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CARR Regulators' Forum: Second Meeting

Emerging Risks

Emerging risks present a challenge to all regulators. They raise issues about how regulators can deal with uncertainties, they fit uneasily with demands for 'risk-based regulation', and they challenge capacities for organisational and inter-organisational learning.

How relevant are emerging risks for regulators?
Emerging risks were seen as problematic and highly relevant for regulators. In practice, risks were often identified when they were no longer risks but issues which had already emerged or when problems had already occurred. Regulators were likely to be in a position of constant 'catch-up'.

Across regulators, three principal different sources of emerging risks were identified. The first were risks arising from technological changes, such as the use of new materials or products, others from new types of communication (such as the emergence of new social media), and scientific advances. The second were risks which arose from changed behaviours among regulated entities and wider society. There could be an interaction between technological and behavioural change, as some of the new technologies transformed the role of humans in performing various regulated activities. In other areas, change in technology and industrial practices proved more complex than anticipated as different standards emerged, creating unintended consequences (and further emerging risks). The third source of new risks was the wider political and legislative context, especially as legislative changes elsewhere might have unintended side-effects on a particular regulator's activities.

One key challenge was how to handle emerging risks. One issue here was the handling of emerging risks across different regulatory organisations that shared responsibility for a particular sector. Fragmented responsibilities meant that there were different degrees of prioritisation among organisations, and not always a clear understanding of responsibilities. It was therefore important to have an understanding as to who was in charge of different areas of risk. There was also the issue about how to handle risk without discouraging innovation. Some regulators wanted to encourage an appetite for innovation and risk amongst market actors, particularly in sectors where market actors were relatively risk averse.

Emerging risks could be highly disruptive by coming 'out of nowhere', but awareness of potential sources, such as the political, legal and business environment as well as funding cycles, was essential. The critical issue was how to assemble these different signals in such a way as to produce a coherent 'risk landscape'.

Also, however, it had to be recognised that risks did not only emerge from the external environment. Inter- and intra-organisational factors could themselves pose risks to the regulators' ability to achieve their objectives. In particular, the ability to attract and sustain sufficiently qualified inspection staff, and confusion about responsibilities in the context of organisational and inter-organisational responsibilities.

How do regulators organise the identification, management and communication of emerging risks?
Some regulators had designated emerging risk teams. With other regulators, reliance was placed on internal reporting processes. This created a set of layers for risk identification. This could then lead to the production of risk reports that could be submitted to key decision-makers in the regulatory organisation. Lessons could be drawn from the past, but knowledge exchange required 'safe places' for sharing concerns in confidence and in a high trust environment.

Some regulators could rely on vast amounts of data from a large variety of organisations. The challenge was to sift through the information and to identify what was most critical. There was a natural tendency towards focusing on those emerging risks that were more widely on the public agenda. There was always a risk of 'false prioritisation' (which could only be identified with hindsight).

One regulator relied on a process of secondment from the regulated sector to offer insights into potential shortcomings in regulatory practice. As this was an ongoing process of constant review, considerable lessons could be learnt from how regulatory practice was seen as relevant to identifying risks in the industry. Other sources for identifying emerging risks were 'meta-regulators', other regulators in the sector, and off-the-record conversations with trade associations.

The 'culture' within organisations was important – it was essential that there should be an environment in which all layers were encouraged to report risk and express their concerns, regardless of level of seniority. This required 'endlessly curious decision-makers'. A broader issue concerned the risk of 'group think', i.e. the tendency to develop shared understandings. Information from inspectors was one essential source, but a diversity of sources was important. It was therefore important to develop an environment for the exchange of information where regulatees (or their associations) felt confident to report on emerging risks. However, it was also acknowledged that whatever the efforts by regulators, the problem of group think might never go away completely. Regulators were putting a lot of effort into identifying emerging risks, but they might prove to be the 'wrong' ones.

To deal with the issue of attention to emerging risks, one method was to facilitate the transfer of information to specific units or individuals. This would allow emerging risks to be analysed and considered, reducing the risk that they would have to compete with rival priorities. One way to do so was to impose the same kind of management system onto one's own organisation as one did on the regulated industry. Some regulators who had implemented this practice found that it introduced a discipline on reporting and management that had not existed before to such a formalised extent. Nevertheless, reporting of risks was always an issue. On the one hand, there was the question whether individuals would report concerns about what they thought was 'just obvious', based on

their their tacit knowledge. On the other, there could be a tendency to over-report, perhaps where there was concern that failure to do so would result in a poor view of the person's performance. In other words, trying to install rigorous systems was potentially painful: it required willingness from organisations to highlight areas of concern that might be perceived as critical of individuals' regulatory practices. It was also taking regulatory practices outside their comfort zone. Initiatives such as 'risk profiling' were extremely delicate as this involved targeting particular areas and pursuing differential treatment across different regulatees.

One response to emerging risks might therefore be not to deal with the specific issues, as these were largely uncertain, but to rely on creating 'buffer zones' that would offer resilience to potential emerging risks.

Emerging risks varied, and so did the responses to them, especially when it came to questions of loss of life or financial loss. For some, this was about accepting that risks existed, for others, the key challenge was to create a level-playing field so as to ensure that there was no race to the bottom in terms of safety, while also ensuring that standards did not prevent market entry. To some extent, different levels of risk appetite reflected on the target population, and their ability to manage risk themselves. One of the key challenges was that emerging risks were often not recognised within legal frameworks, but were identifiable as potentially harmful. This again raised issues of responsibility for managing new risks and ensuring that that organisations consistently shared information. This made emerging risks particularly challenging when they emerged as a common theme that cut across a particular area, rather than being a specific issue.

In what ways can emerging risks be incorporated into day-to-day practices?
It was argued that highly prescriptive regulatory frameworks were unlikely to encourage people to search for emerging risks. Once identified, emerging risks required a menu of different intervention mechanisms, not all of which may be available in the regulators' legal mandate. In some areas, scandals, ie crystallised risks, led to immediate responses and these would then be incorporated into day-to-day practices. In other cases, one was reliant on inspectors to adjust their practices to incorporate consideration of the newly identified risk. However, pressures on supervisors or inspectors to change their behaviour could be met either with inertia or with resentment, in both cases resulting in non-cooperation. As a result, new practices had to be introduced as part of a change management process and supported by formalised provisions.

In other cases, the regulator would look to the market actors to manage the risks in the first instance. The appropriate response was to communicate the importance of considering emerging risks to the regulated entities, thereby making them responsible for addressing them. However, all modes of response involved an overall formalisation of the process of identifying and analysing emerging risks.

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