

**INDUSTRY-LED  
REGULATION**

**DISCUSSION PAPER**

**JULY 2005**

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## FOREWORD

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Achieving the right regulatory balance to promote an inclusive, innovative economy for all, while enhancing effective protection for consumers presents important challenges for regulators.

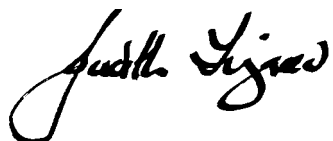
It also presents an opportunity for society – industry, consumers and government – to work together to produce new and innovative ways of reducing regulatory costs and enhancing consumer protection.

Industry-led approaches, such as voluntary codes of conduct and consumer dispute resolution schemes, have been encouraged by government and promoted by industry to achieve the outcome of consumers transacting with confidence. These tools stand as alternatives and complements alongside traditional regulatory approaches adopted by government.

Over the next year, the Ministry of Consumer Affairs will examine the effectiveness of current practices in industry-led regulation, as well as its role in the broader mix of regulatory approaches to consumer protection, redress and enforcement.

This paper starts the process by setting out a draft framework to help consumers and industry establish, operate and evaluate industry-led regulatory schemes. The aim of the framework is to empower consumers and industry in understanding the effectiveness of a particular scheme.

I encourage industry and consumers to participate in this review and help build an effective and efficient regulatory environment.



Hon Judith Tizard  
Minister of Consumer Affairs

# INTRODUCTION

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A review of the role of the Ministry of Consumer Affairs<sup>1</sup>, which examined the role and scope of consumer policy and identified key strategic issues that may influence or impact on the outcomes of the Ministry in the next five to ten years, was completed in May 2003. The review recommended that the Ministry initiate a first-principles review of self-regulation and the Ministry's involvement in it.

A further recommendation was that self-regulation should be considered as part of a review of the mix of approaches to redress and enforcement that will best contribute to the Ministry's outcome of consumers transacting with confidence.

The purpose of this review is to assist industry, consumers and government in developing, operating and evaluating industry-led regulatory schemes, such as voluntary codes of conduct and consumer dispute resolution schemes.

This review will consider whether industry-led schemes are effective in promoting an environment in which consumers transact with confidence, and to clarify the circumstances in which such schemes work best.

This review builds on previous work undertaken by the Ministry on self-regulation (including the Ministry's publication "Codes of Practice – Guidelines for Developing a Code of Practice"), as well as examining other material from New Zealand and overseas.

The key issues to be addressed in the review are:

1. Assessing current trends in regulatory practice in New Zealand and overseas - how do industry-led schemes fit within the overall regulatory environment?
2. How effective are industry-led schemes in creating an environment in which consumers transact with confidence:
  - a. What is an appropriate evaluation framework to assist industries, consumers and government in assessing whether schemes are effective in practice?
  - b. Applying the evaluation framework in a case study analysis of selected schemes to determine whether the schemes are successful in creating an environment in which consumers can transact with confidence
  - c. From the case studies, developing a set of best practice principles. These principles will cover issues such as the circumstances in which industry-led regulation is likely to be most effective.
  - d. Are there gaps in the coverage of schemes?

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<sup>1</sup> Ministry of Consumer Affairs, *Creating Confident Consumers: The Role of the Ministry of Consumer Affairs in a Dynamic Modern Economy*, May 2003, <http://www.consumeraffairs.govt.nz/aboutus/review/report/>.

3. To what extent should the government be involved in self-regulation?

## **OUTLINE OF THIS PAPER**

The purpose of this paper is to provide the background context to the review, to outline the industry circumstances which have been identified overseas as being indicative of effective industry-led regulation, and to develop a framework for evaluating industry-led regulatory schemes. The paper begins by considering the importance of an effective and efficient regulatory environment in achieving the Ministry's goals of promoting economic development and creating confident consumers.

It then goes on to describe a model of the regulatory environment which incorporates the different forms of regulatory instruments, including alternative and complementary schemes, and the interaction of these instruments.

Part 2 considers the linkages between an effective regulatory environment and confident consumers and develops them into a draft framework for evaluating industry-led regulation. The draft evaluation framework will form the basis of a number of case studies of schemes currently operating in New Zealand. The case studies will not be seeking to "tick" or "cross" whether a scheme is successful or not, but will lead to a more general identification of the features which are present in successful schemes. This will lead to the development of best practice principles for developing and operating a scheme.

A subsequent paper, to be released later in 2005, will examine the appropriate role for government in participating in industry-led regulation. It will consider various models adopted by governments overseas, and whether one of these models, or a hybrid, is appropriate for New Zealand.

In addition to this review of self-regulation, the Ministry has also launched a review of the enforcement of consumer protection law.

## DISCUSSION QUESTIONS

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The following discussion questions have been prepared as an aid to assist discussion of the issues raised in this paper. You are invited to comment on any aspect of industry-led regulation.

Written submissions close 14 October 2005 and should be addressed to:

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### *Official Information Act 1982*

In providing your submission, please advise us if you have any objections to the release of your submission, and, if you do object, the parts of your submission that you wish withheld and the grounds for withholding. When preparing and releasing any summary and when considering any formal Official Information Act requests, the Ministry will carefully review any representations you make in this regard.

### *Privacy Act 1993*

Any personal information that you supply to the Ministry in the course of making a submission will be used only by the Ministry when considering matters covered by this discussion paper.

When preparing any summary of submissions on Ministry discussion papers, it is the Ministry's normal practice to set out the names of parties making submissions. Your name will be included in any such summary unless you inform the Ministry that you do not wish your name to be included. To indicate your wishes, or to view personal information held about you in relation to matters covered by this discussion paper, or to request correction of that information, please contact the Ministry of Consumer Affairs, telephone 04 474 2750.

## **Regulatory context**

The Ministry invites comment on the environment for industry-led regulation. The following questions are designed to illuminate some of the particular issues, however feel free to explore other issues in your submission.

What are your experiences of the interaction between industry-led regulation and other forms of regulation?

What have been your experiences of the advantages and disadvantages of industry-led regulation, in New Zealand and/or overseas?

In your experience, which schemes and industries have operated effective industry-led regulation in New Zealand?

In practice, do firms respond differently to government regulation and industry-led regulation? Do consumers?

Is it important whether consumers are aware of the voluntary or mandatory nature of a particular regulatory instrument?

What have been your experiences of the costs of industry-led regulation for industry? For consumers? For government?

Do the different forms of industry-led regulation impose different costs or achieve different benefits?

## **Framework for evaluating effective industry-led regulation**

Is the framework a suitable mechanism for evaluating industry-led regulation?

Does the framework accurately describe the process/concepts for evaluating industry-led regulation?

Does the framework incorporate the appropriate elements for evaluating the effectiveness of a scheme?

## **Market structure and industry circumstances conducive to effective industry-led regulation**

In your experiences, which markets and industries in New Zealand have successfully operated effective industry-led regulation?

What market structures and industry circumstances characterise these industries and lead to the success of industry-led regulation?

Does the framework incorporate all the elements necessary to describe the market structure and industry circumstances which are conducive to effective industry-led regulation? What other elements should be considered?

## **Content of the scheme – meeting the reasonable expectations of consumers**

In your experiences, which types of schemes have successfully operated effective industry-led regulation?

What content (eg objectives, purpose, scope, rules) characterises these schemes and leads to the success of industry-led regulation?

What scheme development processes lead to effective industry-led regulation?

Does the framework incorporate all the elements necessary to describe the content of a scheme which is conducive to effective industry-led regulation? What other elements should be considered?

## **Operation and enforcement of the scheme**

What operational processes (eg administration, monitoring, review, etc) lead to effective industry-led regulation?

What enforcement processes lead to effective industry-led regulation?

What types of sanctions are necessary to ensure effective industry-led regulation?

What types of complaints resolution processes are necessary to ensure effective industry-led regulation?

Does the framework incorporate all the elements necessary to describe the operation of a scheme which are conducive to effective industry-led regulation? What other elements should be considered?

## **Evaluation template**

Does the evaluation template accurately capture the issues in evaluating effective industry-led regulation?

Are additional questions necessary to elicit information that would be important in evaluating the effectiveness of a scheme? Are some questions unnecessary?

# PART 1: REGULATORY CONTEXT

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## CONFIDENT CONSUMERS, ECONOMIC DEVELOPMENT AND THE REGULATORY ENVIRONMENT

The primary role of the Ministry of Consumer Affairs is to promote an environment in which consumers transact with confidence.<sup>2</sup> This recognises that:

- when consumers' expectations about a transaction are met, transactions are successful and, collectively, successful transactions generate confidence;
- market rules and institutions influence the confidence of consumers; and
- consumers have a reasonable expectation that effective redress is available.

These objectives build on the wider government goal of growing an inclusive, innovative economy for all<sup>3</sup>, as well as contributing to the strategic framework of the Ministry of Economic Development (which is focused on improving New Zealand's rate of economic growth) through, in part, the promotion of competitive and dynamic markets.

Consumers have a vital role to play in the development of such markets through making decisions between products, services and suppliers, and demanding new and better products and services. Optimal participation in these markets over the long term depends on confident consumers.

The Ministry of Economic Development's Statement of Intent outlines the critical role that regulation plays in shaping the business environment in which economic activity takes place. The goal of this strategic priority is to ensure that regulation is well designed and implemented to foster achievement of economic objectives, while also ensuring that social and environmental objectives are met.<sup>4</sup>

There has also been much international work on the quality of government regulation, and the effects of regulation on innovation and economic growth. In particular, the OECD has been active in promoting a program to encourage reform of regulations that raise unnecessary obstacles to competition, innovation and growth, while ensuring that regulations efficiently serve important social objectives.<sup>5</sup>

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<sup>2</sup> Ministry of Consumer Affairs, *Creating Confident Consumers: The Role of the Ministry of Consumer Affairs in a Dynamic Modern Economy*, May 2003, <http://www.consumeraffairs.govt.nz/aboutus/review/report/>.

<sup>3</sup> "Key Government goals to guide the public sector", DPMC, [http://www.dPMC.govt.nz/dPMC/publications/key\\_goals.html](http://www.dPMC.govt.nz/dPMC/publications/key_goals.html).

<sup>4</sup> Ministry of Economic Development, *Statement of Intent 2005-2008*, <http://www.med.govt.nz/about/soi/2005/soi-2005.pdf>, p34.

<sup>5</sup> OECD Regulatory Reform Programme, [http://www.oecd.org/topic/0,2686,en\\_2649\\_37421\\_1\\_1\\_1\\_1\\_37421,00.html](http://www.oecd.org/topic/0,2686,en_2649_37421_1_1_1_1_37421,00.html).

## REGULATION

It is helpful at this point to define what we mean by the terms regulation, self-regulation, co-regulation, industry-led regulation, etc.

*Regulation* is the process of making rules which govern behaviour.<sup>6</sup> This is broader than legislation imposed by government on industry, and encompasses a range of mandatory and voluntary instruments from a variety of sources. What is important is that the regulatory instrument sets standards for the behaviour of market participants (businesses, consumers and government), and influences compliance with those standards. Influence may be brought to bear through government enforcement or through voluntary acceptance by the firm.

While not regulation, there are also other means of influencing the behaviour of market participants. For example, government and/or industry information and education campaigns to raise consumer awareness and enhance consumer and trader understanding of acceptable trading standards. A competitive market may also adopt a 'hands off' approach, where the decisions of consumers drive trader behaviour and adoption of acceptable trading standards.

## DEFINITIONS

*Self-regulation* refers to those regulatory schemes which obtain their legitimacy through voluntary adoption by industry, rather than being imposed through the coercive power of the state.

However, it is more accurate to think of schemes where industry, rather than government, takes the lead role in setting regulatory standards and enforcing compliance as *industry-led regulation*.

Self-regulation usually has no or little government involvement. However, it is important to note that where industry is, in effect, regulating itself, there is not a total absence of government regulation. In consumer markets, businesses are subject to the Fair Trading Act and the Consumer Guarantees Act, as well as various other laws of general application that apply in areas such as companies, contracts and competition, which set a basic legal framework within which self-regulation must operate.

Industry-led regulatory schemes may also be thought of as *alternatives and complements to government regulation*. Effective industry-led regulation builds on the existing law, as well as addresses specific issues in the particular industry, and is supported by information and education activities for both traders and consumers.

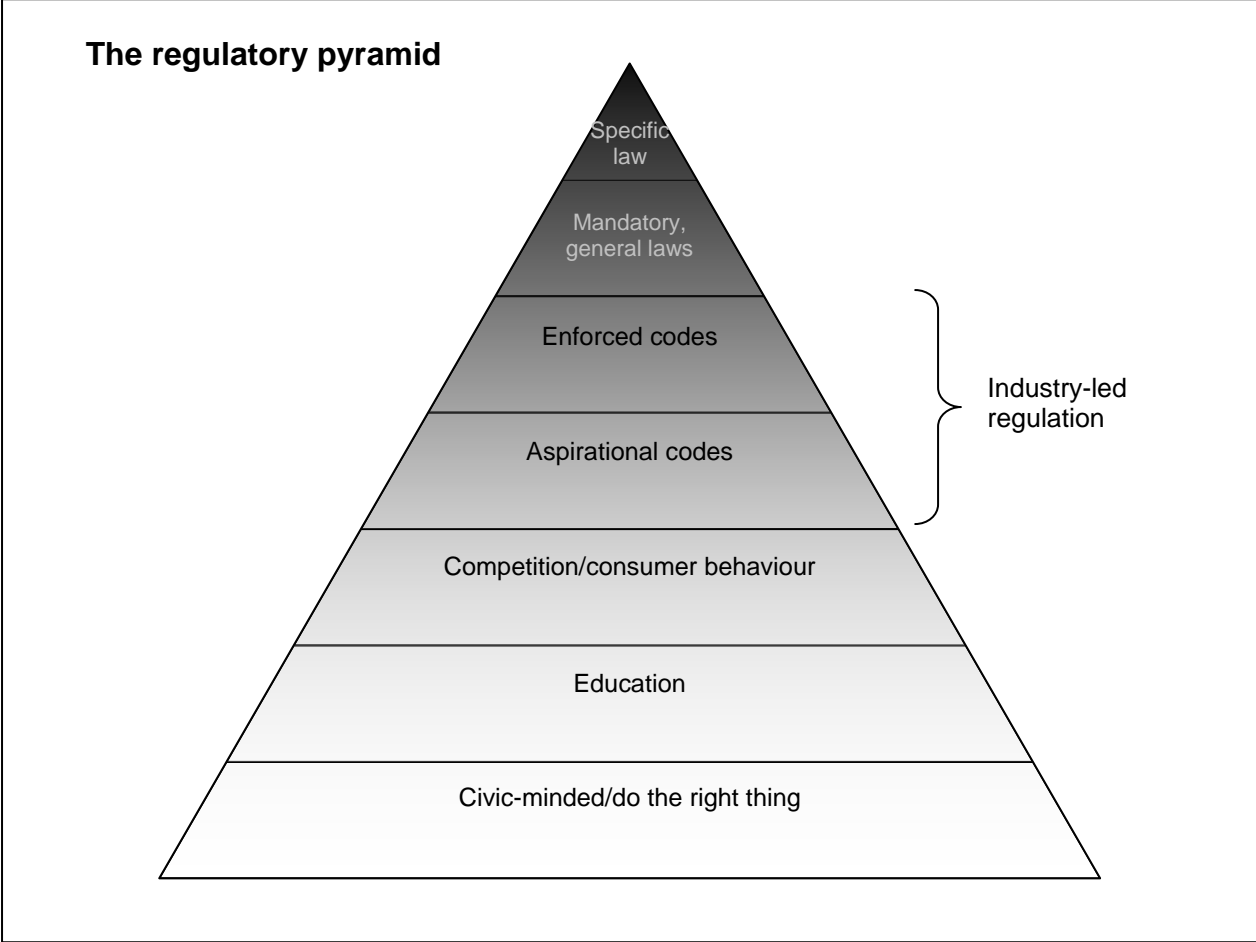
A *code of practice* is the most common form of industry-led regulation. A code sets out the rights and responsibilities of both businesses and consumers. A code may also include an industry-based *consumer dispute resolution mechanism*, which provides a low cost, informal alternative to the court system for resolving disputes between

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<sup>6</sup> Ministry of Consumer Affairs, *Guideline for Developing a Code of Practice*, July 2000.

businesses and consumers. For convenience, this paper refers to an industry-led regulatory tool as a *scheme*.

### THE REGULATORY PYRAMID



The regulatory environment can be modelled in terms of a pyramid,<sup>7</sup> showing the increasing level of intervention in a particular market. The pyramid also shows the extent to which regulation is binding on market participants.

At the lowest levels, the regulatory pyramid implies only a limited role for intervention in a market. Businesses are a part of society, and as such, they are motivated by the impulse to “do the right thing”. However, it may be necessary to educate businesses and consumers on their respective rights and responsibilities.

The lower levels of the pyramid also take into account the effect of competition in influencing trader and consumer behaviour. Competition acts to constrain any bad

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<sup>7</sup> This pyramid is adapted from Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, 1992 and Australian Consumers' Association, *Submission to Australian Competition and Consumer Commission discussion paper “Guidelines for developing effective voluntary industry codes”*, October 2003.

behaviour from firms. Through their choices about suppliers and products, consumers drive the promotion of dynamic and efficient markets. In a competitive market, firms must respond to customer demand if they wish to continue in business. Where competition is not sufficiently present, for example the market is subject to a monopoly or duopoly, further intervention may be necessary. This could be in the form of general anti-competition legislation, such as the Commerce Act.

The pyramid shows that market interventions should build on each other to achieve the appropriate mix. Where social mores, combined with education, in a competitive market, are not sufficient to create an environment in which consumers transact with confidence, regulatory intervention in the market will be needed.

Industry-led regulation begins to appear in the middle of the pyramid. Codes of practice are a means of setting out the relationship between businesses and consumers in a more formal way.

“Aspirational codes” refer to those schemes which set out the standards industry will strive to achieve, but do not provide any effective methods for enforcing the code, or holding firms to those standards. While aspirational codes have a role in influencing the behaviour of firms, there are no mechanisms for compelling compliance with the scheme.

The next stage up the pyramid involves stronger intervention in the market. The distinction between aspirational codes and enforced codes is on the extent to which the regulatory scheme is binding on market participants, rather than the process by which the scheme was developed. The difference between an enforced code and an aspirational code refers to whether there is a mechanism for hearing complaints or enforcing the scheme in such a way that decisions are binding on scheme members. This could be through an industry-run scheme (such as the Banking Ombudsman) or it may be through a co-regulatory scheme, where there is some government involvement in enforcement.

Where industry-led tools are not effective in a market, it will be necessary for the government to take action to promote an environment in which consumers transact with confidence.

Mandatory requirements of general application covers those laws and standards which apply generally to all businesses, such as the Fair Trading Act and the Consumer Guarantees Act. These provide a legislative safety net for consumers, but do not necessarily address the specific problems in particular markets.

The top point of the pyramid involves legislation governing a specific market. This stage is the most powerful tool in the regulatory pyramid for influencing the behaviour of market participants. Examples of specific law to deal with particular problems in a market include the Motor Vehicle Sales Act, the Credit Contracts and Consumer Finance Act, and the Product Safety Standards (Cigarette Lighters) Regulations.

It must be remembered that the appropriate mix of regulatory tools will depend on the circumstances of the specific market. In particular, whether industry or government is better placed to set regulatory standards and enforce compliance will be an important consideration in choosing the best regulatory tool. The purpose of this paper is not to

set out the factors that influence the decision on whether to undertake government regulation or industry-led regulation. Rather, once a decision has been made to undertake industry-led regulation, the framework outlined in this paper will assist industry and consumers in developing and evaluating the scheme.

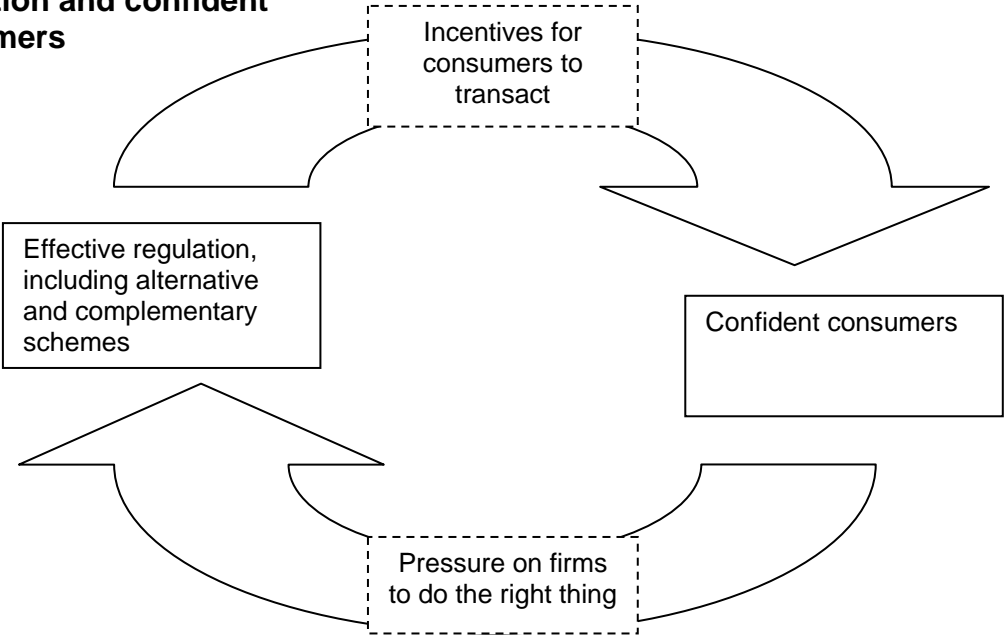
**RELATIONSHIP BETWEEN REGULATION AND CONFIDENT CONSUMERS**

Regulation has an influence on the behaviour and decision making of consumers and firms. To encourage consumer participation in markets, consumers and firms need to have confidence in their integrity and effectiveness. The regulatory environment is an important factor in creating consumer confidence in the integrity of the market.

Consumer confidence also feeds back into the design of the regulatory system. As confident consumers enter the market, their purchasing decisions, in particular the choices they make between different products and suppliers, will influence the behaviour of firms to become responsive to consumers’ concerns. Confident consumers will exert their rights, and expect firms to follow those rights. Confident consumers will also seek out redress mechanisms. This will also put pressure on firms to be seen to be doing the right thing by their customers, such as by joining a self-regulatory scheme and agreeing to a code of practice. Firms will seek out these schemes as a means of differentiating themselves from their competition.

As firms voluntarily conform to fair trading standards in response to consumer behaviour, there is less need for government intervention in the market. This in turn promotes industry-led alternatives and complements to government regulation.

**Relationship between effective regulation and confident consumers**



The regulatory environment also has an important impact on promoting economic growth. By influencing the decisions of firms, it impacts on the overall level of economic activity, the ability and willingness of firms to choose the most efficient

means of producing, the allocation of resources in the economy to their most productive uses, and the rate of productivity improvement over time through innovation.

It is important that the right regulatory tool is chosen in order to advance the goal of an innovative, inclusive economy for all. In some cases, this might be government regulation; in other cases the market circumstances might be such as to support an industry-led regulatory structure. Consideration must be given to social and environmental outcomes, as well as economic outcomes. Regulation will be appropriate where it is necessary to protect consumers, or to otherwise enhance the market. This means balancing the rights and responsibilities of all market participants – businesses, consumers and government.

## INDUSTRY-LED REGULATION

As mentioned earlier, the focus of this paper is not on determining the best form of regulation in a particular market. However, it must be remembered that industry-led regulation sits between government regulation and no regulation in a market. As such, industry-led regulation can have some advantages over these alternatives, and also some disadvantages.

### *ADVANTAGES AND DISADVANTAGES OF INDUSTRY-LED REGULATION*

Industry-led regulation can have a positive role in creating an environment in which consumers transact with confidence:

- It can promote good practice and target specific problems within industries. With regard to consumers' expectations, it can add to the existing broad rights and responsibilities of consumers and businesses under the law by providing specific guidance that is tailored for the particular market.
- It can have a role in promoting consumer confidence in market rules and institutions by promoting awareness of consumers' rights and allowing for consumer participation in rule making.
- It can provide access to quick and informal complaint handling and redress mechanisms. Schemes developed by industry can set agreed quality standards of work that serve as benchmarks in settling disputes. Sanctions developed by industry may be more appropriate for the particular circumstances than sanctions imposed by government.
- It can be less costly for government, as the industry is responsible for enforcing the scheme. The industry will have incentives to minimise these costs, thus benefiting firms and consumers.

However, industry-led regulation can also have disadvantages:

- Industry-based dispute resolution may lack teeth. For example, businesses that have signed up to a scheme may choose to withdraw if faced with a sanction or enforcement. Industry enforcement of the scheme may not align with consumers' or government's priorities.

- Insufficient coverage within the industry may result in some consumers being without protection.
- Constraining the actions of firms through a self-regulatory scheme may limit competition and reduce the incentive for firms to innovate for the benefit of consumers.
- It may be quite costly for an industry to establish and operate a scheme.

### *TYPES OF INDUSTRY-LED REGULATION*

As “alternatives and complements” to government regulation, industry-led schemes can encompass a diverse range of regulatory structures with different objectives, costs and benefits.<sup>8</sup>

As mentioned earlier, regulation consists of setting standards and influencing compliance with those standards. Different types of schemes will approach these tasks in different ways, and may be more successful in some respects than others. A particular scheme may incorporate elements from several categories. It is important to ensure that the scheme is designed appropriately to work in the particular market it is situated.

#### *Firm-based service charters*

This is where a firm voluntarily sets out what it is going to do for its customers. It may involve an internal complaints handling procedure. The charter is voluntary, and creates no legal rights for consumers.

#### *Aspirational code*

This is where an industry comes together to set out a voluntary code of practice. It is often written in “aspirational” terms, and does not provide a dispute resolution procedure. It is intended to raise awareness or promote industry reputation. It is often accompanied by an information campaign.

Codes can be either institutional (ie applying to firms in a particular industry) or functional (ie applying to firms conducting a particular activity).

#### *Model contracts*

Model contracts provide an opportunity for industry, consumers and (where appropriate) government to agree on standard terms for the supply of goods and services. Model contracts will usually be appropriate where the goods or services being offered are largely identical between suppliers and competition is on the basis of

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<sup>8</sup> There have been several attempts to categorise the types of industry-led schemes. For example, Australian Government, *Taskforce on Industry Self-Regulation in Consumer Markets*, August 2000, [http://www.consumersonline.gov.au/content/SelfRegulation/finalreport\\_taskforce/](http://www.consumersonline.gov.au/content/SelfRegulation/finalreport_taskforce/); UK National Consumer Council, *Models of Self-regulation*, November 2000, [http://www.ncc.org.uk/regulation/models\\_self\\_regulation.pdf](http://www.ncc.org.uk/regulation/models_self_regulation.pdf).

price and service standards. Industries considering model contracts should be careful to ensure that they do not breach the law against anti-competitive conduct.

#### *Accreditation/quality assurance scheme*

This is where an industry body accredits participants to advertise that they are members of the scheme or have complied with certain standards. It is voluntary, so there is no legal requirement for a person to obtain accreditation in order to participate in the industry. However, the industry association often has considerable reputation, and accreditation is a big advantage. It is more involved than an aspirational code, as the industry association has a monitoring role in ensuring that members comply with the standards set by the association.

#### *External dispute resolution*

This type of scheme establishes a formal external dispute resolution service or ombudsman. It may set standards for behaviour in a code of practice, or it could operate solely as a dispute resolution service. The scheme usually provides that the service is free for consumers, and that the decision of the ombudsman is binding on the firm.

#### *Standards*

Standards are consensus-based documents which set out minimum technical or performance requirements in areas such as safety or consumer protection. They are often developed by the industry, or a subset of the industry, for example a committee convened by Standards NZ. Standards may have legal force through incorporation in legislation, or may be voluntary.

#### *Legal codes/co-regulation*

These are codes that have some backing by legislation. This may include codes which are developed by industry but which have some government enforcement. It may also include schemes where membership of a code is mandated by government but it is left to industry to develop the detailed rules of the code.

#### *Other types*

Other approaches to industry-led regulation have been developed in a number of jurisdictions. These mechanisms involve government partnership with industry in regulating.

In the UK, codes of practice can be approved by the Office of Fair Trading. Approval is only granted where the code has been developed in accordance with rigorous requirements to ensure it effectively addresses consumer concerns in that market. Code approval conveys a reputational advantage on members. There is no enforcement of the code by the OFT, however approval may be withdrawn if the code sponsor fails to ensure members comply with the code.

In Australia, codes of practice which don't fit under sector specific legislation can be prescribed under the Trade Practices Act. Prescribed codes can be mandatory (that is, binding on all participants in an industry) or voluntary (that is, only binding on those

businesses which formally subscribe to the code). The criteria for prescribing a code include issues such as whether self-regulation has been examined and demonstrated to be ineffective, whether any systemic enforcement issues exist, the benefits of the code to the community as a whole, and whether the code is the most effective means for remedying an identified market failure or promoting a social policy objective. Codes which are prescribed under the Trade Practices Act are enforced by the Australian Competition and Consumer Commission.

### **Discussion questions**

The Ministry invites comment on the environment for industry-led regulation. The following questions are designed to illuminate some of the particular issues, however feel free to explore other issues in your submission.

What are your experiences of the interaction between industry-led regulation and other forms of regulation?

What have been your experiences of the advantages and disadvantages of industry-led regulation, in New Zealand and/or overseas?

In your experience, which schemes and industries have operated effective industry-led regulation in New Zealand?

In practice, do firms respond differently to government regulation and industry-led regulation? Do consumers?

Is it important whether consumers are aware of the voluntary or mandatory nature of a particular regulatory instrument?

What have been your experiences of the costs of industry-led regulation for industry? For consumers? For government?

Do the different forms of industry-led regulation impose different costs or achieve different benefits?

## **PART 2: EVALUATING EFFECTIVE INDUSTRY-LED REGULATION**

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The previous section has shown the relationship between an effective regulatory environment, including alternative and complementary regulatory schemes, in creating an environment in which consumers transact with confidence. This section of the paper takes the analysis a step further, and sets out a framework to consider the assumptions underlying an assessment of whether a regulatory instrument is successful and the features of an effective industry-led scheme.

The aim of the framework is to provide a tool to empower consumers and industry in understanding the effectiveness of industry-led regulation. For example, the framework provide a means of gathering and organising evidence to demonstrate the effectiveness, or non-effectiveness, of a particular scheme.

### **Evaluation framework**

The evaluation of a scheme begins with considering the objectives of the scheme. A well functioning market satisfies the economic, social and environmental needs of all market participants. If there is a problem in the market, one solution might be regulation. That is, regulation needs to be in response to an identified problem in a market or to promote a particular outcome. This has been identified in the Guide to Preparing Regulatory Impact Statements<sup>9</sup> in the case of government regulation, and this purpose is equally true of industry-led regulation.

Once the scheme's objectives have been identified, the scheme must be designed appropriately to meet those objectives. In this way, the scheme will address the identified problem or promote its particular outcome. This assumes that the objectives of the scheme meet consumers' reasonable expectations and provide incentives for consumers to transact confidently with scheme members, and that the scheme is enforced and operated effectively so that traders comply and, in case of non-compliance, consumers have access to redress.

However, it is not enough that the scheme simply meets its own objectives. As mentioned previously, effective industry-led regulation forms part of the regulatory environment along with government regulation. This means that, for the scheme to be effective, the structure of the market must be conducive to industry-led regulation so that the scheme integrates with the rest of the regulatory environment. This will lead to consumer confidence in market rules and institutions.

Having established that the scheme effectively addresses its objectives, and that it successfully integrates with the regulatory environment, we can conclude that that scheme contributes to an environment in which consumers transact with confidence.

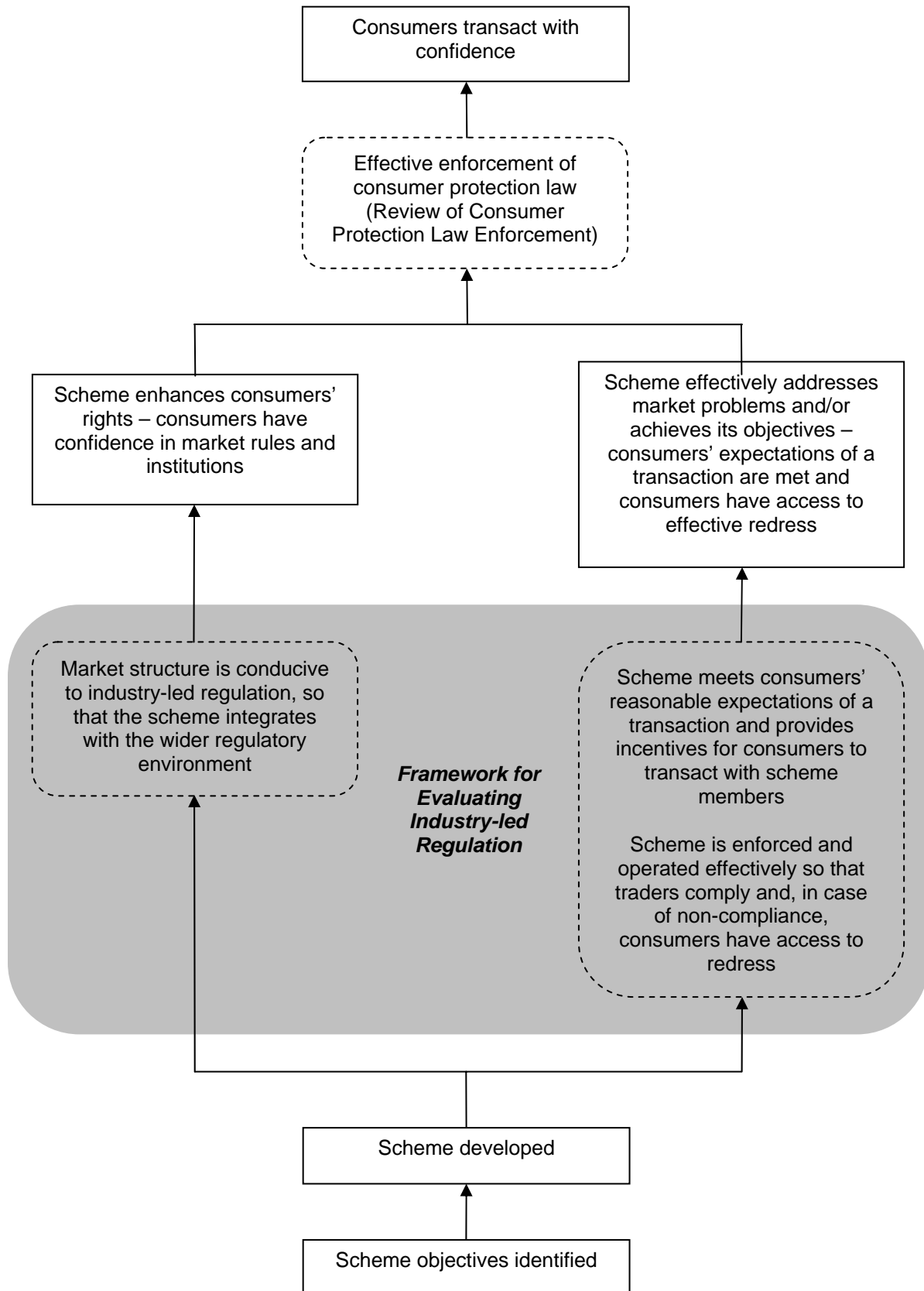
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<sup>9</sup> Ministry of Economic Development, *A Guide to Preparing Regulatory Impact Statements*, March 1999, page 5, <http://www.med.govt.nz/buslt/compliance/risbccs/regimpact/>.

If an element in the framework is not satisfied, it does not necessarily follow that the scheme is detrimental to consumers; it simply means that the scheme does not provide any benefits over the alternative of no regulation.

While this framework focuses on the conditions that lead to effective industry-led regulation, it must be remembered that there are also consumer protection laws which provide the underlying legal environment. Successful industry-led regulation will depend on effective enforcement of consumer protection law. This issue is being addressed by the Ministry in the project Consumer Protection Law Enforcement.

## Evaluating effective industry-led regulation



## ELEMENTS OF EFFECTIVE INDUSTRY-LED REGULATION

The framework above identifies a number of elements which underlie the evaluation of whether an industry-led regulatory scheme is effective and the features of a successful scheme. The elements of effective industry-led regulation outlined in the framework are:

- The scheme meets consumers reasonable expectations and provides incentives for consumers to transact – if the scheme addresses an identified problem in the market, consumers will be more confident in transacting with scheme members. This also includes issues such as consultation between industry and consumers to identify problems, and publicity and awareness raising about the scheme and consumers' rights under the scheme.
- The scheme is enforced and operated effectively so that traders comply and, in case of non-compliance, consumers have access to redress – this relates to the availability and independence of dispute resolution procedures, as well as the existence and use of credible sanctions for non-compliance. Effective redress also depends on consumers' awareness of their rights under the scheme, and ability to access dispute resolution procedures. Ongoing administration and monitoring is also important in effective operation of a scheme.
- The market structure is conducive to industry-led regulation – there may be some features of the market or the industry structure which mean that industry-led regulation may not be successful. This could include issues such as the level of competition in the industry, public confidence or the extent of potential harm. This will also have implication for the type of scheme adopted.

The following sections set out these elements in more detail. The information provided has been drawn from previous work undertaken by the Ministry<sup>10</sup>, as well as studies from overseas.<sup>11</sup>

This project will apply the framework developed in this paper in a case study analysis of selected schemes to test whether these features are present in schemes operating in New Zealand. If they are found not to be true, we can conclude that the scheme is not an effective means of creating confident consumers. The evaluation template summarises the issues that are relevant in evaluating whether a self-regulatory scheme is effective.

### Discussion questions:

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<sup>10</sup> Ministry of Consumer Affairs, *Guideline for Developing a Code of Practice*, July 2000.

<sup>11</sup> Australian Government, *Taskforce on Industry Self-Regulation in Consumer Markets*, August 2000, [http://www.consumersonline.gov.au/content/SelfRegulation/finalreport\\_taskforce/](http://www.consumersonline.gov.au/content/SelfRegulation/finalreport_taskforce/); Better Regulation Task Force (UK), *Alternatives to State Regulation*, July 2000, <http://www.brtf.gov.uk/reports/alternativesentry.asp>; Industry Canada, *Framework for Evaluating Voluntary Codes*, March 2000, [http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/en/h\\_ca00880e.html](http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/en/h_ca00880e.html).

Is the framework a suitable mechanism for evaluating industry-led regulation?

Does the framework accurately describe the process/concepts for evaluating industry-led regulation?

Does the framework incorporate the appropriate elements for evaluating the effectiveness of a scheme?

## **MARKET STRUCTURE AND INDUSTRY CIRCUMSTANCES CONDUCTIVE TO EFFECTIVE INDUSTRY-LED REGULATION**

The framework recognises that effective industry-led regulation requires more than just the scheme itself. A crucial question is whether the market structure and industry circumstances are conducive to effective industry-led regulation. Even if a scheme is designed following best practice guidelines, if the market is not conducive to effective industry-led regulation, then the scheme will fail to encourage consumers to transact with confidence.

The Ministry has previously considered the design of self-regulatory schemes in the *Guideline for Developing a Code of Practice*. This Guideline considered the costs and benefits of a code of practice, but did not formally consider which market structures and industry circumstances are likely to be conducive to effective self-regulation.

Although these issues have not been studied in New Zealand, some guidance can be obtained from studies conducted overseas, such as the Australian Taskforce on Self-Regulation<sup>12</sup>, and the UK Better Regulation Taskforce.<sup>13</sup>

### *MARKET STRUCTURE*

Since industry-led regulation requires some centralised organisation, it is likely to be more effective when it is led by a strong industry association or code champion. The industry association can galvanise action and provide leadership. The ability and willingness of an industry to organise itself collectively can demonstrate its capacity to undertake self-regulation and the commitment necessary to ensure self-regulation succeeds.

As with a strong industry association, industry-led regulation is likely to be more effective in a market which is cohesive. For example, large businesses with multiple retail outlets and smaller, niche firms may have different interests, such as their relationships with customers and suppliers. Where industry players have similar interests they can more likely agree on common rules to follow, and are more likely to comply with those rules.

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<sup>12</sup> Australian Government, Taskforce on Industry Self-Regulation in Consumer Markets, August 2000, [http://www.consumersonline.gov.au/content/SelfRegulation/finalreport\\_taskforce/](http://www.consumersonline.gov.au/content/SelfRegulation/finalreport_taskforce/).

<sup>13</sup> Better Regulation Taskforce, *Alternatives to State Regulation*, July 2000, <http://www.brta.gov.uk/reports/alternativesentry.asp>.

Wide coverage is also an important factor in ensuring effective industry-led regulation. If a substantial part of the industry does not belong to the scheme, then it cannot be said that that scheme is delivering good results for all or most of the consumers in the market.

As with any form of regulation, by setting common rules a scheme can have a tendency to reduce competition and the incentive for firms to innovate and create new products or services. It is therefore important that the industry scheme takes into account the potential effects on competition, and includes safeguards to ensure that members are not constrained in their ability to compete for new customers on price, quality and product and customer service standards. In terms of market structure, therefore, industry-led regulation is likely to be more effective in a competitive market, where there already commercial incentives for firms to be responsive to their customers.

Similarly, in a mature market where there is little differentiation on price or product quality, firms are forced to compete on customer service. Membership of a scheme, and agreeing to uphold the standards of the scheme, provides an opportunity for members to demonstrate their commitment to high standards of customer responsiveness, and is therefore a clear commercial advantage for members.

However, industry-led regulation may also be effective in a new market which is trying to build consumer confidence in the industry by providing guidance and reassurance for potential customers about the standards they can expect from members.

#### *EXTENT OF MARKET FAILURE OR POTENTIAL HARM*

The type of regulation which is appropriate in any given market will depend on the nature of the market failure, including the extent of harm which may potentially be suffered by consumers.

Self-regulation is likely to be less effective where there is a high risk of serious harm to consumers. Where there is a threat to public health or safety, compulsory regulation through government intervention may be more effective to ensure that all firms obey appropriate standards of behaviour.

However, industry-led regulation can still be effective if, by nature of the market structure and incentives for traders to join, the scheme enjoys de facto compulsory membership, so that, in effect, the entire industry is subject to appropriate standards.

#### *INCENTIVES FOR FIRMS TO PARTICIPATE*

A scheme will only be effective if firms join and comply with the scheme. It is important therefore that the scheme provide incentives for firms to join and comply. There are a number of incentives that could motivate an industry to develop a scheme or a firm to join a voluntary scheme. These will often depend on the objectives the scheme is trying to address.

For example, the industry may be motivated to adopt self-regulation where it is seeking to achieve a common goal. Many industry schemes seek to improve

consumer confidence where it is currently inadequate, such as in areas of new technology or where there have been problematic industry practices.

For individual firms, an incentive to join an industry scheme could be where there is a clear commercial advantage to membership, such as where the scheme allows a firm to differentiate from its competitors on the basis of customer service.

Another incentive to join could be the possibility of adverse consequences from non-participation. Self-regulation can be developed by industry as a first step to prove to government that the industry can regulate itself. Non-participation could signal that the scheme is unlikely to be successful, and may lead to government regulation.

### *CONSUMER RECOGNITION/PUBLIC CONFIDENCE*

Along with incentives for firms to join and comply, a scheme must also work to establish consumer confidence in the scheme and the industry. To be effective in promoting consumer confidence, a scheme must provide additional benefits to consumers above those already available under the law. Confidence in the scheme will depend on consumer recognition of the advantages of dealing with a scheme member.

The scheme must be more than just a marketing campaign for the industry. Businesses have a relationship not just with their current customers, but also with the wider community. Recognition of this relationship in the scheme gives the industry an opportunity to develop a reputation for social responsibility.

The failure of industries to act in a manner consistent with society's broad social objectives can have a damaging effect on their overall reputation and profitability. Introducing effective industry-led regulation can be an important factor in improving their corporate image.

#### **Discussion questions:**

In your experience, which markets and industries in New Zealand have successfully operated effective industry-led regulation?

What market structures and industry circumstances characterise these industries and lead to the success of industry-led regulation?

Does the framework incorporate all the elements necessary to describe the market structure and industry circumstances which are conducive to effective industry-led regulation? What other elements should be considered?

### **CONTENT OF THE SCHEME – MEETING THE REASONABLE EXPECTATIONS OF CONSUMERS**

This element of the framework refers to the need for the scheme to be designed appropriately so that it encourages behaviour from firms which meet the reasonable expectations of consumers. This is essential in ensuring that consumers have

confidence in the scheme, and are encouraged to transact with the industry and with scheme members.

This framework builds on the Ministry publication *Guideline for Developing a Code of Practice*, which assists industry in developing a code of practice, including practical guidance on the content of the code.

#### *TYPE OF SCHEME*

As mentioned earlier, alternatives and complements to government regulation encompass a wide range of regulatory structures, with different levels of complexity, cost, obligations, responsibilities and expectations.

There is no 'one size fits all' approach to self-regulation. The most effective type of scheme will depend on the market structure and industry circumstances. For example, a complex customer dispute resolution mechanism may not be justified if the scheme receives only a few complaints per year. The costs involved in administering such a scheme may be translated into higher prices for consumers. Industry-led regulation will be more effective where the type of scheme adopted is suited to the industry.

#### *OBJECTIVES, SCOPE AND RULES*

Effective industry-led regulation should be clear about its purpose, scope and requirements. The scheme should describe the objectives it is seeking to achieve, the parties to which it applies, and the behaviour which is expected of scheme members.

The scheme's objectives should be given effect to in clear rules. The rules should specify what actions must be performed and when. Rules may be more effective when they are not restrictive in prescribing how actions must be performed, but are flexible enough to allow for individual innovation. To ensure compliance, rules should provide for some measurable performance standards.

It is also important that the rules be clear, and that the scheme documentation, such as a code of practice or terms of reference, set out the rules in a manner easily understood by all participants, including traders and consumers.

#### *CONSUMER PARTICIPATION*

Consumer participation is necessary in the development of effective industry-led regulation. A scheme will be more effective where it is developed in partnership with the community. This will work to ensure that consumers accept the scheme.

Consultation is an exchange of perspectives and an exchange of knowledge to identify problems and develop decisions which have the best chance of providing solutions which work and meet the terms of the problem. If consultation is to meet its purpose then it must be a genuine exchange of views between people who have the knowledge and experience to confront the issues.

Further information on consulting consumers can be found in the Ministry's publication *Consumer Representation: Consulting Consumers*, June 2004.<sup>14</sup>

**Discussion questions:**

In your experience, which types of schemes have successfully operated effective industry-led regulation?

What content (eg objectives, purpose, scope, rules) characterises these schemes and leads to the success of industry-led regulation?

What scheme development processes lead to effective industry-led regulation?

Does the framework incorporate all the elements necessary to describe the content of a scheme which is conducive to effective industry-led regulation? What other elements should be considered?

## **OPERATION AND ENFORCEMENT OF THE SCHEME**

### *ADMINISTRATION AND MONITORING*

A successful scheme will include a body to administer and monitor the operation of the scheme. Administration and monitoring has the ability to detect and report on systemic issues. This can indicate areas where the entire industry needs to lift its performance, and this could be addressed by amendments to the scheme.

Ideally, the scheme should set out the performance indicators against which it can be reviewed and monitored. This will provide a simple means of assessing whether the scheme has met its objectives. As well as the objectives set out in the scheme, the performance indicators also need to assess the ongoing level of consumer satisfaction with the scheme, and with the behaviour of scheme members and the industry as a whole. This will show whether the scheme is successful, or whether some other form of regulation would be better for the industry.

Integral to the monitoring of the scheme is the publication of the results in a way that is understood by, and accessible to, consumers. This may give consumers the ability to assess whether the scheme is successful, and promotes transparency and accountability.

The scale of administration and monitoring to be undertaken depends on the type of scheme and the nature of the industry. Regardless of the scale of administration and monitoring, there will be costs for scheme participants. The administration body must be adequately resourced to enable it to undertake appropriate administration and monitoring.

Appropriate resources are also important to ensure operational independence so that the administration body is not subject to interference and withholding by scheme members.

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<sup>14</sup> <http://www.consumeraffairs.govt.nz/aboutus/consumer-rep/CRCConsultingconsumers.html>.

## *PUBLICITY AND AWARENESS*

A scheme should engage in publicity and awareness raising. This should be directed at both consumers and traders. By raising awareness of the scheme with consumers, it will help consumers become aware of their rights under the scheme, and let them know where to go to complain. Awareness raising and training is also important for traders to make them aware of their rights and responsibilities under the scheme, and to help them better deal with their customers.

## *INDEPENDENCE AND CONSUMER REPRESENTATION*

The scheme must be operated independently of the industry participants who are members of the scheme. This is essential to promoting consumer confidence in the scheme. One means of ensuring independence is to have equal representation by consumer representatives on the scheme's governing board.

As with consumer participation in the development of the scheme, consumer representation is essential in ensuring that all issues are considered, and that the scheme continues to deliver outcomes that encourage consumer confidence.

## *ENFORCEMENT AND SANCTIONS*

An effective scheme will provide for rigorous and appropriate enforcement to ensure compliance by scheme members, including disciplinary procedures with a range of sanctions against non-complying members. Effective sanctions can raise the level of credibility and consumer confidence in a scheme.

As discussed above, there must be incentives for members to join and comply with the scheme. This will mean that sanctions have teeth, as members will lose their competitive advantage if they simply withdraw from the scheme when faced with adverse sanctions/consequences.

Sanctions must be scaled so that they do not lose their threat. For example, if expulsion is the only sanction available, members may feel that they are able to indulge in minor breaches of the rules, as they will not be hit with expulsion. A range of sanctions must be available to deal with all kinds of breaches.

Sanctions and disciplinary proceedings should also be published. As the scheme is a source of competitive advantage as a way of differentiating members from the rest of the industry, consumers need access to information about scheme members and their compliance with the scheme rules.

## *COMPLAINTS RESOLUTION*

While enforcement by the scheme administration body and sanctions for non-compliance act to deter future conduct by industry participants, the scheme must also consider redress for individual consumers who have been harmed by scheme members.

As a minimum, the scheme should require members to adopt internal complaints handling processes to deal with consumer problems fairly and in a reasonable time. If

a consumer is dissatisfied with the business's internal processes, the business should provide the consumer with information about how to access other avenues of redress, such as an external complaints resolution body or the Disputes Tribunal.

Depending on the objectives of the scheme and the nature of the industry, it may be appropriate for the scheme to include a complaints resolution body to provide appropriate redress for consumers when scheme members breach the agreed standards of behaviour. The need for a complaints resolution scheme cannot be judged solely on current complaints in the industry. For example, the number of complaints may be low if it is difficult for consumers to complain, or they don't think it is worth complaining.

The form of the complaints resolution body will depend on many factors, including the size of the industry, the extent of problems in the market, the complexity of complaints, etc. At the more interventionist end of the spectrum, the scheme could provide for an external dispute resolution scheme. This may be appropriate where businesses are dealing with a large number of complaints and/or dealing with complaints of a more serious nature.

Regardless of its scale, the complaints resolution body should be designed in accordance with the principles of accessibility, independence, fairness, accountability, efficiency and effectiveness.<sup>15</sup>

**Discussion questions:**

What operational processes (eg administration, monitoring, review, etc) lead to effective industry-led regulation?

What enforcement processes lead to effective industry-led regulation?

What types of sanctions are necessary to ensure effective industry-led regulation?

What types of complaints resolution processes are necessary to ensure effective industry-led regulation?

Does the framework incorporate all the elements necessary to describe the operation of a scheme which are conducive to effective industry-led regulation? What other elements should be considered?

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<sup>15</sup> Benchmarks, <http://www.consumersonline.gov.au/content/SelfRegulation/benchmark/>.

# EVALUATION TEMPLATE

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## ***Market structure and industry circumstances***

Describe the structure of the market:

1. What is the size/scale/scope of the market?
2. Who are the key players in the market (firms, consumers, government)? Do these key players have a role in the scheme?
3. Is there a strong industry association and/or code champion to coordinate action and drive development of the scheme?
4. How widely does the scheme cover the industry, eg number of participants, proportion of market share, etc? Is the industry association representative of a large proportion of the industry?
5. Is the industry cohesive, ie characterised by common interests, such as similar relationships between firms, customers and suppliers?
6. What is the level of competition in the market? What effect does the scheme have on competition and innovation in the industry?
7. At what stage is the industry – is the market mature? Is it a new industry which is trying to build confidence in the industry?
8. What is the extent of market failure or potential harm in the industry? Is there a risk of serious harm to consumers, eg public health and safety?

Describe the benefits to industry and consumers of participating in the scheme:

9. What incentives, in the context of the market and industry circumstances, does the scheme provide to encourage firms to join and comply?
10. What additional benefits does the scheme provide to consumers above those already available in law?
11. Does the scheme recognise members' relationship with the wider community/social responsibility? How?

## ***Content of the scheme***

Describe the type of scheme adopted:

12. What are the objectives, purpose and scope of the scheme? Is this clear from the scheme documentation?
13. Does the scheme provide clear rules setting out the rights and responsibilities of all parties? Are the rules flexible?
14. Do the rules reflect the objectives of the scheme?

15. Are the rules accessible and easily understood by all parties?

16. Is the type of scheme suited to the industry and the market?

Describe how the scheme was developed:

17. Who was responsible for development of the scheme?

18. What consultation process was undertaken in the development of the scheme? Were all relevant parties (consumers, industry, government, regulators) consulted?

19. What issues were identified during consultation? Were these issues appropriately considered in the development of the scheme?

### ***Operation and enforcement of the scheme***

Describe how the scheme is administered and monitored:

20. Does the scheme have a body for administration and monitoring? Is the administration and monitoring body adequately resourced?

21. How is the scheme's governing board constituted? Is the board independent of participating firms and the industry?

22. Does the scheme set out performance indicators against which it can be reviewed and monitored, eg the ongoing level of consumer satisfaction with the scheme, the behaviour of scheme members and the industry as a whole?

23. Are results of the monitoring published? How often?

24. Does the scheme engage in publicity and awareness raising, for both consumers and traders?

Describe how the scheme is enforced:

25. Does the scheme include procedures for disciplining non-complying members?

26. Are there sanctions to deal with behaviour of scheme members? Is there a range of sanctions to deal with different levels of non-compliance? Do the sanctions have teeth?

27. Are sanctions and disciplinary proceedings published?

Describe how the scheme assists resolution of consumers' complaints:

28. Describe the nature of consumer complaints in the industry, eg number, complexity, etc. Are existing complaints resolution mechanisms adequate/appropriate to address consumer complaints?

29. Does the scheme require members to have a fair internal complaints handling procedure?

30. Does the scheme include a complaints resolution body which is independent of participating firms and of the industry?
31. Is the size and scale of the complaints body appropriate to the type and number of complaints received?
32. Is the complaints resolution body accessible, independent, fair, accountable, efficient and effective?

**Discussion questions:**

Does the evaluation template accurately capture the issues in evaluating effective industry-led regulation?

Are additional questions necessary to elicit information that would be important in evaluating the effectiveness of a scheme? Are some questions unnecessary?

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