BECKER'S
Hospital Review
BUSINESS & LEGAL ISSUES FOR HEALTH SYSTEM LEADERSHIP

Simple and Strategic: The Next Generation of Executive Benefits

By David Cohn, Principal, Sullivan, Cotter and Associates, Inc.

Hospitals and health systems are moving away from complex, difficult-to-administer executive benefits in favor of streamlined programs designed to withstand scrutiny and enhance organizational stability. More than ever, healthcare organizations are using their executive benefits more strategically — a shift that is evident in four key benefits trends.

Trend 1: Easy to Understand

Many healthcare organizations prefer executive benefits programs that are easier for compensation committees of boards to govern and less costly to administer. While there are situations where defined benefit plans make sense, most hospitals and health systems seem to prefer to offer their executives simple, defined contribution plans that mirror the trend for programs offered to other employees. Executives are almost twice as likely to be offered a defined contribution plan compared to other types of plans, according to SullivanCotter's *2014 Survey of Manager and Executive Compensation in Hospitals and Health Systems Survey*. The reasons for the shift in practice are fairly straightforward:

- Defined contribution plans are easier to understand and administer.
- Organizations can adjust contributions to respond to changing business needs.
- Defined contribution plans can take advantage of vesting approaches that enhance retention while "spreading out" taxes and the IRS Form 990 impact, where each contribution can be vested after future service is earned.

Executive benefits that are decreasing in prevalence include executive-specific flexible benefits programs that provide participants with an allowance to allocate among various benefits and supplemental retirement benefits that are usually funded through split-dollar life insurance policies. These plans can be complex to administer, communicate and maintain.

To identify opportunities to simplify executive benefits, board members should conduct an independent evaluation of these programs and ask the following questions:

- Can I easily explain the benefits plan to participants and board members?
- Do I understand the risks associated with changes in interest rates, tax rates and investment markets?
- Is the benefits plan aligned with the organization's current and future business needs?

Trend 2: Ability to Withstand Scrutiny

Past and recent media events reflect the heightened scrutiny of executive compensation. Each year, the public release of the Form 990 generates front-page articles on executive pay across the country. These articles may contain misleading information that can compromise an organization's relationship with its employees and community.

For this reason, hospital leaders and board members are seeking information on how compensation will appear on future Form 990 disclosures. Supplemental retirement programs — through which benefits are earned over many years — can result in large amounts reported in a single year. Board members should focus on these retirement programs and review the amounts that will be reported on the Form 990 before it is filed.

Given the complicated nature of the Form 990 and the number of potential questions that may be posed — by a reporter, donor or even an employee — most organizations designate a board member as a spokesperson in addition to a leadership or public relations expert. In most cases, these benefits are explained by using market data that support the organization's compensation philosophy. The due diligence process used by boards is an important factor in demonstrating the facts and reasoning used in the compensation decision-making process.

Other benefits that are more challenging to defend include perquisites that do not provide a direct benefit to the employer, such as reimbursements for personal financial, estate or tax planning services, and expensive automobiles. Boards would be well served to take a look at the executive benefits program from an outsider's perspective.

Trend 3: Stability During Change

As merger and acquisition activity continues to ramp up, board members are determining how to structure their retention and severance benefits for leadership stability. For example:

- Health systems that acquire other hospitals want benefits that are scalable and can absorb the hospital's executive team without making significant changes or exceptions.
- Acquired organizations want their executive team to remain intact through the transaction and integration period by providing an adequate safety net (via severance) and providing positive encouragement to stay (via retention programs) through a particular date.

Hospital leaders should ask questions about the stability of their benefits plans during periods of uncertainty. Is the compensation plan designed to:

- Encourage essential executives to stay during a period of change?
- Protect executives if their positions are eliminated?
- Offer vested supplemental retirement and retention programs following a transition?
- Provide a severance package to an executive that separates after a change?

Perspectives vary on the use of compensation packages during organizational change. Health systems acquiring hospitals may be able to absorb the risk of executive departures after the merger is complete, lessening the need for retention programs. On the other hand, boards of the acquired hospitals may want to use these programs to motivate their executives to complete the deal successfully by protecting their benefits whether they stay or to leave. In either case, both parties in successful mergers need to consider how to best support the emerging organization.

Trend 4: Complement Succession Planning

According to a recent report from the American College of Healthcare Executives, one in five healthcare CEOs turned over in 2013 — a record high. That trend will likely continue because:

- Competition is fierce for seasoned executives who can lead during uncertain times.
- Company and personal retirement savings have rebounded, making retirement more palatable for executives.
- M&A activity will continue, resulting in fewer leadership positions.

In response to this trend, healthcare organizations are focusing on strategies that promote stable leadership in turbulent times. These arrangements can be individualized for key executives that are affected by the transition. These strategies may incorporate retention plans, severance or a combination of the two.

Executives feel most secure when they are protected during a time of change. Designing a program that provides security in selective circumstances may require tailored solutions.

These solutions can be valuable, but must be viewed as a complement to a broader succession planning strategy. Boards should review their succession plans annually — not just when contracts are expiring — to help with continuity in leadership, particularly during times of change.

Summary

Executive benefits design varies based on the needs of the hospital or health system as well as its executive team. Healthcare leaders can best serve their organizations by reviewing their executive benefits regularly and designing programs that are flexible enough to meet the needs of a changing healthcare environment.