

## EXECUTIVE COMPENSATION

Health care organizations should all have a board-approved compensation philosophy that:

- Defines a peer group that the committee responsible for executive pay uses for comparative purposes.
- Specifies executive salary positioning and administrative guidelines.
- Defines cash-compensation opportunities and competitive positioning based on performance.
- Defines a benefit, perquisite and severance strategy.
- Defines how total compensation (total cash compensation plus benefits) will be positioned .

It is a standard policy of organizations to conduct a new analysis of executive total compensation (salaries, incentives, benefits and perquisites) periodically (one to three years).

## EXECUTIVE COMPENSATION TRENDS 2011 TO 2012

***These data are reported in the Sullivan, Cotter and Associates, Inc.'s 2011 Survey of Manager and Executive Compensation in Hospitals and Health Systems which includes information from 1,230 organizations, including 298 health systems and 932 hospitals.***

### Health Care Executive and Manager Compensation Strategy

SullivanCotter identified the following trends in compensation strategy for health care executives and managers:

- Approximately 89 percent of the systems with established compensation strategies reported current executive base salaries approximate their intended compensation strategy and 84 percent reported current manager base salaries are consistent with their intended strategy.
- Approximately 82 percent of the systems with established compensation strategies reported current executive cash-compensation levels approximate their intended compensation strategy and 87 percent reported current manager cash-compensation levels are consistent with their intended strategy.

## Health Care Executive and Manager Salary Movement Summary

SullivanCotter identified the following trends in salary levels for health care executives and managers:

- 2012 projected median-salary range adjustments for both system and hospital executives and managers are 2 percent.
- Projected median-salary increase levels for both system and hospital executives are 3 percent and for managers are 2.8 percent.

## Health Care Salary Range Adjustments

Most systems use salary ranges for administering leaders' salaries. Approximately 65 percent of organizations use salary ranges for executives and 95 percent use ranges for managers:

Participant Group	Salary Range Adjustments			
	25 <sup>th</sup> Percentile	Median	Average	75 <sup>th</sup> Percentile
Executives	2.0%	2.0%	2.4%	3.0%
Managers	2.0%	2.0%	2.3%	3.0%

## Health Care Same-Incumbent Salary Increases

Same-incumbent increases refer to salary increases for employees who remain with their organizations, in the same job, from one year to the next. The following table shows 2010 to 2011 same-incumbent salary increases for executives and managers in health care systems:

Participant Group	Same Incumbent Increases			
	25 <sup>th</sup> Percentile	Median	Average	75 <sup>th</sup> Percentile
Executives	2.5%	3.0%	3.0%	3.0%
Managers	2.5%	2.8%	2.7%	3.0%

Most systems are budgeting 3 percent salary increases for 2012, excluding merit or market salary adjustments, which may be above these market adjustments to bring an executive's salary level to the desired position based on experience, performance, recruitment or retention needs.

## Incentive Compensation

Over 80 percent of the system participants have formal short-term, lump-sum cash incentive plans for one or more of their executives or managers or both.

Current annual incentive award opportunities (i.e., award potentials) vary by executive position:

Job/Participant Group	Median Target Award Opportunity	
	System	Hospital
Chief Executive Officer	35%	30%
Chief Financial Officer	28%	25%
Chief Medical Officer	25%	20%
Senior Vice Presidents	25%	20%
Vice Presidents	20%	15%

## Benefits and Perquisites

The cost of executive benefits does increase from year to year (due to increases in the cost of health insurance and other benefits). However, generally the value of executive benefits, as a percent of salary, increases slowly from year to year. The value, or cost, of executive benefits in the marketplace has not changed noticeably in the past year.

The visibility of perquisites may cause adverse publicity for executives and the board or committee in charge of overseeing the compensation program and approving perquisites. As a result, over the last few years the value of perquisites has declined.

## Effect on Total Compensation

Whenever an organization makes specific decisions about any aspect of executive or manager compensation, it should consider the impact on total compensation above the range for comparable positions. This will help ensure continued compliance with the intermediate sanctions regulations issued under Section 4958 of the Internal Revenue Code.

The committee's minutes should reflect that it made compensation decisions relying on the comparability data provided.

## OTHER TRENDS IN EXECUTIVE COMPENSATION

### General

- The full impact of health care reform is yet to be determined but there are some emerging trends in executive pay practices.
- Business strategies vary based on geography and economic conditions in the service area, which is influencing pay.
- Consolidation in the market, including the development of integrated delivery systems and accountable care organizations, is leading health care organizations to use more specialized peer groups.
- The delta between low- and high-performing organizations is widening and affecting pay levels.
- Turnover in the C-suite continues to increase and unique pay arrangements are being used to recognize and retain executives with proven performance.
- Health care organizations are reviewing total compensation more frequently today given the increased scrutiny of executive pay and changes in the industry.

### Governance

- Committees and boards have become more sophisticated and more engaged in executive pay matters than ever before.
- Executive compensation decisions are more fully vetted to ensure they reinforce business strategy, advance the mission of the organization and serve a legitimate business purpose, while remaining competitive.
- Compensation philosophies are being adjusted to accommodate changing environments, challenge past practices, examine the role of each pay element, narrow peer definitions and integrate executive and physician pay philosophies.
- The rebuttable presumption of reasonableness is being challenged by legislatures.
- The linkage between compensation, documentation and governance practices is a regulatory focal point.

## Wall Street Reform is Spilling Over to Health Care

- Dodd-Frank is leading to even more scrutiny of executive pay in all industries and requires the following:
  - An emphasis on compensation committee and advisor (consultant) independence.
  - A clear link between pay and performance.
  - Public reporting of ratio of CEO total compensation to median total compensation of all employees.
  - Clawback provisions in incentive plans becoming the norm.

## Base Salaries

- Approximately 95 percent of health care organizations are budgeting salary increases in 2012.
- Increases will continue to be modest (excluding merit increases), and salary freezes will continue to be less common than in the last few years.
- There is a continued consideration of paying employees first and considering the community's circumstances and those of other key constituents.

## Incentives

- Most of today's metrics still reflect the pre-health care reform environment.
- Increasing emphasis on efficiency, quality, physician alignment, community benefit and consistency with payers' expectations.
- The use of long-term incentives is increasing.
- Some organizations are now including long-term strategic milestones in their annual incentive plans.
- In general, actual incentive awards for 2011 performance are returning to historical levels.

## Benefits and Perquisites

- Supplemental benefit plans are changing because of higher visibility on Form 990, economics and demographic changes in executive teams.
- Employment contract terms, severance benefits and change of control agreements are evolving.
- The use of special purpose retention plans is more common today given the changes affecting health care organizations today.
- Red-flag perquisites are decreasing in prevalence (e.g., gross-ups, spouse or first-class travel).

## SUMMARY

If health care organizations properly document their executive compensation practices through committee charters and compensation philosophies, and conduct periodic total-compensation studies consistent with the requirements outlined in Internal Revenue Code 4958, they will be managing executive compensation consistent with industry practice.

## ABOUT SULLIVANCOTTER

SullivanCotter is a human resources consulting firm that specializes in the provision of compensation consulting services to not-for-profit health care organizations, with a primary focus on executives and physicians. Their Clients include health systems, academic medical centers, community hospitals and health systems, medical schools, managed-care organizations and major physician groups. Annually, they publish a large national survey regarding health care executive compensation practices