

Massachusetts Public Charities CEO Compensation Review



REVIEW

DECEMBER 2013

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EXECUTIVE SUMMARY

Executive compensation, particularly that of chief executive officers (CEOs), has increased rapidly in recent decades and has become a frequent subject of discussion nationally and regionally. While CEOs at for-profit companies have commanded the highest compensation packages, CEO compensation at public charities has also increased. In fact, high executive compensation at public charities frequently leads to greater levels of concern, because of the view that large compensation packages take money away from charitable missions. They can also negatively affect the perception of the charities with employees, donors and other constituencies, as well as with the general public. At the same time, the largest public charities are complex organizations in their own right, and demand a level of executive ability that is at least commensurate with that complexity.

The Non-Profit Organizations/Public Charities Division (the Division) of the Office of the Attorney General (AGO) undertook this focused review of CEO compensation as part of the AGO's efforts to increase transparency of executive compensation at public charities in the Commonwealth. This study explores a new approach to reporting executive compensation at public charities, describes components of executive compensation, and explains the process used by the organizations in the study to set and to evaluate CEO compensation.

We asked 25 of the largest public charities in Massachusetts to complete a prototype of a new reporting form for CEO compensation data for a three year period (2009-2011). We intend to incorporate a version of this new form, the "Schedule EC," into the Form PC annual report for certain Massachusetts public charities. We also requested the opportunity to review certain additional information about the 25 organizations' approach to executive compensation.

We found that CEO compensation at these organizations is complex and includes a variety of components, often including special retirement benefits not available to most segments of the workforce. Some CEO retirement programs are designed to replace a percentage of income in retirement, much like the defined benefit pension plans that have become rare for most segments of the workforce.

CEO compensation is generally high. Among the charitable organizations in the study it ranged from a low of \$487,397 annually to a high of \$8,827,494 (considering all elements of reported compensation).

Compensation for the CEO tended to increase annually, but total reported CEO compensation can fluctuate due to isolated payments or vesting events involving retirement and certain other forms of compensation. These types of payments and vesting events can make straightforward year-to-year comparison of compensation levels challenging.

Executive compensation comprises several broad categories of compensation and benefits. Public reporting of compensation is based on the following broad categories required by the Internal Revenue Service (IRS):

- Base Compensation
- Bonus and Incentive Compensation
- Other Reportable Compensation
- Retirement and Other Deferred Compensation
- Nontaxable Benefits

While we determined that it made most sense to build more detailed reporting using the IRS categories, the additional detail in the Schedules EC and in the materials we reviewed as part of the study led us to describe compensation components and other benefits that are part of CEO compensation under the following headings:

- Cash Compensation
- Retirement and Other Deferred Compensation
- Other Forms of Compensation and Benefits
- Contingent and Contractual Benefits

A set amount for base salary was the most prevalent element of compensation, used by all the organizations in our study. Nineteen organizations reported incentive compensation – either annual or long term – as an additional element of cash compensation. Nineteen organizations reported some form of supplemental executive retirement program or “SERP” to supplement retirement benefits available to non-executive employees.

We found that the organizations in our study approached setting the CEO’s compensation with care and attention to the standards the IRS has set forth creating a presumption that the compensation is reasonable. Twenty-three used outside compensation consultants to assist them. The remaining two used IRS Form 990 data from comparable organizations to assess the reasonableness of their CEO’s compensation. Despite the care these organizations took in setting CEO compensation, we found little evidence that the process restrained CEO compensation or its growth.

We believe that adding certain additional data points and aspects of analysis to the process of setting CEO compensation may lead to more moderate rates of increase in CEO compensation, allowing more charitable resources to be devoted to the organization’s charitable mission. That might also decrease the disparity between CEO pay and that of the rest of the workforce, a disparity that has generally increased in the United States in recent years and is a cause of concern to many.¹ Finally, broadening the analysis behind setting CEO compensation to include elements outside the narrow approach of peer comparison may increase public confidence in the fairness or reasonableness of CEO compensation. Examples of additional data points and aspects of analysis we recommend charities consider include:

- Charge the compensation committee with evaluating the reasonableness of compensation for other segments of the charity’s workforce as well as executives.
- Include analysis of the relative magnitude of the CEO’s total compensation package in relation to that of the non-executive workforce.
- Consider the level of public support the charity enjoys in the form of exemption from property tax and other forms of taxation.

This study and the Division’s new Schedule EC are intended to increase transparency by explaining the types of compensation and benefit vehicles large public charities use to compensate senior executives and by requiring additional detail not generally reflected in the IRS filings (e.g., Schedule J), and by doing so on a more current basis.

¹ See, e.g., Facundo Alvaredo, Anthony B. Atkinson, Thomas Piketty and Emmanuel Saez, “The Top 1 Percent In International and Historical Perspective,” Journal of Economic Perspectives, Volume 27, Number 3 (Summer 2013), pages 3-20.

The Office of the Attorney General wishes to express its appreciation to the 25 organizations that participated in this focused review. They are, in alphabetical order:

Baystate Health	ISO New England
Beth Israel Deaconess Medical Center	Lahey Health System
Blue Cross and Blue Shield of Massachusetts	Lawrence General Hospital
Boston Medical Center	Massachusetts General Hospital
Boston University	Massachusetts Institute of Technology
Brandeis University	Northeastern University
Brigham and Women's/Faulkner Hospitals	Partners HealthCare System
Children's Hospital	Sturdy Memorial Hospital
Dana-Farber Cancer Institute	Suffolk University
Fallon Community Health Plan	Tufts Associated HMO
Harvard Management Company	Tufts University
Harvard Pilgrim Health Care	UMass Memorial Health Care
Harvard University	

INTRODUCTION

As part of their fiduciary responsibility, boards of directors of public charities are responsible for furthering the missions and safeguarding the assets of the charitable organizations they serve. An important element in that responsibility is to carefully scrutinize the executive compensation arrangements that they establish for their CEOs. Compensation that is excessive (or that is perceived to be excessive) can have significant negative impact on a public charity's operations and mission, and may result in tax penalties. Negative perceptions can also harm a charity's reputational assets, and large compensation packages often act as a lightning rod for criticism. Moreover, as our society becomes increasingly concerned about issues of income inequality, high executive compensation at charitable institutions—particularly at those institutions providing essential services like health care and education—is likely to receive more public attention. When members of the public pay high and rapidly escalating prices for these important services, high executive compensation packages spark even more pointed debate and suspicion. It is not always clear that large compensation and benefits packages are actually necessary to attract and retain executive talent. And apart from the simple cost of these high compensation packages, depending on the types of benefits that are included, some compensation arrangements can place the charity at considerable financial risk.

The CEO's compensation (along with that of other highly paid executives and employees) must be publicly reported, in some detail, on Schedule J to a public charity's IRS Form 990 (IRS Schedule J). The Form 990 is filed with the IRS; a copy is submitted to the Division for Massachusetts public charities. Because the IRS Schedule J reporting of compensation data is somewhat limited, and is generally delayed by more than a year, the Division has proposed the introduction of a new schedule—Schedule EC—to the AGO's reporting form, the Form PC.² The new Schedule EC would require additional, and earlier, reporting on executive compensation for Massachusetts public charities.

This report describes the compensation of CEOs at 25 large Massachusetts public charities and the processes those organizations used to determine, evaluate and approve the compensation packages. We hope the report assists readers in understanding the ways in which charitable organizations compensate executives, how various forms of compensation relate to the organization's charitable mission and direction, and how existing regulations may impact and influence compensation decisions.

The AGO conducted its focused review of CEO compensation by requesting the completion of a prototype Form PC schedule that covered a three-year period from 2009 to 2011. The goals of this review, and the development of the new Schedule EC, are to assist the public in obtaining more comprehensive information about executive compensation at Massachusetts public charities, and to do so in a way that is more timely than the reporting to the Internal Revenue Service.

2 All financial filings submitted to the Division are digitally scanned, and are available for public viewing at www.mass.gov/ago/doing-business-in-massachusetts/public-charities-or-not-for-profits/public-charities-annual-filings/public-charities-annual-filings.html.

- While the IRS has established a process for setting executive compensation which, if followed, allows a public charity to invoke a presumption that the compensation is reasonable under federal tax law, the AGO believes that this process alone may not assure reasonable compensation and that there are additional considerations that should be included.
- Responses to the prototype Schedule EC are included as appendices in a separate volume, published on the web and available at <http://www.mass.gov/ago/ceocomp>; the data obtained from those responses is presented in multiple charts within this report to allow for visual comparisons among organizations.
- The report takes a detailed look at the different types of compensation and benefits that were reported in the Schedule EC responses, and provides explanations to assist the reader in understanding the more comprehensive information included on the responses to the Schedule EC.
- The report next looks in detail at the different aspects of the compensation-setting process, including: the use of board compensation committees; the types of comparability data that are employed; the prevalent use of outside compensation consultants; and other institutional considerations that influence compensation levels.
- A number of observations follow, including discussions of: certain large lump-sum payments that appear on compensation reports; the fact that some CEO retirement plans are designed to operate much like the defined benefit plans that have declined in use for much of the general workforce; the exclusive and sustained focus on executive-suite compensation and benefits packages that may lead to a loss of perspective on what is “reasonable” and, over time, contribute to the escalation of CEO compensation packages at public charities.

The Public's Interest in Executive Compensation Information

In 2009, the AGO observed that in the health care arena, the rapid escalation of executive compensation in the context of rapidly increasing health care costs merited additional and more timely reporting on executive compensation. The same can be said for higher education. The extent to which the size of executive compensation packages directly contributes to the cost of these important charitable services is less important than the attitude toward costs that is created or supported by the existence of rich compensation packages.

See footnote 11 p. 14.

THE REGULATORY CONTEXT FOR A DISCUSSION OF CHARITABLE EXECUTIVE COMPENSATION

A. THE AGO's OVERSIGHT ROLE

The AGO, through the Division, is responsible for “see[ing] to the due application of funds given or appropriated to public charities” in the Commonwealth and charged with “prevent[ing] breaches of trust in the administration” of public charities.³ Within this broad mandate, the AGO reviews decisions made by boards of directors and senior executives at public charities to ensure that they are consistent with the fiduciary duties of care and loyalty that such decision-makers owe to the charities they serve. Their decisions must be made based on the best interests of the charity and may not result in the diversion of funds away from their charitable purpose to the unwarranted private benefit of other persons or entities.

Payments that exceed fair market value, including excessive compensation, could constitute a misapplication of charitable funds as well as a breach of trust in the administration of those funds. Determining what constitutes fair market value for executive services, however, can be difficult. Even deciding on the factors relevant to the determination is not straightforward. For example, is the relevant “market” for this “fair market value” determination limited to other similar non-profit organizations whose CEOs have similar responsibilities? Or does the “market” include all companies that might seek the services of the individual whose compensation is under review, irrespective of for-profit or non-profit status and irrespective of similarity of organization? Alternatively, should for-profit companies be excluded from the “market” on the ground that for-profits likely pay more, and salaries should be lower at charitable companies simply as a matter of principle?

In assessing a board’s performance of its fiduciary duties in making these and other decisions, the Division examines the way in which the board approached determinations like these. There are no regulations dictating precisely how a board should make these determinations consistent with its fiduciary duties. Of course, reasonableness is always required. Regulations and standards from other relevant oversight bodies can provide useful guidance. The most prominent example of such guidance is the Treasury regulations issued under section 4958 of the Internal Revenue Code.

B. INTERNAL REVENUE SERVICE (IRS) STANDARDS: SECTION 4958

The IRS oversees tax-exempt organizations, including most public charities, in part for purposes of ensuring that the organizations’ exemption from taxation is warranted. One aspect of IRS oversight is ensuring that the resources of an exempt organization are devoted to the organization’s mission and not paid or used for the private gain, or inurement, of particular individuals. Compensation, like other payments charities make, must be no more than fair market value for the services being provided. In 1996, Congress enacted new provisions of the Internal Revenue Code that authorize the IRS to impose significant taxes on charity insiders who receive excessive compensation and on directors and officers who knowingly approve such compensation arrangements. Prior to this change, the IRS’s sole remedy in cases of excessive compensation was revocation of the organization’s exempt status. Because the new section 4958 and its associated regulations provide an alternative to the rarely-invoked “ultimate penalty” of revocation, they are often called the “intermediate sanctions” framework.

³ M.G.L. ch. 12, § 8.

Section 4958 of the Internal Revenue Code provides for significant taxes to be assessed against people involved in an “excess benefit transaction” (including a transaction in which a charity pays compensation in excess of fair market value to a “disqualified person” – someone in a position to exercise significant influence over the affairs of the organization).⁴ Regulations provide a “safe harbor” or a set of conditions which, if met, create a rebuttable presumption that a compensation arrangement is not an “excess benefit transaction” (and that it is reasonable). A compensation arrangement is entitled to the rebuttable presumption of reasonableness if:

- The compensation arrangement is approved in advance by an authorized body of the organization (e.g., the board of directors or a committee of the board) composed entirely of individuals who do not have a conflict of interest (e.g., a body composed entirely of independent directors);⁵
- The authorized body obtained and relied upon appropriate data as to comparability prior to making its determination; and
- The authorized body adequately documented the basis for its determination concurrently with making that determination.⁶

The IRS may rebut the presumption of reasonableness only if it “develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body.”⁷ If the transaction involves a fixed payment, such as under an employment contract, the IRS’s evidence is “limited to evidence relating to facts and circumstances existing on the date the parties enter the contract pursuant to which the payment is made.”⁸ Relevant data for assessing reasonableness of compensation includes, but is not limited to, “compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the availability of similar services in the geographic area of the applicable tax-exempt organization; current compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the disqualified person.”⁹

C. MASSACHUSETTS CHARITIES LAW CONSIDERATIONS

The Division has looked to an organization’s compliance with section 4958 as an important factor in analyzing the appropriateness of executive compensation and its consistency with Massachusetts charities law.¹⁰ However, the AGO does not enforce tax laws or regulations, including section 4958, and is not bound by the standards these tax regulations set forth. The Division noted in its 2009 Memorandum on executive and director compensation¹¹ that since the enactment of section 4958 and the issuance of the “rebuttable presumption”

⁴ For example, the “disqualified person” receiving the excess benefit may be subject to a tax of 25% of the amount of the excess benefit and, if the excess benefit is not returned to the charity, a tax of 200% of such excess benefit. Also, any organization manager who knowingly participated in (for example, by approving) the excess benefit may be subject to a tax of 10% of the excess benefit. See 26 U.S.C. § 4958.

⁵ Independent directors do not have a financial interest in the transaction.

⁶ 26 C.F.R. § 53.4958-6(a).

⁷ 26 C.F.R. § 53.4958-6(b).

⁸ 26 C.F.R. § 53.4958-6(b).

⁹ 26 C.F.R. § 53.4958-6(c)(2).

¹⁰ See, e.g., letter to John William Poduska, Sr., Chairman of the Board of Directors, Citi Performing Arts Center, dated December 5, 2007, available at www.mass.gov/ago/docs/nonprofit/findings-and-recommendations/citi-center-findings-letter-120507.pdf.

¹¹ See memorandum to Massachusetts Hospital Association, Blue Cross and Blue Shield of Massachusetts, Harvard Pilgrim Health Care, Tufts Health Plan, and Fallon Health Plan, dated September 2, 2009, available at www.mass.gov/ago/docs/nonprofit/findings-and-recommendations/bcbs-memo-090209.pdf (2009 Memorandum).

regulations, executive compensation at public charities increased rapidly, continuing a trend that predated section 4958. The Division raised the concern that instead of setting a “ceiling” on compensation rates, section 4958 may have instead created a floor, and raised the question whether section 4958 has served well the public’s interest in ensuring that charitable assets are devoted to charitable missions.¹² As noted above, the AGO assesses executive compensation at public charities in terms of whether the compensation is consistent with fiduciary duties the executive and the board owe to the charity. Those duties may require the consideration of factors beyond the steps needed to comply with section 4958.

In addition to assessing compensation itself, the AGO supports increasing the transparency of executive compensation. The Division’s 2009 Memorandum also explained some of the challenges to creating and supporting transparency in the reporting of executive compensation. For example, “compensation” for purposes of section 4958 and reporting on IRS Form 990 (the annual information return the IRS requires of most tax-exempt organizations) and the Massachusetts Form PC (the annual report the Division requires of Massachusetts public charities) includes various forms of retirement benefit plan and deferred compensation amounts, including amounts that have not yet been paid and, in some cases, amounts to which the executive does not yet have a vested right. Those same amounts will be reported later when the executive’s unqualified right to receive them “vests” (that is, when he or she is entitled to receive them at the appointed time, such as retirement, and they are no longer subject to risk of forfeiture). This results in double-reporting of certain amounts, many of which do not initially appear on the individual’s W-2 form because they have not been paid, but only set aside for the CEO’s future benefit.¹³

Reported figures in the “retirement” or “other reported compensation” categories may give the impression that executive compensation varies considerably from year to year. Sometimes significant reported figures are due to adjustments in or funding of retirement or other benefit or deferred compensation plans. Such amounts are frequently not related to the executive’s performance in that particular year, but instead reflect a negotiated benefit package designed to pay the executive a certain amount at a point of time in the future. If the organization hasn’t adequately funded the plan, it may make a significant “catch-up” transfer in one year. Or, a large number may be reported in a given year because the executive vested in a portion of the benefit (meaning that his or her right to receive that amount is no longer subject to risk of forfeiture). Many organizations maintain these kinds of plans for executives, but they differ in how they report payments to these plans. Some may report them as “retirement” while others may report them as “other reportable compensation.” As described more fully below, the lack of consistency in reporting reflects a flexibility in the design of such supplemental executive plans, but contributes to misunderstandings about the nature of executive compensation as reported on the Form 990.

Moreover, the information reported on the Form 990 and Form PC is often quite stale by the time it is reported. In some cases, it may be nearly two years old. The Form 990 requests compensation data from the calendar year that ended during the fiscal year that is the focus of the Form 990. While the Form 990 is due four and a half months after completion of the fiscal year, organizations are generally entitled to two extensions of three months each. For organizations whose fiscal year ends on September 30, for example, the Form 990 might not be submitted until mid-August of the following year; the compensation data reported on IRS Schedule J will reflect the calendar year ending during that fiscal year end, i.e., the year ending almost 20 months prior to the report’s submission. The delay is an obstacle to transparency.

12 2009 Memorandum at 4.

13 The final column on IRS Schedule J attempts to account for such double reporting by requiring charities to indicate whether any of the compensation on the current report had been reported as some form of deferred compensation on a prior year’s IRS Schedule J. But because of its lack of specificity, the Division has found this column to be of only limited utility. Some of the organizations we spoke to have expressed similar reservations about its usefulness.

STUDY METHODOLOGY

We selected 25 Massachusetts public charities from among those with the highest reported gross support and revenue and the highest reported compensation.¹⁴ While we did not set out to confine the study to particular industries, the group of 25 includes a health care sub-group (including four health plans and twelve hospitals or provider systems) and a higher education sub-group (including seven universities). This allowed us to compare and contrast approaches and practices within and between these two major groups. The other organizations in our study, Harvard Management Company and ISO New England, also share certain characteristics in that other entities in their primary areas of activity are generally commercial rather than charitable.¹⁵

We asked each organization to complete and submit a prototype “Schedule EC” for its CEO for calendar years 2009, 2010, and 2011.¹⁶ We focused on CEO compensation rather than asking for information about a broader set of executives because we deemed the CEO position to be most analogous across organizations (whereas other positions can encompass different duties depending on varying organizational structure and staffing). We requested three years of data in hopes of observing trends and a variety of examples of reports to determine how effectively the prototype form would capture and explain those variations.

We developed the prototype Schedule EC based on the IRS Schedule J, which already calls for fairly detailed information about executive compensation. The Schedule EC requests information in the same general categories as the IRS Schedule J, but the EC asks for information about each individual component within the categories. It also asks for narrative explanations about each figure or program that is not self-explanatory. We believe that the break-down of information and the accompanying explanations will significantly increase the transparency of compensation reporting and will reduce confusion that may arise from various aspects of current reporting mechanisms, such as the double-reporting of certain elements and aggregation of others (such as “other reportable compensation,” one of the categories in the IRS Schedule J).

In addition to the Schedule EC, we asked the organizations to assemble additional information for our review that we thought would enable us to understand the process the organizations used to assess the “reasonableness” of the compensation packages reported.¹⁷ This deeper examination helped us develop an understanding of organizations’ practices in invoking the section 4958 rebuttable presumption and helped us develop impressions about which questions and information requests might be most productive to implement on a broader basis.

The Impact of Transparency: Blue Cross Blue Shield Example

In 2011, the AGO conducted an investigation of Blue Cross and Blue Shield of Massachusetts’ payment of more than \$4.2 million in severance to its former CEO, whose employment the board had terminated. The AGO’s investigation and report shed light on the practice of including severance provisions in CEO contracts that entitle the CEO to substantial payments upon termination of employment for nearly any reason short of intentional misconduct. Blue Cross and Blue Shield refunded \$4.2 million to its members.

See footnote 32 p. 68.

¹⁴ Selections were based on data reported for calendar year 2009, the latest year for which we had complete reported information for all public charities.

¹⁵ Harvard Management Company is, essentially, an investment management firm that manages the Harvard University endowment in the same way that commercial investment managers would. Harvard’s decision to “in-source” this service allows it to avoid paying large advisory and incentive fees to outside commercial investment managers. ISO New England manages the power grid and market for the New England states, dealing with the largely for-profit power companies in the region.

¹⁶ See Appendix A for a copy of our prototype Schedule EC, and Appendices C through AA for the submitted Schedules EC.

¹⁷ A copy of the Information Request is at Appendix B.

Some of the organizations did not make available all the information we had requested.¹⁸

Other organizations, including all of the hospitals, offered or even requested the opportunity to discuss with us our impressions and questions about the materials we had reviewed. We found these discussions helpful and express our thanks to those organizations.

Because the additional information we reviewed is sensitive, because we have not reviewed the same level of information at organizations other than the 25 in our study, and because the review is intended to contribute to better understanding of procedures and practices generally, we do not report organization-specific information that is not reported in the attached Schedules EC.

18 Several of the universities declined to allow us to review some of the materials that would have been responsive to our Information Request and provided access instead to a subset of materials and/or a narrative constructed to explain the organization's approach to executive compensation.

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PART I: WHAT THEY ARE PAID

CEO COMPENSATION AT 25 LARGE PUBLIC CHARITIES IN MASSACHUSETTS

When public charities report their compensation numbers on IRS Schedule J, they present the data, as required by the IRS, in a spreadsheet format. As an aid to understanding the compensation data that we received from the group of 25 charities, and to permit comparisons among the various organizations, we have prepared a number of charts.

IRS Schedule J asks for compensation data in several broad categories: base compensation; bonus and incentive compensation; other reportable compensation; retirement and other deferred compensation; and nontaxable benefits.¹⁹ These are general compensation categories, any of which may include more than one component. One goal of the Division's review, which included the formulation of the prototype Schedule EC that was completed by the group of 25 charities, was to break down the compensation into its component parts; this serves to provide additional transparency in reporting compensation data.

The Schedule EC responses that we received appear as Appendices C through AA available at <http://www.mass.gov/ago/ceocomp>. A review of those responses reveals considerable variety in the compensation components across the group of 25 charities. Largely because of that variety, and because of the difficulty it presents in allowing "apples-to-apples" comparisons among the organizations in the group, we have chosen to use the more generalized compensation categories from IRS Schedule J in our charts, which appear on the following pages. While the IRS Schedule J categories permit a cleaner and more accessible graphical representation of data, they should be read together with the Schedule EC responses in order to gain a full picture of the compensation being provided to the CEOs in our review.

It is also important to note that, in Part II of this report, there is an extended discussion about the types of compensation and benefits that were reported to us on the Schedule EC responses. The subsections in that discussion are not intended to correspond to the generalized IRS Schedule J compensation categories. While there is some overlap among categories, the Part II discussion is intended to address—and provide a fuller explanation of—the forms of compensation and benefits actually reported to us on the Schedule EC.

The Part II discussion will also note that certain forms of compensation or benefits may appear to fit within more than one category—certain forms of deferred compensation might appropriately be placed in "other reportable compensation" or "retirement and other deferred compensation," depending on the particular nuances of the compensation or benefit plan. Different organizations may make different determinations about the category in which to report certain forms of compensation or benefits. Thus, when considering the attached charts, please recall that any analysis of the allocation between the IRS Schedule J categories should be informed by the more specific information included on the Schedule EC responses.²⁰

19 IRS Schedule J (and, in turn, the Schedule EC) asks organizations to report amounts paid to or earned by certain individuals. If an individual forgoes compensation to which he or she would otherwise be entitled, it may still be listed on the IRS Schedule J and Schedule EC. See, for example, the notes to Chart 3 (Blue Cross and Blue Shield of Massachusetts) on p. 22.

20 The Schedule EC responses may also include additional detail about "double counting" of certain deferred or other compensation components.

Also, when viewing the graphs that provide year-by-year compensation data, please note that in cases of CEO succession during the relevant period (2009 to 2011), we provide data for both the outgoing CEO and the incoming CEO (and, where appropriate, for any interim CEO). This results in more than three “years” of data being reported for certain organizations, but presents a more complete picture of the compensation expenditures associated with CEO succession.

Some of the organizations in our review took a broader approach to reporting compensation data on the Schedule EC, providing all relevant data regarding a CEO’s compensation, even for those years before or after the relevant individuals served as the organization’s CEO. Others took a more narrow approach, providing only the compensation for the organization’s then-current CEO; this approach omitted certain payments to the relevant individuals that took place before or, more commonly, after, their service as CEO.

Because CEO succession was fairly prevalent in our review group during the relevant period—affecting 12 of the 25 organizations—and because a CEO’s resignation or retirement frequently triggered payment of certain types of compensation (including funds held in retirement plans or other forms of deferred compensation, or, in some cases, severance and other end-of-service payments) that may occur in years subsequent to a CEO’s resignation or retirement, we believe that the broader approach is the better one. It provides a more complete picture of charitable expenditures associated with overall CEO compensation. The charts that follow indicate when such payments have not been included in the Schedule EC reporting.

CHART I: HEALTH PLAN COMPARISON 2009-2011

(Graphical representation of Schedule EC data presented according to IRS classifications)

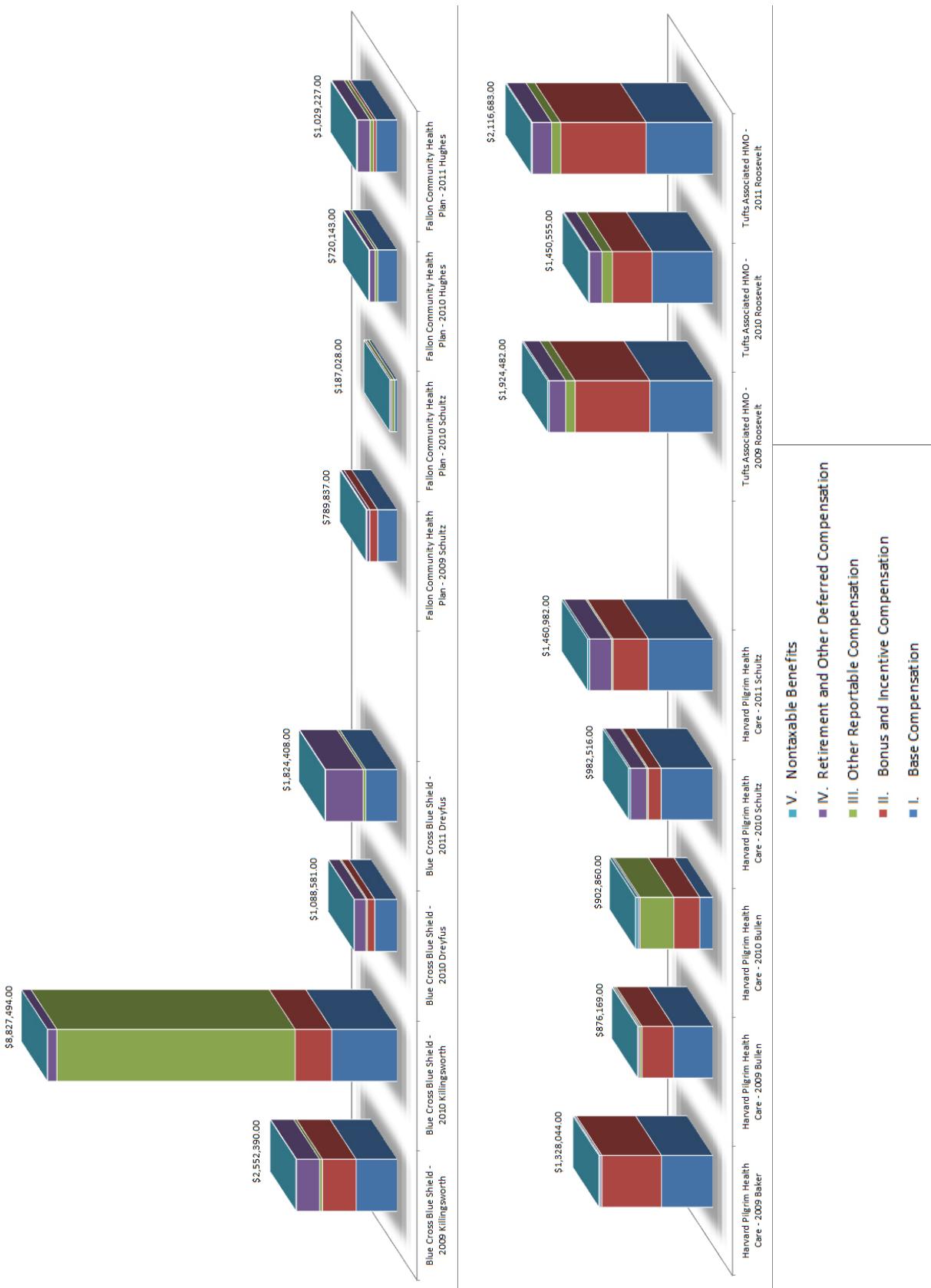
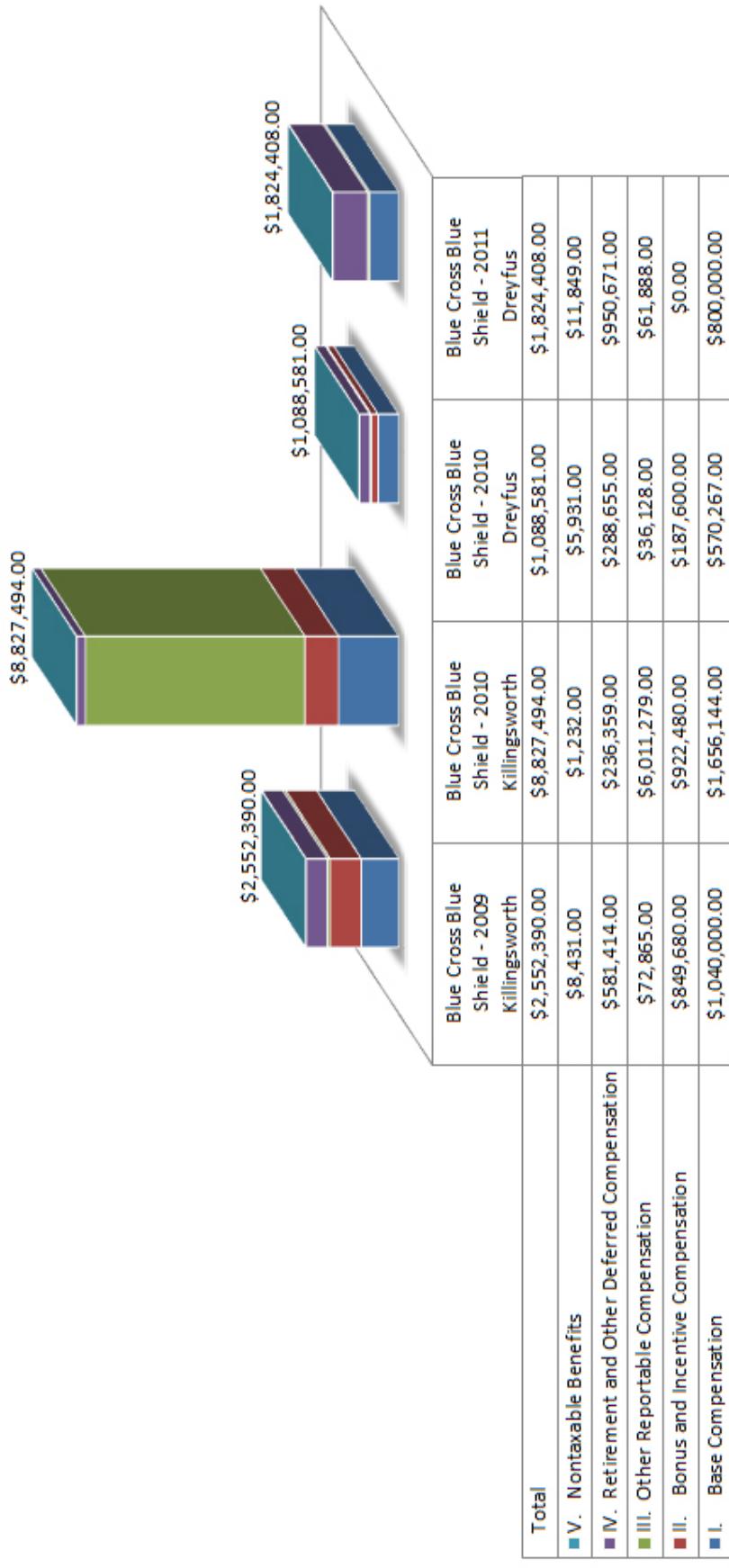


CHART 2: BLUE CROSS AND BLUE SHIELD OF MASSACHUSETTS

(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to CEO Cleve Killingsworth in 2010 include a significant severance payment and a payout of accrued vacation time.
- Interim CEO William Van Faasen does not appear here because he was not compensated for his term of service (3/16/2010 to 9/6/2010).
- Payments to CEO Andrew Dreyfus in 2010 include payments made to him as Executive Vice President prior to serving as CEO.
- In 2011, CEO Andrew Dreyfus was eligible for \$300,000 in compensation from BCB SMA's Leadership Performance Plan (LPP) and was eligible for \$413,333 in compensation from BCB SMA's Long-Term Incentive Plan (LTI). Because these amounts accrue to him under the normal operation of those two compensation plans, they are reported by BCB SMA on both the IRS Schedule J and the Schedule EC. However, we are informed by BCB SMA that: (i) Dreyfus did not receive the \$300,000 LPP payment until 2012; and (ii) declined to accept the \$413,333 LTI payment. Thus, his actual total income for 2011 was \$1,111,075.

CHART 3: FALLON COMMUNITY HEALTH PLAN

(Graphical representation of Schedule EC data presented according to IRS classifications)

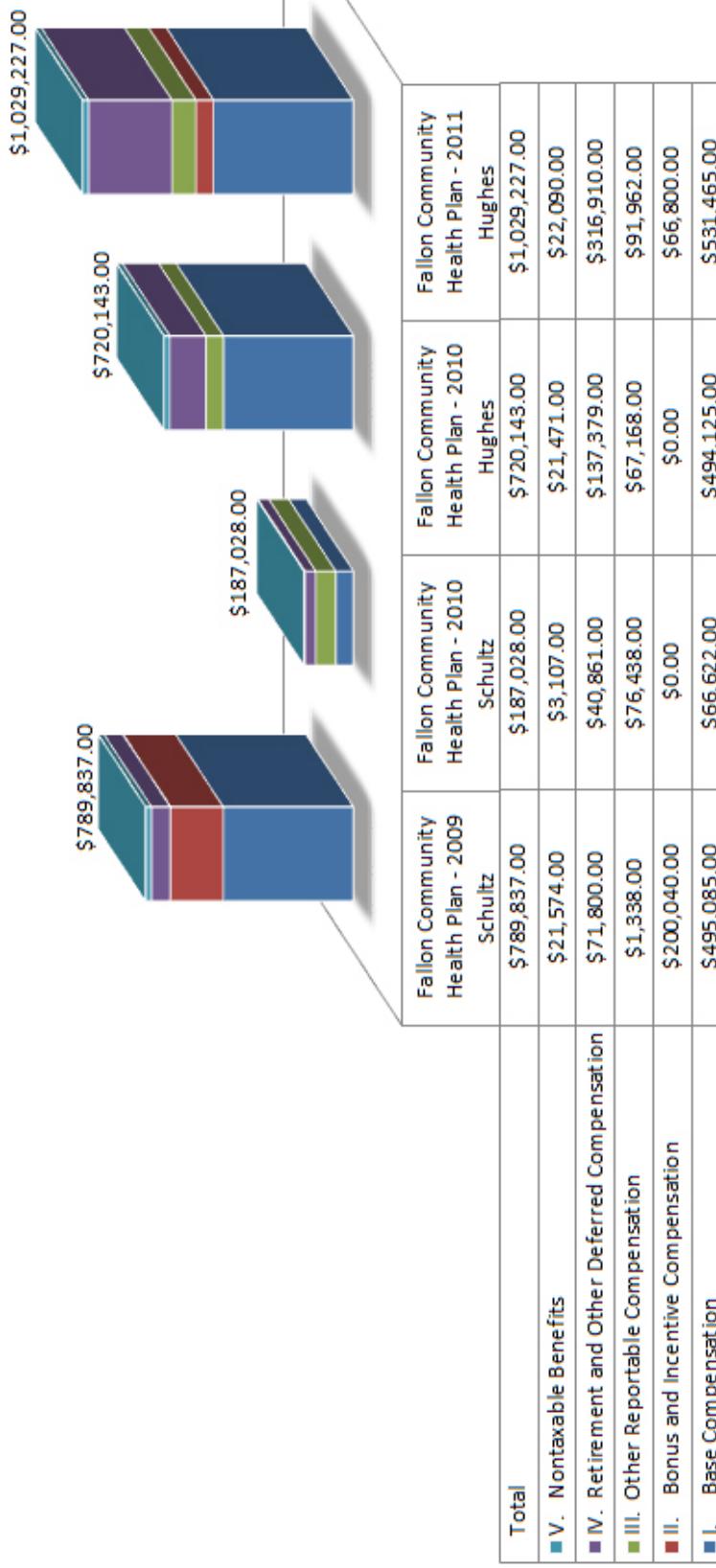
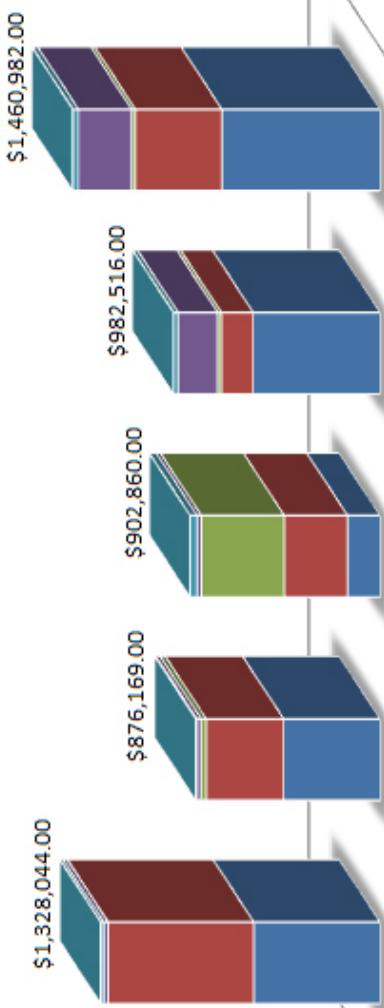


CHART 4: HARVARD PILGRIM HEALTH CARE

(Graphical representation of Schedule EC data presented according to IRS classifications)



	Harvard Pilgrim Health Care - 2009 Baker	Harvard Pilgrim Health Care - 2009 Bullen	Harvard Pilgrim Health Care - 2010 Bullen	Harvard Pilgrim Health Care - 2010 Schultz	Harvard Pilgrim Health Care - 2011 Schultz
Total	\$1,328,044.00	\$876,169.00	\$902,860.00	\$982,516.00	\$1,460,982.00
V. Nontaxable Benefits	\$14,372.00	\$4,860.00	\$32,682.00	\$21,508.00	\$25,938.00
IV. Retirement and Other Deferred Compensation	\$19,600.00	\$19,600.00	\$19,600.00	\$187,500.00	\$252,100.00
III. Other Reportable Compensation	\$1,529.00	\$24,024.00	\$395,009.00	\$18,029.00	\$19,122.00
II. Bonus and Incentive Compensation	\$692,071.00	\$367,971.00	\$300,699.00	\$151,247.00	\$410,450.00
I. Base Compensation	\$600,472.00	\$459,714.00	\$154,870.00	\$604,232.00	\$753,372.00

- Payments to CEO Charles Baker in 2009 include a payout of accrued vacation time.
- Payments to Interim CEO Bruce Bullen in 2009 include payments made to him as COO prior to serving as Interim CEO.
- Payments to Interim CEO Bullen in 2010 include severance, a payout of accrued vacation time, and other “end-of-service”* payments.

* End-of-service payments are discussed more fully in Part II D, on page 67.

CHART 5: TUFTS ASSOCIATED HMO

(Graphical representation of Schedule EC data presented according to IRS classifications)

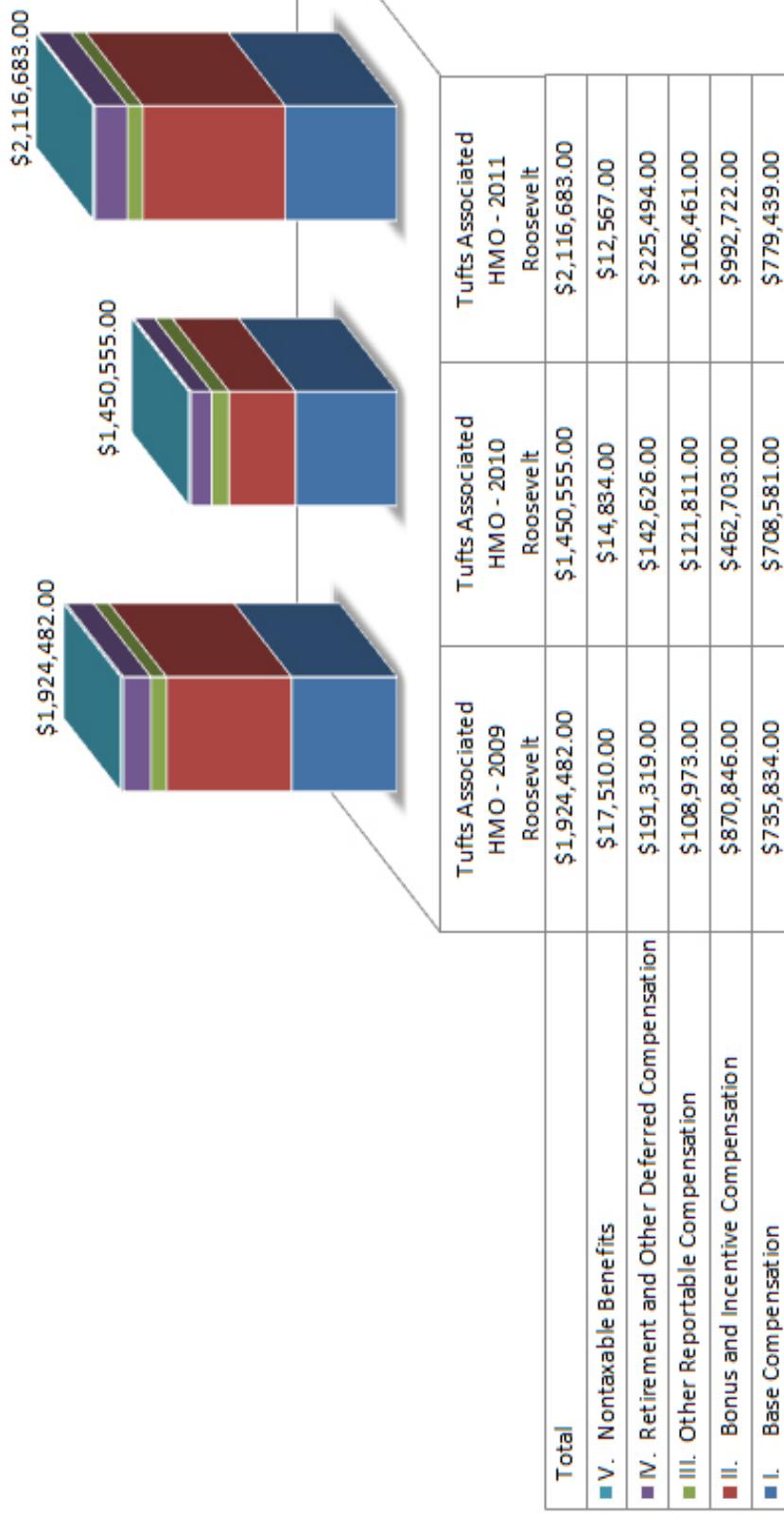


CHART 6: HOSPITAL AND PROVIDER SYSTEMS COMPARISON 2009-20

(Graphical representation of Schedule EC data presented according to IRS classifications)

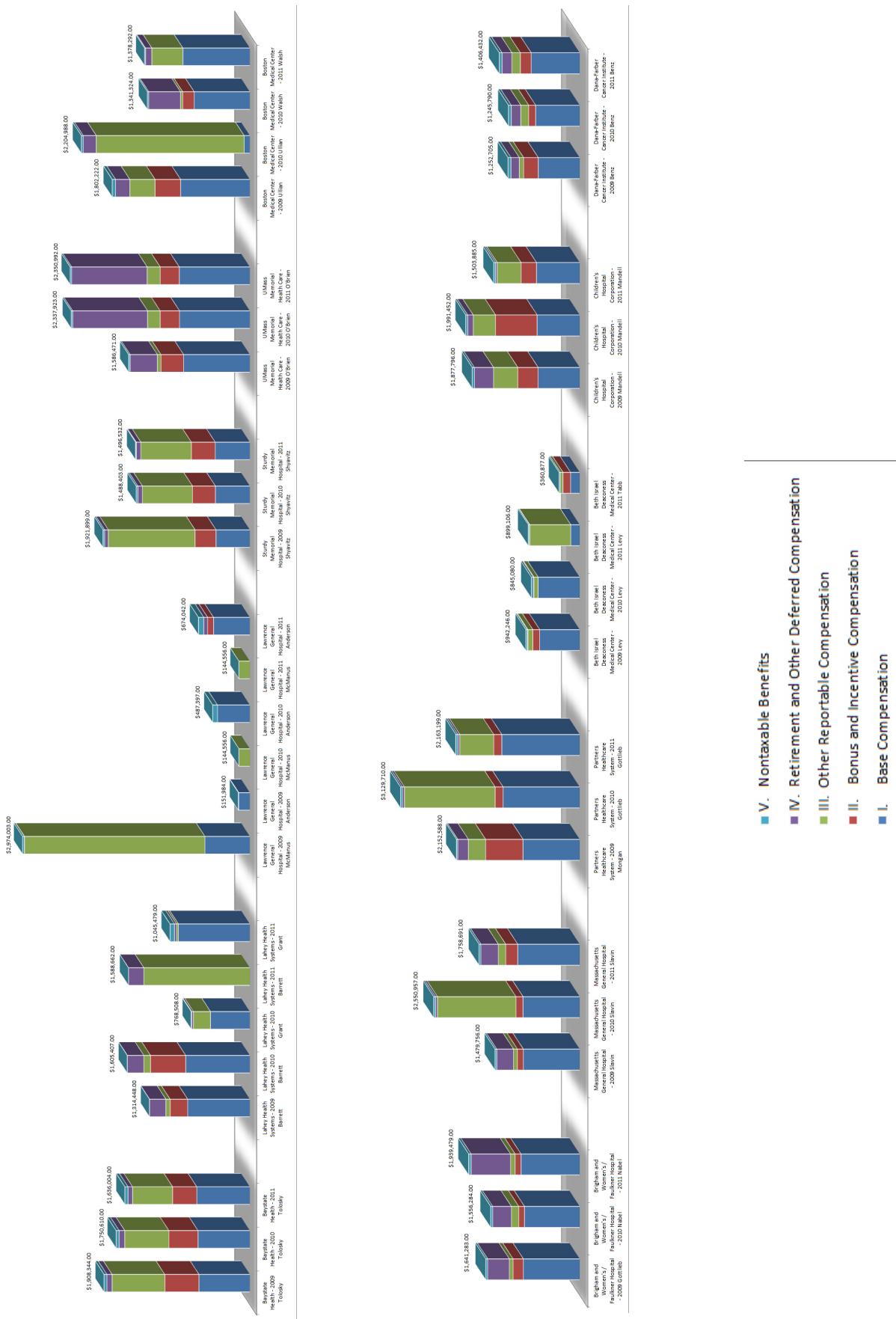


CHART 7: BAYSTATE HEALTH

(Graphical representation of Schedule EC data presented according to IRS classifications)

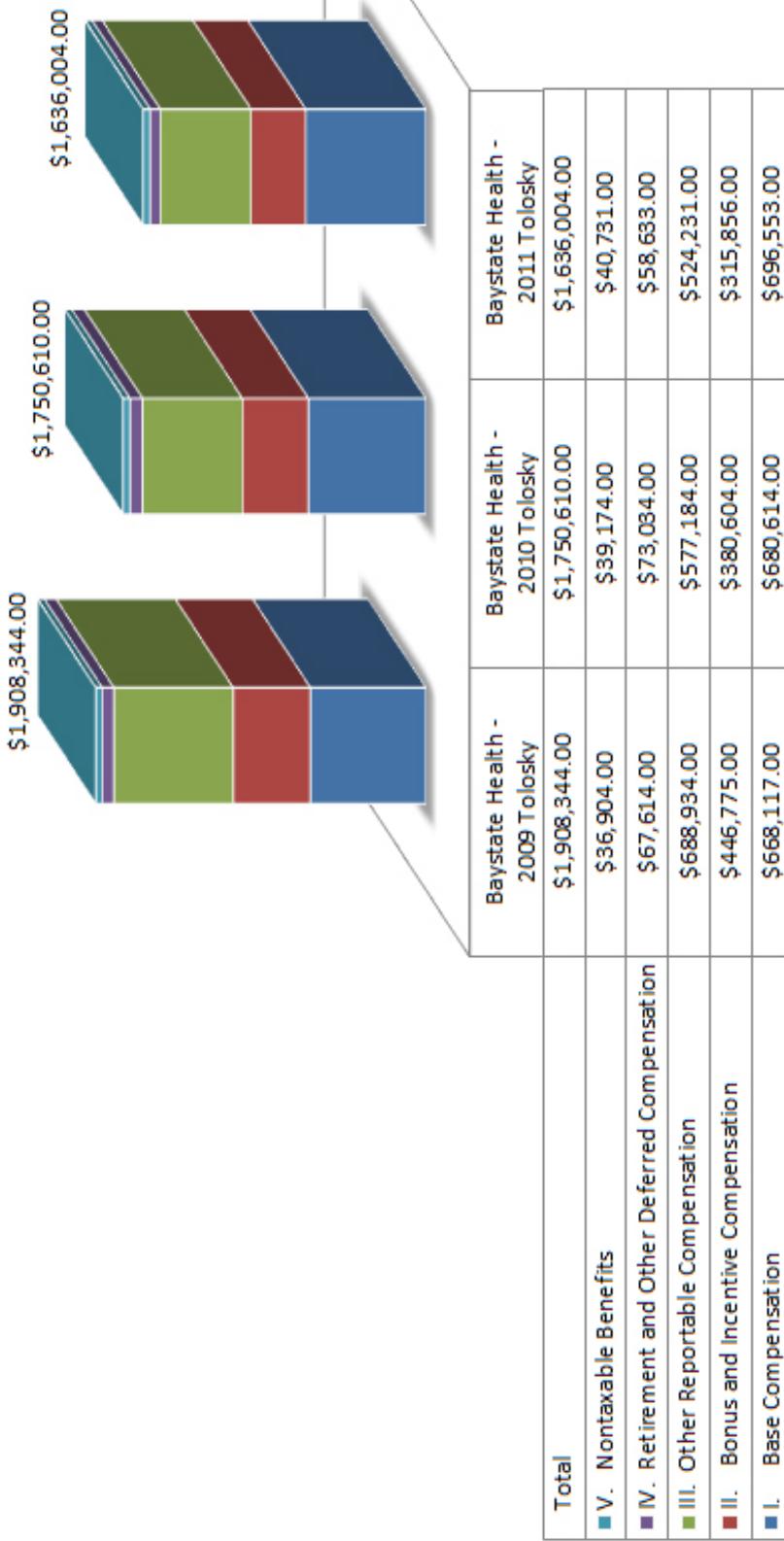
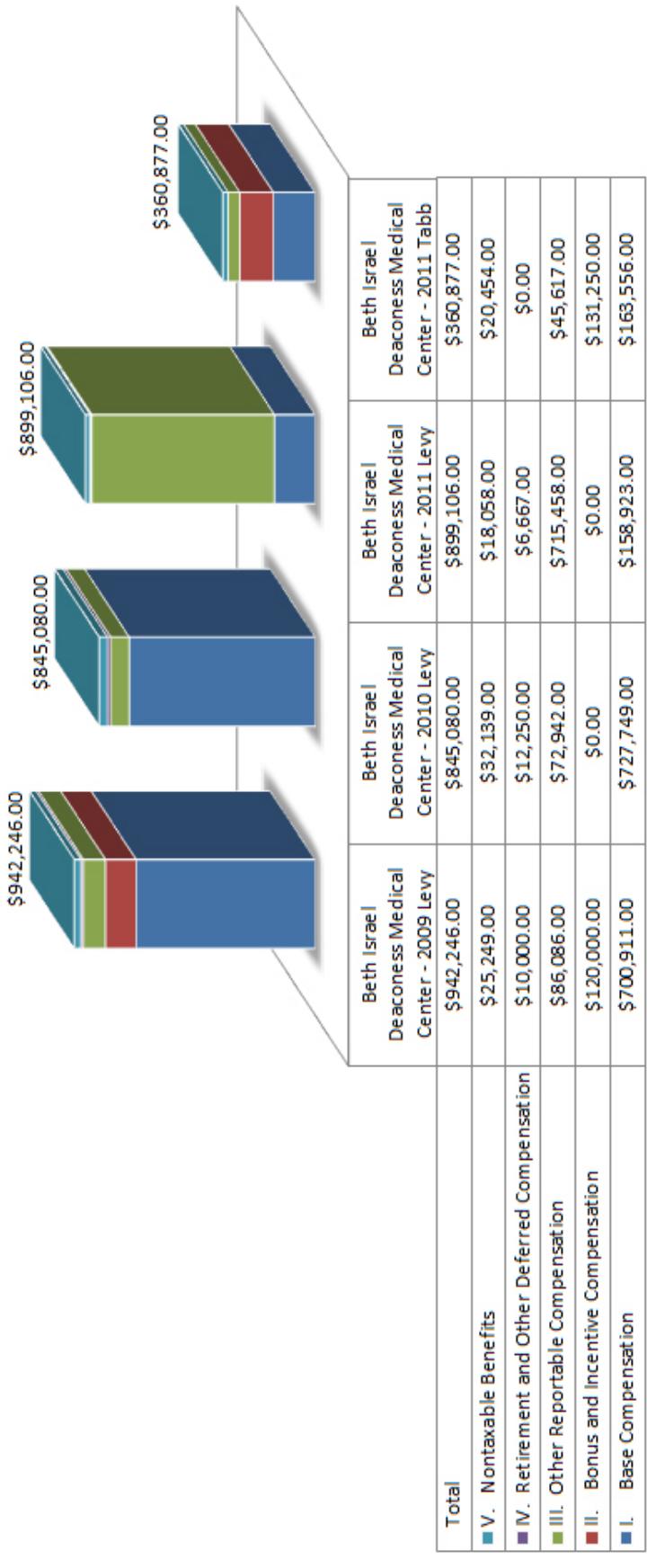


CHART 8: BETH ISRAEL DEACONESS MEDICAL CENTER

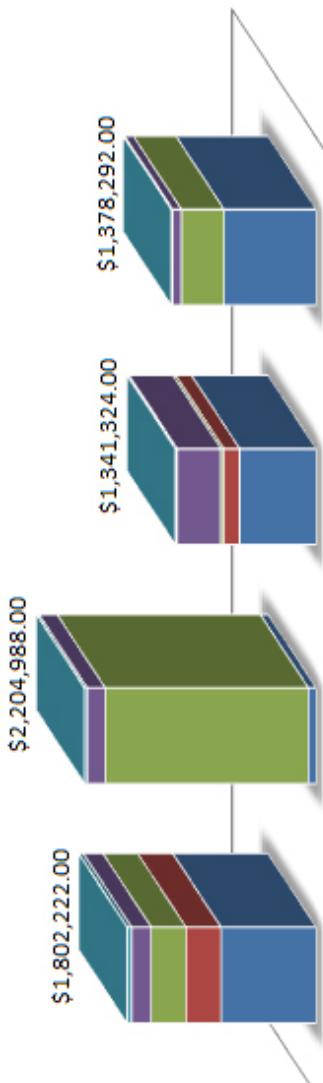
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to CEO Paul Levy in 2011 primarily represent severance.

CHART 9: BOSTON MEDICAL CENTER

(Graphical representation of Schedule EC data presented according to IRS classifications)



	Boston Medical Center - 2009 Ullian	Boston Medical Center - 2010 Ullian	Boston Medical Center - 2010 Walsh	Boston Medical Center - 2011 Walsh
Total	\$1,802,222.00	\$2,204,988.00	\$1,341,324.00	\$1,378,292.00
V. Nontaxable Benefits	\$43,604.00	\$24,502.00	\$17,084.00	\$11,949.00
IV. Retirement and Other Deferred Compensation	\$186,299.00	\$169,433.00	\$414,958.00	\$81,750.00
III. Other Reportable Compensation	\$330,699.00	\$1,934,648.00	\$29,169.00	\$406,353.00
II. Bonus and Incentive Compensation	\$333,878.00	\$0.00	\$150,000.00	\$0.00
I. Base Compensation	\$907,742.00	\$76,405.00	\$730,163.00	\$878,240.00

- Payments to CEO Elaine Ullian in 2010 include payments of accrued retirement and deferred compensation at the time of her departure.

CHART 10: BRIGHAM AND WOMEN'S/FAULKNER HOSPITALS

(Graphical representation of Schedule EC data presented according to IRS classifications)

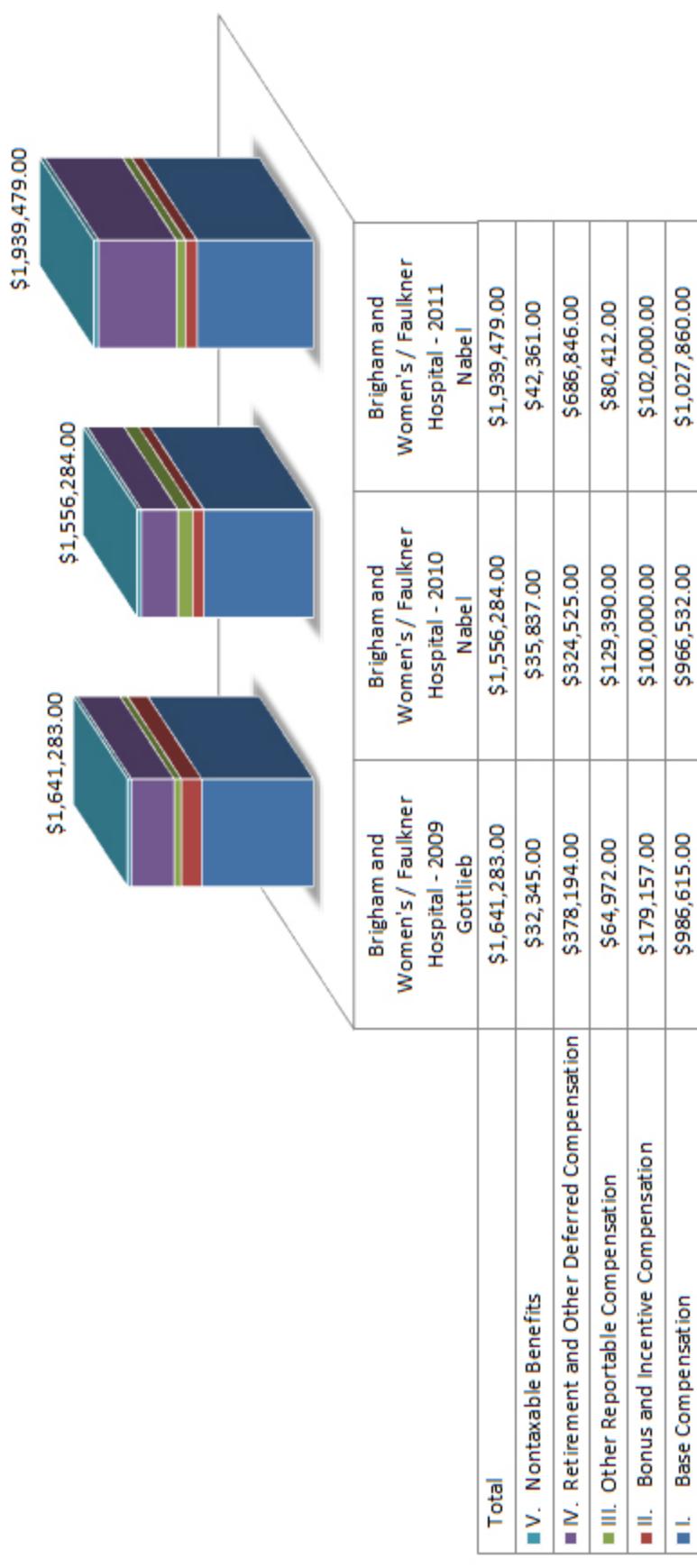
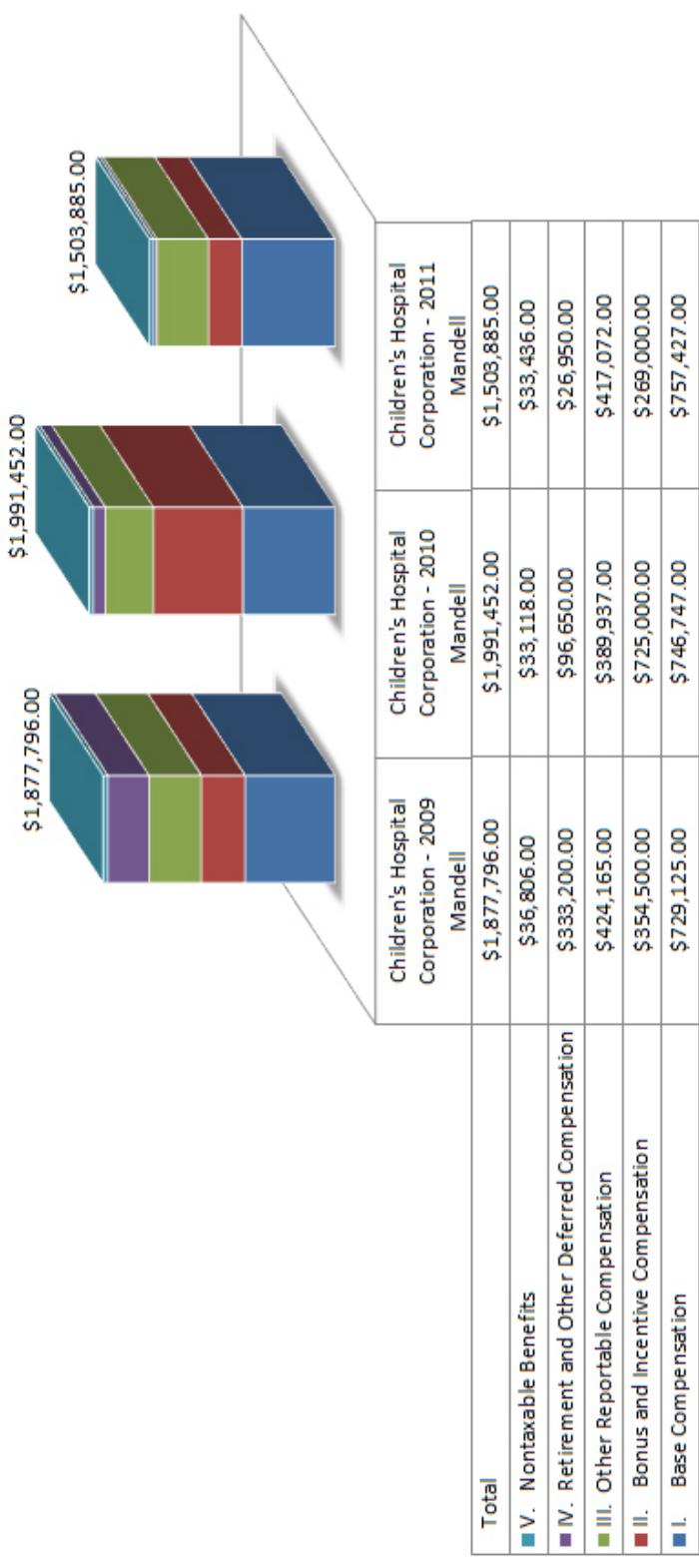


CHART II: CHILDREN's HOSPITAL

(Graphical representation of Schedule EC data presented according to IRS classifications)



- Based on internal changes, two years' worth of Bonus and Incentive Compensation were awarded during 2010.

CHART 12: DANA-FARBER CANCER INSTITUTE

(Graphical representation of Schedule EC data presented according to IRS classifications)

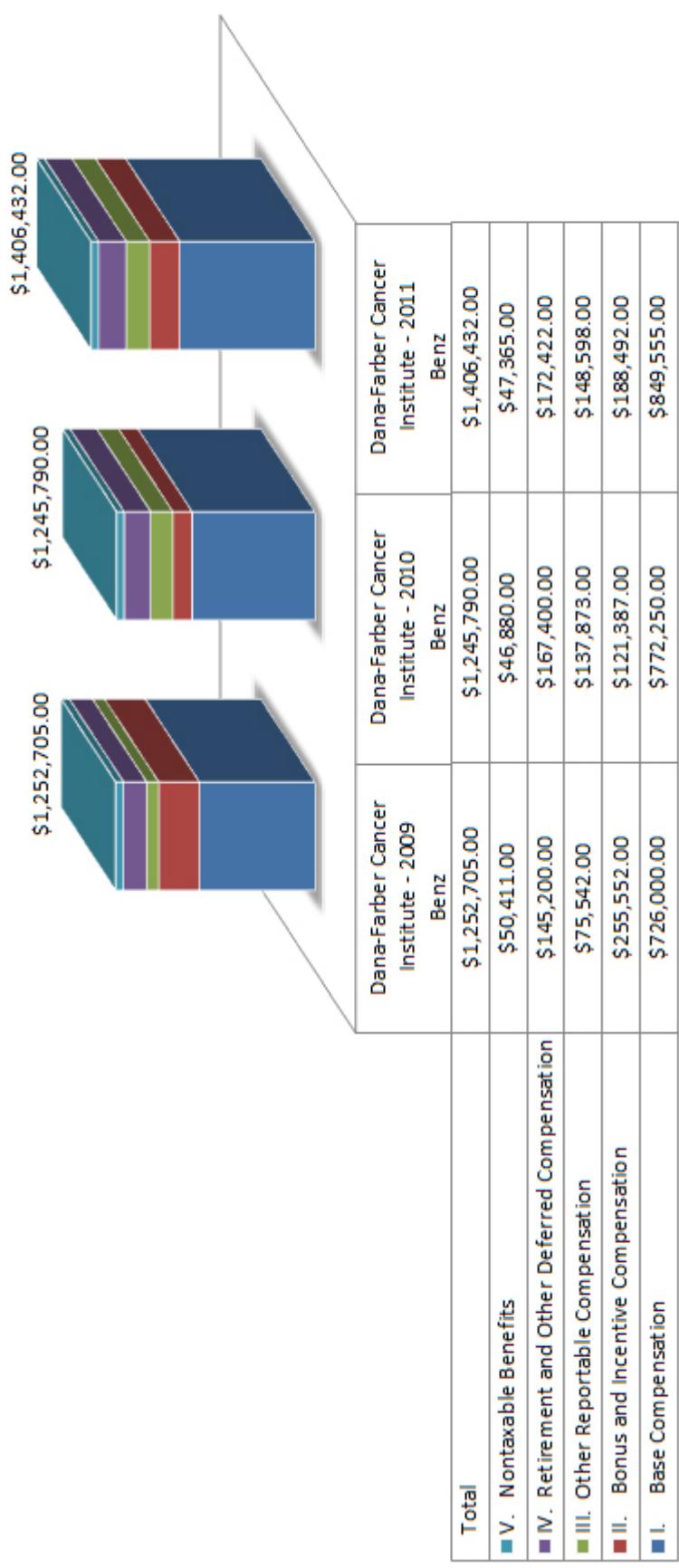
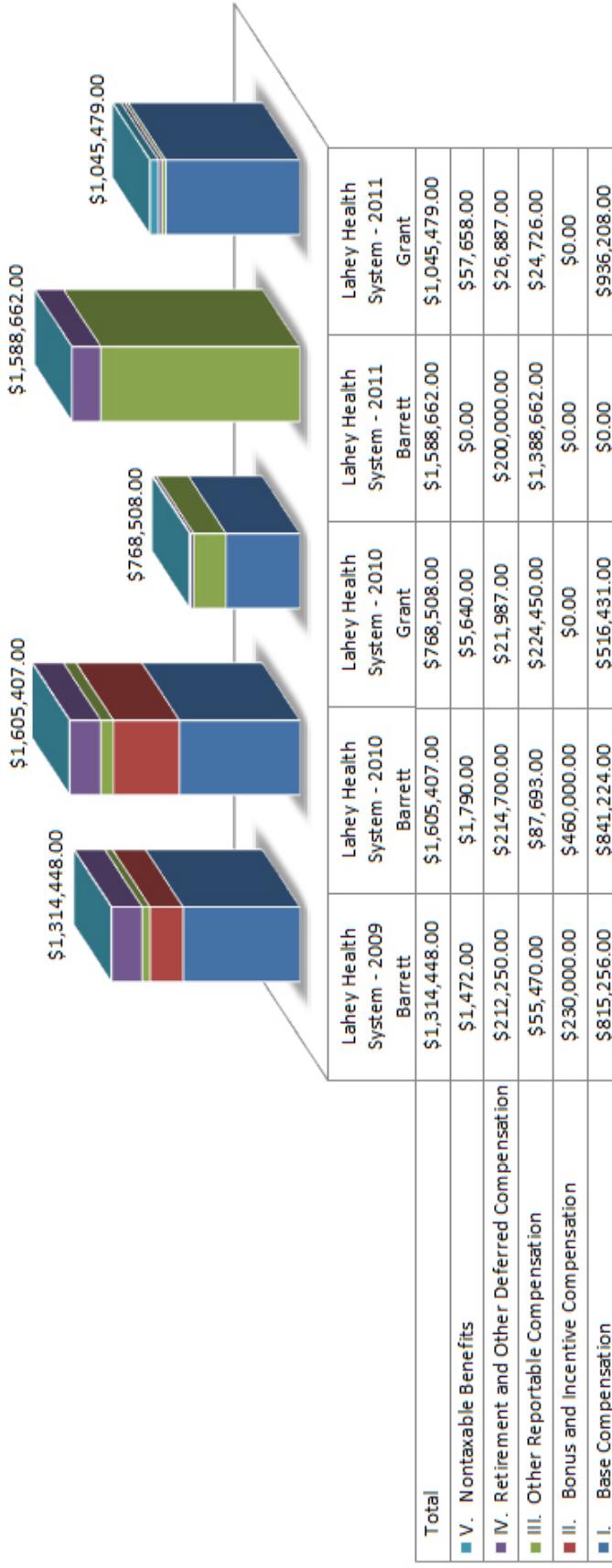


CHART I 3: LAHEY HEALTH SYSTEM

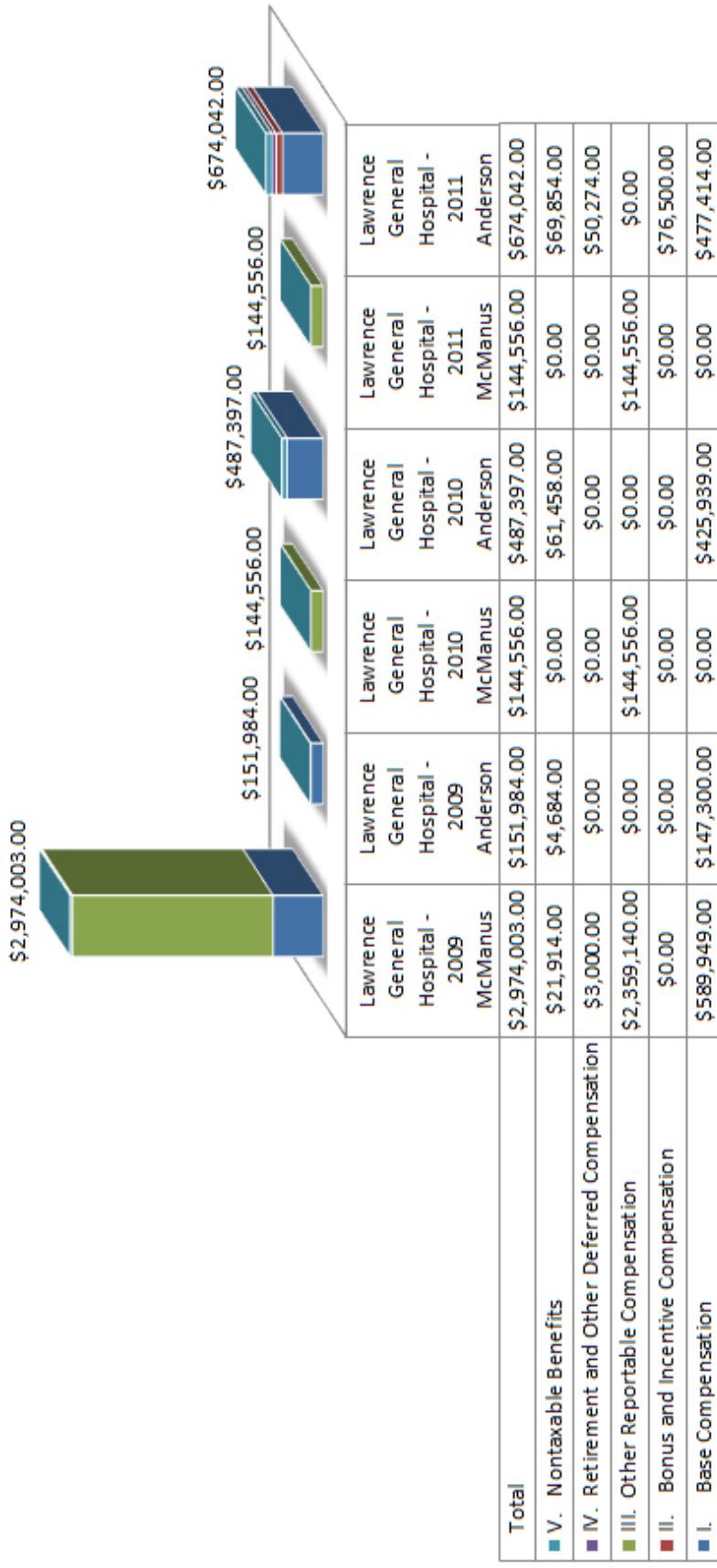
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to CEO David Barrett in 2011 primarily represent severance (“composed of numerous components”) and a payout of accrued vacation time.
- Payments to CEO Howard Grant in 2010 include moving expenses and compensation to make up for forfeited compensation from prior employer.

CHART 14: LAWRENCE GENERAL HOSPITAL

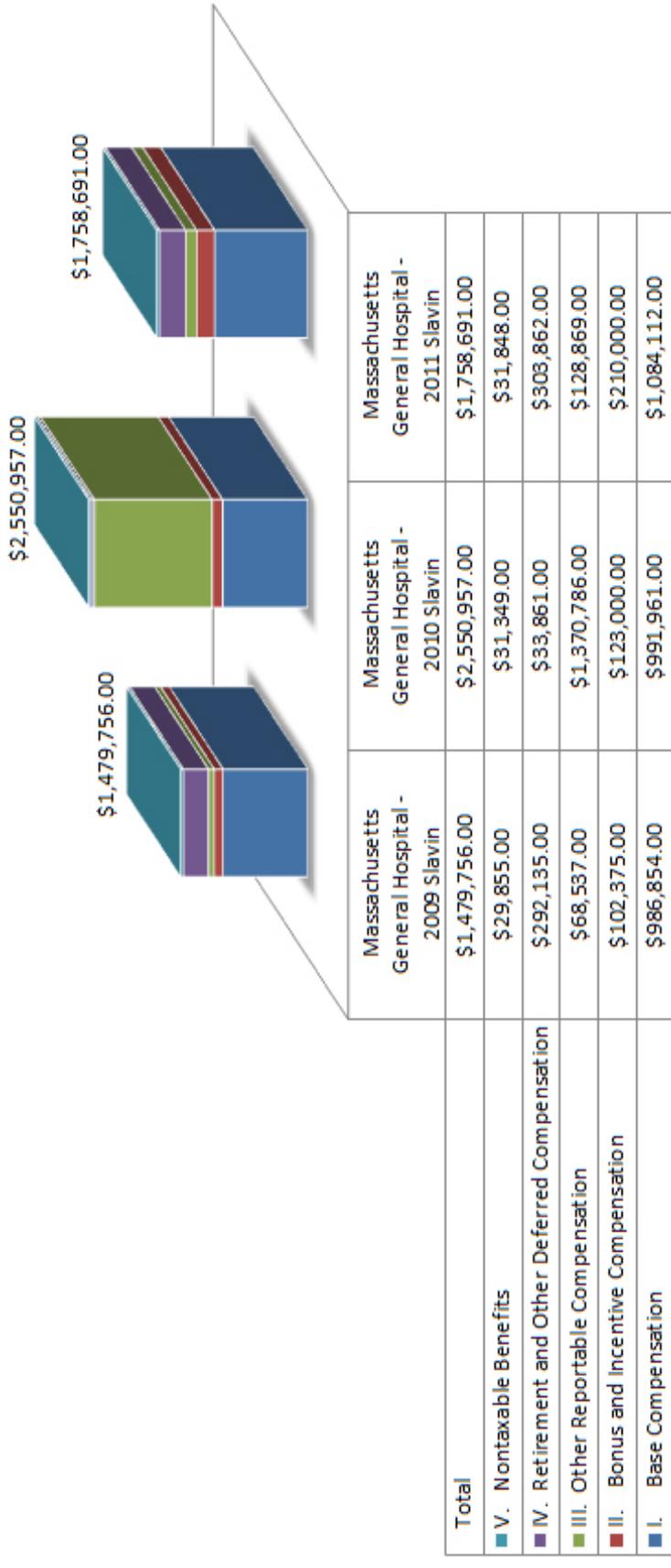
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to CEO Joseph McManus in 2009 include deferred compensation paid at the time of retirement after 30 years with the hospital.

CHART I 5: MASSACHUSETTS GENERAL HOSPITAL

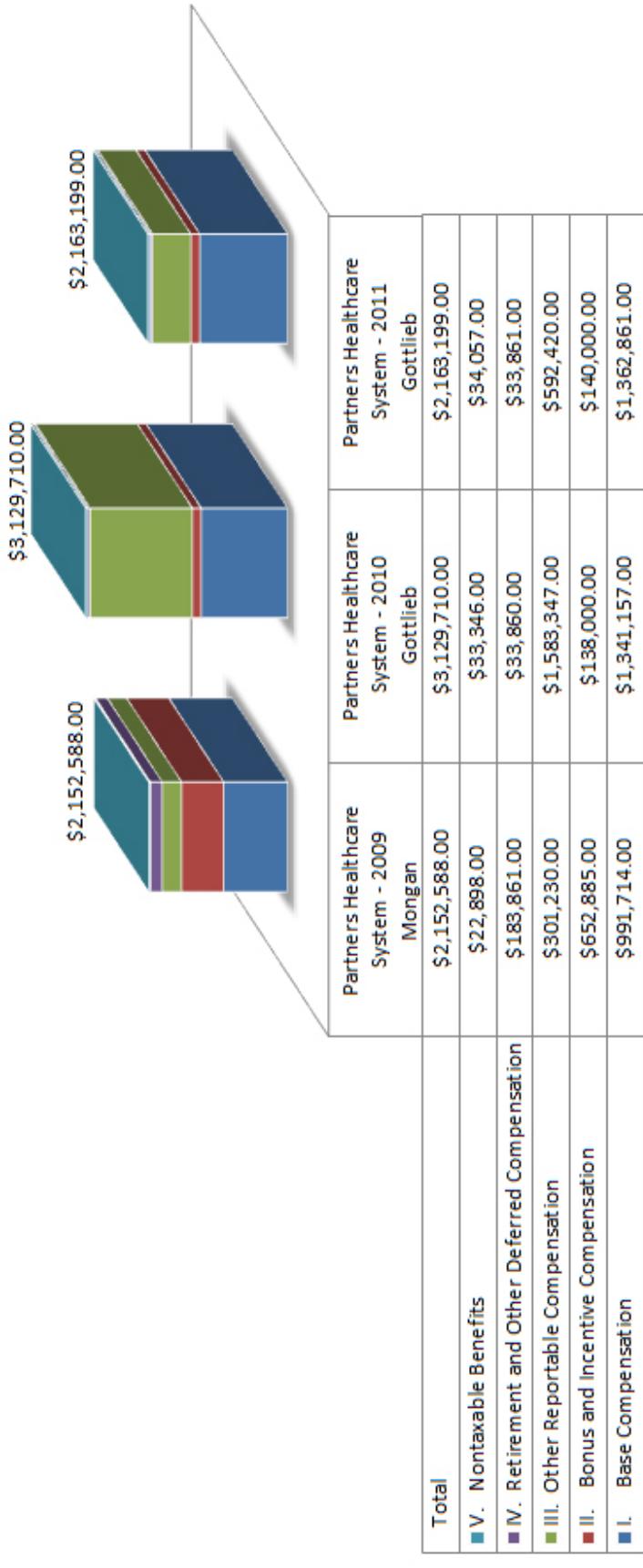
(Graphical representation of Schedule EC data presented according to IRS classifications)



- CEO Peter Slavin became vested in his SERP in 2010, triggering certain reporting requirements.

CHART 16: PARTNERS HEALTHCARE SYSTEM

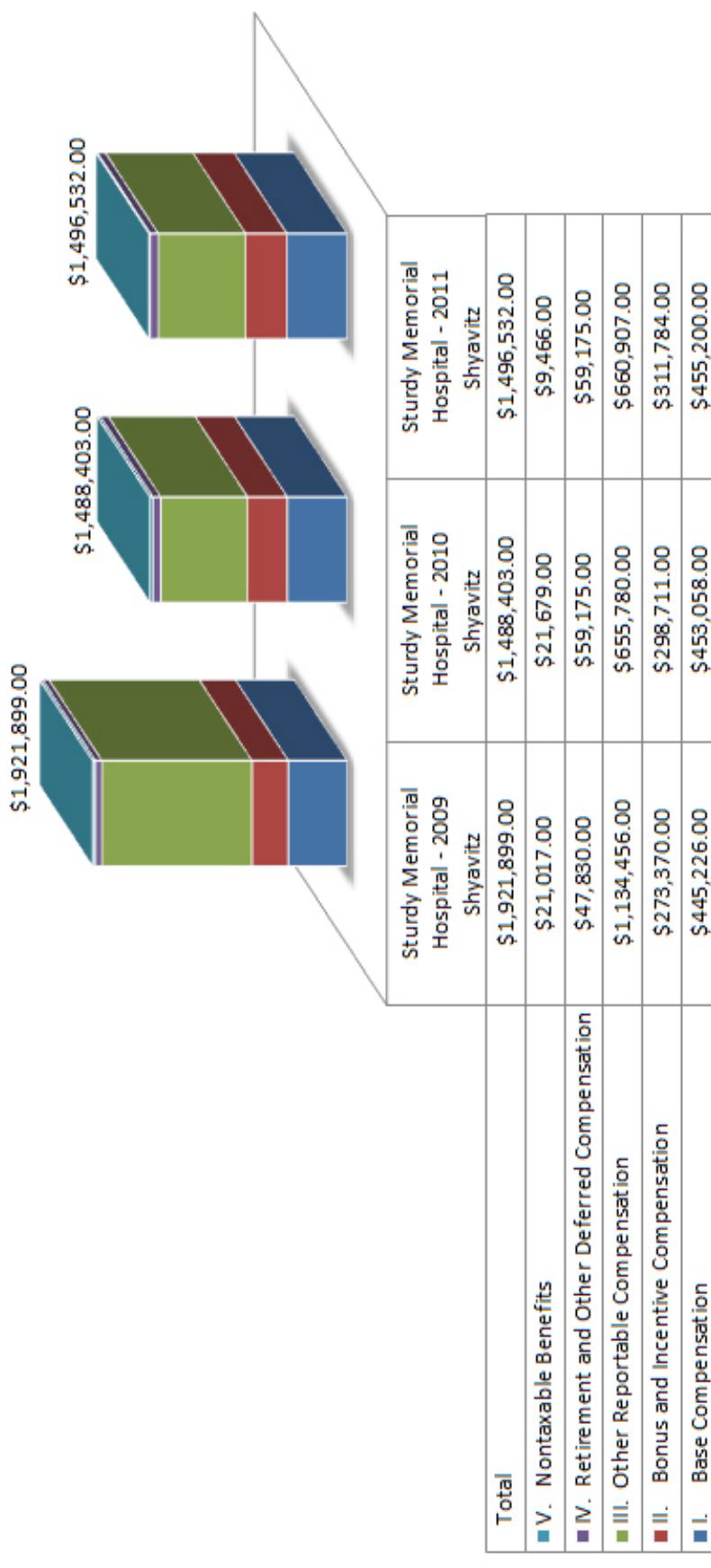
(Graphical representation of Schedule EC data presented according to IRS classifications)



- CEO Gary Gottlieb became vested in his SERP in 2010, triggering certain reporting requirements.

CHART 17: STURDY MEMORIAL HOSPITAL

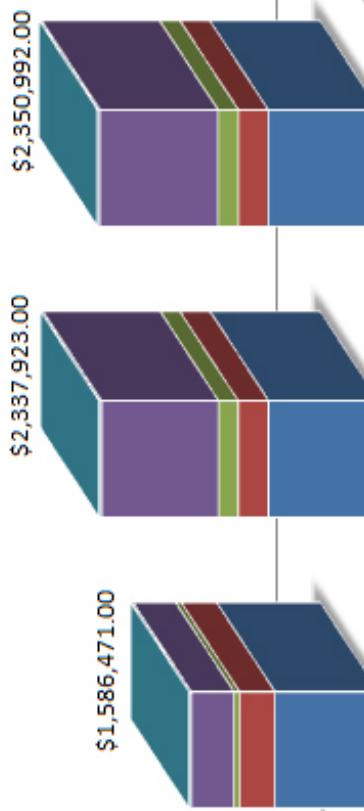
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Each year's reported amounts for CEO Linda Shyavitz include large retirement contributions needed to correct previous underfunding of her retirement account.

CHART 18: UMASS MEMORIAL HEALTH CARE

(Graphical representation of Schedule EC data presented according to IRS classifications)



UMass Memorial Health Care - 2009 O'Brien	UMass Memorial Health Care - 2010 O'Brien	UMass Memorial Health Care - 2011 O'Brien
\$1,586,471.00	\$2,337,923.00	\$2,350,992.00
\$18,756.00	\$19,046.00	\$19,064.00
V. Nontaxable Benefits		
\$355,741.00	\$978,472.00	\$986,946.00
IV. Retirement and Other Deferred Compensation		
\$47,360.00	\$165,178.00	\$170,629.00
III. Other Reportable Compensation		
\$296,660.00	\$253,219.00	\$249,750.00
II. Bonus and Incentive Compensation		
\$867,954.00	\$922,008.00	\$924,603.00
I. Base Compensation		

- Second SERP was established for CEO John O'Brien in 2010.

CHART 19: HIGHER EDUCATION INSTITUTIONS COMPARISON 2009-2011
 (Graphical representation of Schedule EC data presented according to IRS classifications)

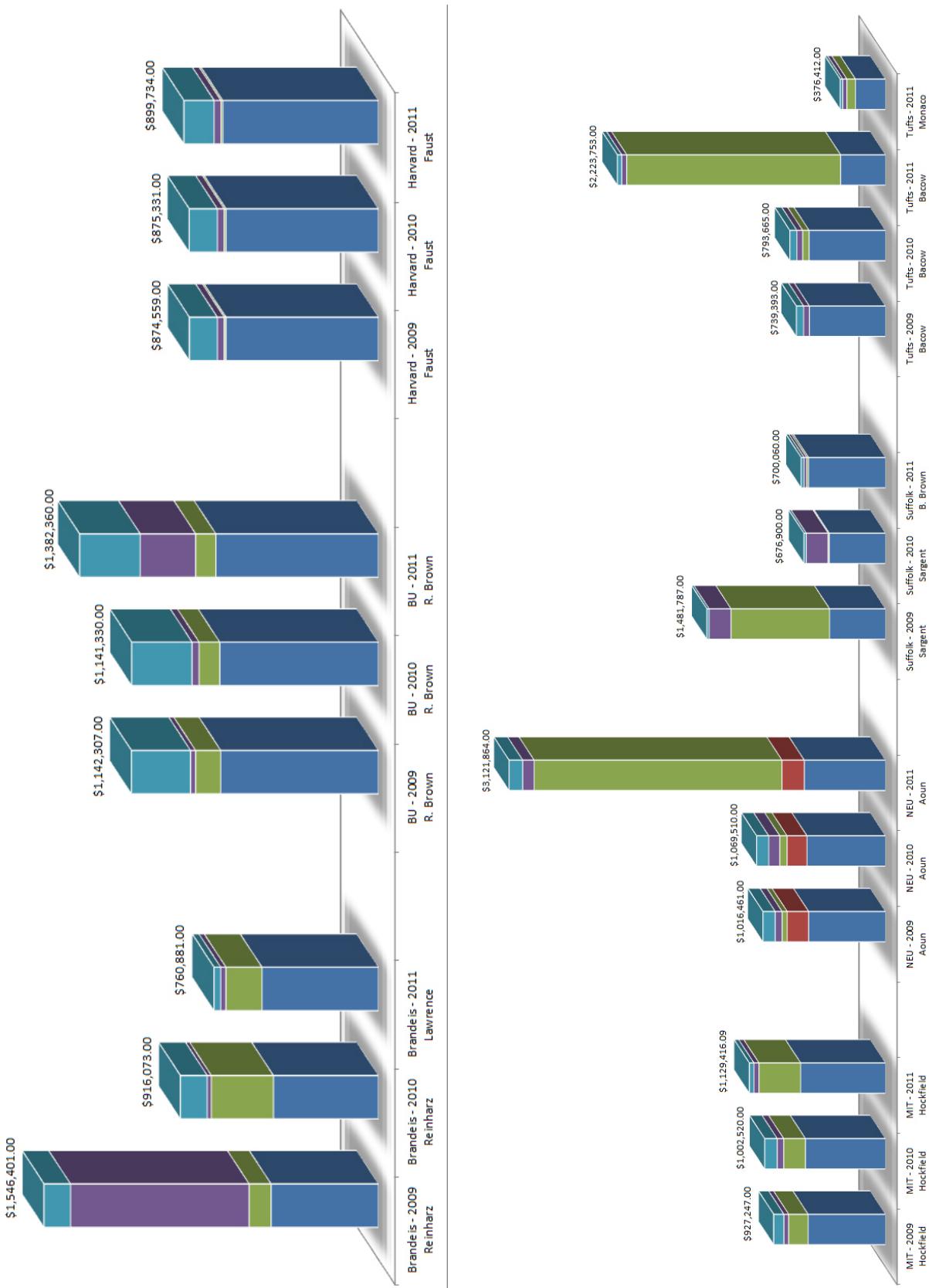
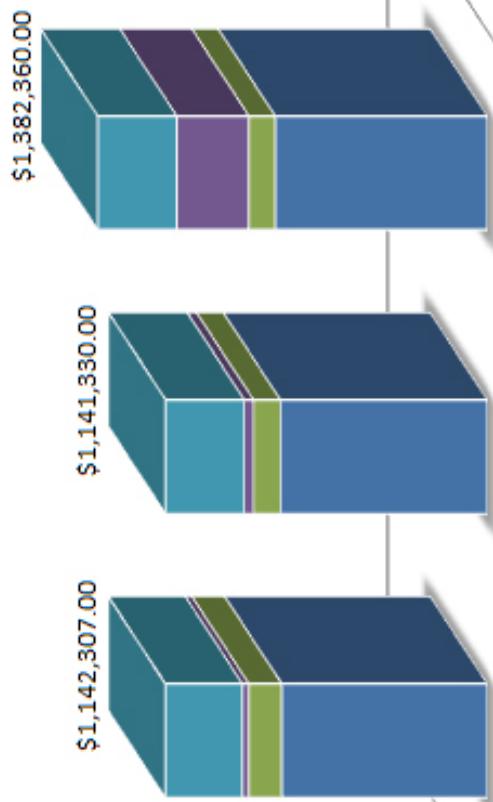


CHART 2O: BOSTON UNIVERSITY

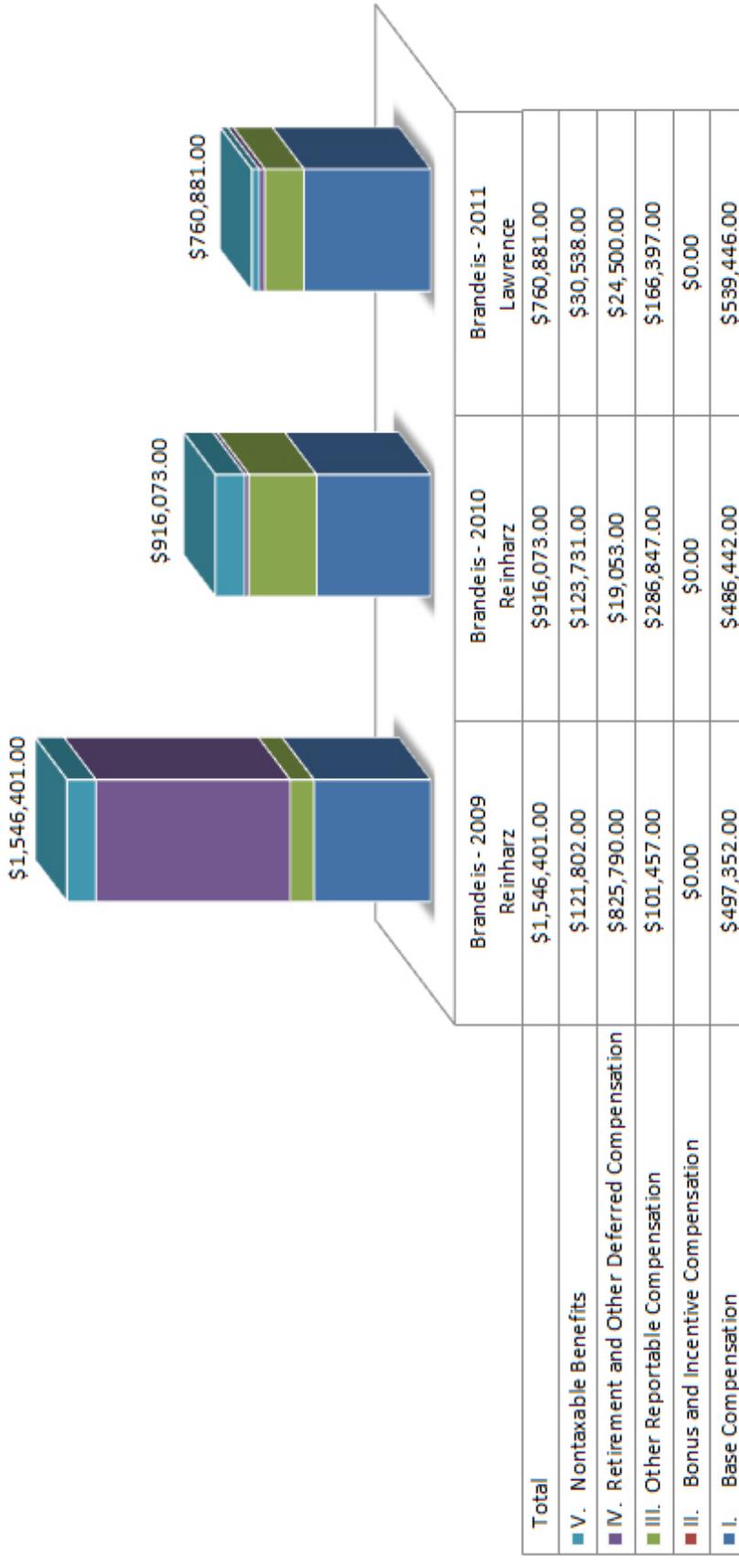
(Graphical representation of Schedule EC data presented according to IRS classifications)



	BU - 2009 R. Brown	BU - 2010 R. Brown	BU - 2011 R. Brown
Total	\$1,142,307.00	\$1,141,330.00	\$1,382,360.00
V. Nontaxable Benefits	\$272,744.00	\$278,744.00	\$279,987.00
IV. Retirement and Other Deferred Compensation	\$23,349.00	\$32,540.00	\$256,064.00
III. Other Reportable Compensation	\$116,361.00	\$95,697.00	\$93,577.00
II. Bonus and Incentive Compensation	\$0.00	\$0.00	\$0.00
I. Base Compensation	\$729,853.00	\$734,349.00	\$752,732.00

CHART 2 I: BRANDeIS UNIVERSITY

(Graphical representation of Schedule EC data presented according to IRS classifications)



- In 2010, now-President Frederick Lawrence commenced employment with Brandeis as president-elect and was compensated in that position. Because he was not then the CEO, this compensation was not reported on the Schedule EC. It does, however, appear on the IRS Schedule J filed for FY2011. Similarly, in 2011, President Emeritus Jehuda Reinharz, who also holds a tenured faculty position, likely received compensation associated with his prior service as president. Such amounts were similarly not reported on the Schedule EC.

CHART 2.2: HARVARD UNIVERSITY

(Graphical representation of Schedule EC data presented according to IRS classifications)

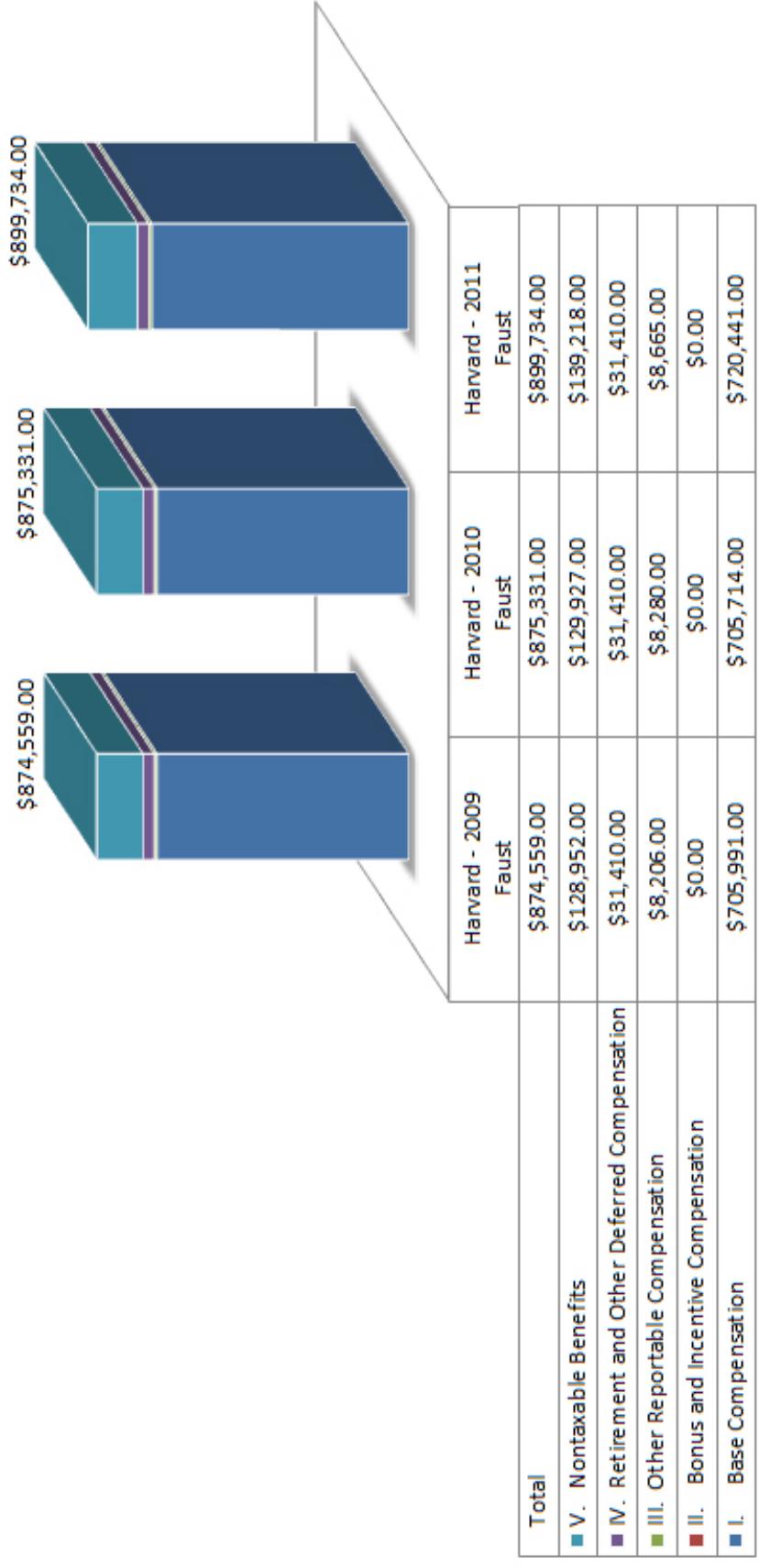


CHART 23: MASSACHUSETTS INSTITUTE OF TECHNOLOGY

(Graphical representation of Schedule EC data presented according to IRS classifications)

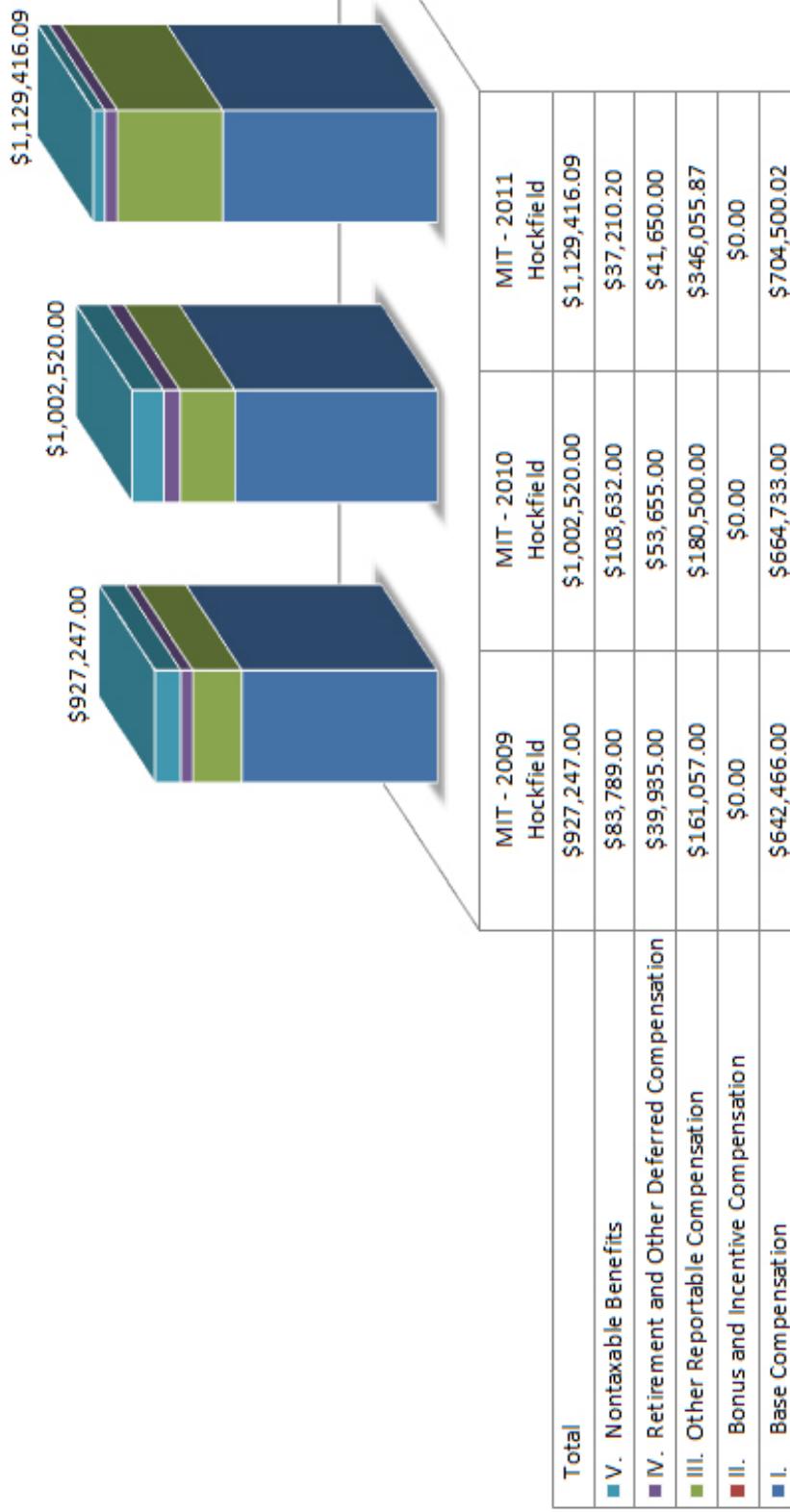
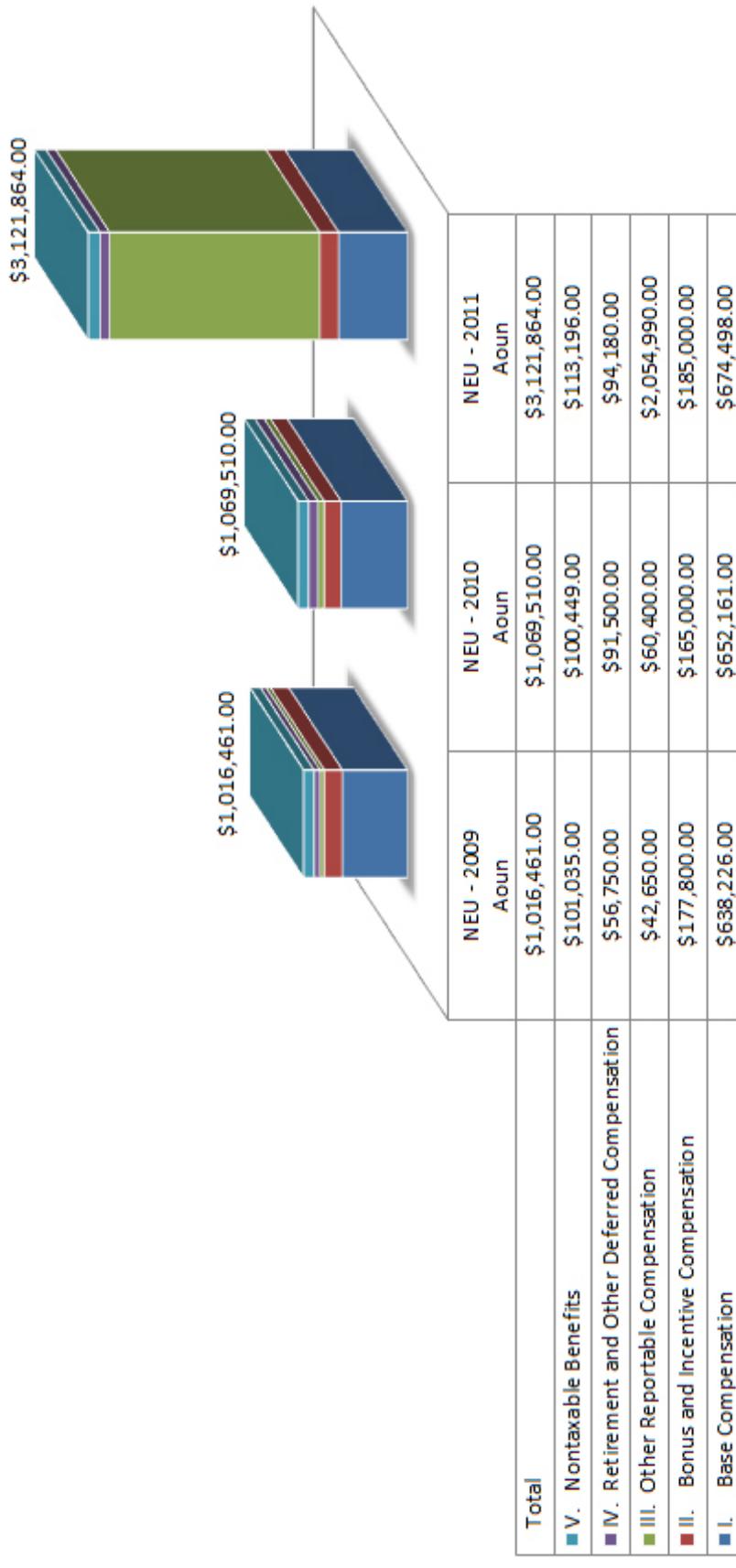


CHART 2.4: NORTHEASTERN UNIVERSITY

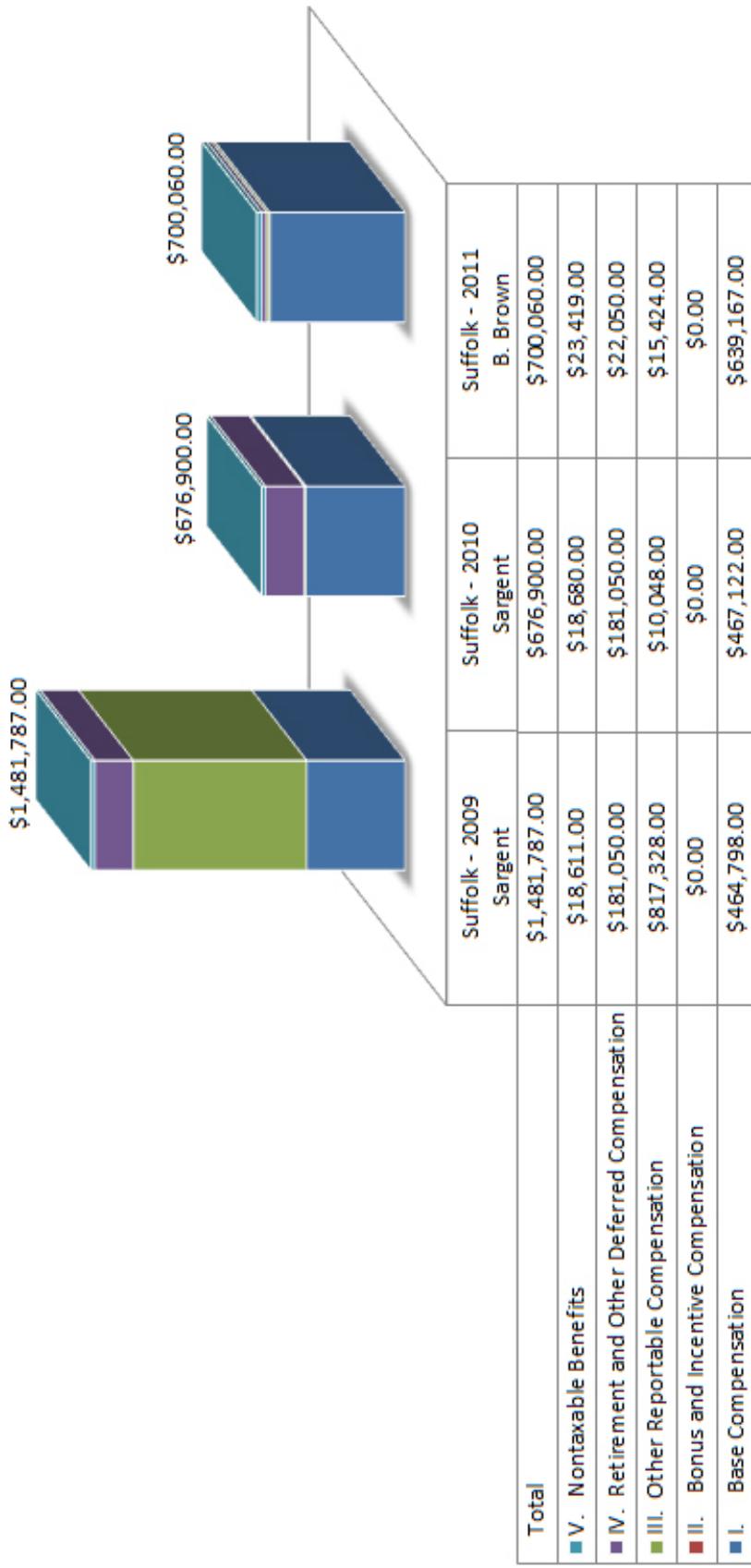
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to President Joseph Aoun in 2011 included a \$2 Million “retirement benefit” that he would receive when he concludes his service at Northeastern.

CHART 25: SUFFOLK UNIVERSITY

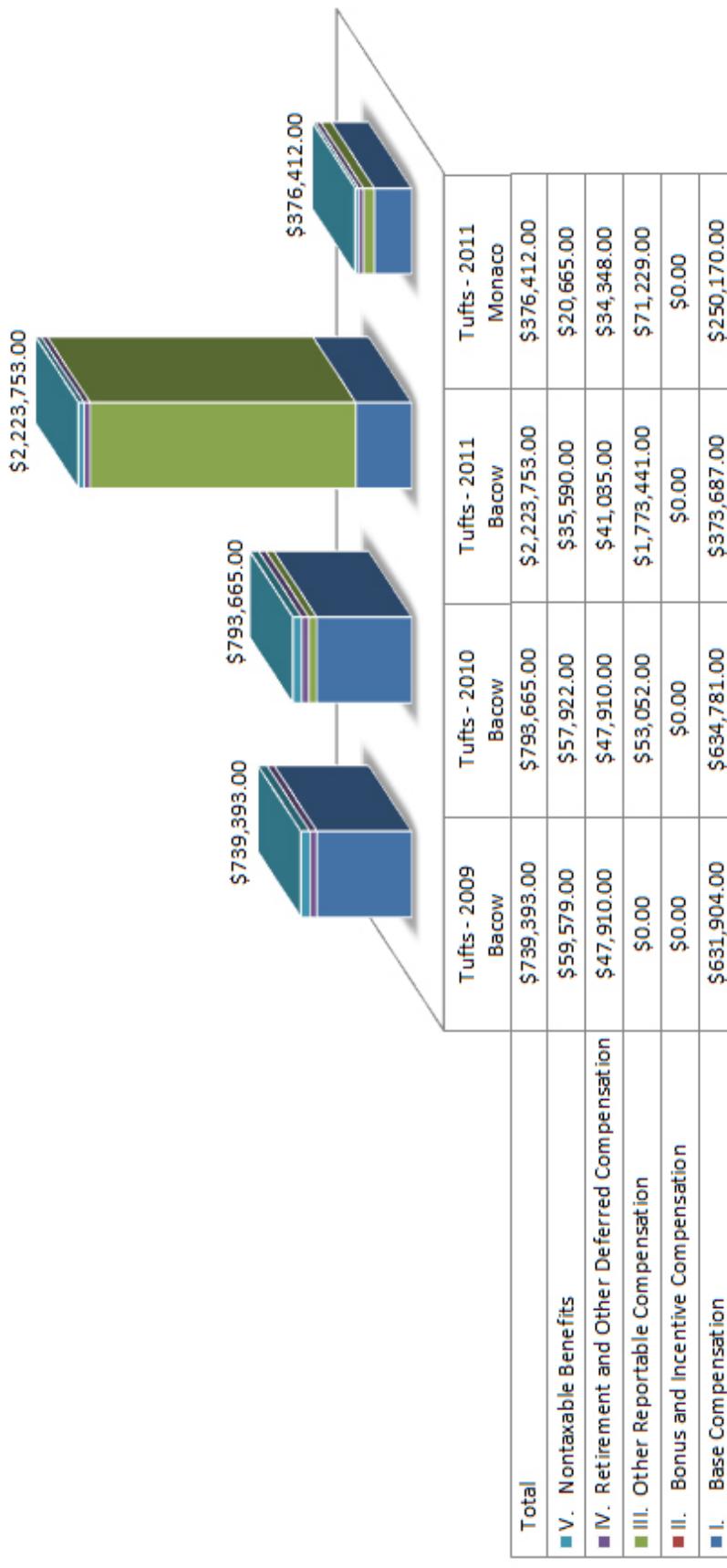
(Graphical representation of Schedule EC data presented according to IRS classifications)



- Provost Barry Brown, who became acting president in October 2010, received his normal compensation as provost for 2010. In 2011, he received an “Acting President Stipend” to compensate him for his additional responsibilities during that calendar year and for the period of October through December 2010.

CHART 2.6: TUFTS UNIVERSITY

(Graphical representation of Schedule EC data presented according to IRS classifications)



- Payments to President Lawrence Bacow in 2011 include a large “end of service”* payment which he received at the time of his retirement.

*End-of-service payments are discussed more fully in Part II D, on page 67.

CHART 27: ADDITIONAL ORGANIZATIONS

(Graphical representation of Schedule EC data presented according to IRS classifications)

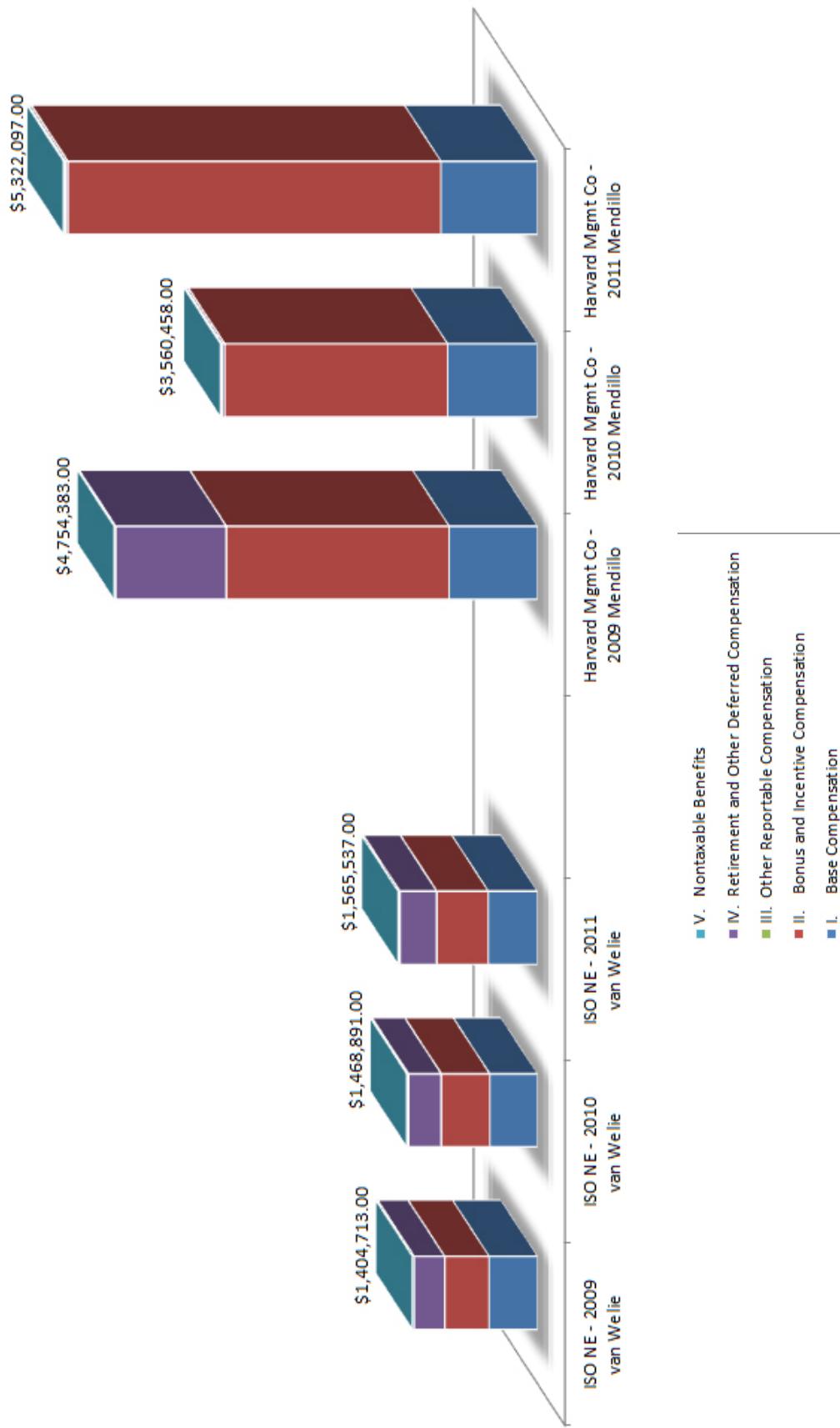
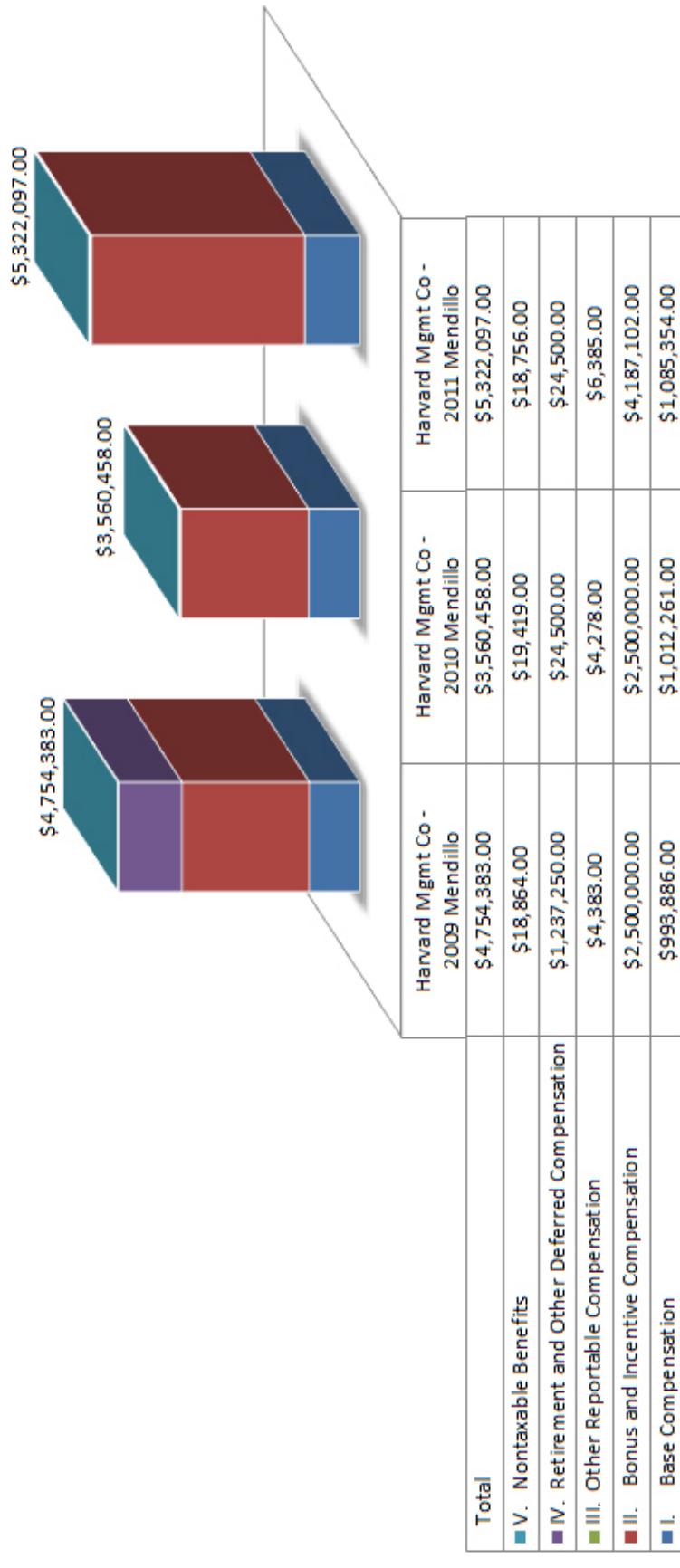


CHART 28: HARVARD MANAGEMENT COMPANY

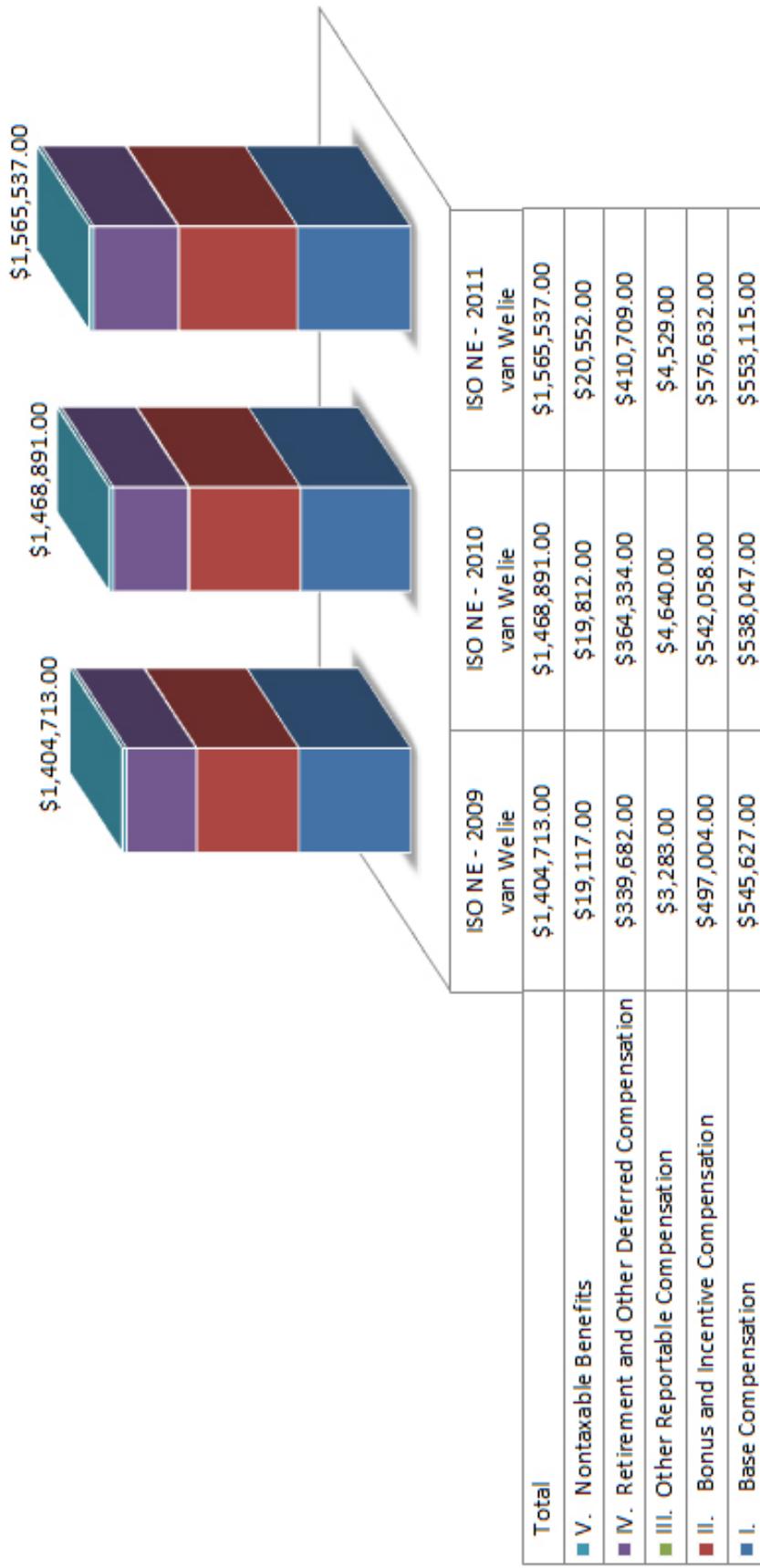
(Graphical representation of Schedule EC data presented according to IRS classifications)



- After Jane Mendillo's first two years of employment as CEO, during which she received a predetermined bonus of \$2.5 Million per year, the amount of bonus is determined in part at the discretion of the Board by reference to her performance in managing the company, and in part by performance of assets under management in accordance with an established formula and subject to withholdings and "clawbacks" if future performance of investments does not meet an established benchmark.

CHAR 29: INDEPENDENT SYSTEM OPERATOR - NEW ENGLAND (ISO-NE)

(Graphical representation of Schedule EC data presented according to IRS classifications)



- Compensation under ISO-NE's overlapping LTI plans appears under both 'Bonus and Incentive Compensation' and 'Retirement and Other Deferred Compensation'. Only the LTI amount listed under Bonus is actually paid in the given calendar year.

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PART II: HOW THEY ARE PAID

COMPONENTS OF PUBLIC CHARITY CEO COMPENSATION

As noted above, the types of compensation and benefits described in this section are based on reports from the organizations in our review. There may be other forms of compensation or benefits described in Forms 990 and in future Schedules EC from these or other organizations. Also, we anticipate that compensation and benefit consultants will develop new mechanisms to help organizations and executives take permissible advantage of tax code provisions and other regulatory changes. This section of the report is meant as a guide to introduce some of the major components of compensation, to describe the variability and flexibility of some mechanisms (and thus also the different ways in which some forms of compensation or benefit may be reported), and to illustrate some examples so that readers may be better positioned to interpret current and future compensation reports, such as the IRS Schedule J and the Schedule EC.

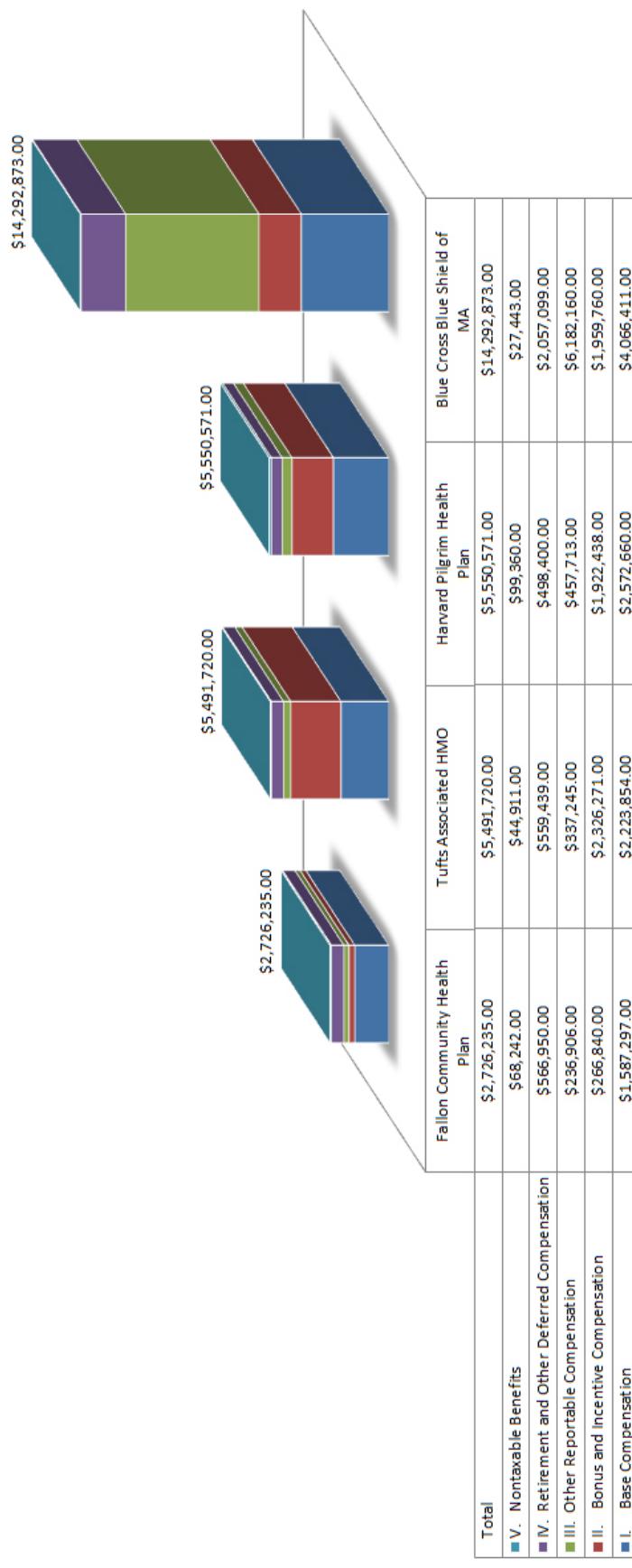
We have categorized forms of compensation and benefits into:

- Cash Compensation;
- Retirement and Other Deferred Compensation;
- Other Forms of Compensation and Benefits; and
- Contingent and Contractual Benefits.

With the exception of Cash Compensation, the distinctions between these classifications are not obvious and some forms of compensation or benefit plans may appear to fit within more than one classification. Indeed, organizations may differ in their interpretations of whether certain forms of payment should be reported as “retirement” or “retention incentive” payments, as “deferred compensation,” or as “other reportable compensation” on the IRS Schedule J (and the corresponding categories on the Schedule EC). This fact illustrates one of the difficulties in obtaining “apples-to-apples” comparisons among organizations and supports our belief that requiring more specific explanations of compensation and benefit components as part of the new Schedule EC will enhance transparency.

Before presenting descriptions of the forms of compensation and benefits, and as an aid to understanding the significance of each category of compensation in the organizations’ CEO compensation programs during the study period, we have prepared charts presenting the aggregated Schedule EC data for three-year period. These charts present data for several sub-groups (e.g., health plans, hospital or provider systems, and universities). It is important to underscore that the three-year charts represent *aggregate* data for the 2009 to 2011 period; the figures are not averages. These comparisons make it easier to identify the organizations that reported greater amounts in retirement or other reportable compensation, reflecting a change in CEO or other significant vesting events during the study period. If a different three-year period were selected for review, it is likely that different organizations would stand out as reporting significant amounts in those categories. The aggregate charts should be read together with the Schedule EC responses (see Appendices C through AA, available at <http://www.mass.gov/ago/ceocomp>) to gain a complete perspective of the CEO compensation being reported.

CHART 30: HEALTH PLAN AGGREGATE COMPARISON 2009-2011



Fallon Community Health Plan

Harvard Pilgrim Health Plan

CEO Charles Baker resigned July 2009.

Interim CEO Bruce Bullen served from July 2009 to March 2010.

CEO Patrick Hughes took office March 2010.

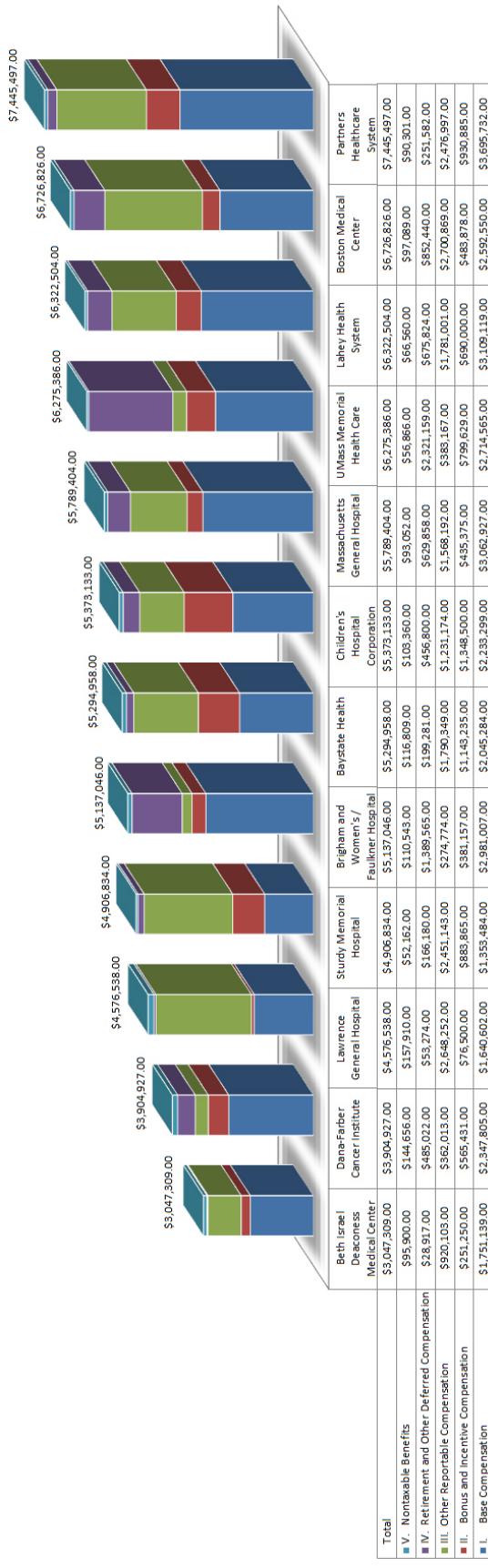
Harvard Pilgrim Health Plan

Blue Cross Blue Shield of MA

CEO Cleve Killingsworth resigned on or about 3/16/2010.

Interim CEO William Van Faasen, who was not compensated, served from 3/16/2010 until 9/6/2010. CEO Andrew Dreyfus took office on or around 9/6/2010.

CHART 3 I: HOSPITAL AND PROVIDER SYSTEMS AGGREGATE COMPARISON 2009-2011



Beth Israel

CEO Paul Levy resigned 02/02/2011.
Interim CEO Eric Buehlers held office 02/02 - 10/17/2011.
CEO Kevin Tabb took office 10/17/2011.

Boston Medical Center

CEO Elaine Ullian resigned 01/31/2010.
CEO Kathleen Walsh took office 03/01/2010.

Brigham and Women's/Faulkner

CEO Gary Gottlieb resigned 12/31/2009.
CEO Elizabeth Nabel took office 01/01/2010.

Lahéy

CEO David Barrett resigned 12/31/2010.
CEO Howard Grant commenced employment 11/15/2010, took
office as CEO 01/01/2011.

Lawrence

CEO Joseph McManus retired 2009.
CEO Dianne Anderson took office 2009.

Partners

CEO James Morgan retired 12/31/2009.
CEO Gary Gottlieb took office 01/01/2010.

CHART 32: HIGHER EDUCATION AGGREGATE COMPARISON 2009-2011

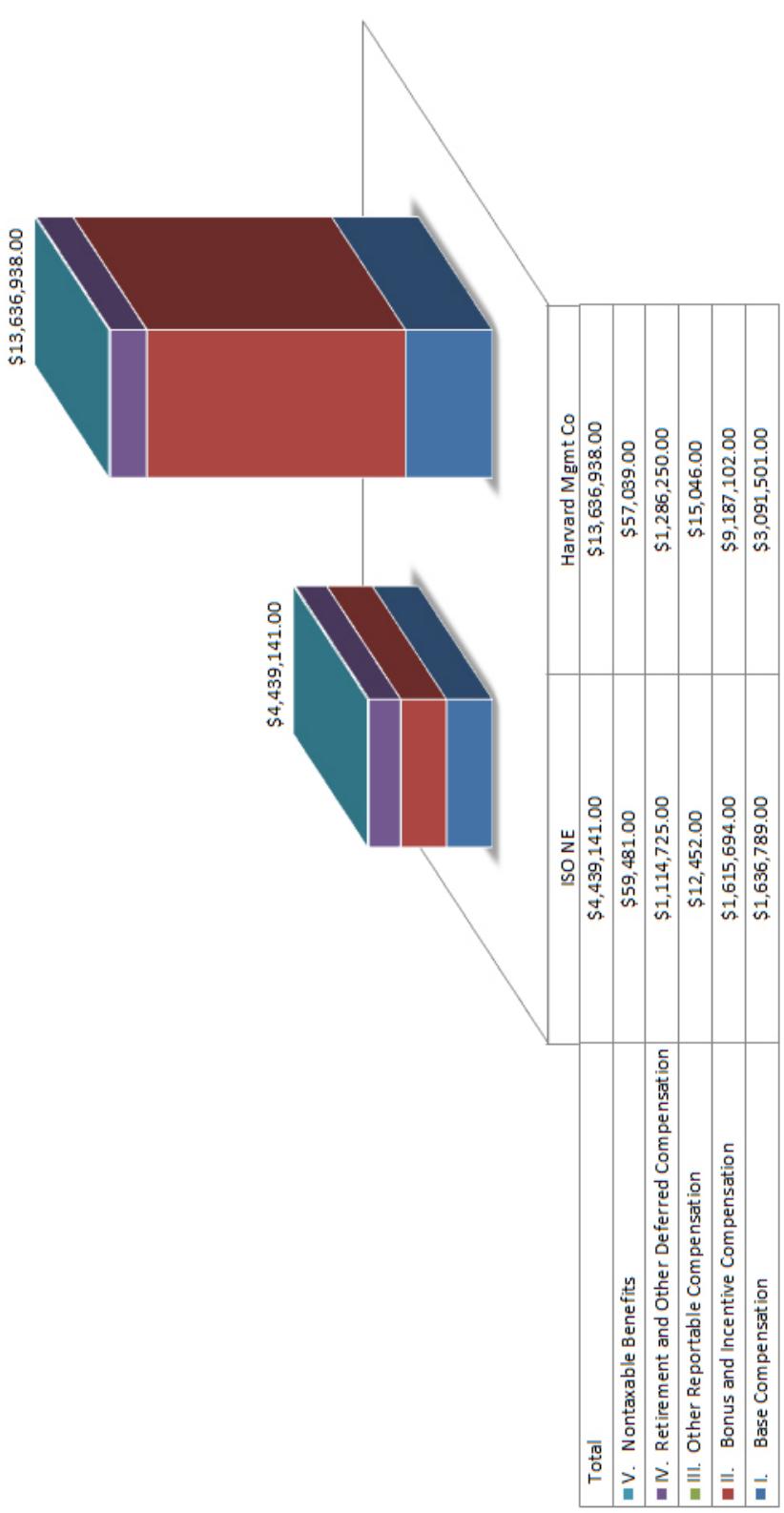


Brandeis

President Jehuda Reinharz resigned from that office 12/31/2010.
President Frederick Lawrence took office 01/01/2011.

Suffolk
President David Sargent retired in October 2010.
Acting President Barry Brown held that office from October 2010 until February 2012.
Before and after that period, he served as Suffolk's Provost.

Tufts
President Lawrence Bacow retired in July 2011.
President Anthony Monaco took office in July 2011.

CHART 33: ADDITIONAL ORGANIZATION AGGREGATE COMPARISON 2009-2011

Having reviewed each organization's reliance, during the three-year study period, on the reported categories of compensation, we now turn to the descriptions of the compensation components and benefit programs that underlie those categories.

A. CASH COMPENSATION

Cash compensation comprises base salary and incentive compensation.

I. BASE SALARY

Base salary is the most straightforward compensation component. All 25 organizations provide their CEOs with a base salary. For CEOs, an initial base salary is typically specified in a multi-year employment agreement. In most cases, the board of directors increases the base salary periodically, typically annually at the time of the board's assessment of the CEO's performance. The board may adjust base salary at other junctures such as significant changes in the organization, the marketplace in which it operates, or the economy in general. Factors such as years of executive experience, years of incumbency, number of years remaining before a planned retirement date, and competing offers from other organizations will influence base salary levels.

In determining annual base salary increases, some organizations establish specific annual increases (either in terms of absolute dollar amounts or percentage increases) in the CEO's employment agreement. Others will leave decisions about increases to the discretion of the board or a board committee.

II. INCENTIVE COMPENSATION

Incentive or "bonus" compensation is a component of annual compensation that the organization pays only if the CEO or the organization meets certain pre-determined levels of performance. Nineteen of the 25 organizations in our review group use some form of annual incentive compensation for their CEOs and other senior managers, though six of the seven universities in our group do not. Four organizations in our group of 25 used long-term incentive (LTI) plans, described below, instead of or in addition to annual incentives.

ANNUAL INCENTIVE COMPENSATION

Annual performance incentive compensation is designed to reward the achievement of certain goals that are measurable on an annual basis. In most organizations, this means the achievement of specific accomplishments or results rather than "doing a great job" overall.

Organizations commonly use incentive compensation programs to guide managers in setting their individual work priorities consistently with identified organizational strategic priorities. Some organizations have an incentive program for a group of senior executives; others establish incentive compensation for the CEO separately. For CEOs, the board or board committee responsible for assessing the CEO's performance usually establishes the CEO's incentive goals with input from senior management (including the CEO). For other senior executives, the CEO will also participate in setting performance goals. In both cases, the goals reflect the organization's priorities as determined by the board with senior management's input. If awarded, this type of compensation is generally paid out within three months of the close of the organization's fiscal year. It is also generally paid out in the same manner as base salary; payment is not deferred.²¹

²¹ Some organizations allow the CEO to elect to defer an amount of annual compensation to defer the payment of tax, and potentially achieve a tax advantage.

In some of the more sophisticated programs, an individual's annual incentive compensation depends on both organizational performance in areas that require effective teamwork and on the individual's achievement of specific personal goals. Wherever possible, boards identify measurable goals rather than relying on subjective assessments of whether or not sufficient progress has been made towards a general goal. The incentive compensation program will set out in advance the maximum amount that the executive is eligible to earn under the program, usually as a percentage of base salary.

Most of the incentive compensation programs we reviewed included goals against which progress could be evaluated only after completion of the operating year or calendar year of performance. The compensation committee or other group of directors responsible for assessing CEO performance typically awards incentive compensation several months after the completion of the year. This often means that the incentive compensation is reported (and paid) in the year after the services were performed. Therefore, incentive compensation reported in a particular year often relates to services performed in the prior year.

Example: A CEO is eligible for annual incentive compensation up to 40% of base salary. The incentive goals each year include objective goals for organizational performance (e.g., revenue targets, service volume targets, and target scores on external quality assessments) and strategic initiative goals, which include some organization-wide initiatives and some for the CEO individually. The board compensation committee assesses the CEO's performance and the organization's progress on the strategic portion, receives the data about whether or not the organization attained the objective goals, and makes a determination whether the CEO has earned all, a portion, or none of the incentive compensation for which he or she is eligible. The amount awarded is reported with the current year salary and other compensation elements.²²

LTI (LONG TERM INCENTIVE) PLANS

The idea behind an LTI plan is to provide a financial incentive for the successful completion of performance goals, projects or campaigns that extend over a number of years. Examples could include the construction of a new building or campus; the attainment of a financial target in a capital campaign; or the conclusion of a multi-year research project. An organization might also use an LTI plan to incent the CEO to guide the organization more generally consistent with its long-term best interests and to avoid or counteract the possible incentive created by annual performance bonus programs to take risks that might result in short-term gains but subject the organization to larger risks in the long term. Organizations may use an LTI plan instead of annual incentive compensation, or in addition to an annual plan.

Some LTI programs include a retention component, making the LTI payments function similar to deferred compensation or retention bonus payments. For example, if the CEO works for the organization for a three-year period, attains certain goals in each year, and is still employed as of a certain date, he or she will be entitled to compensation under the LTI plan; but if the CEO leaves after the second year, he or she might forfeit the LTI compensation earned in the first two years. An organization may use more than one such LTI plan, and may run multiple plans in such a way that they overlap (concurrent plans) or run serially (consecutive plans). Organizations believe that these types of LTI plans serve to focus the CEO's efforts on the performance goals and also act as a retention tool, dissuading the CEO from considering competing employment offers.

²² This example is a composite based on features in several incentive programs we reviewed as part of our information review. It does not describe any particular organization's program.

Examples: As reported on its Schedule EC, ISO New England uses concurrent LTI plans as part of the CEO's compensation. Each LTI award is paid out two and a half years after the end of the relevant plan year if the CEO is still employed by ISO New England. See Appendix AA. The organization reserves the right to reduce or eliminate LTI plan awards if the CEO or the organization subsequently under-performs. Other organizations in our review group using LTI plans include Blue Cross and Blue Shield of Massachusetts, Harvard Pilgrim Health Care, and Northeastern University. See Appendices C, E, and W, respectively.

B. RETIREMENT AND OTHER DEFERRED COMPENSATION

I. INTRODUCTION: TAX-QUALIFIED RETIREMENT PLANS

Tax-qualified retirement plans are those that qualify for favorable tax treatment under IRS rules. In general, these plans are open to most of the organization's workforce and are designed to provide mechanisms and incentives to save for retirement. These may take the form of pension plans (which are generally divided into defined benefit plans and defined contribution plans). They may also, more commonly, take the form of retirement savings/tax deferral plans, particularly those established in conformity with sections 403(b), 401(k), and 457(b) of the Internal Revenue Code.

The IRS imposes various limits on tax-qualified retirement plans; these "caps" are subject to annual adjustment by the IRS:

- The maximum annual benefit that may be funded through a **defined benefit** plan will be \$210,000 per year in 2014.
- The cap on total annual contributions from any source (employee or employer) to most types of **defined contribution** plan(s) (including any combination of 403(b) and 401(k) plans) will be \$52,000 in 2014. Within that overall cap:
 - Employee salary deferrals will generally be limited in 2014 to \$17,500 per year for employees below the age of 50 and \$23,000²³ per year for employees age 50 and older. (See sub-part iii below, discussing 403(b) and 401(k) plans.)
 - The maximum amount of an individual employee's compensation that may be taken into consideration when determining contributions - including contributions made by the employer - will be limited to \$260,000 in 2014.
- Additional contributions may be available under another type of tax-qualified plan; such contributions will also generally be limited in 2014 to \$17,500 per year. (See sub-part iv below, discussing 457(b) plans.)

While all of these caps are important to an understanding of how compensation arrangements may be structured, it is the compensation limit of \$260,000 that seems to have the greatest impact on CEOs. Because most CEOs earn a base salary in excess of the compensation limit, most organizations provide additional "non-qualified" plans to provide additional retirement benefits, described below. Though the non-qualified plans are designed to supplement the tax-qualified plans for which the CEO is also eligible, it is the non-qualified plans that usually deliver larger benefits.

²³ The additional \$5,500 permitted for employees over age 50—sometimes called the “catch-up” contribution allowance—is not counted against the overall \$52,000 cap on annual contributions.

II. PENSION PLANS

Pension plans are retirement benefit plans funded and maintained by the organization that are designed to provide lifetime income to employees in retirement (and, where applicable, to their spouses after their death). They are subject to a host of complex rules and conditions governing employee participation, employer funding, and more.²⁴ Pension plans are usually designed either to provide a fixed stream of payments in retirement (called a “defined benefit” plan) or to provide for the purchase of an annuity with the proceeds from the tax-deferred investment of annual contributions by the employer for each participating employee (called a “money purchase” or “defined contribution” pension plan).

Defined benefit pension plans have declined considerably in use since the 1980s. According to the Department of Labor, the percentage of private-sector active worker participants in a defined benefit plan (where the defined benefit plan was the only plan) declined from 62% in 1975 to 7% in 2007.²⁵ Because these plans are funded exclusively by the employer, they involve substantial financial risk to the employer, are subject to significant regulation and are complex to maintain. As discussed in sub-part v below, although defined benefit plans are rare these days for workers, some charity CEOs in our review enjoy some form of benefit approximating a traditional defined benefit pension and the retirement income stability such a plan is designed to offer.²⁶

Defined contribution pension plans are more common than defined benefit plans, but even these are declining in use. These plans, while still heavily regulated, are less costly to the employer and involve fewer obligations. Even defined contribution pension plans, however, are not common among our group of 25. Instead, most organizations rely on tax-qualified retirement savings plans that allow employees to set aside a portion of their regular compensation on a tax-deferred basis.

III. RETIREMENT SAVINGS/TAX DEFERRAL PLANS: 403(B) AND 401(K) PLANS

All 25 of the organizations in our review offered some form of tax-qualified retirement savings plan. The most common type of plan is the section 403(b) plan, although some tax-exempt employers may also offer the section 401(k) plans which are offered by many for-profit employers and are similar to section 403(b) plans in many respects. The 403(b) and 401(k) plans allow participants to defer a portion of their compensation pre-tax, invest it through the plan, and then withdraw the deferred amount and any accumulated growth in retirement (when income tax is assessed on the withdrawals). Under the caps outlined in sub-part i above, the annual IRS cap on qualified plan contributions applies to all 403(b) and 401(k) plans in which an individual participates. An employee’s total pre-tax salary deferrals across all 403(b) and 401(k) plans may not exceed \$17,500 or \$23,000 in 2014, depending on whether the employee has attained age 50.

²⁴ Among others, they are subject to various sections of the Internal Revenue Code and its implementing regulations. They may also be subject to the Employee Retirement and Income Security Act (ERISA) and its implementing regulations.

²⁵ Employee Benefit Research Institute, EBRI Databook on Employee Benefits, Chapter 1, p. 4 (citing multiple sources including U.S. Dept of Labor Form 5500 filings), available at www.ebri.org/pdf/publications/books/databook/DB.Chapter%2001.pdf.

²⁶ While the decline in traditional defined benefit plans in the private sector has been widely discussed, most public employers, including the Commonwealth of Massachusetts, still maintain such plans for most employees. In addition, some private employers, including several in our study group, maintain “cash balance” defined benefit plans (in which the level of promised benefit is defined in terms of a stated account balance and not a level of income replacement) for most employees. Sturdy Memorial Hospital informs us that it still maintains a traditional defined benefit pension plan for all qualifying employees targeting income replacement at 60% of final five years of compensation.

Some organizations include an employer “match” contribution up to a certain percentage of the employee’s pre-tax salary deferrals; others do not. Organizations may also offer an employer “nonelective” contribution which is made regardless of whether the employee makes pre-tax salary deferrals. Employer contributions (whether matching or nonelective) can be limited by the cap on total contributions to a defined contribution plan, which will be \$52,000 per year in 2014.

As noted in sub-part i above, compensation in excess of the \$260,000 limit is not taken into consideration. Some compensation consultant reports term this effect “discrimination” in tax treatment of retirement savings for highly compensated executives. As discussed below, additional retirement savings vehicles are available to many highly compensated employees, including tax-qualified 457(b) plans as well as “nonqualified plans” (which, while permitted under the Internal Revenue Code, do not qualify for the same tax benefits as tax-qualified retirement plans).

iv. RETIREMENT SAVINGS/TAX DEFERRAL PLANS: 457(b) PLANS

Section 457(b) of the Internal Revenue Code allows employees of tax-exempt organizations to accumulate additional pre-tax retirement savings. Employers can only offer them to a select group of management or highly compensated employees, in which case they are often referred to as “top hat” plans.²⁷ In 2014, up to \$17,500 per year may generally be contributed on a tax-deferred basis to a 457(b) plan in any combination of employer contributions and employee pre-tax salary deferrals.

Because this general \$17,500 annual contribution limit for employee contributions to 457(b) plans operates in addition to the combined \$17,500/\$23,000 annual limit on employee pre-tax salary to deferrals to 403(b) and 401(k) plans, a 457(b) plan can offer an additional vehicle for executives to accumulate retirement savings. Furthermore, the additional \$17,500 that may be contributed to a 457(b) plan *is not* included whenever determining when the limit on total annual contributions to a defined contribution plan is met (\$52,000 in 2014).

v. NON-QUALIFIED PLANS, DEFERRED COMPENSATION, AND SERPs

Almost all of the organizations in our study (19 out of 25) used one or more mechanisms to provide for retirement pay for the CEO above the level available to him or her through the tax-qualified plans. As with tax-qualified plans, such mechanisms may be structured as defined benefit or defined contribution plans. Broadly, they are often called Supplemental Executive Retirement Plans (SERPs). Whether organizations use the term “SERP” or some other label, they generally use SERPs for top executives and key employees. While our review was focused on CEOs, it would not be unusual to see several other members of senior management (e.g., CFOs, COOs, and similar positions) be eligible to participate in a SERP. However, it is also important to note that in order to satisfy the applicable ERISA rules, participation in a SERP must generally be restricted to a select group of management or highly compensated employees.

Tax-exempt organizations generally offer SERPs under Section 457(f) of the Internal Revenue Code, which appears to allow considerable flexibility in their design, as long as the amounts are subject to a substantial risk of forfeiture and the CEO’s right to receive them depends on performance of services in

²⁷ Inclusion in this select group is based, in part, on an assumption that an employee included in the select group can negotiate his or her compensation package and has an understanding of the financial risks associated with such plans.

the future. However, 457(f) plans are generally also subject to Section 409A of the Internal Revenue Code which impose strict terms on their documentary form and actual operation along with the possibility of severe tax penalties on the executive for any documentary or operational failures.²⁸

Payments into these types of plans are reported on the IRS Form 990, Schedule J when made, even though they are still subject to that substantial risk of forfeiture. When the CEO's right to receive the amount vests fully, then he or she owes income tax on that amount, and the organization must report it again on the IRS Schedule J. If the amount is not paid out at the time of vesting, but at a future date (at the time the CEO retires, for example), it is possible that the amount will need to be reported for a third time.

The design of these mechanisms and the terminology organizations use to describe them vary greatly. All, however, are designed to take permissible advantage of the tax code so as to defer or minimize the tax the CEO would owe on the payments under these plans if they were not designed to conform to the applicable tax code requirements. In general, to be eligible for deferral of income tax, the amounts in these plans must remain subject to a substantial risk of forfeiture. This means that the CEO would lose the right to receive those amounts under certain circumstances. Weighing the risk to the CEO of maintaining this "substantial risk of forfeiture," the tax liability the CEO incurs when his or her right to an amount becomes fully vested, and the organization's obligation to maintain funding for these plans until they are actually paid out to the CEO results in variations in plan design, in the timing of vesting (and thereby also reporting), and in characterization of the plan. For example, plans that provide for vesting in certain amounts every year after an initial waiting period might be called "deferred compensation" plans; plans that provide for full vesting only at retirement might be called "retirement" plans.

SERPs include various forms of deferred compensation. Some SERPs are designed much like defined benefit pension plans and are intended to yield a specified payment per year after the CEO's retirement, irrespective of the amount it costs the charity to provide this benefit. In practice, these SERPs are usually reduced to their present value and paid out in a lump sum upon the CEO's retirement. Usually these benefit payments are described in terms of a percentage of the CEO's final average compensation (e.g., 50-70% of the average of the CEO's final three years' base salary plus incentive compensation). The guaranteed income is adjusted downward if the CEO did not work his or her entire career at the organization and is discounted by other sources of income in retirement, including Social Security income and payments from all other plans (such as the tax-qualified plans available to the CEO). This defined benefit style SERP, like the defined benefit pension plans described above, can place the organization at significant financial risk. For example, if the organization's projections of the CEO's final average compensation have been too low, the organization may need to make substantial financial commitments in the final years of the CEO's employment in order to be able to provide the promised benefit at the time of the CEO's retirement.

²⁸ Section 409A was enacted, in part, in response to abuses in the payout of deferred compensation in the waning days of Enron. Certain Enron insiders hastily changed the terms of their own plans, accelerating the distribution of their deferred compensation just prior to Enron's corporate collapse.

Examples: Baystate Health indicated on its Schedule EC response that five components of its CEO's compensation, when considered together, are parts of a SERP that targets 50% of the CEO's total compensation based on a minimum 20 year service requirement.²⁹ See Appendix G. On its Schedule EC response, Sturdy Memorial Hospital indicated that the retirement goal for its CEO, contingent on 25 or more years of service before age 65, is a lifetime annual retirement income equal to 60% of the CEO's final five-year average earnings (defined as base salary plus bonus). See Appendix Q.

A "restoration" SERP is designed to provide approximately the same level of benefit the CEO would have received through the organization's qualified retirement plan were it not for the IRS cap on those plans.

A "defined contribution" SERP functions similarly to a defined contribution pension plan. The organization commits to a specific contribution per year and invests it for the benefit of the CEO, often with the CEO's input on investment. Among public charities, these plans generally function on an unfunded or "virtual" basis, meaning that the plan does not actually maintain a separate account, but instead tracks the notional "contributions" the organization has made and the performance of the notional "investments" that have been selected, while the plans' assets are actually not segregated from the organization's general assets and are subject to the organization's general creditors.

Example: Boston University has reported on its Schedule EC response that, beginning in 2011, it established a SERP for its president into which the university annually credits 30% of the president's base salary for the prior 12-month period. Subject to certain conditions, the president's rights in the plan will vest at a future date. See Appendix S.

As explained by compensation and benefits consultants, organizations use SERPs for a variety of reasons. They can serve as a retention tool, to the extent that the executive forfeits the right to receive the benefit if he or she departs prematurely. They can also serve as a recruitment tool, and in this respect some organizations and consultants note that they can take the place of stock option plans offered by for-profit companies (public charities have no stock). Whatever the rationale, SERPs provide additional compensation in the form of retirement benefits, retirement savings paid out at the point of retirement, or periodic payments that might (or might not) be used to supplement the CEO's personal retirement savings, on top of annual compensation that would, on its face, appear to allow for substantial personal retirement savings. While some organizations stress the distinction between cash compensation provided in consideration of services and SERP payments made for retirement benefits, both types of payment come from the charity's resources and are made for the personal benefit of the CEO (or other executive). Understanding the reporting difficulties SERP plans present due to double-counting and the timing of certain large payments is important to ensure that compensation amounts are not over-stated, but we believe payments into and out of SERPs and other deferred compensation plans are appropriately reportable during the CEO's tenure as well as at the time of payment because they are, in fact, part of the compensation the organization is making available to the CEO from charitable resources.

²⁹ Baystate informs us that it made annual payments to the CEO after an initial five-year vesting period to fund the defined benefit SERP on an ongoing basis, avoiding the accumulation of an unfunded liability on its books.

In addition to reporting sums set aside and invested for the benefit of the CEO, the Division believes that it is important for boards and the public to understand the type of retirement benefit or deferred compensation the organization has committed to provide to the CEO. Some benefit plans expose the charity to greater risk than others, even though the periodic payments into different types of plans may appear similar. For example, a defined benefit style SERP subjects the charity to considerable risk, even though it might be “reasonable” in comparison to the value of compensation and benefit packages being offered to CEOs at similar organizations. Transparency about the risks to the charity that some SERPs entail may be just as important as disclosure of the dollar amounts involved year over year. This is one reason our new Schedule EC asks for a description of all elements reported.

VI. LIFE INSURANCE

All organizations in our review provide life insurance for their CEOs. Some provide substantial life insurance through split-dollar arrangement, under which the charity pays the premiums for the policy and is named as a beneficiary. When the CEO eventually dies, the charity recovers the amount it paid in premiums and the rest of the benefit is paid to the CEO’s named beneficiary.

These arrangements seem to have fallen out of favor, however, because the policy must be maintained after the CEO retires, presenting uncertain financial exposure to the organization for continued premiums and presenting logistical challenges in maintaining a relationship with the CEO after he or she has left the organization. If the policy lapses for any reason, the organization’s investment could be at risk.

FIGURE 1: TABLE OF COMPENSATION COMPONENTS

(From Schedules EC and EC-1)

		Base Salary	Annual Performance Incentive	LTI	SERP/NQP
1.	Blue Cross Blue Shield of MA	✓	✓	✓	✓
2.	Fallon Community Health Plan	✓	✓		✓
3.	Harvard Pilgrim Health Care	✓	✓	✓	✓
4.	Tufts Associated HMO	✓	✓		✓
5.	Baystate Health	✓	✓		✓
6.	Beth Israel Deaconess Medical Center	✓	✓		
7.	Boston Medical Center	✓	✓		✓
8.	Brigham and Women's/Faulkner Hosp.	✓	✓		✓
9.	Children's Hospital	✓	✓		✓
10.	Dana-Farber Cancer Institute	✓	✓		✓
11.	Lahey Health System	✓	✓		✓
12.	Lawrence General Hospital	✓	✓		✓
13.	Massachusetts General Hospital	✓	✓		✓
14.	Partners Healthcare System	✓	✓		✓
15.	Sturdy Memorial Hospital	✓	✓		✓
16.	UMass Memorial Health Care	✓	✓		✓
17.	Boston University	✓			✓
18.	Brandeis University	✓			✓
19.	Harvard University	✓			
20.	MIT	✓			✓
21.	Northeastern University	✓	✓	✓	✓
22.	Suffolk University	✓			✓
23.	Tufts University	✓			
24.	Harvard Management Co.	✓	✓		
25.	ISO New England	✓	✓	✓	

For Figure 1: A check mark indicates that this compensation component was provided at some point during the review period (2009 to 2011).

C. OTHER FORMS OF COMPENSATION AND BENEFITS

I. HOUSING

Some organizations, particularly in higher education, provide their CEOs with housing or a housing allowance, each of which would be reflected as part of the CEO's reported compensation (9 out of 25 organizations in our review provide this benefit, and 6 out of 7 universities provide it). Three of the 9 organizations providing this benefit were hospitals or provider systems that paid for temporary housing for an incoming CEO who was relocating to Massachusetts from another region of the country. Many colleges and universities require that the president/CEO live in close proximity to the institution, frequently at a university-owned building that is intended as the presidential residence. They also expect that the president will take part in hosting events at this residence, such as fundraising events with alumni and corporate donors. For some college or university presidents, living on-campus in the institution's facility is a condition of employment as president.

While the value of the residence provided in these arrangements may be excluded in whole or in part from the president's income under section 119 of the Internal Revenue Code (it is not taxable income), the value of the residence is nonetheless reported on the IRS Schedule J. Sometimes the residence arrangement includes the provision of cleaning and other household services, which the college or university may see as protecting its investment in the facility and making sure that it is ready at all times for official functions. Some organizations provide these services only in the "public" portion of the residence facility.

Because provision of on-campus housing is a common part of a college or university president's compensation package, even those colleges and universities that don't have a president's residence will sometimes provide a housing allowance on top of, or as a distinct component of, the president's compensation. The organizations say that this is necessary in order to make their compensation packages competitive with those of peer institutions. While this approach may be consistent with section 4958 from a comparability standpoint, the Division encourages colleges and universities to consider whether it is truly necessary and the best use of charitable resources to provide a housing allowance on top of what is likely already a healthy salary.

II. AUTOMOBILE, CELL PHONE, AND FINANCIAL PLANNING ALLOWANCES

Some organizations provide their CEOs with allowances for automobiles. During the initial portion of our study period, two organizations also provided reimbursement for their CEO's cell phones and mobile service.³⁰ As with housing, these allowances should be reflected as part of the CEO's compensation. While housing is more commonly provided at higher education organizations, automobile and cell phone allowances are provided at a variety of organizations we reviewed (9 out of 25 provide automobile allowances and 2 out of 25 provide cell phone allowances).

Six out of 25 organizations provide their CEOs with a financial planning allowance during this

³⁰ Pursuant to guidance issued by the IRS in 2011 (IRB 2011-38), which interpreted a provision of the Small Business Jobs Act of 2010, employers that provide cell phones to their employees for business reasons (such as enabling the employer to contact an employee in case of a work-related emergency) do not have to include the value of the employer-provided cell phone as income to the employee. Thus, most organizations now provide their employees with cell phones for business use (rather than providing a cell phone allowance),

study period, often in significant amounts.³¹ Organizations explain this as warranted because of the complexities involved in navigating the tax obligations that are associated with CEO compensation (particularly with respect to SERPs and deferred compensation).

FIGURE 2: TABLE OF OTHER BENEFITS

(From Schedules EC and EC-1)

		Life Insurance	Housing	Auto Allowance	Cell Phone Allowance	Financial Planning Allowance
1.	Blue Cross Blue Shield of MA	✓		✓		✓
2.	Fallon Community Health Plan	✓		✓		
3.	Harvard Pilgrim Health Care	✓				
4.	Tufts Associated HMO	✓				
5.	Baystate Health	✓		✓		✓
6.	Beth Israel Deaconess Medical Center	✓	✓*			
7.	Boston Medical Center	✓		✓		✓
8.	Brigham and Women's/Faulkner Hosp.	✓	✓*			
9.	Children's Hospital	✓		✓		✓
10.	Dana-Farber Cancer Institute	✓			✓	
11.	Lahey Health System	✓	✓*			
12.	Lawrence General Hospital	✓		✓		✓
13.	Massachusetts General Hospital	✓				
14.	Partners Healthcare System	✓				
15.	Sturdy Memorial Hospital	✓		✓		
16.	UMass Memorial Health Care	✓				
17.	Boston University	✓	✓		✓	
18.	Brandeis University	✓	✓	✓		✓
19.	Harvard University	✓	✓			
20.	MIT	✓	✓			
21.	Northeastern University	✓	✓	✓		
22.	Suffolk University	✓		✓		
23.	Tufts University	✓	✓			
24.	Harvard Management Co.	✓				
25.	ISO New England	✓				

* Temporary housing allowance provided to CEO relocating to Massachusetts from another region.

For Figure 2: A check mark indicates that this benefit was provided at some point during the review period (2009 to 2011).

³¹ Some organizations point out that they no longer provide this benefit.

III. ADDITIONAL BENEFITS

Organizations include certain other benefits on a less widespread basis. For example:

- Spousal travel, where the spouse is expected to accompany the CEO on charity-related business (e.g., fundraising events).
- Relocation assistance for CEOs relocating to Massachusetts from other parts of the country.
- Loans for purposes of obtaining housing in Massachusetts (to be repaid, or if forgiven, recorded as compensation).
- Club membership for purposes of entertaining important donors and other business contacts.
- Payments to compensate an incoming CEO for deferred compensation that he or she forfeited by being recruited away from the prior employer.
- Tuition payments for immediate family members of university presidents, either at the institution itself or at another school.

D. CONTINGENT AND CONTRACTUAL BENEFITS

The CEO’s employment agreement often contains provisions that amount to additional benefits that are not reported on the IRS Schedule J unless they are actually paid. We believe that the mere existence of the commitment to make some of these benefit payments can create an imbalance in the supervisory relationship the board has to the CEO.

Many of these provisions will be triggered only when the CEO departs the organization, and the board must grapple with their financial consequences when considering how to effect a transition from one CEO to a successor CEO. Some organizations report “end-of-service” payments, which may include severance payments, and payments associated with continuing organizational relationships (both discussed immediately below), and also payouts of accrued but unused vacation days, or outplacement services to assist an outgoing CEO with a job search. The organization’s contractual obligation to make such end-of-service payments (if such provisions are included in the CEO’s employment agreement) may also result in a negotiated separation agreement with the departing CEO—an added burden on the organization and its board at a time of institutional transition.

These provisions are distinct from the obligation of the organization to make certain benefits payments that are triggered by CEO resignation or retirement (including payment of funds held in retirement plans or other deferred compensation). Depending on the circumstances, payout of accrued but unused vacation time—if all parties agree what the CEO has accrued and is owed—may be a similar obligation.

I. SEVERANCE PAYMENTS

Many CEO employment agreements include a severance provision entitling the CEO to a payment of up to two times his or her annual cash compensation in the event the CEO is terminated without cause (some severance benefits are only one year’s compensation; some are limited to base salary and don’t include the value of incentive compensation; some include continuation of health insurance benefits for a period of up to two years). The definitions of for-cause termination we saw were extremely narrow, encompassing things like the CEO’s conviction of a felony or perpetration of deliberate acts that harm the organization. The effect is that if the board terminates the CEO’s tenure for any reason other than the CEO’s gross misconduct, the severance obligation is triggered. Even where the board is dissatisfied with the CEO’s performance, its evaluation of whether or not to terminate the relationship must take

into account the severance obligation. The existence of such a provision in the CEO's contract places the organization in the difficult position of having to negotiate a separation agreement in the context of a hefty payment obligation, even if the CEO's performance has been substandard or damaging to the organization.

The Division commented on severance provisions like these in the 2011 letter to Blue Cross and Blue Shield of Massachusetts regarding the payments made to outgoing CEO Cleve Killingsworth.³² Now, as then, "It is the position of the AGO that they diminish board independence, when triggered are costly both in dollars and public perception, and, in most cases, do not sufficiently advance legitimate corporate purposes to merit their scope and pervasive use."³³ While we were disappointed to see so many severance provisions in the contracts we reviewed, we also note that the period of time under review in this study ended with 2011, the year in which the letter on the Killingsworth severance was issued. There would not have been time for that letter to have an impact on the arrangements we reviewed for this study. The Division sincerely hopes that organizations whose CEO contracts include severance provisions like these will seriously consider eliminating such provisions in the future. Even if these types of provisions remain commonplace in this region, the Division believes that they are unwarranted and potentially damaging to the charitable organizations that allow them in CEO contracts.

II. CONTINUING ORGANIZATIONAL RELATIONSHIPS

Some of the organizations we reviewed include contractual provisions in the CEO's employment agreement that address a continuing relationship between the organization and the CEO in the months or years after he or she has been replaced by a successor. In some cases, these provisions seem to be designed to ensure that the organization is able to take advantage of the institutional knowledge of the former CEO and to use it to advance the organization's continuing goals. At some higher education organizations, such provisions may be designed to return a departing president to a tenured faculty position that he or she had earned prior to becoming president. At other organizations, though, these provisions seem to be intended more to provide a post-departure compensation stream for the CEO, particularly where the provisions are agreed to at the outset of the CEO's employment and the long-term benefits to the organization of the continuing relationship are difficult to discern. These types of provisions also place a board of directors at a disadvantage when considering whether to replace a CEO, or in negotiating with a CEO over the terms of his or her departure. At least one organization we reviewed took a different approach, believing that a former CEO should not continue to have a role at the organization so that the incoming CEO will have a freer hand in managing the organization.

By way of example,³⁴ a CEO employment agreement might contain a provision stating that upon the CEO's retirement or other voluntary termination, he or she has a right to enter into a two-year consulting arrangement with the organization that will include a certain payment rate for a certain number of hours per year of consultation. Another organization's employment agreement might provide that the CEO

32 See letter to William C. Van Faasen, Chair of the Board of Directors, Blue Cross and Blue Shield of Massachusetts, Inc., dated July 6, 2011, available at www.mass.gov/ago/docs/nonprofit/findings-and-recommendations/bcbs-report-final-7-11.pdf (2011 Letter).

33 2011 Letter at 2.

34 The examples provided in this paragraph are amalgams of different post-CEO organizational relationships. They are not contractual terms taken from specific employment agreements, though they are representative of the types of contractual terms we saw in some of the employment agreements we reviewed.

agrees to stay on for at least five years after his or her term as CEO and will have pay stepped back down over those five years to what he or she would earn in the position he or she held prior to becoming CEO. A third variation might provide that after his or her term as CEO, the CEO will have a right to serve as the “past president” for a certain number of years, at a certain salary level.

Some “continuing relationship” arrangements seem designed to support the charity’s identified need for an ongoing relationship with the CEO. However, the existence of these provisions also places the charity at considerable risk if the relationship should sour. If a separation is required, the CEO will likely argue that he or she has a right to receive the compensation contemplated by the contractual provision addressing the continuing relationship. The existence of the provision, like the existence of a severance provision, places the charity at a disadvantage in negotiating a separation.

III. OUTSIDE BOARD SERVICE COMPENSATION

It is not uncommon—or surprising—for CEOs of prominent organizations to serve on the boards of directors of other corporate entities, both non-profit and for-profit. Such outside board service may advance the institutional goals of the organization, and thus may be in the best interest of the organization. While directors of non-profit organizations are typically not compensated for their service, directors of for-profit corporations frequently are compensated. There is at least the potential for CEOs to leverage their position to gain outside board positions to further their own interests, including financial interests, rather than the charity’s interests. The AGO has commented previously that the position of the CEO is an asset of the charity and that boards should oversee the use of that asset, including outside board service by the CEO.³⁵

Most of the organizations we reviewed exercise oversight of outside board service, whether compensated or uncompensated, through a conflict of interest/conflict of commitment assessment. Under this approach, the CEO must obtain approval—usually from the board chair—for each outside board position. The board chair makes a determination whether the outside board position will present a conflict of interest with the CEO’s obligations to his or her employing organization, and also whether the demands of the outside board position will not be so substantial as to interfere with the CEO’s ability to meet his obligations as CEO (i.e., a conflict of commitment assessment). The Division believes that this case-by-case analysis and review is appropriate, when coupled with an assessment of the CEO’s entire portfolio of outside commitments (to guard against a situation in which a CEO serves on a number of outside boards, any one of which could be managed with his or her duties as CEO, but when taken as a whole, present the risk of a conflict of commitment).

A minority of the organizations in our review do not require the CEO to obtain approval for or even to disclose outside board service. Some stated that because the CEO, like all other officers and directors, has agreed to abide by the organization’s conflict of interest policy, the board trusts that the CEO will not undertake any position that presents a conflict. Some have also commented that they believe the CEO’s outside activities are private and that inquiry by the board into those activities is intrusive and unwarranted, and that any actual conflict of commitment will be reflected in the CEO’s performance and remedied. The better practice, we believe, includes organizational oversight of outside commitments to ensure that the outside commitments do not negatively affect the CEO’s obligations to the organization, and serve to advance the organization’s interests.

³⁵ 2011 Letter at 3.

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PART III: HOW CEO COMPENSATION IS DETERMINED

THE PROCESS OF ESTABLISHING PUBLIC CHARITY CEO COMPENSATION

Most of the organizations in the review used a process designed to invoke the rebuttable presumption of reasonableness of section 4958 in approving the CEO's compensation and benefits package. That is, most organizations:

- Used a compensation committee composed of independent trustees or directors;
- Relied on comparability data from organizations the committee considered to be similarly situated, or "peer" organizations; and
- Documented the compensation committee's deliberations and determinations contemporaneously.

Most, though not all, engaged one or more outside professionals—attorneys or compensation consultants—to assist in the process of determining the reasonableness of the CEO's compensation.

A. COMPENSATION COMMITTEES

While each organization had an appointed compensation committee, there was considerable variability in the breadth and depth of the committees' charges, the frequency of their meetings, and the level of detail recorded in their minutes.³⁶ For example, some committees seem to have met only once or twice a year for the sole purpose of approving the compensation of the senior officer or officers and recorded only summary minutes or votes, while others, including many of the health care organizations, met regularly throughout the year, and considered and acted on various aspects of peer group selection. A few of the compensation committees also considered compensation issues for additional segments of the organization's workforce. Most recorded detailed minutes of their discussions. In general, the more robust committee records, including minutes and copies of presentations and analyses, increased our confidence in the process and the level of care being exercised.

Compensation committees generally review the CEO's (and other senior executives') compensation packages for reasonableness at several different points in time. For example, the committee would evaluate the reasonableness of the compensation and benefits package proposed for a new CEO prior to finalization of employment terms. It would evaluate the same package at or near the end of the CEO's first year, when certain elements of the package (e.g., incentive compensation) will appear as a number rather than a possible range. If the package includes deferred compensation or retirement pay, those elements will also be included in the committee's review for the year in which the CEO vests in those amounts.

A typical year in the work of a more robust compensation committee includes at least quarterly or perhaps even monthly meetings. At least annually, a compensation consultant provides information about developments in law, regulation, and oversight of executive compensation; trends in executive compensation and benefits practices; sources of comparability data; and parameters in the selection of "peer" organizations. A robust committee will engage actively in debate about the appropriateness of different sets of comparability data (discussed more fully below).

³⁶ As noted earlier in this Report, some of the organizations in our review did not provide access to all requested records; some omitted compensation committee records or clarified that the compensation committee does not keep minutes. See footnote 18.

The robust committee will receive detailed information about the CEO’s entire compensation and benefits package, including anticipated social security benefits that would offset the organization’s liability to pay certain forms of retirement benefits (e.g., in a defined benefit style SERP). The committee may request and review different datasets and analyses comparing their CEO’s proposed package with others in the dataset.

A less robust committee might meet only once or twice a year, review the CEO’s compensation package against Form 990 data from several selected peer organizations, and approve the compensation package as reasonable based on that discussion.

Where the CEO’s compensation package is near the average of CEO packages at reasonably selected peers, the organization might determine that it need not devote additional resources and expense to the type of detailed and intensive analysis that a more robust committee engages in. Where the CEO’s compensation hovers near the top tier of packages at peer organizations, more scrutiny is warranted. However, we found that sustained focus on the large and complex compensation packages of CEOs across peer organizations tended to make adjustments and increases in the organization’s CEO package seem reasonable more often than not, even when the adjustments involved significant sums of money or presented risk to the organization. The narrowness of the compensation committee’s mission, coupled with the complexity of its task and its single-minded focus on compensation of CEOs at other organizations, can lead to a rarefied discussion that reflects a lack of perspective on the straightforward, common-sense meaning of “reasonable compensation.” For example, we did not see evidence that the committees regularly considered the reasonableness of the CEO’s compensation when compared with the compensation paid to other members of the organization’s workforce, or discussion about how the CEO’s compensation related to or advanced the charitable mission of the organization. These things are not elements of the section 4958 rebuttable presumption safe harbor. Nonetheless, we believe that a broader set of considerations in the compensation committee’s work would help assure a broad perspective is brought to its task and guard against a disconnect between a compensation committee’s view of reasonable compensation at a charity and the views of donors or the public.

B. COMPARABILITY DATA

As noted in the discussion of the Regulatory Context above, the section 4958 rebuttable presumption “safe harbor” requires that the compensation committee obtain and rely upon “appropriate data as to comparability” prior to determining whether the CEO’s proposed compensation package is reasonable. Treasury regulations further specify that relevant information includes, but is not limited to, “compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions.”³⁷

A few organizations in our study relied only on publicly available Form 990 data from a limited number of “peer” institutions selected by members of the compensation committee. Most compensation committees employed a more nuanced, detailed and multifaceted approach to the selection of comparability data. Most committees relied to some extent on compensation survey data compiled by an external source, such as a compensation consulting firm. Some committees relied on their consultants’ and experts’ suggestions about appropriate “peer” group selection. Some also engaged actively in debating the appropriate criteria for peer group selection and made several adjustments during the period we reviewed.

All of the surveys or data-sets we observed were specific to the broad industry sector in which the organization operated (e.g., higher education; hospitals; health plans). Put another way, we did not see evidence of any committee stretching the boundaries of appropriate “peer” designation in the selection of industry data sets.

³⁷ 26 C.F.R. § 53.4958-6(c)(2).

In general, universities were more likely to rely on comparability data from a small number of named institutions they determined were comparable, or to rely on data from a regional survey to which they submitted data on their own CEO's compensation. Other organizations in our study used more sophisticated (and expensive) approaches to identifying "similarly situated" organizations and compensation levels from larger proprietary datasets maintained by compensation consulting firms. In fact, some organizations appear to have selected consultants in part based on the datasets to which they had access.

With the exception of the four health plans, Harvard Management Company, and ISO New England, we did not observe many examples of committees including data from for-profit companies in their comparability datasets. In a few cases where data from for-profits was included, there was discussion and documentation of the rationale for doing so. For the health plans, Harvard Management Company, and ISO New England, committees concluded that most similarly situated organizations were for-profit, and that it was therefore appropriate or even necessary to include for-profit companies in order to obtain a reasonable dataset for comparison purposes.

Most committees restricted the survey data they relied upon to data from organizations that were of a similar size, but there was variability in how committees viewed size similarity. For example, several committees included comparator organizations with gross revenue between 50% and 200% of the gross revenue of the organization itself. While we did not have access to the raw data included in the resulting datasets, it would not be surprising to find that larger organizations would award higher compensation. Accordingly, it would not be surprising if this approach to size similarity resulted in a dataset with compensation figures skewed toward the larger end of the spectrum.

At least one committee decided, after discussion, to eliminate "peer" institutions located in areas with especially high cost-of-living (e.g., New York City) because committee members believed compensation paid in such areas skewed the range of reasonableness to the disadvantage of the charitable organization.

Some committees relied on more than one "peer group" for purposes of comparing compensation. For example, the committee might rely on compensation data from a national or regional survey of non-profit organizations with similar levels of gross revenue, but would also use data from a more limited group of named institutions with similar structures, reputations, and geographic locations. Some committees used one peer group based on organizations with similar characteristics, and a second group based on organizations with characteristics the organization desired to develop as part of its strategic plan.

C. COMPENSATION CONSULTANTS

Most of the organizations in our review (23 out of 25) engaged at least one compensation consultant to assist the compensation committee in its reasonableness review. Generally, each consultant offered access to its own proprietary data on compensation and benefits obtained through its surveys and compensation review work with other entities. Some consultants also purchase datasets from one or more other consultants.

Some organizations engaged different consultants in different years. They explained that periodic change in consultants could bring a fresh perspective, ensure the consultant's objectivity and independence, and allow access to a different database for comparability data. A few organizations in our review did not engage a consultant, but relied instead on published Form 990 compensation data or on data from consultant surveys in which the organization itself participated (which are generally made available in some form to survey participants). Generally, hospitals and health plans were more likely to retain large firms with national practices and considerable regional experience. The higher education organizations were more likely to rely on local consultants, survey data to which they had direct access, or published Form 990 data.

Nine of the health care organizations in our review retained Sullivan, Cotter and Associates; four organizations retained Towers Watson; and at least two retained ML Strategies. Some committees consciously chose a consultant with other clients in the area, reasoning that a consultant's experience in the Massachusetts market made it better qualified and more informed. Other committees took the opposite view, reasoning that a consultant from outside the area would bring a more critical eye and different ideas.

Each consultant provided the compensation committee with information about trends in compensation and benefit package design (including regional variations), tax regulation, and relevant industry trends in addition to providing an analysis of compensation and benefit levels among comparable organizations. Typically, consultants' reports compared the CEO compensation package under review with the value of packages in the "peer" group at the 50th percentile, 75th percentile, and 90th percentile. Consultants also assisted in determining the parameters of the "peer" group to be used in constructing the comparability dataset. This involves developing a subset of a much larger dataset based on aspects of the organization conducting the review. For example, as discussed above, some consultants suggested using data from comparator organizations with gross revenue between 50% and 200% of the organization's revenue.

We found no evidence of manipulation of peer group selection in order to support the reasonableness of the CEO's compensation package. However, we were also unable to verify that peer groups were selected entirely without regard to how the CEO package under review would likely compare with those in the peer group.

A few organizations also engaged attorneys to provide reasonableness opinions in addition to the compensation consultant's analysis. In general, organizations engaged additional advisory resources where the CEO's compensation package fell toward the upper range of the comparability data, probably because the organizations believed they would be taking on an increased risk that the compensation could be deemed excessive (opening the possibility of the imposition of excise taxes under the "intermediate sanctions" of section 4958 described above). From one perspective, the increased risk justified the engagement of advisors to assure the committee that approval of the compensation package was defensible and consistent with its fiduciary duty to the organization. Of course, it also meant that not only was the organization paying a high amount of compensation to the CEO, it was also expending even more resources to ensure that the expenditure could be defended if it were challenged.

D. COMPENSATION PHILOSOPHY

Most organizations have a policy or philosophy that targets compensation at the mid to middle-upper range of comparables. That is, some organizations target compensation at the 50th percentile (of peer groups' compensation); most state that executive compensation should be targeted not to exceed the 75th percentile. Nearly all organizations considered both compensation and benefits when determining the reasonableness of the entire compensation/benefits package (but certain contractual entitlements such as severance and continued work opportunities as described above would not be included if not actually paid during the time period under review).

Most of the compensation committees used a "tally sheet" approach to ensure that they were including all aspects of compensation and benefits accruing to the CEO when determining whether or not the package was consistent with the organization's philosophy or policy.

A few organizations have compensation policies or philosophies that apply to larger segments of the workforce. A few organizations explained that the same compensation committee reviews the CEO compensation, and the compensation and benefits design, increases, and trends for the entire workforce. This practice seems a good way to support consistency in compensation practices across the organization, and was in contrast to most compensation committees, which focused exclusively on senior managers.

E. RECRUITMENT AND RETENTION CHALLENGES

Some organizations described, either in the documents they allowed us to review or in discussions about the materials, challenges they face in recruiting and retaining talented professionals for leadership positions. For example, the CEO of at least one organization received a lucrative offer from a competitor outside the region. The compensation committee and board leadership evaluated the costs and benefits of conducting a search for a new CEO during a phase already replete with upheaval and change across the organization. It determined that increasing the CEO's compensation to match the competing offer in order to retain the CEO's services, which they deemed stellar, was in the best interests of the charity, even though it resulted in a new "floor" for executive compensation at the organization. Large and complex organizations like those in our review group explained that they require talented and experienced leaders (the kind of individuals always in high demand) and stability in leadership to develop and achieve long range goals.

Other organizations recruited senior leaders from other parts of the country and told us that they had to provide additional compensation or benefits to help with transitioning new leaders to greater Boston due to the high cost of living, especially housing, in this area. While this challenge did not require additional salary compensation for services above the level the previous individual in the position had been paid, it did require an initial set of payments, loans, or benefits to allow the recruited individual to obtain housing.

F. TIMING

Compensation packages are generally reviewed for reasonableness when they are initially agreed to in an employment agreement and also when reported or paid. This means that the same elements of compensation may be considered for reasonableness and reported at several different times. Similarly, as discussed in Part II above, Form 990 reporting requirements result in some elements of compensation being reported multiple times, even though they are only paid once. Some components, such as retirement investment accounts, may be assigned a different value at different reporting or consideration times due to changes in market value of the investments. All this can lead to confusion and "double counting" (or even "triple counting") in analysis of reported compensation figures. The new Schedule EC and the additional detail it requests are intended to reduce the confusion around these aspects of compensation.

Most organizations in our review made decisions about compensation to be paid for work in a given calendar year by the spring of the following year. Some aspects of incentive compensation depend on analysis of year-end performance and so are actually paid in the following calendar year. While those amounts are attributable to work performed the previous year, they are analyzed and reported as part of compensation in the year in which they are paid.

Based on the fact that compensation for a given calendar year is determined within months of the close of that calendar year, we believe that charities are able to report publicly on compensation earlier than the Form 990 currently requires. We cannot influence the Form 990 reporting schema and will continue to require that organizations submit their Form 990 along with their state Form PC. Going forward, however, we intend to require that certain organizations include in the Schedule EC more timely compensation data. More information about new reporting requirements will be forthcoming in revised Form PC instructions.

G. DOCUMENTATION

Our description of the manner in which compensation committees document their work is limited because, as noted above, some organizations declined to allow us to review all of their documentation; see footnote 18 above. As a general matter, most of the documentation the hospitals, health plans and other organizations showed us evidenced fairly detailed records of the deliberations of compensation committees and advice of consultants. The description of more and less robust compensation committee processes in Section A above is based largely on the variable levels of detail in documentation we reviewed.

PART IV: OBSERVATIONS

Thanks to the cooperation of the 25 charities in this study, the Division has gained valuable insight into charitable CEO compensation, its components, and how it is established. With that new learning, the Division provides these observations:

- Large lump-sum payments often reflect funding, vesting or payment of compensation that is styled as a retirement benefit or “other reportable compensation” payment. These lump sums relate to a CEO’s engagement and/or performance over a period of time longer than the year in which they are reported.

These large lump sums often lead to scrutiny of the organization—perhaps in the press, or among organizational stakeholders (i.e., unions or other significant constituencies), or by regulators—that detracts from the charitable mission of the organization. The confusion over these lump sums frequently results from an inadequate understanding or explanation of why the sums are being paid out (or merely reported). But it can have significant deleterious effects on an organization, impacting public views of the organization and affecting core functions (such as fundraising campaigns).

In some cases, the large reported payment is simply the vesting of a known and predictable amount of deferred compensation. While these large payments may present a reporting or communication challenge, this can be addressed with additional detail in the reports. Large payments may also present a challenge from the perspective of defending the reasonableness of the CEO’s total compensation for the pay-out year. Compensation committees should carefully weigh the value the public charity derives from the deferred nature of the compensation (e.g., the value of the retention incentive effect) against the risk that such large payments could be deemed excessive.

- Some executive retirement plans are designed to replace a percentage of income, much like defined benefit pension plans. The prevalence of these pension plans has declined dramatically for most of the workforce, yet seems to be still relatively high for chief executives at large public charities. These types of benefit plans place the public charity at considerable risk.

For example, if a CEO’s employment contract includes a right to a SERP that, together with all other forms of retirement pay and deferred compensation, will pay the CEO in retirement the equivalent of 60% of the CEO’s final average compensation, a number of variables can create an “underfunding” situation that requires an additional expenditure by the organization just to maintain the promised benefit. Even if the organization has been setting aside an appropriate amount to fund the SERP each year, a sudden drop in the value of investments or an unanticipated increase in compensation before retirement can lead to this result. The organization must then make a particularly generous payment to the SERP vehicle in order to avoid more significant payment liability later when the CEO retires. Benefit plans designed to achieve a defined benefit level over time (e.g., income replacement retirement plans that resemble old-style “defined benefit” pensions) are more likely to open the organization to this type of risk.

That is not to say that a defined benefit plan is not an appropriate benefit for a workforce at large (even if it would seem generous in today’s world). But this type of income replacement benefit, particularly with respect to that substantial portion of CEO compensation in excess of the IRS

caps on qualified plans described in sub-part II B i above, seems increasingly anachronistic now that most workers are expected to manage their own retirement income needs through their own savings and other employer-sponsored plans using contributions made during their working years. While this type of benefit seems not uncommon among senior executives in this region, we question whether it is actually reasonable, particularly for public charities, to be providing it for their senior executives in light of the facts that: (1) most other workers do not enjoy this level of income replacement benefit; (2) executive pay is generally high enough to allow personal savings for retirement during working years; and (3) the risks to the charity described above can be substantial. While it is true that federal income tax rules limit the amount that can be saved for retirement on a pre-tax basis, and that the savings needed to generate retirement income that will support a more expensive lifestyle will therefore need to be accumulated on a post-tax basis, we do not deem this type of “discrimination” in tax-advantaged savings vehicles a reason to develop income replacement benefit plans that place the charity at risk.

- Sustained focus on executive compensation as an isolated matter can lead to a loss of perspective on the amount of compensation at issue and its reasonableness in comparison with other aspects of the charity’s mission and resources.

Only a few organizations in our study told us that their compensation committee reviewed compensation levels and increases for all segments of their workforce, and not just the executives. Including in the compensation committee’s mandate the discussion, analysis or even simply information about pay rates for other segments of the organization’s workforce may help moderate executive pay increases. The Securities and Exchange Commission recently proposed standards requiring publicly traded companies to report on the ratio of their CEO’s pay to that of the median compensation of all other employees.³⁸ These kinds of comparisons might moderate the increasing pay disparity between executives and others in the workforce, and increase public confidence in the appropriateness of CEO compensation.

- Inclusion of for-profit companies in the set of “comparables” for section 4958 analysis does not explain the high levels and rapid increase in CEO pay at public charities.

Some people have wondered whether the increase in compensation has been due in part to the inclusion of for-profit companies in the set of comparables for purposes of the section 4958 reasonableness assessment. Apart from the health plans (which operate substantially like insurance companies, most of which are for-profit), and Harvard Management Company and ISO New England (whose comparators are for-profit entities), inclusion of for-profit companies among peer groups was rare in our review group. The few committees that included for-profits did so after discussion about the implications of the decision and after concluding that omission of for-profits would result in too small a peer group based on the relatively small cohort of truly comparable organizations (by size, complexity, or industry) in the non-profit sector. We saw no instances of “gaming” by charities in this regard.

- Not all CEO compensation expenditures occur during the years in which an individual is serving in that position. In order to obtain a complete picture of expenditures associated with a CEO’s tenure, all such payments need to be taken into account.

³⁸ 78 Fed. Reg. 190, 60560-60605 (Oct. 1, 2013).

As noted above, CEO succession—which occurred at 12 out of the 25 organizations in our review during the three-year period—frequently triggers the payment of funds in retirement plans or other deferred compensation vehicles. It may also involve the payment of severance or accrued vacation time. In limited cases it may also mark the beginning of a different role for the outgoing CEO, whose employment agreement provides for a continuing organizational relationship in the years after CEO service. All of these expenditures are, in our view, associated with the individual’s service as CEO.

The organizations that took a broader approach to reporting compensation on the Schedule EC—providing all relevant data regarding a CEO’s compensation, even for those years before or after the relevant individuals served as the organization’s CEO—are meeting one of the key goals of expanded executive compensation reporting: maximal transparency of the costs associated with CEO service.

- Exclusive focus on “market” rates of pay for similarly situated executives as the basis for determining reasonableness of pay will support continued escalation in the level and complexity of executive pay and benefit packages. Additional factors should be included in the analysis of “reasonableness” to broaden the context for the determination.

Based on our experience during this review, sustained focus on the details of compensation packages and percentiles in the data cohorts chosen as comparators can lead to a loss of perspective on the size of compensation packages for senior executives as compared with compensation paid to workers in other segments of the organization’s workforce or the Commonwealth’s workforce at large. Increases that seem small when compared with other CEO packages can be substantial in real dollar terms; contribute to the widening gap between executive compensation and general workforce compensation;³⁹ and take resources away from other aspects of the charity’s mission. A few organizations in the review group explained that their compensation committee considers or approves compensation and benefits for all segments of the organizations’ workforce, and that they employ a similar method (using comparator data and market trend information) for each segment. Broadening the compensation committee’s scope of analysis to include other aspects of the charity’s operations, workforce, mission, and expenditures may help compensation committees moderate the rate of increase in executive pay. In addition, compensation committees should include in their analysis the impact high executive compensation has on public perception as well as donors’ perceptions of the charity.

An important factor in public perceptions of reasonableness of executive pay at public charities is the level of public support that tax-exempt charities enjoy. Though many large public charities do pay taxes⁴⁰ or payments in lieu of taxes, most still enjoy considerable public support in the form of tax exemption that translates into a subsidy or “tax expenditure” for the government units foregoing revenue and for the taxpayers who make up the difference. Executive pay at large companies that received government support under the federal TARP program, which began in 2008, came under scrutiny and was subjected to limitations because of the public support those companies enjoyed.

³⁹ See, e.g., Alvaredo, et al., *supra* note 1.

⁴⁰ For example, Blue Cross Blue Shield of Massachusetts, while a public charity under Massachusetts law, is not exempt from most forms of tax under federal law and pays state taxes on premiums.

Some national and state leaders have suggested that executive pay at public charities should be subject to similar limits because of the public support that tax exemption provides.⁴¹ While we do not at this time recommend specific limits on executive pay, we do recommend that public charities consider the level of public support they receive as an aspect of determining the reasonableness of executive pay, as well as the impact high executive compensation may have on public and donor perceptions of the charity.

⁴¹ U.S. Senator Charles E. Grassley is an outspoken critic of high executive compensation at charitable organizations. While he has frequently expressed concern about executive compensation at charitable hospitals and health systems, his current focus is on compensation practices at New York University. See, e.g., Ariel Kaminer, “N.Y.U. Impeding Compensation Inquiry, Senator Says,” New York Times, July 10, 2013. In Massachusetts, state Senator Mark Montigny has filed legislation that proposes to limit executive compensation to \$500,000 at public charities with gross revenues in excess of \$1 million. See *An Act Relative to Public Charity Executive and Board of Directors Compensation*, available at malegislature.gov/Bills/188/Senate/S768. See also Ralph De Jong and Michael Peregrine, “Opinion: Why Charity Leaders Should Pay Close Attention to Obama’s Pay Guidelines,” Chronicle of Philanthropy, Feb. 6, 2009, available at <http://philanthropy.com/article/Opinion-Why-Charity-Leaders/63010/>.

CONCLUSION

Executive compensation arrangements must be scrutinized closely, for a variety of reasons. At a surface level, they must be carefully reviewed in order to meet the requirements of the relevant Treasury regulations, and to conform to the required public reporting standards. On a deeper level, other considerations should influence a Board's review. Unnecessarily large or excessive compensation packages can have a negative impact on a charity's core mission and can cause significant reputational harm. Charities should be aware of the considerable financial risks they take on with certain types of compensation arrangements, and—in an exercise of their fiduciary responsibilities—should be unwilling to pay more than is necessary to secure the executive talent they need.

The Division will implement a revised version of the prototype Schedule EC as part of the Form PC, requiring detailed information about CEO compensation. As noted above in the discussion of timing of public reporting, we believe that this will result, for many public charities, in more timely public reporting of compensation data.⁴²

Also as a result of this review, we will add certain questions to the Schedule EC asking whether organizations have included some of the additional factors in their analysis of compensation reasonableness as suggested above. We believe that this information will be useful in broadening and informing the public discussion about executive compensation among public charities. We hope that requiring reporting on these additional aspects of the compensation review process will help broaden the factors actually considered in that process and that this, in turn, will moderate the rate of increase in executive compensation and will reduce the level of risk public charities take on in structuring executive compensation and benefit packages.

The Division will review and report periodically on the results of the Schedule EC implementation.

⁴² Some public charities are already subject to earlier reporting requirements from other oversight agencies. Health plans generally file calendar year compensation information with the Division of Insurance by March 1 of the following calendar year. The Center for Health Information and Analysis is implementing a new requirement that hospitals submit detailed compensation information for the top ten earners and, after the initial reporting year, is likely to require reporting earlier than the IRS Form 990 time frame.

APPENDICES

APPENDIX A: FORM PC, SCHEDULE EC (CEO)

Form PC, Schedule EC (CEO)

All questions are with regard to your organization's chief executive officer, and are made for the period beginning January 1, 2009 and ending December 31, 2011. Please refer to the Form PC instructions for definitions of terms (including "Related Organization", "Related Party", and "Termination of Employment or Change of Control Compensatory Arrangement").

1. For the three relevant calendar years, please provide compensation information on the attached Schedule EC-1.
2. For each calendar year, please describe the nature of each compensation component and provide an explanation with regard to how and when any forms of contingent compensation (e.g., deferred compensation, incentive compensation, and retirement) accrue, vest, and are (or will be) paid; please make reference to the relevant row and column of Schedule EC-1. If any contingent compensation amount is reported in more than one year, please indicate (i.e., identify double-reported amounts) and describe the reasons for doing so.
3. For each calendar year, please list any loans or loan guarantees initiated or existing between your organization (or a Related Organization) and your chief executive officer.
4. To the extent that your organization used an independent compensation consultant in establishing the compensation of your chief executive officer, please identify the compensation consultant by name, and the name of the company or firm for which the compensation consultant works.
5. How often is your chief executive officer's compensation reviewed for reasonableness?
6. Does your organization's policy, procedure, and approach to setting compensation for other members of your senior management team differ substantially from its policy, procedure, and approach to setting the compensation of your chief executive officer? If so, please provide a brief explanation of any differences.

Form PC, Schedule EC-1

Please provide the following information with regard to your chief executive officer's compensation; there are three pages, one for each of calendar years 2009, 2010, and 2011.

Name of Organization	CEO Name

Calendar Year 2009	Component A	Component B	Component C	Component D	Component E	Total, All Components
I. Base Compensation	i.					
	ii.					
II. Bonus and Incentive Compensation	i.					
	ii.					
III. Other Reportable Compensation	i.					
	ii.					
IV. Retirement and Other Reportable Compensation	i.					
	ii.					
V. Nontaxable Benefits	i.					
	ii.					
Total						

Instructions: The categories of compensation in rows I. through V. above correspond to columns (B)(i) through (D) on Form 990, Schedule J, Part II. To the extent that any of the figures in those columns on Schedule J, Part II are comprised of component parts, please provide the amounts for each of the component parts. This Schedule EC-1 shows columns for five components, though you may have more or fewer components. If you have more than five components, please provide a spreadsheet using the same format as this Schedule EC-1. As with Form 990 Schedule J, Part II, subrow (i) is for reporting compensation from your organization and subrow (ii) is for reporting compensation from related organizations (as that term is used in the Form 990).

Form PC, Schedule EC-1

Please provide the following information with regard to your chief executive officer's compensation; there are three pages, one for each of calendar years 2009, 2010, and 2011.

Name of Organization	CEO Name

Calendar Year 2010	Component A	Component B	Component C	Component D	Component E	Total, All Components
I. Base Compensation	i. ii.					
II. Bonus and Incentive Compensation	i. ii.					
III. Other Reportable Compensation	i. ii.					
IV. Retirement and Other Reportable Compensation	i. ii.					
V. Nontaxable Benefits	i. ii.					
Total						

Instructions: The categories of compensation in rows I. through V. above correspond to columns (B)(i) through (D) on Form 990, Schedule J, Part II. To the extent that any of the figures in those columns on Schedule J, Part II are comprised of component parts, please provide the amounts for each of the component parts. This Schedule EC-1 shows columns for five components, though you may have more or fewer components. If you have more than five components, please provide a spreadsheet using the same format as this Schedule EC-1. As with Form 990 Schedule J, Part II, subrow (i) is for reporting compensation from your organization and subrow (ii) is for reporting compensation from related organizations (as that term is used in the Form 990).

Form PC, Schedule EC-1

Please provide the following information with regard to your chief executive officer's compensation; there are three pages, one for each of calendar years 2009, 2010, and 2011.

Name of Organization	CEO Name

Calendar Year 2011	Component A	Component B	Component C	Component D	Component E	Total, All Components
I. Base Compensation	i.					
	ii.					
II. Bonus and Incentive Compensation	i.					
	ii.					
III. Other Reportable Compensation	i.					
	ii.					
IV. Retirement and Other Reportable Compensation	i.					
	ii.					
V. Nontaxable Benefits	i.					
	ii.					
Total						

Instructions: The categories of compensation in rows I. through V. above correspond to columns (B)(i) through (D) on Form 990, Schedule J, Part II. To the extent that any of the figures in those columns on Schedule J, Part II are comprised of component parts, please provide the amounts for each of the component parts. This Schedule EC-1 shows columns for five components, though you may have more or fewer components. If you have more than five components, please provide a spreadsheet using the same format as this Schedule EC-1. As with Form 990 Schedule J, Part II, subrow (i) is for reporting compensation from your organization and subrow (ii) is for reporting compensation from related organizations (as that term is used in the Form 990).

APPENDIX B: EXECUTIVE COMPENSATION INFORMATION REQUEST

Executive Compensation Information Requests

All requests are for the period beginning January 1, 2009 and ending December 31, 2011, and, except as noted below, are made with regard to your organization's chief executive officer.

"Schedule J" means Schedule J, Schedule J-1, and Schedule J-2 (including all attachments) to your organization's Forms 990, as filed with the Internal Revenue Service and the Division.

A. Executive Compensation.

- (1) In completing Schedule EC-1, you will provide a brief description of components of compensation paid or vested and a description of any vesting triggers for compensation components reported in each of the three years requested. This paragraph A(1) requests more detailed information about those components as well as information about rights or agreements that may not have resulted in reportable compensation at the time you complete this request.
 - (a) Please describe any rights to contingent compensation not reported on Schedule EC-1 (e.g., the right to receive additional compensation in the case of severance or change in control), and provide copies of documents setting forth those rights.
 - (b) With respect to, as applicable, (A) deferred compensation, (B) incentive compensation, (C) retirement, and (D) other contingent compensation:
 - (i) What are the metrics or criteria used to determine whether your chief executive officer is to receive the contingent compensation?
 - (ii) How were those metrics or criteria selected?
 - (iii) By whom?
 - (iv) Who applies the metrics or criteria to make the determination as to whether the compensation is to be paid or the right to receive it has vested?
 - (v) When are such determinations made?
 - (vi) How are records of such determinations kept?
- (2) For each calendar year, please list other compensation received by your chief executive officer but not reported on Form 990, Schedule J, including but not limited to: compensation from corporate entities that are not Related Organizations; or compensation for service on boards of corporate entities that are not Related Organizations. If you do not collect this information, please explain why not. Please describe your process for reviewing potential conflicts of interest or conflicts of commitment.

B. Certain Expenses Incidental to Employment.

- (1) With respect to those expenses enumerated in Schedule J, Question 1a, if you answered “yes” to Schedule J, Question 1b, please provide a copy of any and all written policies “regarding payment or reimbursement or provision of” the enumerated expenses.
- (2) Are there any other of these types of perquisites that Schedule J does not ask about (in Questions 1a, 1b, and 2), that your organization provides to your chief executive officer, or for which your organization provides payment or reimbursement? If so, what sort of documentation or approval process is required? Are the same perquisites also available to members of your organization’s senior management team?

C. Process Used In Setting Executive Compensation.

- (1) Compensation Committee.

To the extent that your organization used a compensation committee in establishing the compensation of your chief executive officer, please provide the following:

- (a) a list of the members of the compensation committee by name and title;
- (b) copies of the minutes of compensation committee meetings (these may be redacted to exclude non-relevant information, and also to exclude confidential performance evaluations);
- (c) copies of any written reports, recommendations or other documents used by the committee or provided to the committee in connection with your chief executive officer’s compensation or compensation policy.

- (2) Written Employment Contract.

- (a) To the extent that your organization used a written employment contract or agreement in documenting the compensation arrangement for your chief executive officer, please provide copies of the current employment contract or agreement, including, without limitation, all exhibits, appendices, extensions and amendments thereto. If the current employment agreement is an amendment to an earlier employment agreement, please also provide copies of the initial employment agreement and any intervening amendments, including, without limitation, all exhibits, appendices, and extensions thereto.
- (b) Whether or not there is a written employment contract or agreement, were there negotiations around establishing your chief executive officer’s compensation?
- (c) Who participated in the negotiations?

- (d) What were the dates of the negotiations in relation to the start of the contract?
 - (e) Describe any particular factors that warranted an upward or downward adjustment from a beginning point.
- (3) Independent Compensation Consultant.
- (a) To the extent that your organization used an independent compensation consultant in establishing the compensation or the reasonableness of compensation of your chief executive officer, please provide copies of any engagement letter(s), contract or agreement for services (including payment terms), memoranda, and interim and final reports, surveys, or studies.
 - (b) What other work does that compensation consultant or his or her firm (or related firms) do for your organization, if any?
 - (c) Who made the decision to engage a compensation consultant, and how was that decision reached?
 - (d) Who chose the compensation consultant used, and what process was used to make that choice?
- (4) Compensation Survey or Study.
- (a) To the extent that your organization used a compensation survey or study in establishing the compensation of your chief executive officer, please provide copies of any such compensation surveys or studies.
 - (b) To the extent that any such compensation surveys or studies do not list the organizations or other corporate entities that were included in your organization's peer group, please provide a list of the peer group entities, and indicate whether they are non-profit organizations or for-profit entities.
 - (c) How and by whom were the organizations included in the survey or study selected?
 - (d) To the extent that your organization used Forms 990 of other organizations in establishing the compensation of your chief executive officer, please provide a list of those organizations, including the fiscal years reviewed. If these organizations are different from those included in the compensation survey or study, how and by whom were these organizations selected for inclusion in your organization's review process?
 - (e) What were the metrics or criteria used in establishing the peer group (e.g., financial size, number of employees, organizational complexity)?

- (f) How does your chief executive officer's compensation compare with those in the peer group?
- (5) Approval by Board or Compensation Committee.

To the extent that your organization obtained the approval of your board and/or any board committee in establishing the compensation of your chief executive officer, and to the extent the records are not otherwise being provided in response to these Executive Compensation Requests, please provide the following:

- (a) copies of minutes of any board or committee meetings in which the employment contract or agreement and/or executive compensation and/or performance bonus(es) were discussed, reviewed or acted upon by the board or any committee;
- (b) copies of any written reports, recommendations or other documents used by the board or committee, or provided to the board or committee, in connection with any discussion, review, or actions as contemplated in subpart (a).
- (6) Compensation Philosophy.
- (a) Describe your organization's philosophy or policy with regard to compensation. Please provide a copy of any such policy.
- (b) Is it contained within a document, or recorded in some other form?
- (c) Do you have a target of where you want your organization to fall within the peer group?

- (7) Qualifications.
- (a) What are the qualifications for your chief executive officer?
- (b) Was there competition for this position?
- (c) Was there the need to retain your existing chief executive officer in response to a competing offer?
- (d) Are there other challenges your organization faces in obtaining or retaining executive talent that you believe are not adequately captured in other responses, that you think are important to understanding your compensation-setting process? Have there been other such challenges in the past?
- (e) Please provide copies of any documents that inform your responses to subparts (a), (b), (c) and (d).

D. Other Payments As Reported On Schedule J, Part III.

- (1) To the extent that your organization answered “yes” to any of Questions 4 through 7 on Schedule J for compensation to your chief executive officer, requiring an explanation to be made on Part III, please provide a copy of the document(s) that set forth the chief executive officer’s right to the compensation in question (if not already provided in response to these Executive Compensation Information Requests), or, if the compensation arises from a broader plan in which other employees participate, a description of the plan.



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