Report on Director Compensation in Key For Profit Industry Segments and in Not-For-Profit Health Care-Related Organizations

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Introduction

This report has been prepared by the Alliance for Advancing Nonprofit Health Care for the Not-For-Profit (NFP) Blue Plan Leadership Council of the Blue Cross Blue Shield Association. It summarizes available information concerning the use and level of compensation for Directors of Boards among for-profit industry segments, non-Blue NFP health plans and major NFP health care/hospital systems. The report is for the exclusive use of the Leadership Council for its various purposes.

Organization of the Report

The report is organized according to sources of key relevant information. In Part I, information from key for-profit industry segments is presented. In Part II, relevant information for hospitals and health care systems is presented, based on survey information and a literature search. Part III focuses on the results of primary research based on IRS 990 submissions for specific NFP health care delivery and financing organizations. Part IV contains summary conclusions and recommendations for next steps.

Part I—Director Compensation in Key For-Profit Industry Segments[1]

The National Association of Corporate Directors (NACD) publishes detailed director compensation information for twenty-four for-profit industry segments. Based on consultation with Leadership Council staff, it was agreed that this report should focus on four:

- Banks (companies include BB&T, Wells Fargo & Co, US Bancorp)
- Diversified Financials (companies include American Express, Bank of America, Capital One Financial Corp)
- Healthcare Equipment and Services (companies include Aetna, Baxter International, Cardinal Health, CIGNA, Wellpoint, Coventry Health Care, McKesson, Medco)
- Insurance (companies include Aflac, Allstate AIG, Hartford Financial Services Group, Prudential Financial, The Progressive Group)

[1] Information in Part I is taken from "NACD Director Compensation Report: 2010-2011," National Association of Corporate Directors (NACD), 2011

NACD information is comprehensive and can be analyzed in a number of ways:

- by *company size*, including: "micro"(revenues from $50million < $500 million); "small"(revenues from $500 million < $1.0 billion); "medium" (revenues from $1.0 billion < $2.5 billion); "large" (revenues from $2.5 billion < $10.0 billion); and "top 200 companies" (largest 200 companies in the S&P 500);
- by *region*: North Central, Northeast, Northwest, South Central, Southeast, Southwest; and
- by *specific director compensation practices:* including breakouts by *compensation category* (cash retainer, board meeting fees, equity awards, stock options); by *board and committee service* (audit, compensation, nomination/governance) and *role* (chair, member).

Table 1 shows median total direct compensation for all industries and the four industry segments across all size classifications. For the four industry segments, the median total compensation "rank" of the industry among all 24 industry segments is shown in ( ), with "1" as the highest compensation and "24" as the lowest compensation. It should be noted that the companies noted above as "health care equipment and services" companies are all in the "top 200 companies" category.

Table 1—Median Total Direct Compensation Per Board Member, By For-Profit Industry and Size (Revenue)

Industry	**Micro Companies** **$50million < $500 million**	**Small Companies** **$500 million < $1.0 billion**	**Medium Companies** **$1.0 billion < $2.5 billion**	**Large Companies** **$2.5 billion <$10.0 billion**	**Top 200 Companies**
All Industries	$90,775	$119,408	$148,476	$175,750	$228,058
Banks	$42,454 (22)	$84,107 (21)	$106,938 (23)	$135,594 (22)	$192,441 (20)
Diversified Financials	$122,000 (5)	$198,462 (4)	$162,132 (11)	$177,367 (10)	$253,797 (5)
Health Care Equipment & Services	$101,195 (8)	$106,403 (15)	$163,503 (10)	$197,017 (5)	$266,388 (3)
Insurance	$53,273 (19)	$96,667 (19)	$123,429 (20)	$164,179 (16)	$207,458 (18)

With respect to changes in compensation over time, the NACD report observes that the early-to-mid 2000s witnessed rapidly increasing director pay, ostensibly in response to increased regulatory demands. However, compensation growth rates slowed and in some classifications were negative in the 2007-2008 recession. Based on changes from 2009 to 2010, growth in director compensation levels has returned, ranging from a 20% increase for "Micro" companies, to 5% for "Top 200" companies.

Part II—Director Compensation in NFP Health Care Organizations

There are few sources of director compensation information for NFP organizations. The Governance Institute is a prominent, independent source of governance survey information on NFP health care organizations, conducting a biennial survey[2] of NFP hospitals and health care systems focused on a number of governance practices, including Director/Trustee compensation.

Based on survey responses from 740 NFP hospitals and health systems, including government-sponsored organizations (including district/authority, and county and city hospitals but not including federal, state, and public health hospitals), 9.6% of respondents reported that their board chair is compensated and 65% of these reported that compensation is less than $5000. 10.2% of respondents reported that all or some other board members are compensated, and 76% of these reported that compensation is less than $5000.

Table 2 displays this information for "board chair" compensation, by type of organization, for 2009 and 2007.

Table 2—Percentage of NFP Health Care Organizations that Compensate the Board Chair, by type of organization, 2009 and 2007

	2009	2007
Overall	9.6%	9.5%
Systems	12.7%	10.0%
Independent Hospitals	4.7%	3.9%
Subsidiary Hospitals	5.3%	8.5%
Government-Sponsored Hospitals	19.1%	19.9%

The Governance Institute's data indicate a small increase in the proportion of all respondents that compensate the Board chair, with increases for Systems and Independent Hospitals partially offset by decreases for Subsidiary Hospitals and Government-Sponsored Hospitals.

Table 3 shows the percentage of responding organizations, by type, that compensated "Other Board Members" in 2009 (2007 data was not available).

[2] Governance Institute information in Part II is taken from "Governance Structure and Practices: Results, Analysis, and Evaluation—The Governance Institute 2009 Biennial Survey of Hospitals and Healthcare Systems" 2009, The Governance Institute.

Table 3: Other Board Members Receiving Cash Compensation for Their Services in NFP Health Care Organizations, 2009

	All Other Board Members Receive Compensation	Some Other Board Members (Committee Chairs, Officers) Receive Compensation	Total
Overall	9.1%	1.1%	10.2%
Systems	11.9%	2.4%	14.3%
Independent Hospitals	3%	1%	4%
Subsidiary Hospitals	6.8%	0	6.8%
Government	19.2%	1.1%	20.3%

Tables 4 and 5 show 2009 survey responses regarding the level of compensation for Board chairs (Table 4) and Board members (Table 5), by type of organization and bed size. The number of organizations responding is shown in ().

Table 4—Annual Dollar Amount of Compensation for the Board Chair in NFP Health Care Organizations

	<$5000	$5000-$19,999	$20,000-$49,999	>$50,000
OVERALL (69)	65.2%	23.2%	8.7%	2.9%
ORGANIZATION TYPE				
System (16)	18.8%	37.5%	31.2%	12.5%
Independent (12)	66.7%	33.3%	0	0
Subsidiary (7)	57.1%	28.6%	14.3%	0
Government (34)	88.2%	11.8%	0	0
ORGANIZATION SIZE (# OF BEDS)				
<100 (28)	92.9%	7.1%	0	0
100-299 (18)	61.1%	27.7%	0	0
300-499 (7)	57.1%	42.9%	0	0
500-999 (7)	42.9%	57.1%	0	0
1000-1999 (2)	0	0	100%	0
2000+ (7)	14.3%	28.6%	28.6%	28.6%

The survey data in Tables 2-4 suggest that the practice of compensating board members is associated with the increased size, and--by proxy--complexity, of NFP health care organizations. It is also interesting that, while compensation levels are not high, a higher percentage of government hospitals, relative to the other organization types, compensate their board members.

Table 5, below, shows that the *level of compensation paid to other board members* is consistent with a higher level of compensation for larger organizations.

Table 5—Annual Cash Compensation for Other Board Members of NFP Health Care Organizations

	<$5000	$5000-$19,999	$20,000-$49,999	>$50,000
OVERALL (68)	75.7%	17.5%	4.1%	2.7%
ORGANIZATION TYPE				
System (17)	29.4%	47.1%	17.6%	5.9%
Independent (12)	75.0%	16.6%	0	8.3%
Subsidiary (9)	100%	0	0	0
Government (36)	91.7%	8.3%	0	0
ORGANIZATION SIZE (# OF BEDS)				
<100 (30)	96.7%	3.3%	0	0
100-299 (238)	80%	15%	0	5%
300-499 (81)	71.4%	28.6%	0	0
500-999 (7)	57.1%	42.9%	0	0
1000-1999 (4)	50%	25%	25%	0
2000+ (6)	0	50%	33%	16.7%

A literature search was conducted to identify any articles or papers that addressed the topic of compensation for Directors or Trustees in NFP health care-related organizations. Not unexpectedly, the search uncovered many articles regarding “executive” compensation but very little regarding “board member” compensation.

In October, 2010 Modern Healthcare reported an emerging, though small, trend toward NFP hospitals and healthcare systems compensating board members based on IRS 990 filings for 2008 and 2009. The practice was attributed to the increased complexity and risk associated with governing these organizations. However, the article noted that the countervailing argument against such practices is that NFP hospitals are “legally and culturally understood as charities.”

Notwithstanding variations in state laws that determine a "charity" designation, it is worth noting that to the extent that a NFP organization is *perceived* as a charity, the compensation of board members may be viewed negatively by the community.

The article references the Governance Institute survey data reviewed above and notes that larger organizations are more likely than smaller organizations to compensate board members. Also, the article references experts as reporting that NFP health insurers regularly compensate their board members.

The article identifies a number of specific NFP organizations that are compensating their independent board members: Banner Health, Phoenix AZ; Kaiser Permanente (technically, Kaiser Foundation Health Plan and Kaiser Foundation Hospitals), Oakland CA; McClaren Health Care Corp., Flint, MI; Providence Health & Services, Renton, WA; Sutter Health, Sacramento, CA; and Trinity Health, Novi, MI. [3]

Part III—The IRS 990 Filings as a Key Information Source

Organizations that are exempt from federal income tax, other than churches, are required to file with the IRS one of several types of Form 990. While there are 28 Section 501-type organizations required to file 990s, this analysis focuses on NFP health care and hospital systems and NFP health plans that are categorized as either Section 501 (c) (3) or 501 (c) (4) organizations.

Beginning in tax year 2008, the IRS Form 990 was revised to require organizations to report certain compensation information based on amounts reported on Form W-2 (employees) or Form 1099-MISC (non-employees). Also, definitions of persons required to be listed as officers, directors, trustees, key employees and the five highest compensated employees were revised, including requiring organizations to report compensation received by an individual from a "related organization" which is defined generally as "a parent, subsidiary, brother or sister organization under common control."

The revised IRS 990 also requires the organization to formally designate board members who are "independent voting members," based on a four-part definition as described in the Instructions for Form 990.[4]

[3] "Keeping Pay in Check," J. Carlson, Modern Healthcare, October 4, 2010

[4] A member of the governing board is considered independent only if all four of the following circumstances applied at all times during the organization's tax year: (1) The member was not compensated as an officer or other employee of the organization or of a related organization;(2) The member did not receive total compensation or other payments exceeding $10,000….as an independent contractor, other than reasonable compensation for services provided in the capacity as a member of the governing body; (3) Neither the member, nor any family member, was involved in a transaction with the organization… that is required to be reported; (4) Neither the member, nor any family member of the member was involved n a transaction with a taxable or tax-exempt related organization… (2010 Instructions for Form 990 Return of Organization Exempt From Income Tax, IRS Catalog No. 11283J)

Organizations are also required to report specific titles and the number of hours per week that Board members spend on the organization's governance activities.

An important result of requirements associated with the revised IRS Form 990 is that it is now possible to obtain systematic and comprehensive compensation and related information for independent board members of federally tax-exempt NFP organizations.

The data provided below[5] in Tables 6 and 7 are taken from IRS Form 990 submissions for organizations in two classifications, section 501 (c) (3) and 501 (c) (4). These are the two classifications that generally include NFP health care delivery organizations (hospitals and healthcare systems) and NFP health plans. [6] The Alliance for Advancing Nonprofit Health Care chose these organizations as reasonably comparable with Leadership Council members in terms of purpose and size.

Regarding the data shown, in some cases, individual board member compensation varies among all board members. In these instances, a "range" in individual board member compensation is shown. It should also be noted that some of the organizations listed in Table 6 have "related" organizations in Table 7. These organizations are marked by an asterisk.

Table 6: Major NFP Health Care and Hospital Systems, Independent Board Member Compensation Data,

Based on IRS Form 990 501 (c) (3) Filings

Organization	990 Filing Year	Total Revenue	Total/Independent Governing Body Voting Membership	Average Hours/Week for Independent Governing Body Members	Reportable Annual Compensation for Independent Members, per member
Adventist Health System-West, Roseville CA	2009	$174 million	13/8	1	$300-$11,400
Allina Health System, Minneapolis, MN	2009	$2.5 Billion	17/16	2	None-$21,500
Ascension Health, St. Louis MO	2008	$407 million	14/13	1	None
Banner Health, Phoenix, AZ	2009	$4.2 billion	15/8	4	$27,000-$31,000 (for all members, except one who is not paid)
Catholic Health East, Newton Square, PA	2009	$107 million	17/15	20 30 hrs for Board Chairperson	None for all, except for Board Chairperson ($50,000)
Catholic HealthCare West, San Francisco, CA	2008	$7.8 billion	20/17	2	None

[5] IRS Form 990s were accessed electronically using the Foundation Center's free "990 Finder" service (see http://foundationcenter.org/widgets.html)

[6] As noted in the tables, some NFP health plans are classified as 501c3 and others are classified as 501 c 4

Christus Health, Irving TX	2008	$335 million	15/14	1	None-$1139
Cleveland Clinic Foundation, Cleveland, OH	2009	$3.7 billion	23/12	3	None
Geisinger Clinic*, Danville PA (see Geisinger Health Plan, Table 7)	2008	$453 milliion	7/6	2	None
Geisinger Medical Center*, Danville PA (see Geisinger Health Plan, Table 7)	2008	$762 million	7/6	2	None
Group Health Cooperative of Puget Sound, Seattle WA (Note: data is for both the delivery system and health plan)	2009	$2.7 billion	11/11	8	$7875-$13,500
Henry Ford Health System*, Detroit MI (see Health Alliance Plan, Table 7)	2009	$2.1 billion	24/18	.5-2	None
Intermountain Health Care*, Salt Lake City UT (see SelectHealth, Table 7)	2008	$2.2 billion	18/14	2-5	None
Kaiser Foundation Hospitals*, Oakland CA (see Kaiser Foundation Health Plan, Table 7)	2009	$14.5 billion	14/12	6-8	Reported as compensation from related organization, Kaiser Foundation Health Plan: $118,000-$228,000
Partners HealthCare System, Boston, MA	2008	$545.5 million	16/4	1	None
Providence Health System*, Renton, Washington (see Providence Health Plan, Table 7)	2009	$3.2 billion	14/14	3-5	3 Members-None 6-$15,000 4-$18,000-$18,750 Board Chair-$50,000
SSM Health Care, St. Louis, MO	2009	$1 billion	11/7	NA	None
Spectrum Health System*, Grand Rapids MI (see Priority Health, Table 7)	2008	$70.6 million	13/9	2-4	None
Sutter Health, Sacramento CA	2009	$496 million	14/13	7-12	$27,500
Trinity Health System, Novi MI	2008	$594 million	11/10	2	None-$25,000; Board Chair-$50,000

University of Pittsburgh Medical Center (UPMC Group), Pittsburgh PA	2008	$6.6 billion	86/24	1-3	None

Table 7-- Major NFP Health Plans, Independent Governing Body Member Compensation Data,

Based on IRS Form 990 501 (c) (3) or 501 (c) (4) Filings

Organization	990 Filing Year/Tax Status	Total Revenue (Part VIII, Line 12)	Total/Independent Governing Body Voting Membership	Average Hours/Week for Independent Governing Body Members	Reportable Annual Compensation for Independent Members, per member
Geisinger Health Plan*, Danville PA	2008/501c4	$827 million	13/8	2	None
Harvard Pilgrim Health Care, Wellesley MA	2008/501c3	$2.2 billion	12/9	3-5	None-$35,000
Health Alliance Plan*, Detroit MI	2009/501c4	$1.7 billion	17/14	1	None
HealthPartners, Minneapolis MN	2009/501c4	$1.6 billion	15/14	2-6	$11,250-$23,250 Board Chair-$31,750
Kaiser Foundation Health Plan*, Oakland CA	2009/501c3	$33.2 billion	14/12	6-8	$118,000-$228,000
Medica Health Plans, Minnetonka, MN	2009/501c4	$1.4 billion	13/12	7-15	$30,000-$74,000 Board Chair-$84,000
Priority Health*, Grand Rapids MI	2009/501c4	$1.3 billion	21/19	2	None
Providence Health Plan*, Beaverton OR	2009/501c4	$995 million	14/14	3-6	Reported as Compensation from Related Organization, Providence Health System—WA: 3 members-None 6-$15,000 3-$18,000 1-$18,750 Board Chair-$50,000
SelectHealth*, Murray UT	2009/501c4	$1 billion	15/10	2-5	None

Part IV—Conclusions and Recommendations

A general review of the literature has revealed a number of different arguments in favor of not-for-profit Blue plans compensating board members: the complexity and risk associated with governing and managing the organization; competition with publicly held for-profit organizations; the increased value

that board members produce for the organization; the likelihood that compensation will result in board members taking their governance responsibilities more seriously; the time required and the consequent loss of income by some board members; and the need to recruit board members nationally rather than locally.[7]

Based on our data analysis, there may be an emerging trend toward compensation of independent board members of major non-Blue NFP health care and related organizations. This buttresses the arguments that compensation of board members is necessary due to one or more of the arguments listed above. Related, the survey data indicates that some government hospitals compensate board members; however, the circumstances under which this practice occurs are not clear.

While it is difficult to pinpoint when the practice of compensating independent board members commenced, the revised IRS Form 990 does and will provide key information over time to enable future trend-tracking and will permit analyses by such factors as *type of organization*, *size* (as measured by total revenues and/or assets) and *time commitment* i.e., "number of hours/week" that members perform governance duties. Also, to the extent that organizations identify specific *board member roles* (e.g., chairperson), it will be possible to track compensation trends related to specific board roles.

With the possible exception of Kaiser Foundation Hospitals/Health Plan, the level of compensation in those NFP organizations that compensate board members is well below all of the for-profit industry segment groupings discussed in Part I. This would appear to run counter to the argument that board compensation is necessary to remain competitive with for-profit counterparts. An important question for the Leadership Council members is whether their levels of board compensation are comparable to the levels of board compensation of similarly-sized for-profit competitors.

Arguments made against compensating NFP board members are largely based in the historical practice of charitable organizations not doing so, the associated belief that the right numbers and types of board members should and will donate their time and knowledge, and the assumption that such compensation creates a conflict of interest.[8]

Whether a given NFP Blue plan is legally a charity or not, the distinction is likely to be very difficult to get across to the general public, policymakers and opinion leaders, who will see any NFP health care organization, just because it is "not-for–profit," as a "charity."

Principles developed by the Independent Sector regarding compensating board members of NFP organizations are equivocal at best. For example, in its argument that NFP board member compensation creates a conflict of interest, the State of Massachusetts references principles for good governance

[7] "What Does It Take to Build a Strong NonProfit Health Care Board?" Reprint of Inquiry Article, Spring 2007, Alliance for Advancing NonProfit Health Care Website, Resources--Governance Section

[8] April 14, 2011 letter from the Office of the Attorney General, Commonwealth of Massachusetts, to Blue Cross Blue Shield of Massachusetts, Fallon Community Health Plan, Harvard Pilgrim Health Care and Tufts Health Plan

developed by the Independent Sector.[9] However, a review of these principles indicates that the Independent Sector explicitly contemplated situations in which NFP board members of charitable organizations are compensated:

> Principle 20: Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. *A charitable organization that provides compensation to its board members should use appropriate comparability data to determine the amount to be paid, document the decision and provide full disclosure to anyone, upon request, of the amount and rationale for the compensation.(*emphasis added*)*[10]

The IRS "test" for assessing independence is not based on the simple fact of <u>whether</u> board members are compensated, but on other factors (see Part III above).

The Alliance believes that decisions on board compensation practices should be left in the hands of the nonprofit health care boards that have the legal and ethical responsibility to govern their organizations to the best of their abilities; however, whether they are legally charities or otherwise not-for-profit, if they decide to compensate their board members they need to be prepared to explain their decisions to the general public, policymakers and opinion leaders.

It is important to note that none of the arguments that have been made, pro or con, have been empirically or factually proven based on comparisons of organizational performance or other measures.

Our belief is that the practice of compensating independent board members of <u>major</u> non-Blue NFP health care-related organizations will become more widely known and adopted, and we recommend that the Leadership Council consider taking the following actions to address this issue:

- Collect systematic information concerning its own members' board compensation practices, addressing the levels of compensation, the process by which compensation levels have been determined and how the organization has guarded against possible "conflicts of interest"
- Identify a specific "comparison group" (including as appropriate both For-Profit and NFP organizations) and track the board compensation practices of that group over time
- Consider exploring, through surveys, focus groups or both, the specific <u>reasons</u> why its members, its comparison group and other groups (e.g., government hospitals, private foundations) do or do not compensate, plan to compensation, and/or are seriously considering compensating some or all of its board members.

The Alliance for Advancing Nonprofit Health Care is available to provide additional advice and support to the Leadership Council upon request. Please feel free to contact Bruce McPherson, President & Chief Executive Officer of the Alliance at mcphersonbruce@aol.com, 301-467-8014.

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[9] "Principles for Good Governance & Ethical Practice: A Guide for Charities & Foundations," Panel on the Nonprofit Sector, Convened by Independent Sector, October, 2007

[10] See FN 10, page 19