

Addressing COVID-19: Key Considerations for the Board Compensation Committee



The COVID-19 crisis is impacting not-for-profit hospitals and health systems in a myriad of ways. The crisis is placing an enormous strain on both financial and workforce resources by creating uncertainty regarding current/future revenue, volume, employee safety and job security. The Board Compensation Committee (Committee) serves a critical governance role in the organization's efforts to navigate uncertainty by advising management on talent risks, supporting a focus on the key success factors to survive and recover from this crisis, and ensuring that—if scrutinized—the executive compensation program reflects best governance practices, given market dynamics and the need for Compensation Committees to move quickly.

Guiding principles for the Committee in these unpredictable times may include:

- Relying on sound business judgment and discretion in compensation decision-making by considering organizational finances, employee health and safety, broader workforce impacts (e.g., furloughs, layoffs), talent risk and burnout, local and industry market responses and competitive market positioning.
- Basing decision-making on the organization's specific circumstances with due consideration of market practice intelligence and optics.
- Being flexible to adapt to a dynamic and fluid environment that will continue to evolve over the coming months.
- Considering the organization's compensation strategy and the short/long-term impact of major changes to the compensation program in response to the crisis.
- Defining key success factors for managing through this crisis, and anticipating the post-crisis changes to strategic and operating priorities, in preparation for discussions on incentive plans that may no longer have relevance due to the disruption caused by COVID-19.
- Balancing internal and external perceptions of compensation decisions, especially if the organization is receiving financial assistance and/or implementing furloughs/layoffs, with the need to honor previous compensation commitments.
- Mitigating any immediate key talent risks while maintaining a long-term focus on talent retention and succession planning.
- Ensuring transparency to the full Board on any compensation actions taken during the crisis.

SUCCESSION PLANNING

If within the Committee's purview, consider the development of an emergency succession plan that identifies the individuals who can serve as interim replacements for key executives who may require an extended quarantine period or experience severe burnout. It is also important to consider whether the current succession plan requires any changes given the emerging organizational challenges as well as the skill sets and qualifications of the current candidates. The crisis will allow for identification of individuals who are stepping up and exhibiting leadership, which will help to inform the Committee's succession planning efforts. Prepare for a longer-term review of the talent strategy that will be needed to adapt to and thrive in the post-COVID-19 environment as strategic priorities shift and operating models change.

COMPENSATION DECISIONS DURING THE CRISIS

The Committee should consider the competitiveness of total compensation while also evaluating retention risks. This requires a facts-and-circumstances approach when evaluating potential compensation reductions. If a long-service executive's total compensation is high relative to the market with limited variable compensation, the impact of a salary reduction is much different than in a situation involving a short-service executive with below-market compensation and higher variable pay (with incentives unlikely to be paid).

Consider market intelligence on COVID-19-related compensation practices of similarly-situated organizations. To date, the not-for-profit health care sector's actions related to temporary executive salary reductions, salary increase deferrals and salary freezes have been modest compared to the more aggressive approach of publicly-held companies. These practices are subject to change as financial challenges increase and the impact on the health care workforce continues to evolve.

A major focus area for the Committee is the annual incentive plan given the economic uncertainty facing hospitals and health systems. Since incentive plans can be helpful in focusing executives on key priorities, rather than suspending or eliminating the plan, give consideration to a more discretionary and flexible approach to performance measurement. This may include re-setting goals, assessing performance pre- and post-COVID response, eliminating irrelevant goals, and/or including measures that focus on restarting the organization and near-term recovery. If utilizing a discretionary approach, guiding principles should be established to help inform decision-making. In some cases, the Committee would be well-served to delay the finalization of incentive measures and goals for forthcoming incentive plans until there is less organizational and market uncertainty. The timing of the conclusion of the performance period will impact the Committee's options. Those with calendar year-ends may have more time to plan.

While most organizations have not taken any action to date regarding long-term incentive plans (LTIPs), we expect that, similar to annual incentive plans, the negative financial impact and potential reassessment of strategic plans will impact future goal setting and LTIPs that are already in place. As some organizations are considering postponing the implementation of new LTIP cycles, most are waiting until the crisis starts to subside before making any decisions on these plans.

Given the number of new and emerging financial challenges, the Committee should explore actions that will help to control costs without creating significant talent retention risks or sending unintended messages to the workforce. In addition, such actions need to be assessed in light of any implications related to employment agreements and 457(f) and 409A deferred compensation rules.

If your organization is considering loans and loan guarantees available under the CARES Act or the Main Street Lending Program (as available to not-for-profits), assess the required compensation restrictions and their implications for executive and physician recruitment and retention for individuals with CY 2019 total compensation exceeding \$425,000.

ACTIONS FOR ENHANCING RECOVERY

After addressing issues requiring immediate attention, the Committee should consider actions for enhancing organizational recovery. The definition of performance in the new environment post-crisis continues to evolve, and it may be appropriate to refine the way organizational and individual performance is assessed. The Committee should work with management to define both short and long-term goals required to support recovery (e.g., cost reductions, financial stability, workforce engagement, care redesign) and, if appropriate, include these in incentive plans. Given changes in the delivery model, it may be time to assess organizational structure, spans of control and the scope and definition of various executive roles. Underlying all these actions is the need to identify critical talent and update succession plans and talent management strategies.

COMPENSATION COMMITTEE GOVERNANCE

The Committee should review approval procedures and processes and modify if necessary to ensure critical executive and physician compensation arrangements can be acted upon in a timely fashion. The Committee should consider adjusting its calendar to include more regular discussions on compensation and talent implications over the coming months since the environment is dynamic and circumstances are rapidly changing. If virtual Committee meetings are being considered for the first time, the General Counsel should ensure the desired method is acceptable under state law.

PHYSICIAN COMPENSATION

The Centers for Medicare and Medicaid Services (CMS) has issued blanket waivers for potential sanctions under the Physician-Self Referral Law (Stark Law) which provide broad latitude in structuring financial relationships between physicians and health systems/hospitals while the national state of emergency exists. Legal experts expect that such arrangements will be scrutinized by “whistleblowers” and the Department of Justice, which may result in False Claims Act litigation. If within its purview, the Committee should ensure such arrangements are reviewed for compliance and that all required documentation is completed.

MOVING FORWARD

Although the future is uncertain, an active and focused Compensation Committee will help to ensure that the organization can retain, manage and develop highly effective individuals for key roles who can lead the way in the post-crisis world. The market dynamics around executive compensation are very fluid. Any major program design changes should be carefully considered before implementation as these may impact leadership retention, recruitment and succession planning initiatives in an environment where exceptional health care leaders will be highly sought after.

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