New Priorities For Exempt Organization Compensation Committees In 2020

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The new priorities for tax-exempt organization compensation committees in 2020 primarily fall into four key areas: remaining market competitive for key leaders, succession planning, evolution of the compensation committee to a more strategic role, and examining the bigger picture of executive pay costs and results. This article offers an overview of these emerging topics and trends.

IN DEPTH

An appointment to the board-level compensation committee of a large tax-exempt organization is a major time commitment, involving complex issues, huge agenda books and challenging oversight matters. And just as one year ends and its challenges are met, a new year begins, and the priorities and focus of the compensation committee continue to shift and grow. The year 2020 is no exception.

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How to Remain Competitive with Regard to Key Leaders

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On the Subject
Larger organizations, particularly those that have grown through acquisitions and affiliations, are moving away from lockstep compensation approaches and toward those that help to identify and retain the most critically important leaders. Even though base salary and incentive programs remain uniformly structured and administered, many organizations are considering special compensation approaches for their “superstars,” such as the following:

- Special merit adjustments to base salary
- Incentive modifiers for particularly outstanding achievement on incentive goals
- Retention incentive bonuses
- New long-term incentive bonus structures for a very select leadership group
- Using of a different peer group to evaluate market-competitive pay.

When special compensation arrangements are considered for select leaders, the compensation committee has a greater burden to show that total compensation remains reasonable under federal tax law standards, and to provide the appropriate supporting rationale. The committee should also take into consideration the disclosure implications on the Form 990 annual tax return, and the tax implications under the still-new Section 4960 excise tax (on annual remuneration over $1 million to any member of the five highest paid employees of the organization), which first applied to fiscal years beginning in 2018.

**Succession Planning for the Top Executive Leadership Tier**

Compensation committees are grappling with the effects of retirements in top leadership. Although many leaders delayed their retirements during and after the 2008–2009 recession, many have recently retired or are about to retire, and compensation committees find that they have to be prepared for the next wave. Committees are working with the CEO to make sure that emergency successors are identified, and that the next generation of leaders for key executive positions is being identified, assessed and developed with appropriate leadership opportunities. Increasingly, these succession planning efforts are integrated with the focus mentioned above on keeping compensation competitive, as organizations identify the next cohort of top leaders and use long-term incentive plans to challenge, reward and retain those leaders.

When succession planning involves the CEO position in particular, compensation committees face a new set of challenges. Committees are working with the CEO to assess “ready now” and “ready later” candidates for the CEO position, and to ensure that top candidates are being developed. Committees are using compensation mechanisms to retain top succession candidates (to ensure they are not poached and do not grow tired of waiting for the CEO opportunity) and to protect those who ultimately are not chosen. Committees are also working with the CEO to make sure that the timing of search and succession is sufficient for the board but does not lead to a breach in the confidentiality of the process. Compensation committees may find that an advisor experienced in the succession planning process can help them navigate these delicate and difficult issues.
Evolution of the Compensation Committee’s Role

Increasingly, compensation committees are becoming less transactional and more strategic. This shift involves moving away from tasks such as reviewing and approving the compensation of a large number of executive leaders for the organization, and toward strategic priorities such as vetting and approving new approaches to compensation that will help to identify and retain critical current and future leadership, and using compensation to guide where the organization wants or needs to be in five to 10 years.

This change in focus does not mean that review and approval of compensation is no longer an important function of the compensation committee—after all, the “rebuttable presumption of reasonableness” (a principal procedural underpinning of the committee’s work) is still the most important legal protection available to a tax-exempt organization in paying executive compensation. Rather, committees are recognizing that their oversight role may be more effective if they spend less time on the granular review of compensation market data for the fourth tier of executives, for example, and more time on how compensation approaches can be used to ensure appropriate leadership succession, provide greater community access to affordable healthcare, or meet the organization’s long-term strategic objectives.

Looking at the Bigger Picture of Cost and Results

As compensation committees step back from an intense transactional role of reviewing and approving compensation for multiple levels of executive leadership, they more frequently look at the bigger picture of total cost of executive pay and how the organization is performing in its local or regional market, or nationally, on a wide variety of metrics. The cost analysis increasingly includes the long-term cost of retirement supplements, the full potential variation in annual and long-term incentive awards, and the cost of the new Section 4960 excise tax. The performance metrics increasingly include quality and safety dashboards, the relationship of executive pay to operating revenue and other financial indicators, diversity and inclusion, and other indicators of the organization’s reputation and industry stature.

Conclusions

The changing landscape of healthcare, and the growth and increased complexity of hospital systems, are causing compensation committees to adapt their priorities and approaches. These fresh areas of focus for 2020 show that compensation committees are increasingly thinking about how to position their organizations for long-term success through retention of key leaders, succession planning for long-term leadership stability, and broader measurement of competitiveness through a wide variety of external metrics.

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