



The Importance of Taking a Pro-Active Approach to Risk Management in the LPL Marketplace.

WHITE PAPER

A White Paper for Risk Management in the Lawyers Professional Liability Market



AFFINITY

LPL Risk Management

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FROM REACTIVE TO PROACTIVE

For purposes of this brief report, we define risk management as the process of quantifying and qualifying various risks and developing strategies to effectively manage those risks.

Traditionally, most attorneys have taken the view of risk management as being akin to putting out brush fires when they occasionally ignite. In other words, their risk management role has been a reactive one. When a problem arises, the attorney would step in and put out the fire.

Today, however, with the proliferation and augmentation of risks that attorneys face daily, they often find themselves in the middle of full-scale forest fires which can no longer be extinguished by the same old methods. The pervasive and extensive financial crisis of 2008 and the resulting economic slump that followed have highlighted the inadequacies of traditional risk management solutions. One of the more immediate effects of this transformation has been the scrutiny with which investors, shareholders, regulators and the media are looking at organizations' risk management policies.

The traditional risk management role of passive observation has become a relic of the past, and has been replaced by a new model which places greater emphasis and focus on risk prevention and avoidance.



TRADITIONAL LPL RISK MANAGEMENT

... a law firm must first identify all known risks that can adversely affect their day-to-day performance.

Regardless of what many people believe, risk management doesn't necessarily mean reducing or eliminating risk. Every legal transaction or service performed for a client involves a certain amount of risk. The real goal of risk management isn't to eradicate, or even to diminish risk, but to keep those risks at levels that are consistent with a company's previously decided strategic goals and capacity for risk.

From a business standpoint, it's possible for an organization's risk level to be too low and end up having an adverse effect on prospecting and growing the business. If a law firm focuses on avoiding all cyber risk, or intellectual property cases, for example, it may lose out on potentially profitable customer relationships.

Traditional risk management employs a tactical, methodical approach.

In a tactical approach, a law firm must first identify all known risks that can adversely affect their day-to-day performance. Risk statements may be prepared for each risk which provides details on the potential for loss. Probability and impact are established for each risk statement, and risk exposure is determined from the individual values of probability and impact. Law firms employing this approach can easily identify hundreds of potential risks.

continued ...



Lawyers and their clients need to work with financial experts to identify risks ...

Since tactical approaches rely on aggregation techniques to get a more panoramic view of risk, they are referred to as incorporating a bottom-up, rather than a top-down analysis. Many law firms and legal organizations are successfully employing tactical approaches for managing risk. But it seems as though just as many struggle to effectively manage the high numbers of risk statements. In some cases, decision makers in these programs spend too much time manipulating and analyzing risk statements and too little time actually managing their risk.

But as the business community and regulatory agencies place increasing emphasis on enterprise risk management (ERM), many organizations expect their legal counsel — both internal and external — to take a more proactive approach.

Lawyers and their clients need to work with financial experts to identify risks systematically and assess their potential impact on the organization. Experts also can help develop a plan for controlling or mitigating risks.



ENTERPRISE RISK MANAGEMENT (ERM)

... seemingly minor mishaps are more likely to be viewed as presenting substantial legal malpractice risk, along with a negative public relations impact ...

Unlike traditional risk management approaches, enterprise risk management offers a more comprehensive solution to the problem of managing risk. By taking an integrated approach that considers all of the risks associated with legal transactions or legal services that may be undertaken on behalf of a client, ERM can discover potential problems and help identify possible solutions. Before ERM, many large law firms managed risk by reacting to known risks as they happened. There was little or no effort expended at anticipating and controlling risks that may not have been evident by using traditional, reactionary risk management techniques.

Suppose, for example, that a law firm fails to comply with certain deadlines involving appeals or other legal motions. In a traditional risk management environment, these may be seen as relatively minor violations which present little risk. But in an ERM environment, these seemingly minor mishaps are more likely to be viewed as presenting substantial legal malpractice risk, along with a negative public relations impact and damage to the firms' reputation.

According to the ISO (International Organization for Standardization), the world's largest developer and publisher of International Standards, one commonly-accepted definition of ERM is "the commitment to managing risk as an integral component of an entity's operations, in order to maximize opportunities and minimize setbacks to the entity's mission, strategies, and objectives."

As this definition and most others clearly reveal, ERM takes into account not only possible setbacks and problems, but also potential opportunities by maintaining a focus on the big picture of an institution's mission, strategies, and objectives. It's accurate to say that by following the best practices of ERM, a law firm is able to manage adversity and seize opportunity at the same time.



POSITIVE IMPACT OF PROACTIVE APPROACH

With the establishment of a proactive approach to risk management through the adoption of a fully integrated ERM system, law firms are experiencing higher credit ratings and lower costs of capital.

In fact, law firms that manage their risk can also look forward to these positive results:

You can help your clients avoid many negative repercussions.

- **Accurate Predictability:** Proactive identification and management of key risks decreases the occurrence of unexpected events, stabilizes earnings fluctuations and increases client and prospective client confidence.
- **More Effective Decision-Making:** Law firms are able to make more informed, reliable decisions when the identification and evaluation of risk and opportunity are better defined and built into existing daily activities.
- **Improved Corporate Control:** Specific risk reporting and communication protocols can help fulfill expectations of key clients and partners, and enhance regulatory compliance.

Some legal problems are unavoidable and will require your quick reaction. But you can help your clients avoid many negative repercussions of unmanaged risk by working with the insurance and financial experts of USI Affinity to implement an effective ERM system.



USI AFFINITY RESOURCES

For over 75 years, the divisions of USI Affinity have developed, marketed and administered insurance and financial programs that offer professional organizations, affinity clients and their members unique advantages in coverage, price and service. Our programs offer clients, from associations and unions to law firms, the edge they need to both retain existing and attract new clients and partners. As the endorsed provider of affinity groups representing over 20 million members, USI Affinity has the experience and know-how to navigate the marketplace and offer the most comprehensive and innovative insurance packages available.

The LPL Risk Management Group of USI Affinity specializes in providing comprehensive professional liability insurance programs to large and small law firms and legal organizations. Our lawyers professional liability consultants have on average 20 years of experience in the marketplace.



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