Working Papers for the Joint Task Force, President of the University, and CEO of the Health System

Prepared for Discussion in Closed Session

Virginia Commonwealth University
VCU Health System

Enterprise Governance Report

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DRAFT

Introduction

The Joint Task Force (JTF) of the Board of Visitors (BOV) of Virginia Commonwealth University (VCU) and the Board of Directors (BOD) of VCU Health System (VCUHS), engaged The Chartis Group (Chartis), a national healthcare consulting firm, to assist with defining a target future-state enterprise governance model for VCUHS. The majority of this work was conducted from May through September 2023. The remainder of this report outlines the background and scope of this initiative, key findings, and recommendations. The report reflects the recommendations of Chartis and not those of the JTF, VCU Board, or VCUHS Board. Following consideration and/or endorsement of these recommendations by the VCU and VCUHS Boards, additional legal due diligence will be required prior to requesting formal Board approval and legislative amendments.[1]

Background and Scope

The 1997 creation of VCUHS resulted in VCU's healthcare delivery and academic programs being governed by two separate boards, which are interconnected through cross-membership by a designated number of Board seats and select ex officio executive positions. VCU's Board of Visitors governs the Health Sciences college and schools. VCUHS's Board of Directors governs the hospitals, clinical operations, and related services, in conjunction with their own individual boards. VCU's Senior Vice President for Health Sciences also serves as the CEO of VCUHS, and VCU's President also serves as the President of VCUHS Authority and Chair of the VCUHS Board of Directors. This model creates numerous boards which must be consulted, and it allows the potential for overlapping authority and other inefficiencies which if streamlined could optimize overall performance, better harness capabilities, and enhance the overall stature of the VCU enterprise.

Within this context, VCU and VCUHS wanted to assess whether the enterprise is optimally structured, and if not, understand the opportunities for improvement. The JTF, composed of members of the VCU Board of Visitors and VCUHS Board of Directors, was appointed and charged by the BOV Rector and BOD Chair to:

- Strengthen the One VCU enterprise governance to ensure alignment and accountability in carrying out the institutional mission as a public research university and academic health system.
- Address ways to improve communications and working relationships between the VCU and VCUHS Boards moving forward.

[1] VCU and VCUHS legal counsel were involved throughout the planning process and preliminary guidance was obtained from external bond counsel. Additional legal due diligence is required to refine the specifications of the future state model such as defining the future legal structure of VCUHS (e.g., 501(c)(3), nonstock corporation, or other options).

- Address best practice governance models and the accountability of VCU and VCUHS Boards within those models.

The JTF engaged Chartis to assist with defining a target future-state enterprise governance model for VCUHS. This initiative identified four key questions to be addressed:

1. How should the relationship between VCU and VCUHS be structured to improve alignment on an ongoing basis?
2. What is the optimal VCUHS Board composition and appointment process? What mechanisms need to be in place for the VCUHS Board to function effectively?
3. Should the VCU President continue to serve as Board Chair of VCUHS?
4. Should the roles of VCUHS CEO and VCU SVP for Health Sciences continue to be held by a single individual? Based on this, should there be any other changes to the senior leadership structure of the clinical enterprise and/or the related component of the academic enterprise including the addition of significant operational roles?

The desired outcome is to position the University and Health System for long term success in an evolving healthcare landscape and position the Health System to better compete with other health systems in the region.

Key Findings

Chartis reviewed source documents (e.g., corporate documents, financial statements), interviewed approximately 40 stakeholders across VCU and VCUHS, and facilitated a series of work sessions with both the VCU and VCUHS Executive Sponsors[2] and with the JTF to inform development of the recommendations. The key finding is that there is a compelling case for change in the organizational structure and Board composition of VCUHS to better align VCU and VCUHS for long term success.

Healthcare Landscape

Several regional and national healthcare trends are impacting health systems like VCUHS, and the proactive response of health systems to these market forces will set the foundation for their long-term success. Key trends include:

- **Financial Constraints:** Financial pressures will remain significant due to a confluence of factors including a continued shift to government pay resulting from an aging population, workforce challenges and rising labor costs, necessary investments in information technology and security, and supply cost inflation. Inpatient care is increasingly

[2] Executive Sponsors: Todd Haymore (VCU Rector), Marlon Levy, MD (VCUHS CEO and VCU SVP), Michael Rao (VCU President), Carmen Lomellin (VCU JTF Co-Chair), Wally Smith, MD (VCUHS JTF Co-Chair).

concentrated in large hospitals able to provide complex care, with small community hospitals facing declining inpatient admissions due to a shift towards ambulatory care.

- **Competition:** Large, regional and national health systems, with strong brands and financial resources, such as Bon Secours Mercy Health and HCA Healthcare, may continue expanding their presence in the region. However, academic health systems, such as VCUHS, can build differentiated programs in areas such as cancer, neurosciences, child health, cardiovascular care, etc., by aligning their clinical and academic capabilities to provide the region's most advanced, highest quality care.
- **Virtual Care/Consumerism:** Virtual care reduces geographic constraints on serving patient needs, creating opportunities and risks for VCUHS. Patients have increasing expectations for timely access, convenience, and involvement in their care.
- **Provider Consolidation:** Private capital entities (including payors) are attempting to consolidate physicians and other providers to take advantage of the significant growth in ambulatory care and to arbitrage rate differentials across outpatient care settings. Payors are increasingly becoming providers in order to direct commodity outpatient care to lower cost settings. Private equity firms are investing in and consolidating select specialties with significant downstream outpatient technical fee revenues. All of these factors will create pressure on hospital outpatient revenues.
- **Shift to Value:** There is an ever-increasing focus on demonstrating superior value for episodes of care and populations to ensure optimal benefit from the community's investment in healthcare.

Comparisons with Other Public Universities

VCUHS's enterprise governance model was compared with other public academic health enterprises across the spectrum of organizational structures, including UW Health (Wisconsin) in which the University and Health System are independent affiliates similar to VCU's, UNC Health in which the Health System is structured as a subsidiary of the University, and UVA Health and UM Health (Michigan) in which the Health System is structured as an operating division of the University. This peer group was selected given their public status, evolution of their enterprise governance, and range of organizational models; these selections were confirmed by the Executive Sponsors prior to the development of case studies. Some of the key areas of focus and findings include:

- **Organizational Structure:** All three types of organizational structures can be effective (or ineffective); governance is one of several dimensions typically addressed to achieve alignment, in addition to strategy, operations and management structures, and the financial model(s).

- **Board Authority:** When the Health System is structured as a subsidiary of the University (e.g., UNC Health), the Health System Board typically has significant delegated authority to govern the Health System (while the University retains oversight and reserve powers related to major decisions). Under the operating division model, the University Board has

full governing authority and the Health System Board primarily serves in an advisory capacity to both the University Board and leadership on strategic direction and operating performance, while typically retaining narrowly defined delegated authority related to licensure and accreditation requirements. Under the affiliate model, the Health System Board serves as the governing authority and the University participates in governance by appointing a portion of the Board.

- **Board Composition:** Compared to VCUHS, comparator health systems 1) place a greater emphasis on ensuring the appropriate balance of expertise amongst Board members in areas such as academic health system management and finance and accounting; 2) members are typically appointed based on recommendations from a Nominating Committee; and 3) medical school faculty are often represented by Clinical Chairs or other senior clinical leaders (e.g., Faculty Group Practice President) rather than by individual faculty members.
- **Integrated Academic and Clinical Leadership Team:** When a single leader oversees the clinical enterprise and the medical school and/or health sciences component of the academic enterprise, they are typically supported by strong executive(s) over each enterprise with delegated authority (e.g., U-M Health Executive Vice Dean of Clinical Affairs and President of the Health System)

Interview Findings

Internal stakeholders agree on the need for change to remain successful and to enhance collaboration. Key themes derived from individual and group discussions conducted between June and August 2023 included:

- There were mixed opinions as to whether VCUHS should remain independent from the University (as a public body corporate, political subdivision and instrumentality of the Commonwealth of Virginia) or transition to becoming a subsidiary or operating division of the University.
    - Stakeholders in favor of preserving the existing structure cited the increased flexibility of the Authority structure, scale of the Health System relative to the University, and opportunities to increase coordination without changing the structure.
    - Stakeholders in favor of corporate integration of the Health System with the University cited both the need for better coordination between VCUHS and VCU and the duplicative governance structure of having multiple Boards.
- There is a widely perceived lack of transparency and coordination between the VCU and VCUHS Boards. The Clay Street project was the most commonly cited example.
- Interviewees see substantial opportunity to refine the VCUHS Board in terms of its appointment processes, range of relevant expertise in key areas, tenure of members, and education/onboarding processes, including:

- The VCUHS Board currently lacks expertise and/or has insufficient representation in several key domain areas necessary to effectively govern a large academic health system.
    - Stakeholders consistently indicated a preference that the VCU President not also serve as the VCUHS Board Chair.
    - The current three-year Board terms are perceived to be too short; the high rate of turnover, particularly if there is a change in the political composition of the appointing entity, sometimes leads to a meaningful loss of institutional knowledge.
- Many stakeholders believe that the VCUHS CEO and VCU SVP for Health Sciences roles should continue to be held by a single individual. Further, they noted that significant turnover in this position in recent years has created difficulties with establishing a strategic direction. Other stakeholders have suggested that VCU and VCUHS should have the flexibility to separate these positions; this stance was reiterated during JTF meetings.
- In recent years, there has been a lack of a clear and unified strategic plan for VCU/VCUHS; however, more recently a set of strategic objectives has been identified collaboratively between VCU and VCUHS.
- There is perceived to be significant opportunity for VCUHS to serve more patients through inpatient expansion (both on the main campus and in the suburbs), additional ambulatory sites in a distributed geography, and targeted partnerships/acquisitions. Additionally, there is general agreement that growth in the number of patients served is critical for academic health system success given the high fixed-cost nature of health care delivery and insufficient annual increases in reimbursement.

Financial Implications

Based on consultations with the financial leadership of VCU and VCUHS, as well as the guidance they received from bond counsel, key financial considerations pertinent to developing the recommendations were:

- *Existing Debt:*
    - VCUHS is the issuer of approximately $800 million in outstanding long-term debt, of which approximately $362 million is governmental tax-exempt bonds.
    - Debt is subject to a Master Trust Indenture which contains certain covenants to protect the bondholders that have loaned credit to VCUHS under that structure.
    - There is no bar against a change of control of VCUHS (without combining credits and debt portfolio with the University). However, any change causing VCUHS to not be a public instrumentality of the state, such as converting to a nonstock corporation, would be problematic both under the Master Trust Indenture and with respect to the continued qualification of the VCUHS's tax-exempt bonds.
    - If VCUHS became a 501(c)(3) organization, its governmental bonds would need to be remediated through redemption, refinancing, or other means. This would likely be very expensive in today's higher interest rate environment.

- *Rating Outlook:* One of the risk factors cited by a rating agency in a recent VCUHS review is political risk due to the high level of governmental involvement in selecting and appointing Board members.
- *Tier 3 Status:* A downgrade of the University's bond rating below AA by S&P or below Aa by Moody's could compromise the University's Tier 3 status (impacting payroll, procurement, etc.).
- *External Contracts:* Contractual relationships with affiliates and other external entities are expected to remain in place following the recommended transition to a subsidiary model (aside from those which are voluntarily terminated by VCUHS to achieve efficiencies). Communications can be conducted with these organizations to determine the exact extent of the impact of these contracts following the potential endorsement of the recommendations by the Boards.

VCU and VCUHS should continue to work with external advisors (e.g., bond counsel) on financial and legal due diligence.

Recommendations

The assessment resulted in four core recommendations, that will be refined based on subsequent discussions with the JTF, VCU Board, VCUHS Board, and representatives of the Commonwealth of Virginia. The recommendations include:

1. Explore the feasibility of transitioning to an organizational structure in which VCUHS is a subsidiary of VCU.
2. Enhance the VCUHS Board composition to gain the expertise necessary to govern an academic health system with VCUHS's scale ($3+billion of revenue) and complexity.
3. Develop a Joint VCU and VCUHS Board Coordinating Committee to ensure alignment and communications on strategic direction and key decisions.
4. Make refinements to the leadership model (including the VCUHS Board Chair position and the addition of a senior operating executive in the health system) and preserve the model whereby the VCUHS CEO and VCU SVP for Health Sciences continue to be held by a single individual.

Following the necessary approvals, these recommendations would be implemented through a phased approach. Additional detail on each of these recommendations is provided below.

Recommendation #1: Explore the feasibility of transitioning to an organizational structure in which VCUHS is a subsidiary of VCU.

The organizational model that best positions VCU and VCUHS for long term success across the academic and clinical missions is structuring VCUHS as a non-profit corporation which is a subsidiary of VCU, with VCU as sole corporate member. This model will more effectively enable the organizations to achieve future requirements for success, including:

- Enhancing the reputation of the overall University by developing leading interdisciplinary discovery and innovation programs (e.g., biomedical engineering) and providing an attractive clinical experience to learners
- Building differentiated service lines that link discovery, innovation, care delivery, and exceptional patient experience and attract patients from Virginia and beyond
- Recognizing the differences between healthcare delivery and the academic enterprise by providing the Health System with the appropriate level of autonomy to manage their complex healthcare ecosystem
- Creating a mechanism for current and future community hospital affiliates to participate in Health System governance
- Continuing to grow the clinical enterprise through targeted expansion into the suburbs, while maintaining a firm commitment to current patients
- Creating a manageably sized board structure with the expertise needed to make decisions efficiently and effectively to compete in a dynamic healthcare environment
- Attracting and retaining leading healthcare professionals through competitive total rewards and an attractive professional environment
- Continuously improving clinical and operational efficiency to demonstrate the region's most effective care and earn margins required for reinvestment in the clinical and academic enterprises

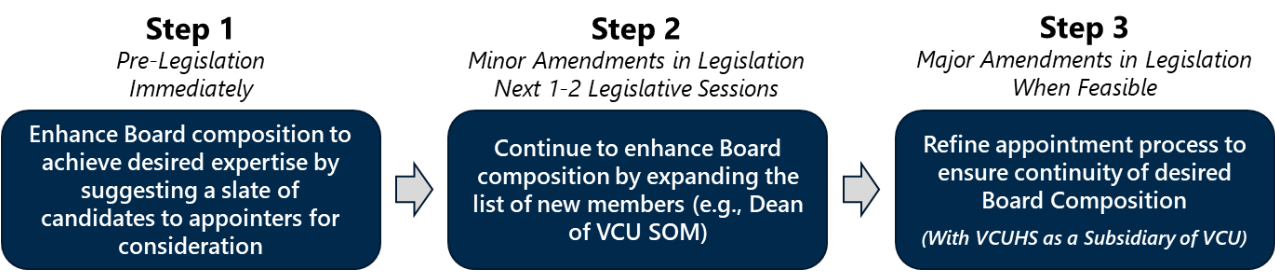
In certain areas, such as continued growth of the clinical enterprise, both the affiliate and subsidiary models can be effective. However, in other areas such as enhancing the reputation of the overall university, providing an attractive clinical experience to learners, and building differentiated service lines, the subsidiary model offers a clear advantage. See the Appendix A for a comparison of the effectiveness of each organizational model at achieving the requirements for future success.

The recommended model is likely to require several years to implement given both the magnitude of the change, the need for legislative action, and the potential need to refinance VCUHS' existing debt at a time of high interest rates. In the interim period leading up to legislative amendments which would enable the new organizational structure, VCUHS has ample opportunity to refine the existing affiliate structure (as described in subsequent recommendations). That said, the timeline for transitioning to a new structure could be expedited if certain triggers are met, such as

challenges implementing and/or sustaining recommended Board changes, continued lack of coordination between VCU and VCUHS, or improvement/stability in VCUHS financials and reductions in interest rates that lessen the risk of a negative financial impact on VCU. It is also expected that it will take time to build political support for a transition to a new model.

Recommendation #2: Enhance the VCUHS Board composition to gain the expertise necessary to govern a $3+ billion academic health system.

VCUHS's Board composition should gradually be enhanced through a phased process, as legislation is amended. This provides time to build support for the evolving model, allow existing Board members to complete their terms, ensure the appropriate transition timing, and further develop the relationship between VCU and VCUHS before shifting to a new organizational structure. The phased approach is illustrated below:



Step 1

Prior to amending VCUHS' enabling legislation, VCUHS and those who appoint members to the VCUHS Board can enhance the Board's expertise by recommending a highly qualified slate of candidates to appointers for consideration.

Additionally, in the immediate term, Board education can be improved through enhancement of the VCUHS Board orientation process and initiation of annual peer-to-peer assessments of Board member performance to ensure Board members are fully informed about the organization and their responsibilities.

Step 2

Over the next two legislative sessions, the passage of minor legislation will codify the skills required for an effective Board, the process for identifying potential board members with these skills, and a reduced Board size.

The term for each Board member should be increased to four years, allowing for an increased level of institutional knowledge for Board members. At the same time, the total number of Board seats should be reduced to approximately 17, allowing for more robust and focused deliberations

and enhanced decision making. This should also boost each Board member's engagement in key discussions. Simultaneously, there should be increased specificity regarding Board qualifications, while maintaining a high level of appointment authority for the Governor of the Commonwealth (from 6 to 5), Speaker of the House of Delegates of the Commonwealth (from 5 to 4), Senate Committee on Rules of the Commonwealth (3 to 2), and Rector (5 to 3) for at-large members. Such adjustments are intended to also incorporate certain ex-officio members, including[3]:

- Dean, VCU SOM
- Dean of one other health profession school (on a rotating basis)
- Clinical Chairs and/or MCVP President (2) (Required to be active clinicians)
- Community Hospital Board Chairs (1, Rotating)

The VCU President would continue to serve as an ex officio voting member of the VCUHS Board but would no longer be mandated to serve as Chair. Instead, the Board would have the ability to select a Chair (and the VCU President would be eligible for consideration).

Step 3

Lastly, at the appropriate point, major legislation should be introduced allowing a transition to the subsidiary model, including refining the appointment process to ensure continuity of the desired VCUHS Board Composition.

The Board size should be further reduced to approximately 15 members. Oversight and approval authorities from the VCU Board on major decisions of VCUHS enables the VCUHS Board to be leaner than under the existing affiliate model. With the passage of legislation enabling this change in organizational structure, approval authority for Board members would shift to the VCUHS Board and VCU Board of Visitors as appropriate, based on recommendations from the Governance Committee.

Over the course of these three steps, Board composition will evolve to a point in which members have the expertise needed to govern the $3 billion academic health system. Specific areas in which board members should have expertise include academic medicine (required), finance and accounting (required), and human resources, information technology, health plans, and transactions (including real estate).

The resulting target composition of the VCUHS Board is as follows:

[3] A Freedom of Information Act (FOIA) exemption would be requested for regular business meetings of these individuals.

- *University Representation:* VCU President, VCU SVP for Health Sciences[4], Dean of VCU SOM[5], Dean of one other health profession school on a rotating basis, and Rector with two additional appointees
- *VCUHS Representation:* VCUHS CEO[4], VCUHS EVP for Health Affairs[5], community hospital Board Chair on a rotating basis, and 2 clinical chairs and/or MCVP President
- *Other Members:* 5 nationally recognized leaders or local community leaders with expertise in targeted areas of importance to VCUHS

All individuals listed above would serve as voting members of the Board. Additional leaders (e.g., VCU and VCUHS Chief Financial Officers) may be invited to Board meetings as non-voting participants.

Additionally, the Conflict of Interest policy for the VCUHS Board will be revaluated to ensure clear parameters for disclosure of conflicts and limitations on membership. When evaluating potential VCUHS Board candidates, consideration will also be given to potential conflicts related to personal loyalties that may not be classified as conflicts of interest. Appointed Board members will receive education on their fiduciary responsibilities to VCUHS during onboarding and on a periodic basis throughout their term.

Recommendation #3: Develop a Joint VCU and VCUHS Board Coordinating Committee to ensure alignment and communications on strategic direction and key decisions.

A Joint Board Coordinating Committee should be formed in the very near term (prior to transitioning to a subsidiary organizational model) to better align strategic direction, communications, and operations of VCU and VCUHS. This Committee would serve in an advisory capacity to the VCU and VCUHS Boards and each of these Boards would maintain their respective fiduciary responsibilities. The Committee should remain lean with approximately eight members, including the VCU Rector, two additional VCU Board Members, the VCUHS Board Chair, two additional VCUHS Board Members, the VCU President, and the VCUHS CEO / VCU SVP. The VCU President could chair this Committee or it could be co-chaired by the VCU Rector and the VCUHS Board Chair.

The scope of this Committee would be:

- Review strategic plans of each organization to ensure both plans leverage capabilities across the enterprise, are mutually supportive, and do not cause material conflicts.
- Review capital and operating budgets for VCUHS and the VCU Health Sciences Schools and recommend adoption to the VCU and VCUHS Boards.

[4] VCU SVP for Health Sciences and VCUHS CEO are dual roles.
[5] Dean of VCU SOM and VCUHS EVP for Health Affairs are dual roles.

- Review major strategic initiatives and recommend adoption by the VCU and VCUHS Boards, as appropriate.
- Identify opportunities to engage the community in VCU and VCUHS and to better serve the region.
- Identify potential nominees for open VCUHS Board seats (and potentially VCU Board seats) and make recommendations to the VCUHS Governance Committee.

Two initial areas of focus for this Committee should be identifying opportunities for greater strategic and economic alignment between VCU and VCUHS. The organizations have made some progress on a unified strategic vision, but lack a joint strategic plan which defines how the enterprise will differentiate itself by leveraging capabilities across the tripartite mission to build leading interdisciplinary programs and deliver superior value to patients and trainees. Additionally, the existing funds flow model between VCU and VCUHS is complex and based on historical arrangements which could be redesigned to enhance economic alignment between the University, School of Medicine (SOM), health system, faculty group practice, and the SOM departments. The future model should motivate and reward attainment of shared strategic objectives, superior performance in all mission areas, increased transparency, and reduced administrative complexity.

Recommendation #4: Make refinements to the leadership model (including the VCUHS Board Chair position and the addition of a senior operating executive in the health system) and preserve the model whereby the VCUHS CEO and VCU SVP for Health Sciences roles continue to be held by a single individual.

The existing leadership model has the same individual serving as both the VCUHS CEO and the VCU SVP of Health Sciences. At this juncture, this single leader model is appropriate and supports more effective coordination between the University and Health System on strategic direction and allocation of resources across all missions.

In order for this single leader model to be effective over the longer term and to enable this leader to focus on strategic issues - including driving an integrated vision - rather than on operational issues, an important change to the management structure is strongly recommended. Such a change would not require a legislative amendment. Specifically, the appointment of a senior executive in the Health System to oversee clinical operations under the supervision of the VCUHS CEO and Board would significantly enhance the ability of the CEO to focus primarily on strategic direction and implementation, advancement of the clinical and academic enterprises, and alignment with the other components of VCU. The addition of this executive position would also reduce the number of direct reports to the CEO/SVP. The title for such a role varies across health systems, with the titles of Chief Operating Officer (COO), System COO, or President being commonly used. Roles and functions that could report to the System COO or President include

hospital presidents, director of the Massey Cancer Center, nursing, quality and safety, and health impact. Ambulatory services may also align with the System COO position, although several other options also exist. See Appendix B for a simplified and illustrative future-state management structure. The currently defined VCUHS Chief Operating Officer role does not include this scope and is much more narrowly defined, more akin to a Chief Administrative Officer.

Case for Change and Factors for Success

There is a compelling case for VCUHS to transition to an organizational structure in which VCUHS is a subsidiary of VCU, and to quickly enhance the composition of the VCUHS Board to ensure the appropriate level of expertise for governing a large academic health system. Recent events, such as the Clay Street real estate transaction, have clearly demonstrated a foundational lack of alignment between VCU and VCUHS and has illuminated existing gaps in the Board's composition with regard to several key areas of expertise. To effectively govern a large academic health system with $3+ billion of revenue today (which could easily reach $3.5-4.0 billion in the next several years), and to position VCUHS for continued advancement aimed at optimally serving the Commonwealth and becoming more competitive nationally, these substantial changes are recommended, rather than a set of more minor adjustments, in order to meaningfully address some of the observed issues. Further, without legislative change, the organizations would be at risk of reverting to prior practices with each new State Government administration.

Successful approval and implementation of the recommendations will be contingent upon buy-in from the legislature; a shift in culture and communications across VCU and VCUHS at all levels to promote collaboration; timing to preserve the momentum of this initiative and mitigate any transitional barriers (e.g., potential refinancing of debt); and effective change management.

APPENDIX A

Perceived Effectiveness of Each Organizational Model at Achieving Each Requirement for Future Success

Requirement for Future State Success	Affiliate Model	Corporate Subsidiary Model	Operating Division Model
1. Enhance the reputation of the overall University by developing leading interdisciplinary discovery and innovation programs (e.g., biomedical engineering) and provide an attractive clinical experience to learners	◕	●	●
2. Build differentiated service lines that link discovery, innovation, care delivery, and exceptional patient experience and attract patients from Virginia and beyond	◕	●	●
3. Recognize the differences between healthcare delivery and the academic enterprise by providing the Health System with the appropriate level of autonomy to manage their complex ecosystem	●	●	◑
4. Create a mechanism for current and future community hospital affiliates to participate in Health System governance	◑	●	◔
5. Continued growth of the clinical enterprise through targeted expansion into the suburbs while maintaining a firm commitment to current patients	●	●	◑
6. Creates a manageably sized board structure with the expertise needed to make decisions efficiently and effectively to compete in a dynamic healthcare environment	◑	●	◕
7. Attract and retain leading healthcare professionals through competitive total rewards and an attractive professional environment	●	●	◑
8. Continuously improve clinical and operational efficiency to demonstrate the region's most effective care and earn margins required for reinvestment in the clinical and academic enterprises	●	●	◑

APPENDIX B

Simplified Management Structure
(Intended to illustrate reporting relationships to CEO/SVP and new Senior Executive Position)