HOUSE OF LORDS

Industry and Regulators Committee

Corrected oral evidence: UK regulators

Tuesday 24 October 2023

10.30 am

Watch the meeting

Members present: Lord Hollick (The Chair); Lord Agnew of Oulton; Baroness Bowles of Berkhamsted; Lord Burns; Viscount Chandos; Lord Clement-Jones; Lord Cromwell; Lord Gilbert of Panteg; Baroness McGregor-Smith; Baroness O'Grady of Upper Holloway; Baroness Taylor of Bolton.

Evidence Session No. 1 Heard in Public Questions 1 – 12

Witnesses

I: Gareth Davies, Comptroller and Auditor-General, National Audit Office; Richard Sullivan-Jones, Senior Audit Manager, National Audit Office.

Examination of Witnesses

Gareth Davies and Richard Sullivan-Jones.

Q1 **The Chair:** Good morning and welcome to the first meeting of the inquiry into UK regulations. I am delighted to welcome two members of the National Audit Office, Gareth Davies, who is Comptroller and Auditor-General, and Richard Sullivan-Jones, who is senior audit manager. Our inquiry, which is a relatively short one, is looking into the effectiveness of regulation, the effectiveness of parliamentary scrutiny of regulation and a number of related matters.

I wonder if we could just start off by you telling us about your involvement in regulation, what oversight you provide to regulation and what additional work you might be able to do in order to help improve oversight of the performance of regulators.

Gareth Davies: Good morning. In principle, our role is the same as it is for all our work in auditing government. As the committee knows, we are the external auditor of central government, every government department and their arm's-length national bodies. We audit the accounts of all the regulators that you are likely to be considering in the remit of the inquiry. All the "Ofs" and related organisations have the NAO as their external auditor, which gives us a continuous relationship with all of them. Our external audit teams will be working with them throughout the year, for example attending all their audit committee meetings, and so we have a good sense of the risks that the regulators are managing and how they are approaching that through their work. That is one stream of work with the regulators.

Secondly, we carry out value-for-money studies of government spending. These can cover the policy departments responsible for areas that regulators operate in, as well as the regulators themselves. Regulation features quite prominently in our programme of value-for-money work. Just so that the committee understands how we decide what to cover in that work, it is selective. By necessity, we have finite resources.

The Chair: Are they selected by you?

Gareth Davies: They are selected by me, advised by my teams. We listen very carefully to the views of Parliament. After all, we are there to help Parliament scrutinise government. Our lead relationship in Parliament is with the Public Accounts Committee in the Commons. We also work closely with the Environmental Audit Committee, which is highly relevant to a discussion about regulation in that area, and other Select Committees on a selective basis.

Our programme includes between 60 and 65 pieces of value-for-money work each year, covering the entirety of public spending. We have to be very clear about the basis for our selection. It is usually about value-for-money risks, so where we think the biggest opportunities are for saving money, for tackling poor performance and for identifying and spreading good practice. Those are the kinds of things that we use to decide our programme.

As I say, regulation features prominently, not so much because of the size of the regulators as spending organisations but because of their influence and their ability to exercise leverage on outcomes for the public. Individual regulators and systems of regulation have featured prominently in the last few years of our value-for-money work.

The Chair: What are the criteria that you use to select a particular regulator? Am I right in saying that, in a sense, you are looking pretty much in the rear-view mirror rather than at forward-looking risks?

Gareth Davies: I will give you some examples. Audit is sometimes about accountability—how was the money spent, why was it spent in that way and what is there to learn from that? That is a perfectly necessary and proper role of audit. Increasingly, we have made sure that some of our programme is also intervening when there is still time to avoid or minimise problems.

I will give you an example that is relevant to regulation. During the energy price crisis of the last year or two, we did a very prompt piece of audit work on the energy support schemes being implemented by what was then BEIS, which was the department responsible, closely involving Ofgem. The Public Accounts Committee was able to take evidence from officials from both the regulator and the department on the design and operation of that scheme within a few months of the first payments being made and well before the end of the scheme. In other words, there was still time to implement any improvements.

That was a feature of our pandemic work as well, which is where this capability that we have has developed quite quickly. So yes, audit is sometimes retrospective, but we quite often intervene when there is still time to make improvements.

The Chair: One thing that has come through in inquiries that this Committee and others have done is controlling large infrastructure projects. HS2 is a current example, but the water industry is something that we have looked at in great detail. To what extent do you have the skills, resources and time to look into these major infrastructure projects and to see whether the regulator is playing a helpful, positive and critical role in ensuring that Parliament and the public can be assured that the money is being spent properly?

Gareth Davies: We are in a relatively fortunate position that our resources are voted to us annually by Parliament through the Public Accounts Commission, which is a cross-party group of MPs whose sole purpose is to oversee the governance of the National Audit Office and to approve our annual estimate. That is a privileged position, because it means that government cannot determine our resources. Although the Public Accounts Commission receives advice from the Treasury, it is not obliged to take it.

If we can make a case for investment in the audit function to cover the kinds of risk areas that you have just mentioned, it is up to Parliament whether to accept that case. It expects us to be disciplined and to deliver value for money, as we are expecting everyone else to do, and we treat that process very seriously and justify any additional resources that we need. If I felt that we were just not able to tackle a very substantial area of risk to public value for money, I would make a case through that route for the resources.

My experience has been that the Public Accounts Commission has been very responsive. Through the pandemic, for example, it approved short-term increases in our resources to allow us to cope with the unprecedented amount of public spending going through at high speed. Similarly, when it came to dealing with the energy issues that I mentioned, it allowed us to continue to use that additional resource to cover that period. There is a good mechanism in place for ensuring that the NAO has the financial resources in place.

For skills, we have a very experienced body of core value-for-money audit skills—probably the best in the country, I would say—but we are conscious that we need to supplement that with technical expertise in the individual areas that we are examining. Some require quite a high level of that, in which case, if we cannot sustain that in-house, we buy it in for the necessary pieces of work. For example, in some of the work that we are doing on highly specialised areas of environmental regulation, we need expert technical advice to assist with that, and we are able to get it.

Q2 **Baroness Taylor of Bolton:** Can we come to the clarity of the remit of regulators? I take it for granted that you both think that there should be clarity and that regulators should be clear about their objectives and priorities. To what extent have we managed to do that with regulators in the UK?

Richard Sullivan-Jones: It is an excellent question. A general observation that I should probably make is that regulation is a very varied area, and regulators differ in remit, performance, resources and so on. We see areas where there is good clarity, sometimes even in quite complex areas, and a very steer clear from government and Ministers on what the priorities are, but it is a common feature in our work that we have quite frequently found issues, particularly where there are tensions and trade-offs between different objectives that regulators need to support or reach.

Those can be primary objectives that are in tension with each other, or supplementary objectives and wider government policy aims that the regulators are expected to support but that may not sit naturally with their primary objectives, for example net-zero and environmental aims. The investment needed to support those outcomes may be in tension with affordability for consumers. That is quite a common one that we see.

Gareth Davies: I will just give you an example of where this issue has come up prominently in recent work. I mentioned energy, which will, no doubt, come up a few times, for obvious reasons. This is a really clear example of where Ofgem has acknowledged that it was pursuing an objective of competition and innovation in the energy supply sector, which was leading to an expansion in the number of providers, but it turned out to be insufficiently resilient to a significant financial shock to that sector, with all the fallout that we saw and consequences for the taxpayer and the billpayer. That is a really good example of where the regulator was working to what it thought were very clear objectives but turned out to be very vulnerable to the shock to the system that we saw.

Richard Sullivan-Jones: If I might add to that, a really interesting thing about that example is that there are multiple dimensions of these trade-offs. Alongside that drive for competition and innovation in the market, there was also the question of affordability and the concern that more vulnerable consumers were not able to access a lot of the best deals available in the energy market. Understandably, the Government introduced a price cap, which Ofgem implemented and set at a level that it thought was appropriate, but that is another feature of that market that contributed to this lack of resilience and flexibility when wholesale prices flew off the charts.

In that situation, there was an attempt to manage multiple dimensions of trade-offs at the same time. Ofgem was quite open about the fact that it did not get things right in that, but it was a very difficult, complex set of trade-offs to be managing.

Baroness Taylor of Bolton: "Multiple trade-offs" is a very good way of putting it. We have been looking at the water industry, and we are now faced with a very serious problem in terms of the investment that is needed going forward and who is going to pay for it. The Government have a role in this; they send direct messages, but they also send indirect messages. Similarly, when looking at the Office for Students, we find that a Minister says something, so it reacts in a particular way. One thing that concerns us is where there is clarity or transparency about what is a political decision and what is a regulator's decision. I wonder whether you have any thoughts on that.

Gareth Davies: You are right. It is crucial and it will legitimately vary between sectors and situations. Two years ago, we published a paper called *Principles of Effective Regulation*, which, I hope, would be of interest in quite a lot of the areas that you are examining.

There is an issue about the extent to which the regulator operates independently of government, makes its own decisions and raises issues for government where it thinks government needs to take a policy view, because the evidence in front of us says that the existing guidance to us is no longer adequate or sufficient. Those are really important features of an effective system.

Quite legitimately, government will take a different view on how long that arm needs to be in the arm's-length arrangement with a regulator. That might well vary from sector to sector.

Richard Sullivan-Jones: I was just going to offer an observation on the example that you gave of the water sector and the regulators involved there. We did a report a year or two ago on water supply and demand, with exactly these sorts of issues. There were issues of levels of supply and of tackling leakage. There is the question of the clarity of the steer from government and the role of the regulators responding to that. Even where there is a clear direction from government, the regulatory framework, as designed, does not necessarily support being responsive to those kinds of changes.

Taking leakage as an example, Defra had set, in 2016 a new ambition on leakage as a priority, whereas its messaging previously had been that leakage should be considered alongside affordability and price concerns. It was a new focus and priority that was clear and understood by the regulator, but it had, literally only one year earlier, done its latest five-year price review. Unless it took a decision to start intervening between price review periods and introducing changes to the metrics, standards and expectations, which it chose not to do, there was no formal regulatory tool to incentivise that policy steer for three and a half to four years until the next price review, when it finally did that.

Again, the five-year price control cycle is designed to encourage stability, predictability and, therefore, appropriate levels of investment, so, again, you get into these complex trade-offs. It is designed that way for a reason, but that can get in the way of being responsive to policy priorities.

Q3 **Lord Burns:** Good morning. Just continuing on this theme of the independence of regulators, we often hear how important it is that regulators should have independence in terms of giving confidence to companies and consumers, but you have raised this question of how far this independence should stretch. Should the emphasis be on operational independence, as in the case of monetary policy? Where is the boundary between operational independence and strategic guidance? How far does it vary in the existing legislation for regulators, and how far should it vary?

You have already mentioned issues of distributional decisions and choosing between competing objectives, but do you have a view on whether we have a well-defined approach to this and a clear framework in deciding how it should operate between regulators?

Gareth Davies: I mentioned the report that we produced on the principles of effective regulation, and this was an important section of that report. We felt there that there was scope for government to have a clearer framework for making decisions on the degree of independence in each case, because, as I said earlier, it is perfectly legitimate to expect those to be different in different circumstances. What we felt was lacking was a clear framework for taking that decision and evidencing why the particular approach had been taken, so I do think that there is the scope for greater clarity there.

Reflecting on this question of independence of regulators, a really important demonstration of or buttress to that independence is this question of resources. We published a report on the regulation of gambling two years ago or so. A big issue there constraining the effectiveness of the Gambling Commission was its inability to change its fees and, therefore, raise additional resources for the very rapidly changing risk that it faced from online gambling.

That is a really good example of where theoretical independence is not good enough if you cannot back it up with the ability to resource the decisions that you have independently arrived at. A big test of whether an organisation has been made genuinely independent is whether it has the ability to access the resources that it needs to deliver its objectives.

Lord Burns: Could you give some examples of why they should be different between regulators? Which regulators would you see as being at different ends of this spectrum?

Gareth Davies: You gave one example on monetary policy, where making it a non-political decision is almost the point and, therefore, you are looking for a high degree of independence. For other areas where the issue is more technocratic and more about delivering a service efficiently and so on, you want operational independence in that situation, because the detail of how you regulate a particular product for product safety, for example, really should not be for Ministers.

Those are the dimensions of the decision. Are there in-principle reasons for independence because of separation from politics? Are there more practical and operational reasons for technical independence? The answers to those tell you quite a lot about the governance arrangements that you need and, essentially, how much protection from day-to-day political intervention you need because you just have an important job to get on with.

Lord Burns: You mentioned how resources can constrain independence. Of course, another area where independence can be constrained is in terms of appointments and the extent to which they are made or have to be approved by government. Have you seen any big difference between the regulators in those respects?

Gareth Davies: Yes, practice does vary on that, although there are some common themes. One of the loudest messages to us from the regulators that we audit is their collective and individual frustration on the time that it takes to fill vacancies on their non-executive boards, for example, so much so that that has become a piece of NAO work and we are now looking at what is behind these delays in filling vacancies.

It is not just regulators, but public bodies of all kinds. We are working on that at the moment and will be reporting on it in due course. Although bureaucracy and decision-making are reported as a frustration, they are, in practice, having quite a serious effect on the governance of those organisations, and so we are looking at that in some detail.

Q4 **Baroness McGregor-Smith:** Good morning. Could you take us through how regulators co-operate with each other today and how that could be improved? I am thinking about some of the more complex challenges that regulators face, where more than one regulator would be involved.

Gareth Davies: There are a couple of dimensions to that. We could give you a couple of examples from our work. One is an area such as water, which we have already discussed, where you have two, three or more regulators with an important role to play.

The other dimension that we should mention is the central/local dimension. A significant amount of regulation is delivered at local level, through local authorities or other local bodies, and that is a very significant part of the effectiveness of the overall system, so much so that we did a lessons learned report drawing on all our work where local regulation plays a part.

There is a very important issue there about alignment of regulatory objectives between central bodies and the national regulator, if there is one, and then what is happening at a local level. There are lots of lessons to be learned there, so we pulled those together into a report last year called *How to Deliver Effective Regulation Locally*. Rich, you might want to expand on the water point and the local point.

Richard Sullivan-Jones: Yes, and I might, if I may, add a third type of co-operation example, which is also where you have national regulators regulating separate sectors, in theory with separate remits, but dealing with a lot of the same challenges or consumers facing the same problems. We looked at this and we did some work in 2017 on vulnerable consumers, for example. We have done it on performance measurement in regulation as well.

In the case of vulnerable consumers, for example, regulators are dealing with many consumers who are vulnerable to problems in one essential service, such as water, but are likely to have vulnerabilities also in energy, telecoms, financial services or whatever it may be.

This played out in the data. Looking at complaints or concerns raised with Citizens Advice, we found quite a high level of overlap with people raising complaints about multiple services. Then you get into the fact that, while there is no formal overlap or alignment in terms of sectors, the experience that these people face is really affected by the joined-up thinking of the regulators and how they approach these sorts of issues. There are quite a few dimensions to the way that this joint working plays out.

Gareth Davies: I just want to expand on my point about central/local regulation co-ordination. One area of encouraging practice that we found recently was in the area of product safety. The new OPSS, as it is called, is the small central body considering issues of product safety that require a national response. Prior to its formation, it was a pretty unsatisfactory system, where product safety issues were identified by trading standards

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officers at a local level but lacked a coherent national response where that was needed.

The effectiveness of that improvement is then limited by the ability of local trading standards services to be adequately resourced to see through the consequences at a local level of decisions made at a national level. This is a really good example of where bits of the jigsaw have been improved but the whole picture is still not satisfactory because of the need to address both the central and the local dimension. Making sure that national discussions about regulatory impacts take into account the need for coherent local implementation is a really important feature.

Baroness McGregor-Smith: Given the separation of regulators, do they share best practice when they do work together? Do people within each regulator move around? Do you find that they have worked in different sectors to get better and wider experience, or is it very siloed?

Gareth Davies: This is an empirical view that I cannot prove with robust data, but it is a very good thing when regulators move around between different sectors of regulation, because it is a bit like audit in a way. Regulation is a profession and a skill set in itself. While the application of the principles of effective regulation varies from sector to sector, you really do build up a body of expertise and effectiveness by working in more than one field of regulation.

It is also a good counter to the capture of regulators by their industry. You will be very familiar with the revolving door problem of senior private sector managers moving into regulators and then back again in the same sector. Of course, you need some technical expertise in the sector that you are regulating, but you also need this wider experience of regulating in other sectors. Some of the most effective regulators we deal with have come from other sectors where they were previously regulating.

Richard Sullivan-Jones: I would just add that we have seen increasing use among regulators, particularly some of the larger economic regulators, of joint forums, networks and secondments—not just people moving around but seconding between them—where they want to bring in particular experience to help develop their own approaches. To Gareth's point, it does not necessarily fix all the systemic challenges, but we have seen, in the past eight years, increasing use of those sorts of things to share experiences and good practice.

Q5 **Lord Cromwell:** Good morning. Just before I get on to my main question, I want to go back to resources and the NAO. Does the NAO assess the skill sets of the regulators you investigate, and identify and report on gaps in them? To give you an example, Ofwat appeared to be very un-clued up on financial engineering, which meant that it came to grief. Is that something that you advise on?

Gareth Davies: It is, and it comes up in our reports regularly. A very common example is digital skills, which you will not be surprised to hear. We have even challenged Permanent Secretaries on their ability to make strategic decisions on digital transformation projects without greater knowledge themselves. We take very seriously what is essential to be effective in the role that you are playing and, if there are gaps, we call them out.

Lord Cromwell: My main question really reflects a frustration in Parliament about how we can better achieve an interactive accountability with regulators, and what the roles of Parliament, government, the regulators and the regulatees are in achieving that. I would be very interested in any suggestions, with brevity, that you have on those.

Secondly, you gave us some examples of more proactive, forward-looking work, but it feels like it is fairly unsystematic and reactive. When there is a scandal, people go in and have a look, but there is not a regular, systematic process with a forward look attached to it. You may want to challenge that.

Finally, before I let you come back, is there a case for a regulator of regulators or is that just another buffer between Parliament and the regulators?

Gareth Davies: There are some really big questions there. Some of these are policy questions, and are almost parliamentary policy questions for Parliament rather than me, but I will give you my views freely from the experience that we have had.

At the moment, it is up to departmental Select Committees in the areas that the regulators operate in to hold those regulators to account, typically with the policy department alongside them, and we see many examples of that.

The Public Accounts Committee, which is the committee that we have most dealings with, steps into this area where there is a particular financial management angle, for example, or an implication for the taxpayer. In theory, that combination gives you proper coverage of parliamentary scrutiny of the activity of regulators.

To your point about whether that is systematic enough, it does come down to resources in the end. We certainly do not have a plan that says that, every three years, we will carry out a value-for-money audit of every major regulator. We simply are not resourced to do that. It does not apply to any other bit of government either.

Lord Cromwell: I am sorry to interrupt you, but could I turn that around? Could it be the case that, every three years, the regulator comes into some parliamentary group and reports back, and looks forward and back?

Gareth Davies: It quite possibly could. We could try to co-ordinate that through the existing structures of departmental Select Committees, so the Treasury Select Committee and so on.

We have relationships with our opposite numbers in other countries. We know that some parliamentary systems elsewhere have a committee focused on the effectiveness of regulation, for example. I have mixed views on whether that works effectively, because they can be very stretched, given that they have a huge range of areas to cover. They have to be generalists rather than specialists in the sector fields and so on.

Our experience is that both have a role to play. We have the detailed, expert examination of, say, financial services regulation by the Treasury Select Committee, but there are cross-government and cross-regulator themes to draw out as well, which is much harder to do for a Select Committee. Probably the nearest that we get to that is the Public Accounts Committee at the moment. If we were tasked with reviewing individual regulators on a systematic and regular basis, that would have very significant resource implications for us.

Lord Cromwell: I was thinking more about Parliament than the NAO doing it, but thank you. Richard, did you want to add anything quickly?

Richard Sullivan-Jones: You asked about the forward versus the retrospective look. We are quite systematic in considering where there is a benefit to us looking at something with a forward focus. That does not mean that we will do reports systematically on a periodic basis, but I can think of several examples where our work has looked at an upcoming framework, for example *Preparedness for Online Safety Regulation*, which we published earlier this year.

Also, even when we are looking at existing areas of regulation, we are often trying to time our work to inform discussions and considerations that Parliament, government or Ministers may be thinking of in terms of making changes to the system. We did a suite of reports—if I remember the correct order—on gambling, product safety and private renting, where we were aware of the potential for government, through either ministerial Statements or manifesto commitments, to make changes or get wholesale reviews of the frameworks. We do try to time our interventions to support that thinking and that process.

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Gareth Davies: I would just add one point that might be of interest to the committee, because it is relevant to regulation. Like everybody else, we reflected on the experience of the Covid pandemic and what it meant for the approach that we take to our work, particularly on this question of resilience. We are now experimenting with our first piece of work where we are, essentially, taking a risk from the national risk register and assessing the preparedness of government for that risk. That is a different approach from the one that we have taken before. We have picked extreme weather, topically enough, as our first topic on that.

The advantage of that is that it will cover departments with policy responsibility, as well as regulators. It is another way of tackling your challenge: "Are you just coming along after there has been a demonstrable problem or are you getting up stream to look at how government is using public resources to improve resilience, rather than just deal with a problem once it has emerged?"

Q6 **Lord Agnew of Oulton:** Just coming in behind some of this, Gareth, as you know, I am one of the most stalwart admirers of the work that you do. You mentioned that you are doing about 65 reviews a year. Do you ever do an assessment of the impact of your reviews—in other words, how many recommendations are taken up by the Government, how long it takes them to adopt them, and what the impact is?

Linked to that is the issue of the rear-view mirror: the horse has bolted. I worry that you are doing too many autopsies and not enough open-heart surgery. Could you bring forward your work? We did some things together during Covid, where you made a huge impact because you were able to stop mad schemes being unrolled that were, basically, doomed to failure. Could more of that be done?

Gareth Davies: I am trying to remember your first point, sorry, before the point about autopsies.

Lord Agnew of Oulton: Can you track the number of recommendations and whether they are implemented?

Gareth Davies: We do that. We have upped our game on tracking whether the recommendations that we have made have been implemented. That is now visible on our website in a way that it was not three or four years ago. We are now building that up so that, for every report that we have published, you can find the recommendations that we have made, government's response to those and our assessment of whether they have been satisfactorily implemented. That is a big improvement in the transparency of that process.

Clearly, something like that already existed for the Public Accounts Committee's recommendations, but ours are of a more managerial and audit nature, and it was important that we have a proper trail for those too, which we now have. The picture on that is encouraging. A very high percentage—in the 90% range—of our recommendations are implemented.

Whether government gets the full benefit from those recommendations is something that we do not take for granted. We also look at the measurable impact on the areas that we were trying to tackle through those recommendations.

Every year, our annual report and accounts provides two assessments. One is the financial impacts of our recommendations—what the saving from implementing them has been to government and to the taxpayer—and we have a well-established methodology for that. All those savings are agreed by the relevant bits of government as having been made, we check that and the methodology is separately audited.

We then also have what we call wider impacts—in other words, non-financial impacts—such as improvements in control and other improvements that the public would notice. We gather those in a section of the annual report every year as well.

It is really important to us that we can evidence the impact of our work. Am I satisfied that it is as much as it could be? No, absolutely not, and it would be odd if somebody in my position ever was, because government has its own priorities. It is not always devoting as much resource as we have recommended to the areas that we have identified as needing attention. Although the recommendation might have been implemented, it may not have achieved the results that we think it could have done had it been tackled differently. That is still an area of challenge that we will continually raise with individual departments and with government centrally, while encouraging the Public Accounts Committee to do that in public as well.

Could we do more of the open-heart surgery and less of the autopsy? That is the process that I was describing earlier. We have moved upstream by force of circumstance, with the emergencies of Covid, the energy crisis and even the impact of the Ukraine war on all sorts of parts of the public finances. It is now routine for us to say to a department, "We are coming in at an early stage in this programme, rather than waiting until it has gone wrong".

Even that approach is not fool-proof, of course. My predecessor started with reviews of HS2 in its early stages, looking at the risks of that programme and making lots of salient points about the risks on affordability, cost management and so on, not all of which were adequately implemented, as we have seen. Even the auditor reporting in a timely way at the early stages of particularly big, long-term programmes such as that requires a proper response to those reports for it to have the desired effect, but that is absolutely in our methodology now.

Not all of government is yet comfortable with that. A number of times, we have had to resist pushback from departments, where they have said, "There's nothing to audit yet; you've come in too early". Where I have more sympathy is where they say, "All my staff are really busy responding to this emergency. The last thing that they need is an auditor asking questions". Of course, we take that seriously. This was a real issue in some of the health response during the pandemic, for example.

I think that we got that about right. Not everybody who was involved agrees with that, but that is a tension that our job is to manage. If we think that there is a public interest in early audit intervention, particularly, as you say, where it can head off wasted money, we will always make the case for that. I find that opinion in government is shifting in that direction.

Q7 **Baroness Bowles of Berkhamsted:** I would like to move on to transparency and ask how transparent UK regulators are about their own performance. Is it easy to tell when a regulator is performing well or badly? We discover things when we have inquiries into things that have gone wrong, but, in the steady-state peacetime or whatever, beyond the glowing reports that they give themselves in their annual reports, are there metrics that could be used to judge their performance in addition to qualitative evidence?

Gareth Davies: You will not be surprised to hear from somebody in my position that there is still a lot of room for improvement on transparency. This is a general point across government, not just regulators, but it very much applies to regulators. Like many of our answers so far, we see variable practice here. Some tackle this more successfully than others, but, overall, there is still significant room for improvement.

I would observe a couple of things here. First, regimes such as the freedom of information regime have had a positive role in putting a duty on public bodies, including regulators, but also a negative role in too much reliance being placed on the FOI system as the way in which people feel transparent, rather than a routine publication of performance and effectiveness information as a matter of course, whether anybody has asked for it or not.

Through our work, we are encouraging much greater use of routine reporting. Where we see good practice, we try to encourage others to follow it. For example, on the front page of the website, there is a very easy-to-use dashboard with the key performance indicators that really do matter to the public. It is routinely updated, quarterly rather than just annually—whatever the sensible frequency is for that measure—and the regulator can show that there is an effective assurance process backing up the accuracy of those regular reports. That is the world that we are moving into, but we need to move there more quickly and to routinely be transparent about performance data.

Of course, this whole topic of transparency depends on those objectives being clear and agreed, which is where we started this morning, because, unless you have clarity on outcome objectives and so on, you will not be reporting publicly on the right things. These do all go together. Once we have clarity on the right objectives, the world will become one of routine public reporting of performance indicators, which avoids drowning people in data.

This is the other tactic that we see too much of, with pages and pages of spreadsheets and people saying, “Look how transparent we are”. It would be much better to say, “This is what really matters to people and here’s the data, including the awkward bits that we are not proud of”. They need to be equally clear and not buried.

Baroness Bowles of Berkhamsted: I am back. I am afraid that I got frozen out there. I will have to go and listen to it later. I was going to follow up by asking what mechanisms could be introduced to allow greater scrutiny of regulators and about the Government’s role in separating the framework that they operate within. This, to some extent, overlaps with some of the questions from Baroness Taylor about the letters and so on. Should there be more openness about that?

In the recent changes that we made to the Financial Services and Markets Act, as those Bills were going through Parliament, we paid quite a lot more attention to where there are panels as to whether they should be called before Parliament more rather than just the regulators. As an extension of that, we also discussed whether there should be other ways of appointing rather than just government.

One example that I pushed—and we achieved this in the European Parliament when I was there—was to have some Parliament appointees on to panels, so that they perhaps had a bit more loyalty to reporting back to Parliament. In fact, in one instance, we even had parliamentarians appointed. I do not think that that was the original intention, but that is how it ended up.

Gareth Davies: In some ways, those are straying beyond my remit, because they are matters of parliamentary accountability for Parliament to take a view on, rather than the auditor. My observation would be that decisions on how to achieve effective scrutiny of the regulators should be driven by real clarity on what is going to add to public understanding of how they are performing and what will make a difference to the decisions that they take and the improvement that they pursue.

If you get the public accountability wrong, that can sometimes get in the way of some of that. My experience is that people devote a lot of time and effort to managing the risks, as they perceive them, of those public accountability processes, rather than concentrating on improving the things that everybody is keen that they improve. It is about just being really clear that those processes support efficient, well-run organisations and provide the right level of challenge, supported by clear public reporting, rather than becoming an industry themselves. That would be my observation, but those decisions are not for me but for Parliament.

Q8 **Lord Clement-Jones:** I just briefly wanted to follow up on a previous answer that you gave about the more upstream approach that you have. You look at the NRR, you take a risk and then you, in a sense, assess how resilient we are. Does that explicitly include the performance of the regulator or regulators in that particular area of risk and resilience?

Gareth Davies: I am describing something that is in its very early stages, but it is the intention that we are led wherever the risk and the mitigation arrangements take us, rather than having a predetermined list of bodies that we will cover. For example, the reflection that led us to this is that I could not show you an NAO report from the last 10 or 15 years that identified the weaknesses in our pandemic preparedness that turned out to be present. How do we avoid that situation in the future?

We cannot guarantee that we will, but we can certainly make it more likely that we will pick up those kinds of problems by taking this approach to the mitigation of risks that I described. That has to cover regulators, if it is going to be effective. Pretty much all the national risk areas that we are looking at do involve regulators alongside lots of other public bodies.

Lord Clement-Jones: You have the power and the skills to do that.

Gareth Davies: We certainly have the power. Essentially, if somebody is spending public money, we can investigate, which is a very broad power.

Richard Sullivan-Jones: That is apart from the Civil Aviation Authority, we should add.[1]

Q9 **Baroness McGregor-Smith:** Just to follow up on that point and on one of Lord Agnew's points, during the pandemic every single procurement rule that I have ever understood was ripped up overnight. Where was the NAO in that, given the challenges that have now come from some of the procurements that have been shown to have not been value for money? How do you stop that happening to us again? I want to be very specific on that point, because lots of people talk about pandemic preparedness and about all the detail, but, if you look at the really big, material things that did not work, how do we make sure that those cannot happen to us again?

Gareth Davies: First of all, where was the NAO on those questions? We were auditing them as soon as they were being spent. The reason that you know about the VIP lane, for example, is the NAO report of November 2020, which was the first public report of any kind to identify that. We took a sample of procurements that we thought looked extremely high risk—put it that way—and we reported in full detail on those straightaway. The Public Accounts Committee was able to take evidence from officials still in the heat of the pandemic.

This is a good example of that tension that I was describing earlier on, where people were saying, "Do you want us to procure emergency equipment or do you want us to answer audit queries?" We made sure that there was no gap in the accountability, because we could see the speed at which the money was being spent. It was absolutely essential that Parliament had better and independent information on what was happening, so that it could take a view.

Baroness McGregor-Smith: Were lessons learned from that?

Gareth Davies: There were many.

Baroness McGregor-Smith: Would one lesson learned from that be that you do not do X, Y and Z?

Gareth Davies: We published initial lessons learned from our pandemic report a year and a half ago, which covered procurement along with lots of other things. Government also agreed that there were shortcomings in the approach that they had felt they had to implement at the time. They commissioned their own review from Nigel Boardman and have implemented all the recommendations from that review. We keep going back to check that what we have been told is in place actually is in place.

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[1] Note from the witness: The National Audit Office can investigate the Civil Aviation Authority (CAA) where it has spent public money, but does not have general statutory audit rights over the CAA.

To solve something such as the procurement problems in the pandemic, government clearly needed better procedures, including for avoiding conflicts of interest, for example. Fundamentally, they need a more reliable supply chain for domestic supply of emergency equipment, rather than relying on very expensive contracts with China, as it turned out here, and middlemen making, essentially, large amounts of money from striking deals in a seller's market.

The only answer to that is having call-off contracts with domestic suppliers that can be switched to emergency production at short notice. If you are asking, "What are the lessons from the Covid experience on procurement?" supply chain resilience is probably number one.

Q10 **Lord Gilbert of Panteg:** You have touched a great deal on the skills and attributes that are required of effective regulators. I just wanted to ask whether you feel that regulators generally have the skills in-house, the culture and the incentives to carry out their functions effectively. In particular, are they equipped to speak out publicly, speak truth to power and take on government where that is appropriate? It seems to me that that is about not just skills, but character and authority, which are quite hard, specific things to recruit against. Do they generally have the skills and people with that character and authority needed to take on these roles?

Gareth Davies: I would say that, generally, they do. We have some high-quality people in leading positions in our regulators. As a general answer, it is possible to find the skills and experience needed to do an effective job in those areas. From personal experience, as somebody who has to say things that government does not like from time to time, I take a lot of comfort from the institutional arrangements that protect my independence, so I would not underestimate the importance of those here. It is not possible to protect all the regulators in the way that I am protected, because I am protected by parliamentary responsibility and accountability, which makes a big difference. It is not possible to do that for every regulatory role, but interrogating the effectiveness of the independence protections for regulators is a worthwhile bit of challenge.

As you say, it is not to be oppositional for the sake of it, but to have the skills to say, "This issue is emerging as an extremely important one if the regulatory system is going to be effective. Government doesn't seem to be taking it seriously enough. I need ways of raising it, so that it is properly addressed". Those are the kinds of practical circumstances.

It is the political skill of knowing how to raise information and issues in a way that gets their attention and builds personal credibility, so that people take those kinds of things seriously rather than crying wolf every time that an issue arises. It is the ability to discriminate between the ones that need serious escalation and the ones that should be dealt with at an operational level within the regulator. Those are the kinds of judgment skills. As I say, sectors are generally well served by people with those skills in role.

Richard Sullivan-Jones: There are also technical skills within regulators, which are important. There are the political skills that Gareth spoke about, but sometimes they will need to be informed by the analysis and the understanding of the markets. Again, we generally see a lot of good stuff and a lot of highly skilled, experienced people within the regulators that we audit, but we do find gaps. That may be particularly in areas of change, for example new responsibilities or duties that were repatriated to some regulators following EU exit. Although government gave its support and funding was available, the ability to recruit some of these specialist skills at pace and to find the people that they needed to find was not there. That is an area where we sometimes see gaps.

Gareth Davies: If it was a regulator sitting here, it would quickly mention the need to be able to pay the market rate for the required skills. That comes up a lot in our discussions with regulators about the risks that they are managing. As a workforce risk, the availability of that type of skill for the price that they are able to pay as a public body comes up a lot.

Lord Gilbert of Panteg: Do you have sympathy with that?

Gareth Davies: To a degree I do. It is overdone in some cases and requires some challenge, but it is a fair point. I remember speaking to a regulator that was setting up a new organisation a couple of years ago, and my advice was to have this argument with government straightaway rather than take a path of least resistance and then try to come back to it, because it would almost be too late. In that case, it established some ground rules about the skills that would likely be required, and a realistic view about what it would take to acquire those skills and the trade-offs that you have as a public body—usually a better pension and so on—which can help in attracting the right people.

Regulators have become quite skilled at operating within the limits that they have as public bodies and getting the skills that they need, but that is a really important area to scrutinise when looking at regulatory effectiveness.

Lord Gilbert of Panteg: Just on that, have you seen any evidence of predatory regulatees hiring effective regulators from the bodies that regulate them in order to take them out of the regulatory landscape?

Gareth Davies: I do not think that we have audit-standard evidence that I could quote to you on that, I am afraid. I am happy to check and, if so, write to the committee if there is anything that we have.

Q11 **Viscount Chandos:** I should declare various interests but, for brevity, they involve regulation by the FCA, the Charity Commission, Ofsted, the OfS and Ofqual. You referred to being in touch with international counterparts. Are there countries where the issues that you have set out are better addressed and, if so, what could we learn from them?

Gareth Davies: Certainly broad brush, no, I would not point to any country that has got regulation taped, but, on every issue where we think there is value in looking at international practice, we do find examples of good practice. We always have to be careful as to whether they translate to the UK context, but it is nearly always a useful challenge, even if the conclusion is that there are reasons why that would not work here.

Being self-critical, I do not think that we do enough of that, and nor does government. We tend to think that, if we do not have the answer, it may not exist. This is something that we are trying to encourage more of generally. There are examples, such as the regulatory sandbox approach, that have been developed more quickly in other countries. Equally, there are others that come to learn from their UK counterparts. It is a complex picture.

Viscount Chandos: Is there any theme that links where practice appears to be good, whether or not it appears, on examination, to be translatable here?

Gareth Davies: The US, for obvious reasons, is often where you go first, particularly on things such as financial regulation. The approach to regulation there is, in one sense, more heavy-handed, through Sarbanes-Oxley and compliance requirements on financial services of various kinds, but there is also a very open attitude to innovation in financial services.

Even in that one comparison, it is very difficult to say that there is a risk-averse regulatory approach that we can learn from. It is more about cherry-picking and saying, "That looks like an interesting approach to driving up standards of corporate behaviour in that field. How do you manage to do that without discouraging innovation and a competitive market?" It is case by case and very difficult to generalise from the evidence base that we have.

Viscount Chandos: The US separation of powers makes it very different, but, in other countries, what is the relationship between Parliament and regulators? Baroness Bowles referred to her experience in terms of the European Parliament.

Richard Sullivan-Jones: It is not something that has particularly come up in our work, to be honest. We have engaged with other audit institutions around the world. We have done some work through the OECD with regulatory communities. Generally speaking, on some of these issues around accountability, scrutiny, performance reporting and measurement, most major economies are dealing with the same kinds of challenges and difficulties when it comes to trade-offs and how you measure performance with regulatory work that is so distant from the outcomes and so on.

Gareth Davies: If you take environmental regulation, it is pretty well known that Germany is streets ahead of the rest of Europe on things such as recycling. There are technical reasons for that, which are replicable, but it is well known and well understood why it is so far ahead, and certainly well ahead of the UK. That is what I mean by understanding the case and then going to find examples of why that has been possible there, what it would take for us to achieve the same level, and whether those trade-offs are ones that are acceptable to us.

Q12 **Lord Cromwell:** The NAO is, of course, all about performance. Would you agree that one of the fundamental problems here is that regulators are bedevilled by conflicting objectives against which their performance is then measured, and that the reaction of politicians is usually just to add another conflicting objective in the process? Is that fair or is that flippant?

Gareth Davies: It is a description of reality and maybe an unavoidable one. The business of regulation is holding competing objectives in the right balance. It is more sophisticated than that, but that is the essence of it. Those objectives change over time, as we have seen, as policy changes and as some of the challenges that we face change, and so it is not a static balance that you are holding, but a dynamic one. Therefore, it is bound to go wrong, particularly when you see sudden shocks, as we have seen in the last few years.

The mistake then is to say, "That means that we've got the wrong system of regulation". It just means that we need to look at how efficient and effective the mechanisms are for adjusting regulation to rapidly developing circumstances. That is the approach that I would take. I do not think that there is a counsel of despair on it. It is saying, "That is the business of regulation, so how do we just embrace that and then make it work using better information, better data and more agile systems of management and governance in the regulators?"

Lord Cromwell: That, of course, brings us back into issues of measurability, but thank you anyway.

The Chair: Thank you very much, Gareth and Richard, for a very interesting session.