'The future of regulation is culture': opportunities to change unethical behaviour in business and public administration in Brazil*

‘O futuro da regulação é cultura’: oportunidades para mudar comportamento antiético nos negócios e administração pública no Brasil

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ABSTRACT

Isolated application of the deterrence theory isn’t enough to solve most of the problems regarding unethical behavior in business and enterprises, as demonstrated by some works cited in the text. If that were the case, Brazil, a country marked by the vigorous application of such theory, as shown by the traditional application of Brazilian legislation, would not suffer from recurring problems of corruption, such as those denounced by the “car wash” operation, “Petrolão”, etc. Differently from this traditional approach, recent studies presented in the body of this article, based in the behavioral science, show that deterrence is frequently ineffective in affecting future behavior, which conducts enterprises to a “compliance trap”: a false belief that the merely institution of compliance policies would reverse the current ethical crises. The thesis of the article is that such change requires the adoption of an ethical culture, which concerns a switch in regulatory approach, able to modify the nature of law enforcement, but also the engagement of enterprises, it’s directors and collaboratives with this culture. The article also confronts evidence based on behavioral science and recommended by international bodies (such as the OECD) with recent legislative changes in Brazil (in particular the new LINDB and the Economic Freedom Act) that expand the strength of consensus between Public Administration and individuals.

KEYWORDS


RESUMO

A aplicação isolada da teoria da dissuasão não é suficiente para resolver a maioria dos problemas relacionados com o comportamento antiético nos negócios e nas empresas, como demonstrado por alguns trabalhos citados no texto. Se assim fosse, o Brasil, país marcado pela aplicação vigorosa dessa teoria, como se denota pela tradicional aplicação da legislação brasileira, não sofreria problemas recorrentes de corrupção, como os denunciados pela operação “Lava-jato”, “Petrolão” etc. Diferentemente dessa abordagem tradicional, estudos recentes apresentados no corpo do presente artigo, baseados na ciência do comportamento, mostram que a dissuasão é frequentemente ineficaz em afetar o comportamento futuro,
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o que conduz as empresas a uma “compliance trap”: falsa crença de que a simples instituição de políticas de compliance reverteria a atual crise ética. A tese do artigo é a de que essa mudança requer a adoção de uma cultura ética, que envolve uma mudança na abordagem regulatória, capaz de modificar a natureza da aplicação da lei punitiva, mas igualmente o envolvimento de empresas, seus diretores e colaboradores com essa cultura. O artigo também confronta as evidências baseadas na ciência do comportamento e recomendadas por organismos internacionais (como a OCDE) com as recentes mudanças legislativas no Brasil (em especial a nova LINDB e a Lei da Liberdade Econômica) que ampliam a força da consensualidade entre administração pública e particulares.

PALAVRAS-CHAVE
Setor regulatório — compliance trap — teoria da dissuasão — cultura ética — ciência comportamental.

1. Introduction

The “Operation Car Wash” corruption investigation, environmental and labour disasters at Brumadinho and Mariana, fire at the Flamengo Training Center, endemic corruption at Petrobras and other state spheres, misappropriation of funds in the Public Company Pension Funds, tax fraud in the pharmaceuticals sector, 60,000 people killed in traffic accidents and more than 60,000 murders per year, and so many other examples are clear signs that the Brazilian State (at a Municipal, State and Federal level) is failing to regulate itself and the private sector properly.

There are many factors that have contributed to this situation, including the failure of the country’s regulatory system, which is based on the inefficient mechanism of increasing the penalties set out in the laws, disregarding and not applying the most modern regulatory methods applied in the world.

In addition, many Brazilian and international companies that established a presence in Brazil did not cultivate ethical values in their organizations, eventually allowing corruption to spread across many of their departments and operations. Many of the dozens of companies investigated under “Operation Car Wash” had in Brazil and in numerous other countries around the world complex compliance systems that were in place and supposedly
functioning correctly. It is curious that such systems did not prevent what happened.

This article aims to bring some reflections on more efficient ways to operate the regulatory sector and how companies can change the level of ethical behaviour that determines their performance and reputation. To this end, the article confronts the practices commonly adopted in the relationship between the regulatory activity in Brazil and the regulated companies, as well as the prevailing legislation, in order to propose the respective strengthening of consensus, as has been defended by studies of behavioral science and by some government authorities and by non-governmental entities, such as the OECD.

2. Shifts in theory, policy and practice on regulatory enforcement and design

A clear shift is occurring in understanding of how to affect the future behaviour of corporations, in other words, how to regulate. The historical approach is based on a theory, namely that of deterrence, whereas the new approach that focuses on the culture of organisations is based on the science of human behaviour and on empirical evidence.

The historical approach has been to make rules and to take enforcement action against breaches of rules on the theory that such enforcement will deter future breaches. It is assumed that the promulgation of the rule and any subsequent individual actions of enforcement that may occur will cause complete compliance. Those assumptions have, however, been significantly demolished by the reality of empirical evidence. Trying to ‘regulate’ people solely by rules, and imposing sanctions for breaches of rules, misses the point — it will never work well enough. It is always reactive (backward-looking, responding to historic behaviour) rather than engaging with how to affect future behaviour.

Brazil is a good illustration of the above approach, as there have been laws and heavy penalties against corruption and fraud since the 1890 Penal Code, with numerous other laws created over the following decades such as the 1940 Penal Code, Law 1.079/1950, Law 4.717/1965, Law 8.112/1990, the Administrative Improbity Act of 1992 and the Public Procurement Act of 1993. As if these laws were not enough, numerous other laws were created with increased levels of penalties, such as laws against trafficking of
influence in 1995; against money laundering in 1998; against tax and financial crimes in 2000; against crimes committed by individuals in relation to foreign public authorities in 2002; against criminal organizations in 1995, 2001 and 2013 as well as many others. This quantity of laws and penalties has not been able to prevent the tragic unethical and illicit acts that have come to light in Brazil’s recent history. The daily headlines of Brazilian newspapers in the last four years have been dominated by the following eight letters: Lava Jato (“Operation Car Wash”). But not many years earlier, the scandals were “Monthly”, “Leech”, “Post Office”, “Banestado”, “Precatory, Draft”, “Budget Dwarves”, “TRT/SP”, “Bingos”, etc. In an informal survey, it was revealed that in the present decade the print and television media has covered 104 corruption scandals compared to 64 in the 2000s, 30 in the 1990s, 17 in the 1980s, 18 in the 1970s, and 8 in the 1960s.¹

Admittedly, the sense that institutionalised corruption is taking place in Brazil cannot be said to be recent. When Transparency International launched its corruption perceptions index in 1995,² Brazil was already among the lowest ranked countries (37 out of 41 countries surveyed, with an index of 2.7), indicating that it was among the countries with the highest perception of corruption of the world. In 2006 perception improved, with an index of 3.3 but Brazil ranking was still worryingly low (70 out of 163 countries).³

To try to change this scenario, today there are several bills in the Brazilian Congress increasing penalties and creating new types of criminal and administrative infractions, demonstrating that complete faith in the deterrence theory still persists in Brazil.⁴

The theory of deterrence has loomed large in legal philosophy and in economic theory. But there is now a considerable volume of evidence that challenges the assumption that imposing sanctions has much effect on the future behaviour of humans individually or in groups. Some of the main areas of evidence are:⁵

³ Transparency International, Corruption perceptions index, op. cit.
⁴ Recent Anti-corruption Bill (PL 882/19), pending approval by the Câmara dos Deputados is synonymous with this concept.
a) Extensive empirical evidence shows that the imposition of sanctions in order to affect future behaviour (deterrence theory) often has little effect on future behaviour, whether in a public or private enforcement context. Deterrence is essentially now based on classic economic theory; but that classic theory of rational cost calculators has been significantly undermined by behavioural science (behavioural economics, nudge).

b) Extensive research findings from behavioural psychology and the study of group behaviour show that people are not the ‘rational actors’ in making decisions portrayed by pure economic theory, that deterrence is frequently ineffective in affecting future behaviour, and that the imposition of disproportionate sanctions against people who think that they are trying to do the right thing (since the vast majority of corporations that do not have essential purposes that are not anti-social or criminal) produces an effect on compliance that is counter to that intended and a lack of respect for the enforcer and the law generally.

c) The behavioural evidence underpins approaches that many regulatory authorities have evolved to spontaneously in how to affect the behaviour and compliance of businesses. A study of the enforcement policies and practices of a significant number of UK regulatory authorities has shown that many do not use deterrence. The regulators that are effective are those who have—and use—a ‘front end’ (ex ante) regulatory structure, which they use to develop an adult-to-adult ongoing regulatory relationship with businesses. They have changed the regulatory relationship and aim to support businesses who have demonstrated that they wish to improve. They retain a wide toolbox of enforcement powers, and select appropriate tools for use depending on the behaviour of the organisation and people in question. This evolution is supported by the UK Cabinet


Office’s model of ‘regulated self-assurance’, as a matter of the future direction of travel of all national regulatory policy. The Organization for Economic Co-Operation and Development (OECD) is not far behind in major shifts in thinking.

The traditional approach based on the theory of deterrence remains entrenched in some parts of the world and some sectors. One consequence of this thinking leads to a ‘Compliance Trap’. Leading United States enforcement authorities have forced corporations to create or expand internal compliance departments that operate complicated and onerous reporting and monitoring procedures and processes. Much of the practice of what is now a compliance industry operates as a barrier to achieving ethical culture and compliance rather than the converse. The main output of a compliance

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function in a business is to buy a lower penalty when the corporation is prosecuted by the authorities. It is not to achieve compliance, nor will it normally be able to do so.

This situation has been widely seen in recent years in Brazil, especially since the Anti-Corruption Law, which considers the existence of a compliance system as one of the factors for reducing penalties in case of wrongdoing. The Comptroller General’s Office in Brazil has strongly recommended the adoption of integrity structures and policies, certifying those that meet their recommendations and publishing guidelines which in accordance with Decree nº. 8.420 / 2015 sets out 16 assessment parameters.8

Prior to these laws, most large Brazilian companies published codes of ethics in their organizations, as well as providing lectures on how to act ethically in compliance with legislation. However, in practice, companies have rarely organized themselves to implement integrity procedures and lack real tools to educate and monitor their employees and partners. These efforts were largely ineffectual and often contradicted by the argument that in Brazil relations with the government were historically corrupt, as shown by the revelations in Operation Car Wash. By way of example, the testimony of Joesley Batista (owner of the largest meat processor in the world — JBS) to Época Magazine, explaining that his obscure dealings with politicians were:

The Rules of the Game. (...) corruption is in the power, to which we Brazilians are subordinates. When you find yourself within a ministry, dealing with a minister who is your authority, talking about illicit money, you begin to find it normal. Over time, you lose track of what is right and what is wrong, what is legal and what is illegal.9

It is important to note that there were at least 48 companies involved in Lava Jato of which 36 were Brazilian and 12 multinationals. Many of

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these companies already had integrity systems in place when they started operations that were investigated under Operation Car Wash. Furthermore, a number of control bodies such as Tribunal de Contas da União (TCU) and Controladoria Geral da União (CGU), regulatory agencies, the Federal Prosecutor’s Office, and the judiciary have been working hard over the last 20 years fighting irregularities, imposing heavy penalties on infringing companies and managers.

It can be stated without doubt that it was not due to the lack of legislation, control and regulatory bodies, or compliance systems being implemented in companies that serious illicit conduct occurred in the public and private sectors of Brazil. So a different approach is needed.

A seismic transformation is, in fact, under way. The new approach is based firmly on behavioural science, i.e. how people actually behave, rather than on theories.\(^{10}\) The new more sophisticated approach is to rely on evidence that an organisation intentionally strives for an ethical culture, namely that the people who comprise the organisation consistently behave in an open manner in trying to do the right thing all of the time. An ethical culture is a product of the values put into practice by all those who comprise the organisation, beginning with the leadership. It will be more likely to be produced where such the organisation has a clear and strong social purpose and where managers lead by example and all staff consciously strive to put their ethical values into effect in all that they do. This requires alignment of purpose, values, structure and processes, including incentives.

Firm enforcement remains required as a response to deliberate (criminal) wrongdoing. But the majority of people go to work to behave well. They may break rules inadvertently, by being influenced by particular goals rather than others. For example, group and personal influences that incentivise reaching sales or profit targets, or safety precautions that impede action, or desire to maintain confidence in reputation and stock price, may all lead to breaking rules by otherwise honestly-motivated people.\(^{11}\)

The switch in regulatory approach marks a fundamental change in the nature of law enforcement and the method of encouraging good behaviour amongst members of society:


The law focuses to a considerable extent not on creating a positive code but on things one should not do, and on the problems that arise when things go wrong. So it limits its ability to have a positive influence on behaviour, and can lose sight even of the existence of positive behaviour, and the means of promoting the normal position that the considerable silent majority of people in an ethical democracy observe most of the rules most of the time on a daily basis. Law is always trying to catch up. By focusing on problems—criminal behaviour or regulatory non-compliance—legal and economic thought have gone down blind alleys. (...) Compliance with the norms of a social system is produced by ethical values and systems. It is not produced directly by rules (laws) and their enforcement. Systems can be risk-based, but behaviour is value-based.¹²

Brazil, like many other countries whose legal system has its origins in the Napoleonic and Romano-Germanic systems, due to the logic of the principle of legality, always had to rigidly apply its administrative law, that is, if any regulatory authority identified a violation of a rule, it would apply the penalty provided for in the legal rule, with very little room for discretion. Although there has always been some space for discretion in decision making based on common sense (principles of reasonableness and proportionality), the situation described above caused innumerable uncertainties for honest civil servants who wanted to act intelligently and proportionately taking into consideration the specific facts of the case, because of heavy punishments often applied to them by external control bodies where laws are not applied precisely as written.¹³

However, in recent years, the rigid structure of Brazilian law has been attenuated through the consolidation of principles such as reasonableness,
proportionality and administrative efficiency, and in particular with the enactment of Law no. 13.655 / 2018, called the Law of Legal Certainty, which requires analysis of the adequacy and necessity of measures imposed for the invalidation of acts or contracts (Art. 21), as well as providing the necessary conditions for their proportional and equitable regularization, without imposing on the parties involved abnormal or excessive burdens or losses, and taking into account the aggravating and attenuating circumstances and the previous behaviour of the agent (Art. 22). The same law also introduced the possibility of irregularities to be corrected by consensus among the interested parties, seeking proportional, equitable, efficient and compatible solutions considering with the wider public interests (Art. 26).

There is also the brand new Law 13,848, published on June 25, 2019, called the New Law of Regulatory Agencies, which, in addition to expanding the independence and autonomy mechanisms of the Brazilian Regulatory Agencies, provides that they should act with appropriate adequacy considering the means and ends of their actions (Art. 4), institutionalizes the Regulatory Impact Analysis (Art. 6) for their normative acts, and provides for the possibility of concluding agreements with the regulated entities to adjust their conduct, suspending any sanctions that may otherwise have been applied (Art. 32).

Based on these new express Brazilian legal provisions, it is expected that the old rigid models of the application of the exact letter of the law will make way for more collaborative and consensual models, enabling the implementation in Brazil of Ethical Business Regulation (EBR) and Ethical Business Practice (EBP).

3. A short summary of EBP & EBR

These various streams of evidence have been collated into the concepts of Ethical Business Practice (EBP) and Ethical Business Regulation (EBR). These concepts can transform not only the observance of society’s rules but also enlist powerful support for going beyond compliance (achieving consistent performance and improvement) that can drive business growth.

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The key concepts are focusing on ‘doing the right thing’ by a holistic approach to creating an effective ethical culture based upon values and consistently reinforcing and applying those values. Constructive inquiry through conversations to determine what is the right thing to do underpins the approach, as does fair, honest and open feedback, without seeking to blame, for continuous improvement.

Organisations should focus on leadership and culture as well as designing their ethics and compliance frameworks and desired behaviours to produce evidence that shows that they can be trusted — EBP. We describe the components of a generic framework that support EBP; however, each organisation must consider how to adapt these components, depending on their particular values, situation and risks. There is no one culture or set of values that will guarantee compliance in every organisation, indeed perfect compliance is likely unobtainable. The process of developing the elements of the framework itself is an important contributor to the outcome. Relevant evidence should come from all stakeholders, including staff, suppliers, customers, investors, society and regulators.

An outstanding example of the establishment of a cultural approach by organisations throughout a sector is that of civil aviation safety. The key concepts are an ‘open culture’, in which everyone engages constantly by feeding back data, asking questions of themselves and others, and challenging assumptions, and a ‘just culture’ in which people are accountable for the open culture and for the tasks for which they are responsible, and action will be taken for breaches of trust. The focus has shifted from ‘that person did something blameworthy’ to ‘why would any human behave like that in those circumstances so how can we reduce the risk of recurrence?’. It is critical that blame is removed from the general culture. Both an open and a just culture have to apply consistently throughout all parts of the system. The outcome of this approach is that commercial air travel is extremely safe.

EBP can be seen as the next step for many business sectors, given a rise in transparency and the need to maintain market reputations, and requirements such as sustainability/corporate social responsibility (CSR), environmental protection (ESG) and UN requirements on human rights in supply chains.

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Elements of EBR can be identified in the approach of a wide range of regulators, such as pharmaceuticals, medical devices, health & safety, environment, energy, food and the UK’s Primary Authority scheme.

A number of pilot studies are currently underway or about to start, including:

- Cornwall Council and a hospitality group.
- The setting of prices between Water Industry Commission for Scotland and Scottish Water.
- Retirement homes in Ontario.
- The approach to water quality engendered by the Drinking Water Inspectorate in England.
- The framework of approaches to safety of chemicals, nuclear, and consumer protection in Finland.

The Essential Services Commission of South Australia (Escosa) has signalled to utility suppliers and consumers that it wishes the approach to evolve to a model based on EBR culture. This development is merely a continuation of its current key strategic goals, which are:

- Engaging openly, transparently and genuinely with our stakeholders, at all times;
- given rapid changes in the industries we regulate, ensuring that our regulatory frameworks are responsive and fit-for-purpose over time;
- a better regulation approach, which identifies problems and, through transparent processes, identifies appropriate solutions—including non-regulatory responses, and;
- strong regulated entity performance, facilitating accountability and engagement to their customers.

4. Regulating by purpose and aligned values and culture

The point is to expect that businesses will have a clear social purpose, and that the values and behaviours of the people who work in them will be ethical and support the achievement of that purpose, thereby indicating the presence of an ethical culture.

An ethical operation (business or government) will seek to identify and respond to a regulatory problem (whether it has led to non-compliance or not) by taking the following steps (not necessarily in this order):

1. Constantly monitor all relevant sources of information to identify problems. This includes aggregated data fed back from staff, customers, suppliers, regulators, consumer groups, communities, investors and others.
2. Stop any continuing harm.
3. Apologise and explain the cause and the corrective steps taken to those affected.
4. Investigate the root cause of the problem, involving internal, external and regulatory expertise.
5. Implement steps to prevent recurrence (reduce future risk).
6. Rectify any harm caused (redress or repair).
7. Agree any proportionate sanctions with regulators.
8. Monitor the situation to see if further modifications are needed.

These steps will be automatic in entities that have an effective ethical culture. They will be actions that also demonstrate that culture. Operations that adopt this approach deserve appropriate responses from others, such as regulators. Hence, enforcement policies should be based on distinguishing between entities that demonstrate evidence that they can be trusted and take their responsibilities seriously, and those that do not.

Many UK regulators have been enabled to switch to this sort of responsive ‘enforcement’ by having written enforcement policies that list the types of aggravating and mitigating factors that they will take into account in deciding what level of enforcement response they should take to infringements and what seriousness of sanction might be appropriate. In some cases, a business that takes all of the above steps and, for example, voluntarily makes redress payments to customers, staff or suppliers, or to repair the environment, has been considered to deserve no extra financial sanction. Implementation will, of course, be monitored and breach at that stage can be regarded as serious.

In Brazil, the Comptroller General’s Office (CGU), under Decree 8.420 / 2015 (Arts. 17 to 23), for cases of corruption and fraud, has tried to improve its activity in the sense discussed above, presenting evaluative criteria that may reduce administrative sanctions provided for in Law no. 12,846/13 (between 0.1% to 20% of the company’s annual gross revenues). The current mitigating factors are: non-consummation of the infraction; evidence by the company of compensation for the damage caused; degree of company collaboration;
spontaneous communication of the illicit act by the company; and existence of an integrity program.\textsuperscript{17}

In spite of important developments, it is noted that in Brazil there is still a need to evaluate the past more than to plan for the future to avoid recurrences of illicit behaviour.

If the motivation for the harm is intentional (i.e. the wrongdoing is criminal) then strong public sanctions will be entirely appropriate. That is clearly now a rare occurrence in aviation safety. In other situations, it is important for responses by regulatory authorities, employers, professional bodies, the public and the media accurately distinguish between ethical and unethical motivations in responding to harm, and do not seek to blame, or impose deterrent punishment on people who were trying to do the right thing.

Many Brazilian companies have committed serious wrongdoing in the past; however in light of recent developments their shareholders and key executives have realised that this type of behaviour is no longer acceptable or sustainable. They will see the benefits of working in a different business environment where relationships are based on openness and fair competition and the public sector provides legal certainty for companies to develop based on their own skills and resources. Although the enforcement of the law has made an important contribution to fighting corruption in Brazil, the creation of a consistently healthy business environment now depends on spreading the right business culture and developing corresponding regulatory schemes that are more effective and approachable, so that the private and the public sectors can work together.

Past misconduct must be rectified and society should be compensated where victims can be identified and damage proven, but in the logic of EBR, authorities should be forward looking, trying to help those who made mistakes not to repeat them, considering that what we saw in Brazil were not isolated cases of one or two unethical companies; rather it was a systemic network of institutionalized corruption maintained at the highest levels of the Executive and Legislative Power, pervading public agencies and state-owned companies, engulfing Brazilian and international companies who tried to do business here in Brazil.

The paradigm shift needed will unquestionably require firm action by the regulatory authorities, and at the same time they must be open to improve

\textsuperscript{17} Brasil, \textit{Manual prático de avaliação de programa de integridade em PAR}, op. cit.
their own culture and processes. In addition, regulators must be capable of understanding which companies are committed to and have managed to change their culture and are willing to collaborate to assist in the joint implementation of the new ethical business environment in the country.

5. The spread of culture in corporate governance

Realisation that (social) purpose, (ethical) values and (ethical) culture are the central issues for human activities has been identified by leading scholars and is appearing in requirements on corporate governance. A major driver has been the realisation that the goal of maximising profits produces a short-term focus that is economically unstable and that a policy of long-term sustainability is required. Colin Mayer has shown that the historically consistent requirement for corporations is that they have an inherent social purpose. Mayer cites evidence of a positive relation between employee satisfaction, corporate cultures of integrity, and stock returns, at least over the long run. He argues that shareholder value is an outcome, not an objective. The idea of Conscious Capitalism connects all stakeholders—staff, suppliers, customers, regulators, communities, investors—and necessarily takes their needs and interests into account.

These themes are appearing in corporate governance requirements. The G20/OECD Principles of Corporate Governance state: “The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial

stability and business integrity, thereby supporting stronger growth and more inclusive societies”.25

The UK Corporate Governance Code was amended 2018 to refer to a company’s culture, which it said should promote integrity and openness, value diversity and be responsive to the views of shareholders and wider stakeholders.26 It stated the following Principles:

1. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

2. The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

The UK economic regulatory authority for water has inserted similar requirements on purpose, strategy, values and culture into its licence conditions.27

In the same vein, in recent years in Brazil has seen an intense debate among various business and government sectors regarding the best methods to be adopted by companies in order to deliver a positive return to shareholders alongside continued and sustainable success. In reference the OECD, the Brazilian Institute of Corporate Governance (IBGC) updated its, already respected, Code of Corporate Governance Best Practices 200928[1], at the end of 2015, aiming to recommend best practices to achieve the following goals:

(... ) the IBGC presents this document to society, in the hope that its changes and innovations will make the Brazilian corporate and

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institutional environment more robust, fair, responsible and transparent. We hope that the recommendations contained herein contribute to the creation of better governance systems in corporates, aiming for good performance and longevity. (...) In this new environment, ethics becomes increasingly indispensable. Honesty, integrity, responsibility, independence, long-term vision and genuine concern with the impacts caused by their activities are fundamental to the lasting success of organizations. (...) An ethical deliberation is one that considers, throughout the decision-making process, both the identity of the organization and the impacts of decisions on all its stakeholders, society in general and the environment, aiming at the common good.  

The Brazilian Bar Association (Minas Gerais division) and the Minas Gerais Institute of Capital Markets (IMMC) have recently published a Compliance Guide for Brazilian Organizations, also recommending it for “management of state-owned enterprises.”

In 2018, International Chamber of Commerce Brazil (ICC) and Deloitte conducted an interesting survey on the evolution of corporate integrity in Brazil and the development of 211 companies, from various sectors of economic activity, reaching the following key conclusions:

1. In general, the companies surveyed demonstrated a consistent evolution in the adoption of the 3 compliance practices researched. Between 2012 and 2014, only 24% adhered to these practices; between 2015 and 2017, this percentage reached 46%, with the prospect of reaching 65% by 2020. (...) However, it is observed that there is still room for growth in the implementation of compliance measures among the surveyed companies, given that only two thirds are projected to be in the adoption phase of at least 15 of the 30 compliance practices surveyed by 2020.

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29 IBGC, Código das melhores práticas de governança corporativa, op. cit.
2. Compliance has a positive impact on financial results. The contribution of compliance to financial results is understood and accepted by the vast majority of surveyed companies: 84% recognize this correlation.

3. Among the most widely adopted practices by companies are: compliance indicators, “tone from the top” (senior management’s commitment to implementing good practices), conducting internal investigations, financial controls, the implementation of a whistle-blowing hotline and the introduction of a code of ethics and conduct.

4. The main challenges identified by the companies are how to effectively increase the reach of compliance, how to monitor third parties and daily activities in real time.

Some general conclusions were reached in a 2018 survey of 106 companies conducted by Transparency International Brazil. It was observed that the number of Brazilian companies disclosing their anti-corruption programs is higher than the average for companies in other emerging markets; and publicly traded companies are more adherent to good governance practices than private companies (but both public and private have room for improvement).32

In spite of these positive developments, it is now clear that the implementation of compliance systems alone does not secure the necessary cultural shift towards integrity, openness and trust. However, after the introduction of the Clean Companies Anti-Corruption Law in 2013 and all the developments discussed above, Brazilian companies not only began to understand the importance of adopting compliance systems to mitigate the immediate risks relating to criminal acts, bribery, bid-rigging and competition offences, but also have gradually broadened their vision in relation to the potential benefits in creating an honest and transparent culture that meet the needs of regulatory agencies, their own employees, business partners, consumers and society in general.

This increasing awareness, combined with recent experiences with consensual administrative solutions, such as leniency agreements, underpinned by more flexible legal frameworks, creates a unique opportunity to explore how EBP and EBR can help Brazil to improve its standards of integrity and regulation, and the relationship between the private and the public sectors.

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There is a wealth of information and techniques, in Brazil and abroad, to help companies adopt ethical and transparent models of organization and governance, which will facilitate good relations with the regulatory sector. If this is well understood by both sides, there is potential to work collaboratively towards this common goal.

6. The policy objectives for markets and regulation

If one looks at a legal system as a problem-solving mechanism,\textsuperscript{33} the following basic objectives emerge:

- To establish clear rules.
- To support the achievement of compliance and ethical behaviour and culture.
- To identify problems.
- To identify the root cause of problems, recognising that what we see may only be a symptom and not the cause that needs to be addressed to prevent recurrence.
- To support action to prevent recurrence and reduce future risk.
- Monitoring to see if the action has succeeded and if further action is necessary.

An expanded list of the functions that are needed across a legal system to achieve these objectives:\textsuperscript{34}

1. Establishing clear rules and their interpretation;
2. Supporting compliance;
3. Identification of individual and systemic problems, such as non-compliance or new problems that have not been catered for in the rules;
4. Decision on whether behaviour is illegal, unfair, or acceptable;
5. Cessation of illegality;
6. Resolving disputes;
7. Identification of the root cause of the problem and why it occurs;


8. Identification of what actions are needed to prevent the reoccurrence of the problematic behaviour, or reduction of the risk;
9. Dissemination of information to all who might benefit;
10. Application of the actions (a) by identified actors (b) by other actors, either voluntarily or with assistance in changing behaviour, systems or culture so as to reduce risk of reoccurrence;
11. Putting things right where harm has been caused, e.g. by making redress;
12. Imposition of sanctions;
13. Ongoing oversight to verify that the intended actions have been taken, and any consequential action to ensure this or sanction non-compliance;
14. Ongoing monitoring of actions taken and any necessary corrective amendment of the strategy.

The public authority responsible for delivery of these functions should have relevant powers to achieve each of them. These would include powers of making rules, monitoring, investigation, ordering certain activities to cease, ordering actions to be taken, ordering redress or rectification to be made, imposing sanctions, publicising facts and actions, and agreeing actions. Experience has shown that where these functions are approached holistically by both businesses and regulators, all relevant matters are dealt with by open discussion and agreement, rather than by formal use of the powers (enforcement).

A simplified illustration of these core functions (figure 1) shows that they form a continuous cycle of activities, akin to a quality system. It will be seen that this list of functions is more specific and practical than simply declaring or enforcing the application of law and hoping that things change. It seeks to engage mechanisms that are effective in achieving change. The principal purpose of the system is to prevent future problems (or infringements or harm) by using information from constant monitoring of activities so as to reduce future risk of the occurrence of the same or similar damage. Earlier versions of the list have been quoted with approval by the Irish Law Reform Commission\textsuperscript{35} and the Australian Law Reform Commission\textsuperscript{36}.


It is interesting to analyse to what extent legal systems include these functions, which bodies deliver them, and whether they are delivered efficiently and effectively. Some legal systems contain gaps in the list, and others do not function well as a whole.

Figure 1
The cycle of market regulation functions

Source: Professor Christopher Hodges.

In order to deliver the functions, regulatory authorities should have enforcement powers that include the following aspects from the long list:

2. Supporting compliance.
3. Identification of problems, from a wide range of possible sources and prompts, such as inspection, certification systems, market surveillance systems, voluntary reporting, data from Ombudsmen or other complaint data, tip offs, and so on.
5. Cessation of illegality requires a power to impose and injunction of suspend or withdraw a licence to operate.
and 11. Whilst a regulatory authority might not often be involved in dispute resolution, the use of powers to order an entity to effect redress in individual and especially mass cases can be highly effective.

7 to 10. Responding to an individual breach in a superficial way may fail to identify the root cause of a systemic or frequently occurring problem, so proper investigation and root cause analysis may be required.

In Brazil, after some discussion about whether Regulatory Agencies should be able to combine the powers: of creating norms and standards; inspection; sanction application; and the resolution of administrative disputes, the Federal Supreme Court resolved the debate by finding that such powers are compatible with the 1988 Brazilian Constitution.\textsuperscript{37} Most of the founding statutes of the Brazilian regulatory agencies gave them autonomy and independence to carry out this broad range of regulatory functions. However, in practice, due to institutional conflicts, organizational and procedural flaws, the Brazilian regulatory agencies have not been able to exercise their powers effectively.

Many regulatory authorities in the UK now possess powers to order, or seek a court order for, a defendant to make redress.\textsuperscript{38} This function of delivering redress is achieved regularly there, often without formal use of the power. A dramatic example is the change in Ofgem’s approach to sanctions. Its enforcement notices typically set out detailed arrangements on what businesses are going to do in generating change in their behaviour, usually with specific targets, which can be monitored. There has also been a transformative shift between imposing fines to overseeing payment of redress from 2010 to 2015, as shown in Figure 2.\textsuperscript{39} In 2014/15, redress represented 92.5% of the volume of remedies imposed, with £26.4 million being paid or made available to customers, £15 million in penalties, and £19.3 million in payments to charities or other third sector organisations in lieu of financial penalties.\textsuperscript{40} The increase in redress begins to build consumer satisfaction.

\textsuperscript{38} See Hodges and Voet, \textit{Delivering collective redress}, op. cit.
\textsuperscript{39} OFGEM. \textit{Allocation of voluntary redress payments in the context of enforcement cases}. Ofgem, 2016. p. 12.
\textsuperscript{40} OFGEM. \textit{Enforcement overview 2014/15}. Ofgem, 2015.
Regulatory authorities in some countries do not consider that it is part of their function to oversee the provision of private damages to those harmed. The change in approach by UK authorities occurred as a result of deepening consideration of their duty to protect consumers and their duty to maintain the market as having a level playing field. If one player obtains an illegal advantage, the playing field will be distorted and uncompetitive until the illicit gains have been removed and losses suffered by others have been restored, as illustrated in figure 3.\textsuperscript{41}

\textsuperscript{41} HODGES, Christopher. European competition enforcement policy: integrating restitution and behaviour control. \textit{World Competition}, v. 34, n. 3, p. 383, 2011.

\textit{Source: OFGEM. Allocation of voluntary redress payments in the context of enforcement cases. Ofgem, 2016. p 12.}
Since 2014 in Brazil, Anatel (National Telecommunications Agency) (Resolution no. 629 of 16 December 2013) has sought to create consensual mechanisms (known as Termos de Acertamento de Conduta — TACs) to correct the irregular conduct of a given regulated entity, promote redress for consumers affected and adopt measures to prevent future infringements. These measures have replaced the culture of mere application of penalties, generating a substantial reduction in the volume of fines, as shown in the attached graph and in the 2016 Annual Report:42

Figure 3
The level playing field and the effect of unlawful gains and losses


In 2016, the National Electric Energy Agency (Aneel), through Public Consultation, implemented a new methodology of inspection through the Declaration of Regulatory Self-Assessment and Operation Performance, in order to encourage the regulated entities to correct failures in compliance with regulatory rules in return for the non-application of penalties. As a very recent development, to date, there is no concrete data on the results achieved.

Although there is increasing awareness in Brazil, we are still far from achieving an efficient practical result for the application of collaborative regulatory models. The predominant conceptual approach of Brazilian regulators and authorities continues to be that of mandatory orders, control, punishment and the application of financial penalties. In the recent past, when a regulatory agency tried to better understand the issue and deliver an intelligent solution that could evolve and help change business practices, the Brazilian supervisory control agencies resisted such initiatives and threatened to punish regulators who tried alternative approaches. An instructive example is provided by Anatel in 2009, when it sought to implement more reasonable and proportional criteria for the application of financial penalties in its regulations. However, following an application by the Federal Public Prosecutor’s Office against this new approach by Anatel, the Court of Auditors
of the Union invalidated the provisions that attenuated the application of potential sanctions.43

Probably in response to this and to avoid controversy, the new Law on Regulatory Agencies, published in June of this year, included Art. 32 expressly providing that the agencies are authorized to enter into negotiated resolutions with regulated entities. Further, Art. 4 providing for the prohibition against disproportionate sanctions where this is contrary to the public interest. The primary effect of the new laws cited is that opens up myriad possibilities to better apply more sophisticated regulatory methods in Brazil.

7. Discussion

Regulators and governments must make a choice between continuing in a deterrence-based paradigm or a culture-based paradigm. In the former, the basic ideas are that compliance with rules is the sole objective and it is to be achieved as one would improve the engineering on a piece of machinery, by imposing corrective punishment as you go along. But important information is not openly shared, or therefore evaluated, so we do not learn or improve our performance. The cycle of things going wrong and sanctions are imposed just continues with no improvement. In the latter paradigm, information is shared, lessons are learned and corrections are applied. Problems will still occur, but they are identified and addressed earlier. The differentiating features of these two paradigms depend on the strength of purpose, values, blame and culture.

We argue that ‘regulating through culture’ is indeed the most effective tool. Seeking to affect future behaviour by deterrent punishment will not only not work but will condemn the entities in the system to continuing cycles of breaching rules and imposing major sanctions—without having much effect on the incidence of breaches or on achieving improved performance. In addition, it will continue to impose high “compliance” costs in terms of monitoring and reporting which are not justified by the outcome.

43 MARQUES NETO, Floriano de Azevedo; PALMA, Juliana Bonacorsi de; MORENO, Mais (Org.). Observatório do controle da administração pública: relatório de pesquisa bianual — o controle das Agências Reguladoras pelo Tribunal de Contas da União. Faculdade de Direito da Universidade de São Paulo, 2019. Disponível em: <www.academia.edu/38343645/Relat%C3%A7%C3%A7%C3%A7%C3%A9O_de_Pesquisa_-_Observat%C3%A7%C3%A7%C3%A5o_do_Controle_da_Administra%C3%A7%C3%A7%C3%A9o_P%C3%A7%C3%A7%C3%A3o_de_Ag%C3%A7%C3%A3es_Reguladoras_Pelo_Tribunal_de_Contas_da_ Uni%C3%A3o>. Acesso em: 3 set. 2019. p. 75.
There have been many statements within the financial services sector in the past decade that the culture of organisations is critical to compliance. But the implications of that proposition, and what needs to change, has not been widely understood. The UK Financial Conduct Authority’s 2018 discussion paper on culture begins by noting that in the 10 years since the financial crash, “record fines, increasing investigations and an expanding compliance industry” have failed to curb misconduct. It then asks: ‘Why? What have we not learned?’

The critical point is that it is not possible for regulators to impose or ‘regulate’ the culture of another organisation. Culture is indeed created within an organisation. This realisation is the essence of the EBP and EBR models. Organisations should decide if they wish to base all their activities on ethical values, and then work on demonstrating that they do so, building up evidence of this over time. All their stakeholders—staff, customers, suppliers, investors, regulators, communities—will respond to relevant evidence and treat the organisation accordingly.

Regulators can however encourage (or discourage) organisations that they regulate to adopt an ethical culture. It is inexact that regulators are able to ‘supervise culture’, but they can encourage financial institutions to improve it. Only the regulated organisations themselves can transform their cultures. There may be an understandable desire for policy-makers and regulators to determine what culture they think will cause people in financial entities to do the right thing, and then asking people whether they perceive them in their organisation’s culture. It would be more productive to find out what in the culture of a given organisation will support its individuals to do the right thing, and what will get in the way. By adopting a technique of asking people first to choose the values/behaviours they are experiencing day to day and then using the profile that emerges to conduct a series of facilitated conversations, people are engaged in a totally different way than if they were asked to answer a long questionnaire. By asking for what cultural values

46 Tools such as the Barrett Cultural Values Assessment tool are designed to do just this.
people desire to see in their organisation, management is given the beginnings of the answers to any issues existing in the culture so that the engagement is a positive learning experience rather than just a dispiriting exercise (if there are lots of issues) that also gives management information about what matters to their employees and staff, so that when they go about choosing the core values around which to design their cultural transformation they will know if the values matter to the very people who will have to live them.

It is not difficult to see the relevance for decisions of requirements to meet sales or profit targets, or of very large remuneration packages, especially if linked to achievement of financial targets (as opposed to targets about achieving social purpose or cultural values). It is also not difficult to see the effect of such incentives on organisational culture, although many other drivers of organisational culture can be identified.\(^\text{47}\)

### Conclusions

The real means of influence and control over behaviour is the presence or absence of an effective ethical culture throughout an organisation. The decision to consciously foster and the achievement of, an ethical culture can only come from profound support and leadership from within an organisation. The leaders have to believe in the necessity and the advantage for the organisation to be driven by well-chosen core values that are meaningful to its staff and to consistently demonstrate those values in their own behaviour. In that way they will and to engage and harness the commitment of all staff to an open and just culture. Culture works both for business success and observing the norms of society.

A series of systemic reforms may be needed to be able to work ethically and to remove impediments to doing that. Requiring quarterly reporting and maximising shareholder returns mean that the system is part of the problem. Sustainability can only come from long-term vision. Remuneration practices, in particular, will need radical reform. It will not be possible to demonstrate an ethical culture if remuneration remains built on (a) the theory that people work harder just for financial incentives, (b) agency theory (supposed

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\(^{47}\) Evidence has been available in Australia of the relevance of this approach: GENTILIN, Dennis. *The origins of ethical failures: lessons for leaders*. Routledge, 2016.
alignment of interests of owners and [only senior] staff), and (c) the idea that targets can be used as an excuse for paying some people large sums of money that are disproportionate to others in the organisation and to the views of people outside. Success should be rewarded (not incentivised), e.g. by awards or congratulations, or maybe by modest awards of shares to all, not just to some. Variable compensation, if used, should be based on criteria that related to purpose not just profit.

Various approaches are ineffective in achieving an ethical culture: the ‘three lines of defence’ concept, the compliance industry (internal police), a multiplicity of consultants who all have overly complicated, untried and expensive ideas about how to transform or measure culture.

There needs, of course, to be a clear response where people break rules, internally and externally. The underlying points are not that the rule was broken but why, and whether those who were instigators have abused others trust. A ‘just culture’ means that people know that a root cause analysis will determine why things happened, that people will be treated fairly (and so encouraged to speak up without being unfairly blamed), but that a ‘level playing field’ will be maintained for everyone, that will include serious sanctions on people who acted criminally and cannot be trusted.

It is an illusion that regulators can create an ethical culture within the entities that they regulate, or that deterrent enforcement will result in effective ethical behaviour and organisational cultures. Either of those may in fact undermine an ethical culture in regulatees.

Regulators should treat regulated entities as adults. They should be incentivising businesses to adopt a clear social purpose, and identify their core values and to strive consistently for an ethical culture consistent with that purpose. Regulators should also adopt the same approach themselves internally, and think about their own organisational culture and the forces that are driving it. They should invite discussions on what types of evidence will be helpful over time to demonstrate the presence or absence of ethical culture in those they regulate, and respond appropriately to evidence of the presence or absence of ethical culture in organisations.

Enforcement policies should be published that suggest elements of evidence as mitigating or aggravating factors that will be taken into account in decisions on enforcement and penalties by regulators and courts. Supervisory action needs to be transparent. It is fine to reach fair and proportionate agreements on what needs to happen in response to breaches of rules and of trust (such as owning up, identifying root causes, implementing agreed
actions, making redress, and monitoring to see if further changes are needed. But all the points agreed should be published so that they can be publicly scrutinised and monitored.

As demonstrated above, after the so-called Law on Legal Security and the new Law on Regulatory Agencies, there is, legally speaking, more space to establish in Brazil consensual and collaborative dynamics between public authorities and private entities. Some regulatory bodies are preparing to adapt their approaches and evolve their regulatory methods, just as companies are greatly improving their governance structures to respond to the reasonable and legitimate demands of regulators.

Culture change is a gradual process, and must be consciously and constantly nurtured by leaders. The benefits of cultivating an effective ethical culture are many and varied, and accrue not only to the organisation but also to the individuals within and to society in general.

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