Q&A

John Phelps, Director of Business Risk Solutions, Blue Cross and Blue Shield of Florida, Inc.

LIVING WITH UNCERTAINTY

By Russ Banham

John Phelps

RIMS

In the darkest days of World War II, the idea was conceived of a voluntary program permitting Floridians to prepay for physician services. Wartime restrictions and an extreme shortage of medical care specialists prompted two doctors, Ted Arnold and Leigh Robinson, to create what is today Blue Cross and Blue Shield of Florida, which began operations in 1944 in Jacksonville with a staff of four.

Today, Florida Blue, as it is more colloquially known, comprises a family of dozen subsidiaries serving more than 15.8 million people in 16 states. From that humble staff of four, it is now one of the state's largest employers, with approximately 6,500 of its nearly 7,500 employees located in Florida. In charge of advising on the vast array of risks confronting the enterprise is John Phelps, director of business risk solutions. Phelps sat down with RIMS to discuss Florida Blue's ERM program, one that is keenly focused on uncertainty above all other exposure concerns.

RIMS: You've stated in past that the goal of the ERM program at Florida Blue is to better understand uncertainty to thereby reduce it. Would you elaborate on your position?

Phelps: Here's the deal: When you boil down ERM into its essential benefits—basically why you have a program—it's to get at your ability to reduce uncertainty to make better business decisions. If you're not doing that as a risk manager, then you might as well go back to buying insurance. Your job should be to help those in operations understand their risks better so they can then make better decisions.

RIMS: In this process, is it incumbent upon risk management to measure uncertainty in each area that it covers?

Phelps: There are many different measurements of uncertainty, such as traditional metrics like likelihood or probability, and impact or severity. But, there is a need to be flexible, as there is a lack of unanimity with regard to using the same measures for all risks. For instance, with a plain vanilla operational risk you would measure impact, likelihood and effectiveness of controls. With strategic risk, on the other hand, measuring the effectiveness of controls doesn't offer much value when considering long term, high level external risks, so you would estimate the impact using Monte Carlo simulations or stochastic processes examining random variables. These estimations are based on a collective assessment of probabilities. You'd also try to measure velocity, how fast the impact you've just estimated might hit the company strategically. All of these techniques and criteria are tools to estimate the level of uncertainty.

RIMS: Do you actually measure uncertainty?

Phelps: Yes, in a way. We do heuristic evaluations—the 1 to 10 sort of thing, as opposed to a precise measurement because uncertainty in the future often doesn't reveal itself under analysis based upon past events. We often fool ourselves into thinking it does. A good example is litigation risk. If you think you can look at past litiga tion to predict the next few years – especially in a post Obama Care environment, , you're being foolish. Everything is constantly changing and moving too fast.

RIMS: What is a key challenge for you in measuring risks?

Phelps: For us, it's trying to do quantifications that are dollar-oriented. In other words, we want our risk estimations translated into dollars because dollars talk in an organization. We've been experimenting with this for a while, and will do more in future. Now I'm not talking precise dollars and cents, but a range; in other words, if we invest $135,000 in this risk mitigation effort, it could save us between $900,000 and $1 million cost reduction – the nature of which is often "soft costs" and lack the precision of hard dollar cost estimates..

RIMS: Tell us a bit about the ERM process at Florida Blue.

Phelps: We do an operational risk assessment each year, diving into each operational area to develop the list of risks and evaluate them using the heuristics tools—we compare them to the previous years' assessments. But, as far as quantifying (future risk) against the accuracy of the previous estimates, I just don't see the value in that. I'm only interested in the risks in front of us today.

RIMS: I understand you've been riding herd on ERM at Florida Blue since 1997. Do you think of yourself as a pioneer?

Phelps: Well, we started talking about ERM then, but didn't kick off the program until 1999. Back then we called it Integrated Risk Management. We took the traditional risk management responsibilities and sprinkled some ERM fairy dust over them and then called it all ERM. Truth is that it was nowhere near what we have today, given two major ERM standards (COSO and ISO 31000) in place to guide us.

RIMS: What was the precipitator to the program?

Phelps: At the time, I was reporting to the general counsel, and the industry was being hit with a number of very large lawsuits over managed care. People were not getting treatment that was considered experimental or not medically necessary because such treatment is excluded under the contract. These non-covered services were often a last ditch effort by the patient to save their life from the clutches of some terrible disease like cancer. These lawsuits were serious threats and often resulted in tens of millions of dollars in settlement and defense costs. I approached the general counsel and said we need to look at every case and pull apart the facts and consider advocating measures within operations that would protect us against such a suit. We're very good at being reactive but I convinced him that a pro-active approach is less costly in financial and reputation terms. Anyway, this led to a program in which we reorganized so that internal audit, compliance, legal and risk management all reported up to the general counsel. In fact, we are even in the same building and the same floor.

RIMS: Does this proximity have value?

Phelps: Yes, we interact continually, both on an ad hoc basis and formally four times a year to review our risk profiles to determine if we have adequate coverage for operational areas to help them address these risks. We also have what we call our Enterprise Risk Council with many of the same people on it, in addition to director and officer level executives from key operational areas across the organization. Together we review outstanding risks in each of the operational areas and the mitigations in place. We also try to collect perceptions on emerging risks—not to estimate the potential impact but just to keep an eye on these items.

RIMS: I noticed that your department used to be called risk management, but is now referred to as business risk solutions. Why the switch?

Phelps: For ERM to be effective, the operational areas must own the risk—not me and not my department. Whether I am around or not, the inventory of risks are the responsibility of operational areas. My job is to keep them focused on their risks, and help from a risk-coaching standpoint to manage through them. It is impossible for me to be in the trenches managing operational risk. That's why I changed the name. We're an internal consultancy providing risk coaching. Our greatest value is to reduce uncertainty, making them more aware of their risks so they can make better decisions. When you think about it, every operational area should have "risk management" in their name!