

# Trustee Insights

## EXECUTIVE PERFORMANCE AND COMPENSATION



## 2020 Actions for the Board Compensation Committee

Take time in 2020 to reexamine your executive compensation program

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**T**he health care sector continues to undergo unprecedented transformation, and the challenges faced by not-for-profit hospitals and health systems are not abating. As organizations look to navigate these changes, the board compensation committee is well served to assess the impact of this rapidly evolving environment on the executive compensation program and related committee practices. Key actions for committee focus for 2020 are discussed here.

**KEY ACTION: Determine if the committee's time and focus are appropriately directed to the most important issues.**

Compensation committees can consider questions such as these to help determine their priorities and focus going forward: Is the committee strategic in its focus or is it engaged primarily with the approval of transactions? Should more time be spent on providing strategic guidance to the CEO on talent management/risk and succession planning? Can less time

### TRUSTEE TALKING POINTS

- Market dynamics, resulting in the need for change, and related challenges continue to affect not-for-profit hospitals and health systems.
- Board compensation committees must assess the impact of change on their organization's executive compensation program and committee practices.
- Periodic assessment is critical to ensure compensation programs and talent strategies remain aligned with organizational goals and objectives.

be spent on transactional reviews which follow established standards (e.g., total compensation falling at or below the 75th percentile) and are reviewed for policy and regulatory compliance by committee-retained advisors? Is the committee devoting an adequate amount of time to assessing the size, cost and contributions of the executive group?

**KEY ACTION: Assess the adoption of emerging compensation committee practices.**

Compensation committee responsibilities are expanding in response to the changing marketplace. Examples include:

- Identifying the most critical positions, as well as the most promising future leaders, and ensuring the compensation program supports their retention.

- Assessing senior-level talent risk.
- Overseeing talent management initiatives, retention strategies and succession plans.
- Monitoring leadership pay equity, diversity and inclusion.
- Identifying conflicts of interest and commitment related to outside activities that are compensated.
- Providing strategic oversight to physician compensation arrangements.

**KEY ACTION: Assess two traditional elements of the executive compensation philosophy and modify them as necessary to ensure alignment with the leadership development strategy and market reality.**

- Evaluate the use of precise target market percentiles (e.g., total compensation = 75th percentile) as it may be difficult, financially unsustainable or not an effective use of compensation dollars to maintain the same market position for all executives. Deviations may be necessary based on performance, potential and attraction/retention concerns.
- Consider modifying a “one-size-fits-all” philosophy regarding program design. Does the program have the flexibility to respond to all the executive labor markets in which the organization competes? With executives now coming from diverse markets (e.g., financial services, insurance, information technology, cyberse-

curity), a more nuanced approach should be considered. However, protections against bias and inequities need to be in place to support a more flexible approach.

**KEY ACTION: Consider a “Build, Buy, Protect” framework for senior executives to better align talent and executive compensation strategies.**

- **Build:** For roles to be filled by internal candidates, use compensation strategies focused on retention incentives and pay levels intended to recognize the anticipated career trajectory.
- **Buy:** For roles requiring highly experienced external talent, use compensation at the upper end of the market supported by tools such as sign-on bonuses, relocation programs and deferred compensation/retirement plan supplements.
- **Protect:** For high-performing internal talent who need to be retained, use market competitive compensation supported by deferred compensation/retirement plan supplements and retention incentives.

This approach allows the executive compensation program to more effectively support the organization’s long-term leadership talent management strategy than does a “one-size-fits-all” approach.

**KEY ACTION: Evaluate the effectiveness of the executive compensation program in driving and rewarding performance.**

This can be accomplished by examining organizational performance

relative to peer group benchmarks and rates of industry improvement. Performance data for peers abstracted from sources such as audited financial statements, CMS Star Ratings and value-based programs should be assembled. These data will enable the committee to assess pay relative to organizational performance (with the likely intent that the overall executive pay percentile approximates or falls below the overall performance percentile). As part of this effort, the measures and their relative weights should be reviewed for alignment with the organization’s strategic plan. The level of stretch in the performance goals also should be evaluated at threshold, target and maximum levels.

In addition, the committee should consider the use of emerging annual incentive plan (AIP) and long-term incentive plan (LTIP) performance measures. According to SullivanCotter’s 2019 Manager and Executive Compensation in Hospitals and Health Systems Survey Report, the most commonly used AIP measures focus on financial, quality and patient experience/access outcomes. Merger and acquisition activity, as well as cost pressures, are leading to a greater use of AIP measures focused on integration and development through strategic initiatives. Many not-for-profit hospitals and health systems are enhancing community benefit efforts to meet important community needs and reinforce their mission, vision and values and are therefore adding related measures to their AIPs. The survey indicates LTIP measures reflect an increasing focus on system growth, multiyear strategies to

enhance patient experience/access, and strategic initiatives that realize the benefits of merger and acquisition activity.

**KEY ACTION: Assess the peer group(s) used for benchmarking to ensure it is reflective of the organization's scope, complexity and competitors for talent.**

Talent markets may shift as organizational size, complexity and roles change. Maintaining flexibility is critical to support the recruitment and retention of key talent. Nontraditional positions may require unique peer groups and, for certain jobs, the peer group may include general industry if it is a potential source of talent. The SullivanCotter survey also indicates the emergence of material pay differentials for executive positions in high cost-of-living areas, which must be considered in peer group development.

**KEY ACTION: As health care will be a major topic in the 2020 elections, be prepared to respond to allegations of excessive executive compensation.**

The committee should direct the development of a media/public relations strategy and include identified spokespersons. To support this effort, the committee is well served to ensure the design, operation and outcomes of the executive compensation program are communicated on an annual basis to the full board. Some committees find it helpful to provide board members and organizational spokespersons with a docu-

## TRUSTEE TAKEAWAYS

- Ensure the committee spends its time on key issues and priorities.
- Decide whether to adopt emerging committee practices such as assessing senior-level talent risk and monitoring leadership pay equity, diversity and inclusion.
- Consider a "Build, Buy, Protect" framework to better align senior executive talent and executive compensation strategies.
- Given the 2020 elections, be prepared to answer questions about excessive executive compensation.

ment similar to the Compensation Discussion and Analysis documents prepared by public companies.

**KEY ACTION: Identify and monitor excise tax liabilities.**

The provisions of the 2017 tax reform law establish two excise taxes of 21% that apply to compensation arrangements for "covered employees" (the five highest paid employees in the current or a prior tax year):

- Compensation over \$1 million ("excess remuneration").
- Excess parachute payments (payments made contingent on an "involuntary termination of employment") that are more than three times the individual's average annual taxable compensation over the last five years. If triggered, the excise tax is based on the amount that exceeds one times the base amount.

It is important to recognize that

liabilities will likely grow over time. Once an employee is a covered employee, they will remain so. Larger organizations are likely to have multiple sets of covered employees.

Some key actions for the committee include:

- Project potential future excise tax liabilities by considering possible changes in covered employees and future compensation and vesting.
- Assess the excise tax impact of pay decisions and structural changes to the program.
- Assess exposure to excise taxes related to excess parachute payments.
- Prepare for potential scrutiny from disclosure of the organization's excise tax liability.

Not-for-profit hospitals and health systems continue to face of a number of challenges in today's complex operating environment. With these key considerations in mind, the compensation committee must periodically reevaluate its executive compensation programs and talent strategies to ensure continued alignment with organizational goals and objectives in a rapidly changing marketplace.

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