



## ITEM 13

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**For Agenda of:  
March 15, 2017**

March 10, 2017

**TO:** President and Members  
Board of Retirement

**FROM:** Richard Stensrud  
Chief Executive Officer

**SUBJECT:** Proposed Elements for a SCERS Compensation Policy

### **Recommendation:**

**That the SCERS Board consider and provide guidance regarding elements to be incorporated into a SCERS Compensation Policy.**

### **Introduction:**

A properly designed compensation plan is one of the most important elements in addressing the personnel needs of an organization. Together, a sound compensation plan and an effective job classification system, combined with the requisite authority to establish the necessary and appropriate staff size, structure and compensation, provide the cornerstone for an organization's ability to successfully carry out its mission.

Currently, SCERS' staff falls into two categories with respect to how compensation is addressed. The bulk of the staff positions are within the County Civil Service structure, and the compensation for those positions is determined either through collective bargaining, a County directed equity adjustment or a County-conducted salary study. The compensation is then implemented through a salary resolution adopted by the Board of Supervisors. SCERS' executive positions are outside the Civil Service structure and the compensation (as well as the position and job duties) is established by the SCERS Board. However, the compensation for the executive positions also must be implemented through a salary resolution adopted by the Board of Supervisors, which has not always been

forthcoming, with the result that the compensation for SCERS' executive positions has fallen materially below the marketplace.

The purpose of this memorandum is not to address this operating authority disconnect per se, but instead, to present elements which your Board should consider incorporating into a Compensation Policy which can then be used to determine, explain and support the compensation decisions your Board makes. A Compensation Policy will also help provide consistency with respect to how compensation decisions are made, and help assure that compensation is addressed on a regular basis, and not allowed to languish to where 'marking to market' is a difficult and problematic exercise.

In the past, your Board has utilized many of the measures suggested in the discussion that follows, but the compensation analysis has been addressed on an ad hoc basis. It is recommended that the compensation analysis goals, methodology and parameters be integrated into a formal Compensation Policy, which will serve as the basis for compensation analysis going forward.

### **Discussion:**

With respect to broad, overall goals, SCERS' Compensation Policy should:

- Ensure that SCERS has the ability to attract and retain well-qualified employees;
- Provide a defensible and rational basis for compensating employees;
- Allow flexibility for making organization-wide compensation decisions based on changing market conditions;
- Recognize SCERS' responsibility as a public entity in establishing a pay plan that is consistent with public practices; and
- Ensure that SCERS' compensation practices are competitive and consistent with those of comparable employers.

To help achieve these goals a central component of SCERS' Compensation Policy should be the use of properly constructed compensation studies conducted by qualified compensation professionals. Compensation studies are an effective tool for compensation professionals to utilize in assessing an employer's competitiveness with market practices, and are used with both public and private sector employers. Study data is necessary because labor markets are constantly changing in response to the availability of skill sets and fluctuations in economic conditions. These changes can vary among regions and across industries and employer types. Thus, an effective study will provide data that closely reflects the market conditions in which SCERS is competing.

Compensation study data is important for the following reasons:

- Detailed data will allow SCERS to anticipate changing market conditions and understand what peer employers are doing with respect to compensation and benefits.
- Market data will allow SCERS to be deliberate in making compensation-related decisions by reducing guesses or reliance on indexes that may not reflect compensation practices.
- Compensation data can provide defensibility and transparency for employees and other stakeholders.

A properly constructed compensation study will seek to achieve the following objectives:

- Collect and analyze salary and benefits data from employers similar to SCERS.
- Document comparisons with the SCERS compensation plan and identify any issues with the data, comparable jobs, or comparable employers.
- Conduct an internal relationship analysis and develop internal relationship guidelines.
- Present specific salary recommendations based on the results of the market survey and internal relationship analysis.

The primary objective of the compensation study and subsequent analysis is to provide a 'picture' of wage practices in the labor market for comparable jobs. Additionally, the compensation study documents show how SCERS' job classifications compare to similar employers in terms of compensation. The results of the compensation study, therefore, provide a basis for compensating employees in a consistent, equitable, defensible, and competitive manner.

SCERS' Compensation Policy, and compensation studies conducted pursuant to it, should include the following elements:

- Labor Market Definition – The employers or data sources that are used to measure the labor market for purposes of salary setting.
- Labor Market Position – The relative position the organization maintains in the market to ensure its recruitment and retention needs are met within available financial resources.

- **Mix of Salary and Benefits** – How much emphasis or priority the employer places on salary versus benefits and the manner in which total compensation is used to determine salary placements.
- **Internal Equity Mechanisms** – The methods used to maintain internal equity across jobs and minimize salary compaction.

Labor Market Definition:

One of the most important components of SCERS' Compensation Policy will be the definition of the labor market within which SCERS competes. There are typically five important criteria utilized in identifying those employers that comprise an employer's labor market:

- **Historical Practices** — Over time, an employer will develop some level of continuity regarding labor market comparable employers for the purpose of conducting compensation studies. SCERS has a long history of surveying a specific set of employers and these historic practices are an important consideration if for no other reason than deviating from the long term historical practice typically requires a strong, defensible rationale.
- **Nature of Services Provided** — In order to ensure comparable jobs are found when conducting a compensation study, it is important to utilize employers that provide similar services to SCERS. Employers who provide similar services are most likely to compete with one another for employees and will have similar organizational and operational characteristics. For that reason, SCERS has utilized, and the Compensation Policy should continue to utilize, public retirement systems as the primary source of employers used to measure the labor market. That being said, SCERS' Compensation Policy may want to consider comparisons to employers conducting a similar line of business in other segments of the marketplace, such as corporate pension plans, or endowments and foundations. While such employers, and their specific sub-market, may not be as comparable as other public retirement systems, they do compete for employees with the same skills as those at SCERS, and at a minimum, can provide context and another point of reference for assessing the compensation paid to SCERS' employees.
- **Geographic Proximity** – Geographic proximity of potential employers is one of the most important factors utilized in identifying an organization's labor market. This factor is particularly useful because it identifies those employers that directly compete with SCERS to recruit and retain personnel. If a sufficient number of comparable agencies exist within close proximity to SCERS, the defined geographic area may be the local region. If comparably sized or similar services do not exist within close proximity, a wider geographic region may be necessary. It has been SCERS' practice to utilize a statewide market to identify public retirement systems that have similar functions, services and jobs and it is recommended that SCERS'

Compensation Policy continue to utilize a statewide market as the primary source of comparable employers. However, as with the discussion above, SCERS' Compensation Policy may want to consider comparisons to employers in other parts of the country as there is a national market for highly skilled pension professionals.

- **Employer Size** — The more similar employers are in size and complexity, the greater the likelihood that comparable positions exist within both organizations. This factor is less important for jobs where employer size makes little difference in the nature of duties and more important where employee levels or other resources are a defining characteristic of the job. For those jobs where size differences appear to influence wages, these differences can be factored into the data analysis. Recognizing these considerations, SCERS' practice has been, and under the Compensation Policy should continue to be, to include a balance of larger and smaller employers and make appropriate adjustments when size impacts job comparability.
- **Economic Similarity** — While there are a number of economic factors that can be compared among employers, the most important factor related to compensation is cost of living. In some regions, living costs can vary significantly and have an important impact on how potential candidates evaluate compensation. This factor can be important if labor market employers are used beyond the local market, or if there are significant differences in the cost of living. Given that SCERS has been utilizing a statewide labor market, adjustments to reflect economic differences have been made in past compensation studies and it is recommended that this continue to be done under SCERS' Compensation Policy.

Based on these considerations, the following employers have been included in past compensation studies and it is recommended that they continue to be included in future compensation studies under SCERS' Compensation Policy.

Alameda County ERA	Orange County ERS
City & County of San Francisco ERS	CalPERS
City of Los Angeles ERS	San Bernardino County ERA
City of San Diego ERS	San Diego County ERA
Contra Costa County ERA	San Joaquin County ERA
Fresno County ERA	San Mateo County ERA
Kern County ERA	Sonoma County ERA
Los Angeles County ERA	CalSTRS
Los Angeles Fire & Police Pension System	Tulare County ERA
Los Angeles Water & Power ERP	Ventura County ERA
Marin County ERA	

These agencies represent retirement systems throughout California that meet the market selection criteria including a mix of larger, smaller, and similar sized retirement systems. Given the fact that SCERS is in Sacramento, it is important to consider all local retirement organizations, including CalPERS and CalSTRS, which while larger, have a significant impact on local market conditions. As previously noted, analysis of the data can be done in a way to ensure that skewing impacts of an unrepresentative sample of agencies do not occur, and to account for the impact of significant size differences.

#### Labor Market Position:

If the list of labor market employers is comparable overall, most public employers will adopt a market position at the middle of the market. Statistically, the middle of the market is the 50<sup>th</sup> percentile (median) with half the agencies above this point and half below. This has been SCERS' practice in past compensation studies and it is recommended that it continue to be the practice under SCERS' Compensation Policy. However, if SCERS experiences significant recruitment and retention challenges, SCERS' Compensation Policy should allow for flexibility to establish salary ranges above market median for select positions.

For purposes of maintaining competitive salary ranges, it is recommended that SCERS' Compensation Policy include the following components:

- Compensation study data should be collected every three years. While study data provides a precise measure of market trends for specific jobs and skill sets, significant market changes do not typically occur between jobs from year to year.
- For non-compensation study years, SCERS should use a cost-of-living index to maintain overall equity with annual changes in the market.
- SCERS should consider adopting a +/- threshold whereby no salary adjustments are made if market deviations are less than three percent (3%). Thresholds above this amount may introduce salary inequities and are not recommended.
- The objective of the market study is to anticipate and understand market trends with salary adjustments being a deliberate change to maintain market position. If a job is significantly above the market, pay range adjustments should be frozen until the job drifts back to the desired labor market position (market median).
- While SCERS' Compensation Policy will initially focus on those positions where the SCERS Board establishes compensation, with the benefit of greater operating authority, study data should be collected for a large sample of SCERS jobs that

represent all major job 'families' as well as vertical levels from department heads down to line employees.

#### Mix of Salary and Benefits:

SCERS' compensation includes both base salary and employer paid benefits. In order to understand how SCERS' benefits compare to the market, past compensation studies have included and SCERS' Compensation Policy should continue to include, an assessment of benefits. The results of a market benefit study can either be used to adjust salaries using a total compensation model or the data can be used to adjust specific benefits. The major benefit categories to study include the following:

- **Cash Equivalent Benefits** – These are benefits that are usually treated as cash and have a direct impact on how competitive the organization is relative to other employers. Examples of cash benefits include longevity pay, deferred compensation, and retirement pick-up. While retirement pick-up is becoming less common, it is an important benefit to include in surveys.
- **Insurance Benefits** – These benefits can be surveyed to determine trends for insurance costs, but this data should not be used for setting salary ranges since the fixed dollar amounts will have different impacts on jobs depending on whether they are high or low wage jobs.
- **Leave Benefits** – Accrual and cash-out benefits do not change frequently so they may only need to be surveyed when a specific issue or concern is identified. They are not used to compute total compensation.
- **Retirement Benefits** – Employer paid retirement costs are not typically included in total compensation surveys since rates typically don't reflect benefit levels. Rates can be influenced by workforce/retiree demographics, investment performance, benefit tiers, rate buy downs, and other factors. Social Security costs can be included, but it needs to be recognized that this benefit has a cost to the employer and the employee.
- **Other Benefits** – There are other benefits such as car/technology allowances, shift pay, furloughs, assignment pays, etc. which the organization may want to analyze on an ad-hoc basis.

#### Internal Equity:

While the market data for benchmark positions will be the primary determinant in establishing a compensation level, compensation is often adjusted based on internal considerations, such as overall pay equity and internal salary ties. In the past, based on

these considerations, and in light of SCERS' staff structure and respective responsibilities, SCERS has utilized the following internal adjustments:

- The compensation of the Chief Benefits Officer (CBO) and Chief Operations Officer (COO) is set at the same level.
- The compensation of the General Counsel is set 15% above the CBO/COO.
- The compensation of the Deputy Chief Investment Officer is set 20% below the compensation of the Chief Investment Officer (CIO).
- The compensation of the Chief Executive Officer is set 15% above the CIO.

It is recommended that SCERS' Compensation Policy retain these internal equity adjustments.

I hope this information is helpful. With the benefit of guidance from your Board, the plan is to return next month and present a formal Compensation Policy for your consideration.

I will be happy to answer any questions you might have.

Respectfully,

Richard Stensrud  
Chief Executive Officer