

AMGA ANNUAL CONFERENCE

Lahey Clinic's Approach to Governance of Executive Compensation

Presented By

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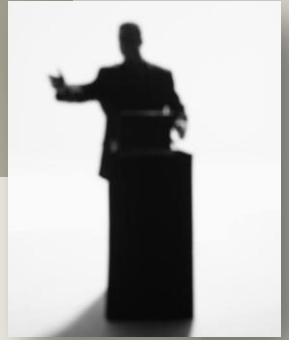
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SATURDAY, MARCH 20 / 2:00 PM UNTIL 3:15 PM



Disclosures



◆ Ron Bradley Lahey Clinic

- Has no actual or potential conflict of interest in relation to this presentation

◆ Ken Ackerman and Dan Schleeter Integrated Healthcare Strategies

- Have a financial interest and affiliation that could be perceived as an actual or potential conflict of interest
- Employed as consultants and receive a salary and other financial benefit

Overview



- ◆ Case study:
Lahey Clinic Executive Compensation Program

- ◆ Discussion Points
 - National trends in executive compensation - governance and transparency

 - How was Lahey Clinic positioned for changes in executive compensation?
 - What were the risks/concerns?

 - What/how changes were made?

 - How did Lahey Clinic change its approach to governing executive compensation?

Changes to Non-Profit Executive Pay Governance



- ◆ Increased attention to executive pay
 - Growing regulatory action
 - Increased government attention
 - Heightened media scrutiny
- ◆ Intermediate sanctions impose financial penalties on organization, executive, board members for “excessive” pay
- ◆ Rebuttable Presumption
 - Shifts burden of proof to IRS
 - Not difficult ... requires well defined process

Changing Governance Landscape



- ◆ Governance reform - never ending
- ◆ Boards under more scrutiny
 - IRS
 - Congress
 - Rating agencies
 - States attorneys general
 - Media
 - Public
- ◆ Resulting in more Board oversight
 - Independence - no conflicts of interest!
 - Peer comparators
 - Documentation

**“I’m ‘working’ more here than at my regular job,
and the ‘pay’ doesn’t match the effort!”**

- Trustee of a major health system

Changing Governance Landscape



“An organization’s lack of adherence to governance principles is one of the strongest predictors of the potential for fraudulent activity.”

Source: Sarah Hall Ingram; IRS Commissioner

Executive Pay Transparency



- ◆ Executive pay - Matter of public record!
- ◆ New Form 990 - More transparent!
- ◆ Defending pay - More challenging!
- ◆ Boards - More cautious and concerned!

Challenge remains:
Recruit, Retain, and Reward Top Talent

Lahey Clinic and the Evolution of Executive Compensation Governance Practices

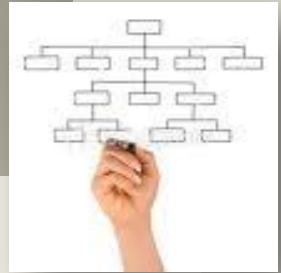
Ron Bradley

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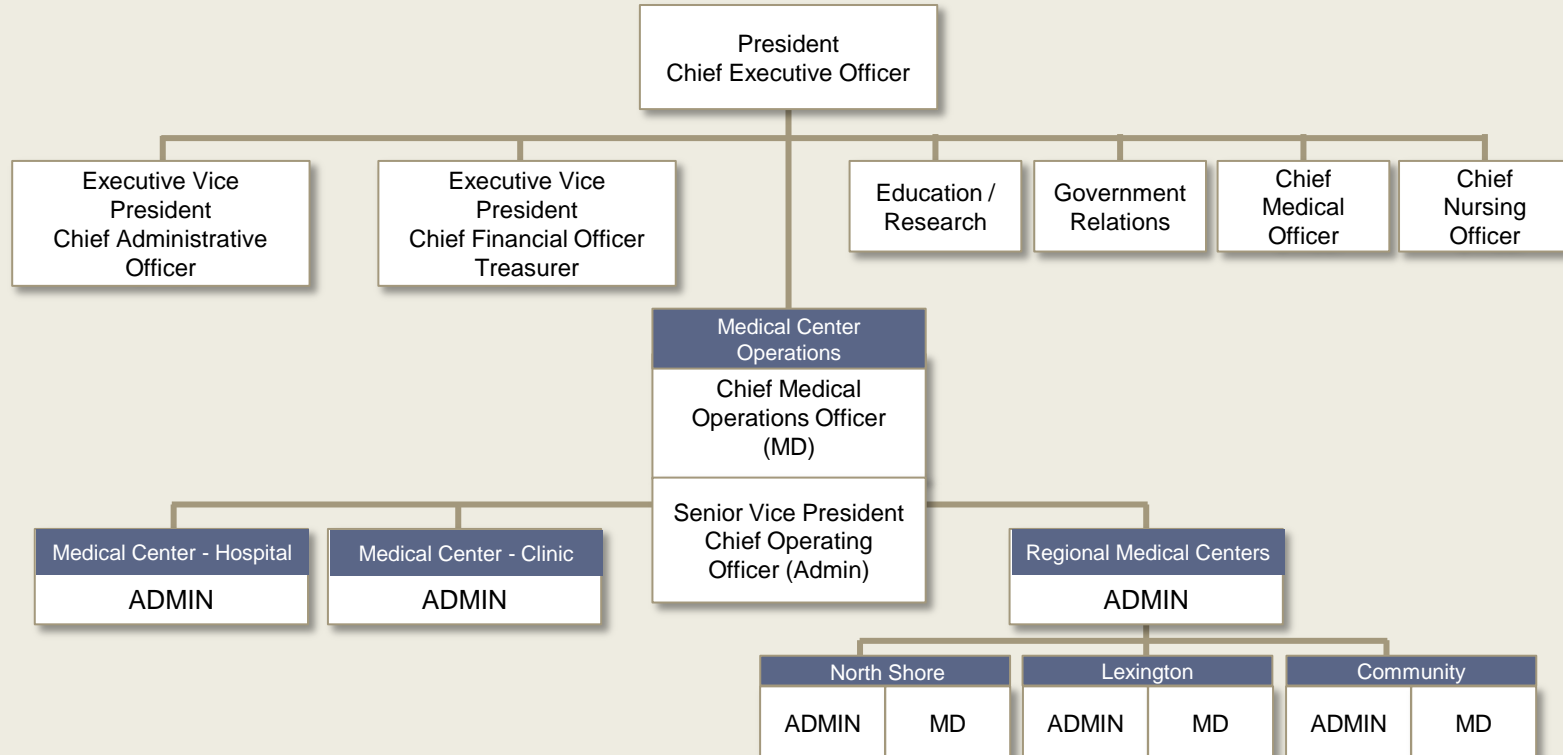


- ◆ Physician-led multi-specialty group practice, or “Accountable Care Organization”
- ◆ Two hospitals and 12 physician group practices
 - Every aspect of patient care under one roof
 - Employ nearly 500 full-time equivalent MD positions
- ◆ Located in suburban Boston, serves Massachusetts and New Hampshire
- ◆ Frequently recognized as one of the best hospital networks in the nation
- ◆ Mission to provide superior care leading to the best possible outcome while exceeding patient expectations and advancing medicine through research and education

Physician Leadership at All Levels



- ◆ President & CEO David Barrett and other senior executives are physicians
- ◆ Physician leadership at all levels – business and medical cooperative management



Lahey Clinic Executive Pay -- 2002



- ◆ Up to 2002, Lahey Clinic tried to manage executive pay, as it understood intermediate sanctions rules
 - Separate Committee of Board makes executive pay decisions, but some legacy practices
 - Approval sought on piecemeal basis, “as needed”
 - Leadership by General Counsel and outside counsel
- ◆ Concerns about executive compensation governance
 - Intermediate sanctions – “ ... are we in compliance?”
 - Independent (board-level) oversight spotty
 - No set policy on peer group or competitive target to guide decision making

Initial Changes



- ◆ Lahey Clinic recognized that it had not sufficiently or comprehensively addressed need for market information on executive compensation
 - Went out to find a consultant that could provide needed data
 - Request for proposal sent out
- ◆ Committee recognized need for more formalized process for governance
- ◆ Compensation Committee turned to Human Resources, and Consultant
 - Human Resources started serving as staff support to Committee
 - Committee started managing consultant, rather than having management do so
- ◆ Decided on specific peer group for executive compensation comparisons and executive compensation governance roles

Executive Compensation Governance Today



- ◆ Expanded group of executives and physicians whose pay is reviewed and approved by Compensation Committee
- ◆ Conducted comprehensive study of executives
 - Physicians on Board and physician executives too
- ◆ Process today
 - Human Resources serves Compensation Committee
 - Attends all meetings, staff to Committee
 - Provide data on current Lahey Clinic pay offering
 - Ensures “implementability”
 - Human Resources & consultant coordinate
 - Compensation Committee has independent contact with consultant
 - Human Resources operates almost in a “internal audit” role

***Steps in Changing How Lahey Clinic
Governs Executive Compensation***

Dan Schleeter

Rebuttable Presumption of Reasonableness



- ◆ IRS regulations provide how an organization can shift the burden of proof to the IRS to prove that executive compensation is unreasonable
- ◆ By following three process steps, the organization creates the

“Rebuttable Presumption of Reasonableness”

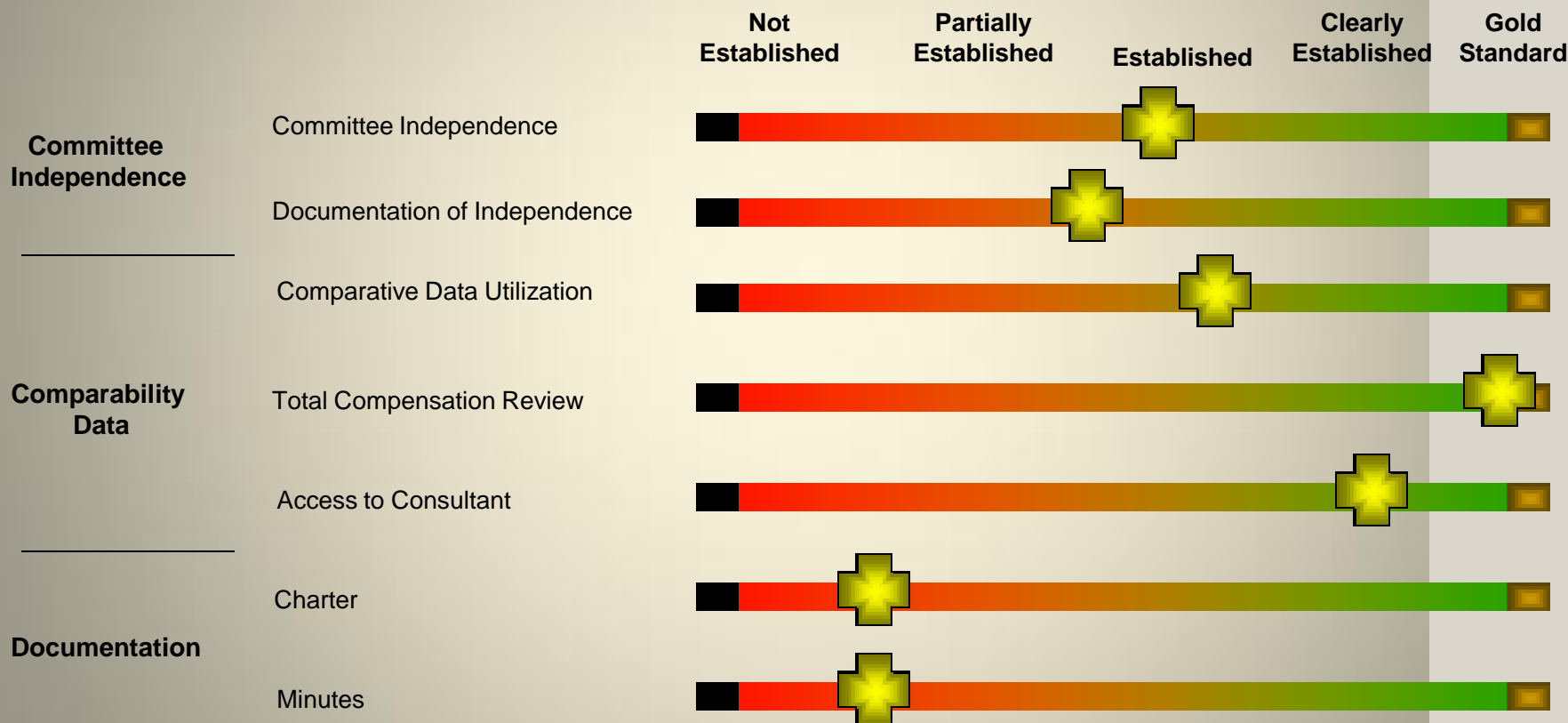
1. Independent members of a board or committee review and approve compensation
2. Make decisions based on appropriate comparability data
3. Promulgate contemporaneous minutes/written record of approval of the body’s work

Facilitating Change

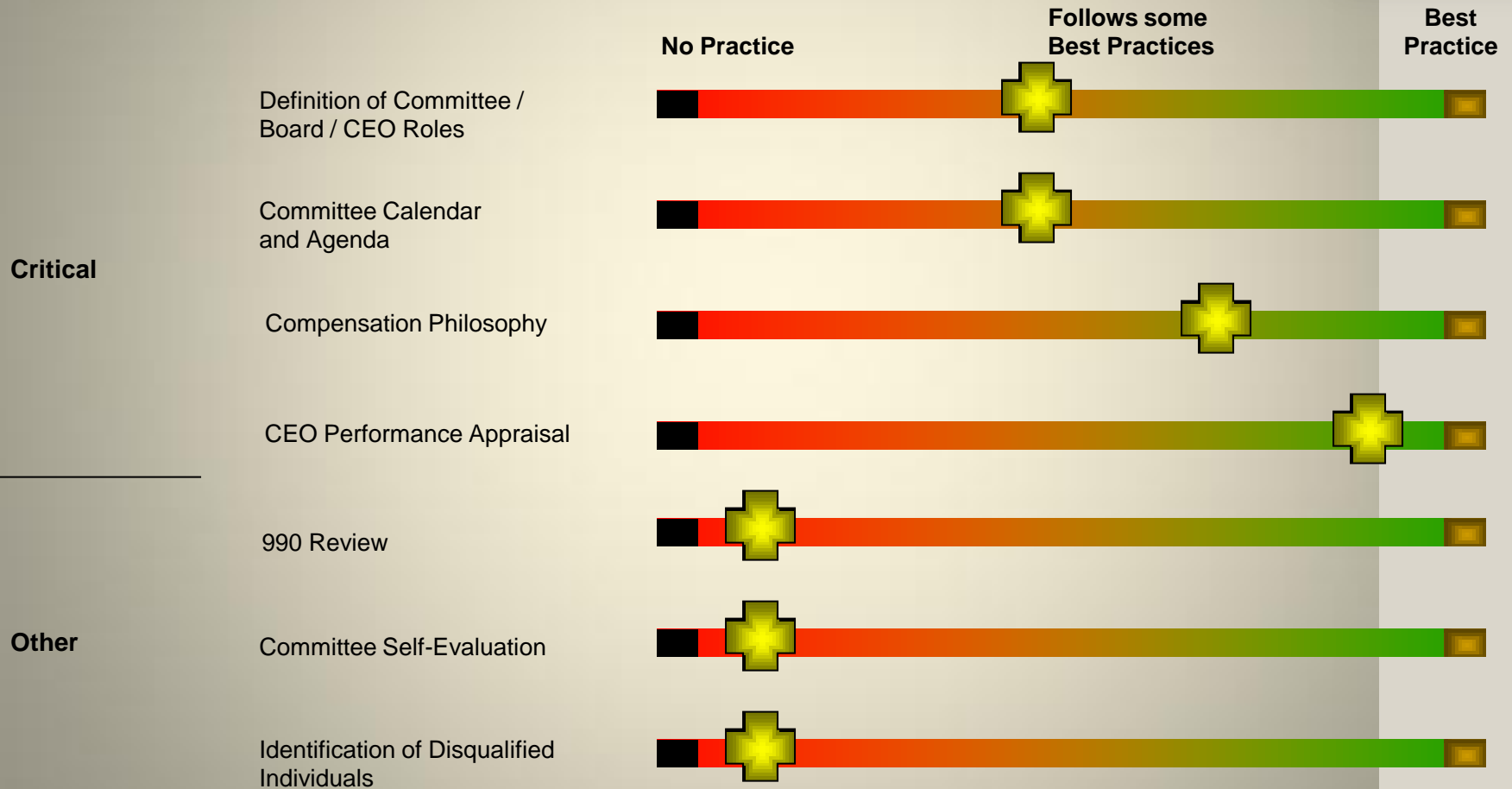


- ◆ Was Lahey Clinic establishing the rebuttable presumption of reasonableness prior to 2002?
- ◆ Legalistic approach ignored importance of process in regulations
- ◆ Listened, promoted internal dialogue, discussed best practices and need for board attention
- ◆ Became compliant pretty readily, then became trend setter
 - Audit governance practices, developed governance manual
 - Improved readiness to respond to questions about executive compensation

Establishing Rebuttable Presumption of Reasonableness



Preliminary Findings – Best Practices



Recommendations for Roles



	CHIEF EXECUTIVE	COMMITTEE	BOARD OF TRUSTEES	BOARD OF GOVERNORS
CHARTER		Recommends and follows	Adopts	
COMPENSATION PHILOSOPHY	Follows	Recommends And Follows	Adopts	
SALARY ADMINISTRATION GUIDELINES	Proposes and follows	Approves		
INCENTIVE PLAN ADMINISTRATION	Proposes goals and participants	Approves goals and participants. Administers plan for CEO and other disqualified executives.	Approves any new plan. Delegates administration to committee.	
EXECUTIVE BENEFITS	Proposes participants	Recommends any new program, and approves participants	Approves any new plan delegates administration to committee	
CHIEF EXECUTIVE TOTAL COMPENSATION		Determines or recommends to board	Receives report	May receive report
OTHER DISQUALIFIED INDIVIDUALS	Recommends salary increases and incentive awards	Reviews CEO's recommended salary increases and incentive awards for approval	May receive report	
CHIEF EXECUTIVE PERFORMANCE APPRAISAL	Does self-appraisal		Conducts appraisal and communicates to CEO	Conducts appraisal and communicates to CEO

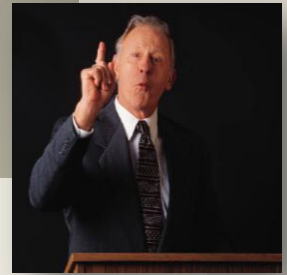
Committee Adopted Administration and Governance Manual



- ◆ Manual for governing executive compensation
 - Facilitates continuity of good governance practices, especially as committee members turn over

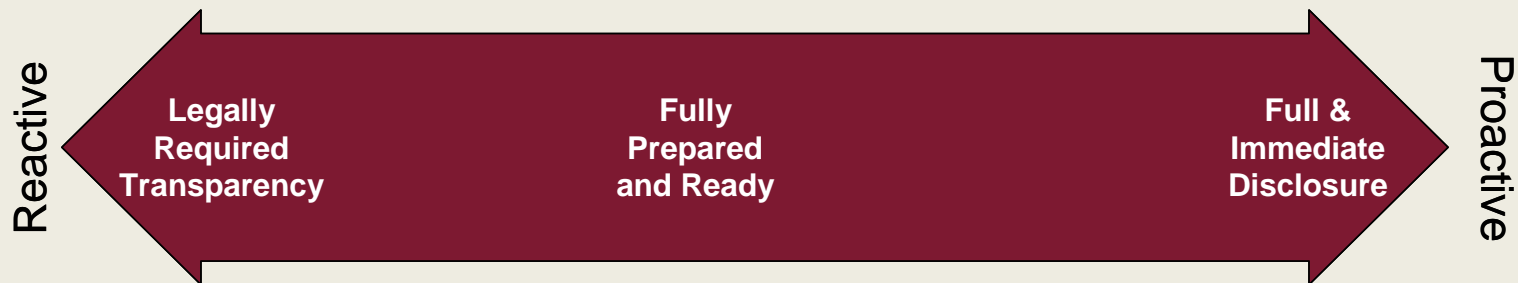
- ◆ Some sections included
 - Governance standards & best practices
 - Charter of Compensation Committee
 - Process for reviewing executive compensation program & managing CEO's compensation
 - Compensation philosophy
 - Committee annual calendar and schedule
 - Current salaries, benefits, perquisites
 - Minutes of meetings

Improve Executive Compensation Communication Readiness



- ◆ Considered how to respond to inquiries from public, media, and other constituencies, and explain process, philosophy, anomalies
- ◆ Collaboration of Human Resources, Public Relations, Consultant, and Committee

Executive Compensation Communication Strategy Continuum



Executive Compensation Communication Tool Kit



- ◆ Developed executive compensation communications kit
- ◆ Some sections of kit (manual):
 - Constituent Communication Strategies
 - Organization Scope and Community Presence
 - Executive Compensation Philosophy
 - Executive Compensation Program Statement
 - IRS Form 990 and Review Process
 - Healthcare Pay Marketplace Information
 - Questions and Answers

QUESTIONS AND ANSWERS