Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 13

MEETING DATE: **August 16, 2017**

SUBJECT: **Proposed SCERS Compensation Policy**

SUBMITTED FOR: ___ **Consent** _X_ **Deliberation and Action** ___ **Receive and File**

RECOMMENDATION

Staff recommends that the Board establish an ad hoc committee to develop a SCERS Compensation Policy that establishes guidelines for regular, periodic compensation studies and development of a SCERS compensation plan.

SCERS' CEO and other senior staff as appropriate will support the ad hoc Committee's efforts. SCERS compensation consultant will also be available to provide input and assistance as desired by the Committee. The Compensation Policy developed by the Committee will be submitted to the full Board for consideration and action at a future meeting.

PURPOSE

A well-defined Compensation Policy will provide a consistent framework for SCERS to conduct market comparisons and make compensation decisions, and help assure that compensation is addressed on a regular basis. The policy would, at least initially, only apply to the exempt positions for which the Retirement Board establishes the job duties and compensation, which is then implemented through a salary resolution adopted by the County Board of Supervisors.

DISCUSSION

With the exception of the recent salary adjustment for the SCERS CEO position in connection with the executive recruitment, the compensation for SCERS exempt positions has not been marked to market in more than ten years. Based on a compensation study conducted in 2016 by Doug Anderson, Vice President at Ralph Andersen & Associates, for SCERS exempt positions, current compensation levels are ~20% to 40% below market.

Recent Exempt Staff Turnover

In the past two years, SCERS has lost its two most senior executives due to compensation levels well below market: The former Chief Investment Officer who was nationally recognized for innovation in institutional investing while at SCERS, and the former Chief Executive Officer who led SCERS for 13 years.

SCERS is a well-run, well-funded retirement system, and has experienced significant growth and change in terms of plan assets and the sophistication of its investment program, as well as the increased complexity of benefit administration and financial operations. This, along with SCERS' multi-year IT modernization program, makes it essential that SCERS have the tools to attract and retain highly-qualified and experienced investment and pension professionals capable of meeting the challenges of investing in a global economy, modernizing retirement services as SCERS enters the 21st century, and continuing growth to beyond $10 billion in assets. A well-designed compensation policy is one of the most important elements in recruiting and retaining top talent for SCERS.

Proposed SCERS Compensation Policy Draft

The attached proposed SCERS Compensation Policy draft establishes a starting point for the ad hoc Committee's work. It contains essentially the same content as outlined for the Board in March when the former CEO presented a memorandum discussing proposed elements for a SCERS Compensation Policy.

The Board has previously used many of the measures suggested in the proposed policy, 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 future compensation analyses and compensation plans.

With the recent salary adjustment applied to the SCERS CEO position for 2017-2018, staff recommends the Committee give specific attention and consideration to 1) defining the labor market to be used for SCERS compensation studies; 2) establishing internal salary relationships to be incorporated into the policy; and 3) proposed forecasted changes to exempt and investment office staff positions.

Following the Board's review and approval of a SCERS Compensation Policy as recommended by the ad hoc Committee, likely next steps would include:

- Request SCERS' compensation consultant apply the SCERS Compensation Policy to the SCERS 2016 Compensation Study and present the findings and recommendations.

- Develop and implement a compensation plan for SCERS exempt positions based on the compensation study analysis and recommendations.

BACKGROUND

SCERS has conducted compensation studies and adjusted salaries for SCERS exempt positions in the past as follows:

- 2001 study; salary adjustments approved by Retirement Board in 2001, implemented in February 2002.

- 2004 study; salary adjustments approved by Retirement Board in November 2004; phased implementation in January 2005 and January 2006.

- 2011 study; salary adjustments approved by Retirement Board in January 2012; not implemented (denied by Board of Supervisors).

The former CEO initiated a compensation study for SCERS exempt positions in 2016. The results were provided to the CEO in February 2017, but no recommended salary adjustments were submitted to the Board for approval prior to the CEO's departure from SCERS. However, the results from the 2016 study were used to prepare the CEO Compensation Analysis used by the Board in adjusting the salary for the CEO position to facilitate the executive recruitment.

Recent CEO Salary Adjustment

In March 2017, former CEO Richard Stensrud submitted a memorandum on "Proposed Elements for a SCERS Compensation Policy" to the Board for consideration. No Board action was requested at that time.

In April 2017, Doug Johnson, Vice President of Ralph Andersen & Associates, presented the results of the compensation analysis for SCERS CEO position. This was provided to assist the Board in comparing the SCERS CEO compensation to the market, and served as the basis for the Board to adjust the CEO compensation as necessary prior to initiating the Board's search for a successor CEO. (Mr. Stensrud had given notice in February that he had accepted other employment and would leave SCERS' employ in May.)

The compensation analysis showed, and the executive search consultant retained by the Board confirmed, that the salary range for the CEO position was considerably below market for comparable employers, which would be a significant and limiting factor in recruiting highly-qualified candidates for the SCERS CEO position.

The Board determined that modifying the salary range for the CEO position is paramount to conducting a successful recruitment. The Board considered (1) the median market salary for the CEO position; (2) the appropriate salary range for the position; (3) the possible need to set the maximum of the salary range above the market median in order to be competitive for the desired knowledge, skills and experience; (4) the impact of compensation elements beyond salary on the competitiveness of the total compensation package; and (5) the substantial adjustment in compensation that would be required in order to bring SCERS into a competitive position given that it had been more than ten years since the CEO compensation was marked to market.

The Board set the annual compensation range to be used in the recruitment for the CEO position at $181,211 to $253,695 for fiscal year 2017-2018, using the 7-agency size optimized market defined in the Ralph Andersen & Associates compensation analysis. This salary range provides much needed flexibility in setting the initial salary for a successor CEO commensurate with the selected candidate's skills and experience.

In May, SCERS staff submitted the Salary Resolution Amendment (SRA) for adoption by the Board of Supervisors at its meeting on June 6th. For this SRA, County administrative staff added its alternative recommendation that the item be sent back to the SCERS Board for further consideration. County officials were concerned that the SRA for SCERS CEO setting a maximum salary above market median would set an undesirable precedent that deviates from County-wide policy, and objected to the Board's consideration of compensation elements other than salary in setting the salary range for the position.

Because time was of the essence for the SCERS Board to commence its CEO recruitment, SCERS requested the Supervisors act sooner than later on the SRA. The salary range set by the Retirement Board was approved, with the addition of setting $230,400 (compensation analysis market median) as the "control point" within the CEO salary range. This means that any recommendation from SCERS to set the CEO salary at an amount above the control point, but within the approved salary range, must be approved by the County (in this instance delegated by the Board of Supervisors to the County Executive Officer).

Subsequently, County officials advised SCERS staff they are available to consult with and assist SCERS in its considerations and actions on compensation, and provided a copy of the County's Pay Plan for Unrepresented Classes, adopted January 5, 2001.

ATTACHMENTS

Proposed SCERS Compensation Policy – Draft dated August 16, 2017

Prepared by:

/S/

Annette St. Urbain
Interim Chief Executive Officer

Proposed SCERS Compensation Policy
for
Retirement Board Discussion

(DRAFT - August 16, 2017)

Introduction

A properly designed compensation policy is one of the most important elements in addressing the personnel needs of an organization. Together, a sound compensation policy 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:

> County Civil Service - The majority of SCERS' 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.
>
> Exempt - SCERS' executive positions are outside the Civil Service structure. The position, job duties and compensation are established by the SCERS Board. However, the compensation for the exempt executive positions is implemented through a salary resolution adopted by the Board of Supervisors.

A compensation policy provides consistency with respect to how compensation decisions are made, and helps assure that compensation is addressed on a regular basis, and not allowed to languish such that 'marking to market' is a difficult and problematic exercise.

Policy Objectives

SCERS' Compensation Policy is designed to achieve the following overall objectives:

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

Compensation Studies

A central component of SCERS' Compensation Policy is the use of properly constructed compensation studies conducted by qualified compensation professionals. Compensation studies are an effective tool 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 compensation study will provide:

- Market data that allows SCERS to be deliberate in making compensation-related decisions by reducing guesses or reliance on indexes that may not reflect compensation practices.
- Detailed data that allows SCERS to anticipate changing market conditions and understand what peer employers are doing with respect to compensation and benefits.
- Transparency for employees and other stakeholders of the compensation data used in developing SCERS' compensation plan.

Study Objectives

A properly constructed compensation study will 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 for a competitive compensation plan based on the results of the market survey and internal relationship analysis.

The compensation study and subsequent analysis provides a 'picture' of wage practices in the labor market for comparable jobs, and documents 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.

Study 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 is the definition of the labor market within which SCERS must compete. There are typically five important criteria used 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 use 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 uses public retirement systems as the primary source of employers used to measure the labor market.

    SCERS may wish 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 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. SCERS' uses a statewide market to identify public retirement systems that have similar functions, services and jobs as the primary source of comparable employers.

- **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. SCERS' includes a balance of larger and smaller employers and makes 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 uses a statewide labor market, adjustments are made to reflect differences in cost of living.

The Labor Market Definition to be used by SCERS will be contained in Appendix A of the final proposed compensation policy.

<u>Labor Market Position</u>

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^{th} percentile (median) with half the agencies above this point and half below. While this remains the SCERS' typical practice under this policy, there may be circumstances where flexibility is warranted. For example, if SCERS experiences significant recruitment and retention challenges, SCERS may 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 uses a cost-of-living index to maintain overall equity with annual changes in the market.

- Market comparisons use 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.

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, compensation studies will 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 a compensation study might include are:

- **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 cafeteria plan allowances.

- **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

SCERS Compensation plan is developed with a primary emphasis on market data, and secondary emphasis on internal equity and job worth.

The internal salary relationships applied to SCERS compensation plan will be contained in Appendix B of the final proposed compensation policy.