Executive compensation packages at nonprofit hospitals have come under increased scrutiny in recent years from regulators and legislators, as well as the media and general public. Health & Human Services’ Office of Inspector General this year announced its intention to examine whether caps on hospital executive salaries could result in substantial Medicare savings. Given the heightened scrutiny, hospital boards are faced with a challenging task: attracting and retaining executive leaders while navigating complex regulatory compliance and disclosure requirements.

When developing compensation packages, hospital boards must ensure that their efforts meet Internal Revenue Service standards for tax-exempt organizations. Executive compensation packages must be consistent with the organization’s charitable mission and adhere to fair-market value. And boards must be prepared to explain their executive compensation program.

The IRS requires that health care organizations be prepared to provide “rebuttable presumption of reasonableness.” Boards should be careful to document all aspects of the executive compensation process.

The development of a compensation philosophy also is recommended to support the rationale for executive pay decisions.


**METRICS**

The review of external benchmark data is an essential component of the executive compensation process. To ensure reasonableness in executive compensation, some boards are redefining their peer groups, looking beyond organizational size and type comparisons. Rohan says that boards are benchmarking against organizations with similar quality and financial metrics. “There’s been a pretty dramatic shift in defining peer groups over the past 12 to 18 months,” he says.

**Trends Reflect Industry Transformation**

- METRICS
INCENTIVES
Executive compensation historically has focused on short-term incentives. Boards are increasingly looking at long-term incentives to retain top talent. Long-term incentives typically focus on performance over a three- to five-year period. Given the complexity of today’s health care environment, long-term incentives allow for review of transformation goals that may take longer than 12 months to achieve. “Long-term incentives increase the amount of leverage in compensation programs,” says Rohan. “It puts more pay at risk.”

BENEFITS
Supplemental executive retirement plans, which are nonqualified defined-benefit plans that are not subject to the same minimum funding as qualified plans, are becoming more common in compensation programs. Supplemental executive retirement plans are a useful recruitment and retention tool, because they allow for the replacement of lost retirement income due to caps under the IRS tax code.

SEVERANCE AGREEMENTS
The transformation of the health care marketplace has created much uncertainty due in part to increased consolidation and the growth in outpatient services. Severance packages most often provide salary and benefits continuation for a set period due to change in control or involuntary termination without cause, and are often based on length of service. Severance packages help from a recruitment perspective, says Rohan. “They create a safety net for CEOs,” he says.