



ROLE OF LAW IN RISK MANAGEMENT IN COMPLEX BUSINESS SCENARIO

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ABSTRACT

Legal governance and risk management have become an integral part in the modern corporate world. Legal governance, risk management and compliance (LGRC), acts as an effective tool that provides rules and systems to implement corporate strategies that can be adopted in the complex businesses to work in compliance with law. Risk management a common term used in the financial aspect has extended its dimensions towards legal risk management which incorporates the regulatory and non-regulatory rules to be adopted in running an enterprise. The entire process requires a sound knowledge of Economics, Finance, Social factors and legal framework. The idea behind legal risk management is to identify, prioritize and minimize the risk encountered in business operations. Legal compliance on the other hand provides ethical codes to all departments and look into the adherence in following these codes. This paper focuses on the issues, processes and procedures related to legal risk management in the ethical conduction of business activities.

Keywords: Legal governance, risk management, compliance, enterprise, ethical codes.

Definition

Legal risk is the risk of financial or reputational loss that can result from lack of awareness or misunderstanding of, ambiguity in, or reckless indifference to, the way law and regulation apply to your business, its relationships, processes, products and services.

Legal risk industry survey explores current working practices around legal risk management, how well legal risk is understood throughout the financial services (FS) sector, the top priorities for businesses, and the challenges that organizations face in their efforts to show that they are in control of legal risk. Three conclusions can be drawn in this perspective:

1. Legal risk is owned by the General Counsel/Inhouse legal department Lawyers' subject management expertise make them (on the face of it) the natural owners for legal risk. But legal risk is such a broad area that you need to create a structured set of supervisory controls to help you meet your risk management responsibilities.
2. Legal risk isn't well integrated into operational risk frameworks because legal risk overlaps with other risk areas, and organizations in financial services are usually very complex, to manage it effectively you need to integrate with operational risk frameworks. And support the development of dashboards, predictive legal risk models and near real-time Key Risk Indicators from current operational risk data sets.
3. There is broad agreement on legal risk priorities and challenges Legislative/regulatory compliance is still a key priority for most respondents, but duty-of-care or "conduct" related risks were a top priority for a significant number of respondents.

The varied roles of a lawyer within three-lines-of-defence

- First line Many businesses employ lawyers specifically to advise, for example, on business transactions, or commercial contract negotiations. Dependent on the specifics of the work they do, this will be considered as either "1a" (front-line) or "1b" (management of front line) activities.

- Second line In-house legal teams have a responsibility to identify, aggregate and advise the business how to proactively manage legal risk. This area has been the focus of regulators and is where many legal functions now need to improve their approach.
- Third line In a very few instances, lawyers will assume 3rd line internal audit responsibilities. They may review the work of other legal teams to assure that they are managing legal risk appropriately. And when they act on internal investigations – fraud or regulatory – they quite naturally adopt a pseudo third-line audit role.

Core interactions between business operations and law & regulation.



Legislative/ regulatory risk : Legislative awareness, impact assessment and ongoing compliance frameworks. Not just compliance, but also the ability to take advantage of business opportunities that arises through heightened awareness of the legislative/regulatory environment.

Non contractual obligations risks: Risks that corporate behavior and individual decision-making could result in a failure in non-legislated duty-of-care (or civil duty) to third parties.

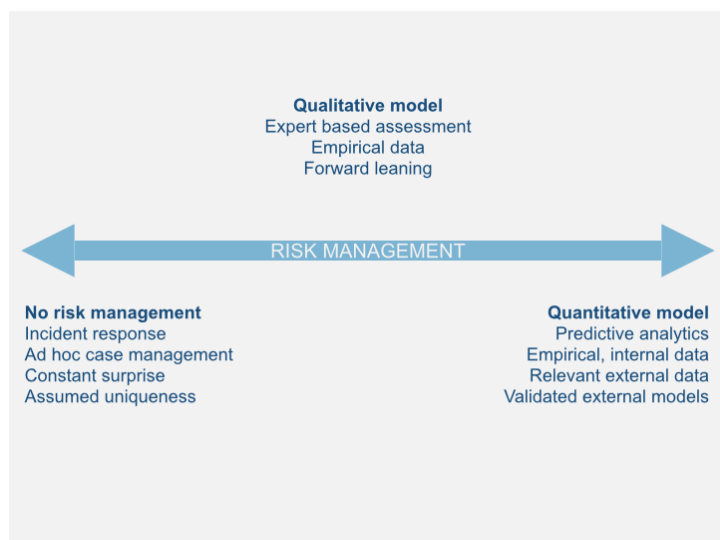
Dispute risk : The risk that your behavior leading up to and within a legal dispute could negatively impact the quantum of loss

Contract risk: The risk that you will fail to keep track of and meet or enforce your contractual obligations or rights, or enter into contracts with terms that are either inadequate, unfair or unenforceable

Non contractual rights (IP) risk :The risk that you will fail to properly protect and leverage your intellectual property, or infringe the non-contractual rights of third parties.

STEPS IN LEGAL RISK MANAGEMENT FRAMEWORK

1. Select framework



Objectives

A risk management framework for legal risk and compliance should meet four objectives:

1. Simple but not simplistic
2. Scalable but not overbearing
3. Adaptable but with clear guidance
4. Practical but not regimented

The risk management framework that best meets these objectives is ISO 31000. ISO 31000 defines risk as, "...the effect of uncertainty on objectives." This sweeping definition includes events that bring unexpected costs, classically thought of as "risk," as well as threats to opportunities.

2. Obtain organizational commitment

Risk management initiatives often stall and stagnate because the organization insists on "doing it right," meaning implementing a risk management framework for the entire enterprise. Enterprise risk management (ERM) is a noble and important endeavor. However, it is not an essential starting point.

General counsel, compliance officers, contract managers, other legal professionals can implement legal risk management within their own domain. A focus on legal risk yields two benefits. First, the broader enterprise will benefit from clarity and measurement of formerly opaque risks. Second, the bar for approval of software and processes is lower than enterprise risk management, because the systems are simpler and the field of use is constrained.

There are four key questions to obtain organizational commitment:

- What is the scope of the legal risk management initiative (meaning: departments, divisions, or enterprise)?

- What types of legal risk will get tracked with the initiative (contracts, regulations, litigation, etc.)?
- Who is the audience for legal risk reporting (management layer, corporate functions, etc.)?
- How much budget is available to track and treat legal risk in terms of time, money, and staff?

Answering these questions will focus the organizational commitment needed to get started.

3. Identify legal risks

Risk identification is an issue spotting exercise. The objective is to compile a broad list of risks. There are three steps to identify legal risks:

Step 1: Find sources of legal risk. The primary sources of legal risk are contracts, regulations, litigation, and structural changes.

Step 2: Recognize potential and actual risks. Uncertainties with legal consequences can arise from hazards (physical injuries), events (a single occurrence), situations (entering a new international market), and scenarios (counterparty does X, Y, or Z).

Step 3: Record risks in a risk register. A risk register is basically a list that also captures some attributes of each risk. To start, track the name of the risk, the likelihood on a simple scale as an estimate, the consequences rating on a simple scale as an estimate, and the combined risk rating on a simple scale.

Now you can subject the risks to analysis, driving toward decisions about how to manage legal risks.

4. Analyze legal risks

Risk analysis is about understanding the risks in the risk register. To analyze legal risks, begin with an assessment of controls. Risk controls can take a variety of forms depending on the risk, the industry, and the organization. For example, to manage a contract risk, an organization might use a requirements tracking system to ensure that individual obligations are satisfied.

Once you have gauged the effectiveness of risk controls, analyze the likelihood and consequences of each risk. The likelihood of a legal risk is the combination of the chance of discovery (will a claimant or regulator identify the problem) and the chance of an adverse decision. Similarly, consequences are the product of damages (usually in financial terms) and frequency (the number of incidents).

5. Evaluate legal risks

Evaluating legal risks is quite different from the analysis of risks. To evaluate a legal risk is to prioritize the response to the risk. At the core of risk evaluation is your organization's risk tolerance. Legal risks that are above the line - intolerable - need risk treatment. The idea behind risk treatment is simple: modify the risk so that it is tolerable. Notice that it is not necessary to eliminate the risk, just render it tolerable.

Risk treatment options are as diverse as the risks we manage. However, there are several repeatable techniques:

- **Avoid** the risk by not starting or continuing the activity that can create the uncertainty
- **Increase** the activity that creates the risk, if the consequence is beneficial
- **Remove** the source of the risk
- **Change** the likelihood and/or consequence of the risk
- **Share** the risk through contracting or insurance

Each of these techniques can change the character of legal risk. Adapting these techniques to legal risks brings legal professionals closer to the operations of the organization to reduce the cost and impact of uncertainty.

6. Communicate and advise

Once legal risks are inventoried and analyzed in the risk register, it is important to communicate the results to the broader enterprise. However, many risk professionals diminish the power of their message and the effectiveness of their communication by presenting each risk. Risk management is the frontier for lawyers, compliance officers, and contract managers to add value to their organizations. A pragmatic approach to legal risk management is within reach!

Legal work is all about risk management. It is impossible to ignore the legal risks that have caused significant damage to companies over the past years. In most cases, the material legal risks faced by those businesses were not clearly identified and mitigated.

General Counsel are under real pressure to become better at managing the legal risks in the business. Traditionally trained to solve problems in a reactive manner, General Counsel need to invest in time and resources to identify and mitigate the legal risks proactively.

Process of Legal Risk Management

The task of managing legal risks is very complex. The number of risks grows with the number of legal entities, contracts and regulation. To start legal risk management, you will need to have a long term plan with clear objectives. This business case needs to justify the investment to be made in the required knowledge, resources and ICT. You can use the following steps for your own business case.

Step 1

You need to assess the maturity of the legal risk management within your company. In general, you can identify 4 levels of maturity:

1. No formal legal risk management reporting, risk decisions made principally on personal judgments.
2. Basic legal risk policies in place, proactive discussions with business, adhoc risk mitigation.
3. Alignment with business objectives, quantitative reporting of legal risks, assigned responsibilities.
4. Dedicated legal risk managers, independent legal risk assurance, automated risk reporting

Step 2

The second step is the creation of a clear Legal Risk Management framework. This framework is a combination of the legal entities, governance structure, contract categories and legislation relevant for your business.

Step 3

The third step is the development of the required business processes and related risk management policies. Relying on the ‘good judgment’ of the business and the in-house legal alone is no longer working. The Legal Department requires structured processes for making risk decisions, escalating issues and integrating with the risk management frameworks of the entire business.

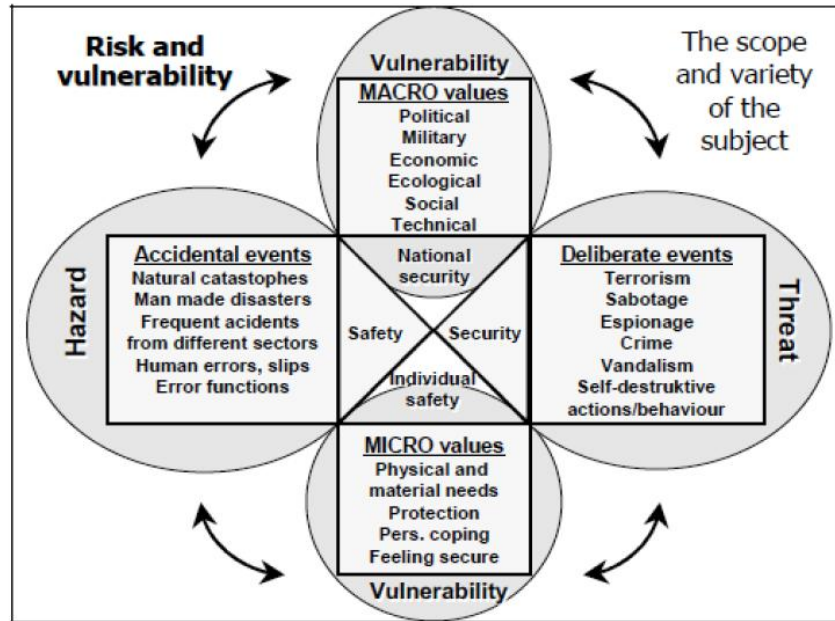


Ready for implementation

The outcome of the legal risk management business case must ensure:

- Board support for discussing, identifying and quantifying risks
- Alignment of objectives with business goals
- Sufficient budget investment in knowledge, human resources and ICT
- Clear legal risk management framework
- Ownership of legal risks embedded in the organization
- Structured training for people involved
- Embed management reporting on legal risks

THE TECHNICAL RISK PERSPECTIVE



The technical risk perspective can be analyzed by its vulnerability towards four variables

1. Macro Values:

The legal risk framework should take into considerations the Political, Military, Economical and Ecological, Social and technical factors.

2. Threat:

The threat is through Terrorism sabotage espionage, crime, vandalism, self destructive actions or behaviors which need to be handled carefully to minimize the effects of this risk.

3. Micro variables

These variables include the physical and material needs, protection from peers, coping up stress and social security.

5. Hazards:

These comprises of natural calamities, manmade disasters, frequent accidents, from different sectors and human errors.

Conclusion:

The risk management process is a complicated issues in dynamic business scenarios as it not only helps in identifying the legal risks but trying to minimize it. The role of lawyers significantly to becomes complicated as the legal frameworks and their applicability has to be well applied to overcome all the related legal and technical risks. Therefore legal governance and risk management have become an inseparable part of corporate business houses for ethical running of businesses

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