

Enterprise Risk: Understanding, Measuring, & Taking Action

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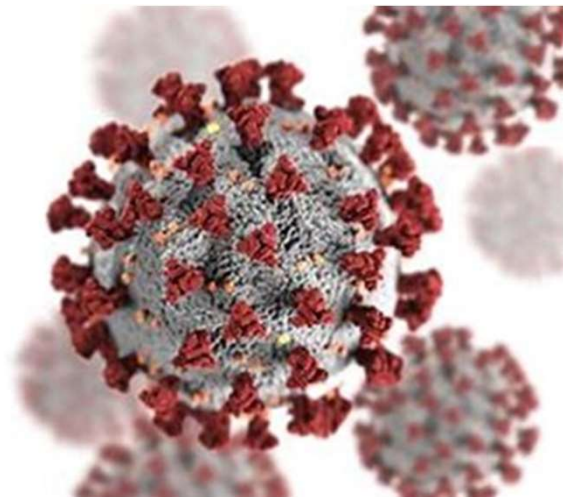


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HEALTH

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Need I Say More?



*Uncertainties
abound related to
how long the
pandemic will last
and how severe
each wave will be*

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Health Care Organizations Are:

Highly Regulated

- CMS
- IRS
- State Attorneys General
- JCAHO
- State Depts of Health
- State CON laws*
- Other state regulatory bodies

and

Being Disrupted By

New Players

- AI - Artificial Intelligence
- Amazon
- Google
- IBM Watson
- Venture-capital-based startups

Plus

Ongoing Market Forces

- Consumerism
- Pandemic
- Payer consolidation

What Could Possibly Go Wrong?

* Certificate of Need (CON) laws still exist in 35 states.

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Overview

Moving Beyond Compliance:
the Multiple Dimensions of Risk

Framework for Managing Risks

Processes and Tools for the Board

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What Is Enterprise Risk Management (“ERM”)?



“Health care organization boards must develop a broad view of threats and opportunities that affect the organization’s strategic goals. A mature ERM program supports the organization in the evaluation and treatment of risk.”

Identify All • Evaluate & Rank • Address Individually

Source: American Society of Health Risk Management (ASHRM), a society of the American Hospital Association, Enterprise Risk Management for Boards and Trustees: Leveraging the Value, page 2. <https://www.ashrm.org/resources/erm-resources>

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What Is Enterprise Risk Management (ERM)?

- Trustees and directors are **required** to review the adequacy of the organization’s risk management processes.
- Boards need to provide **leadership in moving beyond traditional reactive, “siloed” risk prevention approaches.**

Characteristics of Effective ERM

- Proactive
- Accepting of uncertainties and risks
- Multi-dimensional
- Holistic/coordinated
- Aligned with strategic direction
- “Top-down” and “bottom-up”

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S&P Incorporates ERM Factors in Ratings, Recognizes Its Impact on Financial Sustainability

S&P Global

- “The ultimate importance of ERM on a firm's rating will depend on the risks of the firm, the susceptibility of the firm to those risks and the capacity of the firm to absorb losses.”
- S&P evaluates companies within a general ERM framework with four major analytical components:
 - Risk management culture and governance
 - Risk identification and control
 - Emerging risks
 - Strategic risk management

Source: https://www.metricstream.com/insights/erm_credits.htm

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Traditional Focus of Health System/Hospital Risk Management

- “Protection from loss,” such as:
 - Malpractice/patient care
 - General liability
 - Property loss
 - Directors’ and officers’ risk
 - Regulatory compliance
 - Privacy and cyber security
- Responsibilities often siloed within committee and management structures

From TGI Biennial Survey

2019 data indicates that virtually all hospitals or systems maintain a board committee that focuses on compliance¹

Board Committee Name	% of Hospitals and Systems with Committee
Audit & Compliance	53%
Compliance	42%

Source: ¹The Governance Institute, 2019 Biennial Survey of Hospitals and Healthcare Systems. Systems typically maintain these committees at the system level only.

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More Robust View of Enterprise Risk

Enterprise risk is much broader than “compliance issues”

Enterprise Risk Framework

- Preventable Risks
- Strategic Risks
- External Risks

Clinical ♦ Operational ♦ Strategic ♦ Financial ♦ Legal ♦ Technology ♦ Hazard

! Any of the three categories of risks could fatally harm the enterprise

Source: Harvard Business Review, “Managing Risks: A New Framework,” Robert S. Kaplan and Anette Mikes, June 2012

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Polling Question #1

On which of the three categories of risk does your board and its committee have the greatest focus?

1. Prevention risks
2. Strategic risks
3. External risks
4. All get similar focus
5. Not sure

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Under Any Domain, Risks Can Fall into Any of the Three Framework Categories: Simple Example - Finance

	Preventable	Strategic	External
Examples	<ul style="list-style-type: none"> Fraud and abuse/ billing accuracy and compliance Accounts receivable/ collections 	<ul style="list-style-type: none"> Alternative payment models (ACOs, bundled, etc.) Medicare Advantage Plan partnership/ ownership Philanthropy Access to capital/ credit rating 	<ul style="list-style-type: none"> CMS payment cuts Medicaid restructures payment programs/ approaches Interest rate fluctuations ACO overturned: increase in uninsured patients
Approaches	<ul style="list-style-type: none"> Rules-based compliance Transfer some risk or "avoid" risk altogether 	<ul style="list-style-type: none"> Courageously identify risks Mitigate risks Monitor early indicators Contingency plans 	<ul style="list-style-type: none"> Scenario planning "No regrets," "Hedge," "Big Bet" strategies

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Processes & Tools for the Board

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Board To-Do's

#1 - Understand Where You Are Starting

#2 - Articulate Your Risk Preference/
Appetite; Align with Strategy

#3 - Use Effective Board Processes
and Tools

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Polling Question #2

How familiar are you personally with your organization's current approaches to overall enterprise risk management across all domains?

1. Extremely familiar
2. Somewhat familiar
3. Not very familiar
4. Not at all familiar

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#1 - Agree on Where You Are Starting: Board Refresher on ERM Approaches

Board To-Do's

Review:

- ✓ **Current ERM** approaches
- ✓ (If available) Statement or policy on **organizational risk preference/“appetite”**
- ✓ Current - and as needed - proposed revisions to **Compliance Committee Charter**
- ✓ **Current risk exposure**
- ✓ **Current ERM** and management and board reporting relationships

Key Generative Discussion Questions

- What information about each major risk currently is shared with senior management? The compliance committee? The full board?
- How do we measure the success of our ERM program? How *should* we?
- How does our ERM dovetail into our strategic planning process? Our financial decision making/ resource allocation?

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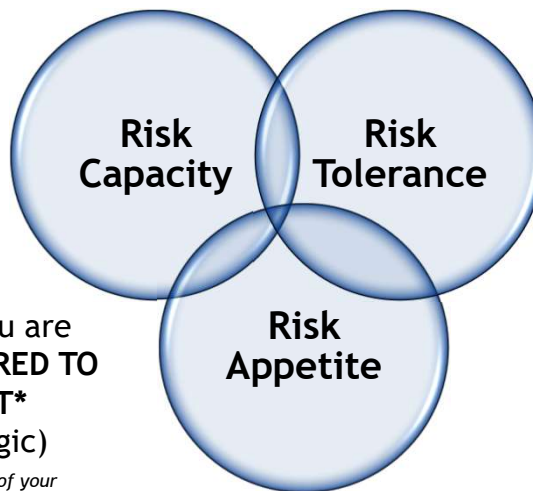
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#2 - Clearly Define Your Risk Capacity, Tolerance, and Appetite

Board To Do's



Risk you can **AFFORD** to take (financial)



Risk you **PREFER** to take (cultural)

Risk you are **PREPARED TO ACCEPT*** (strategic)

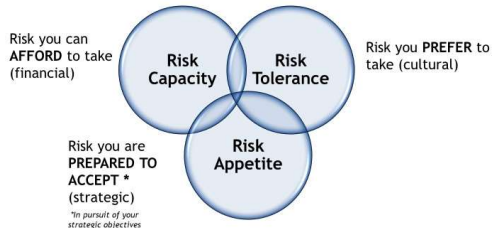
**In pursuit of your strategic objectives*

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Punchline!

#2 - Clearly Define Your Risk Capacity, Tolerance, and Appetite



Critically Important!
 Ensure that your “risk tolerance” and “risk appetite” align with your strategic direction and plan

An audacious vision without proper resourcing and effective risk management in an industry changing as rapidly as health care is unlikely to succeed.

#2 - Risk Capacity: Financial

What’s the Difference between Jeff Bezos’s Risk Capacity and Your Organization’s?



Your starting balance sheet strengths or weaknesses translate directly into intrinsic financial risk and risk capacity

Financial Measure	Desired Starting Point
Bond Rating	A+ rating or better
Debt capitalization ratio	<35%
Cash/investments	>170% of LTD and/or >215 days of cash on hand
Average Age of Plan	<11 years

#2 - Risk Tolerance: Preference

Key Question

“What is our tolerance for a critical or existential risk?”

- How much volatility and uncertainty are we comfortable with?
- How much of a financial cushion do we need in light of the myriad future uncertainties?
- What is our track record of effectively managing risks - and have we demonstrated the ability to take corrective action early?

Often framed in terms of continuum from “highly risk averse” to “risk seeking”

... what are implications of being stewards of a vital community resource?

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#2 - Risk Appetite: Strategic

Key Question

How Much Risk Are We Prepared to Accept in Pursuit of Our Strategy and the *Potential* to Create Future Value?

- Should be a clear statement of intent, which sets boundaries related to what constitutes acceptable risk for *your* organization

Example: Risk Appetite Statement

Our health system will achieve and maintain financial ratios consistent with at least Standard & Poor’s “A+” rating by:

- Achieving annual operating margins of ≥ 3 percent, through a combination of cost reduction, effective risk identification/management, and focused growth;
- Pursuing alternative payment models with limited downside risk;
- Maintaining our reputation for exception quality, service, and institutional integrity; and
- Using traditional, predictable financing vehicles.

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#2 - Risk Appetite: Strategic Strategy/Market Stance Must Tie to Your Risk Appetite

Example: Alternative Payment Models



- Participate in a Blue Cross “patient-centered medical home” (PCMH) with 5 - 15% upside bonus potential around quality & cost management



- Participate in a shared saving type Accountable Care Organization (ACO) with asymmetrical downside risk (less for you than insurer)



- Actively pursue risk contracts for managing population health with Blue Cross
- Develop your own Medicare Advantage Plan
- Buy or build own health plan

#3 - Effective Board Processes & Tools

Board To-Do's: Effective Board Processes

1. Create a “culture of safety” around risk management, broadly defined.
2. Avoid “groupthink.”
3. Re-evaluate your board committee structure & the roles/responsibilities of your Compliance Committee.
 - Consider a **Compliance & Risk Management Committee** - with Audit Subcommittee reporting to Finance Committee.

(continued)



Be Courageous!
Be willing to consider a “stress test” scenario for your organization - and whether you are spreading yourself too thin

#3 - Effective Board Processes & Tools

Checkpoint:

Does Your Organization Demonstrate “Omission Bias”?

“We would rather not do something and have something bad happen, than do something and have something bad happen”

Board To-Do’s: Effective Board Processes

4. Recognize the risks of not taking strategic action
5. Recognize risks and uncertainties without becoming paralyzed

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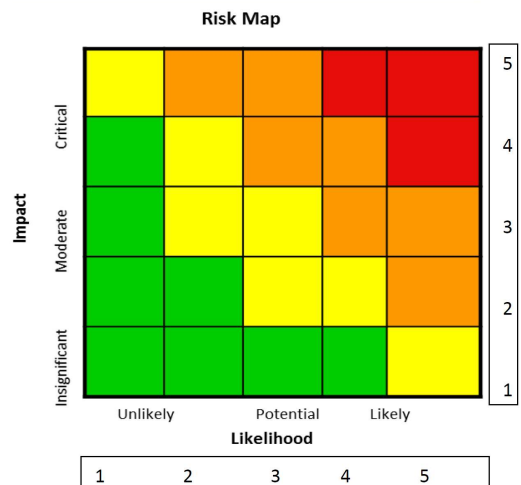
#3 - Effective Board Processes & Tools

Use a Decision-Analysis Framework

- Create a framework for assessing both the adverse **impact** of an event and the **likelihood** of the risk’s occurring.
 - **Impact x likelihood = risk to organization**
- Some organizations include a third dimension in this equation: “velocity.”

Risk Rankings	
Risk is ranked as...	...if the product of Impact & Likelihood is...
VERY HIGH	Greater than 17.0
HIGH	Greater than 10.0, but less than 17.0
MEDIUM	Greater than 5, but less than 10.0
LOW	Less than 5.0

Risk Ranking Matrix



Source: Matrix from ASHMR, *Enterprise Risk Management: A Framework for Success*, © 2014, American Hospital Association

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Tool: “Risk Event Card”

Risk Category: Strategic
Risk Domain: Financial

Strategic Objective	Risk Event	Potential Adverse Events/Impacts	Likelihood/ Impact	Mitigation	Accountable Manager
Alternative Payment Models	Medicare Advantage Plan Launch	<p>Financial losses on plan (negative ROI)</p> <p>Losses at hospital(s) due to reductions in utilization</p> <p>Political challenges with physicians</p> <p>Adverse response from major commercial payer</p> <p>Medicare changes “rules of the game”</p>		<p>Partner w/ group experienced in mgmt of MA Plans</p> <p>Invest in “best in class” data analytics</p> <p>Hire experienced executive team</p> <p>Reduce hospital costs/right-size for reduced utilization</p> <p>Closely monitor CMS policies</p>	Penny Wise, Chief Financial Officer

Source: Robert S. Kaplan and Anette Mikes, “Managing Risks A New Framework,” *Harvard Business Review*, June 2012. Modified by M. Jennings Consulting.

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Tool: Enterprise Risk Inventory

How much overall risk can your organization effectively manage?

RANK	RISK EVENT	PRIMARY RISK CATEGORY/ DOMAIN	IMPACT	LIKELIHOOD	RISK RATING
1	Medicare Advantage Plan Launch	Strategic/Financial	4.5	4.5	20.3 (Very High)
2	Public Payment Changes/Reductions	External/Financial	4.1	4.8	19.7 (Very High)
3	IT Infrastructure/Data Analytics	Strategic/Technology	4.4	3.9	17.2 (Very High)
4	\$150M North Tower Replacement	Strategic/Strategic	4.1	4.0	16.4 (High)
5	Cybersecurity/Data Confidentiality	Preventable/Technology	4.4	3.5	15.4 (High)
6	Serious Safety Event	Preventable/Clinical	3.5	3.6	12.6 (High)



17	Nursing Strike	Strategic/Operational	3.9	2.3	9.0 (Medium)
18	Disaster Preparedness	Preventable/Hazard	3.6	2.5	9.0 (Medium)
19	Regulatory Compliance	Preventable/Legal	2.5	2.9	7.3 (Medium)

Source: Risk Inventory from ASHMR, Enterprise Risk Management, A Framework for Success, © 2014, American Hospital Association. Modified by M. Jennings Consulting.

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Polling Question #3

Which statement below best describes how your organization assesses enterprise risk?

1. We assess cumulative risk across all domains ranked by their likely impact, as in the example on slide 23
2. We assess cumulative risk in individual domain: for example, the finance committee assesses payment and other financial risks
3. We assess risks individually (e.g., risk of starting an ACO) but don't "add them all up"
4. Combination of 1 - 3
5. Not sure

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What Should You Do Tomorrow?

Now Understand Your Current ERM Approaches

- How much risk - broadly defined - have we assumed already? What is on the horizon?
- How does information flow from management through committees and to the Board?
- What is our current "risk capacity"?

Create Culture Ensure Your Board's Culture Supports Effective ERM

- Articulate your risk preference/appetite - and align them with your strategic plan.
- Build risk assessment into all business planning processes.
- Ensure a "culture of safety" to encourage transparency when adverse events occur.

Processes/Tool Use New or Enhanced ERM Approaches

- Evaluate best committee approaches to support governance oversight of ERM.
- Create and regularly update your enterprise "risk inventory."
- Actively use scenario planning - and closely monitor potential "clouds on the horizon."

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Well Said!



“A firm’s ability to weather storms depends on how seriously leaders take risk management **when the sun is shining** and no clouds are on the horizon”

Source: Robert S. Kaplan and Anette Mikes, Managing Risks A New Framework, *Harvard Business Review*, June 2012.

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