



# A Regulatory Toolkit for the Digital Economy

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# A Regulatory Toolkit for the Digital Economy

**Technology companies are introducing innovative, life-changing products, services, and features at an unprecedented pace.** Across all markets, established products and services that are integral today can be replaced seemingly overnight with the next set of disruptive innovations. And this is especially true for digital services, the characteristics of which support swift development and evolution as compared to technologies of the past. Technology markets themselves are rapidly evolving – new markets are created as ideas are brought to life, and existing markets evolve to respond to changes in consumer behavior and R&D-fueled innovation. These shifts bring both benefits and potential risks to society, and regulators face the challenge of designing policies that maximize the social benefits of technology while appropriately mitigating societal risk and promoting the public interest.

**New, innovative services within rapidly evolving markets require thoughtful approaches from regulators and policymakers.** As regulatory policymakers consider the digital economy, they address several critical questions, including:

1. Is there an issue in the market that warrants regulatory attention?
2. What precisely is the issue and its scope?
3. What is the significance of the issue?
4. What are the causes?
5. Is government intervention necessary?
6. What action(s) can effectively address the issue while limiting unintended or adverse impacts?

Regulators and policymakers have many choices about how to engage with participants in the digital economy. There are a variety of regulatory tools available, each with its own opportunities and challenges, and each allowing different approaches to addressing public needs while not unnecessarily impeding innovation and limiting potential social and economic benefits.

Therefore, it is important that regulators take a robust and careful approach as they assess the range of tools available, and endeavor to strike an appropriate and careful balance between protecting the public while not reducing the benefits to society that flow from innovative technologies as they design the risk management solution.

It is advisable for decision makers to develop a thorough understanding of the relevant issues associated with various regulatory tools and weigh their options carefully before taking action to best promote the desired outcomes.

**The accompanying materials provide an overview of eight key tools available to regulators, ranging from least to most interventionist:**

- Observation
- Education
- Suasion
- Self-Regulation
- Co-Regulation
- Experimental Regulation
- Formal Regulation
- Enforcement

Regulators can use these tools to help identify and assess challenges and opportunities, and to tailor their actions to support their objectives. The range of tools can also help regulators iterate into a regulatory approach as both the risks and the benefits of new technologies become clearer over time. For each tool, these materials describe both the benefits and challenges, the factors that can support effective implementation, and offer case studies to help explore how global regulators have used these tools across a range of applications.

# Observation

## Overview

Observation – and the findings derived from it – is the foundation for effective regulation. Observation provides regulators with the facts needed to design and implement effective regulatory strategies. Without effective observation, regulators risk, for example, devoting resources toward more interventionist strategies when targeted, less costly consumer education or industry suasion could effectively address identified issues. And if regulators lack full information about market realities, then regulatory intervention may have negative unintended consequences. For example, if regulation increases compliance costs for industry, it may create barriers to entry, thereby decreasing competition and increasing consumer costs. In such scenarios, the potential increased costs could outweigh the benefits of regulation. Effective regulators assess market practices, the effectiveness of existing regulations, market

competition, societal impacts of current practices, and the likely impacts of regulatory action.

Regulators rely on observation to:

- Learn about the current status of the market, including key participants, and common practices;
- Evaluate the impacts of existing regulations;
- Determine the level of competition in the market;
- Assess the broader, social impacts of market practices;
- Consider whether further regulatory action may be warranted; and if necessary,
- Publish findings or recommendations.

Regulators can engage in observation in many ways. They can:

- Observe markets passively;
- Conduct or commission market or consumer research;
- Host workshops that convene industry, subject matter experts, authorities from various jurisdictions, academics, and other stakeholders to share experiences, insights, and recommendations; or
- Engage in active information-gathering exercises, such as the 2014 “cookie sweeps” in the European Union.<sup>1</sup>

Regulators may retain their learnings internally or publish findings and/or recommendations for review by other regulatory bodies, industry, consumers, or other stakeholders.

**As regulators increasingly incorporate behavioral economics into their analysis and modelling, robust observation becomes even more important to understand the behavioral factors driving consumer conduct.** Traditional economic thinking and models presume that consumers have full knowledge of their market options and act rationally in pursuit of their preferences and economic interests. Behavioral economics questions this assumption and instead looks to psychological research regarding human decision-making to understand how humans behave in real-life situations. People often lack complete information and fail to make decisions that promote their best interests. Research reveals that individuals facing complex decisions often rely on cognitive shortcuts or default options to make a choice, and that individuals do not generally engage in deep assessments of what actions will maximize utility. Given that consumer activity is often driven by behavioral traits rather than utility maximization, effective regulators consider the behavioral factors driving consumer conduct.

## Benefits of Observation

**Observation is the foundation of effective regulation.** It provides the inputs for assessing whether regulatory action is needed and what types of actions likely will promote regulatory objectives. Without observation, regulators lack the information needed to regulate effectively. Observation helps regulators identify issues or concerns in a given market, the sources of any concerns, their scale, and whether the concerns might require some form of action or are likely to subside or correct themselves over time in

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<sup>1</sup> Eur. Comm'n, *Cookie Sweep Combined Analysis - Report* (Feb. 3, 2015), [https://ec.europa.eu/newsroom/article29/document.cfm?action=display&doc\\_id=56123](https://ec.europa.eu/newsroom/article29/document.cfm?action=display&doc_id=56123).

the absence of regulatory intervention. For example, observation may reveal that an identified issue likely will disappear due to increased competition arising from new market entries, technological innovations will reduce costs, or consumers would benefit from an enhanced understanding of market options.

**Observation helps regulators prioritize their efforts to reflect policy objectives.** Most, if not all, regulators operate subject to resource constraints. And some regulators are required by law to respond to specific issues. When regulators have the opportunity and resources to choose which initiatives to undertake, they generally seek initiatives that will best promote their policy objectives. Observation is key to this decision-making process. Regulators who possess detailed information about the markets they supervise can assess the presence, nature, and magnitude of issues in the marketplace, allowing them to prioritize what will best achieve policy goals.

**Observation helps regulators frame issues for stakeholders.** Legislators, industry, consumers, or other stakeholders commonly question regulators about their regulatory decisions or activities. Regulators who possess a deep understanding of the markets they supervise better explain and justify their actions. This understanding can help regulators establish and maintain credibility with stakeholders and encourage active stakeholder participation in the policymaking process. To develop an expert understanding of markets, regulators may seek input from a range of sources, including industry, consumers, subject matter experts, academics, and regulators from other jurisdictions.

## Challenges for Observation

**If regulators rely on information obtained from a limited range of sources, they will have an incomplete understanding of market circumstances.** When regulators do not have a complete picture of market circumstances, they risk overstating the extent of consumer detriment, misidentifying the cause of market issues, failing to appreciate the potential adverse impacts of regulation, or otherwise failing to understand the complexities of market realities. For example, regulators that focus on consumer or competitor complaints without considering the positive experiences of consumers who have not registered complaints may underestimate the benefits of market practices. Regulators that rely on media reports and publicly available information for observation, without also soliciting inputs from industry and subject matter experts, may lack the technical understanding needed to identify practical solutions to market issues. Regulators that focus on localized market issues may lack an understanding of how industry practices and regulatory intervention may impact other markets.

**Prolonged observation can lead to unnecessary delays.** Obtaining a complete understanding of market complexities can be a time-consuming process. Although observation is fundamental to effective regulation, regulators may sometimes wish to limit the timeframe for observation. For example, extensive observation processes may prevent regulators from acting when there is a clear need for regulation (or when an industry proactively seeks regulation). For example, consider the regulatory observation of the Unmanned Aircraft Systems (“UAS”) market in the United States. UAS is a new and innovative technology emerging in the highly regulated aviation sector. All relevant stakeholders generally agree that regulation is required. However, prolonged and ongoing observation efforts have hampered industry and regulatory authorities by delaying regulatory action that would allow UAS companies to move forward with some degree of certainty. In these circumstances, regulators may achieve positive results by implementing experimental regulatory approaches or preliminary

performance-based regulatory frameworks that regulators can adapt as observation delivers more information.

## Effective Implementation

**To support effective regulation, regulators design observation programs to ensure that inputs are received from a diverse and comprehensive group of sources.** Depending on the circumstances, additional sources of information might include:

- Research conducted by consumer groups, academics, trade associations, localities, industry, or consulting firms;
- Workshops or similar public fora;
- Surveys of consumers or businesses; and
- Focus groups.

Joint actions of the US Federal Trade Commission (“FTC”) and the National Highway Traffic Safety Administration (“NHTSA”) in the automotive industry provide a good example of how to collect diverse inputs during observation. In 2017, the FTC and NHTSA hosted a “Connected Cars” workshop intended to gather information about the potential privacy and data security risks and benefits of the collection of precise location information, vehicle-to-vehicle data sharing, usage-based insurance, and other activities related to the connected vehicle ecosystem.<sup>2</sup> The day-long event included speakers from the FTC, NHTSA, auto manufacturers, automotive suppliers, trade associations, consumer rights groups, consulting firms, and academia. In addition to information received during panel discussions and remarks, the FTC and NHTSA collected dozens of public comments.

**Consider opportunities to coordinate with other regulators and across jurisdictions.** Regulators can benefit from learning from authorities in other jurisdictions or from authorities that have overlapping oversight responsibilities. Other regulators may have real-world insights into the potential effects of regulatory intervention and how market practices may evolve in the long term. Regulatory cooperation in the context of observation is particularly useful when regulators may have overlapping areas of concern. For example, by co-hosting the Connected Cars workshop, the FTC and NHTSA were able to assess how to allocate their regulatory responsibilities. When NHTSA published its federal guidance for automated vehicles, the agency noted the FTC’s role in protecting consumer privacy in the connected vehicle ecosystem.

**When regulators engage in observation, they can consider benefits as well as potential concerns associated with market activities.** Consider the European Commission’s (“EC’s”) Business Innovation Observatory (“Observatory”). The Observatory was established to study innovative companies in the European Union (“EU”) to “identify the latest innovation trends . . . ; identify the dynamics of good business practices of innovative companies . . . ; understand the barriers to innovation and propose policy tools to overcome them; nurture [mutually beneficial] relationships between entrepreneurs, policy makers, innovation facilitators and researchers; [and] enhance awareness of the latest business innovation trends, success stories and related business opportunities and barriers.”<sup>3</sup> The Observatory’s case study, Big Data: Analytics & Decision Making, for instance, identified the potential for substantial

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<sup>2</sup> FTC, *Connected Cars: Privacy, Security Issues Related to Connected, Automated Vehicles* (2017)

<https://www.ftc.gov/news-events/events-calendar/2017/06/connected-cars-privacy-security-issues-related-connected> (last visited Jan. 4, 2021).

<sup>3</sup> Business Innovation Observatory, Eur. Comm’n, [https://ec.europa.eu/growth/industry/policy/innovation/business-innovation-observatory\\_en](https://ec.europa.eu/growth/industry/policy/innovation/business-innovation-observatory_en) (last visited Jan. 4, 2021).

economic and social benefits of big data technologies, assessed financial and regulatory barriers to adoption, and recommended simplifying administrative requirements for start-ups to foster innovation and competition.<sup>4</sup> The case study relied on information sourced from publications and interviews with industry representatives.

**Regulators can engage third parties to support observation activities.** Third-party researchers often are better equipped to conduct focused research activities, which can reduce costs to regulators. Third parties that specialize in market research may have more success obtaining and analyzing relevant, statistically significant results. Consider the research of the United Kingdom’s (“UK’s”) media/telecom regulator, Ofcom, into Internet users’ experience of potential online harms. Since 2018, Ofcom has commissioned an independent research firm to conduct a survey to assess adult and youth perspectives regarding online harms. In 2020, the research firm conducted 2,080 in-home interviews with internet users over the age of sixteen, with quotas based on age, gender, region, social grade, and urbanity, and 2,001 online interviews with children between the ages of twelve and fifteen, with quotas based on age, gender, region, and social grade.<sup>5</sup> Market research activities such as those conducted by Ofcom may involve developing numerous, detailed charts and tables. Market research firms may develop and produce such materials with enhanced efficiency.

**Regulators may provide opportunities to share information confidentially.** Industry and other stakeholders often are willing to discuss market practices, technological innovations, business practices, and other issues with regulators. However, helpful sources of information may wish to keep certain information confidential. For example, some businesses may be willing to educate regulators about forthcoming products and services so long as proprietary information is not publicized or revealed to competitors. Therefore regulators may wish to adopt restrictions on the use or disclosure of certain information collected during observation to encourage robust participation from relevant stakeholders.

## Case Studies

### Case Study 1A

#### US Federal Trade Commission and National Highway Traffic Safety Administration Connected Cars Workshop



On June 28, 2017, NHTSA and the FTC held a day-long workshop to discuss consumer privacy and security issues associated with connected cars. Representatives from a broad range of stakeholders participated, including the automotive and communications industries, consumer groups, government regulators, and academics. Prior to the workshop, the FTC solicited public comments regarding the topics to be covered, including:

<sup>4</sup> Eur. Comm’n, *Business Innovation Observatory, Big Data Analytics & Decision Making* (Sept. 2013).

<https://ec.europa.eu/docsroom/documents/13411/attachments/1/translations/en/renditions/native>.

<sup>5</sup> Jigsaw Research, *Internet users’ experience of potential online harms: summary of survey research*, Ofcom (Jan.–Feb. 2020).

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0024/196413/concerns-and-experiences-online-harms-2020-chart-pack.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0024/196413/concerns-and-experiences-online-harms-2020-chart-pack.pdf).

- The types of data that vehicles with wireless interfaces collect, store, transmit, and share;
- Potential benefits and challenges posed by such data collection;
- Privacy and security practices of vehicle manufacturers;
- The roles of the FTC, NHTSA, and other government agencies regarding privacy and security issues related to connected vehicles; and
- Self-regulatory standards that might apply to privacy and security issues related to connected vehicles.

The FTC's Bureau of Consumer Protection published an overview of the workshop and its major takeaways in January 2018.<sup>6</sup> The workshop helped the FTC and NHTSA develop an informed understanding of how industry was addressing privacy and data security issues and what the respective roles for NHTSA and the FTC should be. The attention to the issue also prompted industry to seek to address these issues more comprehensively. As a result, in early 2020, NHTSA acknowledged that data privacy and data security are important issues for the connected and automated vehicle industry. But it also noted that regulatory intervention for cybersecurity issues may not be warranted in light of the automotive industry's efforts, which included the formation of the Automotive Information Sharing and Analysis Center as a clearinghouse for cybersecurity information sharing. NHTSA also recognizes that the FTC is the agency with primary jurisdiction regarding consumer privacy issues.

## Case Study 1B

### European Commission Business Innovation Observatory



The Business Innovation Observatory (the “Observatory”), established within the EU Commission’s Directorate-General for Internal Market, Industry, Entrepreneurship, and SMEs, coordinates with subject matter experts to explore innovative trends in business and industry. The Observatory’s focus is on the benefits of market activities. It publishes case studies and trend reports providing insights into business innovation trends that the Observatory believes have high socio-economic potential. The case studies have covered topics such as the sustainable supply of raw materials, space technology and services, and big data.<sup>7</sup> Commissioned third parties generally produce the Observatory’s trend reports. The third parties typically seek inputs from diverse sources regarding the challenges and benefits associated with innovative business practices and technologies. The reports include policy

<sup>6</sup> FTC Bureau of Consumer Prot., *Connected Car Workshop Staff Perspective* (Jan. 2018)

[https://www.ftc.gov/system/files/documents/reports/connected-cars-workshop-federal-trade-commission-staff-perspective/staff\\_perspective\\_connected\\_cars\\_0.pdf](https://www.ftc.gov/system/files/documents/reports/connected-cars-workshop-federal-trade-commission-staff-perspective/staff_perspective_connected_cars_0.pdf)

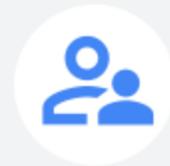
<sup>7</sup> Business Innovation Observatory, *Case Studies*, Eur. Comm'n, [https://ec.europa.eu/growth/industry/innovation/business-innovation-observatory/case-studies\\_view\\_en](https://ec.europa.eu/growth/industry/innovation/business-innovation-observatory/case-studies_view_en) (last visited Jan. 4, 2021).

recommendations and are designed to help policymakers understand business and industry trends.<sup>8</sup> Trend reports have addressed topics such as:

- Regulatory barriers and firm innovation performance;
- Regulatory barriers and cross-border commercialization of innovation;
- Optimal recycling, big data from space, and blockchain applications: disruption and policy responses;
- Disruptive innovations and policy responses: self-production, insects as food, flying sensors, graphene & others;
- Disruptive innovations and forward-looking policies towards smart value chains;
- Smart factories, cleantech, and customer experiences;
- Design for innovation, smart living, and innovative business models; and
- Unlocking the potential of business and societal innovation.

## Case Study 1C

### Ofcom Internet Users' Experience of Potential Online Harms



Ofcom, the UK's communications regulator, undertakes observation activities as part of its work to fulfill its media literacy duties.

Since 2018, Ofcom has commissioned research to quantify the UK public's concerns about, and reported experiences of, online harms in (i) online content; (ii) interactions with other users; (iii) data/privacy; and (iv) hacking/security. The research also explores views about the current level of regulation that applies to broadcast and online environments. Ofcom explains that the research uses "various methodologies to develop a full picture of the behaviour and attitudes of UK adults and children in relation to their online, media and communications habits."<sup>9</sup> The UK's data protection regulator, the Information Commissioner's Office, provides advice on research design and analysis.

Ofcom commissions specialist market research firms to design and conduct this research into online harms. Kantar Media conducted the 2018 survey, and Jigsaw Research conducted the 2019 and 2020 surveys. Private firms such as Kantar Media and Jigsaw Research have a deep expertise in market research techniques, including designing and conducting surveys. By outsourcing the research activities to third-party experts, Ofcom can focus its resources on analyzing and communicating the research outputs to support its stated objective of

<sup>8</sup> Business Innovation Observatory, *Reports*, Eur. Comm'n, [https://ec.europa.eu/growth/industry/policy/innovation/business-innovation-observatory/trend-reports\\_en](https://ec.europa.eu/growth/industry/policy/innovation/business-innovation-observatory/trend-reports_en) (last visited Jan. 4, 2021).

<sup>9</sup> *Raising Awareness of Online Harms*, Ofcom (July 22, 2020), <https://www.ofcom.org.uk/about-ofcom/annual-reports-and-plans/2019-20-annual-report/raising-awareness-of-online-harms>.

“help[ing] curtail the internet’s harmful aspects, while preserving its powerful benefits to society, culture, trade and freedom of expression.”<sup>10</sup>

Ofcom has devoted substantial efforts to assess the types of harms that may arise online and effective mitigation strategies for harms identified.<sup>11</sup> In 2019, Ofcom published a white paper regarding online market failures and harms, noting that regulators must carefully assess the potential impacts of intervention because of complexities in the online market. Ofcom suggested that regulators in this space likely will benefit from robust information sharing. And in light of the rapid innovations in online markets, Ofcom concluded that regulatory interventions should be flexible and adaptable. The white paper demonstrates the importance of regular and detailed observation efforts to support reasoned regulatory policy development.

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<sup>10</sup> *Id.*  
<sup>11</sup> *Id.*

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# Education

## Overview

Regulators use education as a tool to inform consumers, industry, or other stakeholders about topics such as applicable legal frameworks, market practices, the costs or benefits of engaging in certain actions, the potential impacts of new technologies or business practices, and regulatory policy. By raising awareness of such issues, regulators may be able to impact market behavior without prohibiting or requiring certain behaviors.

Education initiatives can take a variety of forms, including:

- Short-term awareness campaigns that focus on particular issues (e.g., consumer alerts about new types of scams);
- School-based programs designed to develop lasting skills in consumers (e.g., financial literacy campaigns); and
- Comparison tools that enable consumers and others to more easily assess market choices with, for example, calculators or tables.

## Benefits of Education

**Education initiatives are easier to craft and adapt than more interventionist regulatory tools, such as formal regulation.** This is particularly beneficial for markets involving innovative and rapidly evolving

technologies. Regulators overseeing such markets may lack the data needed to accurately assess the potential long-term impacts of new technologies, business practices, or competition. Thus, they may want to exercise caution before establishing formal regulations that may turn out to be poorly designed, inefficient, or ineffective over the long term. Through education, regulators can address potential issues by informing consumers and other stakeholders about potential risks and benefits, potentially positively influencing behavior.

**Education can help reduce costs for regulators.** Regulators can typically launch education initiatives without going through time-consuming, notice-and-comment proceedings like those associated with formal regulation. Moreover, education initiatives generally do not require ongoing oversight or enforcement activities. Therefore education can reduce costs for regulators, especially in cases where the externalities are rooted in consumers making decisions that are clearly contrary to their long-term interests. For example, regulators may wish to educate consumers about the potential long-term savings of buying energy-efficient devices that may have a higher purchase price than less efficient devices.<sup>12</sup> Or regulators may seek to reduce consumer harm by educating consumers about the potential dangers of purchasing goods or services from unlicensed providers.<sup>13</sup> If effective, such education initiatives may address identified issues without requiring substantial market intervention.

## Challenges for Education

**Poorly targeted or unengaging education initiatives can lack effectiveness.** Traditional web platforms, newspapers, or broadcast channels may not be effective means to engage with audiences that receive information via social media or similar outlets. And when regulators want to provide consumers with information about specific types of potentially harmful transactions, they may seek to target consumers *before* they enter into those transactions, particularly if the transactions are consequential and infrequent.

**Regulators may lack experience in creating engaging and impactful education and awareness initiatives.** Regulators tend to have strong experience in traditional, core activities like promulgating and enforcing regulations. But regulators may not have extensive experience in designing education campaigns. Effective education initiatives have clearly defined objectives, target the appropriate audience, and engage that audience. Therefore, regulators may benefit from partnering with other organizations—such as communications firms, educational institutions, or industry groups—to deliver effective initiatives.<sup>14</sup> Successful consumer education programs regarding financial issues often involve partnerships between government, industry, market research firms, schools and universities, and media organizations.<sup>15</sup> For example, the U.S. Internal Revenue Service has partnered with industry groups to educate consumers about the risks of phishing, tips for secure online shopping, and the importance of strong passwords.<sup>16</sup>

**Poorly designed education initiatives risk unintended negative consequences.** When regulators warn consumers about potential risks in a market, they can take care not to cause undue alarm or other

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<sup>12</sup> See Glen Hepburn, *OECD Report: Alternatives to Traditional Regulation* 51, <http://www.oecd.org/regreform/regulatory-policy/42245468.pdf>.

<sup>13</sup> See OECD, *Use of Behavioural Insights in Consumer Policy* 20 (2017).

[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP\(2016\)3/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP(2016)3/FINAL&docLanguage=En).

<sup>14</sup> OECD, *Toolkit for Protecting Digital Consumers* 84 (2018), <http://www.oecd.org/digital/consumer/toolkit-for-protecting-digital-consumers.pdf>. (“Joint initiatives can be particularly effective, as the partners can often communicate more effectively with target audiences, drawing on specific experiences, resources, and knowledge.”).

<sup>15</sup> See Barbara Smith, *Financial Education: What Makes a Successful Public Awareness Campaign?*, OECD (Sept. 21–22, 2006), <http://www.oecd.org/finance/financial-education/37371299.pdf>.

<sup>16</sup> *National Tax Security Awareness Week 2019*, Internal Revenue Service (Oct. 20, 2020), <https://www.irs.gov/newsroom/national-tax-security-awareness-week-2019>.

unintended side effects. For example, education initiatives alerting consumers to the security risks associated with a specific mobile payment method should be designed to avoid causing consumers to distrust all mobile payment methods.

## Effective Implementation

Effective education initiatives involve:

- Defined objectives and strategies;
- Appropriate targeting;
- Engaging and understandable content;
- Timely delivery;
- Coordination and cooperation with stakeholders; and
- Post mortems to identify learnings.

**Regulators can clearly define the policy objectives and desired consumer action before developing education initiatives.** Explicitly defined objectives for education initiatives help regulators better assess how to design and deliver the pertinent information to the public. For example, the European Cybersecurity Month program has a clearly defined objective – to raise awareness of cybersecurity issues. This has helped the program address a broad range of stakeholders more effectively by designing a variety of online and offline channels to deliver its message to specific subgroups. Or consider the UK Financial Conduct Authority’s (“FCA’s”) campaign to educate consumers about the need to submit complaints about payment protection insurance by an August 2019 deadline.<sup>17</sup> The campaign established clearly defined objectives and achieved key performance indicators regarding awareness-raising and help provided via web and helpline calls.<sup>18</sup>

Regulators may also try to leverage research about market practices and consumer interests to develop education strategies. Behavioral economic models can help to assess likely motivations and factors influencing consumer behavior and identify ways to influence those behaviors.

**Regulators can target education initiatives to the appropriate population at the appropriate times.** To target education initiatives in a manner that can achieve the regulatory objectives, regulators may consider the composition and characteristics of the relevant audience, including age, social demographic, education level, rural/urban location, type of consumer, and channels used by that audience to find consumer information. For example:

- Where the objective of the education initiatives is to develop long-term skill sets in children and young people, regulators may deliver education within schools, libraries, or through advertising on digital or social media consumed by the relevant age group.
- If education initiatives are intended to influence consumer actions in a specific transactional context. In that case, regulators can target the messaging so that it reaches consumers just prior to or in the course of the transaction. For example, retailers may be required to provide consumers with specific information prior to completing a transaction.

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<sup>17</sup> FCA, Payment Protection Insurance Complaints Deadline: Final Report (2020), <https://www.fca.org.uk/publication/ppi/payment-protection-insurance-complaints-deadline-final-report.pdf>.

<sup>18</sup> *Id.* at 17.

**Regulators can design education initiatives to be engaging, understandable, and accessible.** To promote audience engagement, regulators can develop memorable, interactive or multimedia content delivered via channels and modalities that the audiences are familiar with and use regularly. For example:

- Simulations that create “game-like” opportunities for audiences can illustrate the long-term impacts of certain market choices. Financial literacy games, for example, can help high school students about the potential impacts of borrowing excessive amounts to cover education expenses.<sup>19</sup> And consider the NewsWise initiative launched by three UK non-governmental organizations, which offers online games and tools to help school children develop news literacy skills and identify misinformation.<sup>20</sup>
- The UK’s FCA captured consumer attention regarding a complaint deadline by adopting a multi-channel communications campaign that featured an animatronic model of Arnold Schwarzenegger. The campaign was “designed to cut through the white noise and capture people’s attention.”<sup>21</sup>

**Regulators typically benefit from coordinating and cooperating with other stakeholders to deliver effective education initiatives.**

Working with other stakeholders may help regulators reach target groups. For example:

- Companies may have ready access to channels that reach target groups, such as their marketing campaigns and social media pages. In many cases, industry participants may be eager to work with regulators to educate their customers and promote the growth of beneficial practices while addressing potential policy concerns. Australia’s Financial Capability Strategy (“Strategy”) provides a good example of this. The Australian Securities & Investments Commission coordinated the Strategy in partnership with industry financial institutions, trade associations, consultants, non-profit advocacy groups, and researchers. A key part of the initiative is the Moneysmart website, which has developed a substantial audience.
- In some cases, regulators may require that industry pay for education initiatives. For example, eighteen banks funded a £42.2m campaign led by the UK’s Financial Conduct Authority to inform consumers of the deadline to claim compensation for Payment Protection Insurance.<sup>22</sup>
- When education initiatives benefit from delivery within schools, regulators coordinate with schools, colleges, and education agencies to deliver the content in a manner that integrates with established curricula.<sup>23</sup>

Working with industry participants and other partners can also help regulators identify and avoid potential unintended consequences of education initiatives such as inadvertently creating alarm about certain activities. Private sector stakeholders may be better positioned to identify the potential for education initiatives to create unwanted side effects or unintended concerns about beneficial market

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<sup>19</sup> Brian Page, *10 Free Financial Literacy Games for High School Students*, Edutopia (Apr. 7, 2020),

<https://www.edutopia.org/article/10-free-financial-literacy-games-high-school-students>.

<sup>20</sup> NewsWise for Families: Looking Out for Fake News, Guardian (Mar. 21, 2020),

<https://www.theguardian.com/newswise/2020/mar/21/newswise-for-families-looking-out-for-fake-news> (last updated May 19, 2020).

<sup>21</sup> Mark Sweney, *Hasta la Vista, PPI! Schwarzenegger Fronts FCA’s £42m Campaign*, Guardian (Aug. 29, 2017),

<https://www.theguardian.com/business/2017/aug/29/ppi-schwarzenegger-fca-campaign-claims-deadline>.

<sup>22</sup> FCA, *Payment Protection Insurance Complaints Deadline: Final Report* (2020),

<https://www.fca.org.uk/publication/ppi/payment-protection-insurance-complaints-deadline-final-report.pdf>.

<sup>23</sup> About Moneysmart for Teachers, Moneysmart.gov.au, <https://moneysmart.gov.au/about-moneysmart-for-teachers> (last visited Jan. 4, 2021).

practices. For example, when creating awareness campaigns to inform consumers about products that may be unsafe in certain circumstances, regulators may partner with industry participants or other subject matter experts to confirm that consumers are not unduly deterred from using products in beneficial, safe ways.<sup>24</sup>

### **Regulators can evaluate education initiatives to incorporate lessons learned for the future.**

Assessing the impact and success of education initiatives helps regulators identify opportunities to improve future education initiatives and regulatory policies. Regulators are able to determine whether the long-term durability and the continued impact of the messages delivered through public awareness and educational campaigns. For education initiatives designed to influence behavior, regulators may consider whether different content or alternative communication channels could have had a greater impact. And regulators can assess whether changes in behavior led to better policy outcomes.

## Case Studies

### Case Study 2A

#### European Cyber Security Month

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The European Cyber Security Month (“ECSM”) has many features of an effective education initiative. ECSM originated in 2012 as a pilot program of the European Union Agency for Cybersecurity and has become an annual campaign.<sup>25</sup> The objectives of ECSM are to:

- Raise awareness of cybersecurity issues;
- Increase safe use of the Internet; and
- Increase media interest in cybersecurity issues.

ECSM delivers messaging via various channels, including conferences, workshops, trainings, webinars, presentations, and social media. ECSM involves hundreds of partners from government, academia, think tanks, non-governmental organizations, professional associations, and industry. Recognizing that cybersecurity is a long-term concern, ECSM occurs annually in October, targeting a new set of issues each year. The scope of ECSM has increased over the years from 184 activities across 30 countries in 2014 to 525 activities across 36 countries in 2019.<sup>26</sup>

Focusing on a single month – rather than delivering messaging throughout the year – can be an effective way to highlight issues without risking information overload or message fatigue. Annualized message delivery also allows ECSM to identify and target the issues most relevant at a given time in light of technological and other developments. Each year, ENISA publishes a

<sup>24</sup> See Pharma Guy, *Unintended Consequences of FDA Warnings: Lilly-funded Antidepressant Case Study*, Pharma Marketing Network (June 2, 2009), <https://www.pharma-mktg.com/blog/unintended-consequences-of-fda-warnings/>.

<sup>25</sup> Eur. Cybersecurity Month Through the Years, Eur. Cybersecurity Month, <https://cybersecuritymonth.eu/about-ecsm/ecsm-through-the-years> (last visited Jan. 4, 2021).

<sup>26</sup> *Id.*

detailed “deployment report,” intended for private and public sector organizations and IT security professionals that analyzes impact (e.g., messaging and engagement) of the previous year’s campaign and cites lessons learned for the following year.<sup>27</sup>

## Case Study 2B

### Australia Financial Capability Strategy

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The Australian National Financial Capability Strategy (“Strategy”) is an initiative of the Australian Securities & Investments Commission (“ASIC”) in partnership with other governmental and non-governmental organizations.<sup>28</sup> The Strategy’s core mission is to “empower Australians to be in control of their financial lives.”<sup>29</sup>

ASIC launched the Strategy in 2018 following consultations with interested stakeholders. Through these consultations, ASIC identified three core behaviors that the Strategy could address:

- **Managing money day-to-day:** Track money in and out, look at spending priorities, manage debt and credit use, get into a savings habit.
- **Making informed money decisions:** Learn more about money, talk more about money, consider options and choices, get help when needed.
- **Planning for the future:** Work towards savings goals, stay on top of superannuation, make informed investment choices, protect what matters most.<sup>30</sup>

Moneysmart, a website created by the ASIC to help consumers improve their finances (e.g., by managing money, reducing debt, and financial planning), is a key part of the Strategy.<sup>31</sup> ASIC reports that 1 in 2 Australian adults visited the Moneysmart website in 2019-2020.<sup>32</sup>

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<sup>27</sup> Eur. Cybersecurity Month Deployment Report 2019, Eur. Union Agency for Cybersecurity (Jan. 19 2020), <https://www.enisa.europa.eu/publications/ecsm-deployment-report-2019>.

<sup>28</sup> National Financial Capability Strategy 2018: Australians in Control of Their Financial Lives, Financialcapability.gov.au, <https://www.financialcapability.gov.au/strategy#home> (last updated May 2020).

<sup>29</sup> *Id.*

<sup>30</sup> SVA Consulting, National Financial Capability Strategy research report 3 (Mar. 2020), <https://financialcapability.gov.au/files/200320%20SVA%20National%20Financial%20Capability%20Strategy%20research%20report%20for%20ASIC%20web.pdf>.

<sup>31</sup> Moneysmart.gov.au, <https://moneysmart.gov.au/> (last visited Jan. 4, 2021).

<sup>32</sup> Financial Capability, ASIC, <https://asic.gov.au/for-consumers/financial-capability/> (last visited Jan. 4, 2021).

## Case Study 2C

### NewsWise

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NewsWise is a news literacy program launched in 2018 through collaboration between three UK-based non-governmental organizations – The Guardian Foundation, National Literacy Trust, and PSHE Association – to help students from ages nine to eleven better understand news and identify misinformation. Although NewsWise is not a regulatory initiative, it illustrates how innovative education efforts can address regulators’ issues of interest. The program’s stated goals are to:

- Deepen participants’ understanding of why and how news is produced;
- Enable participants to navigate the news through active and critical engagement; and
- Empower participants to tell their own news stories by creating and sharing their own news.<sup>33</sup>

When NewsWise launched in 2018, it sought to collaborate with schools whose student population showed a need for news literacy support (schools located in areas with high literacy vulnerability and under-representation in mainstream media). Since 2018, NewsWise has provided training to teachers for the incorporation of news-literacy materials into their lesson plans.<sup>34</sup>

As part of the program, students have been asked to complete surveys before and after their participation in a NewsWise workshop. Responses from participants to measure long-term changes have been difficult to obtain. However, initial survey responses have shown substantial improvement in news-literacy related metrics (e.g., 70% of participants reported checking the trustworthiness of a news source after participating in NewsWise versus 48% of participants who reported doing so before participating in NewsWise).<sup>35</sup>

In 2019–2020, NewsWise reported increased rollout of its program to a total of 150 schools.<sup>36</sup> It also began hosting “festivals,” which are public workshops targeting news literacy at the family level, an extension of its initial targeting to students ages nine to eleven.<sup>37</sup>

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<sup>33</sup> Chiara Cappellini & Irene Picton, *NewsWise Evaluation Report 2018-2019* (2019), <https://files.eric.ed.gov/fulltext/ED598399.pdf>.

<sup>34</sup> *Id.* at 5.

<sup>35</sup> *Id.* at 10.

<sup>36</sup> *Families Trained as fake news Detective at NewsWise Festival*, Nat'l Literacy Tr. (Jan. 29, 2020), <https://literacytrust.org.uk/communities/stoke/families-trained-fake-news-detectives-newswise-festival/>.

<sup>37</sup> Irene Picton, Chiara Cappellini, & Sian Hackett, *NewsWise Evaluation Report 2019-2020* (2020), [https://uploads.guim.co.uk/2020/09/16/NewsWise\\_Evaluation\\_Report\\_2019-20.pdf](https://uploads.guim.co.uk/2020/09/16/NewsWise_Evaluation_Report_2019-20.pdf) (highlighting that the family workshop events reached 113 children and 85 adults).

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# Suasion

## Overview

Suasion is another tool that regulators use to influence behavior without engaging in formal regulation or enforcement activities. The methods of persuasion vary. For example, regulators can publicly praise favored business practices in speeches or online communications, issue awards for behaviors or practices, criticize firms that act in disfavored ways, publish guidance regarding best practices or expectations, or issue warnings of regulatory interventions if certain practices do not change. Regulators can use persuasion particularly effectively if they have the authority to take more interventionist actions (e.g., formal regulation or enforcement) if market behaviors do not change in the ways that the regulator seeks.

## Benefits of Suasion

**Suasion preserves regulatory flexibility.** Regulators retain flexibility by adopting suasion tools instead of more interventionist regulatory practices because they can more readily adapt or suspend suasion practices in light of changed circumstances.

**Regulators can more rapidly implement suasion campaigns.** Regulators can generally implement suasion more rapidly than more interventionist regulatory practices, especially if the regulator has a robust market understanding and evidence base. Suasion does not require regulators to engage in lengthy notice-and-comment processes, and it can be a useful tool even for some time-sensitive or emergency issues.<sup>38</sup>

**Suasion can enhance efficiency for regulators and industry.** Suasion often costs less and increases efficiency for regulators compared to more interventionist regulation. For example, regulators can use suasion to communicate their expectations with the aim of market participants adapting their behaviors without the agency having to conduct a formal rulemaking. Moreover, similar to self-and co-regulation, regulators can use suasion to avoid prohibiting potentially beneficial practices in markets or activities where the impacts of formal regulation may not be fully understood.

## Challenges for Suasion

**The effectiveness of suasion depends on some amount of trust between regulators and industry participants.** Without such trust, industry participants may have little reason to believe that regulators' statements are accurate indicators of regulatory objectives, compliance expectations, or enforcement priorities. Industry participants would then be less likely to modify their behaviors in response to the suasion efforts.<sup>39</sup>

**Suasion efforts are also affected by the extent to which the regulator can take more interventionist measures.** Regulators seeking to use suasion may need to have authority to take action in the markets they seek to influence. Suasion is more effective when industry participants believe that the costs of ignoring regulatory appeals will exceed the costs of following regulatory appeals.<sup>40</sup> Denmark's environmental regulator, for example, publishes a "List of Undesirable Substances" to dissuade industry from using those substances, the suggestion being that more interventionist action is possible if industry ignores the list.<sup>41</sup>

**Suasion is less effective when it deviates from or conflicts with other stated regulatory policies and priorities.** As noted above, suasion may, in some circumstances, be less costly for regulators to implement than more interventionist tools such as formal regulation. This may be particularly true where suasion is deployed using online communications platforms, which generally involve fewer costs than other media. Where these costs are lower, there may be increased risk of regulators launching suasion

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<sup>38</sup> See COVID-19 Supervisory and Regulatory FAQs, Federalreserve.gov (June 16, 2020), <https://www.federalreserve.gov/covid-19-supervisory-regulatory-faqs.htm>; Wallace Oates & William Baumol, *The Instruments for Environmental Policy*, Economic Analysis of Environmental Problems (95-154) (E. Mills ed. 1975), <https://core.ac.uk/download/pdf/6871706.pdf>.

<sup>39</sup> See Central Bank of Nigeria, *Understanding Monetary Policy Series No. 28: Moral Suasion as a Monetary Policy Instrument* 9 (2013), <https://www.cbn.gov.ng/out/2016/mpd/understanding%20monetary%20policy%20series%20no%2028.pdf>.

<sup>40</sup> *Id.* at 10

<sup>41</sup> OECD, *Reviews of Regulatory Reform: Regulatory Policies in OECD Countries* 139-140 (2002), <https://www.oecd.org/gov/regulatory-policy/35260489.pdf>.

initiatives without carefully planning and considering articulated regulatory policies and priorities. In the absence of clearly defined objectives or a full understanding of industry motivations and applicable regulatory frameworks (both local and across jurisdictions), regulators risk launching suasion campaigns that fail to achieve desired goals. That may create market confusion by failing to align with prior regulatory policy.<sup>42</sup>

**Suasion can become less effective over time.** Suasion typically relies on voluntary (or at least semi-voluntary) compliance, and industry participants' willingness to engage voluntarily may fluctuate over time. For example, some participants may become aware that certain other firms are not changing their behaviors, reducing the incentives to adhere to suasion messaging.<sup>43</sup> Suasion may also be prone to habituation effects when firms become accustomed to regulatory messaging and the motivational impact of the messaging decreases.<sup>44</sup> Therefore regulators will generally consider on a case-by-case basis the likely impacts of suasion activities.

## Effective Implementation

**Suasion efforts have clearly defined objectives and strategies.** Before undertaking suasion initiatives, regulators identify the specific market behaviors they wish to influence, confirm that sufficient justification exists to support changing market behavior, and verify that suasion techniques align with regulatory authority and resources. As with education efforts, research regarding market practices and consumer interests informs the identification of objectives and strategies for suasion campaigns. As suasion relies on market actors changing behavior based on persuasive inputs, insights from behavioral economics can benefit the development of effective suasion campaigns.<sup>45</sup>

The U.S. Federal Trade Commission's ("FTC's") efforts to encourage the online advertising industry to adopt self-regulatory principles for online behavioral advertising illustrate how defining the objectives of suasion initiatives can promote effectiveness. Prompted by concerns about consumer privacy, the FTC sought to "encourage industry to develop meaningful self-regulation" for online behavioral advertising. To achieve this goal, the FTC hosted a "Town Hall" to discuss with industry and other stakeholders the benefits and issues raised by online behavioral advertising. A set of self-regulatory principles were released for public comment. They were then revised based on the comments received and a staff report was published. In the report, published in 2009, the FTC noted that it would "continue to examine this marketplace and take actions to protect consumers as appropriate."<sup>46</sup> By mid-2009, industry associations had developed a set of self-regulatory principles building on the FTC's proposal. The effectiveness of the FTC's efforts benefited from the FTC's strategy of bringing together industry and others to focus on specific market issues and the potential for self-regulation to address issues.

**Regulators carefully consider the timing and method of delivery for suasion communications.** As noted above, suasion efforts may lose effectiveness if used too frequently. Regulators therefore assess whether the time is right for suasion. Regulators also consider the appropriate method of delivery for suasion communications. Regulators can deploy suasion via speeches at industry conferences,

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<sup>42</sup> Glenn Hepburn, *OECD Report: Alternatives to Traditional Regulation* 52-53 (2009), <https://www.oecd.org/gov/regulatory-policy/42245468.pdf>.

<sup>43</sup> Don Drummond et al., *Market-Based Solutions to Protect the Environment* 5 (2007), <https://www.td.com/document/PDF/economics/special/td-economics-special-bc0307-env.pdf>.

<sup>44</sup> Koichiro Ito, et. al., *Moral Suasion and Economic Incentives: Field Experimental Evidence from Energy Demand*, *American Economic Journal: Economic Policy* 240-267 (2018), <https://pubs.aeaweb.org/doi/pdfplus/10.1257/pol.20160093>.

<sup>45</sup> Behavioral economics looks to psychological research regarding human decision-making to understand how humans behave in real-life situations.

<sup>46</sup> FTC, *FTC Staff Report: Self-Regulatory Principles for Online Behavioral Advertising* (2009), <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-staff-report-self-regulatory-principles-online-behavioral-advertising/p085400behaviorreport.pdf>.

comments before legislative or other government bodies, press releases, social media, direct conversations with market participants, published reports, or media briefings. Regulators therefore consider which communications channels are best suited to deploy suasion in specific circumstances. They also keep in mind that their statements can move markets and greatly impact the marketplace; therefore, timing is key. Regulators also communicate in a way that protects proprietary and confidential information. In some cases, direct communications with industry may be most effective. In others, public communications may better achieve defined goals.

Consider the United Kingdom Office of Communications' ("Ofcom's") suasion efforts to promote competition and consumer benefits with respect to telecommunications services. Ofcom publishes annual reports comparing customer service for mobile, home broadband, and landline services.<sup>47</sup> By publishing the reports annually, Ofcom mitigates the risk of its suasion efforts losing effectiveness due to frequent use. Ofcom presents the information in a user-friendly and engaging format, including graphics "notes to editors" which explain and simplify dense information.<sup>48</sup> And by distributing the report publicly, Ofcom can influence industry behavior by providing consumers with information that may influence their purchases and by creating incentives for providers to compete on customer service.

**Regulators avoid penalizing market participants that voluntarily change behaviors to align with suasion efforts, especially where such suasion is intended to promote best practices that exceed legal requirements.** In some situations, regulators may seek to persuade industry to adopt practices that exceed legal and regulatory requirements. For example, in response to the COVID-19 pandemic, U.S. financial service regulators encouraged financial institutions to work with borrowers on payment deferrals.<sup>49</sup> Such action was not required by law or regulation, but was assessed to be a reasonable response to economic hardships. Market participants that elect to adopt "best practices" promoted by regulators may adopt market practices or undertake costs that put them at a competitive disadvantage with respect to market participants that ignore calls for change. For suasion to succeed, market participants must feel confident that "non-compliers" will not be able to unfairly capitalize on the advantages obtained by ignoring regulatory calls to adopt best practices. Regulators can help assure market participants that their voluntary efforts will not be penalized by praising firms that adopt best practices, and by maintaining pressure on and bringing public attention to those that do not, including by credibly indicating that the failure to change behavior may lead to formal regulation.

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<sup>47</sup> *Best and Worst Phone and Broadband Customer Service Revealed*, Ofcom.org.uk (Aug. 21, 2020), <https://www.ofcom.org.uk/about-ofcom/latest/features-and-news/customer-service-revealed>.

<sup>48</sup> See <https://www.ofcom.org.uk/about-ofcom/latest/media/media-releases/2020/customer-service-revealed>.

<sup>49</sup> *COVID-19 Supervisory and Regulatory FAQs*, Federalreserve.gov (June 16, 2020), <https://www.federalreserve.gov/covid-19-supervisory-regulatory-faqs.htm>.

## Case Studies

### Case Study 3A

#### UK Ofcom Phone and Broadband Customer Service Report

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Ofcom, the UK telecommunications regulator, publishes a report each year comparing customer service for mobile, home broadband, and landline services.<sup>50</sup> The report is intended to “offer[] an independent insight into what level of service phone and broadband customers can expect, helping [consumers] to shop around for a provider that meets their needs.”<sup>51</sup> Ofcom communicates its findings clearly. In addition to concise written descriptions, the report and its corresponding webpage feature simple tables, making the results clear and accessible. Ofcom also provides an interactive online tool that consumers can use to compare selected providers.<sup>52</sup>

By providing consumers with clear, easily accessible information regarding customer service, Ofcom can influence industry behaviors. Consumers can access the report prior to selecting a communications provider, which creates incentives for industry to improve customer service and attract new customers.

### Case Study 3B

#### FTC Staff Report: Self-Regulatory Principles for Online Behavioral Advertising

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In 2007, the FTC focused its attention on potential privacy concerns regarding online behavioral advertising. Specifically, the FTC was concerned that consumers may not understand how their information was collected and used, and that information about online consumer behaviors might be used for unexpected purposes. To learn about the potential risks and benefits of the collection of online consumer data, the FTC hosted a two-day town hall in November 2007. Following the town hall, FTC staff published draft self-regulatory principles for online behavioral marketing. After soliciting comments and receiving comments from 87 stakeholders, the FTC issued in 2009 a final staff report on proposed Self-Regulatory

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<sup>50</sup> Ofcom, *Best and Worst Phone and Broadband Customer Service Revealed* (Aug. 21, 2020), <https://www.ofcom.org.uk/about-ofcom/latest/features-and-news/customer-service-revealed>.

<sup>51</sup> *Id.*

<sup>52</sup> Ofcom, *Interactive report: Comparing customer service: mobile, home, broadband and landline* (Aug. 21, 2020), <https://www.ofcom.org.uk/phones-telecoms-and-internet/advice-for-consumers/quality-of-service/report/interactive-report-2019>.

Principles for Online Behavioral Advertising, in which FTC staff stated that “[self-regulation] provides the necessary flexibility to address evolving online business models.”<sup>53</sup>

The proposal included four core concepts:

1. Companies that collect information for behavioral advertising should prioritize transparency and control through meaningful disclosures to consumers and choice about whether to allow data collection.
2. Reasonable security and limited data retention should be provided so that behavioral data does not fall into the wrong hands.
3. Affirmative express consent should be required to support material changes to privacy policies.
4. Affirmative express consent should be required before using sensitive data for behavioral advertising.

The FTC’s efforts spurred prompt action from the industry. Less than six months after the FTC published its final principles, the Digital Advertising Alliance (a coalition of major industry groups) adopted the Self-Regulatory Principles for Online Behavioral Advertising, which closely tracked the FTC principles.<sup>54</sup>

## Case Study 3C

### Ethical Accountability Framework for Hong Kong, China



The Hong Kong Office of the Privacy Commissioner for Personal Data commissioned a report in October 2018 on the ethics of data processing, which set out the Ethical Accountability Framework for Hong Kong, China. The Privacy Commissioner for Personal Data and the Information Accountability Foundation (a global policy think tank) co-authored the framework it sought feedback from twenty-three organizations from various industries in Hong Kong. The framework provides guidance to organizations deploying information technologies, particularly those leveraging big data, artificial intelligence, or machine learning.

The framework is comprised of three Data Stewardship Values (Respectful, Beneficial, and Fair) that are supported by model impact assessments and a Process Oversight Model. The “Respectful” value requires that the context in which the data was originally collected determines the reasonable later uses of the data; later uses must align with the reasonable expectations of those who provided the data identified and, where possible, mitigated before

<sup>53</sup> FTC, *FTC Staff Report: Self-Regulatory Principles for Online Behavioral Advertising* 11 (Feb. 2009), <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-staff-report-self-regulatory-principles-online-behavioral-advertising/p085400behavadrport.pdf>.

<sup>54</sup> Digital Advertising Association, *Self-Regulatory Principles for Online Behavioral Advertising* (Jul. 2009), <https://www.iab.com/wp-content/uploads/2015/05/ven-principles-07-01-09.pdf>.

being. The “Beneficial” value requires that risks of data use be identified and, where possible, mitigated before being balanced against the benefits to individuals and society. The “Fair” value requires that data-processing activities must be impartial and be subject to regular monitoring regarding the risk of discrimination.<sup>55</sup> The report also provides model impact assessments and a Process Oversight Model for companies to use to evaluate their own data-processing activities and data protection processes.<sup>56</sup>

To promote the application of the Ethical Accountability Framework, the Privacy Commissioner worked with the Hong Kong Monetary Authority (“HKMA”) and Hong Kong Association of Banks (“HKAB”). In 2019, the regulators held a joint seminar regarding the implementation of the Framework for fintech initiatives. Soon after the seminar, the HKMA issued a circular encouraging all HKMA-authorized institutions to adopt and implement the Ethical Accountability Framework.<sup>57</sup>

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<sup>55</sup> Office of the Privacy Commissioner for Personal Data, *Ethical Accountability for Hong Kong, China* 24–27 (Oct. 2018), [https://www.pcpd.org.hk/misc/files/Ethical\\_Accountability\\_Framework.pdf](https://www.pcpd.org.hk/misc/files/Ethical_Accountability_Framework.pdf).

<sup>56</sup> *Id.* at 28–32.

<sup>57</sup> Hong Kong Monetary Authority, *Use of Personal Data in Fintech Development* (May 3, 2019), <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2019/20190503e1.pdf>.

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# Self-Regulation

## Overview

Although there are many models for self-regulation, it typically involves private sector participants in a given industry, market, or ecosystem voluntarily developing one or more of the following:

- Technical standards;
- Codes of conduct that guide industry behaviors;
- Rules that prohibit or prescribe certain activities; or
- Accountability mechanisms to monitor or enforce compliance within the group.

In many cases, self-regulatory efforts focus on issues that regulators have scrutinized or that industry participants believe may soon attract regulatory attention. Indeed, industry participants may initiate self-regulatory efforts in an attempt to avoid further regulation. As a result, self-regulation can occur while regulators are using less prescriptive and interventionist tools (e.g., observation or education) and *before* they turn to more prescriptive tools (e.g., formal regulation).

Self-regulatory activities sometimes involve collaborations or partnerships with a range of stakeholders. For example:

- Five prominent advertising and marketing trade groups based in the United States (the American Association of Advertising Agencies, Association of National Advertisers, Council of Better Business Bureaus, Direct Marketing Association, and Interactive Advertising Bureau) founded the Digital Advertising Alliance (“DAA”) and developed its foundational Self-Regulatory Principles for Online Behavioral Advertising. Many of the founding members participated in U.S. Federal Trade Commission (“FTC”) town halls that resulted in an FTC

proposal for self-regulatory principles, which the DAA used as the basis for its principles.<sup>58</sup>

- Telecommunications firms in Australia must consult with the public, consumer representatives, the Australian Competition and Consumer Commission (“ACCC”), and others before registering self-regulatory codes with the Australian Communications and Media Authority.<sup>59</sup>

Self-regulatory frameworks may differ in their enforcement mechanisms. In certain frameworks, industry groups themselves may retain enforcement responsibilities. For example, an industry association enforces Mexico’s Code of Marketing of Food and Non-alcoholic Beverages to Children.<sup>60</sup> Alternatively, the self-regulatory body may delegate enforcement authority to an independent body. For example, Denmark’s Framework Agreement for Mobile Content and Payment Services tasks enforcement to independent third parties that report to a Consumer Ombudsman, a public authority.<sup>61</sup>

## Benefits of Self-Regulation

**Self-regulation can identify effective solutions.** Self-regulation involves industry participants identifying and promoting practical solutions to identified concerns and externalities. Companies that develop self-regulatory frameworks can rely on their technical expertise and market experience to help inform effective and flexible mitigation strategies. This is particularly so with multi-stakeholder self-regulatory frameworks that draw on their stakeholders’ diverse expertise, experiences, and perspectives. In addition, self-regulation can increase the likelihood of compliance, as self-regulated entities will have voluntarily committed to the standards.

The Danish Framework Agreement for Mobile Content and Payment Services (“Framework Agreement”) demonstrates how self-regulation can lead to substantive, socially beneficial outcomes without requiring direct government action. The Framework Agreement enhanced transparency limited the charges that businesses can levy for one-time or subscription services, and provided consumers with the right to withdraw from service agreements without regulatory intervention by the government.<sup>62</sup> The Framework Agreement also provides an example of how industries can seek to self-regulate in an attempt to convince regulators that no direct intervention is needed.

The cryptocurrency industry has undertaken self-regulatory efforts, at least in part, in response to increased regulatory scrutiny and in an effort to avoid burdensome formal regulatory frameworks by demonstrating successful self-policing.<sup>63</sup> For example, the Virtual Commodity Association began work in 2018 to develop a self-regulatory framework for cryptocurrency marketplaces.<sup>64</sup>

**Self-regulation can often be implemented swiftly.** Self-regulation can often be implemented more quickly than more prescriptive regulatory efforts that generally require lengthy notice and comment

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<sup>58</sup> The FTC held town halls in 2007 and published a Staff Report in 2009 regarding recommended principles for self-regulation in online behavioral advertising. FTC, *Fed. Trade Comm’n Staff Report: Self-Regulatory Principles for Online Behavioral Advertising* (Feb. 2009), <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-staff-report-self-regulatory-principles-online-behavioral-advertising/p085400behavadrport.pdf>. In July 2009, DAA published its Self-Regulatory Principles for Online Behavioral Advertising. DAA, *Self-Regulatory Principles for Online Behavioral Advertising* (Jul. 2009), [https://digitaladvertisingalliance.org/sites/aboutads/files/DAA\\_files/seven-principles-07-01-09.pdf](https://digitaladvertisingalliance.org/sites/aboutads/files/DAA_files/seven-principles-07-01-09.pdf).

<sup>59</sup> OECD, *Industry Self-Regulation: Role and Use in Supporting Consumer Interests* 13 (Mar. 23, 2015), [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP\(2014\)4/FINAL&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP(2014)4/FINAL&docLanguage=En).

<sup>60</sup> *Id.* at 50.

<sup>61</sup> *Id.* at 57.

<sup>62</sup> OECD, *Industry Self-Regulation: Role and Use in Supporting Consumer Interests* 57 (2015), [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP\(2014\)4/FINAL&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP(2014)4/FINAL&docLanguage=En).

<sup>63</sup> Osato Avan-Nomayo, *Pushing for Crypto Self-Regulation Amid Tightening Government Scrutiny*, Cointelegraph (Oct. 12, 2019), <https://cointelegraph.com/news/pushing-for-crypto-self-regulation-amid-tightening-government-scrutiny>.

<sup>64</sup> Virtual Commodity Association, <https://virtualcommodities.org/> (last visited Jan. 4, 2021).

rulemaking processes. Especially when regulators lack sufficient data to support more prescriptive formal regulation, encouraging self-regulatory efforts can be a valuable alternative. Motivated industry groups may be able to develop self-regulatory frameworks in less time than would be required for regulators to obtain data sufficient to support regulatory intervention and complete notice and comment rulemaking processes. This makes self-regulation particularly beneficial in industries with new market players or technologies and/or novel policy issues.

**Self-regulation is flexible.** One key advantage of self-regulation for regulated entities and regulators alike is that, when compared to more interventionist regulatory tools like formal regulation, it provides increased flexibility to adapt to rapid technological innovation and dynamic changes in behavioral norms. Self-regulatory frameworks allow industry sectors, groups of companies, or single firms to establish independent standards for market behaviors. Self-regulatory bodies often can more flexibly adopt or adapt standards to address newly emerging or evolving issues. Such actions can help regulation reflect emerging trends in a timely way, especially in areas where regulators may lack data or information about how to design more formal regulatory tools.

**Self-regulation enhances transparency.** Self-regulation can promote transparency of existing market practices. This is particularly true for frameworks that rely on publicly reported independent audits or assessments as the primary mechanism for accountability.

**Self-regulation promotes industry accountability.** Self-regulatory frameworks can promote industry accountability through the monitoring or enforcement of standards by self-regulatory bodies. In addition, in markets subject to consumer protection or other laws that more generally prohibit deceptive acts and practices, when a company publicly commits to adhere to self-regulatory standards, such action can establish grounds for legal enforcement if the company fails to live up to its public commitments.<sup>65</sup>

## Challenges for Self-Regulation

**Self-regulatory frameworks require careful design.** Industry participants can sometimes be reluctant to adopt transparent, substantive requirements within a self-regulatory framework. However, self-regulation must transparently impose substantive requirements backed by enforcement mechanisms. Absent those elements, participants should expect reduced credibility in the market for self-regulatory frameworks to have long-term impact and efficacy,

**Self-regulation can impose costs on participants that are not shared with non-participating firms.** Formal regulation generally imposes costs on all firms within a particular market. Self-regulation, on the other hand, has an asymmetric impact on firms that commit to the frameworks. Participating companies are subject to constraints and potentially increased legal exposure, which could affect innovation, business planning, and ultimately their financials. Consumers and business partners may favor companies that voluntarily commit to adopting limitations that improve market conditions or advance the public good, providing market and reputational benefits, which may balance the costs. However, in markets where all industry actors share reputation, firms that do not participate in self-regulatory

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<sup>65</sup> Roscoe B. Starek III, *The ABCs at the FTC: Marketing and Advertising to Children*, FTC (July 25, 1997) (“[A]n explicit claim that a marketer complies with a particular industry code, when in fact it does not, would violate the FTC Act.”), [https://www.ftc.gov/public-statements/1997/07/abcs-ftc-marketing-and-advertising-children#N\\_47](https://www.ftc.gov/public-statements/1997/07/abcs-ftc-marketing-and-advertising-children#N_47).

frameworks may receive reputational benefits from self-regulatory activities without incurring self-regulatory costs.<sup>66</sup>

## Effective Implementation

**Proper Scope.** Self-regulatory frameworks are scoped to address the societal concern. When developing a self-regulatory framework, key questions for industry and other stakeholders include:

- To what extent do the commitments address the activities or societal impacts that regulators are otherwise inclined to regulate?
- Are the commitments sufficiently detailed?
- What activities or potential for abuse are not addressed?

**Broad industry acceptance promotes credibility and compliance.** The support of a majority of industry or sectoral players is essential to establish credibility and promote compliance. Regulators and the public may view weak participation by industry or sectoral firms as a sign that the framework does not address an important issue or that the industry, as a whole, lacks concern about the issue and a commitment to it. Disincentives for participation include the perception that standards are impractical, impact stakeholders unevenly, or have costs that exceed the benefits.

**Transparency supports credibility.** When an industry seeks self-regulation in an attempt to satisfy regulatory concerns, there is a risk that critics may view the process as self-serving or uninformed. Self-regulatory initiatives can address this by adopting fair, transparent processes. For example, industry participants can publish proposed frameworks for public comment, or ask key stakeholders (including, where appropriate, industry regulators) to review and propose changes before final adoption. Doing so can help establish credibility and support the adoption of substantive measures designed to address issues of specific concern.

Transparency is beneficial in the course of maintaining self-regulatory frameworks as well. Providing publicly accessible information regarding framework requirements, benefits, accountability proceedings, and participation can enhance credibility. Consider the European Advertising Standards Alliance (“EASA”), which consists of 26 European self-regulatory organizations and fourteen industry members with European or global footprints. The EASA’s website is publicly available and provides a broad range of resources for industry, including guidance and best practices for the self-regulatory frameworks operating under the EASA network. EASA members consult on enforcement best practices and collaborate on a cross-border complaints system that allows parties to address cross-border advertising issues.<sup>67</sup> In addition, the EASA conducts awareness campaigns to educate regulators, industry, and consumers about the effectiveness of self-regulation in the advertising sector.<sup>68</sup>

**Self-regulation is more effective when independent experts participate in the development and review of the frameworks.** Expert inputs promote legitimacy and recognition for self-regulatory frameworks. Incorporating some level of independent or third-party review of self-regulatory frameworks can promote additional credibility and help to avoid “blind spots,” including areas of

<sup>66</sup> Greg Distelhorst et al., *Certifiably Responsible? Self-Regulation and Market Response in China* 7 (2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3593837](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3593837).

<sup>67</sup> EASA, *Cross Border Complaints System*, <https://www.easa-alliance.org/coverage/cross-border-complaints-system> (last visited Jan. 4, 2021).

<sup>68</sup> EASA, *Self-Regulation in Advertising – A Successful Model* (Nov. 28, 2018),

[https://s3.eu-west-1.amazonaws.com/assets.dogandcatwelfare.eu/live/media/publicationtemp/EASA\\_-\\_Advertising\\_SR\\_a\\_successful\\_model\\_2018.pdf](https://s3.eu-west-1.amazonaws.com/assets.dogandcatwelfare.eu/live/media/publicationtemp/EASA_-_Advertising_SR_a_successful_model_2018.pdf).

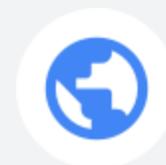
potential concern to regulators or other stakeholders that industry participants do not readily understand. If independent or third-party review is infeasible, self-regulatory bodies should consider whether other mechanisms might be used to assess potential gaps and confirm the frameworks' continued suitability in light of evolving marketplace conditions.

As a trustmark, the International Organization for Standardization's ("ISO's") voluntary standards have gained standing in large part due to the fact that standards are developed by technical experts. Another example of the benefits of expert input is the Global Network Initiative, which strives to protect freedom of expression and privacy by setting high standards for its members and publishing assessments of its member companies.<sup>69</sup> The Initiative's success at addressing issues related to digital harms and limits on government surveillance without direct government intervention is due, at least in part, to the participation of both corporate and non-governmental organizations that are viewed as leaders in the fields of information and communications technology, human rights, or freedom of speech.<sup>70</sup>

**Self-regulatory frameworks benefit from the inclusion of accountability mechanisms.** For example, the U.S. automobile industry's privacy principles adopted in 2014 by members of the Alliance of Automotive Manufacturers and Global Automakers, have been criticized by some for lacking internal enforcement mechanisms. However, by publicly committing to the substantive commitments contained in the principles, participating members may be subject to enforcement from consumer protection authorities on the grounds that the failure to adhere to the standards constitutes a deceptive act. The absence of internal enforcement mechanisms has likely contributed to a string of proposals to more formally regulate privacy in the automotive sector. On the other hand, the DAA's "OBA Principles," referenced above, have benefited from robust codes of conduct that are enforced by independent bodies. In addition, the Global Network Initiative's success may also be due, in part, to its adoption of independent audits and commitments to agree to remediation plans when opportunities for improvement are identified.

## Case Studies

### Case Study 4A ISO Standards



The International Organization for Standardization ("ISO") is a global network of national standards bodies from 165 countries that develops and publishes international standards for a vast array of industries and markets. ISO standards take many forms and can provide rules, guidelines, or characteristics for various activities. ISO has published tens of thousands of standards that have been adopted globally on topics ranging from toy safety, to environmental management, to global date and time formats. Standardization builds consumer

<sup>69</sup> GNI, *Company Assessments*, <https://globalnetworkinitiative.org/company-assessments/> (last visited Jan. 4, 2021).

<sup>70</sup> See *About GNI*, <https://globalnetworkinitiative.org/about-gni/>.

trust, eases transaction costs for businesses, and provides regulators with baseline considerations for regulatory activity.

ISO features three tiers of membership for national standards bodies: full members, correspondent members, and subscriber members. Full members participate and vote in ISO technical and policy meetings, which influence the standards and ISO strategy. Correspondent members observe technical and policy meetings. Both full and correspondent members sell and adopt standards for their country or territory. Subscriber members are advised of ISO's work but do not participate in standards development or meetings.

ISO creates standards in response to stakeholder requests to meet a market need. When designing a new standard, ISO members nominate independent technical experts in the relevant field to develop the standards scope and content. ISO uses a consensus-based approach that leverages expert experience and considers input from stakeholders to determine final standards.<sup>71</sup> When a standard is complete, member standard organizations may adopt that standard for their nation or territory according to that organization's procedures.

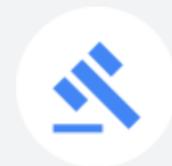
ISO does not provide certifications or conformity assessments. However, regulatory bodies can adopt ISO standards and incorporate their own enforcement regimes.

ISO's standards are widely adopted and accepted in significant part because of the deep expertise with which standards are crafted and because ISO involves consumers, industry experts, and representatives from a variety of countries in the development of standards.

## Case Study 4B

### Data Driven Marketing Association of Singapore's Code of Practice

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The Data Driven Marketing Association of Singapore (“DMAS”) is a non-profit trade organization for the marketing industry in Singapore and the region. A cornerstone of DMAS is the Code of Practice, which is intended to “establish and maintain a credible and effective system of self-regulation that will meet the reasonable expectations of the direct marketing industry and its member companies.”<sup>72</sup>

The Code of Practice establishes standards of ethical conduct, best practices, and an accountability system for its members. It addresses responsible use of personal data, advertising ethics and rules (e.g., no advertisement may quote a price that omits a

<sup>71</sup> ISO, *Who Develops Standards*, <https://www.iso.org/who-develops-standards.html> (last visited Jan. 4, 2021).

<sup>72</sup> DMAS, *Data Protection & Business Practice*, <http://www.dmas.org/business-practice/> (last visited Jan. 4, 2021).

non-optional extra charge), and customer service standards. It also provides procedures for the settlement of disputes involving DMAS members, whether with customers, the general public, or between multiple members.

The DMAS Code of Practice Committee investigates complaints from members and the public. It also adjudicates alleged infringements of the Code and issues sanctions against infringing members, including formal admonishment, suspension or expulsion from the Association. This accountability function lends credibility to DMAS, as it demonstrates that the commitments are substantial.

## Case Study 4C

### European Advertising Standards Alliance

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The European Advertising Standards Alliance (“EASA”) promotes and facilitates self-regulation within the advertising industry in Europe. EASA members include advertising self-regulatory bodies from Europe and industry stakeholders, including advertising and media associations. EASA assists in the development and coordination of self-regulation across Europe through advocacy and policy, development and coordination of self-regulatory standards and processes, and administering a cross-border complaint mechanism.

The EASA Best Practice Model and Charter provides standards and recommendations for advertising self-regulatory frameworks. The Best Practice Model outlines ten components of effective self-regulation, including independent or third-party reviews, effective accountability mechanisms, and broad participation:<sup>73</sup>

- Universal Application of the self-regulatory framework to advertisers, agencies, and media companies;
- Sustained and effective funding to maintain the self-regulatory framework;
- Independent and resourced administration so that the public can be confident that the framework operates independently of the organizations that fund it;
- A code of advertising practice that applies to all forms of advertising and is publicly available;
- Self-regulatory organizations should provide members with compliance guidance;

<sup>73</sup> EASA, *The EASA Best Practice Self-Regulatory Model* (Apr. 2004)  
<https://www.easa-alliance.org/sites/default/files/EASA%20Best%20Practice%20Self-Regulatory%20Model.pdf>.

- Prompt and efficient handling of complaints;
- Independent and impartial adjudication processes that are not subject to pressure from industry, government, or non-government organizations;
- Effective sanctions;
- Compliance monitoring; and
- Industry and consumer awareness.

Although EASA has no internal enforcement mechanisms, EASA facilitates international collaboration and enforcement. EASA members that operate national self-regulatory frameworks consult on best practices for enforcing their respective frameworks. EASA also coordinates a cross-border complaints system through which citizens in one country can submit a complaint about an ad originating from another and receive the same redress available in the country of origin.

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# Co-Regulation

## Overview

Although there are numerous models for co-regulation, this tool typically involves private sector participants in a given industry, market, or ecosystem collaborating with state regulators to develop, assess, or enforce standards, codes of conduct, or rules governing market behavior.

Co-regulation can address emerging technology issues while allowing sufficient flexibility to promote innovation. At one end of the spectrum, co-regulation involves government regulators providing input to industry participants regarding the development of self-regulatory frameworks. At the other end of the spectrum, co-regulation involves government regulators enforcing frameworks or developing regulatory frameworks that industry groups will enforce.

Examples of co-regulation include:

- The development of internationally recognized standards, guides, and recommendations;
- Internationally recognized private sector conformity assessment systems (e.g., the International Laboratory Accreditation Cooperation Mutual Recognition Arrangement); and
- Mutual recognition arrangements (e.g., the IEC System of Conformity Assessment Schemes for Electrotechnical Equipment and Components CB Scheme).<sup>74</sup>

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<sup>74</sup> See CB Scheme, IECCE.org, <https://www.iecee.org/about/cb-scheme/> (last visited Jan. 4, 2021).

## Benefits of Co-Regulation

**Co-regulation can produce substantive outcomes that are more flexible and practical than those that a regulator might adopt on its own.** As co-regulation involves collaboration between industry and regulators, the standards and requirements adopted can be both practical, due to inputs reflecting industry expertise, and substantive, reflecting the policy goals of regulators. This may lead to stronger levels of compliance as compared to formal regulation. And if circumstances change, stakeholders often can update co-regulatory frameworks without having to navigate the lengthy notice-and-comment proceedings associated with formal regulation. This allows stakeholders to adapt co-regulatory frameworks to rapidly evolving technologies and market practices.

**Co-regulation can promote transparency and education.** As co-regulation enables regulators to partner with industry in addressing specific issues, regulators often gain additional insights regarding market practices. And co-regulatory partnerships provide industry with the opportunity to gain insight into the concerns and priorities of regulators. These insights can help industry develop innovative solutions for identified policy concerns and help regulators develop more informed approaches to regulation.

**Co-regulation can work where the boundaries of regulatory authority are not clear.** Co-regulation can be particularly effective in situations where there is an open question about the extent of the regulator's authority over a particular subject matter, industry, or other market practice. In such circumstances, stakeholders may be eager to collaborate in an effort to avoid litigating issues of regulatory jurisdiction or resolving the issues via legislation, which could impact industry and regulatory flexibility.

**Co-regulation can enhance efficiencies for regulators.** Co-regulation can reduce administrative or enforcement costs for regulators relative to traditional regulatory efforts. For example, private sector participants can, depending on the framework, support implementation, assess compliance, or maintain responsibility for enforcement.

## Challenges for Co-Regulation

**Multi-stakeholder collaboration with clear process design is key to co-regulation.** One challenge at the beginning of co-regulatory efforts is determining which stakeholders to convene. And once stakeholders are involved, organizers need to carefully consider how to allocate responsibilities within the framework. For example, should regulators or independent assessors have enforcement powers? Which stakeholders may amend the substantive requirements? What process will be required for amendment? How may market entrants participate in co-regulatory frameworks?

Co-regulatory participants can develop processes that will promote collaboration. If the process is not well-designed or lacks firm deadlines, multi-stakeholder discussions risk stagnating or breaking down, potentially leading to unwanted and unnecessary regulatory uncertainty for stakeholders.

**Participants may be competitively penalized.** Co-regulation involves collaboration between specific existing industry participants and regulators. As new entrants to a market emerge, they may fall outside

of the pre-existing co-regulatory framework. Those new companies may benefit from co-regulation, if the reputational benefits of co-regulatory frameworks are shared by all industry actors, without undertaking any of the industry costs associated with co-regulation.<sup>75</sup> As a result, some companies may thrive competitively without taking any steps to address the issues for which the co-regulatory was designed. Regulators can take steps to ensure that industry participants in co-regulation are not penalized (e.g., competitively), with respect to out-of-scope new entrants, by virtue of their participation in the co-regulatory framework.

## Effective Implementation

**Promote strong state-industry collaboration.** Co-regulation requires convening relevant stakeholders and promoting constructive communication and cooperation among private and state actors. All relevant stakeholders must understand and commit to their roles in the regulatory process and to the deadlines set for milestones to promote confidence in the co-regulatory process.

The Internet Corporation for Assigned Names and Numbers (“ICANN”), which is responsible for allocating and maintaining the global Domain Name System (“DNS”) for the Internet, is one example of a successful co-regulatory approach consisting of a diverse group of government and industry stakeholders. Comprising governments, industry, civil society, and end users from around the world, ICANN has created contractual rules and a compliance system underpinning the DNS, including allocating and assigning domain names and IP addresses.

**Clearly define enforcement responsibilities.** Effective co-regulation generally requires enforcement mechanisms that demonstrate that industry is subject to substantial obligations and that the co-regulatory framework is more than aspirational guidance. Enforcement responsibilities can be allocated to industry, regulators, independent third parties, or a combination thereof. Effective co-regulatory frameworks also clearly allocate enforcement responsibilities and escalation procedures.

For example, consider the implementation of the Children's Online Privacy Protection Act (“COPPA”) in the United States, which is primarily enforced by the Federal Trade Commission (“FTC”). In recognition of the dynamic nature of Internet activity, COPPA contemplates a role for industry and co-regulation. The Better Business Bureau’s Children's Advertising Review Unit (“CARU”) administers a co-regulatory framework for compliance with COPPA. CARU monitors participants' compliance with the program on an ongoing basis, and can refer non-compliant participants to the FTC for investigation and possible enforcement action. Participants that comply with CARU’s guidelines are deemed in compliance with COPPA and are granted a safe harbor from FTC enforcement action.

Other co-regulatory examples involve the private sector agreeing on the substantive commitments and “rules of the road” and then leaving the regulator to enforce those commitments. For example, in the United Kingdom (“UK”), the Broadcast Committee of Advertising Practice (“BCAP”) is a co-regulatory body governing radio and television advertising. In 2004, the UK Office of Communications (“Ofcom”) granted to the Advertising Standards Authority (“ASA”) day-to-day responsibility “for writing and maintaining the [BCAP Code], but Ofcom retains overall sign-off on major changes.”<sup>76</sup> Ofcom also retains authority to enforce Code violations that ASA refers to Ofcom.

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<sup>75</sup> Greg Distelhorst et. al., *Certifiably Responsible? Self-Regulation and Market Response in China* 7 (May 5, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3593837](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3593837).

<sup>76</sup> *Self-regulation and co-regulation*, ASA, <https://www.asa.org.uk/about-asa-and-cap/about-regulation/self-regulation-and-co-regulation.html> (last visited Jan. 4, 2021).

## Case Studies

### Case Study 5A ICANN Domain Name System

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ICANN is a California-based nonprofit corporation administering the Domain Name System (“DNS”). The U.S. Department of Commerce established ICANN in 1998 to coordinate various functions related to the allocation and assignment of domain names on the Internet.<sup>77</sup> To perform its functions in the public interest, ICANN contracts with government agencies such as the U.S. Government’s National Telecommunications and Information Administration.<sup>78</sup>

In its role of coordinating allocation and assignment of domain names, ICANN accredits private sector organizations known as registrars who are responsible for receiving domain name registrations from individuals and entities.<sup>79</sup> Registrars are required to collect information from registrants, which ICANN makes publicly available through the WHOIS (domain name registration data lookup) database. ICANN enters into an accreditation agreement with registrars, and registrars contract with registrants as part of the domain name registration process. ICANN manages complaints received from registrants as part of its administration of the DNS.<sup>80</sup>

ICANN prioritizes developing strong, collaborative relationships among its stakeholders. ICANN’s Global Stakeholder Engagement deploys staff in more than twenty countries to drive participation in ICANN activities. To further enhance its effectiveness, ICANN undertook a review of its multistakeholder governance model – soliciting public comments and publishing a set of proposals for improving the model. ICANN identified that the diversity of stakeholder interests might create challenges for reaching consensus on policy issues. To address the potential problems, ICANN has developed a Consensus Playbook to provide a framework for facilitating multistakeholder initiatives that lead to productive outcomes.<sup>81</sup>

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<sup>77</sup> Ramaswamy Chandramouli & Scott Rose, *Secure Domain Name System (DNS) Deployment Guide*, NIST Special Publication 800-81-2, 2-3 (Sept. 2013), <https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-81-2.pdf>.

<sup>78</sup> A Quick Look at ICANN (Nov. 2013), <https://www.icann.org/en/system/files/files/quick-look-icann-01nov13-en.pdf>.

<sup>79</sup> *Registrar, ICANN Acronyms and Terms*, ICANN, <https://www.icann.org/icann-acronyms-and-terms/en/G0123> (last visited Jan. 4, 2021).

<sup>80</sup> Between September 2019 and February 2020, ICANN’s Global Support Center reported receiving 8,857 registrant inquiries, which accounted for approximately 80% of all inquiries. ICANN, Volume 3: Issues and Challenges Impacting Domain Name Registrants (May 1, 2020), <https://www.icann.org/en/system/files/files/domain-name-registrants-issues-challenges-report-01may20-en.pdf>.

<sup>81</sup> ICANN, *Enhancing the Effectiveness of ICANN’s Multistakeholder Model* (2020), <https://www.icann.org/en/system/files/files/enhancing-effectiveness-multistakeholder-model-14oct20-en.pdf>.

## Case Study 5B

### CARU's Safe Harbor Program for COPPA



Under the Children's Online Privacy Protection Act ("COPPA"), the U.S. Federal Trade Commission ("FTC"), as the lead enforcer, may bring enforcement actions against violators. The statute also authorizes the FTC to approve safe-harbor programs related to COPPA's requirement that certain operators of online websites and services obtain verifiable parental consent before collecting personal information from children under 13 years of age. The Children's Advertising Review Unit ("CARU") created the first such safe harbor program, which the FTC approved in 2001.<sup>82</sup> Participants that meet CARU's program requirements satisfy their COPPA compliance obligations, insulating them from formal enforcement actions.

CARU monitors program participants' COPPA compliance through its Self-Regulatory Program for Children's Advertising.<sup>83</sup> The framework establishes principles that participants must adhere to in order to remain in the program, and is an approved FTC COPPA Safe Harbor program.

CARU's COPPA Safe Harbor Program requires that participants agree to the following program components:

- Full adherence to the requirements set forth in the CARU Safe Harbor Participation Agreement;
- Compliance with CARU's Self-Regulatory Program for Children's Advertising, including the Guidelines for Online Privacy Protection;
- Review by CARU staff of the participant website's information practices;
- Ongoing monitoring by CARU staff of the participant's website to assess and ensure compliance with the Safe Harbor Program;
- Completion of CARU's Self-Assessment Form and Attestation by the Safe Harbor participant; and
- Submission to CARU of an updated Self-Assessment Form and Attestation on each anniversary of the date of acceptance in the CARU Safe Harbor Program.<sup>84</sup>

When CARU identifies behavior that violates its program principles, it works with participants to change non-compliant behavior. CARU reports that most of its cases against members for COPPA violations result in voluntary self-correction.<sup>85</sup> However, when a member company refuses to correct violations, CARU may refer the case to the FTC for investigation. For example, in 2019, CARU referred Musical.ly, a CARU safe harbor participant, to the FTC for

<sup>82</sup> COPPA Safe Harbor Program, FTC, <https://www.ftc.gov/safe-harbor-program> (last visited Jan. 4, 2021).

<sup>83</sup> Children's Advertising Review Unit, *Self-Regulatory Program for Children's Advertising*, Council of Better Business Bureaus (2014), <https://bbbnp-bbbp-stf-use1-01.s3.amazonaws.com/docs/default-source/caru/self-regulatory-program-for-childrens-advertising-revised-2014-.pdf>.

<sup>84</sup> CARU Safe Harbor Program and Requirements, BBB Nat'l Programs Archive, <https://bbbprograms.org/archive/caru-safe-harbor-program-and-requirements> (last visited Jan. 4, 2021).

<sup>85</sup> BBB National Programs, *Twenty Years of Successful Co-Regulation Under COPPA: A Model for Fostering Consumer Privacy*, BBB NP Report, (Oct. 2019), <https://bbbprograms.org/media-center/newsroom/twenty-years-of-successful-co-regulation-under-coppa>

violations of the COPPA rule. This referral resulted in an enforcement action by the FTC and a historic \$5.7 million payment by the company to resolve the FTC’s charges.<sup>86</sup>

Safe Harbor program applications are subject to public comment, which creates an opportunity for stakeholders to assess applications.<sup>87</sup> And the FTC issues written determinations within 180 days of applications being filed, which mitigates the risk of protracted program development.<sup>88</sup> The FTC’s COPPA regulations require Safe Harbor programs to submit periodic reports. This promotes the sharing of information to assess program effectiveness and creates a strong incentive for program administrators to maintain the integrity of their Safe Harbors.<sup>89</sup>

## Case Study 5C

### Code of Broadcast Advertising

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The UK Code of Broadcast Advertising (“BCAP Code”)<sup>90</sup> governs all advertisements appearing on radio and television services licensed by Ofcom. By statute, Ofcom is responsible for maintaining broadcast advertising standards. The Communications Act 2003 required Ofcom to consider alternative forms, including co-regulation, where feasible.<sup>91</sup> As a result, in 2004, Ofcom delegated to the Advertising Standards Authority (“ASA”) responsibility for developing, maintaining, and administering the BCAP Code. Ofcom retains authority to approve substantial changes to the Code, establish certain standards (e.g., with respect to political advertising), and take action against broadcasters subject to referrals from ASA as may be needed.<sup>92</sup>

The co-regulatory framework for the BCAP Code is clearly established by a memorandum of understanding between ASA and Ofcom.<sup>93</sup> This clarity of roles and responsibilities contributes to effective co-regulation. And, as noted by the UK’s Better Regulation Executive, the development of the BCAP Code framework illustrates the importance of confirming that there is substantial industry buy-in to the co-regulatory process and ensuring that co-regulatory partners have sufficiently similar interests, at least with respect to core elements of the framework, to make co-regulation feasible.<sup>94</sup>

<sup>86</sup> *In re Musical.ly, Inc.*, FTC File No. 172 3004, <https://www.ftc.gov/enforcement/cases-proceedings/172-3004/musically-inc>.

<sup>87</sup> See 16 CFR 312.11(a).

<sup>88</sup> See *id.*

<sup>89</sup> See 16 CFR 312.11(d).

<sup>90</sup> Broadcast Code, ASA.org.uk, <https://www.asa.org.uk/codes-and-rulings/advertising-codes/broadcast-code.html> (last visited Jan. 4, 2021).

<sup>91</sup> *Id.*

<sup>92</sup> See Appendix 1 Statutory Framework for the Regulation of Broadcast Advertising, ASA.org.uk, [https://www.asa.org.uk/type/broadcast/code\\_section/appendix-1.html](https://www.asa.org.uk/type/broadcast/code_section/appendix-1.html).

<sup>93</sup> Memorandum of Understanding Between Ofcom, ASA, BCAP & BASBOF (2014), [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0029/79472/memorandum\\_of\\_understanding\\_2014.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0029/79472/memorandum_of_understanding_2014.pdf).

<sup>94</sup> Better Regul. Exec., *Self- and Co-Regulation: The Advertising Standards Authority*,

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# Experimental Regulation

## Overview

Experimental regulation typically involves regulators partnering with private enterprises, states, localities, or academic institutions to actively monitor and assess innovative technologies. Regulators use experimental regulation to observe and supervise the testing, refinement, and deployment of innovative technologies within defined markets or subject to specific operating parameters. Such efforts may take several forms, including regulatory sandboxes, pilot programs, waivers, exemptions, or experimental licensing programs, typically in a time-limited manner.

Regulatory sandboxes involve regulators establishing frameworks that enable firms to conduct live experiments with innovative technologies or business offerings within controlled environments under regulatory supervision. Sandboxes may be established with limited time frames and limited markets, enabling regulators to test the effectiveness of potential regulatory frameworks on a small scale for a limited period of time. Depending on the context, sandboxes can vary in the duration of the testing, the number and diversity of participants, and the size of the markets that the sandboxes will cover. Regulatory sandboxes have become increasingly popular in the fintech sector, including in the United Kingdom, Australia, Hong Kong, Abu Dhabi, Canada, Denmark, and Singapore.<sup>95</sup>

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<sup>95</sup> Andrew F. Tuch, *Introduction: The Rise of Fintech*, 61 Wash U.J.L. & Pol'y 1, 57 (2020), [https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=2123&context=law\\_journal\\_law\\_policy](https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=2123&context=law_journal_law_policy).

Other forms of experimental regulation involve regulators granting relief to one or more market participants from existing regulatory provisions. Regulators often grant such relief in circumstances where existing regulations appear to be outdated or ill-suited for innovative technologies or business practices. Such relief can help industry and regulators assess the benefits, risks, and consequences of innovative offerings. With that information in hand, regulators, perhaps in consultation with industry, can assess whether risk mitigation controls are warranted and identify practical solutions to identified issues. For example, the U.S. Federal Communications Commission has a long history of granting experimental licenses that permit parties to develop new technologies and services while limiting the interference with incumbent services. The agency has also developed Innovation Zones that serve as “city-scale test beds for advanced wireless communications and network research.”<sup>96</sup> As another example, the UK Office of Gas and Energy Markets launched the Innovation Link program in 2017 to support innovators seeking to trial or launch new products, services, methodologies, or business models in the energy sector.

## Benefits of Experimental Regulation

**Experimental regulation promotes innovation** by supporting the development, testing, and rapid deployment of new technologies and service offerings. Through experimental regulation, regulators can provide entrepreneurs with trials to test new technologies with reduced risk, encouraging new and innovative business models. In this way, experimental regulation promotes economic growth and societal benefit. Regulators also avoid the risk of promulgating untested rules that can become entrenched and unduly limit consumer choices and industry flexibility. Typically, the potential for such benefits is greatest in particularly dynamic or emerging sectors such as digital technology.

**Experimental regulation allows regulators to avoid unintended consequences.** Often old or archaic regulatory frameworks may apply by default to new emerging technologies, even though regulators did not foresee this when designing the regulations. In 2001, for example, a report commissioned by EU finance ministers concluded that the EU regulatory framework for securities markets was not well-suited for the rapidly changing market for financial services.<sup>97</sup> To assess the suitability of new regulatory frameworks, EU financial regulators have turned to sandboxes and other experimental programs that can be quickly terminated or adapted to address observed issues. The ability to waive or modify archaic rules to accommodate marketplace or technological changes, or new and emerging risks, especially for nascent and innovative industries, is critical for effective governance.<sup>98</sup>

**Experimental regulation provides teaching opportunities.** Experimental regulation provides opportunities for regulators, industry, and society more broadly to learn about the benefits and potential issues associated with new technologies and offerings. Sandboxes and other experimental efforts can provide a low-cost means for industry, regulators, and other stakeholders to jointly learn from trial and error before making important regulatory or policy decisions.

**Experimental regulation can promote competition in the marketplace.** For example, regulatory sandboxes can reduce regulatory barriers to allow new firms or small businesses to compete more effectively on a level playing field with bigger firms. Sandboxes enable start-ups, small businesses, and

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<sup>96</sup> FCC, *What the FCC Has Accomplished Under 3 Years of Chairman Ajit Pai's Leadership* (2020), <https://docs.fcc.gov/public/attachments/DOC-362141A1.pdf>.

<sup>97</sup> ESMA, *Final Report of the Committee of Wise Men on the Regulation of the European Securities Markets* (2001), [https://www.esma.europa.eu/sites/default/files/library/2015/11/amfalussy\\_report.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/amfalussy_report.pdf).

<sup>98</sup> Policy Dep't Economic, Scientific and Quality of Life Policies, *Regulatory Sandboxes and Innovation Hubs for FinTech*, Eur. Parl. (2020), [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652752/IPOL\\_STU\(2020\)652752\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652752/IPOL_STU(2020)652752_EN.pdf).

industry generally to conduct limited tests of their products with fewer regulatory constraints, less risk of regulatory enforcement action, and the benefit of ongoing consultation with and guidance from regulators.

**Experimental regulation can benefit individual jurisdictions or regulators.** Experimental regulation signals to the entrepreneurial community a willingness to encourage and enable innovation, and encourages industry participation in local marketplaces. It can also communicate to industry and the market that a jurisdiction or regulator is flexible, approachable, and keen to support innovative enterprises.<sup>99</sup> This is particularly true where jurisdictions are first, or at the leading edge of developing an experimental approach to sectoral regulation. For example, studies have credited the United Kingdom's regulatory sandbox approach to fintech (under which the Financial Conduct Authority authorized firms to test innovative propositions in a controlled environment) with helping the country to become a leading global hub for fintech.<sup>100</sup>

## Challenges for Experimental Regulation

**Experimental regulation is typically a short-term solution.** Although experimental regulation has clear benefits for many sectors in the short-term, it typically will not serve as a robust, long-term regulatory solution. It tends to be temporary and subject to modification; it does not take the place of broad, long-term regulatory frameworks that may offer industry enhanced certainty about the state of the marketplace or more expansive market deployment opportunities. Indeed, for industries seeking regulation that does not require case-by-case approvals by regulators (including in the sandbox or pilot program environments), a more stable regulatory environment may lead to improved market outcomes.

Relatedly, experimental regulation may be less useful in homogenous and mature sectors in which there is little empirical uncertainty regarding a desirable long-term regulatory approach. For these sectors, the timely implementation of long-term regulatory frameworks may be preferable for enhancing certainty in the marketplace.

**If not designed carefully and transparently, experimental regulation may invite criticism from those not participating.** Market participants that do not participate in experimental regulation may view the programs as unequal or unfair. For this reason, effective regulators clearly articulate the guiding principles, shared goals, and relevant rules of the experimental regulatory approach to all relevant stakeholders.

**Experimental regulation requires sufficient investment from both industry and government.**

Industry participants must allocate sufficient resources to guarantee successful outcomes. Start-ups and firms with little experience in regulated markets may discover that participation in sandboxes or other experimental programs requires substantial investment in legal and compliance support.<sup>101</sup> Similarly, regulators allocate sufficient staffing, time, and resources to ensure a successful program.<sup>102</sup> To oversee sandboxes and other experimental programs, regulators likely will need to dedicate additional

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<sup>99</sup> Tuch, *supra* note 1 at 55, 71.

<sup>100</sup> See EY, *UK FinTech: On the Cutting Edge, An Evaluation of the International FinTech Sector*, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/502995/UK\\_FinTech\\_-\\_On\\_the\\_cutting\\_edge\\_-\\_Full\\_Report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/502995/UK_FinTech_-_On_the_cutting_edge_-_Full_Report.pdf). See also Hilary J. Allen, *Regulatory Sandboxes*, 87 *Geo. Wash. L. Rev.* 579 (2019), <https://www.qwlr.org/regulatory-sandboxes/>; <https://www.fca.org.uk/firms/innovation/regulatory-sandbox>; and FCA, *The Impact and Effectiveness of Innovate* (2019), <https://www.fca.org.uk/publication/research/the-impact-and-effectiveness-of-innovate.pdf>.

<sup>101</sup> Deloitte, *A Journey Through the FCA Regulatory Sandbox: The Benefits, Challenges, and Next Steps*, (2018),

<https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fca-regulatory-sandbox-project-innovate-finance-journey.pdf>.

<sup>102</sup> Allen, *supra* note 6.

resources so that routine regulatory activities are not impacted.<sup>103</sup> Without sufficient resources, processes may suffer, leading to less beneficial outcomes.

## Effective Implementation

**Set and publicize clear rules for participation.** Regulators clearly define program goals as well as the rules for participation (e.g., time limitations, the scope of regulatory permissions or waivers, and the restrictions or limitations on activities). This is important to guide agency action, and to provide companies with the certainty they need to assess whether to participate. Clearly defining program boundaries helps regulators to ensure sufficient resource allocation to enable the success of the program. To promote industry and public support for experimental regulation, regulators publicize the rules for participation to demonstrate the fairness behind the approach.

**Carefully consider the appropriate number and diversity of participants for ideal outcomes.** While the ideal number of participants in experimental approaches may vary, participation requirements should be broad enough to encourage participation from a wide range of firms. If participation is limited to a small number of firms, regulators and industry participants may lack data needed to support generalized conclusions regarding the effectiveness of the experimental approach. The risks and benefits identified from experiments with small numbers of participants may reflect circumstances unique to the participants, rather than general market factors. Moreover, experimental programs that include diverse participants reduce the likelihood that the programs will be criticized for unduly favoring certain companies or market sectors. Therefore, participation requirements for experimental regulation should generally encourage applications from participants that differ in size, location, and resources.

**Account for all relevant laws, rules, and policies that could affect industry conduct.** For an experimental regulatory approach to be valuable to regulated entities, the program should be designed to preempt enforcement and other more intrusive regulatory actions by a range of federal and local regulatory actors.<sup>104</sup> Regulators designing effective experimental programs consider the full range of laws and regulations that might govern industry conduct.

**Ensure relevant regulator collaboration to design programs.** In sectors subject to a variety of regulators and authorities, a successful experimental regulatory approach ensures that all relevant regulators have a seat at the table in designing the program. Without this collaboration and broad buy-in from relevant regulators, industry participants may be reluctant to participate due to concerns that regulators not participating in the experiment will take action against industry participants.

**Streamline participation processes.** Regulators can provide streamlined processes for participating in experimental programs. If timelines and procedural requirements for regulatory approvals are substantial, industry may be less likely to apply, particularly if there is a risk that regulators will deny applications. For example, participants in the UK Financial Conduct Authority's sandbox for fintech reported that they found the participation process "fairly daunting."<sup>105</sup> To reduce barriers to entry, regulators can take steps to reduce the costs and complexities associated with applications for participation.<sup>106</sup>

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<sup>103</sup> See *id.*

<sup>104</sup> *Id.*

<sup>105</sup> Deloitte, *supra* note 7.

<sup>106</sup> Brian Knight, *How to Build a Good Regulatory Sandbox: Four Principles to Help Policymakers Get It Right*, Mercatus.org (Apr. 17, 2019), <https://www.mercatus.org/bridge/commentary/how-build-good-regulatory-sandbox>.

**Carefully define regulator data needs.** It is important at the outset for regulators and industry to work together to define what empirical data will be shared and gathered. Experimental regulation succeeds when it provides regulators, industry, and policymakers with information about the impacts of innovative technologies or offerings. Therefore, regulators and industry should agree up front the types of information that will be collected, what parties will have access to the information, and how it will be shared. If such an agreement is not reached, experimental regulation may fail to produce timely information about how to proceed in the long term.

**Consider non-industry partnerships.** Regulators may partner with local governments rather than with industry directly. For example, the U.S. Federal Aviation Administration’s Unmanned Aircraft Systems Integration Pilot Program partnered the agency with nine states and localities in an effort to promote innovation and gather empirical data for future rulemaking efforts. In South Korea, Infrastructure and Transport partnered with the City of Seoul in furtherance of its Cooperative-Intelligent Transport Systems (“C-ITS”) Verification Project to promote the development of autonomous and connected vehicle technology. Through this partnership, the Seoul Metropolitan Government constructed the world’s first autonomous vehicle test bed utilizing a 5G network, among other autonomous vehicle initiatives.<sup>107</sup>

## Case Studies

### Case Study 6A

#### UK Office of Gas and Energy Markets Details



The UK Office of Gas and Energy Markets (“Ofgem”) launched the Innovation Link program in 2017 to support innovators seeking to trial or launch new products, services, methodologies or business models across the energy sector. Innovation Link offers a regulatory sandbox with four characteristics:<sup>108</sup>

- Formal relief from specific rules that a participant cannot comply with;
- Individual guidance from Ofgem on interpreting how regulations may apply to a specific product, service, method or business model during trial periods;
- Shared risk for compliance and enforcement during trial periods; and
- At the end of a trial, confirmation from Ofgem that a proposition is permissible.

Innovation Link has succeeded, at least in part, by attracting a wide range of participants from across the energy industry. As of October 2019, Innovation Link had worked with more than 200 innovators.<sup>109</sup> Participant products and programs include:

<sup>107</sup> Press Release, Seoul Metropolitan Government, *Seoul to complete construction of the world’s first 5G convergence autonomous driving test bed at Sangam Digital Media City* (Jan. 18, 2019), <http://english.seoul.go.kr/seoul-to-complete-construction-of-the-worlds-first-5g-convergence-autonomous-driving-test-bed/>.

<sup>108</sup> UK Office of Gas and Energy Markets, *The Innovation Link: About Us*, <https://www.ofgem.gov.uk/about-us/how-we-engage/innovation-link> (last visited Jan. 4, 2021).

<sup>109</sup> Neil Barnes, *How Ofgem’s Innovation Link Supports Low Carbon Projects*, UK Office of Gas and Energy Markets (Oct. 17, 2019), <https://www.ofgem.gov.uk/news-blog/our-blog/how-ofgem-s-innovation-link-supports-low-carbon-projects>.

- An app that helps homeowners track and manage different home energy utility spending and usage;
- A connected system of batteries and electric vehicle charging for homes and businesses, and;
- A device that removes air from the water in closed-loop heating and cooling systems which improves efficiency and durability of these systems.<sup>110</sup>

## Case Study 6B

### **U.S. Federal Aviation Administration Integration Pilot Program**

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Given the benefits of drone technology and challenges associated with regulating unmanned aircraft under the existing manned aviation regulatory framework, the U.S. Federal Aviation Administration (“FAA”) launched the Unmanned Aircraft Systems Integration Pilot Program (“IPP”) in 2017.<sup>111</sup> Policymakers designed the IPP to bring together state, local and tribal governments with private sector entities to promote innovation and gather data to inform rulemakings to govern UAS integration. As part of the program, nine local governments have worked with the FAA and industry to test and evaluate the integration of civil and public drone operations into the national airspace system.

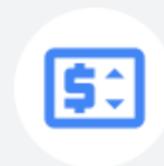
The program has assisted the U.S. Department of Transportation and FAA as the agencies seek to craft new rules that support more complex low-altitude drone operations by identifying ways to balance local and national interests related to drone integration; improving communications with local, state and tribal jurisdictions; addressing security and privacy risks; and accelerating the approval of operations that currently require special regulatory authorizations. The program expired in 2020, and the industry anticipates future formal regulation that will allow the operations that were safely tested within the scope of the IPP to be allowed to scale.

<sup>110</sup> UK Office of Gas and Energy Markets, *Innovation Link Case Studies* (June 16, 2019) <https://www.ofgem.gov.uk/publications-and-updates/innovation-link-case-studies>.

<sup>111</sup> FAA, *UAS Integration Pilot Program* (last updated Oct. 30, 2020), [https://www.faa.gov/uas/programs\\_partnerships/integration\\_pilot\\_program/](https://www.faa.gov/uas/programs_partnerships/integration_pilot_program/).

## Case Study 6C

### Monetary Authority of Singapore Fintech Regulatory Sandbox



The Monetary Authority of Singapore (“MAS”) Fintech Regulatory Sandbox is a leading example of effective implementation through clear guidance and boundaries. MAS published Fintech Regulatory Sandbox Guidelines in November 2016 to lay out the objectives of the sandbox, details of the application and approval process, evaluation criteria, and sandbox exit or extension criteria.

Per the Guidelines, the sandbox allows financial institutions, fintech firms, and professional services firms “to experiment with innovative financial services in the production environment but within a well-defined space and duration.”<sup>112</sup> The sandbox includes safeguards to “contain the consequences of failure,” including requiring entities to propose clearly defined boundaries that will protect consumers and the industry in their applications.<sup>113</sup>

The sandbox is time-limited. MAS assigns a sandbox duration to each accepted project based on project needs.<sup>114</sup> At the end of the sandbox period, the entity may deploy the experimental financial service only if (1) both MAS and the entity are satisfied that the sandbox has achieved its intended outcomes; and (2) the sandbox entity can fully comply with legal and regulatory requirements.<sup>115</sup> MAS may discontinue a sandbox if a project has not achieved its intended purpose, is unable to comply with legal or regulatory requirements, or the sandbox reveals a flaw in the financial service that makes risks outweigh potential benefits.

## Case Study 6D

### South Korea Automated Driving Initiatives



The South Korean Ministry of Land, Infrastructure and Transport (“MOLIT”) launched the C-ITS Pilot Project to promote the development of autonomous and connected vehicles with the ultimate goal of eliminating traffic accidents in 30 years.<sup>116</sup> This program is designed to attract cutting-edge transportation companies to South Korea, which will both foster innovation and speed deployment of important safety technologies.

<sup>112</sup> Monetary Authority of Singapore, *Fintech Regulatory Sandbox Guidelines 4* (Nov. 2016), <https://www.mas.gov.sg/-/media/MAS/Smart-Financial-Centre/Sandbox/FinTech-Regulatory-Sandbox-Guidelines-19Feb2018.pdf?la=en&hash=B1D36C055AA641F580058339009448CC19A014F7>.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 5.

<sup>115</sup> *Id.* at 6–7.

<sup>116</sup> Ministry of Land, Infrastructure and Transport, *About C-ITS*, <http://www.c-its.kr/english/introduction.do> (last visited Jan. 4, 2021).

MOLIT is spearheading projects and partnering with other agencies to create C-ITS programs throughout South Korea. In December 2018, MOLIT opened the Korea Automobile Testing and Research Institute (“KATRI”) or “K-City.” It is the world’s largest testbed for self-driving vehicles: 320,000 square meters with a city-center area (featuring intersections, buildings, and bus lanes and stations), a community area (featuring a school zone, pedestrian and bike area, and road shoulder parking), and an autonomous parking area.<sup>117</sup> K-City is also the first test site that uses a 5G network. The facility is open to private companies, research institutes, start-ups and universities in order to involve all participants of the automated vehicle industry. In June 2019, the Metropolitan Government of Seoul and MOLIT opened the Seoul Future Mobility Center, another 5G test bed.<sup>118</sup> A pilot program of 5G self-driving buses was also launched in the area in summer 2019.<sup>119</sup>

It is too early to assess whether MOLIT’s efforts have been effective, but Hyundai Motor Group is set to invest \$35 billion in autonomous vehicle technologies to help make South Korea a leader in the field.<sup>120</sup>

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<sup>117</sup> Michael Herh, *Korea Builds World’s First Self-Driving Car Test Bed Running on 5G Network*, Business Korea (Dec. 10, 2018)

<http://www.businesskorea.co.kr/news/articleView.html?idxno=27337>.

<sup>118</sup> Seoul Metropolitan Government, *Seoul Hosts the Sangam Autonomous Driving Festival, the World’s First Test Stage for 5G Autonomous Driving* (June 21, 2019), <http://english.seoul.go.kr/seoul-hosts-the-sangam-autonomous-driving-festival/>.

<sup>119</sup> Seoul Metropolitan Government, *Seoul to complete construction of the world’s first 5G convergence autonomous driving test bed at Sangam Digital Media City* (Jan. 18, 2019), <http://english.seoul.go.kr/seoul-to-complete-construction-of-the-worlds-first-5g-convergence-autonomous-driving-test-bed/>.

<sup>120</sup> Sean Szymkowski, *Hyundai to Invest \$35 Billion in South Korea for Autonomous Cars*, CNET.com (Oct. 16, 2019), <https://www.cnet.com/roadshow/news/hyundai-self-driving-autonomous-car-investment/>.

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# Formal Regulation

## Performance-Based and Prescriptive Regulation

### Formal Regulation Overview

When less interventionist measures – such as suasion or co-regulation – have proven ineffective at addressing issues of concern, regulators may influence market activities by adopting formal rules designed to establish legally-binding requirements.<sup>121</sup> Formal regulation is generally not well-suited as a tool of first resort as rule-based regulation processes typically take years and involve substantial public notice and comment processes. These processes can benefit from consultation and cooperation with other regulators, including those in other jurisdictions.<sup>122</sup> Formal regulation tends to be more common in industry sectors where:

- Market failures may have important impacts on the economy, society, or individuals;
- Use of public assets (e.g., radio spectrum, airspace) must be allocated among diverse stakeholders;
- Certain aspects of a particular industry, such as economies of scale or barriers to entry, may limit competition or otherwise impede the development of a more competitive market;
- Market activity has the potential to have a substantial impact on public safety or national security; or
- Regulation is needed to promote national commerce and innovation.

Industries that exhibit at least some of these elements include, for example, energy, the environment, transportation, banking and finance, telecommunications, and healthcare.

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<sup>121</sup> See generally Cary Coglianese et al., *Performance-Based Regulation: Prospects and Limitations in Healthy, Safety and Environmental Protection*, 55 Admin. L. Rev. 705 (2003), <https://heinonline.org/HOL/Print?collection=journals&handle=hein.journals/admin55&id=718>.

<sup>122</sup> As formal rule-based regulation can increase the risk to regulators of protracted litigation challenging substance or process, the rule-making process may be further extended.

Formal rules tend to fall into two general types: (1) “performance-based” rules that establish performance goals without requiring or prohibiting specific methods, processes, or other activities to achieve that goal; and (2) “prescriptive” or “means-based” rules that impose specific requirements, actions, or prohibitions related to market activity.

The following table illustrates the difference between performance-based and prescriptive approaches to the same issue:

Performance-based	Prescriptive
Digital advertisers are required to present ads in a manner that reasonably conveys to consumers that the purpose of the message is to advertise or promote a product or service.	Digital advertisers are required to state explicitly in their marketing that “this is an advertisement” in a font size larger than any surrounding text.
Businesses are required to use reasonable security measures when transmitting sensitive information.	Businesses are required to deploy 3DES encryption when transmitting sensitive information.
Businesses deploying facial recognition technologies in physical facilities are required to provide reasonable notice to individuals entering those facilities.	Businesses deploying facial recognition technologies in physical facilities are required to display signs at least 90cm x 60cm at every point of entry.

In some instances, formal regulation can result in rules that contain both performance-based and prescriptive provisions. For example, a hybrid rule could include performance-based triggers for the application of prescriptive design requirements (or prescriptive triggers for the application of performance-based requirements).

We address the considerations for both performance-based and prescriptive regulations below.

## 7.A Performance-Based Regulation

### Overview of Performance-Based Regulation

Performance-based regulation entrenches regulatory policy – in ways that less interventionist methods do not – by establishing performance goals for regulated entities. Regulators resorting to performance-based regulations seek to establish policy goals while giving regulated entities some flexibility to determine how to best achieve those goals. The flexibility inherent to performance-based regulation may lead to more innovative and cost-effective outcomes than more prescriptive regulation.

Regulators can craft performance-based regulations broadly or narrowly. But in either event, performance-based regulation provides regulated entities more flexibility than prescriptive regulation with respect to how they can satisfy regulatory requirements. Performance-based requirements can use varying metrics and levels of granularity:

- A narrow emissions limitation could require industry to meet certain measurement goals through certification and testing (e.g., emitting no more than a specific amount of pollutants in a given time period). Industry participants may find it easier to determine whether they are complying with narrowly defined performance regulations that require specific testing because the requirements for compliance are relatively clear.
- By comparison, a broad, qualitative safety regulation could require that industry not “recklessly” endanger the public.<sup>123</sup> For regulations with broader, qualitative requirements, regulators or trade associations can provide guidance or other materials to help industry identify regulatory requirements and assess compliance.

Over the last few decades, performance-based regulation has gained increasing global support as the preferred option when formal regulation is deemed appropriate. The World Trade Organization (“WTO”) has stated formally that it favors the use of performance standards rather than prescriptive regulations.<sup>124</sup> The Organisation for Economic Co-operation and Development (“OECD”) has noted that “the use of performance-based regulation is rapidly developing in OECD countries.”<sup>125</sup> And the United States, Mexico, and Canada have committed in a jointly adopted Regulatory Cooperation Framework to deploy performance-based regulation rather than prescriptive regulations when appropriate.<sup>126</sup>

Performance-based regulation is well-suited to innovative, dynamic, and rapidly changing markets. In circumstances where regulators determine formal regulation to be necessary, performance-based regulation can promote innovation for digital and information technologies. For example, privacy regulators can establish data security standards to protect personal information via performance-based regulations (e.g., requiring regulated entities to adopt reasonable safeguards to protect data) rather than by specifying the use of certain technologies or processes to protect data.<sup>127</sup> In the transportation sector, regulators can establish minimum safety requirements for tires or brakes on motor vehicles, for example, without specifying how those standards must be met.<sup>128</sup>

## Benefits of Performance-Based Regulation Compared to Prescriptive Regulation

**Performance-based measures support lower regulatory costs, flexibility, and innovation.** Less interventionist measures (e.g., suasion and co-regulation) generally have greater benefits in these regards. However, when formal regulation is deemed necessary, performance-based regulations set goals for industry and let market participants use their own expertise to determine the best way to meet those goals. Consumers can benefit from this in the form of lower prices and a greater range of options.

<sup>123</sup> See, e.g., 14 CFR Part 107.23 (establishing performance-based requirements for unmanned aircraft systems), <https://www.govinfo.gov/app/details/CFR-2000-title14-vol2/CFR-2000-title14-vol2-sec107-23>.

<sup>124</sup> Eleni Doeroukakis, *Performance-Based Codes Impact on International Trade* 4-5 (2000), [https://www.ircc.info/Doc/Impact\\_on\\_International\\_Trade.pdf](https://www.ircc.info/Doc/Impact_on_International_Trade.pdf).

<sup>125</sup> See OECD, *OECD Reviews of Regulatory Reform: Regulatory Policies in OECD Countries* 135 (2002) (“[Performance-based regulation] has been increasing significantly in relation to health, safety, consumer protection and environmental regulation in particular.”), <https://www.oecd.org/gov/regulatory-policy/35260489.pdf>.

<sup>126</sup> Article 2.8 of Agreement on Technical Barriers to Trade, World Trade Org., Apr. 15, 1994, 1868 U.N.T.S. 120, [https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm); *Security and Prosperity Partnership of North America, Common Regulatory Principles*, 1 (2007).

<sup>127</sup> See 201 CMR 17, <https://www.whitehouse.gov/sites/default/files/omb/oir/irc/SPP-Common-Regulatory-Principles.pdf>. See also White House Office of Management and Budget Regulatory Analysis (Sept. 17, 2003), <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A4/a-4.pdf> (“Within a command-and-control regulatory program, performance-based standards generally offer advantages over standards specifying design, behavior, or manner of compliance.”) (implementing United States White House Executive Order 12866).

<sup>128</sup> See 201 CMR 17, <https://www.mass.gov/regulations/201-CMR-17-standards-for-the-protection-of-personal-information-of-residents-of-the> (Massachusetts security regulations).

<sup>129</sup> For example the U.S. National Highway Traffic Safety Administration has established performance testing for motor vehicle safety including tires, brakes, child restraint systems, ejection mitigation, and more. See, e.g., 49 C.F.R. §§ 571.109 (tires), 571.135 (brake systems), 571.213 (child restraint systems), and 571.226 (ejection mitigation).

The benefits are likely to be greatest in heterogeneous and dynamic sectors such as digital and transportation technology, which feature many different types of market participants of varying sizes, supply chains, processes, and approaches regarding how best to achieve compliance goals.<sup>129</sup>

Two recent examples of the EU using performance-based regulation in dynamic sectors include:

- For video-sharing platforms, and as set out in more detail in case study 7B, the EU's recent revisions to the Audiovisual Media Services Directive require that video-sharing platform services take "appropriate measures" to protect minors and the general public from certain categories of harmful and unlawful content.<sup>130</sup>
- To regulate cybersecurity across a variety of sectors, the EU's Directive on Cybersecurity of Network and Information Systems ("NIS Directive") requires relevant businesses to evaluate risks and adopt measures "appropriate and proportionate" to manage cybersecurity risk.<sup>131</sup>

**Performance-based measures can promote more effective policy outcomes.** Performance-based regulation focuses regulatory and policy debates regarding formal regulation on the key topic: What is the ultimate objective of regulation? Focusing on the end goal enables regulators to better meet or even exceed that goal over time. Regulators routinely design policy objectives, and consider societal benefits and harms, two strengths that regulators develop during observation, education, and suasion initiatives. When necessary, these strengths can be utilized for performance-based regulation. In contrast, regulators typically do not possess the deep knowledge and understanding of industry technical issues that would enable them, for instance, to optimally design products. When formal regulation is necessary, performance-based measures may promote the achievement of regulatory goals better than prescriptive rules, as regulators can focus on policy while industry focuses on meeting policy goals.

**Performance-based measures may be relatively streamlined and cost-effective for regulators to design.** Regulators know how to design policy goals for regulation. Although formal regulation generally requires substantial public notice and comment processes, regulators can streamline the formal regulatory process by designing performance-based rules and focusing on the goals to be achieved rather than spending substantial time and resources determining how best to achieve those goals via prescriptive regulation. Performance-based regulation can therefore lead to lower costs for regulators than may be possible with prescriptive regulation.

**Performance-based measures can be more effective than prescriptive regulations in evolving marketplaces.** Regulators may disfavor formal regulation in evolving markets due to the lack of information regarding the existence, cause, nature, and magnitude of market issues. However, where formal regulation is deemed necessary and appropriate for an evolving market, performance-based rules enable regulators and industry participants to accommodate and adapt to market and technological developments. For example:

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<sup>129</sup> Cary Coglianese, *The Limits of Performance-Based Regulation*, 50 U. Mich. J.L. Reform 525, 545 (2017).

<sup>130</sup> Directive 2018/1808 amending Directive 2010/13/EU on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services (Audiovisual Media Services Directive) in view of changing market realities, 2018 O.J. (L. 303/69), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L1808&from=EN>.

<sup>131</sup> Directive (EU) 2016/1148 of the Eur. Parl. And of the Council concerning measures for a high common level of security of network and information systems across the Union, 2016 O.J. (L. 194/1), [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.194.01.0001.01.ENG&toc=OJ.L:2016:194:TOC%20%2F2%2E0%20L2%2FRemediations%2F2019%20Planning](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.194.01.0001.01.ENG&toc=OJ.L:2016:194:TOC%20%2F2%2E0%20L2%2FRemediations%2F2019%20Planning). See also See 201 CMR 17, <https://www.mass.gov/regulations/201-CMR-17-standards-for-the-protection-of-personal-information-of-residents-of-the> (Massachusetts' data security regulations provide specific considerations, such as available resources and amount of data stored, that allow for flexibility that may help small businesses comply with an obligation to establish and maintain an information security program).

- In nascent and innovative industries, prescriptive rules may lose effectiveness over time. Processes or technologies specified in prescriptive regulations may become obsolete. New technological capabilities may emerge that can address identified risks in ways not considered when regulators established prescriptive rules.
- Where mature industries (such as public utilities) undergo innovative transformations, and when market conditions are changing quickly, regulators can use performance-based frameworks to achieve their policy goals. For example, and as set out in case study 7D, the United Kingdom’s Office of Gas and Electricity Markets, developed a performance-based regulatory framework that rewards utilities for innovation and delivers outputs that meet the changing expectations of consumers and society.<sup>132</sup>

**Performance-based measures allow for marketplace competition in ways that prescriptive measures do not.** When regulators issue technology-neutral policies that do not mandate that the market employ one specific process or technology, regulators can avoid picking winners and losers in the marketplace. Performance-based regulation enables industry to assess the marketplace and determine the preferred means of compliance. Such choices allow for competition and innovation.

**Performance-based measures are less harmful to trade and global markets than prescriptive measures are.** When different jurisdictions adopt different prescriptive regulations for the same products or services, there is a risk that such rules will conflict. Performance-based measures reduce this risk, as they do not require businesses to adopt or refrain from implementing specific practices. Therefore performance-based regulations can be less harmful to trade and global markets by permitting businesses to adopt practices that will satisfy outcome-based goals across markets.<sup>133</sup>

## Challenges for Performance-Based Regulation

**Performance-based measures may increase uncertainty.** While performance-based regulation promotes some degree of flexibility in the marketplace, it can also introduce costs and uncertainty in some situations. Without a clear standard for when enforcement is warranted regulators may need to exercise enhanced discretion as they seek to enforce imprecise performance-based standards. Firms, in turn, may lack certainty about their compliance status and could unnecessarily limit or forego otherwise effective compliance approaches. Consider, for example, a requirement that a mode of transportation be “safe” or a requirement that certain types of data be subject to “reasonable safeguards.” Absent guidance regarding what constitutes safe transportation or reasonable safeguards, businesses may struggle to identify compliant solutions.

**Performance-based measures are potentially burdensome for smaller regulated entities.** Poorly designed performance-based requirements can unduly burden small businesses. For example, performance-based regulations sometimes require industry participants to document their assessments of how their processes meet regulatory objectives.<sup>134</sup> The burden of doing so may

<sup>132</sup> Coley Girouard, *UK RIIO sets out to demonstrate how a performance-based regulatory model can deliver value*, Util. Div. (May 30, 2019), <https://www.utilitydive.com/news/uk-riio-sets-out-to-demonstrate-how-a-performance-based-regulatory-model-ca/555761/>

<sup>133</sup> See OECD, *APEC-OECD Integrated Checklist on Regulatory Reform* 28 <https://www.oecd.org/regreform/34989455.pdf> (“Approaches to regulation that are trade friendly and avoid unnecessary burdens on economic actors can be achieved in various ways, for instance by ... basing regulation on performance rather than design criteria....”).

<sup>134</sup> See Rex Deighton-Smith, *Process and Performance-Based Regulation: Challenges for Regulatory Governance and Regulatory Reform*, ch.7 (2008), <http://onlinepubs.trb.org/onlinepubs/PBRI.it/DeightonSmith.pdf>.

overwhelm small businesses.<sup>135</sup> And while many firms may prefer the flexibility offered by performance-based requirements, other market participants, including small businesses, may prefer the certainty of understanding exactly what they need to do to comply. To mitigate this risk, and where appropriate given policy objectives, regulators may set thresholds to exempt small businesses or otherwise factor the size of the business into compliance requirements.

**Performance-based measures may be challenging to amend.** Given the formal notice and comment process requirements for formal regulation, which can take years, regulatory frameworks—including performance-based rules—can be difficult to change and update to respond to evolving market conditions. Therefore, it is critical that regulators attempt to “future-proof” performance-based rules to accommodate developments over time.

## Effective Implementation of Performance-Based Regulation

**Regulators design performance-based regulations transparently and with support from key stakeholders.** As noted above, performance-based regulations can unduly interfere with market activities if the rules are not focused and well-designed. Once regulators have decided that formal regulation is necessary, they follow clear and transparent processes that include outreach to a diverse group of relevant stakeholders. This will help regulators establish clearly defined performance goals that promote policy objectives.

Effective regulators encourage regulated entities to participate in the design process. This is particularly important in emerging technology sectors where regulators may be unfamiliar with the state of existing and future technologies, products, and capabilities, as well as with the regulatory frameworks in other jurisdictions. Industry feedback regarding testing requirements is essential to confirm that they are practicable in the market.

**Regulators carefully consider the nature of the industry requiring regulation.** Performance-based regulations are most effective in industries where regulators and regulated entities can monitor and verify performance appropriately and cost-effectively, but they may suffer where objective performance is not easily measured or verified. It is important for regulators and industry to understand how success will be measured.

**To avoid impeding innovation, regulators design performance-based regulations with realistic goals that allow for flexibility.** To promote compliance, performance-based regulations include realistic objectives and timelines. And such measures are designed with sufficient flexibility: narrow performance-based requirements may leave such limited discretion to the marketplace that they negate the potential benefits of performance-based regulation. In the United States, for example, the Federal Aviation Administration (“FAA”) recently issued a broad performance-based rule to authorize Unmanned Aircraft Systems (*i.e.*, commercial drones) to operate over people.<sup>136</sup> However, the final rule contains such strict kinetic energy injury thresholds that very few operators on the marketplace will be able to comply—which may effectively prevent operations and severely hamper the emergence and growth of a new industry.

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<sup>135</sup> *Id.*

<sup>136</sup> Final Rule, Operation of Small Unmanned Aircraft Systems Over People, FAA (Dec. 28, 2020), [https://www.faa.gov/news/media/attachments/OOP\\_Final%20Rule.pdf](https://www.faa.gov/news/media/attachments/OOP_Final%20Rule.pdf).

**Regulators can encourage open communication with the marketplace.** For performance-based rules to function well, regulators clearly communicate performance standards. To enhance effectiveness, regulators draft performance-based regulations in plain language. In addition to publishing clear regulations, regulators can provide guidance and examples for how industry may meet performance standards and clearly explain to industry how they will oversee compliance.

It is also critical that the marketplace makes reliable and accurate information accessible to regulators. The 2015 Volkswagen diesel emissions scandal provides one example where misleading information from the marketplace led to challenges in implementing relevant regulations.<sup>137</sup>

**Inspectors responsible for assessing compliance with performance-based regulations should be well-trained.** If regulations require inspections by inspectors who will need to exercise their own judgment, as opposed to simply implementing a technology checklist, the inspectors should be properly trained. Moreover, and especially where performance is difficult to physically measure through testing or other mechanisms, regulators can provide inspectors with models or other tools that support reasonable assessments of performance.

**Consider effects on the marketplace.** Given the potential challenges discussed above, regulators should address the potential impacts of performance standards on small businesses. For example, regulators can provide guidance on how to design compliance programs or measure compliance. Or regulators can offer checklists or tools that businesses can use to assess their own compliance, while permitting businesses to use other approaches if desired.

**Consider effects of regulation in other jurisdictions.** To enhance the effectiveness of performance-based regulations in global markets, regulators may consider cross-jurisdictional regulatory cooperation to minimize conflicts between regulations in different jurisdictions.

## Case Studies

### Case Study 7A

#### US National Highway Traffic Safety Administration



The U.S. National Highway Traffic Safety Administration (“NHTSA”) has established performance testing requirements for motor vehicle safety. These standards apply to parts, such as tires and brakes, as well as to design measures that mitigate the risk of ejection in a crash. The performance-based approach to regulation allows manufacturers to experiment, innovate, and differentiate their vehicles and parts so long as components and design meet performance specifications.

<sup>137</sup> Cary Coglianese, *What Volkswagen Reveals about the Limits of Performance-Based Regulation*, *The Reg. Rev.* (Oct. 5, 2015), <https://www.theregview.org/2015/10/05/coglianese-volkswagen-performance-based-regulation/>.

For instance, NHTSA’s rule specifies lab test requirements for tires related to qualities such as structural integrity, strength, endurance, and high-speed performance.<sup>138</sup> Similarly, the rule requires that certain features be included in braking systems without specifying how manufacturers design these features.

## Case Study 7B

### EU Audiovisual Media Services Directive

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The EU’s 2018 Audiovisual Media Services Directive (“AVSMD”) requires that video-sharing platform services protect minors and the general public from certain categories of harmful or unlawful content, and specifies that Member States must ensure that video-sharing platform providers under their jurisdiction take “appropriate measures” to establish such protections.<sup>139</sup> The Directive does not require market participants to adopt particular measures, but does include a non-exhaustive list of measures that may be considered appropriate.<sup>140</sup>

The Directive instructs Member States to ensure that platforms in scope take “appropriate measures” to protect minors from content that could adversely impact their “physical, mental or moral development” and to protect the general public from content that may incite violence or hatred toward certain groups or is unlawful under Union law.<sup>141</sup> Member States are to implement the AVMSD so that the appropriateness of measures is determined by weighing “the nature of the content in question, the harm it may cause, the characteristics of the category of persons to be protected as well as the rights and legitimate interests at stake.”<sup>142</sup>

By taking this approach, the Directive enhances the protection of minors and the general public without establishing specific requirements that may not be appropriate for all video-sharing platforms, as different platforms may have different technological capabilities.

The Directive also accounts for the varying roles of actors within the video-sharing ecosystem. For example, the Directive acknowledges that “[a] significant share of the content provided on video-sharing platform services is not under the editorial responsibility of the video-sharing platform provider,” while noting that video-sharing platform providers are responsible for organizing content.

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<sup>138</sup> 49 C.F.R. § 571.109 (S4.2.2.6).

<sup>139</sup> 2018 O.J. (L. 303/69), Article 28b(1), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L1808&from=EN>; Directive 2018/1808 concerning the provision of audiovisual media services (Audiovisual Media Services Directive) in view of changing market realities, 2018 O.J. (L. 303/69), <https://eur-lex.europa.eu/eli/dir/2018/1808/oj>.

<sup>140</sup> 2018 O.J. (L. 303/69), Article 28b(3), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L1808&from=EN>.

<sup>141</sup> 2018 O.J. (L. 303/69), Recital 47, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L1808&from=EN>.

<sup>142</sup> *Id.*, art. 28b(3).

## Case Study 7C

### EU Directive on Cybersecurity of Network and Information Systems

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The EU adopted the NIS Directive in 2016 to boost the overall level of cybersecurity in the EU. The NIS Directive regulates cybersecurity across a variety of essential sectors, including energy, transport, water, banking, financial market infrastructures, healthcare, and digital infrastructure.<sup>143</sup> The Directive instructs Member States to require relevant businesses to evaluate risks and adopt measures “appropriate and proportionate” to manage cybersecurity risk.<sup>144</sup>

Given the wide range of industries impacted and the fast-moving nature of cybersecurity issues, the Directive avoids requiring the adoption of specific technologies. The Directive specifies the generally required security program features, such as “monitoring, auditing and testing” and “business continuity management.” But the Directive directs Member States to leave it to industry to determine how to implement reasonable security. Notably, the Directive prioritizes flexibility and notes that regulators should “avoid imposing a disproportionate financial and administrative burden on operators of essential services and digital service providers.”<sup>145</sup>

## Case Study 7D

### UK Gas and Electricity Markets

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The UK Office of Gas and Electricity Markets (“Ofgem”) regulates energy prices using a comprehensive, outcome-focused system of regulations. Ofgem offers incentives that encourage utilities to innovate in areas that otherwise likely would not be profitable using a framework referred to as RIIO—Revenues = Incentives + Innovation + Outputs. Under the RIIO framework, Ofgem sets targets for reliability, availability, environmental stewardship, connections, customer service, social obligations, and safety, and awards financial incentives for hitting those targets.<sup>146</sup> The core principles of RIIO are to reward innovation and deliver outputs that meet the expectations of consumers and society.

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<sup>143</sup> Directive 2016/1148 concerning measures for a high common level of security of network and information systems across the Union, 2016 O.J. (L 194/1), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1148&from=EN>.

<sup>144</sup> *Id.*, art. 14(1).

<sup>145</sup> *Id.*, Recital 43.

<sup>146</sup> Coley Girouard, *UK RIIO set outs to demonstrate how a performance-based regulatory model can deliver value*, (May 30, 2019), <https://www.utilitydive.com/news/uk-riio-sets-out-to-demonstrate-how-a-performance-based-regulatory-model-ca/555761/>.

For example, Ofgem uses the RIIO framework to limit how much money utilities can charge for energy services. Ofgem’s goal is to control prices while ensuring utilities can recover enough to cover their costs and obtain a reasonable return on their investments.<sup>147</sup>

## Case Study 7E

### Australian National Enforcement Guidelines for Automated Vehicles

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The Australian Road Rule 297(1), a performance-based requirement promulgated well before automated vehicles were designed, requires that “[a] driver must not drive a vehicle unless the driver has proper control.” The Road Rule does not define “proper control,” but is often interpreted as having a driver in the driver’s seat with at least one hand on the wheel. With the advent of automated vehicles, the need for “proper control” over a vehicle has not changed despite the potential removal of the human driver from the vehicle. Through the use of a performance-based requirement, rather than prescriptive rules, the Australian Road Rule standard can more easily be applied to emerging technologies.

In 2017, the Australian National Transport Commission issued national enforcement guidelines for automated vehicles, the purpose of which was to interpret “proper control” for vehicles with automated functions and confirm that a human driver is still responsible for complying with road traffic laws when a vehicle’s automation is engaged.<sup>148</sup> The guidelines list examples of behaviors that reflect proper control, leaving flexibility for interpretation. As explained in a 2016 policy paper, this ensures that “prescriptive requirements that diminish the law’s capacity to target unsafe behaviours” are avoided.<sup>149</sup>

## 7.B: Prescriptive Regulation

### Overview of Prescriptive Regulation

Unlike performance-based regulations, prescriptive regulations impose specific requirements, actions, processes, or prohibitions related to market activity. When formal regulation is deemed necessary and appropriate, regulators tend to adopt prescriptive regulations where:

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<sup>147</sup> Ofgem, *Why and how we use network price controls*, <https://www.ofgem.gov.uk/regulating-energy-networks/why-and-how-we-use-network-price-controls/watch> (last visited Jan. 4, 2021).

<sup>148</sup> Nat’l Transp. Comm’n Austl., *National enforcement guidelines for automated vehicles* (2017) [https://www.ntc.gov.au/sites/default/files/assets/files/AV\\_enforcement\\_guidelines.pdf](https://www.ntc.gov.au/sites/default/files/assets/files/AV_enforcement_guidelines.pdf).

<sup>149</sup> Nat’l Transp. Comm’n Austl., *Regulatory reforms for automated road vehicles*, 33 (2017), <https://www.ntc.gov.au/sites/default/files/assets/files/NTC%20Policy%20Paper%20-%20Regulatory%20reforms%20for%20automated%20road%20vehicles.pdf>.

- **Defined markets pose high risks of identifiable harm.** In areas of higher risk to public life or health, such as the environment, manned aviation, or medical devices, less prescriptive tools may not fully address that risk. For example, to promote safety, regulators have long directed the processes by which companies produce nuclear power.<sup>150</sup>
- **Consumers may not readily be able to make informed choices regarding market offerings.** In the consumer protection context, regulators have established default contractual terms like cancellation rights and warranties that specify how certain offerings may be brought to market.<sup>151</sup> And to address the perceived lack of information in consumer-oriented markets, regulators have required businesses to make specific disclosures, such as ratings schemes,<sup>152</sup> lending disclosures,<sup>153</sup> and labelling requirements.<sup>154</sup>
- **There is a need for consistency among compliance approaches.** For example, in telecoms regulation, regulators may mandate interoperable technologies to facilitate public safety and emergency response.

Regulators may be more likely to implement prescriptive mandates in scenarios where the rights or protection of minors or other at-risk groups would be threatened. For example, the U.S. Federal Trade Commission's Children's Online Privacy Protection Rule places several prescriptive requirements on operators of websites and online services directed to children under 13 years of age.<sup>155</sup>

## Benefits of Prescriptive Regulation Compared to Performance-Based Rules

**Prescriptive regulatory approaches can support homogeneous or mature markets.** Some industries, such as public utilities or traditional manned aviation, are relatively homogenous with limited competition. Firms in such markets tend to have products and services that are similar in many, if not most, important aspects, and may share technologies, supply chains, and/or processes to achieve business goals. When less interventionist tools are deemed ineffectual in these market sectors, regulators may adopt prescriptive rules.<sup>156</sup> In such circumstances, prescriptive regulation creates certainty for regulators, the regulated entities, and the public. And because the market participants are similarly situated, the costs of compliance for different players remain relatively constant. As one example, the U.S. Federal Aviation Administration (as well as other global civil aviation authorities) have issued globally harmonized aircraft design requirements for the manned aviation industry intended to ensure that aircraft are airworthy and safe to operate in the airspace system.<sup>157</sup>

**Regulators may find it more straightforward to enforce prescriptive rules.** Where regulation specifies that a particular action be taken or that a particular process or technology be implemented,

<sup>150</sup> Wendell Pritchett, *Types of Regulation*, *The Reg. Rev.* (Apr. 5, 2016), <https://www.theregreview.org/2016/04/05/pritchett-types-of-regulation/>.

<sup>151</sup> See, e.g., Directive 2011/83/EU ("EU Consumer Rights Directive"), 2011 O.J. L. 304 22.11.2011 (establishing that Member States must require businesses are required to provide consumers with information regarding prices, consumer rights, payment and delivery), <https://eur-lex.europa.eu/eli/dir/2011/83/2022-05-28>.

<sup>152</sup> Infocomm Media Dev. Auth., *Films*, IMDA.gov.sg (last updated Mar. 27, 2020) (describing film ratings framework), <https://www.imda.gov.sg/regulations-and-licensing-listing/content-standards-and-classification/standards-and-classification/films>.

<sup>153</sup> 12 C.F.R. pt. 1026 (Truth in Lending Act regulations requiring lenders to disclose certain information in writing), available at <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/1/>.

<sup>154</sup> Food Standards Austl. & N.Z., *Labelling*, Foodstandards.gov.au (last updated Sep. 7, 2020), <https://www.foodstandards.gov.au/industry/labelling/pages/default.aspx>.

<sup>155</sup> Children's Online Privacy Protection Act Rule ("COPPA"). Similarly, the U.S. National Highway Traffic Safety Administration's ("NHTSA's") safety standard for child restraint anchorage systems requires, in part, that the tether anchorage must be located within a certain zone, and stipulates the configuration of the lower anchorages. See 49 C.F.R. § 571.225. NHTSA's occupant protection standard also includes airbag labeling requirements that prescribe particular warning language: "The back seat is the safest place for children." *Id.* § 571.208.

<sup>156</sup> Coglianes, *supra* note 9 at 546.

<sup>157</sup> See, e.g., Part 27 of the U.S. Federal Aviation Regulations.

regulators may find it easier to assess compliance. Instead of considering whether a process achieves a certain compliance goal, regulators may be able to observe whether the required conduct took place.

**Prescriptive regulation promotes understanding of compliance requirements.** When formal regulation is deemed necessary and if prescriptive regulations are drafted clearly, regulated entities will have more certainty about what is required to comply. This certainty may support regulatory policy goals, and it may also reduce the burden on regulated entities, as industry may have a clearer understanding of what behaviors are required.

## Challenges for Prescriptive Regulation

**Prescriptive regulatory approaches can be costly to design and defend.** Because of their level of detail, prescriptive rules may require more extensive agency resources to develop than performance-based approaches. Prescriptive rules may also require significant consultation with industry: regulators typically do not possess the technical knowledge that would enable them to optimally design products or solutions to achieve the policy goal. Therefore, regulators may engage with industry and educate themselves about the implications of prescriptive requirements.

Prescriptive regulation can also enhance the risks of litigation for the regulator. For example, regulated entities may challenge whether the selected compliance requirements promote relevant policy objectives. Even just the threat of litigation can increase costs for the agency.

**Prescriptive regulatory approaches can be more costly for industry and the public.** If not carefully considered and properly designed, prescriptive regulation may unnecessarily increase the cost of products or services to the public.<sup>158</sup> This risk may be especially high in heterogeneous and dynamic sectors, such as digital services and transportation technology, which feature many different types of market participants of varying sizes, supply chains, and processes.<sup>159</sup> In markets with such a variety of participants, demanding that all participants adopt the same technology or process to achieve a regulatory goal likely will be inefficient. Differently situated entities likely will best achieve regulatory goals by adopting different technologies or processes. Requiring specific processes likely will raise costs for certain firms, which likely will be passed along to the public.<sup>160</sup>

**Prescriptive regulations may fail to accommodate evolving markets.** Prescriptive regulations do not easily accommodate changes in the market, such as to business models or technologies. By their nature, prescriptive regulations are not adaptable or flexible. And the process for modifying prescriptive regulations can take a substantial amount of time. As a result, prescriptive regulations often are a poor fit for nascent or innovative industries. As new and better solutions and technologies disrupt the marketplace, prescriptive regulations mandating a specific solution quickly become outdated. This is why regulators generally seek to regulate emerging technologies such as Unmanned Aircraft Systems and autonomous vehicles under a performance-based framework; regulators can promote safety or other goals without mandating that industry use a particular technology or process. Prescriptive regulations are also unlikely to accommodate emerging hazards or risks that may have been unforeseeable or considered unlikely when the rule was developed. And prescriptive regulations may fail to capture unforeseen social and economic benefits of regulated technologies or activities.

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<sup>158</sup> See Pritchett, *supra* note 30. See also Coglianese, *supra* note 9 at 526.

<sup>159</sup> Coglianese, *supra* note 9 at 545.

<sup>160</sup> Laura Montgomery et. al., *Performance Standards vs. Design Standards: Facilitating a Shift Toward Best Practices 9* (2019), <https://www.mercatus.org/system/files/montgomery-performance-design-standards-mercatus-working-paper-v1.pdf>.

**Prescriptive approaches have the potential to stifle innovation.** Because prescriptive rules require particular designs, technologies, or processes, they risk impeding innovation and preventing industry from moving toward better or less expensive methods of achieving policy goals. When a more effective or efficient solution emerges, prescriptive rules that specify a particular method of compliance may prevent a firm from using new or alternative solutions. For this reason, prescriptive regulations generally fail to suit innovative sectors, including digital and information technologies.

**Prescriptive approaches may ‘pick’ market winners.** By mandating a single solution for the whole industry, prescriptive regulation may result in regulators effectively picking marketplace winners and losers. Early adopters of the required solutions, particularly those that adopted the solutions prior to regulation, may be better positioned to succeed than those firms that need to change their processes to address compliance. As with performance-based regulation, regulators should consider whether prescriptive approaches should apply in the same way to all firms in the sector. For example, regulators should consider whether prescriptive regulations create unduly burdensome requirements for smaller firms, which could risk a reduction in competition by creating barriers to entry.

**Prescriptive approaches can impede trade and regulatory cooperation.** Inconsistent prescriptive regulations between countries increase non-tariff barriers to commerce and the movement of goods and services between nations. When global prescriptive regulations are inconsistent, production costs increase for firms that must modify products to meet varying standards intended to achieve similar goals. These costs are passed on, at least in part, to consumers. For this reason, governments consider prescriptive regulation to be a significant non-tariff barrier to trade. As noted above, in recent years, trade and regulatory cooperation authorities have increasingly promoted performance-based regulation over prescriptive requirements.<sup>161</sup>

**Prescriptive approaches may be challenging to amend.** Given the formal notice and comment process requirements for formal regulation, which can take years, regulatory frameworks –including prescriptive rules – can be difficult to change and update to respond to evolving market conditions. Therefore, it is critical that regulators attempt to “future-proof” prescriptive rules to accommodate developments over time.

## Effective Implementation of Prescriptive Regulation

**Transparency and multi-stakeholder engagement are essential to regulatory design.** Even more so than with performance-based regulation, if prescriptive regulations are not carefully considered and well-designed, they risk unduly interfering with innovation and market activities. If regulators determine that prescriptive regulation is necessary, effective regulators will follow a clear and transparent process that includes outreach to a diverse group of relevant stakeholders and a genuine interest in receiving and meaningfully considering feedback. Regulators possess limited information regarding market conditions and business practices. Industry often will be better situated than regulators to provide information about how proposed prescriptive regulations will impact business practices and whether the regulations will effectively promote regulatory objectives.<sup>162</sup>

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<sup>161</sup> See, e.g., Article 2.8 of Agreement on Technical Barriers to Trade, Apr. 15, 1994, 1868 U.N.T.S. 120, [https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm); *Security and Prosperity Partnership of North America, Common Regulatory Principles 1* (2007)

<https://obamawhitehouse.archives.gov/sites/default/files/omb/oir/irc/SPP-Common-Regulatory-Principles.pdf>.

<sup>162</sup> Montgomery, et. al., *supra* note 40 at 9.

Such collaboration is particularly critical in emerging technology sectors and long-stable sectors experiencing disruption from new processes and products. Effective regulators specifically seek information about the state of existing and future technologies, products and capabilities, and regulatory frameworks in other jurisdictions.

**Clearly communicate expectations to regulated entities.** Regulators write prescriptive regulations, and their justifications for resorting to such regulations, in plain language to enhance their effectiveness. Highly complex or internally inconsistent regulations create challenges for industry, thereby reducing compliance.

**Consider the nature of the industry requiring regulation.** As discussed above, prescriptive regulation may be warranted in sectors that pose substantial dangers to the public, such as nuclear power, where new technologies or product innovation do not frequently disrupt the marketplace and where less interventionist tools are deemed to be ineffective. There is less of a risk in these sectors that a prescriptive mandate will quickly become outdated and ineffective.

**Consider compliance accommodations.** Given the nature of prescriptive regulation, regulators include waiver mechanisms that allow regulated entities to seek and obtain authorizations to adopt alternative means of achieving regulatory goals. Waivers can minimize potential adverse impacts to industry and competition when there are lower-cost and suitable alternatives to prescriptive requirements. Waivers may also reduce the risk to regulators of litigation by allowing industry to seek alternatives. In addition, regulators may consider whether it may be appropriate given the policy goals to make special accommodations for small businesses or other uniquely situated groups.

**Consider effects in other jurisdictions.** Regulators may consider cross-jurisdictional cooperation to enhance the effectiveness of prescriptive regulations in global markets. Such collaboration is even more crucial for prescriptive regulations, as conflicting requirements may increase costs for global offerings, which are passed on to the public.

## Case Studies

### Case Study 7F

#### U.S. Federal Trade Commission's Children's Online Privacy Protection Rule



The United States enacted the Children's Online Privacy Protection Act ("COPPA") in 1998 to give parents control over the online collection and use of children's personal information. COPPA applies to operators of commercial websites and online services, including mobile apps and smart devices, directed to children under thirteen years of age that collect, use, or disclose children's personal information, or on whose behalf such information is collected such as by an ad network.

The U.S. Federal Trade Commission (“FTC”) has rulemaking authority with respect to COPPA. The FTC’s COPPA Rule contains prescriptive requirements, including specifying the content to be contained in parental notices (*i.e.*, name, address, phone number, and email) and requiring that privacy notices include hyperlinks (as opposed to technology-neutral mechanisms) to specific privacy resources. However, to accommodate innovation while addressing concerns about children’s privacy, the FTC permits industry to submit co-regulatory frameworks for approval. The co-regulatory frameworks may set forth prescriptive requirements that differ from those outlined in the COPPA Rule so long as the FTC determines that the co-regulatory frameworks provide substantially the same or greater protections as those established under COPPA. This illustrates how reasonable co-regulatory processes can support prescriptive regulation.

## Case Study 7G

### EU’s Audiovisual Media Services Directive

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As noted above, the EU’s Audiovisual Media Services Directive contains many performance-based elements, but it also includes prescriptive requirements where the risk of harm is greater, such as the protection of minors.

For example:

Article 6a(2) prohibits processing personal data collected from minors for commercial purposes (*e.g.*, direct marketing, profiling, and behavioral advertising); Article 9 of the AVMSD prohibits the use of subliminal techniques and commercial communications promoting tobacco products or the immoderate consumption of alcoholic beverages; Article 10 prohibits the commercial sponsorship of news programs; and Article 20 permits films made for television to be interrupted by advertising only once in every 30-minute period.

## Case Study 7H

### U.S. Federal Aviation Administration

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The manned aviation industry is relatively mature and homogenous, with limited competition. Firms, including aircraft manufacturers and operators, are generally similarly situated with comparable technologies, supply chains, and processes. In addition, the

potential safety costs of a marketplace failure – such as an airline crash – are catastrophic. Hence civil aviation authorities tend to prescribe design requirements for the manned aviation industry.

As one example, the U.S. FAA has issued aircraft design requirements intended to ensure that aircraft are “airworthy” and safe to operate in the airspace system. Under Part 27 of the Federal Aviation Regulations, rotorcraft manufacturers must meet particular strength, design and construction, power, equipment, and related requirements.<sup>163</sup> The compliance costs vary little between industry players, and the FAA frequently inspects aircraft to ensure compliance with the rules.

One benefit to these prescriptive rules is the public’s appreciation, given the risks of flying, that all industry actors must adhere to a minimum level of safety. Another benefit is that the FAA can more easily confirm that market players have adopted the highly complex standards. Prescriptive regulatory approaches can be effective in homogenous markets in part because the rules impact various market players in the same way. Firms in homogenous markets generally face the same compliance challenges, making it less likely that prescriptive regulations will unduly burden certain firms more than others.

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<sup>163</sup> Found at <https://www.ecfr.gov/cgi-bin/text-idx?node=14:1.0.1.3.13#sp14.1.27.a>.

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# Enforcement

## Overview

When less interventionist methods would not be effective, regulators use enforcement tools to penalize non-compliant firms, deter other firms from engaging in non-compliant behaviors, and provide redress to stakeholders that have been harmed. The enforcement tools available to regulators include warning letters, civil penalties, cease-and-desist orders, injunctive relief, license suspensions or revocations, and criminal sanctions. Regulators generally have some discretion regarding whether to deploy enforcement tools, which tools to use, and when to use them. However, applicable legal frameworks may specify the available tools or impose other limitations.

Given the range of tools available and regulatory discretion regarding whether enforcement is necessary, effective enforcement requires sound consideration of policy goals and enforcement strategies supported by up-to-date observational findings, behavioral understandings, and analyses of the anticipated public costs and benefits of the actions. Regulators that rely on transparent, fair, and reasonable enforcement strategies will more likely receive support from relevant stakeholders and may be more agile in adapting to changed circumstances or novel behaviors.

## Benefits of Enforcement

**Influences market activities and promotes the achievement of policy objectives.** When enforcement is necessary and deployed in a transparent, fair, and reasonable manner, it can help reduce risk or prevent harms, promote trust within markets, and enhance the public interest by creating incentives for compliance.

**Can promote stable markets.** If industry participants understand that regulators will deploy enforcement tools only when less interventionist measures would not be effective and in a transparent, fair, and reasonable manner, industry can more efficiently design compliance programs to mitigate regulatory risk.

**Transparent, fair, and reasonable enforcement can promote collaboration between industry and regulators.** When participants believe that regulators will deploy enforcement tools as necessary, in a fair and reasonable manner, with the goal of achieving legitimate, articulated policy objectives, industry may be more willing to engage with regulators to address emerging or unsettled issues. Moreover, regulators that have a reputation for deploying enforcement in a transparent, fair, and reasonable manner typically can better use the specter of enforcement or other suasion tools as an effective means of influencing industry behavior.

**Transparent, fair, and reasonable enforcement can engender support for regulatory objectives.** Regulators can build support for their missions and objectives by clearly explaining their enforcement priorities, the factual and legal grounds supporting the choice to resort to enforcement, and the ways in which enforcement has benefited consumers and competition.<sup>164</sup> When regulators have the support of the public and policymakers, regulated businesses may be more responsive to suasion and other less interventionist regulatory tools. And regulated businesses may be less likely to challenge regulatory activities, including enforcement, when there is broad public and policymaker support for the regulator.

## Challenges for Enforcement

**Uninformed enforcement leads to poor regulatory outcomes.** If regulators resort to enforcement based on information received from limited sources, such as isolated consumer complaints, regulators risk focusing their attention on issues that concern a small percentage of stakeholders and that pose little risk to the market as a whole. As the Organisation for Economic Co-operation and Development (“OECD”) has noted, consumer complaints may provide useful inputs for regulatory activity. However, some complaints may not be valid, and a vocal minority of complainants may disguise a silent majority of satisfied consumers.<sup>165</sup> Similar risks apply if regulators justify enforcement actions solely on complaints from industry, academia, or advocacy groups.

**Poorly prioritized enforcement can impede broader policy goals.** For example, a regulator may wish to encourage innovation in a particular market to increase competition and enhance the provision of public benefits. If the regulator determines that less interventionist measures would not be effective and initiates a substantial enforcement action against a firm that allegedly failed to adhere to research and

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<sup>164</sup> Int’l Org. of Sec. Comm’s, *Credible Deterrence In the Enforcement of Securities Regulation* 41 (2015), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD490.pdf>

<sup>165</sup> See OECD, *Consumer Policy Toolkit* 60 (2010), [https://read.oecd-ilibrary.org/governance/consumer-policy-toolkit\\_9789264079663-en#page1](https://read.oecd-ilibrary.org/governance/consumer-policy-toolkit_9789264079663-en#page1).

development obligations, it may decrease the level of research and innovation in the market.<sup>166</sup> Or a regulator seeking to keep consumer costs low might take enforcement action against a business with limited resources that violated a technical requirement. Such enforcement may drive the business out of the market, leading to increased consumer costs.

**Arbitrary, biased, or poorly prioritized enforcement adversely impacts trust in regulators.** If regulated businesses, consumers, or advocacy groups believe that regulators are deploying enforcement tools in a needless, arbitrary, or biased manner, trust in regulation is likely to diminish. This can result in calls for reforms, such as legislative limits on regulatory enforcement, or even reduced funding. When trust in regulation suffers, courts or oversight bodies may be more likely to overturn regulatory decisions.

**Strict enforcement can have a chilling effect on innovation if compliance requirements are not clear.** If performance-based regulations lack objective criteria for measuring compliance or if prescriptive regulations are unclear, regulated entities will lack certainty regarding what they must do to meet regulatory requirements. In such circumstances, if enforcement measures are employed strictly based on the regulator's interpretation of requirements, regulated entities likely will be reluctant to deploy innovative technologies or practices.

## Effective Implementation

**Evidence- and risk-based enforcement.** To assess whether enforcement is necessary and effectively promotes compliance, regulators consider the following questions:

- Are the policy objectives, legal requirements, behavioral expectations, and enforcement actions made reasonably clear to regulated entities?
- What material regulatory violations are occurring in the market?
- What actions are other regulators or stakeholders taking to address violations?
- Would less interventionist tools be effective at shaping market behavior?
- What enforcement tools are available?
- What are the likely impacts of enforcement?
- How effective were past enforcement activities?

More details on these issues are provided below.

**Clarify policy objectives, legal requirements, behavioral expectations, and enforcement actions.** Regulators promote trust when they undertake efforts to promote and support compliance. Rather than relying on the notion that industry participants should know the law, regulators can bolster arguments that enforcement is delivered transparently, fairly, and when necessary by providing industry with guidance, checklists, and other tools designed to assist their compliance efforts. As the OECD has stated, "it is inadequate to just assume that business operators [can] understand what is expected without any assistance."<sup>167</sup> When regulators inform industry participants about their obligations, regulatory policy, and behavioral expectations, participants are better able to comply fully and less likely to have a reasonable argument that they lacked notice of the compliance requirements. And regulators that publicize enforcement actions can promote compliance more effectively. This is because industry

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<sup>166</sup> *Id.* at 104.

<sup>167</sup> OECD, *OECD Regulatory Enforcement and Inspections Toolkit 45* (2018), <https://www.oecd.org/gov/regulatory-policy/oecd-regulatory-enforcement-and-inspections-toolkit-9789264303959-en.htm>.

participants have the opportunity to learn more about regulatory priorities, the factors that led to enforcement, and the considerations that the regulator took into account when determining what specific actions to take.

**Identify material violations in the market.** By developing an understanding of any violations occurring in the markets they regulate, regulators can determine whether enforcement is necessary and how to initiate enforcement in a manner reasonably designed to promote compliance and achieve regulatory policy goals. To account for resource constraints, regulators deploy limited enforcement resources only when necessary and where they can have the most impact.<sup>168</sup> Systemic compliance failures, where a firm or group of firms consistently fails to adhere to regulatory requirements, may therefore warrant more attention than transactional failures in which a firm fails to meet requirements in a specific circumstance. For example, Consumer Affairs Victoria’s regulatory approach expressly focuses on acting “where it counts and target[ing] the areas of greatest risk of consumer harm.”<sup>169</sup> Determining the risk of harm is an “intelligence-led” effort for Consumer Affairs Victoria, relying on information collected from state and local authorities, industry groups, social media, and consumers. The U.S. Federal Trade Commission (“FTC”) articulated its approach to obtaining information about market issues in its Strategic Plan for Fiscal Years 2018 to 2022.<sup>170</sup> To ensure it has a broad perspective on marketplace activities, in addition to its own investigative and monitoring activities, the FTC gathers information from consumer complaints, national surveys, federal and state law enforcement agencies, Better Business Bureaus, industry, FTC investigations, and international partners.

**Consider measures being taken by stakeholders or other regulators to address compliance.**

Self-regulatory bodies, advocacy groups, or other regulators may already be taking action to address specific market issues. For example, a regulator in another jurisdiction may have already penalized a firm for a compliance issue, deterring that firm and others from future non-compliance with regard to the specific activity. If such actions are effective or appear to be effective, a regulator may wish to refrain from taking enforcement action.

**Consider whether less interventionist measures would be effective.** Regulators may be able to promote compliance without resorting to enforcement, such as by encouraging industry participants to self-report violations or by issuing notices of non-compliance and allowing firms a period of time in which to correct their behaviors. Consider, for example, the California Consumer Privacy Act, which established a range of new compliance obligations for firms doing business in California. The California Attorney General is authorized to enforce the law and its implementing regulations, but only after informing alleged violators and allowing them 30 days in which to cure the violation.<sup>171</sup> Providing industry participants with an opportunity to remedy alleged violations and thereby reduce or avoid penalties can be particularly effective in innovative or newly regulated industries in which participants may lack a complete understanding of compliance expectations or feasible approaches to compliance.

**Consider available enforcement tools.** Regulators often have a range of tools that they can use to address perceived violations when enforcement is deemed necessary, including warning letters, injunctions, civil penalties, operating bans, revocations of licenses, or even criminal sanctions. When a regulator determines that enforcement action is warranted, they carefully consider the tools available and the degree to which those tools will help achieve regulatory policy objectives. In many cases, warning letters may be sufficient to both change the target’s behaviors and signal to the market that the

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<sup>168</sup> OECD, *Consumer Policy Toolkit* at 102.

<sup>169</sup> Consumer Affairs Victoria, *Our Regulatory Approach and Compliance Policy* (last updated Nov. 9, 2019), <https://www.consumer.vic.gov.au/about-us/regulatory-approach-and-compliance-policy/our-regulatory-approach>.

<sup>170</sup> FTC, *Strategic Plan for Fiscal Years 2018 to 2022*, [https://www.ftc.gov/system/files/documents/reports/2018-2022-strategic-plan/ftc\\_fy18-22\\_strategic\\_plan.pdf](https://www.ftc.gov/system/files/documents/reports/2018-2022-strategic-plan/ftc_fy18-22_strategic_plan.pdf).

<sup>171</sup> Cal. Civ. Code 1798.155(b).

regulator is monitoring compliance and prepared to take action. In other cases, substantial penalties, such as revocations of licenses or hefty fines, may be warranted. However, as noted below, regulators carefully consider the full range of potential impacts before taking such action. For example, substantial penalties may dissuade new entries into the market, which could reduce competition.

**Assess potential impacts of enforcement.** Regulators implement enforcement tools to achieve desired goals, such as promoting competition, minimizing consumer detriment, encouraging innovation, or otherwise influencing market behaviors when less interventionist measures would not be effective. If enforcement activities are not necessary, have limited or no impact on market activity, or lead to long-term adverse impacts without countervailing benefits, regulatory trust and support will likely deteriorate.

Effective regulators do not focus solely on the impact that enforcement will have on targeted violators. Enforcement actions typically will also have impacts on current and prospective market participants. Regulators may therefore consider the following impacts when considering the deployment of enforcement tools:

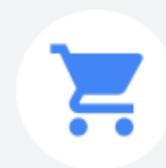
- Will enforcement promote compliance in other market participants?
- Will enforcement impact competition in the market (e.g., by creating disincentives to market entry based on perceived risk)?
- Will enforcement increase costs to consumers or others?
- Will enforcement encourage (or discourage) innovation?
- Does enforcement establish precedent that the regulator is willing to accept in light of regulatory policy goals?

**Review the effectiveness of enforcement activities.** Regulators benefit from understanding how enforcement activities shaped market behaviors and assessing whether alternative enforcement tools or other regulatory tools (e.g., suasion) could have achieved more optimal outcomes. The learnings from these *post facto* reviews will support regulators in assessing whether, when, and how to deploy enforcement tools in the future. To engage in such reviews, regulators may wish to collect information on market activities prior to and following enforcement, monitor consumer and industry complaints, survey regulated entities regarding enforcement impacts, assess the costs of enforcement actions, or even engage independent entities to develop reports on enforcement effectiveness.<sup>172</sup>

## Case Studies

### Case Study 8A Federal Trade Commission

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The FTC has a broad mission to protect consumers and competition. To use its limited resources effectively, the FTC focuses its consumer protection law enforcement

<sup>172</sup> OECD, *OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections* 17-22 (2014), <https://www.oecd.org/gov/regulatory-enforcement-and-inspections-9789264208117-en.htm>.

authority on cases that cause or are likely to cause substantial consumer injury. The FTC identifies potential issues by collecting consumer complaints, researching market activities, holding workshops, and exchanging information with other law enforcement authorities. The agency publishes reports and guidance materials to educate consumers and industry regarding potential issues and compliance expectations. Recognizing the importance of international collaboration, the FTC also collaborates with foreign counterparts on cross-border investigations and enforcement activities.

The FTC routinely evaluates whether its enforcement activities are promoting the achievement of policy goals by:

- Considering whether changes in demographics or market practices warrant new priorities;
- Assessing whether enforcement actions target issues of concern to consumers;
- Comparing money restored to consumers as a result of enforcement actions to the resources that the FTC spends on enforcement actions; and
- Reviewing investigations to identify ways to reduce burdens while improving efficacy.

## Case Study 8B

### Consumer Affairs Victoria

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Consumer Affairs Victoria (“CAV”) is the competition regulator in the Australian state of Victoria. CAV takes an “intelligence-led” approach to target enforcement on the most serious market risks. To achieve this goal, CAV assesses the potential impacts of enforcement and available tools before taking action. CAV’s enforcement tools include education, formal written warnings, and civil or criminal penalties.

To identify potential enforcement targets, CAV relies on information gathered in the course of its regulatory operations, other Australian regulators and stakeholders, and consumer reports. If CAV determines that enforcement is warranted, the agency considers which enforcement tool(s) will best achieve the desired outcome in the specific circumstances. One of the factors the agency considers is whether the target is likely to change its conduct based on a warning or minor penalty or whether a substantial penalty is needed to deter future noncompliance. CAV also considers the seriousness of the conduct, whether the conduct is industry-wide, whether the conduct targets vulnerable groups, and whether the public will benefit from the enforcement action.

## Case Study 8C

### UK Competition and Markets Authority Enforcement During COVID-19

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In times of significant market disruption, protecting the public may require relaxing regulatory enforcement. A prime example of this is the UK Competition and Markets Authority’s (“CMA’s”) relaxation of certain rules against cooperation between competitors in response to the COVID-19 pandemic. On March 25, 2020, the CMA announced that it would adjust its enforcement approach to business cooperation. It noted that while competition typically benefits consumers by resulting in lower prices and better service, during the pandemic “competition law enforcement could impede necessary cooperation between businesses to deal with the current crisis and ensure security of supplies of essential products and services.”<sup>173</sup>

The CMA modified its enforcement approach, recognizing that agreements and arrangements between competitors that under ordinary circumstances might have the effect of restricting competition could be beneficial in a health crisis. The CMA stated that where businesses coordinate in the public interest to avoid shortages resulting from the pandemic, the agency would not take action if the coordination lasted only as long as necessary to address the crisis. The CMA also provided detailed guidance to help businesses determine whether agreements or arrangements would be lawful under the CMA’s adjusted approach.

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<sup>173</sup> See Competition & Markets Authority, *CMA Approach to Business Cooperation in Response to Coronavirus (COVID-19)* (2020), <https://www.gov.uk/government/publications/cma-approach-to-business-cooperation-in-response-to-covid-19/cma-approach-to-business-cooperation-in-response-to-covid-19#our-approach-to-the-exemption-criteria-during-the-coronavirus-outbreak>.

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