

Applying Risk-Based Regulation

by Rebecca Durcan
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A lot of people talk about risk-based regulation. Some regulators even use risk management tools in their decision-making. However, as of yet, few regulators systematically engage in risk-based regulation.

A recently published paper by Adam Dodek and Emily Alderson discusses just what that might look like for the legal profession in Canada. In “Risk Regulation for the Legal Profession”, the authors begin by explaining why the legal profession appears to lag behind some other professions in adapting to regulatory issues. They conclude that “For the most part, legal services regulation remains rigid, reactive and complaint-based.” The authors argue:

Command and control regulation allows many cases of lawyer misbehavior to slip through the cracks. It is based on the unrealistic expectation that clients will know the standards of lawyer competence, know their rights, and know when and where to complain – as well as have the motivation to do so. Complaints-based discipline also does not catch lawyer misbehavior that benefits the client in question.

They also argue that without risk-based regulation, regulators “[fail] to provide sufficient focus on the content of the public interest”. They give examples of regulators “squelching dissent” and focusing on civility [to other lawyers] which they characterize as not involving significant public harm, consuming excessive resources and distracting the regulator and

the profession from addressing more harmful conduct, such as abusive demand letters sent by lawyers to parents of shoplifters.

The article says that regulators who take risk-based regulation seriously will apply risk management principles to:

1. Identify the risks of harm that should be the focus or object of their activities;
2. Justify the explicit goals that they have set for themselves;
3. Design their operations and procedures to meet these risk-related goals; and
4. Serve as the standard by which their work is evaluated and they are held accountable.

Risk-based regulation involves moving from a general commitment to the “public interest” to identifying the specific, and relevant, risks of harm that the regulator will focus on at a particular period of time. The goals should be explicit, specific and transparent. For example:

In Ontario, scholars have long argued that the Law Society of Upper Canada has been particularly concerned with certain types of risks or behaviours at the expense of others, especially concentrating on financial wrongdoing and failure to respond to the Law Society. Under risk regulation, the Law Society might still be able to focus on these forms of risk, but there would be a clearly-articulated public rationale as to why they were prioritizing these risks as opposed to others. Identifying objectives at the beginning of the process keeps regulators focused on what matters most. *[Footnotes omitted]*

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Regulators would likely be expected to publish and justify their regulatory priorities as involving a significant risk of harm. For example, the authors expressed grave skepticism about prioritizing protection of the reputation of the profession.

Once objectives and risks have been identified and prioritized, data must be gathered so that a risk assessment may be conducted. This can include analyzing information gathered from:

- Regulated individuals through the annual renewal process;
- Complaints from clients and the public;
- Surveys (for example, UK surveys of medical residents helped identify areas of malpractice);
- Interactions between the staff of the regulator with members (e.g., rudeness, substance abuse concerns, acknowledged financial and personal issues); and
- Self-assessments by members.

On the issue of self-assessments, the authors said:

Empirical studies of this self-assessment process found it very successful in improving standards of practice and reducing complaints. Forcing someone to answer questions about their practice helps him or her recognize deficiencies that may have otherwise gone unnoticed. The added step of adding a negative label such as “partially compliant” or “non-compliant” might shame firms into making improvements. *[Footnotes omitted]*

The authors indicated that lawyers, unlike some other professions, are unaccustomed to invasive regulation:

The cruel fact is that Facebook and Google have more information about most lawyers in Canada than their regulators do. It will require a culture change for regulators to accustom lawyers to providing more information about their practices than they currently do.

Some innovative regulators compile a standardized numerical score from all of this information to identify practices that may be at highest risk of causing harm to the public. The following formula was suggested:

$$\text{Event score} \times \text{Impact Score} \times \text{Source Credibility} \times \text{Strength of Evidence} = \text{Event Risk}$$

Risk-based regulation also applies risk principles to selecting the most appropriate response to concerns. These responses can range from:

- Sending information to the profession as a whole,
- Compliance audits,
- Early intervention such as offering programs and resources to members,
- Placing the member under supervision, and
- Formal discipline.

The risk management cycle then requires that the above experience results in the periodic evaluation, feedback and modification of the risk-based regulation program. They give the example of some regulators replacing the focus on the financial viability of members after the 2008 financial crisis with information security as the highest risk of harm to the public at this time.

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In addition, risk-based regulation could also “impact the relationship between legal regulators and law schools, licensing standards, continuing professional development, the provision of legal services by non-lawyers, Alternative Business Structures (ABS) and other subjects.”

The article can be found at:

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3026869.