
4. Identifying and Designing Options

The next step in undertaking an RIA is to identify and design options that can address the problem that has been identified. This step should ideally answer the question:

What policy options are you considering?

Once the market failure (or the problem to be addressed) is identified, and the scale of the problem in terms of its on various stakeholders is quantified to the extent possible using available data and information, the next step in an RIA process is to identify and design options for addressing the problem and achieving the regulatory objectives.

However, before identifying the options, policymakers should ask some key questions, which are discussed next.

4.1. Are there private solutions that address the problem/market failure?

It is important to carefully consider what might happen if the private market is left to resolve the situation on its own without government intervention. Private solutions can be preferable to regulation, because they avoid the compliance costs and distortions to incentives that arise from regulation. They also avoid the costs of establishing and monitoring a regulatory regime, and can be more flexible and adaptable to changing circumstances.

An option to address the problem may therefore be to do nothing, and allow private solutions to develop organically, to help guide the market back towards the efficient outcome. For example, warranties, online reviews, and consumer groups can lessen asymmetric information about product quality. Industry groups can help resolve market failures through self-regulatory mechanisms, such as voluntary certification and industry standards to indicate business quality.

Sometimes regulation ‘crowds out’ private solutions, preventing them from developing, so the assessment should look for any evidence that existing regulation has done this. It is also important to consider if regulation can facilitate private solutions, such as through clarifying property rights or lowering transaction costs to better enable market participants to resolve externality or information problems.

4.2. Is there a risk of government failure?

While governments are generally well-intentioned in addressing market failures to increase society's welfare, their incentives and limited information about various aspects of the market mean they can fail to achieve this - or can create unintended consequences from intervening. As a result, government intervention may inadvertently create a larger reduction in society's welfare than results from the market failure. For instance, RBI's regulatory interventions in the prepaid payment instruments (PPI) market, issued without an RIA, have adversely impacted market outcomes for PPI operators and consumers.

Governments may not have sufficient information to determine the optimal response to a market failure, because that information is dispersed across society and constantly changing. All these effects are examples of government failure, which skew outcomes away from those that are welfare-maximising. Any proposed regulation should also be assessed as to whether it creates a risk of government failure.

Elected members of government may also be seeking re-election while appointed officials may be looking to expand an agency's influence or budget, or being influenced by lobbying to put the interests of specific parties above those of society (that is, they may be subject to 'regulatory capture'). These forces can mean that despite best intentions, the incentives that policymakers face might lead to interventions that do not necessarily lead to an improvement in the overall welfare of stakeholders.

4.3. When to Start Designing Options

The timing of options identification is important. If options are developed too early, before the problem, and its underlying causes are properly understood, there is a risk that the resulting interventions will be misaligned with the actual policy need. Conversely, if options are developed too late—there is a risk that political or institutional preferences get crystallised—and the exercise risks becoming a mere justification of a pre-selected solution.

It is therefore important that no preconceived notions, preferences or biases are able to influence the option design process. The RIA can then genuinely inform decision-making rather than retrospectively rationalise pre-decided outcomes.

In practice, our recommendation is that regulators begin designing options only once three conditions are satisfied:

- First, the problem has been clearly articulated in terms of its causes (for example, information asymmetry, externalities, or market power) and its impact on various stakeholders.
 - Second, the objectives of intervention clearly define the problem or issue to be addressed and, where possible, measurable; and
 - Third, a credible baseline scenario has been established using available evidence and data.
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The baseline (no change or a no regulation scenario) is particularly important because it provides the counterfactual against which all options are to be assessed. The importance of sequencing is illustrated in the United Kingdom's Online Harms framework, where the UK Government first undertook a detailed articulation of harms in digital markets before identifying a range of options.

4.4. Policymakers should consider multiple options

It is important to consider multiple ways in which the identified issues or market failures can be addressed, and regulatory objectives can be achieved. A regulator must not limit its options to interventions it can make, but should also consider possible non-regulatory and co-regulatory solutions.

Regulation is only one among many possible instruments of public policy, therefore all plausible alternatives, including non-regulatory solutions must be taken into account.

The options identified should also include those with variations in stringency.

For instance, in order to address the problem of systemic risks to financial markets due to overleveraging, while different similar options may comprise capping leverage at different levels, other options can include imposing higher capital requirements, increased information disclosure and reporting, and strengthening monitoring and supervision to contain bad actors.

Different options will generate different distributions of costs and benefits across stakeholders, and may vary significantly in their effectiveness, efficiency, and feasibility. Only by comparing these options can policymakers identify the intervention that maximises net social welfare.

The “no-change” scenario should also be included as an option. This is because the costs and benefits of the options need to be compared with this no change scenario to determine whether benefits of the options outweigh their costs, if they do not and instead, the costs of an option are greater than its benefits, then an RIA can support the decision to not intervene and let the status quo continue.

RIA therefore can also help prevent unnecessary regulation as much as it helps design optimal and effective regulation.

For instance, in order to address the problem of overleveraging in financial markets, letting firms fail in a no-change scenario, which leads to freeing up of resources, should also be considered.

Different options may diverge along several dimensions. They may differ in:

- their likelihood of correcting the identified market failure
 - in the extent to which they impose costs on stakeholders
 - in their distributional impacts across different stakeholders, and,
 - in their administrative and enforcement requirements.
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For example, an information disclosure requirement may impose relatively low compliance costs but may be ineffective in addressing information asymmetry because consumers may lack the capacity to interpret complex information. Conversely, a price control option may be highly effective in addressing monopoly pricing but may reduce incentives for investment.

An example of this approach can be seen in the development of the **Consumer Data Right** framework in Australia, where the Australian Government evaluated a spectrum of options ranging from no action, to voluntary industry-led solutions to a comprehensive regulatory framework. The final decision was based on an explicit comparison of these alternatives.

Types of Options and the Regulatory “Menu”

An RIA should ensure that the range of options considered is sufficiently broad and diverse. There can be a temptation to default to a narrow set of familiar options—typically variants of command-and-control regulation—thereby limiting the scope for innovation and potentially overlooking more efficient solutions.

To help identify a diversity of options, stakeholder consultation and expert interaction can play a useful role. By opening up different options considered by the regulator to public scrutiny, it can also get feedback on other options it should ideally consider, to address the market failure and achieve the regulatory objectives.

Options considered should go beyond typical ‘Command-and-Control’ regulation

Traditional “command-and-control” regulation typically involves prescriptive rules specifying what stakeholders must do. While such approaches may be appropriate in certain contexts—particularly where risks of adverse outcomes are high—they are often inflexible and may impose unnecessary costs.

Several broad categories of alternative options are discussed below:

(a) Performance or outcome-based options

Performance or outcome-based regulation specifies the desired outcomes the regulator wishes to see, rather than specifying the means of achieving them. Stakeholders are given the flexibility to determine how to comply, which can reduce costs and encourage innovation.

For example, environmental regulation may require firms to meet emission targets without prescribing the technology to be used to achieve them. This approach has been widely used in jurisdictions such as the United States and the European Union. The OECD notes that such approaches “allow firms to identify processes that are more efficient and lower cost” than a more prescriptive regulatory regime, and also promote technological innovation.

(b) Information disclosure options

These aim to correct information asymmetries by improving the availability and quality of information to consumers, other market participants or the regulator. Examples of these are product labelling requirements and cost disclosure obligations.

A well-known example is nutritional labelling requirements in food markets, which aim to enable consumers to make informed choices. However, their effectiveness depends on behavioural factors, including the ability and willingness of consumers to process information. For instance, it has been widely recognised that consumers do not read lengthy labelling notices.

(c) Voluntary and self-regulatory approaches

Voluntary approaches to addressing the underlying problem can include industry-led codes of conduct, voluntary agreements, and self-regulation. These approaches rely on reputational incentives and peer monitoring rather than formal enforcement.

However, these rely on voluntary co-operation of all stakeholders to abide by the agreements.

(d) Co-Regulation

Co-regulation combines elements of self-regulation with formal regulatory backing. Typically, industry develops practice standards, but compliance is monitored or enforced by a public authority using varying instruments of sanction.

This approach seeks to balance flexibility with accountability and is often used in sectors where industry expertise is critical but enforceability is required to be strengthened.

(e) Behavioural interventions (“Nudges”)

Behavioural approaches draw on insights from behavioural economics to influence decision-making without restricting choice. These include default rules, framing effects, and simplification of choices.

The OECD highlights the growing use of behavioural insights as part of modern regulatory toolkits. For instance, automatic enrolment in pension schemes has been used in several countries to increase participation rates without mandating contributions.

(f) Economic Instruments

Economic instruments include price based or quantity-based interventions. For example, taxes, subsidies, tradable permits, or industry quotas. These are particularly useful in addressing externalities by aligning private incentives with social costs or benefits. Carbon taxes and emissions ‘cap and trade’ systems are prominent examples of this approach.

Economic instruments essentially incentivise market participants to behave in a desirable manner (or disincentivise them to not behave in an undesirable way).

For instance, the use of Unified Payment Interface in India is subsidised, and the government reimburses the cost of running the UPI system to the market players in return for them not charging the users directly. While calls have been made to make UPI chargeable to make UPI system self-sustainable, doing away with already introduced subsidies is very difficult. This shows lack of RIA while introducing subsidies for UPI.

(g) Direct Regulation (which exists on a spectrum of stringency)

Direct regulation exists along a spectrum of stringency, ranging from relatively flexible, transparency-based interventions to highly prescriptive controls that directly constrain market

outcomes or behaviour.

Overly stringent regulation can impose unnecessary compliance costs and distort incentives, while overly light-touch approaches may fail to correct the market failure adequately.

Examples of direct regulatory instruments with varying levels of stringency are:

- Light-touch regulation: information disclosure and reporting requirements, “comply or explain” frameworks
- Intermediate regulation: licensing, operational standards, entry/exit conditions
- Stringent regulation: price controls, quantity restrictions, bans

(i) Light-Touch Regulation

Light-touch regulation typically relies on transparency, reporting, disclosure, and reputational incentives. These approaches preserve flexibility for regulated entities while nudging behaviour in desired directions.

Such instruments are particularly appropriate where:

- Market failures arise from information asymmetry
- Stakeholders are capable of responding to information requirements
- Risks are relatively low or evolving

Common forms of light-touch regulation include:

- Mandatory disclosure requirements
- Reporting obligations
- “Comply or explain” frameworks

(ii) Intermediate Regulation

Intermediate regulation involves direct obligations on market participants, but still allows some degree of flexibility in how those obligations are met. These measures are typically used where:

- Market failures are more pronounced
- Risks to consumers or the system are significant
- Pure disclosure is insufficient to address the problem

Common instruments include:

- Licensing or registration requirements

- Operational or technical standards
- Entry and exit conditions
- Process regulation (how firms must operate)

These approaches impose some conditions for participation or operation in the market, ensuring baseline quality, safety, or reliability.

(iii) Stringent Regulation

Stringent regulation involves direct control over market outcomes or behaviour, often leaving limited discretion to regulated entities. These measures are typically justified where:

- Market failures are severe (e.g., monopoly power, systemic risk)
- Risks are high (e.g., public safety, financial stability) (e.g. pharmaceutical approvals, nuclear power plant regulations)
- Other interventions have proven ineffective.

Common instruments include:

- Price controls (price caps, tariffs)
- Quantity restrictions (quotas, production limits)
- Bans or prohibitions
- Mandatory standards with little flexibility

Such interventions can be highly effective but also carry risks of:

- Regulatory distortion
- Reduced innovation
- Enforcement challenges

The spectrum of direct regulation highlights that option design is not a binary choice between regulation and non-regulation, but a graduated set of interventions.

Effective RIA navigates this spectrum carefully, selecting the level of stringency that best balances effectiveness, efficiency, and flexibility.

Shortlisting and Structuring Options

Given the breadth of the regulatory “menu” regulators may need to narrow down the list of options for detailed analysis. Shortlisting can be achieved by assessing options against criteria

such as strategic relevance/fit, technical feasibility, administrative implementability, and capacity.

4.5. Safeguards in Designing Regulatory Options

The identification of multiple options is a necessary but not a sufficient condition for effective RIA. The quality of the options—and the integrity of the process through which they are developed—are equally important.

One common problem is the presentation of options that are not meaningfully distinct. For example, regulators may present three options that differ only in minor parameters, such as thresholds or timelines, while excluding fundamentally different approaches. This undermines the comparative nature of RIA and limits its analytical value.

A second challenge is confirmation bias. Regulators may have implicit or explicit preferences for particular interventions, leading to the construction of alternative options that are designed to appear inferior. The OECD warns against this tendency, noting that RIA should not become an exercise in “justifying a particular regulatory action.”

To address these risks, several safeguards are necessary. Transparency in documenting how options were identified and shortlisted is critical. Independent oversight bodies can play an important role in scrutinising the adequacy of the options considered. Stakeholder consultation can also serve as a check on bias, particularly when conducted early in the process.

Another important safeguard is proportionality. The range and depth of options considered should reflect the significance of the problem. As the OECD notes, RIA should be “proportional to the significance of the regulation,” ensuring that analytical effort is focused where it is most needed.

Finally, the baseline scenario must be constructed carefully. An unrealistic baseline can skew the comparison of options and lead to misleading conclusions.

4.6. Iterative and Participatory Design of Options

Option design is not a one-off exercise but an iterative process that evolves as new information becomes available. The OECD explicitly recognises RIA as an “iterative process,” in which different stages may be revisited in light of new evidence or stakeholder input.

Stakeholder engagement plays a central role in this process. Early consultation can help identify feasible options, reveal unintended consequences, and improve the overall quality of analysis. Stakeholders often possess detailed knowledge of market conditions and operational realities that may not be available to regulators.

In some cases, stakeholder input can fundamentally reshape the set of options under consideration. For example, industry participants may propose voluntary or co-regulatory approaches that achieve policy objectives at lower cost, while civil society organisations may highlight distributional impacts that were not initially apparent.

Recognising the iterative and participatory nature of option design is particularly important in complex or rapidly evolving sectors, where rigid or overly prescriptive approaches may quickly become outdated.

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