prisons' in JQ Wilson & J Petersilia (eds), *Crime* (Institute for Contemporary Studies Press, 1995) 387, 408-09. See also M Miller, *Director Leadership of Health and Safety* (Health & Safety Laboratory, 2005), iv.

[48] B Hutter, 'Regulating Employers and Employees: Health and Safety in the Workplace' (1983) 20 *Journal of Law and Society* 452; B Hutter, *Regulation and Risk: Occupational Health and Safety on the Railways* (Oxford University Press, 2001).

spies, surveillance and informers.[49] If a repressive and deterrent approach is adopted towards people who think that they are trying to get things right, it will reduce their willingness to comply and collaborate, and there is little evidence that it will induce them to ensure that their future behaviour complies with the rules. In contrast, imposing a serious sanction would be both a proportionate response to serious wrongdoing and may also be the right response to psychopathic or sociopathic offenders.

Supportive and responsive regulation

In contrast to the deterrent approach to *enforcement*, there is now a significant body of evidence that enforcers in a wide range of regulated environments seek to maximise *compliance and performance* based on supporting rather than blaming. Evidence has been assembled from careful research into regulation of care homes for the elderly,[50] water pollution,[51] occupational health and safety and environmental control and also railway safety,[52] environmental protection,[53] the mining industry,[54] manufacturing in Thailand,[55] and food businesses,[56] a range of Australian agencies,[57] Danish farming,[58] and UK fish protection.[59] Similarly, research by different agencies found that small and medium sized businesses (SMEs) believe that they are complying until a person they respect points out that they could improve, in response to which advice they usually follow the advice.[60] That person

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[49] M Glennie, *The Balkans: Nationalism, War and the Great Powers, 1804-1999* (Penguin Books, 1999); M Glennie, *The Rebirth Of History: Eastern Europe in the Age of Democracy* (Penguin Books, 1990); D Galligan and M Kurkchiyan, *Law and Informal Practices: The Post-Communist Experience* (Oxford University Press, 2003), T Judt, *Postwar: A History of Europe Since 1945* (London, William Heinemann, 2005).

[50] Summarised in the seminal work: I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

[51] K Hawkins, *Environment and Enforcement: Regulation and the Social Definition of Pollution* (Clarendon Press, 1984); K Hawkins, *Law as Last Resort* (Oxford University Press, 20902).

[52] H Genn, 'Business responses to the regulation of health and safety in England' (1993) 15 *Law and Policy* 219; BM Hutter, *Compliance: Regulation and Environment* (Clarendon Press, 1997); BM Hutter, *Regulation and Risk: Occupational Health and Safety on the Railways* (Oxford University Press, 2001).

[53] P Grabosky, 'Beyond the Regulatory State' (1994) 27(2) *Australian and New Zealand J of Criminology* 192; P Grabosky, 'Green Markets: Environmental Regulation by the Private Sector' (1994) 16(4) *Law and Policy* 419-48; N Gunningham and P Grabosky, *Smart Regulation. Designing Environmental Policy* (Oxford University Press, 1998).

[54] F Haines, *Corporate Regulation: Beyond 'Punish or Persuade'* (Clarendon Press, 1997).

[55] F Haines, 'Regulatory Reform in Light of Regulatory Character: Assessing Industrial Safety Change in the Aftermath of the Kader Toy Factory Fire in Bangkok, Thailand' (2003) 12 *Social and Legal Studies* 461; reprinted in F Haines (ed), *Crime and Regulation* (Ashgate, 2007).

[56] BM Hutter and C Jones, 'From government to governance: external influences on business risk management' (2007) 1 *Regulation & Governance* 27.

[57] J Braithwaite and P Grabosky, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (Oxford University Press, 1987).

[58] PJ May and S Winter, 'Regulatory Enforcement and Compliance: Examining Danish Agro-Environmental Policy' (1999) 18(4) *Journal of Policy Analysis and Management* 625.

[59] J Black and R Baldwin, 'Really Responsive Regulation' (2008) 71(1) *Modern Law Review* 59.

[60] R Fairman and C Yapp, *Making an impact on SME compliance behaviour: An evaluation of the effect of interventions upon compliance with health and safety legislation in small and medium sized enterprises* (Health and Safety Executive, 2005), Research Report 366; *The Anderson Review of Government Guidance on*

need not be a public official and could be from a Chamber of Commerce, trade association or other expert or adviser.

In accordance with that body of research, both UK government policy and the practice of many regulators have adopted an approach towards regulatory enforcement that is based on differentiating between a supportive approach for most firms and a punitive approach for manifestly wrongful behaviour. Thus, the Hampton Report advocated that regulators should adopt a risk-based approach towards securing compliance, and use advice and persuasion as the first step.[61] The first of the Macrory Penalty Principles for regulatory enforcement for all regulatory enforcement is to aim to change the behaviour of the offender.[62] The duty imposed on many regulatory bodies[63] to observe statutory principles of good regulation is that 'regulatory activities should be carried out in a way which is transparent, accountable, proportionate, consistent, and that regulatory activities should be targeted only cases in which action is needed.'[64] Specified bodies are also under a duty not to impose or maintain unnecessary burdens in the exercise of regulatory functions.[65] The Regulators' Code[66] stresses the need for regulators to adopt a positive and proactive approach towards ensuring compliance, requiring that:

Regulation. Business Perspectives of Government Guidance. Research Study Conducted for Department for Business, Enterprise and Regulatory Reform. Final Report (Ipsos MORI, 2008); *The Anderson Review. Summary of views from meetings with small and medium sized enterprises (SMEs)* (Department for Business, Enterprise and Regulatory Reform, 2009); *How Your Business Can Achieve Compliance: Guidance* (Office of Fair Trading, 2010) OFT1278.

[61] P Hampton, *Reducing administrative burdens: effective inspection and enforcement* (HM Treasury, 2005).

[62] R Macrory, *Regulatory Justice: making sanctions effective* (HM Treasury, 2006); reprinted in R Macrory, *Regulation, Enforcement and Governance in Environmental Law* (Hart Publishing, 2010). Implementation was in the Regulatory Enforcement and Sanctions Act 2008. Subsequent codification occurred in the Consumer Rights Act 2015.

[63] See The Legislative and Regulatory Reform (Regulatory Functions) Order 2007, SI 2007/3544 specified various bodies including 27 national regulatory agencies including the Civil Aviation Authority, the Environment Agency, the Financial Services Authority, the Food Standards Agency, the Health and Safety Commission, the Health and Safety Executive, the Office of Fair Trading (other than any regulatory function under competition or merger law), the Pensions Regulator. See subsequent amendments in The Legislative and Regulatory Reform (Regulatory Functions) (Amendment) Order 2009, SI 2009/2981, The Legislative and Regulatory Reform (Regulatory Functions) (Amendment) Order 2010, SI 2010/3028, The Legislative and Regulatory Reform (Regulatory Functions) (Amendment) Order 2014, SI 2014/860 (adding the Groceries Code Adjudicator, Monitor and the Regulator of Community Interest Companies, and omitting three others). An order may not specify *regulatory* functions in relation to the Gas and Markets Authority, the Office of Communications, the Office of Rail Regulation, the Postal Services Commission, and the Water Services regulatory Authority (since these are specified in primary legislation): Legislative and Regulatory Reform Act 2006, s24(5).

[64] Legislative and Regulatory Reform Act 2006, s21. The government later claimed that the principles of Good Regulation were 'a widely accepted definition of best practice': S Vadera, *Government Response to the House of Lords Select Committee on Regulators-Report on UK Economic Regulators* (Department for Business Enterprise & Regulatory Reform, 2008), para 1.2.

[65] Regulatory Enforcement and Sanctions Act ss 72, 73(3)-(6).

[66] *The Regulators' Code* 2014. Introduced as the *Regulators' Compliance Code: Statutory Code of Practice for Regulators*, (Department for Business Enterprise and Regulatory Reform, 2007), made under the Legislative and Regulatory Reform Act 2006, s 22(1).

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow; and
- Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply.[67]

In the past five years, all major public regulatory bodies have issued enforcement policies, analysis of which[68] illustrates the notable shift in approach from hard enforcement to support of compliance and performance[69]—with only a small number of exceptions.[70]

Ethical business practice as a sound regulatory strategy

It follows from what is said above that there is a strong case for basing ethics in organisational practice as a sound regulatory strategy, for encouraging businesses to provide evidence of their profound commitment to all-pervasive ethical business practice, and for regulatory bodies to promote, encourage and reward demonstrable ethical cultures by businesses. It is also a fundamental requirement that regulatory bodies should themselves behave—and be seen to behave—ethically and fairly in all their activities. Indeed, it can be predicted that if there is *not* an alignment between the ethical values of society and those of either or both of businesses and enforcement authorities, not only will (sometimes very serious) problems of non-compliance continue to arise, or not be identified quickly enough, but also achievable improvements in conformity, performance, innovation and growth will not be made.

Ethical business practice as a sound commercial strategy

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[67] Regulators' Code, provisions 1 and 5.

[68] See CJS Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance, Culture and Ethics* (Hart Publishing, 2015), ch 13.

[69] *Enforcement and Sanctions – Guidance. Operational Instruction 1356_10, version 2* (Environment Agency, 2014); *The Bank of England's Approach to the Supervision of Financial Market Infrastructures* (Bank of England, April 2013); *The Prudential Regulation Authority's Approach to Banking Supervision* (Prudential Regulatory Authority, 2013); *The Prudential Regulation Authority's Approach to Enforcement: Statutory Statements of Policy and Procedure* (Prudential Regulatory Authority, April 2013); *Enforcement Guidelines: Ofcom's guidelines for the handling of competition complaints and complaints concerning regulatory rules* (OFCOM, 2012); *Enforcement Guidelines* (OFGEM, 2014); *Procedural Guidelines on the Authority's use of its Investigatory and Enforcement Powers under REMIT* (OFGEM, 2013); *Ofwat's approach to enforcement* (OFWAT, 2009); *Delivering proportionate and targeted regulation: Ofwat's risk-based approach* (OFWAT, 2012); *Office of Rail Regulation: Empowering stakeholders through enforcement* (Office of Rail Regulation, 2010); *ORR's HSWA enforcement policy statement* (Office of Rail Regulation, 2013); *Civil Aviation Authority Regulatory Enforcement Policy* (Civil Aviation Authority, 2012); *Compliance and Enforcement: Statement of Policy* (Legal Services Board, 2010); *National Local Authority Enforcement Code. Health and Safety at Work. England, Scotland & Wales* (Health and Safety Executive, 2013); *Fraud, Bribery and Money Laundering Offences Guideline. Definitive Guidance* (Sentencing Council, 2014); *Enforcement policy* (Care Quality Commission, 2015); *Statement of consumer protection enforcement principles* (Office of Fair Trading, 2012); *Consumer Protection: Guidance on the use of its consumer powers* (Competition and Markets Authority, 2014).

[70] *Decision Procedure and Penalties (DEPP) Manual* (Financial Conduct Authority); *OFT's Guidance as to the appropriate amount of a penalty* (Office of Fair Trading, 2012); *Administrative Penalties: Statement of Policy on the CMA's Approach* (Competition & Markets Authority, 2014).

A business that fails to behave ethically in a society where such behaviour is expected can expect to encounter serious reputational and commercial damage when its behaviour becomes public. In simple terms, ethics are increasingly seen as good for sustainable business in an increasingly open society. An increasing number of companies have adopted clear and strenuously supported policies of 'doing the right thing', on the basis of 'enlightened self-interest' and gaining competitive advantage. Over 8,000 companies in over 160 countries have, for example, adopted the United Nations Global Compact on sustainable corporate success, which is based on operating with integrity in human rights, labour, environment and anticorruption.[71] The preface of the UK Corporate Governance Code makes clear that a key role for the board is 'establishing the culture, values and ethics of the company'—although that principle is not in fact included in the body of the Code, for example as a principle that the culture and values should be ethical.

Bringing compliance activities on *all* relevant aspects under a single ethical framework should result in increased efficiency, better compliance outcomes, and lower cost of investigating and rectifying non-compliance.

Adopting ethical business practice systematically may involve some cost for some businesses, but it is one voluntarily accepted by individual firms as a necessary cost of doing business. It is not proposed that regulatory arrangements should necessarily require EBP by any firm (although this is a legal requirement in some cases): adoption should be consciously chosen by individual firms, and individually demonstrated. Where a business is shown to have behaved ethically, or to have intended to have done so, appropriate credit should be given, for example in selection of regulatory responses or mitigation in sanctions.

However, it is possible to envisage a mechanism by which a firm would be able to demonstrate that it consistently intends to act ethically in relation to all its activities, has taken steps that are regarded as best practice in achieving that end, and is able to point to satisfactory evidence that its culture and actions are ethical. In such circumstances, external recognition could be given of the systemic adoption what might be regarded as a best practice standard of Ethical Business Practice (EBP). Such recognition could be awarded by external bodies such as the Institute of Business Ethics, Investors in People, or British Standards Institute certification, but could also be through arrangements with regulatory bodies on the Primary Authority model. Thus, regulators should enable firms to enter into EBP arrangements, but not require this: consumers, society and the market should drive spread of EBP. The firms that demonstrate EBP should benefit commercially through reputation and commercial results, and the fact of having entered regulatory agreements is only one aspect of demonstrating their essential ethical trading culture. EBP agreements between firms and regulators should tend to save both parties money, since they should avoid duplication of tasks on ensuring compliance.

Best practice on what constitutes EBP generally, and in specific sectoral contexts, should be encouraged to be agreed and to evolve. It is important that achievement of EBP is not

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[71] *Guide to Corporate Sustainability: Shaping a Sustainable Future* (United Nations Global Compact).

regarded as a 'tick box' or administrative exercise. It is essential that ethical culture and behaviour are at the centre of the concept, and drive all activities and decisions by the organisation. The EBP concept should cover a 'law-abiding' approach to regulatory performance and compliance, but it would include acceptance that not every action might be perfect. Things sometimes go wrong, but the key issues would be whether this was not intentional and whether failure was acknowledged, things were put right, and lessons were learned and applied. EBP would need constant evidence to sustain it, and both reputation and any recognised status should be able to be lost.

Practical steps which might be taken to incentivise organisations to adopt meaningful ethical policies and build ethical cultures

Given the analysis above, a series of practical steps can be suggested for how ethical culture and practice could be embedded and sustained in business and regulatory practice. The basic principles should be

a. adoption of EBP should be a *voluntary* behaviour by an individual business and its staff, in which they earn recognition;
b. regulators and enforcers should *recognise* when a firm has acted ethically, giving credit for this in their relationships and interactions;
c. regulators and enforcers can take steps to *incentivise and promote* wider and deeper adoption of EBP within the business community and in markets.

Much of what is suggested can build on existing structures and practice, such as co-regulatory systems, the existence in some firms of ethical mission statements and corporate responsibility goals, and the shifts that have been identified above in UK regulatory and enforcement practice. The Primary Authority scheme provides a useful model for the collaborative agreements that would be necessary to support ethical culture and behaviours.

In some sectors, both firms and regulators may find the adoption of ethical practice a straightforward next step that requires little change. However, some other sectors may need to undergo significant readjustment. In achieving such change, it will be essential that appropriate moral leadership is shown by politicians, business leaders and officials, and appropriate incentives are in place and legislative and cultural barriers removed. Piloting the approach in some sectors and practice can be anticipated to illuminate and assist change more widely.

A. Actions by business

1. Businesses should gain public accountability that links EBP and compliance with regulation. The ideal public demonstration of this would be through signing up to an EBP Protocol with the public authorities. Adopting EBP should be a voluntary choice, but there is no reason why any business should be unable to operate on an ethical basis. It is, however, appropriate that the regulatory burden should be proportionate to the size and

risk of businesses. It should be clearly possible to identify those firms that choose to adopt EBP.

2. Adopting EBP will require clear formal adherence by management in statements and demonstrable action, but will also need the full support of the entire workforce, the assent of stakeholders, and systems that will demonstrate whether or not it has comprehensive adoption. It may take time to achieve comprehensive adherence and adoption of the right structures and practices. Best practice discussions and support will be necessary. Particular actions might include:

   a. Detailed consultation with all staff on what the firm stands for, what its core values are and what is expected of them and how to improve the culture, looking at what practices should be affirmed or should change.
   b. A culture that encourages employees to speak up and does not tolerate retaliation for doing so in good faith.
   c. Clear public statements of adherence to EBP, similar to the Partnering Against Corruption Initiative (CEO signs personally) or the UN Global Compact.
   d. Incentivisation and support of EBP throughout the business structure, performance management and operational culture, plus removal of impediments to its achievement. Careful consideration of what incentives are used, so that they do not inadvertently cause problems.
   e. Adopting policies on commercial activities and remuneration that are seen to be fair by external stakeholders.
   f. Enlisting well respected employees to be ethics ambassadors in addition to their usual responsibilities.
   g. Periodic auditing of the extent to which EBP is demonstrated in practice. Developing some metrics for this.
   h. Obtaining external feedback from customers and stakeholders, for example by joining an Ombudsman scheme.
   i. Structures and a demonstrated commitment to a no blame culture, including questioning and feedback from staff and stakeholders to identify how mistakes occur, where practice might be improved, and providing suggestions for improvement and innovation (a learning culture). This would maintain accountability of individuals.
   j. Decision making models and other structures for checking business decisions against wider ethical principles and expectations of all stakeholders.
   k. Performance management taking into consideration how results are achieved as well as what is achieved.
   l. Means for demonstrating the extent to which EBP exists, and therefore that trust can be placed in the firm, including that feedback, appropriate response and improvements are made.

B. Actions by regulatory and enforcement bodies

1. Regulatory and enforcement authorities should review their objectives and enforcement strategies and policies to enable individual businesses to engage the entire regulatory community on an EBP Protocol.

2. Businesses should be able to individually commit to an EBP Protocol with all regulatory authorities, including their stakeholders, that is 'recognised' by an external body such as under the Primary Authority scheme, and that includes agreement on which regulatory control activities and systems will be performed by which tier, and the evidence that will demonstrate their ongoing adherence to ethical commerce.

3. EBP Protocols should cover joint:
   a. Commitment to supporting ethical behaviour.
   b. Commitment to work collaboratively.
   c. Details on how outputs are to be delivered and monitored.
   d. Means of visible compliance.
   e. Means of monitoring performance, including facility for receiving and demonstrating response to complaints.
   f. Protocols on approach to identification of problems, and means of agreement of holistic responses to addressing problems.
   g. Commitment to identifying causes of unethical behaviour and implementing means of supporting rectification and redress.

4. Demonstrable achievement of EBP should be encouraged and rewarded by regulators. Hence, Enforcement Policies and Sentencing Guidelines should be revised and specify an appropriate collaborative response to those who demonstrably observe EBP Protocols.

5. In order to ensure a consistent and proportionate response to business and to similar behaviours, there should be a mechanism for harmonisation of approach between different regulators and enforcers.

6. Sufficiently wide adherence to EBP, since it would justify a reliable co-regulatory approach, should trigger a comprehensive Better Regulation review of the regulatory system, so as to reallocate responsibilities to the appropriate level of actor, whilst ensuring transparency and verification of practice.

7. Bodies responsible for enforcement should have a wide-ranging toolbox of powers, including inspecting, verifying, obtaining relevant information, initiating and approving actions aimed at reducing future risk and making redress for harm caused, and initiate the imposition of proportionate sanctions.

8. The response to adverse events should, where proportionate, focus on identifying the cause of the problem, identifying an effective means of reducing the risk of reoccurrence, making demonstrably fair remedial and redress measures, and finally considering what marking or sanctioning should apply.

9. In imposing sanctions, the behaviour of individuals and the systems and controls of an organisation should be considered separately, and in context. Thus, individuals' actions may be seen to be perhaps either a mistake or criminal, viewed in the context of what the organisation has done to support individuals to operate in a compliant way.

10. The approach to enforcement strategy should:
    a) Set out the circumstances in which powers will or will not be considered for use.
    b) Be based on principles of predictability, fairness, proportionality, reducing risk, and encouraging improved performance.
    c) Investigate the causes of serious or potentially systemic non-compliance, so that potential options for reducing the risk of reoccurrence of non-compliance, whether by an infringer or others, can be decided upon, and implemented.
    d) Evaluate the impact on victims, so that risk-based remedial action can be identified and taken.
    e) Encourage those businesses and individuals who have demonstrated their trustworthiness to continue to operate on a fair, no blame environment.
    f) Recognise that individuals are the root cause of both good and bad behaviour, whilst the behaviour of individuals and groups can be influenced by external factors such as incentives, group culture, level of support, education, reminders, …
    g) Support a virtuous business ethic.
    h) Give fair incentives to infringers to avoid, reduce, acknowledge, redress and mitigate the harm they cause.
    i) Recognise that problems will occur, irrespective of blame, and that most people in most businesses wish to do the right thing most of the time, and hence support them.
    j) But distinguish those whose motivations and actions are ethically unacceptable, to be sanctioned proportionately.
    k) Evaluate the moral seriousness of the motivation, actions and outcomes of actors who have broken the rules, and impose proportionate sanctions appropriately.

C. Actions by Government

1. Political leadership should explain and endorse the concept of Ethical Business Practice (EBP) and empower official bodies to support it in practice, including through arrangements to incentivise businesses to adopt EBR and to remove barriers to its achievement and recognition.

2. There should be a consistent approach by all public regulators to recognising ethical practice by firms, whether or not formal arrangements existed. That would involve review and alignment of the Regulators' Code (which would be made applicable to all enforcers) and of all relevant policy documents, including enforcers' Mission Statements and Enforcement Policies and the courts' Sentencing Guidelines, so as to ensure a consistent approach.

3. All regulatory and enforcement bodies should be able to encourage adoption of EBP on the part of those they regulate, to support pilot schemes, and to enter protocol

arrangements, including adding an ethical component within Primary Authority arrangements where acceptable evidence supported this in particular cases.

4. There should be recognition that regulatory and business compliance systems should function as a more integrated system. Hence, the collaborative approach illustrated by the Primary Authority scheme should be extended to as many areas of business and regulated sectors as possible.

5. Government should facilitate a permanent forum for discussion involving representatives of all regulators, enforcers, firms and other stakeholders on what constitutes best practice in EBP (which may vary depending on sector or circumstances) and how arrangements should evolve.

6. Government should take steps to facilitate the spread of British ethical values, and discussion on their content and how they apply in practical situations. This would involve inclusion of ethics in formal educational and skills teaching, accreditation, and trading, provided by educational, commercial and professional organisations.

7. Political statements and information on EBP will be necessary to explain the rationale for not responding to every adverse event with a punitive response ('Who is to blame? Who is going to be punished?') if lessons are to be learned and applied and improvements in performance and reduction of risk are to be achieved.

8. Government should review the statutory basis and mandates of regulators to ensure they can and will encourage EBP and recognition. This would involve:
   - Revision of competency provisions (training and assessment) to ensure frontline officials are equipped professionally and culturally to support EBP.
   - Ensuring performance of regulation is based on how far they recognise and respond to variation in demonstrated compliance e.g. through EBP.
   - Reviewing resources and intra-regulatory cooperation, including cross government leadership.

9. Government should consider whether and how adoption of EBP might be encouraged under public procurement arrangements.