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2018 Governance Trends for Hospitals and Health Systems

By Michael W. Peregrine, Esq., McDermott Will & Emery LLP

Experience and a review of leading indicators and developments suggest the following as trends that will inform board duties in 2018:

1. **Enhanced director engagement**. Hospital and health system boards should be prepared to address an exceptional number of enterprise-level challenges expected to arise in 2018. In normal years, any one of these developments alone would be sufficient to occupy much of the board's attention for the year. However, the incredible pace of change and looming industry disruption promises to test the capacity and effectiveness of the governing board. Individual board members will need to commit to the demands of hospital/health system board service.
2. **Anticipating business disruption**. The board will be heavily involved in matters relating to the long-term sustainability of the hospital or health system at two levels. One will be a direct focus on how the organization responds to the dual challenges of 1) the increasing need for organizational "scale" and 2) the unceasing level of industry consolidation. Second will be the board's need to partner with management in identifying and responding (at multiple levels) to the threats arising from technology-based business model disruption.
3. **Supporting tax-exempt status**. An unmistakable theme arising from the Tax Cuts and Jobs Act is increasing Congressional skepticism that non-profit hospitals and health systems deserve the benefits associated with tax-exempt status under Section 501(c)(3). It will thus be important for both the governing board and executive leadership to invest greater effort in preserving—and promoting for public consumption—how the delivery of hospital services through a non-profit model is distinguishable from the delivery of such services through a proprietary model.
4. **Asset diversion strategies**. Following the Tax Cuts and Jobs Act, the hospital's/health system's long-term commitment to tax-exempt, non-profit status is a legitimate strategic issue. The relationship between exemption benefits and its related regulatory requirements may be less balanced than before. In this new environment, it is appropriate for the board to consider the benefits of greater investment in for-profit vehicles. A variety of options are available to shift to a partially or completely taxable structure.
5. **Recalibrating the executive compensation committee**. The Tax Cuts and Jobs Act has enormous consequences for how tax-exempt hospitals and health systems compensate their senior executive leaders. The board will thus need to become more engaged in the executive compensation process in order to ensure compliance with these new statutory provisions, maintain a competitive executive recruitment and retention process, and address the broader issues (e.g.,

state attorney general concerns) that may be triggered by compensation structures that are subject to the new taxes.

6. **Executive-level risk insensitivity**. A significant emerging governance issue is how best to monitor—and influence—the management style of senior executives who by nature or business pressures reflect insensitivity to the risks of their initiatives. Their potential insensitivity to risk can trigger enterprise-level concerns. The attentive board is well positioned to identify and address this concern. Its resolution can serve to reconcile the risk-oversight role ascribed to the board with the daily risk-management responsibilities of senior executives.
7. **Officer/director liability exposure**. Directors may face increasing exposure to claims that they failed to monitor business and/or compliance risks. This exposure is based on recent case law, and concerns that allegations involving extreme or egregious fact patterns could, in certain situations, overcome traditional protections that are deferential to the board's method for monitoring these risks. The board benefits from increased training from the general counsel on how to identify, and react to, "red flags" as communicated to the board.
8. **Continued individual accountability**. Anticipated changes by the Department of Justice to its "Yates Memorandum" are unlikely to change its historical enforcement focus on holding individuals accountable for corporate wrongdoing. Any changes are likely to be consistent with administration policies intended to reduce what it perceives as unnecessary regulatory burdens on corporations. However, boards should anticipate—and respond to—the potential for some employees to misinterpret any change to Yates as a rollback on the emphasis on individual accountability.
9. **Oversight of workforce culture**. Boards will be expected to implement their new responsibilities for oversight of workforce culture. This will require consideration not only of what "culture" means in the context of the board's fiduciary duty, but also which corporate executives are best suited to advise the board on its culture-related responsibilities. This expectation is now front and center due to several major corporate controversies, widespread media coverage, and the recent release of the NACD report, *Culture as a Corporate Asset*.[1]
10. **Cybersecurity, again and more**. No matter how overexposed they may feel to cybersecurity matters, health industry directors must remain engaged in the development of relevant policies and monitoring mechanisms. This continuing focus is prompted by an increasing recognition of the inevitability of cybersecurity crisis, be it "black swan" or foreseeable. Important ongoing considerations will be evolving expectations of board cyber-risk oversight, continued access to applicable D&O coverage, relevant talent development and retention, and cyber-risk incentives for executive compensation.

The Governance Institute thanks Michael W. Peregrine, Esq., Partner, McDermott Will & Emery LLP, for contributing this article. He can be reached at mperegrine@mwe.com.

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[1] *Culture as a Corporate Asset*, NACD Blue Ribbon Commission Report Series, 2017.