Reassessing Executive Compensation and Benefits in Tax-Exempt Organizations As the COVID-19 Crisis Deepens

Hospitals, health systems and other tax-exempt organizations are responding to a longer and deeper economic crisis by making or considering significant changes to their executive compensation and executive benefit programs. The economic crisis, and these executive compensation and benefit changes, have far-reaching implications for the ongoing work of the board’s compensation committee. We want to provide this review of what we see happening “on the ground” as the crisis continues.

IN DEPTH

Changes to Pay Structures

Here are the executive compensation and executive benefit changes that many larger and more complex exempt organizations have made or are considering:

- Current and upcoming annual incentive plan performance cycles are being
The strategies being deployed include:

- Suspending executive incentive award payments, even if already earned, until the crisis abates. Organizations will have to be mindful of the contractual claims that could be made, and of the tax consequences of delaying or canceling payments that have been earned and approved.

- Cancelling the current performance period, and considering only discretionary awards for crisis leadership performance.

- Reducing the amount of incentive pay potentially available to an executive, such as capping awards at 100% of base salary.

- Moving to more frequent performance periods (such as two or three periods per year), with a smaller set of crisis-response and post-crisis planning goals.

- Leaving the current incentive structure in place, but agreeing to evaluate performance more broadly at the end of the incentive plan year and to use discretion to adjust awards appropriately.

- **Salary increases are being delayed ... for now.** Approved adjustments to executive salaries have been delayed at some organizations, until the crisis abates.

- For other organizations that may have relied heavily on incentive compensation that now is out of reach, **salary adjustments are being selectively or broadly considered** to make up for the loss of incentive opportunity and to keep compensation somewhat competitive.

- **Across-the-board salary decreases have become more prevalent** as the economic crisis has deepened. Some CEOs have voluntarily decreased their base salaries by a larger percentage than has applied to other executives. In these situations, compensation committees should be addressing these implications:
  
  - Is the decrease temporary, and should there be a date as of which it will be revisited?
  
  - Is the decrease actually a deferral, or is it gone for good?
  
  - Does the decrease violate any existing employment agreement or policy (and if so, should it be amended)?
  
  - Is there a retention risk? Could the salary decrease make some executives vulnerable to receiving and considering an offer from another organization?
  
  - Will the salary decrease have an unintended adverse effect on benefit coverages?
  
  - If the media ask about executive pay during this crisis, is the organization prepared to respond appropriately?
To soften the adverse effect of the salary decrease, could or should the committee signal flexibility in the manner in which it will consider discretionary incentive compensation awards when the crisis abates?

- **Supplemental executive retirement plans (SERPs) are undergoing a careful cost review.** Organizations are reviewing these cost structures (which may not have been reviewed in recent years) and considering these potential options:
  - Eliminating or reducing contributions for a specified period
  - Delaying contributions
  - Crediting contributions to book accounts without making actual contribution deposits
  - Reducing, eliminating or suspending earnings or interest credits on accounts.

Note that, for all these potential changes, contractual limitations have to be considered. These limitations may be in employment agreements, incentive plan documents, SERP plans, or in other agreements or plans. The incidental effect of these changes should also be considered, such as whether compensation decreases, suspension or delays could trigger an executive’s right to terminate employment voluntarily for “good reason” and receive severance pay.

**Evaluating and Securing Key Leadership Talent**

Complex tax-exempt organizations need their best leaders more than ever. A key challenge in this crisis is identifying and retaining key leaders, particularly when the compensation tools (most notably performance-driven salary adjustments, incentive compensation awards and additional discretionary incentive payments) are much more limited. CEOs and compensation committees should work together closely to identify key leaders and make sure that sufficient retention approaches are in place or considered. Here are some of the approaches that organizations may wish to consider:

- Providing leadership talent development and promotion opportunities (preferably as part of an executive succession plan regularly reviewed with the compensation committee)
- Entering into a retention incentive arrangement
- Providing an additional long-term incentive opportunity for additional leadership responsibilities
- Adding to the executive’s portfolio with a more highly visible set of crisis-related duties and responsibilities.

**Expanded Role of the Compensation Committee**

In light of these changes, what are the key governance issues for the compensation
committee right now?

First, the committee should receive regular COVID-19 updates from the CEO on issues falling under the oversight jurisdiction of the committee.

Second, the committee should stay current on the organization’s executive succession planning and consider the impact of the health and economic crisis on the succession plan. The plan may need to be made more robust in light of the COVID-19-related challenges.

Third, the committee should not lose sight of the normal activities of executive compensation review and approval, such as supporting total compensation as reasonable, securing the rebuttable presumption of reasonableness for all compensation decisions, receiving regular updates on rapidly evolving pay practices of its market peers and reviewing Form 990 disclosure of executive compensation.

Fourth, the committee should be in frequent dialogue with the CEO to make sure that the organization’s key leaders have been identified and retained.

Fifth, the committee should consider the longer view in assessing near-term compensation changes. For example, if compensation or benefits are delayed until after the crisis, will that cause a bunching of pay that is likely to trigger the 21% excise tax on compensation over one million dollars for covered employees?

Sixth, the committee should work with the CEO to consider what kind of performance metrics are of increased importance in this crisis. These could include various measures of financial stability, workforce health and workplace safety, capital structures and liquidity, workforce sustainability (maintaining current payroll), effective use of voluntary retirement or separation programs, effective mobile operations, planning for post-crisis revitalization, and similar crisis-oriented metrics.

The committee’s most important function during this time, while the CEO is steering the organization through the crisis, is to look carefully and dispassionately at the broader and longer view on executive compensation, looking for unintended consequences, leadership stability, reputational impact, the evolving relationship of pay to performance, and the long-term best interests of the organization and its tax-exempt mission.

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