

REGULATORY REVIEW GROUP ANNUAL REPORT - 2009

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Dear Cabinet Secretary

I am pleased to present the second Annual Report of the Regulatory Review Group to you in line with its overall aims of

- creating a culture and environment in Scotland where both business and Government (in all its forms) work together to create better regulation for all, and
- In doing that, make Scotland recognised as the leading country in Europe in terms of better regulation.

In terms of the latter our work is becoming more widely recognised and commented upon positively by authorities. This will help us aim further and higher in terms of what we aim to achieve.

In pursuing our aims we continue to be aligned with the Scottish Government's Purpose of increasing sustainable economic growth. We are keen to ensure that Scotland improves its competitive position, in part through an improved regulatory environment.

We have made good progress this year across a wide spectrum of areas all within the five key principles of better regulation, namely:

Transparent:

- Government should be open and transparent to all stakeholders, including the regulator, when creating legislation;
- All stakeholders should know why the legislation is being put in place, how it will be implemented, impact on them, and should be encouraged and allowed to contribute to its creation;
- Government should be open and honest in how it communicates its intentions and also be open to receiving and responding positively to feedback;
- Government and regulators should be open, and honest, and be receptive to views and ideas on changing existing legislation based on experience of it working from any source within and out with Government.

Accountable

- All parties, Government (at Scottish national and local level), Regulators, and business, should be accountable for their part in better regulation and work together in partnership;
- Government should be accountable for the legislation it produces, its impact, and for reviewing it where appropriate;
- Regulators are responsible for seeing that businesses comply with legislation and for suggesting and implementing changes to it;
- Businesses are accountable for complying with legislation but also for suggesting changes to legislation where the original outcome desired from the legislation can be achieved in a better way. Regulators and

Consistent

- Government and Regulators must put in place processes that ensure that legislation is created and implemented consistently - whoever does it in their organisations or jurisdictions.

Proportionate

Legislators and policy makers should

- take enough time to look at alternative methods of implementing policy other than legislation;
- understand the breadth and complexity of the markets that the legislation will impact on;
- appreciate how a particular regulation will interact with other regulations;
- Recognise the differing issues and circumstances of businesses of different size and sectors.

Businesses have to be proportionate too, and understand that while legislation is not always an ideal outcome, it reflects the interests, needs and aspirations of the wider community. Businesses have to accept that the burden sometimes may be proportionate to that societal impact or benefit.

Targeted

- Legislation and regulation should only impact on those it was intended to effect and not others.

RRG is striving to build awareness of, and commitment to, these five principles of better regulation. This is a key challenge for us all as it creates a need for some fundamental changes in how individuals in Government, Regulators, and business work and think, both separately and together. Progress depends critically on winning 'hearts and minds' and changing behaviours, rather than reforming processes only, even although they may need changed as well.

We believe that these changes though align well with the general change program within Scottish Government and we are working to ensure that our recommendations become an integral part of that.

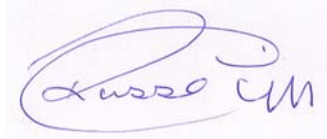
In terms of our recommendations and work plan set out last year we again believe that the partnership between Government, Regulators, business, and other interested parties has worked well in moving all those forward. Our further recommendations are set out in the report. In the main they build on what was there last year. We are confident they can be achieved.

Our only concern in terms of ensuring that we all move forward at the same pace remains around Local Authorities where engagement has been slower than we would have liked. I believe it will be into the coming year before we can assess the impact of their range of new regulatory responsibilities. We

look forward to working with local authorities and with Government to better connect those responsibilities and our 5 principles and also how they fit within the Concordat.

In summary therefore we believe that during this year we have developed the work we are doing and built it into a more holistic framework across Government and Regulators. We are making good progress towards the culture change we all desire.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Russel Griggs", enclosed within a light blue rectangular border.

Professor Russel Griggs OBE
Chair
Regulatory Review Group

1. Introduction and Background

The Regulatory Review Group (RRG) is pleased to present its second Annual Report to the Scottish Government in line with its overall aims of

- creating a culture and environment in Scotland where both business and Government (in all its forms) work together to create better regulation for all, and
- In doing that, make Scotland recognised as the leading country in Europe in terms of better regulation.

In pursuing our aims we continue to be aligned with the Scottish Government's strategy of delivering increased sustainable economic growth and to ensure that Scotland improves its competitive position.

We thank an ever increasing number of individuals and organisations who are working with us on this agenda as RRG cannot, and should never, be seen in isolation but rather as a catalyst, driver, and 'Hub' for change in this area. We thank them all for their honesty and enthusiasm in dealing with us on these issues and look forward to developing our 'hub and spoke' network further over the coming years. In saying that, let us also be clear that while we operate as an independent body to encourage a culture and process that allows better regulation to operate, and be produced, it is not in the end RRG that Government, Regulators and others should be aiming to 'please' in this matter but the businesses and their customers who are impacted by regulation of all kinds, and who will improve Scotland's competitiveness.

We also thank all the political parties in the Scottish Parliament for taking a collegiate approach to this issue, and working with us on what we all accept is a matter that any party in Government has to address and we appreciate their constructive approach to our agenda and discussions.

This is an appropriate time and year to present a report on better regulation. The turmoil in the international financial markets over the last 12-18 months has demonstrated the folly of poor and ill defined regulation or regulatory processes. Punitive regulation is not the answer but the need for better regulation focused on clear and agreed outcomes is surely 'without challenge'. While we will not refer specifically to financial regulation in this report we believe that the approach RRG had already embarked on fits well with how regulation should be created and operated and sets in place a sound basis for moving forward into what will be a different world for us all.

RRG remit

The RRG has been in existence since 2004, as an independent body, but its remit was expanded in 2007 by the Scottish Government to advise it on better regulation [*Its remit and composition are set out in Annexe 1*]. The composition of RRG has changed since our first annual report with Consumer Focus Scotland joining us in March 2009 as a full member. Consumer Focus Scotland is the new consumer advocacy organisation in Scotland. They aim to

secure a fair deal for consumers across Scotland. We are confident that there will be benefit to the Group from their focus on better regulation from the consumer point of view.

The Local Better Regulation Office (LBRO) has joined with observer status. We are pleased to welcome LBRO given that last year we had to intervene in respect of parts of LBRO's objectives which did not fit in Scotland and would have added burden rather than reduce it to businesses in Scotland. That engagement has led us to have more joint discussions around other parts of the LBRO agenda and, importantly, the work they are doing with Local Authorities which we feel can add value to what we are doing in Scotland in getting Local Authorities to better understand the impact of their regulatory role.

The key word here is "Better" regulation rather than less or more. Government, business, and the wider population all want, at some time or other, new regulation to control aspects of what they do, when it needs to be done, and in a way that is appropriate and proportionate to give the desired outcome. This principle of appropriateness and proportionality applies as much to enforcing regulation as it does to its creation and introduction.

Context

RRG decided in its first year that, unlike other bodies of its kind within the UK and elsewhere, it would not focus on targets or budgets as it did not believe that approach would deliver the substantive and real change which is inherent in its remit and core purpose. Better regulation is about achieving exactly that, which a drive for reduction and cost saving may not deliver. Targets tend to influence behaviours and, as can be seen in parts of the financial community over the last couple of years, do not always lead to the right outcome. We resolved also to resist the temptation to take, and promote, a 'tick box' mentality which might appear to show much on the surface but little of substance underneath in terms of culture change.

Instead, RRG has adopted and adapted the five pillars of regulation that have been used elsewhere: transparent, accountable, consistent, proportionate, and targeted. We believe that:

Transparent:

- Government should be open and transparent to all stakeholders, including the regulator, when creating legislation;
- All stakeholders should know why the legislation is being put in place, how it will be implemented, impact on them, and should be encouraged and allowed to contribute to its creation;
- Government should be open and honest in how it communicates its intentions and also be open to receiving and responding positively to feedback;
- Government and regulators should be open, and honest, and be receptive to views and ideas on changing existing legislation based on

experience of it working from any source within and out with Government.

Accountable

- All parties, Government (at Scottish national and local level), Regulators, and business, should be accountable for their part in better regulation and work together in partnership;
- Government should be accountable for the legislation it produces, its impact, and for reviewing it where appropriate;
- Regulators are responsible for seeing that businesses comply with legislation and for suggesting and implementing changes to it which, from experience does not work properly or as intended or where subsequent developments identify ways to enhance implementation or compliance post legislation. However, 'early adopters' should not be penalised retrospectively for having developed solutions that do work;
- Businesses are accountable for complying with legislation but also for suggesting changes to legislation where the original outcome desired from the legislation can be achieved in a better way. Regulators and Government have a responsibility to listen to those suggestions constructively and respond to them.

Consistent

- Government and Regulators must put in place processes that ensure that legislation is created and implemented consistently - whoever does it in their organisations or jurisdictions.

Consistency also relates to the issue of 'gold plating' and 'level playing fields' across jurisdictions, which can impact on competitiveness. At its simplest, it would be ideal if consistency could be achieved across all devolved jurisdictions within the UK, and across Europe, but it is increasingly difficult to do that as devolution impacts on cross-UK regulation. It is too simple to say that if one jurisdiction's way of implementing a regulation is more burdensome than another then it must be wrong. As different jurisdictions look to develop their policies and better regulation in different ways so we are beginning to see that while there may be increasing differences it should not always be concluded that regulation which is tougher or has greater impact is necessarily wrong and needs to be changed. The example of the Energy Performance Certificates Directive is a good example here and is highlighted in detail later in this report in **Section 3: Focus of our work in the past year – Reviewing Legislation**

Proportionate

The impact of regulation should be to produce the effect it was designed to do on those it is targeting, i.e. meeting its objectives. If it does not then – in stark terms - it is not good legislation or the regulator is implementing it badly. Too often legislation has 'unintended consequences' which are not proportionate. We believe that this is often due to legislators and policy makers failing to:

- take enough time to look at alternative methods of implementing policy other than legislation;

- understand the breadth and complexity of the markets that the legislation will impact on;
- appreciate how a particular regulation will interact with other regulations;
- Recognise the differing issues and circumstances of businesses of different size and sectors.

Policy makers need to ensure adequate time during early deliberations both to examine options and understand their ‘customers’.

Proportionality also speaks to the issue we raised in our first Annual Report in that Government needs to get better at communicating new legislation and changes in existing ones to businesses. It is not a core task of business to make themselves aware of those things as they should be focussed on sustaining and/ or growing their businesses. It is therefore up to Government and regulators to ensure that businesses are notified effectively about new or changing regulation both in terms of why it is being put in place and how it will impact on them.

Recent examples to do with REACH regulations and others show that there is still some way to go in making this happen. A Minister standing up and announcing a new or changing regulation in Parliament is not enough which sometimes is still all that happens. We are aware that parts of Scottish Government are active in trying to make this better but it should be taken on board by all those who need to communicate such matters to business. Without it proportionality will not happen as without knowledge a business cannot judge whether it is proportionate or not.

Businesses have to be proportionate too, and understand that while legislation is not always an ideal outcome, it reflects the interests, needs and aspirations of the wider community. Businesses have to accept that the burden sometimes may be proportionate to that societal impact or benefit.

Targeted

Legislation and regulation should only impact on those it was intended to effect and not others. As markets grow more complex and interrelated, the impact of legislation often becomes broader too. The UK Government’s own Standard Industrial Classification (SIC) codes have not kept up with market developments, for example, so as a way of classification for regulation, are neither sensible nor appropriate. Legislators, policy makers, and indeed regulators need to clearly define who and what it is they are trying to effect by legislation and confine it to that. Again, this means that those creating or implementing legislation must understand the market they are targeting and frame the legislation and compliance in a way that only impacts on those it wishes to effect. The changes to the Fire Regulations relating to B&B’s introduced last year is a good example and is highlighted in detail in **Section 3: Focus of our work in the past year – Reviewing Legislation.**

RRG is striving to build awareness of, and commitment to, the above interpretations of the five principles of better regulation. This remains a major

challenge as it creates a need for some fundamental changes in how individuals in Government, Regulators, and business work and think, both separately and together. Progress depends critically on winning 'hearts and minds' and changing behaviours, rather than reforming processes only, even although they may need changed as well.

That is why, in our first annual report, we confirmed our role as changing both the 'engine' of legislation and regulation within Government and also creating a partnership between those three parties, Government, Regulators and business, to create and manage better regulation.

However this requires culture change in all parts of the partnership. That is why we maintain that while the changes we propose, and believe in, will create a culture of better regulation across Scotland, it will take time for the change process to work. Cultural change is a large and complex subject that exists within large and complex organisations so of its nature will not change all at once or at the same speed.

Having said that, we believe we have made real progress in our second year both in terms of driving through culture change and getting specific processes and issues addressed.

We continue to take an evidence-based and inclusive approach to our work, with over 100 meetings with stakeholders (Government, Regulators, and businesses) in the past year. This culminated in a large gathering in March where representatives of an emerging and coherent Scottish regulatory system met for the first time to discuss common goals and issues. The discussion was facilitated and mind-mapped by Jim Mather MSP, the Minister for Enterprise, Energy and Tourism whose portfolio also covers better regulation. As a natural follow-up to this the leaders of the regulatory bodies and key members of their sponsoring divisions have been invited to a further event which is expanded on in the comments set under recommendation 9 in **Section 2** below.

2. Recommendations from First Annual Report

We continue to believe that we should be judged on what we are achieving, so before moving on to specifics of our work this year it is worth reflecting on the implementation status of the recommendations from our initial annual report.

Our key recommendations are in italics below, and progress stated after each:

1. *Government and business (in its widest sense and including all those involved in it) should move to a way of creating and changing regulation which is a true partnership between both parties. This partnership will have at its heart the understanding that to make better regulation, each side should understand what the other is trying to achieve, what the impact of that will be, and agree the most appropriate way for that to be achieved.*

This partnership is holding firm and beginning to develop with, we believe, much more interchange between all parties. Examples include:

- a. Food Standards Agency's positive alignment with the Aquaculture Industry's need to produce more healthy safe nutritious food
 - b. Regulators seeing their roles as enablers rather than enforcers working with the "regulated" to get better results and increased sustainable growth
 - c. SEPA working with companies constructively to try and resolve problems for mutual benefit.
 - d. Government, SEPA and business working together to try and resolve issues around the Waste Incineration Directive
2. *A new shorter and simpler Business Impact Assessment (BIA) should be introduced. To invoke a clear sense of purpose and the resultant culture change that are required the BIA may need to be initially mandatory for all legislation and statutory instruments where businesses will be impacted by its introduction. It would ask 9 straight forward questions that would have to be answered substantively for such legislation etc. Questions 1-7 are questions that business would ask of Government in its creation of the new legislation, and questions 8 and 9 are ones that Government would ask of business.*

As is stated in the recommendation above we did not want the BIA just to become 'another tool' or thing to do or, worse, simply a box that could be ticked to show that it had been done. The questions in the BIA are constructed to bring about a mindset change in those that use them. They represent what any policy maker should be thinking and doing to optimise benefits and impact. Therefore, we have worked to make sure that the thinking within the BIA is very much embedded within the overall Scottish Government change programme which is being instigated for the civil service in Scotland - and promoted to the public sector as a whole. As part of that change programme the Scottish Government is developing a new Business and Regulatory Impact Assessment which integrates the best elements of the existing approach to Regulatory Impact Assessment (RIA) with the added-value and business-focus inherent in the BIA. We hope that now a solution has been reached for the implementation of the BIA it will be implemented as soon as possible to start the change in thinking we believe it will bring and needs to happen.

What is heartening for us is that we have already seen parts of Government using the BIA with positive outcomes which we hope will further encourage early adoption.

The Marine Directorate used the process when it was introducing controls on the movement of fish: Regulating the Introduction of Freshwater Fish and the Crayfish Risk. They aimed to do this in a reasonable and proportionate way and involved various industry bodies in devising arrangements for implementing the new controls. Both users and legislators were satisfied with the outcome and we believe that it represents a good practice model for others to use on engagement and a focus by all on a single agreed outcome and purpose.

With increased awareness and training, and improved monitoring within Government, we expect to see evidence of further progress of an awareness of the impact of proposed regulations on business across the organisation as a whole and related benefits for business in Scotland. We also recognise that this will further develop the role of RRG to include reviewing and contributing to the completion of more challenging BRIA cases, and reviewing existing legislation where changes or review may be necessary.

3. *Each Government Department and Regulator that introduces or enacts legislation affecting business has a group of businesses that it uses to 'road test' all relevant legislative literature and forms prior to implementation.*

See commentary on 4 below.

4. *Government and Regulators constantly review the composition of their stakeholder groups, almost on an issue by issue basis, and continuously ask themselves the question "are these the best people who can give me a true end user view on this specific subject in the detail I require to make the correct decision on the outcome I am seeking?"*

Some progress has been made here but there is much still to do especially tied in with the BIA above. However a good example of involving businesses can be seen within the SEPA change programme.

Scottish Environment Protection Agency Better Regulation Case Study

In August 2008, the Scottish Environment Protection Agency (SEPA) took the bold step of grasping hold of the Regulatory Review Group's (RRG) recommendations and offering to pilot them. Nine projects were quickly scoped out by SEPA and work began in September on a wide range of Better Regulation projects, including:

- Exploring the use of simpler English in key written communications;
- Launching a new Compliance Assessment Scheme;
- Selecting 10 companies to work closely with on simpler ways to comply and how to improve regulation at a site level;
- Developing a 'freeloader' strategy (for non-compliant businesses);

- Driving forward on the Better Waste Regulation Action Programme (jointly with Scottish Government);
- Examining how to simplify the licensing process;
- Delivering phase 1 of Scotland's Environmental and Rural Services (SEARS) and developing proposals for phase 2;
- Seeking to streamline and simplify regulations, for example, the use of standard permits and review of specific legislation with government.

In April 2009, seven out of nine of SEPA's projects were on track and corrective action put in place for the remaining two. SEPA demonstrated a strong commitment to Better Regulation, including the completion of a survey of over 1000 regulated businesses, through these RRG projects. For 2009-2010, SEPA will be implementing an Annual Operating Plan which will include a range of corporate projects on Better Regulation, customer focus, supporting enterprise and encouraging environmental clean technology so as to address cultural issues and provide the necessary focus on outcomes, efficiency and improved effectiveness.

This will include a fundamental review of the licensing framework as well as the current enforcement options, sanctions and penalties etc. SEPA will be exploring the possibility of licensing significantly less activities and giving broader coverage to standard permits, registrations, general binding rules and codes of practice. This will change the nature of regulation and the expectations on the regulator as well as operators. The possibility of single permits will also be addressed in this work with experience being sought from other parts of Europe and the UK. SEPA will be working closely with Scottish Government and its customers in doing this work.

5. *Regulators should be involved, as a matter of course, in the creation and production of new legislation as without their input the Government is not using all the knowledge it has at its disposal to create better regulation.*

This is happening and there are now few barriers to regulatory interaction across all departments and regulators. A good example of this is how those from Scottish Government leading the formation of the new Marine Agency consulted widely with all potential partners on what should its purpose be and what needed to happen to put in place an agency which would deliver the required outcome. This also provided a more holistic approach to the creation of something new, where each organisation's learning and knowledge can add to the process of creation.

We are also pleased that the new Public Services Bill will change the way the Care Commission operate and take away the need to undertake a specific number of inspections per year per care home which we, and they, believe led to poorer regulation as it did not reflect the Care Commission's own view of the need to balance inspection

against those who need it and those who do not. It is also a good example of how when Government adds the 'how to' to legislation, which it did on this occasion in the original Bill, it can hinder the desired outcome of the Bill.

6. *There should be a system in place that tests Westminster regulation against the different practices, legal systems, and methods that apply in each part of the UK **before** it is enacted, rather than after, which appears to be the case currently. We believe that such a system should be the responsibility of Westminster to the creation and implementation of new legislation which applies across the UK.*

See commentary on 7 below.

7. *To ensure transposition of UK-wide legislation into an appropriate form to be enabled in Scottish Law, UK-wide Regulators with HQ based outside of Scotland should have at least one Scottish lawyer employed within them.*

While we have engaged with many on this subject, all of whom at both Holyrood and Westminster agree there is an issue, and perhaps an increasing one, to be resolved here, we have yet to resolve it. The Scotland Office, who we commend for their action, is now trying to make sure that devolution is better understood across Westminster, but this is on a case by case or issue by issue basis, as there does not appear to be a way to build it into the generic process of Government at Westminster.

With the support of the Scottish Government, and The Scotland Office, RRG has proposed a meeting of all those involved in the better regulation process across the UK to meet later this year. This is with a view to discussing how we can understand more of what each other is doing, to learn and share more good practice, and put in place a process for recognising the increasing number of differences that will occur and understand the outcomes of those.

In the meantime issues of difference are still arising and being highlighted to us, for example, the differences in Energy Performance Certificates (EPC) between Scotland and England. Our analysis of this is still ongoing but what we find unacceptable is that those within the Scottish Government who put the permit in place do not know why it is different from that in England. This is an interesting case for us as while the current EPC in Scotland could cause business to be disadvantaged in the short term, arguably it may be a better permit that offers a better competitive advantage for Scotland in the medium to long term.

8. *The Scottish Government should have the right to make its own case directly to the EU where it feels this is necessary rather than relying*

upon the relevant Westminster Department. In this respect we would strongly support the 'Team Scotland' approach in Europe as set out in the key messages of the Scottish Government Action Plan on European Engagement.

There is general acceptance now that this can happen and indeed officials at Westminster have confirmed that it has always been the case that Scotland could make its own representation to the EU on a matter.

Scottish Government is itself working on producing guidance for their staff on the Handling of EU obligations. We welcome this and also that SEPA have made a significant contribution to this, as a result of their own work in the EU, which again we welcome and shows not only a more focussed approach to this subject but also the benefit of different parts of Government working in tandem and together.

9. *The RRG should work with Government and Regulators to develop a system of empowerment which allows relevant officials in Regulators and government, working within clearly defined criteria, to change the way legislation is administered and bring practical proposals to the attention of their senior management who can then discuss with Government how the legislation might be changed.*

This was one of the most important of our initial recommendations and we have made good and positive progress in this, thanks mainly to the positive way that regulators have engaged in the process. Through ongoing consultation with regulators and by adopting our policy of wishing to assist them to run their business in the most effective way to produce better regulation for us all we believe we now have strong working relationships with the majority. We have seen in all regulators signs of change to a greater or lesser degree. We take that as a positive signal that everyone is beginning to work to the same overall agenda on better regulation, and sustainable economic growth. This has manifested itself in many forms and we congratulate all regulators for moving forward on our agenda.

In this respect, SEPA merit a special mention as it has embarked on a wide and challenging change programme within its business, with better regulation as one of the key drivers. SEPA as a regulator is by its size and spread the regulator that has been highlighted on many occasions to us facing challenges in:

- a) The legislation that they have to apply and enforce;
- b) The way they apply and enforce that legislation;
- c) Consistency of approach across their offices and sectors;
- d) Level playing field on legislation with their counterpart the Environment Agency in England, and elsewhere in Europe.

We have met and discussed this change program with SEPA as it has developed throughout the year in terms of how it will address the four factors outlined above. It is now being rolled out across the whole business with key changes to both culture and process which should bring better regulation to us all over the next few years. We will continue to work closely with SEPA to help with implementation challenges they face both from within and out with the organisation. This will include changing the permitting and licensing framework to one of single permits for sites and binding rules for other which very much fits with our better regulation objectives. The singling out of SEPA does not mean that others are not changing but theirs is a complex challenge given the wide sectors they cover and we warmly welcome their approach. However, the proof will be in how quickly SEPA can get management desire and imperative through to those that work with individual businesses on a day to day basis. Only when this happens will business and Government see real change.

We also welcomed the SEARS initiative with the agricultural community, which brought together a number of the public agencies to lessen the visits and burdens on farmers. We also understand that progress to further this is under way. However, two issues have come from the exercise which we should all learn from. Firstly the SEARS initiative focussed primarily on Scottish regulators and not all regulators controlled from other jurisdictions. This was a missed opportunity to recognise that 'customers' do not differentiate between which part or arm of Government regulators come from. We hope that as SEARS develops it can bring in all regulators so that there is truly a single Government approach to how regulators operate in this area and that it could form the basis of good practice to be transferred elsewhere. Secondly in subsequent discussion with farmers, it has become clear that it is not only the public sector regulators that cause them the most challenge or burden but those employed by the privately run 'Quality' bodies who visit them as well. This brings home to us a fact that is sometimes ignored in regulation, in that it is not just the public sector that has rules and regulations that impact on business but the private sector imposes its own as well. While only a thought for the future it would be good to see as SEARS develops, if there is a way of getting all regulators to work together both from the public and private sectors.

There are areas though where we feel much more work needs to be done and, as is stated earlier in this report, we are bringing regulators and their sponsoring departments together on 10th June to try and establish:

1. A set of guiding principles that we can all work to in terms of how we wish better regulation to work.
2. Whether the Key Performance Indicators (KPIs) that the Regulators currently work under lead to or encourage better regulation.
3. A definitive list of what needs to change from which an 'Action Plan' can be produced.

While much progress has been made in this area there is still more to do. Key to this is re-examination of the KPIs the regulators work to, to ensure they drive the type of behaviours that lead to better regulation, with the priority and resources needed over other issues to make it come to fruition. In an outcome based and holistic approach to better regulation, which is where we would wish Scotland to reach, we have to ensure that the KPI's put in place do not act against such an outcome as perhaps some have done, and indeed could still do.

We have, based on evidence from many businesses, strong reservations about the way some Regulators insist on copious amounts of detail being provided to them to 'prove' that businesses are compliant. This switches the accountability from the company – where it should be – to the regulator. Adopting this process also creates mistrust between the company and the regulator and puts the onus on the regulator to say the business complies. In many instances the regulator does not wish to take this responsibility so a continual circle of asking for more information ensues. This taints the tone of relationship between business and the regulator.

We believe that an approach where companies are trusted to comply, through a mixture of self assessment and random audit, leads to a more trusting and enabling relationship.

This has always been the way that businesses generally are treated in terms of their accounting, tax and governance practices where they are trusted to learn and comply themselves and audited to 'check' they have done it correctly.

We believe that regulators in Scotland, where appropriate, should adopt this approach and move away from a regime which encourages mistrust, requiring the provision of copious amounts of information to regulators (much of which is never used) and shifts accountability from the regulator to the regulated.

Over the last two years HMRC has embarked on and enacted a change program which could be a model for others to follow. It is based on systems thinking and a customer driven approach, and is truly holistic. We are working with HMRC and SEPA to see if there is learning and best practice that can be brought from HMRC's work and experience which could be used in Scotland. This approach has also allowed HMRC to focus its vision and objectives more precisely and simply, which others could learn from.

We believe also that the work by the Care Commission and Audit Scotland to move part of their processes to self assessment fits well with the auditing approach set out above.

Sometimes the process of how legislation should be implemented is written into the legislation itself, which we believe in most cases is wrong as it works against the Scottish Government's outcome based approach. Legislation should define what it is that is trying to be achieved (the what) and leave the 'how to' to those regulating or complying with it. Our combined experience tells us that in this ever changing world ways of doing things and processes constantly change and therefore should not be established in statute.

How legislation is implemented and enforced is also critical. Consistency is a key issue that RRG has, and will continue to, tackle as an uneven playing field is one of the most regular 'complaints' from business. This does not just apply across countries, where parliaments and jurisdictions may take a differing view on a subject, but also across and even within organisations where different staff may interpret and enforce regulation differently. Therefore, in their change programs regulators must ensure that consistency of approach is at the heart of what they do. Uncertainty hinders business planning, decisions and investment.

The consistency of implementation and enforcement by Local Authorities is a concern to us and is commented on later in the report. However we would comment here that while we understand and agree with the general thrust of the Scottish Government's concordat with Local Authorities, we need to balance this with the need for consistency of approach in terms of implementing and enforcing legislation that falls to them so we do not return to the days of post codes or areas driving different impacts on businesses.

Finally in terms of new legislation we made the point in our first annual report that many of the areas that legislation and regulators are now impacting on are relatively new. In many cases we are all learning how to do things in these new sectors, such as the environmental area. RRG notes the concerns expressed by some businesses who have been early adopters of the aims of environmental legislation, and who have invested significantly in adhering early with the new legislation. Some appear now to be penalised because regulators have since developed other regulatory practices. We need early adopters in business to better regulation if we are to move forward in many of these difficult areas so they should not be penalised for early adoption.

10. *The RRG should work with Regulators and Government to develop a more effective business model for Regulators which would drive the behaviours we all want to see of empowerment and better regulation, which will include both looking at how certain regulators are financed and also how the NDPB outcomes may be delivered in a way that helps them achieve better outcomes.*

See commentary at 9. above

11. *That the potential skills shortages facing Regulators and Local Authorities be addressed. We ask that the appropriate Cabinet Secretary meets the Regulators concerned to look at how these issues can be managed.*

While we have discussed this with the Cabinet Secretary concerned we have not actively pursued it as yet mainly because the change programs that the regulators are embarked on may in turn change the needs and requirements for personnel.

In summary, we are pleased with progress on our initial recommendations. Although full implementation in some areas is taking longer than we would like we recognise and welcome that there is no fundamental barrier to faster and further progress. The pace reflects the need to imbed these changes in the culture of the organisation - whether Government, Regulator, or business - rather than just as 'other tools' to be used when convenient.

3. Focus of our work in the past year

Apart from continuing the work around the above recommendations we stated that there would be four other areas we would look at in our work during this year. These were:

1. Reviewing Legislation
2. Competiveness
3. Other Government Agencies
4. Local Authorities

Reviewing Legislation

We have been involved in three areas where a review of the legislation could be done and is important in order to improve the regulatory process. A fourth issue is set out below as a standalone case study as we feel it encapsulates many of the frustrations surrounding the current regulatory process as well as the opportunities for improvement.

- a) Extension of Fire Regulations in Scotland – The introduction of the Fire Scotland Act 2005 placed new fire safety duties on small businesses. Although the main aim of the Act was to simplify fire safety legislation by placing a duty on businesses to carry out a risk assessment and take appropriate action, it emerged that the new legislation affected a number of businesses not previously covered by fire legislation. In particular, small Bed and Breakfast establishments and self-catering premises were caught by the new law and covered by the same guidance used to regulate Houses in Multiple Occupation (HMOs) and small hostels which are categorised as higher risk. Subsequent inspections by fire authorities often resulted in costly and disruptive changes to the premises being required which were not necessarily proportionate to the risk. This outcome was not anticipated when

preparing the legislation and the interpretation of the legislation has not resulted in the intended simplified system which would be easy for businesses to use and understand. There are two issues that arise from examining this legislation.

1) While the regulator did consult with trade bodies prior to the introduction of the new legislation, those creating it were not clear as to what its effects would be. There was no detailed understanding of the accommodation market and how it operated, which would have let the regulator better define who should, or should not, be covered. Even if it was decided that everyone was to be covered, this deeper understanding of the market place would have allowed guidelines to be put in place so that different types of B&B, for example, could have been dealt with proportionately.

2) Having introduced the legislation, it was then interpreted differently by Fire Officers across Scotland where some take a light touch and some do not. From subsequent meetings, it is clear that all sides have learned from this but it highlights two of our continuing key concerns with legislation in Scotland; namely, that those creating legislation do not gain a detailed enough knowledge of the market and/ or sector they are targeting so as to understand the effect it will have, and if that effect is the desired one. Also, that inconsistency in delivery across Local Authority areas, in this case by the Fire service, causes inappropriate delivery of the legislation. The latter can only be cured by those in the 'centre' be they national regulators or central policy makers issuing stronger guidelines as to how legislation should be implemented removing the need for substantive local interpretation.

b) Licensing (Scotland) Act 2005 – This is the biggest change to Scotland's licensing laws in 30 years and it affects the vast majority of outlets where alcohol is served and sold. The Act will be fully implemented on 1 September 2009. In 2008 it was brought to our attention that there were concerns around the increased licensing charges for pubs and other businesses as a result of changes in the licensing legislation. On investigation we discovered that the new regulations require each Licensing Board to work on a cost recovery basis i.e. set their fee levels so that the expected income is equivalent to the costs of running the system, which had not previously been the case. In the first year under the new regime costs were estimated and that was the basis for the charge set. At the end of the first year the fee structure will be reassessed in the light of experience and the fees readjusted accordingly. However, it was claimed this was not communicated well to businesses which were understandably upset at an increase with no real explanation. In our opinion from investigation we believe that the business view was substantiated due to the fact that communication only came from a sentence in the Cabinet Secretary's statement in the Parliament which in our view was not sufficient. RRG agreed with the relevant policy officials in Scottish Government that they would remain in contact and review their first

year review and also their communication with the sector. The policy officials will be invited to a RRG meeting later this year to discuss this and other aspects.

This example highlights an issue we raised in our first Annual Report, in that Government and its agencies were not good at communicating. Government's contention that business had been informed through a Parliamentary announcement is not good enough and a fuller communication program to let business understand the process should be in place.

- c) Energy Performance Certificates (EPC) – Following a public consultation on the implementation of Articles 7, 8 & 9 of the Energy Performance of Buildings Directive (EPBD) it was decided, in Scotland, to take an 'asset' based approach with regard to EPCs. This means that each building has recommendations on how it could become better in relation to the calculated annual carbon dioxide (CO₂) emissions of the building. There are differences between Scotland and England & Wales in the way in which the rating of a building is calculated and the extent of information presented on EPCs. In England & Wales the rating is based on a comparison of the emissions from the building with that of a reference building (set at a rating of 100) of similar type. RRG received a complaint that EPC's in Scotland were harsher than in England and, therefore, having a negative impact on property development. We are still in the process of completing this investigation but it already highlights an issue that we feel needs to be addressed. It is clear from discussing it with those within Scottish Government that the Scottish EPC is different substantively to the UK. What concerns us, is that Scottish officials cannot fully explain why it is different. While there may be different policy objectives in devolved areas of the UK, it is important that officials do know and understand why and how this is in order to explain the difference to businesses affected. We recommend that where Scotland does decide to legislate or enforce differently from other parts of the UK, then both legislators and regulators must be able to articulate clearly to business why there is the difference.

Accepting that the Scottish permit may impact negatively on property owners in the short term, it may in fact be a policy decision which in the medium to long term may give a competitive advantage so we will continue our investigation until we decide on which way the balance falls.

Case study

Waste Incineration Directive (WID)

The content and implementation of the Waste Incineration Directive provides a vivid example of the perverse consequences that can arise from new regulation. However, perhaps the most concerning aspect of this case study is not the flaws within the Directive itself; they have been recognised by the European Commission (and by the UK and Scottish Government and SEPA) and will hopefully be addressed in forthcoming legislative changes. Of most concern is that in the intervening period, prior to changes to waste legislation, the most problematic elements of WID are still being strictly enforced in Scotland, while other parts of the UK and Europe appear to take a more pragmatic approach.

WID was passed in Brussels in 2000 and came into force in the UK at the end of 2005. It was aimed at addressing perceived gaps in two existing waste-related Directives. In essence, WID is designed to reduce the impact of emissions that result from the burning of waste. It covers any solid waste, from tyres to household rubbish, to anything liquid such as oils and solvents. Its objectives are laudable, however its impact has been hugely problematic, mostly because of the flaws in what is deemed as 'waste', and therefore within the scope of the Directive. There are two specific examples that highlight the difficulties:

1. One of the by-products of the rendering of livestock carcasses is tallow, which is in effect animal fat. Because it has a high calorific value, it is a good, renewable source of cheap fuel which is environmentally preferable to burning heavy oil. As a result, rendering plants switched to using tallow which delivered economic benefits to their businesses and environmental benefits to society. However, when WID came into force, tallow was deemed a waste which meant only licensed incinerators could burn it. It was estimated at the time that it would cost the rendering industry around £30 million across the UK to become WID-compliant. The perverse situation, therefore, has been that renderers have had to turn their backs on this green alternative and use heavy oil, releasing around a quarter of a million tonnes of extra carbon into the atmosphere every year.
2. Scottish Power's Longannet Power Station uses around four million tonnes of coal per year. This produces around 400,000 tonnes of ash, 275,000 tonnes of which is processed by ScotAsh Ltd on a neighbouring site. The material is separated into low and high carbon ash. The low carbon ash is recycled into sustainable construction material which reduces the environmental impact of both quarrying for new aggregate and landfill disposal of the ash. The remaining high carbon ash could be re-used by Longannet, conserving in the process 16,500 tonnes of coal and saving £1

million in costs. However, under an interpretation of WID, this ash is deemed a waste and Longannet does not have the appropriate licence to allow it to reburn the ash. Therefore the ash currently is returned as waste to lagoons for disposal which is not as good an environmental solution as reburning it.

3. SEPA have also been trying with Scottish Government to look at de-minimus levels where while the legislation may technically apply the risk to the environment is not there and the investment companies would have to apply is therefore disproportionate and unnecessary. Small changes to Scottish Government's rules of interpretation of the directive would allow these cases to disappear, which SEPA and Scottish Government, with RRG assistance are working on.

The good news is that all sides of the debate - Brussels law-makers, Scottish Government implementers and SEPA enforcers - know that the definition of waste is a problem. Even better news is that legislation in Europe is changing and somewhere amongst a new Industrial Emissions Directive, Waste Framework Directive, Animal By-products Regulation and revised Waste Incineration Directive, the issue should be cleared up. However, this legislative process could take years, in the meantime Scotland is enforcing a regulation which is unanimously agreed to be flawed and which is going to change. Elsewhere in the UK, a more pragmatic approach appears to be taken by DEFRA, the Environment Agency, and Local Authorities, who in England control some permitting which SEPA carries out in Scotland; the lessons of which could be learned here. In the absence of a different approach to this issue, an un-level playing field which causes competitive disadvantage in Scotland will continue.

RRG is facilitating a meeting with SEPA and Scottish Government so that jointly we can ensure that both the above are addressed plus critically making sure that what the EU now proposes is fit for purpose and does not, as it could, make the situation worse rather than better.

Competitiveness

Ensuring that regulation in Scotland should, at worst, have a neutral effect on Scottish companies in terms of their competitive advantage is an issue of which we are continually aware. Historically that would mean ensuring that in the main our regulation and enforcement was the same as in other EU countries. However since devolution that increasingly has been to ensure that Scotland was operating competitively in terms of regulation and enforcement against the other parts of the UK as well. Much of what governs business in terms of legislation and enforcement, even if it originates in the EU or Westminster is delivered to businesses by regulators or Local Authorities which operate under distinctly Scottish rules. Therefore we now operate in an environment where in terms of competitiveness we need to test for consistency in three areas:

- a) Across Scotland between Local Authorities where they deliver and enforce specific regulation.

- b) Within the four devolved parts of the UK where an increasing amount of legislation activity and particularly enforcement is different.
- c) Between Scotland and other EU countries.

Although the current Scottish Government has given a commitment to ensure that Scotland neither implements nor enforces legislation in a more burdensome manner than the majority of countries in the EU, we have not been able to identify appropriate processes in place to monitor or review this. We will continue to work with Government to ensure that a level playing field is in place in line with their aspirations and our own.

Whichever way it goes though we believe that Government and businesses should understand clearly why there is a difference which is not always the case.

As we develop our work rather than treat this as a separate issue we have integrated it into all we do alongside sustainable economic growth.

However, it is worth enlarging on how we see competitiveness working in this area. In many ways it should be part of our BIA in that when policy makers and legislators analyse the impact any new legislation has on an individual business or sector it should be asking 'Does this make this business or sector more or less competitive with its counterparts in other jurisdictions?'. Again, this is not to say that the legislation should not be enacted but it is another critical impact measure that Government should use to understand the full impact of what it is doing and perhaps more importantly explain why it is doing it in the light of the adverse effect it might have. This would also put in place a process that satisfies the current Scottish Government's own aspiration.

Other Government Agencies

Businesses can in Scotland not only be impacted on, or inappropriately burdened, by legislation or enforcement but also by how other Government Agencies carry out their work in their interaction with business either as customers or suppliers. This year we have specifically looked at these issues within Scottish Enterprise (SE), Highlands and Islands Enterprise (HIE), Skills Development Scotland (SDS), Office of the Scottish Charities Regulator (OSCR), and VisitScotland (VS).

In each we have examined what their interactions with businesses in Scotland are and whether we think they are doing that within the 5 key principles of better regulation. We are satisfied that each understands their responsibility in these areas but there is not a consistency in response to that understanding for varying reasons.

For OSCR and HIE we are satisfied both understand the needs of their customer and also the issues they need address to satisfy their funders and legislation.

SDS and SE have still some way to go in completing their processes.

SDS we understand and accept is bringing three organisations together, which will take time. SE is in a similar position in restructuring following reform and the transfer of certain aspects of their work to other bodies. We are pleased that we have regularised discussions with these other organisations so we can work with them to ensure this process takes place as their new structures and processes emerge.

However we would comment that while SE is larger than HIE, we do not believe that size need be an impediment in this process. We have agreed to review progress with them again in the coming year as we both believe things could be done more simply despite the constraints they operate within.

Fitting with our role in looking at competitiveness, we have a concern that the services of Business Gateway and especially the Business Gateway website could fall below that which is offered to companies elsewhere in the UK. In this particular case we believe that the UK part of it may be the best practice. In terms of the web site the UK Government has embarked on a project to bring all 160 current business facing web sites into a single portal so that business can access and transact with Government more simply and efficiently. No one can disagree with the objective of the project and good progress has been made in its first year. SE has now met the challenge that brings, and to its credit is working to ensure that other Scottish Government Departments follow in like manner. The challenge now is to ensure that in Scotland and other devolved administrations specific differences due to policy or law are reflected in the 'local' version of the web site. This again highlights the need for Westminster and Holyrood to have a way of working effectively together on issues and projects like this using best practice and resource from both sides. This does not appear to be the case currently and positive interaction occurs on an ad hoc basis.

So that we fully understand the constraints that public bodies of all descriptions operate under we have begun discussions with both Audit Scotland and the EU auditors about processes imposed on Departments and Agencies. Initial discussions with Audit Scotland were heartening and we commend the approach which Audit Scotland appears to be adopting as this fits well with the general systems thinking approach that accommodates better regulation. However we do believe that the EU imposes excessive need for information on Government and businesses. Our view is shared by both Audit Scotland and National Audit Office in Westminster who have both tried, without success, to lessen the burden from this source. Without the EU taking a more outcome driven approach to what they do, it will be difficult for others to progress their own better regulation agendas. The impact of EU auditing is felt across all of Scottish Government so it is something we need to address robustly as it not only imposes a burden on Scottish businesses and Government but also could preclude businesses from using schemes involving EU funding which could in turn disadvantage them against businesses elsewhere in Europe.

Local Authorities

This is the part of our work where we have made least progress and have the greatest concerns over.

We met with COSLA on the 28th October 2008 and the officials appeared to understand the issues we were raising with them and desired to resolve them. However there has been little progress or action from COSLA since and further engagement has proved difficult, and our next meeting with them will be around the time of the publication of this report. Increasingly we have sought to engage with Local Authorities through other avenues but it has been again slow. Our experience reflects the feeling expressed more generally to us by many organisations dealing with local authorities so we do not think we are alone in our feelings.

In our annual report last year we wished to engage with COSLA and Local Authorities to find out

1. If local authorities fully understand their regulatory responsibilities and the potential impact on business.
2. Where they do, whether they instigate and deliver regulation themselves or work alongside Regulators, that they do so in a way that avoids duplication, and is appropriate.
3. How they develop a consistent approach to delivering regulation across Local Authorities where appropriate.
4. How they ensure that sufficient resource is devoted to the above to obtain the desired outcome.

We are sadly no closer to answering these questions. However our concern has increased given that some regulators will be passing over some of their work to the Local Authorities over the coming years. Implicit in many of the change processes a number of regulators have embarked on is an understanding that in a risk based approach it may be that Local Authorities could be the appropriate bodies to deliver some local and non high risk regulation.

With the Single Outcome Agreements now giving each Local Authority total control over how they allocate resources we also have concerns, reflected in item 4 above, that the resources needed to adequately perform the regulatory tasks and responsibilities may be squeezed as other areas are deemed to have greater priority. Given the work the national regulators are all embarked on to ensure they run their business in a way, and have the resources to deliver, better regulation and sustainable economic growth, we believe that Local Authorities should have the same task as a priority. If not, we risk a lot of the good work and progress underway by the national regulators being dissipated on the ground by inconsistency of approach and resource at local level which will in turn impact on business.

Given the benefits but also the responsibilities and accountability the new Single Outcome Agreements bring to Local Authorities we believe that the questions above become even more pertinent and important to ensure that a culture of better regulation is embedded within Local Authorities, as with the rest of Scotland.

Therefore we will increase our effort and examine more direct avenues to engage with Local Authorities so we can begin to work directly with officials within the Local Authorities to take forward our issues with them. We will also continue to seek stronger engagement with CoSLA, recognising the political element to regulatory action and will be examining the Concordat between Local Authorities and Scottish Government to see if a 'better regulation' outcome should be added within individual Single Outcome Agreements as we believe that this has to be a priority for Local Authorities.

4. The Coming Year and the Future

From all the above we believe that in our first two years we have made much progress in:

- a) Understanding the issues and landscape for regulation in Scotland, the UK, and in Europe.
- b) Putting in place a realistic plan of what needs to change to deliver better regulation in Scotland.
- c) Starting the process of change to do that and achieving some significant changes towards that.

Key to moving much of that forward are:

- i) The meeting with regulators and sponsoring departments on June 10th from which we will produce a project plan for action to overcome issues identified as hindering or deterring progress.
- ii) A closer understanding across the devolved parts of the UK of where differences exist, why, and how that impacts on business.
- iii) Engaging with Local Authorities jointly and individually to ensure that they execute their responsibility in this area of better regulation in a manner that provides consistency for business and supports the regulators in their outcomes.

Three small objectives but with a large amount of work and issues surrounding them and we need to progress all speedily or lose the momentum that is now in place around better regulation.

Also, we need to ensure that our BIA which was recommended last year now permeates across all parts of Government in Scotland and that RRG reviews and comments on them. This is not just for primary legislation but to the more important secondary legislation and Statutory Instruments which in truth enact most regulations.

Part of that will be ensuring that its essence is embedded into the overall change program for change within the Scottish Government.

This will also inform the work we still need to do on reviewing legislation which we must make progress on this coming year as we do not believe there are no pieces of legislation effecting business that do not need reviewed.

We will widen the above work into the EU to:

- a) Understand why it takes the time it does to implement and change legislation from this source.
- b) Work with bodies in Scotland to assist them in addressing specific EU issues.
- c) Understand, and if necessary challenge, EU auditing in terms of its burdensome impact on business where it is clear that the level of impact currently applied is not proportionate or necessary.

Finally there may be advantage to examining whether 'turnkey' models can be put in place around projects which involve multi regulators, agencies, communities, and business and other parts of Government all working together. We will look at picking a few pilots in this area to investigate the possibilities of building methodology around these which are occurring more and more as we look at implementing other parts of Government policy for example in the areas of energy and environment.

In all of the above, ensure that we involve the three parts of our partnership, business, regulators, and Government in how we achieve better regulation as without agreement or at worst understanding between the three we will achieve very little.

**Regulatory Review Group
June 2009**

Annexe 1

Remit and Composition of the Regulatory Review Group

The Regulatory Review Group (RRG) was set up in December 2004 to examine the issue of regulation. It is an industry-led group made up of representatives from the main business organisations and its work involves identifying regulations that are causing business concern and investigating areas for review.

In June 2007 the First Minister announced a re-invigoration of the Group under the Chairmanship of Professor Russel Griggs with a remit to:

- continue with its original role, to try and resolve specific problems and regulations that were causing Scottish businesses concern;
- formulate a strategic approach and to develop processes to improve the regulatory landscape such as making recommendations for improving the Regulatory Impact Assessment (RIA) process;
- advise the Scottish Government on all aspects of its Better Regulation agenda, including measuring compliance costs to business, one in one out, proposals for a Local Better Regulation Office etc;
- act as a truly independent and informed monitor, helping to co-ordinate, review and judge the Scottish Government and its regulatory agencies Better Regulation performance;
- report annually, helping the Government in its work to improve the regulatory environment for business.

Membership

Chairman – Professor Russel Griggs OBE – Confederation of British Industry
Charlotte Barbour – Institute of Chartered Accountants of Scotland
Stephen Boyd – Scottish Trade Union Congress
Garry Clark – Scottish Chambers of Commerce
Martyn Evans – Consumer Focus Scotland
Jim Gorie – Forum of Private Business
Susan Love – Federation of Small Businesses
Niall Stuart – Scottish Council for Development and Industry
James Withers – National Farmers Union Scotland

The following people have observer status within the Group:

Kyla Brand – Office of Fair Trading
Michael Gibson – Local Better Regulation Office
John Henderson – Scotland Office