



**PENN PROGRAM ON  
REGULATION**

**What Makes a Regulator Excellent?  
Mission, Funding, Information, and Judgment**

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The question, “What makes a regulator excellent?” is not easy to answer. Is “excellent” synonymous with “effective”? How does a regulator’s judgment factor into the equation, given that one person’s “tough, but fair” regulator may be perceived by another to be “politically motivated,” or another person’s “careful and deliberate” regulator may be perceived in some circles as “captured” by industry? Beyond that, does excellence require certain pre-conditions, such as adequate funding reasonably independent of political pressure?

Mindful of these and other considerations, and at the risk of attempting to answer a question that perhaps cannot be answered, we offer that:

*An adequately funded regulator that wisely manages its resources and effectively navigates its external relationships to act even under difficult circumstances for the purpose of furthering its mission is an excellent regulator.*

Notably, our measure of excellence would judge regulators on the decisions they make based on information available to them (or reasonably foreseeable) at the time of the decision. However, a regulator’s zealous pursuit of information to sharpen its analysis and foresight, and its efforts to work proactively to get ahead of issues to tackle them effectively, is an important characteristic for excellence. In addition, we do not measure excellence based on regulatory philosophies, which may reasonably differ even among excellent regulatory agencies. This is not to say, however, that a regulator that is equipped with relevant information but fails to act upon such information because of a rigid belief in some regulatory “philosophy” gets a free pass; clearly, such a regulator would not be one that has achieved excellence.

In this paper, we unpack the answer provided above while remaining mindful of some practical considerations, such as the role of agency leadership, historic culture, and political context, all of which are influenced by many other factors and contribute significantly to an agency’s overall effectiveness. Specifically, this paper focuses on issues that may be involved in a regulator’s pursuit of its mission—a focus that brings to the fore such topics as (1) the articulation, interpretation and scope of core missions; (2) funding adequacy; (3) priority setting; (4) the ability to influence regulatory outcomes, including by leveraging a regulator’s horizontal (industry-wide) perspective across regulated parties; and (5) the capacity and skills to communicate issues, options, and choices.

### **A Regulator’s Pursuit of its Mission**

#### *The Core Mission*

It is axiomatic that an excellent regulator acts to further its core mission, often articulated in the form of an overarching statement that has taken shape over time. Also axiomatic is that

the absence of a clearly stated and understood mission statement makes it difficult to achieve regulatory excellence because it renders an organization directionless. As explained more fully below, the excellent regulator is guided by organizational mission and taps the power of goals to advance that mission, but also respects and anticipates the limits of missions and goals.

Legislators often specify in law the core mission for a regulatory organization. The U.S. Congress, for example, defined the mission of the Federal Reserve System as providing the nation with a safer, more flexible, and more stable monetary and financial system.<sup>1</sup>

Other times, legislators leave it to the executive or ministerial part of government to define mission statements, expecting it to make coherent the patchwork of purposes laid out in the laws the organization has been mandated to implement. In the United States, when Congress has not done so, every U.S. federal government entity must articulate a mission statement in its strategic plan.<sup>2</sup> The U.S. Environmental Protection Agency (EPA), for example, created by executive order, describes its mission as “protecting human health and the environment.”<sup>3</sup>

A mission statement, on its own, cannot contribute to regulatory excellence. It is just words. Organizational excellence necessitates making sure different parts of an organization understand how they contribute to mission.<sup>4</sup> Toward that end, excellent organizations translate their mission into specific goals, objectives, strategies, and suites of indicators they use to gauge progress on mission and know when mid-course corrections are needed. EPA, for example, identifies five strategic goals supporting its core mission: (1) addressing climate change and improving air quality; (2) protecting America’s waters; (3) cleaning up communities and advancing sustainable development; (4) ensuring the safety of chemicals and preventing pollution; (5) and protecting human health and the environment by enforcing laws and assuring compliance.

Excellent organizations translate general goals into specific targets that lay out how much they hope to accomplish of what by when – and then share that information with people in the organization, delivery partners, and other interested external parties. In addition, they assign responsibility for managing progress on each goal to specific individuals or organizational units.

Goals – especially when specific, ambitious, and not too numerous – offer many benefits. They focus, energize, encourage persistence, and stimulate discovery through four mechanisms: a directive function, an energizing function, persistence, and indirectly by leading to the arousal, discovery, and/or use of task-relevant knowledge and strategies.<sup>5</sup> They do this not only for individuals but also for organizations.<sup>6</sup>

Efforts to clean up the Charles River in Massachusetts illustrate the innovation-driving, persisting power of a well-framed goal, especially when the goal is described in a way that excites a community. In 1995, the New England Regional Administrator of the U.S. Environmental Protection Agency set a specific goal: the Charles River would be swimmable in 10 years. He announced it on the eve of the annual Head of the Charles Regatta, which brings hundreds of thousands of people to the river’s edge. Beyond that, he assigned one person (part-time) to manage progress on the goal, who assembled a team (initially, two other employees part-time) to achieve the goal.

The Regional Administrator did not hesitate to set this place-specific goal because it clearly contributed to EPA's national organizational mission (protecting human health and the environment) and one of its national strategic goals (protecting America's waters.) He also appreciated that setting an outcome-focused goal would energize more than would a goal to issue a specific number of permits, write a rule, take a specific number of enforcement actions, or achieve a higher compliance rate. Beyond that, it would not limit EPA to the tools it traditionally used, but rather invite discovery and innovation.

Six months later, on Earth Day and with great fanfare surrounded by community leaders, the Regional Administrator gave the river a "D" grade. At the same time, he described EPA's planned next steps and explained why those steps were being taken. This established the expectation that EPA would issue a similar Charles River report card every year, not wait until the end of the 10-year goal period.<sup>7</sup>

Driven by the goal and a desire to show progress every year, the EPA "goal leader" and his team sought timely data to understand more precisely possible causes of water quality problems. They turned to data posted online by a local watershed association that had recently started collecting samples every month at 37 points along the 80-mile stretch of the river using trained volunteers. These data revealed downstream water quality readings that were worse than upstream ones that could not be explained by permitted dischargers in-between. Finding these anomalies triggered follow-up inquiries to understand why they were happening. Early on, one such anomaly led EPA to a wastewater source illegally hooked up to the storm sewer (in one case, a 90-bed dormitory), sending untreated waste directly into the river instead of into the wastewater sewer system for treatment.

Using volunteer-collected data departed from past practice. EPA and state regulators traditionally favored data collected by government and government-approved parties, but the temporally frequent and geographically dispersed data collected by volunteers helped EPA discover previously unknown problems. Prior to looking at these data, EPA and local activists had assumed that most of the river's pollution problems came from "non-point sources" such as runoff from roads and fertilizer from fields. The data revealed that "point sources," regulated parties holding wastewater discharge permits, continued to be a problem as did those who were operating illegally without a permit and needed controls.

The Charles River goal and annual report card not only led to the discovery of previously unknown problems, but also encouraged innovative approaches to address them. EPA wanted to find more systematic way to look for and eliminate illicit connections and brainstormed how best to do that. One person suggested lifting manhole covers on storm sewer systems when it was not raining to look for running water. This led EPA to adopt a wholly new way of working with local governments to encourage them to look for, then fix, illicit hook-ups. This resulted in unprecedented improvements in water quality in five years (from being swimmable 19 percent of the time in 1995, to 59 percent of the time in 2000.)<sup>8</sup>

Twenty years, multiple regional administrators, and two Presidents later, EPA continues to issue an annual Charles River report card. It continues to search for the most significant problems and innovate to improve the water quality.<sup>9</sup>

In certain situations, however, goals can introduce systematic harms such as neglect of non-goal areas, a rise in unethical behavior, distorted risk preferences, corrosion of organizational culture, and reduced intrinsic motivation.<sup>10</sup> Recent crime-reduction efforts in the United States, for example, likely suffered because of insufficient attention to police abuse data and community concerns. Teachers in many communities have been charged, at best, with teaching to the test and, at worst, with cheating to help students get better test scores. Linking incentives to goal attainment often tempts measurement manipulation, as has been the charge against some teachers, as well as the adoption of timid targets.<sup>11</sup>

In some circumstances, the mission itself may not be broad enough to keep up with innovation in the world it regulates. In the post-financial crisis world, for example, it has become clearer that there are significant risks in the capital markets outside the reach of the Federal Reserve—but within the jurisdiction of the SEC—that could spill over into the broader financial system. Given the lessons of the crisis, should the SEC look to expand its mission of investor protection, maintaining fair, orderly and efficient markets, and capital formation to include financial stability? The SEC may find some limited support in the 1940 Act for such an interpretation or it might lobby Congress to give it that mandate more clearly. Alternatively, should the Federal Reserve, the ostensible systemic risk regulator, which some have argued has been given the mandate for stability without the necessary jurisdiction or tools seek to expand its focus into the capital markets where it traditionally has not paid significant attention? A broadened focus in this regard might arguably be necessary if the Federal Reserve is to fulfill its financial stability mandate.

Another challenge arises when innovations in the regulated sector spurred by technological advances or other factors require new applications of regulatory tools. In the world of high frequency trading, virtual currency, cybersecurity threats, complex derivatives products, data privacy concerns and other emerging matters, the need to broaden an agency's traditional focus into unfamiliar areas or use authorities in new ways may arguably be necessary. Being able to adapt to changes in the institutions and industries a regulator oversees therefore is critical to achieving regulatory excellence.

We do not take a position on the judgments an agency may make in tackling the specific scenarios raised above. Indeed, the prudence of whether the SEC or the Federal Reserve should expand their focus or the need for regulators to adapt to specific industry innovations could be argued reasonably in support of different perspectives. We provide the examples above to suggest that an excellent regulator at times might need to diverge from the historical application of its power in pursuit of its core mission to adapt to fill a void in regulation, address lessons learned from past failures, or respond to innovation. A rigid vision of mission, goals, or available tools could overly constrain regulators even as the world around them changes and risks build in the regulated sphere.

Moreover, we would argue that an excellent regulator is acutely aware of its powers and jurisdictions (beyond their traditional use) and is willing to exercise those powers in new ways, albeit in very limited circumstances, and where appropriate and necessary, to achieve the desired regulatory outcomes. Importantly, where a regulator does apply its powers in novel ways, it should prioritize communication with regulated industries to restore the element of predictability and expectation, which may otherwise be lost in the process.

### *Funding Adequacy*

Regulatory excellence is difficult to achieve when you lack the resources necessary to accomplish the basic work of your agency. Even the best-intentioned regulators, when faced with budgetary challenges, will not be able to be effective in accomplishing their core missions. The challenge of doing more with less is not easily overcome—corners need to be cut, resources likely become overwhelmed, expertise is not gained (or might be lost), and morale suffers. Over time, agency culture can deteriorate while risks continue to build in the regulated sector.

Regulatory agency funding is a complex issue, however. Most government agencies are funded through legislative appropriation, although a fortunate few are funded by fees not subject to subsequent vote by elected officials.

Funding adequacy has a direct and profound impact on whether a regulator can be effective. Speaking about the inadequacy of funding at the SEC and the Commodity Futures Trading Commission (“CFTC”)—two agencies in the financial regulatory sphere that are funded through congressional appropriation—U.S. Treasury Secretary Jack Lew has said:

Even with the best rules, illegal behavior or excessive risk-taking will go unchecked unless regulators have the resources to conduct regular examinations, monitor suspect behavior, and go after those who break the law. The point is, this is not an either/or proposition. The best rules will fall short without effective supervision and enforcement. And effective supervision and enforcement are only possible with sufficient resources.<sup>12</sup>

With such profound consequences one might wonder why some regulators—typically those funded through legislative appropriations—are in many cases so woefully underfunded. There are many answers to this: in some cases, legislators wish to control what they perceive as excessive spending on misjudged priorities, while in other cases, spending might be restricted as a punitive measure for agencies that failed in the run up to a regulatory failure. But some have argued that funding challenges have sometimes arisen as part of the messy budget process by industry lobbyists who wish to impair the work an agency may be conducting in a specific area. As former FDIC chairman Sheila Bair wrote:

Regrettably, industry lobbyists have found that the best way to harass the SEC and CFTC and block efforts at financial reform is through convincing appropriations committees to restrict how these agencies can use their money. For instance, in the House, there have been attempts to prohibit the CFTC from

using its funds to implement rules forcing more derivatives onto public trading facilities, and other measures.<sup>13</sup>

In short, the politics of appropriations can make managing the necessary resources exceedingly difficult.

On the other end of the spectrum are agencies that are independently funded through fees and assessments on regulated parties, such as the Office of the Comptroller of the Currency, the former Office of Thrift Supervision (“OTS”), and the Board of Governors of the Federal Reserve System. These agencies have a different set of challenges, including establishing strong safeguards to prevent the waste of resources. In addition, regulatory capture has proven to be a challenge for such agencies, particularly where regulated institutions fund the agencies but retain the choice of their regulator. This construct creates a conflict of interest that, in the past at least, has resulted in perverse incentives for regulators to apply a lax form of regulation on regulated institutions.<sup>14</sup>

Indeed, under this construct some regulators may market themselves to institutions and compete with each other to enhance their jurisdictional reach and power. These regulators may also fear at times that tough regulation might result in financial institutions changing regulators, which would have an immediate impact on the agency’s finances, reduce the agency’s power and jurisdiction and perhaps even call into question the very need for the agency depending on its shrinking jurisdictional footprint. In the realm of financial regulation, the Office of Thrift Supervision and the Office of the Comptroller of the Currency provide examples of agencies that succumbed to these challenges in the run up to the financial crisis, according to some observers.<sup>15</sup>

Given the importance of resources to regulatory agencies, and the whimsical nature of congressional appropriations, an excellent regulator would have to be one that is adequately funded, most likely without being subject to appropriation, but yet is effectively managed so its resources are not expended on priorities beyond its mission. It would also be important for the regulator to be confident in the exercise of its jurisdictional power so that it does not fear regulated parties will shop for “friendlier” regulators or otherwise fall prey to inappropriate incentives. Effective legislative oversight (outside of the appropriations process) could also serve as a lever to ensure that resources are adequately targeted and deployed and that the agency is not engaged in waste or abuse of its resources.

All this is not to say that a regulator subject to the appropriations process cannot be excellent—it certainly could be. But given the poor track record for funding of many agencies that do not have independent funding sources, it will be much more difficult for these agencies to achieve the level of excellence that could more reasonably be expected of their independently funded counterparts.

## *Priority Setting*

Still, no agency has infinite resources. Given this state of affairs, priority setting takes on a critically important role. Four core categories of information should influence an agency's ability to set appropriate priorities for itself. A regulator must understand:

- The characteristics of risks and conditions affecting an agency's mission;
- The industries and institutions it regulates, including their risk profiles, business models, and activities;
- Its own risk profile, taking into account its needs for staffing, expertise, and technological capabilities, mindful of such things as upcoming retirements, attrition and other medium to long-term considerations; and
- How to deploy its resources in high needs areas in a manner that would have the greatest impact.

### **Understanding Risks and Conditions Affecting Mission Accomplishment**

Excellent regulators assemble and study information about the risks they seek to prevent and the conditions they hope to improve to inform risk-based priority setting. This information can also be enormously useful for deciding how best to design actions, or treatments, to have the greatest impact relative to available resources.

Arguably, most regulatory agencies work to advance two missions: improving (or preventing the deterioration of) conditions that would threaten the health of complex systems (e.g., the ecosystem, financial markets), and reducing the frequency and consequence of harmful incidents (e.g., bank failures, oil spills, permit violations, traffic and workplace accidents).

The large number of regulatory organizations that seek to prevent bad things from happening and keep their costs as low as possible do especially well when they: consistently collect and code information about harmful incidents and their characteristics; then analyze the data to look for patterns, anomalies, and relationships; and finally disseminate the analysis broadly so others can use it to set priorities for their own preventative or corrective actions. One particularly strong framework for organizing harmful incident information is the Haddon matrix used by the National Highway Traffic Safety Administration (NHTSA). NHTSA codes information gathered by the states to note characteristics of the equipment, operator, physical environment, and social environment for every traffic fatality, noting characteristics before, during, and after the event. This allows identification of the highest risk cars, drivers, and road designs, nominating them for priority attention. The same information can also help local public works departments set priorities for road redesign projects.

Inspection and examination findings can be similarly coded to detect common types of non-compliance problems and the most non-compliant parties.<sup>16</sup> So, too, can near-misses, especially important for low-frequency, high-consequence events.<sup>17</sup>

Savvy regulators have also seen great benefit when they more systematically monitor changes in complex systems, such as water quality, human health, or financial system health,



then share the data broadly along with planned strategies and the impact of past “treatment” or intervention efforts. This kind of information has informed priority setting at the local level in Massachusetts and the state of Washington, but has also worked well at the national level, as demonstrated by the Healthy People initiative that the U.S. Department of Health and Human Services started in 1979.<sup>18</sup>

There is broad recognition that financial regulators do not fully understand the risks in the financial system. To better understand the financial system, the Treasury Department’s Office of Financial Research in conjunction with the Federal Reserve and other agencies is in the process of gathering data about various financial activities, products, and entities and then standardizing that information. In the long run, the compilation and standardization of this information will help in analyzing the risks in the financial sector and help policymakers and regulators with their mission of identifying and addressing threats to financial stability.

### **Understanding Regulated Industries and Institutions**

It is not enough to look at harmful incidents, near misses, and the conditions of complex systems. A regulator’s ability to gain a firm grasp of the business models and institutional risk profiles and vulnerabilities of those it regulates is fundamental to priority setting. A knowledgeable regulator uses this information to deploy its resources where they are likely to be needed most and in a manner that would have the greatest impact. It will also be better able to anticipate where problems may percolate in the future and try to get ahead of them.

Without a clear understanding of the regulated sector and the factors influencing its decisions and actions, a regulator might wind up misallocating resources and over-rely on checklist methodologies instead of focusing on regulated parties and products that pose the greatest risks. This can create significant gaps in supervision and regulation and often result in lulling regulators into complacency.

An example of this phenomenon involved the OTS’s supervision of American International Group (“AIG”). In that case, the OTS focused myopically on AIG’s thrift and failed to understand the risks that AIG’s derivatives business posed to the entire organization, let alone the financial system at large. Virtually every post-mortem of the financial crisis cites OTS’s failure to understand AIG’s business as a critical component of AIG’s near demise and bailout. It is clear that a regulator that is so much in the dark about the institutions it supervises cannot possibly allocate its resources effectively to do its job well.

Another example involves the SEC’s oversight of the stand-alone investment banks such as Lehman Brothers and Bear Stearns under a voluntary program called Consolidated Supervised Entities (“CSE”) program. Through the CSE program, the SEC gained oversight of the investment banks, but only deployed minimal resources to actually examine and supervise them. Had it understood the risks that the investment banks posed it would have either not launched the CSE program or allocated more resources to the program to ensure proper supervision of the firms.

An excellent regulator would understand multiple attributes of the firms and industries it regulates, including obvious characteristics such as size and location but also more complicated factors such as the ownership structure, suppliers, subsidiaries, and employee characteristics. In addition, it helps to understand factors that influence key decision-makers, such as the information channels they use and the regulated parties who most influence their peers.<sup>19</sup> Excellent regulators then use that knowledge to allocate resources in a more targeted, risk-focused manner.

### **A Regulator's Understanding of its Own Risk Profile**

Another critical component of priority setting is to understand where the holes are within the regulatory agency itself. Some have basic challenges, such as, for example, an aging workforce eligible to retire in the near future with many entry-level recruits but few mid-level or high-level supervisors to mentor and supervise those recruits. Other agencies may lack expertise in certain areas, such as, for example, on emerging technologies and products. Many have weak information systems and analytic capacity that make it hard to gather, study, and share relevant information about the characteristics of risks, regulated parties, and the results of inspection and other findings.

There could be many reasons for an agency's workforce challenges. For example, mid-level supervisors may be poached by industry for high paying jobs; at the state level, mid-level examiners can be fertile ground for federal agency recruitment; and long-standing hiring freezes due to budget challenges could cause or exacerbate these challenges even further. Civil service laws and collective bargaining agreements can further perpetuate the problem by preventing the transfer of resources from one area to another, limiting promotion opportunities and creating obstacles in hiring mid-level industry professionals in anything but junior level positions.

Navigating these conditions is critically important for regulatory agencies to be effective. Failure to obtain and deploy resources effectively can lead to a significant buildup of risk, problems with agency morale, with some in the workforce feeling overworked and overwhelmed while others treat the lack of resources as an excuse. Over time, if these conditions persist, agencies might lose their culture as vigorous pursuers of regulatory aims and become beholden to the industries they regulate. Worse yet, they may not be taken seriously as a regulator by their regulatory counterparts or by the industries and institutions they regulate.

Fundamental to all this is the importance of regulatory agencies to be able to hire and retain talented people. In general terms, this means compensating agency staff satisfactorily and creating a satisfying career path for them both in terms of the work of the agency and in terms of career growth.

Also fundamental is training agency personnel not just with respect to innovations that may be taking place in industries that they regulate but also in making the complex tradeoffs required of regulators. It helps to give them multiple opportunities to practice the exercise of discretion and how to use the appropriate regulatory tools and targets with expert feedback.<sup>20</sup>

A well-paid, well-trained workforce that is satisfied with the work it performs and is driven, among other things, by career growth can be energized and fulfill its regulatory obligations more fully than one that is poorly trained, or that believes performance will be unfairly rewarded in career advancement decisions.

Special attention must be given to agency culture, which takes many years to cement and can be very difficult to change. It is a function of all of the factors mentioned above, but perhaps is influenced the most by agency leadership. Indeed, the tone at the top matters, and communicating effectively and driving down change through the ranks of an agency is the only way to accomplish such a deep change. Moreover, an agency's leadership must empower the workforce, in a constructive manner, to challenge situations in the field, ask questions, recommend solutions, feel empowered that they have a seat at the table, and influence the outcome of important decisions.

Finally, a core part of priority setting involves establishing mechanisms to monitor agency and industry performance to detect not only the most prevalent and emerging problems but also to learn about promising developments and to guide the search for causal factors that can be influenced to reduce risks and improve conditions. For that, it is enormously helpful to have robust information systems that make it easy to collect, study, and share information about regulated parties, including self-reported data, information about incidents, and what regulators find during inspections and examinations. It is also important to have people who regularly analyze the data and share the analyses. Especially important is not falling into the trap of treating the number of examinations conducted or number of enforcement actions taken as performance indicators rather than as information about regulatory activity.<sup>21</sup> Key performance indicators must focus on risks, especially within the regulated industry but also within the regulatory agency, appropriately calibrated to reflect the realities on the ground.

#### *Ability to Influence Outcomes*

An effective regulator finds effective ways to influence change in the regulated sphere, using both proven means and creative new approaches. While there are many ways of influencing a change in industry, in this section we will highlight three particular ideas. The first leverages the regulator's ability to assume a horizontal perspective by looking across regulated parties to detect common patterns, detect noteworthy variations across regulated parties, constructively compare to find better or lagging performers, and then encourage adoption of what works better. The second idea, closely related, involves the disciplined collection and use of data, measured trials, and other evidence to assess the impact of prior actions to find more effective and cost-effective ways to reduce risks and improve conditions. The third involves discretion in selecting tools to prevent and remediate problems at individual institutions and perhaps even across the regulated industry.

Regulators benefit when they assume a "horizontal perspective," looking across those whom they regulate to identify those with better performance, both on an absolute scale and in terms of the improvement rate. Industry often describes this as "benchmarking" and it is a common practice for cost-cutting and process-improvement that can readily be applied to regulatory objectives. NHTSA, for example, looks across the data it collects to see when changes

in law in one jurisdiction correlate to changes in the frequency and cost of traffic fatalities, spotlighting practices worth trying to replicate. When they can be replicated with similar favorable results, NHTSA then uses grants, campaign materials, and information to encourage uptake.<sup>22</sup> Policy makers at all levels of government use the information NHTSA collects and shares to decide whether or not to adopt new rules or campaigns to reduce risks (e.g., seat belt and cell phone use campaigns.) A horizontal perspective can also reveal outliers with the worst practices needing attention, whether with assistance or enforcement depending on the circumstances. Excellent regulators build information systems with incident, condition, and compliance data that support this sort of analysis.

On occasion, excellent regulators complement the information they routinely collect with discrete surveys. A few environmental agencies, for example, have tried measuring intermediate outcome indicators, such as awareness, attitudes, and understanding. Oregon, for example, randomly sampled regulated parties to measure their awareness of regulatory obligations.<sup>23</sup> The United Kingdom's environmental agency conducted surveys of small and medium-sized enterprises and learned that three-quarters were not well-versed in environmental legislation.<sup>24</sup> Mandatory confidential online surveys of similarly situated financial institutions could be used to give real-time, confidential feedback to financial institutions on how their cybersecurity practices compare to their peers, implicitly inviting them to take corrective action where they fare poorly on a comparative basis. Since regulators would also have access to these results, examiners might follow up during examinations to determine whether steps were taken to improve. The regulator could also aggregate this data to look for particularly problematic practices across multiple regulated parties that might fare well with a broader brush.

A fundamental question is whether an excellent regulator is bound by the traditional use of its authority to pursue its core mission or whether it can exercise discretion in the application of its tools and authorities. They are not bound. Instead, they should stay relentlessly focused on mission, and flexibly select the tools likely to work best for different situations.

### *Communication for Impact and Accountability*

Excellent regulators need to master the science and art of communication. Too often, communication is treated as the purview of a press office. Communication, in fact, should be treated as a critical regulatory skill needing as much capacity among regulators as marketing, sales, and internal communications do in private firms.

When regulators do their job well, especially when they successfully prevent harmful incidents, associated risks, and deteriorating conditions, few pay attention. A plane landing safely is not newsworthy. The harsh reality, though, is that the absence of attention to accomplishments brought about by regulatory organizations allows the public to forget too easily why a regulator exists. Even worse, because regulators attract public attention when problems arise and often get blamed for falling down on the job, public views about regulators are often biased toward the negative.<sup>25</sup> This cannot only hurt funding adequacy, but also legislated authority.

Excellent regulators realize the need to communicate successfully to the public why they exist, what they do, and why it is important. This is what the U.S. EPA did with its Charles River goal. It is noteworthy that despite failing to meet the 2005 target of a swimmable river, EPA not only escaped criticism but the goal won eight years of attention from a regional administrator of a different political party.

Regulators have many opportunities to communicate effectively about organizational mission: when they announce goals and regularly report progress on them, when new incidents arise or a new regulatory action is taken, or even on key anniversary dates associated with organizational mission. Beyond communicating to inform, excellent regulators communicate to enlist and engage the public – especially regulated parties, their employees, and those affected by those parties –in understanding and reducing the risks the regulated entity seeks to address.

Regulators have increasingly come to appreciate the value of communication to assure awareness of regulatory requirements and understanding of why they are needed.<sup>26</sup> Awareness, understanding, and acceptance of the need for a regulation does not always lead to needed behavior changes, however. Other persuasion factors, such as an interest in following others who have changed their practices, are often more influential.<sup>27</sup>

Communication can be a powerful deterrence tool. Industry participants may be reluctant to change their practices if they believe their competitors are engaged in the same behavior. At the same time, awareness that a violator got caught raises the sense of fairness for those in compliance and fear for those who are not.<sup>28</sup>

In a few areas of regulation, regulatory decisions, and even a regulator's words, may move markets. When that is the case, strong communication skills are critical. Former U.S. Treasury Secretary Tim Geithner, for example, was acutely aware that the way he and his colleagues talked, or failed to talk, about regulatory actions directly affected investor confidence and, ultimately, the stability of the financial system.<sup>29</sup> Similarly, officials at the U.S. Food and Drug Administration know that their actions and words can make or break a product being reviewed, so they must choose their timing and language carefully, balancing the need for transparency and fairness.

It is tempting to ignore regulators' need to master communication skills, but it is costly to overlook it. This is an area that has received woefully little attention, but regulatory excellence necessitates not only an understanding of the science of communication but, given the complexity of the situations in which most regulators work, opportunities to practice to find effective means to do it well.<sup>30</sup>

## **Conclusion**

While there are key elements to regulatory excellence, several elements appear the most significant—mission, funding, information, and judgment. Mission, and the associated goals and strategies, define the direction for regulatory action. Funding provides a regulator with the ability to act to further its mission. It can use its resources to hire talent, retain talent by paying people, creating a career path and training them to adapt to technological innovation. Information

is key for priority setting and influencing outcomes, as is judgment. Excellent regulatory judgment calls for choosing the right regulatory and supervisory tools to solve problems, informed by relevant information. The mix of mission, information (coming in and going out), resources, and judgment ultimately culminates into action through which an excellent regulator drives positive change.

Moreover, excellent regulatory leaders must not be fearful of taking on these challenges nor hesitant about letting others receive some of the credit for their good work. This need is particularly acute for regulatory leaders who succeed those who pursued lax regulation strategies but were the beneficiaries of good economic times and who, fairly or not, received plaudits for a supporting a good economy and job creation.

## Notes

<sup>1</sup> Board of Governors of the Federal Reserve System, *Strategic Framework 2012-15* (2013), available at <http://www.federalreserve.gov/publications/gpra/files/2012-2015-strategic-framework.pdf>

<sup>2</sup> Government Performance and Results Act of 1993 (GPRA), Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

<sup>3</sup> U.S. Environmental Protection Agency, FY 2014-2018 EPA Strategic Plan (2014), available at [http://www2.epa.gov/sites/production/files/2014-09/documents/epa\\_strategic\\_plan\\_fy14-18.pdf](http://www2.epa.gov/sites/production/files/2014-09/documents/epa_strategic_plan_fy14-18.pdf)

<sup>4</sup> Robert S. Kaplan and David P. Norton, *The Strategy Focused Organization* (Boston: Harvard Business School Press, 2001).

<sup>5</sup> Edwin A. Locke and Gary P. Latham, "Building a Practically Useful Theory of Goal Setting and Task Motivation: A 35-year Odyssey," *American Psychologist*, pp. 705–717 (2002); Gary P. Latham, "Motivate Employee Performance through Goal-setting," in *The Blackwell Handbook of Principles of Organizational Behavior*, ed. Edwin A. Locke (Blackwell, 2004), p. 108.

<sup>6</sup> Alvin Zander, *Motives and Goals in Groups* (New Brunswick: Transaction, 1996), p. xvi.

<sup>7</sup> U.S. Environmental Protection Agency, The Charles River Initiative, available at <http://www2.epa.gov/charlesriver/charles-river-initiative#ReportCard>

<sup>8</sup> Shelley H. Metzenbaum, "Measurement That Matters: Cleaning Up the Charles River," in Donald F. Kettl, ed., *Environmental Governance: A Report on the Next Generation of Environmental Policy* (Washington, D.C.: Brookings 2002).

<sup>9</sup> U.S. Environmental Protection Agency, History of Human Impacts on Charles River, <http://www2.epa.gov/charlesriver/history-human-impacts-charles-river>

<sup>10</sup> Liz D. Ordonez et al, “Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting,” Working Paper 09-083 (Cambridge: Harvard Business School, 2009.)

<sup>11</sup> For a summary of the literature and a discussion of how to use goals and minimize dysfunctional problems associated with their use, see Shelley H. Metzenbaum, *Performance Accountability: The Five Building Blocks and Six Essential Practices* (Washington, D.C.: IBM Center for the Business of Government 2006).

<sup>12</sup> Jacob L. Lew, Remarks of Secretary Lew at Pew Charitable Trusts (Dec. 5, 2013), available at <http://www.treasury.gov/press-center/press-releases/Pages/jl2232.aspx>.

<sup>13</sup> Sheila Bair, *Bull by the Horns: Fighting to Save Main Street from Wall Street and Wall Street from Itself* 342 (New York: Free Press 2012).

<sup>14</sup> See generally Daniel Carpenter and David A. Moss, *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge: Cambridge University Press, 2013).

<sup>15</sup> See, e.g., National Commission on the Causes of the Financial and Economic Crisis in the United States, *Financial Crisis Inquiry Report* (January 2011), available at [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

<sup>16</sup> National Center for Environmental Innovation, U.S. Environmental Protection Agency, “ERP States Produce Results: 2007 Report States’ Experience Implementing the Environmental Results Program” (Dec. 2007), available at <http://www.epa.gov/erp/files/2007reportfull.pdf>.

<sup>17</sup> James Phimister, Ulku Oktem, Paul R. Kleindorfer and Howard Kunreuther. 2003. “Near-Miss Management Systems in the Chemical Process Industry,” *Risk Analysis* 23(3): 445–59

<sup>18</sup>In the state of Washington, the Puget Sound Partnership has created a “vital signs” and “report card” to track progress in improving various environmental conditions. See, e.g., Puget Sound Partnership, Puget Sound Action Agenda Report Card, available at <http://gismanager.rco.wa.gov/ntaporta>. The Clean Charles Initiative in Massachusetts also used a report card of water quality. See, e.g., Shelley H. Metzenbaum, “Measurement That Matters: Cleaning Up the Charles River,” in Donald F. Kettl, ed., *Environmental Governance: A Report on the Next Generation of Environmental Policy* (Washington, D.C.: Brookings 2002). The U.S. federal government’s Healthy People initiative now tracks 26 leading health indicators. See Office of Disease Prevention and Health Promotion, Healthy People 2020, available at [www.healthy-people.gov](http://www.healthy-people.gov). On the use of information more generally in priority-setting, see Shelley H. Metzenbaum, “From Oversight to Insight: Federal Agencies as Learning Leaders in the Information Age,” in Timothy J. Conlan and Paul Posner, eds., *Intergovernmental Management for the 21<sup>st</sup> Century* (Washington, D.C.: Brookings 2008);

<sup>19</sup> Michael Wogalter, et al, “Research-Based Guidelines for Warning Design and Evaluation” 33 *Applied Ergonomics* 219-230 (2002); Robert Cialdini, *Influence: The Psychology of Persuasion* (Harper Collins 2009).

<sup>20</sup> Louis Deslauriers et al., “Improved Learning in a Large-Enrollment Physics Class,” *Science* 332, 862 (2011).

<sup>21</sup> Shelley H. Metzenbaum, “More Nutritious Beans,” 20 *Environmental Forum* 19-41 (2002).

<sup>22</sup> Shelley H. Metzenbaum, “Strategies for Using State Information: Measuring and Improving Program Performance,” IBM Center for The Business of Gov’t Managing for Performance and Results Series (Dec. 2003), *available at* <http://www.businessofgovernment.org/sites/default/files/MeasuringandImprovingPerformance.pdf>.

<sup>23</sup> Les Carlough, “General Deterrence of Environmental Violation: A Peek into the Mind of the Regulated Public” (Oregon Department of Environmental Quality, 2010), *available at* <http://www.deq.state.or.us/programs/enforcement/DeterrenceReport.pdf>.

<sup>24</sup> NetRegs, U.K. Environment Agency, SME-nvironment 2003, *available at* [http://www.netregs.org.uk/pdf/sme\\_2003\\_uk\\_1409449.pdf](http://www.netregs.org.uk/pdf/sme_2003_uk_1409449.pdf).

<sup>25</sup> Cary Coglianese, ed., *Regulatory Breakdown: The Crisis of Confidence in U.S. Regulation* (Univ. of Pennsylvania Press 2012); Cary Coglianese and Margaret Howard, “Getting the Message Out: Regulatory Policy and the Press,” 3 *Harvard Journal of Press/Politics* 28-33 (1999).

<sup>26</sup> See also Shelley Metzenbaum, ‘Compliance and Deterrence Research Project: Measuring Compliance Assistance Outcomes’ State of Science White Paper (EPA 2007).

<sup>27</sup> Robert B. Cialdini, *Influence: The Psychology of Persuasion* (New York: William Morrow and Co. 2006).

<sup>28</sup> Dorothy Thornton, Neil A. Gunningham, and Robert A. Kagan, “General Deterrence and Corporate Environmental Behavior,” 27 *Law & Pol’y* 262 (2005).

<sup>29</sup> Timothy Geithner, *Stress Test: Reflections on Financial Crises* (New York: Crown, 2014.)

<sup>30</sup> For the complex challenges of physics and other science and engineering task, Nobel Laureate Carl Wieman recommends 10,000 hours of complex decision-making practice to get to a world-class level of expertise. See Bob Roehr, “Nobel Laureate Carl Wieman: Effective Teaching Should Create Students Who Think Like Scientists,” AAAS, June 8, 2012, *available at* <http://www.aaas.org/news/nobel-laureate-carl-wieman-effective-teaching-should-create-students-who-think-scientists>.



# **What Makes a Regulator Excellent? Mission, Funding, Information, and Judgment**

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The Volcker Alliance

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Shelley Metzenbaum joined the Alliance as its founding President in May 2013. She served as Associate Director for Performance and Personnel Management at the White House Office of Management and Budget from 2009 to 2013, where she was responsible for setting and implementing the Administration's approach to improving federal government program performance. She previously served as Associate Administrator for Regional Operations and State/Local Relations at the U.S. Environmental Protection Agency, and Undersecretary of Environmental Affairs and Director of Capital Budgeting for the Commonwealth of Massachusetts. Additionally, she has also held notable posts in academia, most recently serving as founding director of the Collins Center for Public Management at the University of Massachusetts Boston's McCormack School, and prior to that, as director of the Harvard Kennedy School's Executive Session on Public Sector Performance Management and visiting professor at the University of Maryland's School of Public Policy. Metzenbaum is recognized as an international expert in the field of public sector performance management and measurement, and has authored numerous publications, articles, and case studies on performance management, leadership, and accountability. She is a fellow of the National Academy of Public Administration and holds a Ph.D. in public policy from Harvard's Kennedy School of Government.

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