Guidance Note

Risk based regulatory approaches

Regulation often seeks to reduce or manage risks, including the risk of harm to the health, safety or welfare of individuals or broader society (including environmental and consumer harm). However, in attempting to address these real or perceived risks, regulation may fail to achieve its objectives as well as having unintended impacts on prices, competition and consumers.

> To minimise these consequences, agencies should ensure that new and existing regulations are well targeted, effective, proportionate and flexible, and that they are administered in an effective and efficient manner.

A one-size fits all approach to regulation and its administration may overlook that risks may vary across different businesses based on their size, industry or activity. The Organisation for Economic Co-operation and Development (OECD) therefore promotes the adoption of risk-based approaches to the design and administration of regulation, to deliver better regulatory outcomes while reducing costs for business and the community.[1]

What is a risk based approach to regulation?

A risk based approach to regulation is based on the premise that the nature and level of regulation, and the compliance activity undertaken by the regulator in administering that regulation, will be most effective and efficient, where it is targeted and proportionate to the risk of non-compliance.

For example, a regulator may consider the compliance record of regulated businesses in determining the level of, or need for, inspections, audits and reporting required.

A challenge for both governments and the community is acknowledging that not all risks can be eliminated through regulation and that trade-offs may sometimes need to be made between risk reduction and regulatory burden. This can be particularly relevant to small business, which can face a disproportionate impact from heavy-handed regulation.

Two key elements for a successful risk based approach to regulation are to ensure that:

- regulations are designed and drafted with consideration of risk
- regulators' compliance and enforcement activities are based on the risk that particular businesses and activities pose.

> **Different approaches for low and high risk activities**
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> A low-risk activity or action performed by a business may require less prescriptive regulation and attract less compliance activity on behalf of the regulator, such as allowing businesses to undertake self assessments, self-monitoring and/or reduced reporting. This approach creates efficiencies by allowing the regulator to devote more time and resources to activities of higher risk and to allow industry to focus on more productive activities.
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> Conversely for a high-risk activity, where the consequences of a breach of regulatory obligations may have significant negative consequences, more prescriptive regulation and stronger compliance activity may be required to safeguard the community and/or environment.

Risk based approaches are relevant at all stages of the policy/ regulatory cycle, from determining whether there is a problem requiring regulatory intervention through to evaluating the impact and effectiveness of the regulator's response after implementation.

[1] https://www.oecd.org/content/dam/oecd/en/publications/reports/2010/04/risk-and-regulatory-policy_g1ghc5f1/9789264082939-en.pdf

How to adopt a risk based approach in designing regulation.

The following points should be considered by agencies when adopting a risk based approach to designing regulation:

- **What is the problem?** Agencies should set out relevant information on the nature, size and scope of the problem including:
  - What is the likelihood of the risk occurring and what are the consequences? Is the risk concentrated in a small number of business or is it industry wide?
  - Are risks more certain or less certain (i.e. the result of random events)?
- **What are the options?** Select options that are feasible approaches to addressing the problem including (as appropriate), non-regulatory, self-regulatory and co-regulatory options
  - Could less costly regulatory options (for example, negative licensing) better address the risks?2
- **Assessment of options**. Assess the likely impacts of the potential options
  - Will the option reduce the size of the risk?
  - Will it transfer risk to other parties or have unintended consequences (e.g. moral hazard, services not being provided at all)
  - What are the costs and benefits of addressing the risk? How do they vary under different assumptions?
- **Implementation**: Describe how the proposal will be implemented and what guidance or compliance support will be provided to mitigate any issues or risks
  - Can a regulatory proposal be flexibility designed (e.g. to concentrate on outcomes rather than inputs) to allow for regulators to minimise compliance costs, adapt to new technology and ensure regulation remains fit-for-purpose over time?

How to implement a risk-based approach in administering regulation

The transition to risk based administration of regulation may be challenging for some departments and regulators, but ultimately more effective and efficient in achieving the regulatory objectives. Such a transition may include an in-depth consideration of the risks present in the industries that are regulated and an assessment of whether certain businesses or activities present a higher or lower risk than others, which may warrant different regulatory approaches. These steps are detailed on the next page.

[2] The OBPR has published a guidance note to assist agencies in considering alternative approaches to regulation

Risk based regulatory framework

A risk based regulatory framework[3] should contain the following elements:

- **Define outcomes and risks**: Determine objectives of the regulation and identify the potential harms and risks it is required to control.
- **Determine risk appetite**: Determine the risks the regulator is prepared to tolerate and at what level, consistent with the legislation set down by parliament and other guidance given by government.
- **Risk assessment**: Assess the likelihood and potential impact of an adverse event, the expected value of that impact, and the costs and benefits of any regulatory action or inaction (taking into account which businesses present high risks and whether risks can be self-managed). Consultation with stakeholders may be required to inform this assessment.
- **Prioritise risks:** risk assessments should be used to prioritise risks, based on the characteristics of the regulated industry and business, scale of activities and history of compliance.
- **Implementation and resourcing**: selection of appropriate compliance and enforcement measures and how to allocate regulator resources to address risks (based on risk assessments and prioritisation). Measures should be proportionate to the consequences of non-compliance and consider alternative monitoring, enforcement and reporting requirements that streamline processes. This could include investigation into regulatory technology to improve compliance and risk management and reduce administrative and compliance costs.
- **Review outcomes**: continually review the effectiveness of the regulation (and its administration) at reducing risks (against original objectives and expectations) to improve understanding of risk (including emerging and changing risks over time) and ensuring that risks are being managed and resources allocated in the most effective manner.

[3]Adapted from Productivity Commission 2013, Regulator Engagement with Small Business

Agencies should also consider risk based approaches as part of their regular review of legislation (such as through the sunset review process of expiring regulations).

Further guidance on risk based approaches

There is a variety of published guidance material from other jurisdictions which methodically sets out how regulatory policy makers and regulators can consider risk and implement new methods of monitoring, compliance and enforcement, including the use of self-diagnostic tools (see Additional Resources overleaf).

Consulting such guides will assist agencies in ensuring that the regulatory burden on low risk activities and stakeholders is reduced.

For further information in relation to risk based approaches to regulatory design, implementation and review please contact the Office of Best Practice Regulation (OBPR) via obpr@qpc.qld.gov.au.

More information on the OBPR can be found at: qpc.qld.gov.au/best-practice-regulation.

Additional Resources

The following resources sets out how regulatory policy makers and regulators can consider risk and implement new methods of monitoring, compliance and enforcement.

Victorian Competition and Efficiency Commission – Smart regulation: grappling with risk

In April 2015, VCEC released a guidance note and supporting paper providing information for policy makers and regulators on viewing risk from regulatory design, through to the implementation and administration of regulation. This material may assist agencies in considering risk assessment and ways to streamline reporting and assessments for low risk businesses

The guidance can be accessed here:

https://www.vic.gov.au/sites/default/files/2019-06/Smart-regulation-Grappling-with-risk-Guidance-Note.pdf

NSW Government – Guidance for regulators to implement outcomes and risk based regulation

In October 2016, the NSW Department of Finance, Services and Innovation released guidance for regulators on how to implement outcomes and risk based regulation. The guidance material provides a clear and practical framework for regulators to implement outcomes and risk based regulation through:

- a clear focus contributing to regulatory outcomes (i.e. the impact) and the resources and activities used to achieve these outcomes (i.e. the impacts efficiency)
- greater flexibility to adapt to changing circumstances
- increased transparency through clear outcomes and accountability
- a more informed basis for effective organisational improvement
- more informed and meaningful discussions with regulated entities
- more effective customer engagement, thereby reducing unnecessary regulatory burden.

The guidance provides a framework outlining a process for regulators to implement, and provides worksheets and a diagnostic tool to assess the processes and practices associated with implementing outcomes-based reporting and a risk based approach to compliance and enforcement.

The guidance can be accessed here:

https://www.productivity.nsw.gov.au/sites/default/files/2018-05/Guidance_for_regulators_to_implement_outcomes_and_risk-based_regulation-October_2016.pdf