

# Talking about quality

## risk and regulation

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Professor Colin Raban, Emeritus Professor of the University of Derby, probes the true meaning of 'risk-based regulation' in the context of a rapidly changing higher education landscape.

The Government White Paper *Higher Education: Students at the Heart of the System*<sup>1</sup> (Department for Business, Innovation and Skills, 2011) proposes a quality assurance regime that is 'strong', 'well-adapted' and 'genuinely risk-based'. Some have described the proposals as amateurish and daft,<sup>2</sup> while others see them as evidence of a restored trust in institutions.<sup>3</sup> More remarkable, perhaps, is the extent to which the White Paper prejudices the deregulatory effect of the approach that it advocates. In the wake of the financial crisis, the Regulatory Reform Committee of the House of Commons had already warned that 'analysts and commentators must avoid confusing risk-based regulation [with] so-called "light-touch" approaches', and concluded that 'the better regulation agenda is more important now than ever'.

Risk and risk management have become familiar figures on the higher education landscape. In the 1990s, risk management became a standard corporate governance requirement for the public sector, and in 2000, a Higher Education Funding Council for England (HEFCE) directive stated that institutions should ensure that 'there is an ongoing process for identifying, evaluating and managing risks'. In the following year, HEFCE published its guide to good practice on risk management and, in 2002, it received recognition for having itself moved to a more risk-based approach in the manner of its engagements with institutions. Within these institutions, however, there remained 'a perception that risk management deals only with...central corporate (as opposed to academic) risks'.<sup>4</sup>

Although the idea of academic risk took longer to incubate, it has been invoked with growing frequency in Quality Assurance Agency for Higher Education (QAA) audit reports, and particularly in those reports concerned with the management by institutions of their collaborative provision.<sup>5</sup> QAA guidance material has followed suit. While there was no reference to risk in the first publication, in 1999, of the section of the *Code of practice for the assurance of academic quality and standards in higher education* which deals with collaborative provision, it received a mention in the 2004 edition, and it is the focus of discussion in the current 'amplified' version. The concept of risk also features prominently in QAA's recent publications on employer-responsive provision.

The gestation period for the idea of a risk-based approach to external quality assurance has been even longer. In 2002, QAA declared that it was taking 'a major evolutionary step'. That step, Institutional audit, was described as bringing much closer 'the possibility of a reliable process in which outside intervention in an institution's activities is truly in direct relation to the risk'. Nothing much happened, but evolution takes time. Now, nearly a decade later, the White Paper informs us that risk-based regulation is imminent. However, its form and function remain unclear, as does its provenance. It has yet to be established whether the new arrival is a direct descendant or a Neanderthal cousin of the discussions and debates of the past 10 years.

## Approaches to risk-based regulation

There are precedents overseas for the risk-based regulation of higher education. In Australia, the Tertiary Education Quality and Standards Agency (TEQSA) has adopted a 'risk-based regulatory approach' and is seeking to apply this in accordance with the Bradley report's<sup>6</sup> recommendation that the reaccreditation of a university should be based on 'a realistic risk assessment'. In making this recommendation, the report referred to the 'framework for risk assessment' that had been developed by the Australian Universities Quality Agency (AUQA). Risk-based approaches are also well-established in the regulation of financial services. From the outset, the UK Financial Services Authority (FSA) had 'made a conscious decision to be a risk-based regulator'.

While the implications of a risk-based approach to the external regulation of UK higher education may still be unclear, over the past five years many institutions have developed their own risk-based approaches to quality assurance. Some of the material for this section of the paper is based on the experience of these institutions, working from the premise that this experience may be a useful resource for those who will be responsible for the design of the risk-based regime promised by the White Paper. For the avoidance of confusion, the term 'regulation' will be used to refer to the activities of such external agencies as QAA, and 'quality assurance' will be reserved for the means by which institutions themselves govern the quality and standards of their provision.

The field of risk-based assurance and regulation encompasses a wide variety of approaches. These can be distinguished on the basis of two criteria: the manner in which risks are identified and assessed, and the nature of the action that is taken to 'manage' the identified risks:

### ○ The identification and assessment of risk

The level of 'risk' associated with an institution (or a department) and its activities could be based on a measure of the unit's **performance**, or on some assessment of its **potential** to be placed at risk in the future. For example, an association of risk with performance might entail a focus on a unit's Research Excellence Framework (REF) outcomes. On the other hand, an assessment of risk potential would entail the identification of the external factors or the characteristics of the unit itself that could lead to a positive or negative REF outcome.

### ○ Action to manage identified risks

The action that is triggered by a risk assessment could entail either or both of some adjustment to the **scrutiny** and/or **support** for the department or institution that is judged to be at risk or to have the potential to be placed at risk in the future. The White Paper expects to see 'significantly less use of full institutional reviews' (reduced scrutiny) of those 'providers that have 'a sustained, demonstrable track record of high-quality provision' (that is, those which might be placed in the low risk category). The REF provides an example of an assessment, in this case an assessment of performance, leading to a decision on the level of support (in the form of research funding) received by an institution.

Combining these two criteria enables us to identify four approaches to 'risk-based' regulation and quality assurance.

		Action	
		Scrutiny	Support
Assessment	Performance	1	2
	Potential	3	4

A small number of institutions have begun to express interest in the development of the first approach to risk-based quality assurance (number 1 in the diagram). This entails some variation in the frequency or intensity of scrutiny on the basis of an assessment of performance. To the extent that the White Paper promises reduced regulation for 'high performing' institutions, this is the approach envisaged by the Government. It may also be the approach to risk-based regulation that will be adopted by TEQSA, although it has yet to set out the criteria that will enable it to identify 'higher quality, lower risk providers'.

The White Paper itself says little about the 'objective criteria' by which performance might be assessed and thus the triggers for the closer scrutiny of under-performing institutions. It is clear, though, that they will include some measure of student satisfaction and this would be consistent with a White Paper entitled *Students at the Heart of the System*. They might also include the other measures that define Graham Gibbs' 'product dimension of quality' - student performance, retention and employability.<sup>7</sup> It should be noted, however, that by comparison with the recent report by the House of Commons' Innovation, Universities, Science and Skills Committee on *Students and Universities* (August 2009),<sup>8</sup> the White Paper makes little reference to academic standards. One would hope that this will not mean that a 'high performing' institution worthy of the regulator's 'light touch' could be one with satisfied students but not necessarily one with high standards.

The crucial limitation of this first approach to 'risk-based' regulation has been aptly expressed by the FSA, and repeated in the advertising protocol for financial products. The FSA Task Force on Past Performance had concluded that 'past performance information on its own is of little indicative value to consumers and should be used only in support of other factors when they make their investment decisions'. The point would apply with equal force to regulatory decisions.

The White Paper proposes 'more regular and in-depth review' for new providers with a 'shorter track record of quality'. This could be because QAA will have accumulated insufficient performance data to justify 'lighter touch' regulation; or it may be because the relative immaturity of these institutions - the inexperience of their staff, perhaps, or the untried nature of their quality management systems - is thought to make them vulnerable to future 'risks'. There is also a hint in the Australian proposals that risk-based regulation will not be solely reliant on measures of performance. TEQSA will take into account 'the scale, mission and history of each provider' and AUQA will be identifying 'some themes that have high risks for [institutions]'. These 'themes' could relate to certain types of programme, or operations in certain geographical areas. In Australia and the UK, then, there is some acknowledgement of the importance of risk potential.

On the evidence provided by recent audit reports, it appears that many UK institutions have adopted an approach that conforms to our third type (3 in the diagram). Risk-based arrangements of this kind are most commonly found in institutions' procedures for the approval of collaborative provision. This entails an initial assessment of risk conducted either by a university's registry or quality unit, or by the proposer applying a standard set of previously agreed criteria. A high score obtained against these criteria governs the university's decisions on whether and how to approve the proposal.

These assessments of risk tend to focus on the character of the proposed partner, the nature of the programme and the planned mode of collaboration. These are all important in determining

'risk potential' because they have a bearing on an institution's exposure to risk and its ability to withstand threats or exploit opportunities. There are, however, other considerations that should be taken into account for a full estimation of risk potential. These will include current or future developments in the institution's (or department's) operating environment that may affect its ability to achieve its objectives, and its competence in the management of risk.

This use of 'risk assessment tools' represents an attempt by institutions to anticipate and thus prevent under-performance and reputational damage. However, this approach also has its limitations. It is presumptive, in the sense that the criteria governing the assessment of risk are determined a priori, it rarely considers factors in the external environment, little attention is given to the unit's ability to manage risk, and it is often confined to an institution's approval procedures and employed only as a means of making decisions on the admissibility and scrutiny of a proposal. A small number of institutions have developed approaches to risk-based quality assurance that build upon the third type (3 in the diagram) and which inform decisions on the support as well as the scrutiny of units that are potentially at risk (4 in the diagram).<sup>9</sup> Thus a decision could be made to provide expert advice in support of a potentially high-risk partnership and to ensure that the membership of the approval panel has the expertise to engage in a constructive discussion on how these risks might be averted or managed. Equally, additional staffing resources might be allocated to a department that is having to cope with difficult market conditions and is therefore having to re-design its portfolio of programmes, and this might be coupled with a decision to bring forward the scheduled periodic review of that department.

In addition to some assessment of the risks inherent in a department and its provision, these approaches (3 and 4 in the diagram) entail annual monitoring and periodic review procedures that are 'forward looking' and which include a focus on the wider institutional and external environment. Monitoring and review reports are designed to capture the intelligence on potential threats and opportunities that is brought to the institution by its 'front line' staff. This 'empirical' and 'forward looking' approach to risk identification is important if institutions are to move beyond the management and control of known (and 'presumptively' defined) risks to address the 'new risks' that are likely to emerge in 'a fast changing environment' and where 'past experience is an uncertain or potentially misleading guide'.<sup>10</sup>

In its reference to 'an objective assessment of a basket of data' that will be 'monitored continually but at arms length', the White Paper implies that responsibility for the assessment of risk will lie with QAA or some other agency, working on the basis of previously agreed criteria. This, however, is not the only option. For example, the AUQA Framework provides for institutions themselves to carry out their own risk assessments and to do so in a manner that is 'specific to [their] context'. Institutions, therefore, have at least the opportunity to bring the issue of risk potential into their engagements with AUQA and to contribute to the identification of previously 'unknown' risks.

The third and fourth types of risk-based quality assurance also entail systematic assessments of the competence of operating units in managing the risks to which they are actually or potentially exposed. This would also be a possible feature of a risk-based approach to the regulation of higher education institutions. Indeed, one might argue that QAA audit already provides a means of assessing an institution's capacity to manage risk. In the tacit knowledge of the risks that beset the sector, reports conclude with a judgement of confidence. This entails an assessment of the institution's 'capacity and commitment to identify and address any situation that has the potential to threaten the quality of programmes and/or the standards of awards'. And, of course, closer scrutiny through the QAA follow-up process is a consequence of a judgement of no or limited confidence.

Effective action in support of areas that are exposed to risk requires the close integration of quality assurance procedures with the institution's arrangements for academic planning and resource allocation. In addition, this kind of risk-based quality assurance is only effective if frank reporting is encouraged and rewarded, and where responsibility for 'at risk' provision is shared between staff at all levels within the organisation. This, as we have learned from the Treasury Committee report on the banking crisis, presupposes that institutions do not possess a 'cultural indisposition to challenge'. In the written evidence he submitted to the Committee, Paul Moore (the former Head of Group Regulatory Risk at HBOS) commented: 'Openness to challenge is a critical cultural

necessity for good risk management and compliance - it is in fact more important than any framework or set of processes'.<sup>11</sup>

There is a further lesson that we might draw from the financial sector, and this concerns the distinction between 'idiosyncratic' and 'systemic' risk. Adair Turner has advocated 'a shift in regulatory philosophy' towards a focus on 'systemic risks and judgements about business model sustainability, and away from the assumption that all risks can be identified and managed at a firm specific level'.<sup>12</sup> Such a shift of focus would entail a recognition that risk is 'part of the new enterprise culture of opportunity and innovation that is being encouraged in higher education by the Government. Risk-taking as well as risk avoidance is being sought'.<sup>13</sup> Although the White Paper describes its approach as 'market-based', the outcome will be a regulated and not a free market for higher education. In this regulated market, systemic risk arises as much from the activities of regulators and policy makers as it does from the behaviour of individual institutions.

## The risks of regulation

External processes of quality assurance...will become effective only if [they are]... forward looking and orientated toward building and developing institutions rather than simply inspecting them.<sup>14</sup>

We have been promised a new, fit-for-purpose regulatory framework that is said to be genuinely risk-based. Risk-based regulation is well-established in the financial services and, for a decade, it has been an aspiration for the higher education sector. The White Paper, however, offers us only a tantalising glimpse of its new framework and how it might fit with the wide range of possibilities already available to institutions and their regulators. In these circumstances, the grounds for the White Paper's assertion of the genuineness of its proposed approach remain unclear.

The principles of good regulation - regulation should be proportionate, accountable, consistent, transparent and targeted - might be our first port of call in our search for clarification.<sup>15</sup> Of these five principles, the commitments to proportionate and targeted regulation are of particular interest. As we have seen, the principle of proportionality featured in the 2002 *Operational description* for the then new method of Institutional audit, and the White Paper's proposals appear to be consistent with the requirement that 'any enforcement action should be in proportion to the risk'. However, the principle of targeted regulation - that 'regulation should be focused on the problem, and minimise side effects' - prompts two questions. The first concerns the meaning ascribed to 'risk' and thus the nature of 'the problem'; the second concerns the likely effects of the proposed method of regulation, including the risks of regulation itself.

One of the simpler definitions of risk is 'the possibility of something happening that impacts on your objectives'. To the extent that the White Paper is proposing that the criteria for the assessment of 'overall risk' should be based on performance, and assuming that these performance measures have a direct bearing on student interests, the 'something' will have happened already in those institutions that are identified as 'high risk'. However, the underlying purpose of risk management is to promote preventative rather than remedial action by anticipating threats rather than merely assessing the damage that has been inflicted already.

There might be a greater emphasis on potential or future threats if, in its consultation on the criteria against which risk should be assessed, HEFCE were to work from its own definition of risk. It defined risk as 'the threat or possibility that an action or event will adversely or beneficially affect an organisation's ability to achieve its objectives'.<sup>16</sup> Apart from recognising that risks can be positive as well as negative, and that now perhaps more than ever institutions must take risks in order to survive, the definition alerts us to the need to identify the actions or events that may have a future (beneficial or adverse) impact upon an institution. These actions, events or factors could be features of an institution's operating environment, its behaviour (and risk appetite), its provision, and its internal management arrangements, including its capacity for risk management.

Accepting the definition of risk that is implied in the White Paper, what are the likely effects of a regulatory framework that retains the proposed focus on performance? There is little in the White Paper to suggest that the purpose of regulation is to 'build and develop' institutions.

Indeed, one possible consequence of the risk-based approach is that the under-performance of 'high risk' institutions might be compounded by the need for them to bear the burdens of more intense regulation without some compensating benefits in the form of additional support. This effect would be exacerbated, of course, if 'at risk' institutions were to be required to make a greater contribution, through their QAA subscriptions, to the costs of regulation.

Competition and innovation are two of the principles of good regulation that the FSA is required to observe under the terms of the 2000 Financial Services and Markets Act. Competition is defined as 'the need to minimise the adverse effects on competition that may arise from [the Authority's] activities and the desirability of facilitating competition between the firms we regulate'. Although the White Paper commits the Government to the creation of a level playing field between providers, by amplifying the competitive disadvantages of under-performing institutions (and with others benefiting from 'reduced baseline regulation') the proposed approach to risk-based regulation could have the opposite effect.

'Innovation' refers to 'the desirability of facilitating innovation in connection with regulated activities', including 'scope...for different means of compliance'. Great care will need to be taken in the design of the new framework if it is not to discourage risk-taking innovation and the development by institutions of quality assurance arrangements that are genuinely fit for purpose.

'Fitness for purpose' is an over-worked but nonetheless useful concept. In this context it reminds us that an institution's quality management system may be required to serve two purposes that may be difficult to reconcile with one another. The first is to secure compliance with external expectations or regulatory requirements; and the second is to serve the needs of the institution and its members (including students). For too long, institutions have developed their quality management arrangements through a process of emulation and accretion, borrowing from others and adding one procedure onto another in response to the real or imagined demands of QAA and its predecessors. It is this more than anything else that has led to gold plating - the employment of 'unnecessary bureaucratic procedures in an attempt to guarantee a good [review] outcome' - and the prioritisation of assurance over enhancement.<sup>17</sup>

Risk is real and it is endemic to the sector. What matters is an institution's appetite for risk, its readiness to engage in risk-taking innovation, and its ability to manage these risks. The designers of the new regulatory regime should be sensitive to its possible impact on the behaviour of institutions and on the future development of their internal systems. Quite apart from the perverse incentives that might result from an injudicious selection of performance criteria, the new framework could incur the risk of encouraging an 'over-bureaucratisation' of institutional systems, with processes that 'stress conformity over risk-taking' and which are 'oriented to the past rather than the future'.<sup>18</sup> If this were to be the outcome, institutions' internal quality assurance arrangements would be less than effective instruments for the management of risk.

## Opportunities and challenges

One might conclude that the White Paper's still vague references to risk-based regulation present an opportunity for QAA and HEFCE to develop a method that draws upon at least some of the features discussed in this paper. Experience from institutions, the financial services, overseas quality assurance agencies and from QAA itself provides a rich resource. The new regulatory regime could employ assessments of risk potential as well as institutional performance, it could consider institutions' competence in the management of academic risks, and it could engage institutions in a continuing debate on the nature of the hazards with which they have to contend.

There are some difficult issues that will need to be addressed if the risk-based regime is to be fully effective. In particular, the architects of the new framework should consider its impact on institutions' quality assurance systems, and whether it will be capable of addressing the systemic risks to which the regulators and their political masters are themselves party. If we accept Paul Moore's assertion that 'openness to challenge' is 'a cultural necessity for good risk management', there is a third underlying issue. This is whether the future relationship between regulators and institutions, and between academic staff and their managers, will be conducive to the free exchange of intelligence and critical self-reflection. For those who believe that the White Paper

signals a new willingness to trust universities, the omens are good. On the other hand, from the perspective of those who believe that there has been a long-term erosion of the conditions for partnership and trust between universities, agencies and the state, the White Paper's proposals do not augur well for the future of regulation and quality assurance.

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