FOR AGENDA

EBAP/06/2

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January 6, 2006

To: Members of the Executive Board

From: The Secretary

Subject: **Employment, Compensation, and Benefits Review—Overview Paper**

Attached for consideration by Executive Directors is a paper on the Employment, Compensation, and Benefits Review, which presents an overview of the rationale for proposed changes in the Fund's HR policies and practices and summarizes the main proposals. This paper is tentatively scheduled for discussion on **Wednesday, January 25, 2006.** A companion paper is being issued separately (EBAP/06/2, Sup. 1, 1/6/06).

Questions may be referred to Mr. Márquez-Ruarte (ext. 37180) and Mr. J. Kennedy (ext. 34665) in HRD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

Employment, Compensation, and Benefits Review—Overview Paper

Prepared by the Steering Committee

Approved by Jorge Márquez-Ruarte

January 6, 2006

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I. CONDUCT OF THE REVIEW

1. Responding to a mandate from the Executive Board, the Managing Director set in motion a comprehensive review of the employment framework, compensation, and benefits in the summer of 2004. A Steering Committee of senior staff was appointed by management to oversee the conduct of the review.[1] Following finalization of the terms of reference for the review, an external consulting firm (Watson Wyatt) was hired to conduct an independent examination of current plan designs and practices and make recommendations on how current policies could be strengthened.[2] Its report was provided to management on July 25, 2005 and was made available to the Executive Board and Fund staff shortly afterwards.

2. The recommendations set out in this paper and the companion paper reflect the deliberations of the Steering Committee, consultations with stakeholders (see Box 1), and guidance from Fund management. The Watson Wyatt report served as an important reference point for the issues under consideration, particularly in the initial stages of the review. While agreeing with the thrust of the Watson Wyatt report, the Steering Committee was not bound by either the scope or details of the Watson Wyatt report and did not endorse all of its findings and recommendations.

Box 1. Consultations

The Steering Committee consulted extensively with key stakeholders. Throughout the review, the Steering Committee met with representatives of the Staff Association Committee to exchange views or work through technical issues and possible solutions. Feedback from the staff at large was received through three channels: (i) comments on the Watson Wyatt report collected and presented by each Fund department; (ii) periodic public forums open to all staff; and (iii) a dedicated electronic mailbox. Meetings were held with representatives of staff groups with strong interests in specific issues: A1–A8 staff, U.S. nationals and permanent residents, and European staff. A series of informal briefings and seminars was conducted with Executive Directors to familiarize them with basic information and trends related to Fund employment, compensation, and benefits. Executive Directors also had an opportunity in two informal Board meetings to convey their views on possible changes in these areas on the basis of an outline of preliminary conclusions of the Steering Committee.

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[1] The Steering Committee comprised Benedicte Vibe Christensen, Deputy Director, African Department; Sean Hagan, General Counsel; Bert Keuppens, Senior Advisor, Finance Department; Jorge Márquez-Ruarte (Chair), Director, Human Resources Department; Barry Potter, Director, Office of Budget and Planning; and Raghuram Rajan, Director, Research Department. The Project Manager was Jack Kennedy, Advisor, Human Resources Department; and the Secretary was Christopher Clarke, Assistant to the Director.

[2] The terms of reference for the review, the Watson Wyatt report, and related material are available on the Fund's intranet in *HR Connect* under Your Workplace > Organizational Initiatives > Staff Compensation Review > Compensation Review Home.

3. The Steering Committee recommendations are set out in two papers. This paper presents an overview of the rationale for change in the Fund's HR policies and practices and of the factors that have influenced the proposed direction of change. The main changes being proposed are taken up in summary form in subsequent sections of this paper. The companion paper provides a fuller accounting of recommendations in core areas of the review: the employment framework, career and performance management, the compensation system, and expatriate benefits. Each paper is therefore an integral part of the whole.

II. Strategic Objectives and Human Resource Policies

4. The framework for human resource (HR) management in the Fund reflects efforts over many years to adopt best practices from other institutions, while ensuring that they are consistent with the mission of the institution and the objective of maintaining the quality and diversity of its staff. This framework has served the Fund well but in recent years has been showing signs of strain in the face of changes in the external environment, related changes in the work of the Fund, and demographic trends.

5. The Fund has taken on new tasks that require expertise in disciplines other than macroeconomics, the traditional foundation for much of the Fund's work. The need for this specialized expertise and the drive to improve the quality of the Fund's policy advice have led the institution to rely more heavily on mid-career staff, who bring with them valuable experience. The Fund is therefore competing in new markets for mid-career professionals for whom the traditional pattern of a Fund career spanning more than 20 years may not be relevant. At the same time, career patterns outside the Fund have shifted away from long-term commitments to single employers, in line with pay patterns that emphasize rewards for short-term performance, portability in pension schemes, and paylines that place more emphasis on consistency with market rates and less emphasis on internal equity.

6. The importance of financial markets for the work of the Fund poses challenges. The Fund has acquired considerable expertise in this area in recent years, but the recruitment and career prospects of professionals with the requisite experience and skills in financial sector work are constrained by policies and practices that were designed primarily to attract macroeconomists. Moreover, the recent report of an external expert group chaired by Mr. William McDonough stressed the importance of better integrating financial sector work in the Fund's core activities.[3] The implication of these developments is that the Fund will increasingly require staff with different skill sets and will need to adapt its HR policies and practices accordingly.

7. Internally, the Fund's compensation system has also shown signs of strain. In the markets in which the Fund actively competes for talent, market pay has grown faster at levels corresponding to the upper end of the Fund's salary structure than at the lower end. The

[3] *Report of the Review Group on the Organization of Financial Sector and Capital Markets Work at the Fund* was issued on November 1, 2005, and is available through the OMD pages on the Fund's internal website.

Fund's practice of adopting a uniform structural increase for all grade ranges has thus yielded over time pay further above market for the lower ranges and further below market for the higher ranges. This situation is exacerbated by job grading and promotion policies that have distorted the placement of jobs within the salary structure. As a result, some grades and occupational groups are significantly overpaid relative to the market, while some occupations that are in high demand are underpaid on this basis. Given the large and generally rising share of salaries in administrative expenditures, and the constraint of a zero real growth policy for the budget, these and related issues have become the source of considerable unease in the Executive Board. In approving the annual salary adjustment for May 2005, a number of Executive Directors signaled that they would not support any future salary adjustments on the basis of the current system.

8. The aging of the staff presents both an opportunity and a risk. Demographic data and separation trends suggest the need to replace a large number of experienced staff over the next 5–10 years. On the one hand, new hires bring with them updated skills and a fresh perspective. On the other hand, separating staff take with them institutional knowledge accumulated over many years. The demographics of the Fund therefore underscore the need to ensure that the Fund's compensation and benefits package remains competitive in the global market of today and tomorrow.

9. The current review is therefore a timely opportunity to ensure that the Fund's human resource (HR) policies are in line with the strategic priorities and evolving tasks of the institution. The medium-term strategy of the Fund puts globalization at the center of the institution's work in support of its members and the international financial community more broadly.[4] The medium-term strategy includes the following among the Fund's key tasks:

- make surveillance more effective in each of its different forms—bilateral, regional, global, and among financial markets;
- adapt to new challenges and needs in different member countries—advanced and systemic economies, emerging market economies, and low-income countries; and
- help build institutions and capacity in member countries.

10. The effective execution of this strategy rests on two pillars. First, given the many competing demands on the institution and the constrained budgetary environment, the Fund must be in a position to prioritize and reorganize its work within a medium-term budget. This work is at an advanced stage and is being considered separately by Executive Directors in the context of the work program for the Executive Board and development of a medium-term budgetary framework for the Fund. Second, these same demands and constraints underscore the importance of the enduring objectives of HR management in the Fund: (i) attracting and

[4] The *Managing Director's Report on the Fund's Medium-Term Strategy* was endorsed by the IMFC at its September 2005 meeting, and is available on the Fund's external website.

retaining staff of the highest quality with a diversity of nationalities and appropriate skills, experience, and career preferences; and (ii) managing staff efficiently and effectively, in an environment that rewards excellence, fosters teamwork, and promotes diversity, inclusion, and fairness.

11. To meet these objectives, the framework for managing the Fund's human resources must keep pace with developments inside and outside the institution, including improvements in HR practices in comparable institutions. In key respects, the consequences for the Fund of the evolving environment will be reflected in its medium-term strategy, which is intended to be a "living document," subject to revision over time as tasks take on greater or lesser importance. It follows that the effectiveness of the Fund as an institution could be enhanced by engendering more flexibility in its employment and compensation systems.

12. The recommendations of the Steering Committee are very much driven by these imperatives. Given the linkages among HR policies, its recommendations are intended to provide a comprehensive program for change with special emphasis on achieving:

- an employment framework that secures both continuity and flexibility in staffing, recognizing that the needs of the institution for specific skills and experience can change in unexpected ways;

- a compensation and benefits system that supports the recruitment and retention of an international staff of the highest quality with the requisite mix of experience and expertise required to carry out the mission of the Fund;

- a system of performance and career management that provides incentives for staff to focus on strategic goals and guides staff toward rewarding careers in the Fund; and

- a rules-based compensation system that would provide staff with a predictable salary outlook, while allowing for coherent choices on salaries and budgets within a medium-term framework.

III. EMPLOYMENT, PERFORMANCE, AND CAREERS IN THE FUND

13. The Fund has a broad mandate, with an enduring core that nonetheless changes and grows, at times abruptly. This dynamic mandate, in turn, translates into tasks requiring an evolving range of diverse skills and talents. Looking ahead, the Fund will need added flexibility in its employment framework in order to continue to deploy staff with a broad and changing set of skills (Section I of the companion paper deals with employment). Some further flexibility is needed in particular because:

- Owing to greater emphasis on setting of priorities, changes in the Fund's mandate are being met through redeployment of resources rather than through expansion, as was the case in the 1990s.

- Career patterns outside the Fund have shifted from long-term to shorter-term commitments, presenting both opportunities and challenges for Fund recruitment.

- The quality of the Fund's work would benefit if the institution were more successful in attracting academics, central bank and government officials, and other experts with an interest in a short-term engagement at the Fund.

- The renewal of skills that are needed but cannot be nurtured in the Fund can best be achieved by increasing the frequency of recruitment but shortening tenure.

- The Fund offers limited prospects for advancement for staff in many specialized skill areas, who are not well served by a uniform career path predicated on long tenure at the Fund.

14. Given this environment, the Steering Committee proposes a number of measures to strengthen the employment framework and to introduce greater flexibility (see Section I.D of the companion paper for details):

- Introduce strategic workforce planning across the Fund.

- Introduce renewable three-year terms for staff newly appointed at or promoted to Grade B4, a policy similar to that applied for B5 appointments.

- Extend the length of fixed-term appointments from two years to four years, through an initial two-year fixed-term appointment followed by a two-year extension, before staff may be selected for open-ended positions.

- Review, expand, and use more consistently the criteria for limited-term appointments.

- Build in more flexibility in recruitment practices (e.g., salary setting, recruitment premiums) for limited-term employment.

15. Once the Fund has staff in place with the requisite skills and talents, it is in the interest of the Fund that long-term staff careers be guided to ensure that such staff build up specific human capital and assume appropriate responsibilities at the right time (Section II of the companion paper discusses career and performance management). The Fund has not always been successful, however, in placing staff hired in mid-career in suitable positions and in actively integrating them into the Fund's work environment. In a similar vein, the Fund is recruiting increasing numbers of technical experts for whom the traditional career path leading to a managerial position may not be appropriate. Other concerns with career policies include the quickening pace of promotions in the past few years, and the relatively loose link between promotions and change in job content.

16. The performance of all staff must be monitored and focused on the Fund's priorities. Appropriate rewards must be given for exceptional performance and there must be negative

consequences for poor performance, including separation from the Fund when warranted. In this respect, the chief concerns with performance management in the Fund are the lack of differentiation between performance levels and in the associated merit pay, and the reluctance of supervisors to provide candid feedback to staff and to handle poor performance. These problems are not unrelated to the difficulty of voluntarily separating staff before they are eligible for a pension.

17. Some of these concerns are addressed directly in the recently announced reform of the Annual Performance Review (APR). The changes are consistent with recommendations made by Watson Wyatt. They aim to make the APR exercise more candid, effective, and credible, while also streamlining the process. Key changes include: move to a financial year to align more closely pay with performance; more candid feedback by rating competencies rather than using narrative; and indicating overall relative performance through benchmarking against Fundwide merit guidelines. Looking ahead, HRD is planning the introduction of electronic managerial tools that will permit more effective setting and monitoring of performance objectives. In order to increase the scope for pay differentiation, the Committee recommends developing merit guidelines around terciles rather than quartiles, with the middle range being the largest segment.

18. Pay linked to performance is a critical element of performance management. Staff currently receive annual pay increases that are merit based, with no presumption of receiving the full structural adjustment. Merit pay guidelines are based on performance ratings. To sharpen the incentives for excellent performance, Watson Wyatt proposed that the Fund introduce variable pay through a system of bonuses, beginning with the most senior staff. The Steering Committee concluded that it would not be feasible to introduce bonus pay at this time, because the Fund's tangible outputs are difficult to measure and its working culture and practices make it difficult to attribute outputs to individuals or small groups. In any event, the introduction of bonus pay should be considered only after the planned strengthening of performance management at senior levels has been implemented.

19. The Steering Committee also concluded that more could be done to widen pay differentials based on performance. In this context, further consideration will be given to two broad sets of questions: (a) how the amount of Fundwide resources available for performance-based merit increases and promotions should be determined; and (b) how those resources should be distributed to individual staff members.

20. As regards career progression and promotions, the Steering Committee did not endorse Watson Wyatt's recommendation to reduce the number of grades at this juncture.[5] As set out in Section II.F of the companion paper, the Committee recommends instead to:

[5] The consolidation of grade levels will need to be considered again in conjunction with the consideration of functional paylines, which often are established with broad grade ranges.

- Maintain the current number of grades to provide for career growth, but clearly distinguish requirements for each level.

- Revise promotion policies with a view to strengthen the link between grades and job content.

- Allow promotion to A15 and B levels of staff on the basis of their technical rather than managerial skills (i.e., via an expert track) provided there is a business case, under strict review and quantitative limits.

- Introduce career reviews for all staff at key milestones (Grades A7, A14, B2) in order to examine their long-term career prospects against the evolving needs of the institution.

21. Adoption of these recommendations will nevertheless need to be supplemented by measures to facilitate separations at mid-career, where few voluntary separations occur:

- Revise pension policies to remove disincentives for short-term employment, e.g., more portability, less penalties.

- Explore phased-in retirement options that would allow for the more orderly transfer of knowledge—for example, by facilitating the gradual transfer of duties and responsibilities prior to retirement in order to capitalize on scarce or higher value-added skills.

- Strengthen provisions for the abolition of positions and reductions in employment in the event that major shifts in skills are required.

- Expand and make more flexible the provisions of the Separation Benefits Fund (SBF) to make it more useful as a tool for facilitating separation of mid-career staff in cases of skills obsolescence or career plateauing.

IV. STAFF COMPENSATION SYSTEM

22. In recent years, the staff compensation system has come under considerable strain. Some aspects of the current system, such as the inherent limits on the extent to which salaries for different occupations and grades can be kept in line with market trends, can have a real impact on recruitment. Thus, for example, granting a uniform structural increase for all grade ranges, together with distortions in job grading and promotions, may have driven Fund salaries for some occupational groups concentrated at the lower end of the salary structure above their market equivalents, while depressing Fund salaries relative to market for others. This situation can add to the challenge of attracting mid-career experts interested in a short career in the Fund.

23. Other aspects of the system have become contentious internally. A widely shared view is that annual salary adjustment exercise has simply become too complex, involving the

collection, manipulation, and analysis of large amounts of data derived from numerous surveys of market compensation and national tax systems. To be sure, a degree of complexity is inherent in a rules-based compensation system for an international institution that aims to hire from a global market. At the same time, the Fund must strive for a simpler and more transparent compensation system.

24. These concerns also reflect a lack of confidence in the compensation system, as articulated in recent years in the context of the annual review of staff compensation by the Executive Board. Accordingly, there have been a number of calls from Executive Directors for a clear and simple mechanism to guide the Board in setting annual salary increases within the context of the medium-term budget.

25. The independent assessment of Watson Wyatt was that the compensation system has, on the whole, been able to deliver levels of pay that effectively support staff recruitment and retention and that are in line with those of other leading employers. Nevertheless, Watson Wyatt saw room for improvement in several areas, notably the inclusion of comparators that better represent the countries, markets, and sectors in which the Fund actively competes for talent and the correction of grading and promotion practices that have distorted intended market relationships and may have led to salary increases that are larger than necessary to maintain competitiveness. Watson Wyatt recommended for reasons of efficiency and cost that the Fund move to a system of biennial salary reviews based on comprehensive market surveys as at present, with salary adjustments in intervening years made on the basis of indices of general market movements.

26. The proposals of the Steering Committee aim at providing lasting solutions to the problems that have arisen in the compensation system. The rationale and definition for each proposal are discussed in detail in Section III of the companion paper. The remainder of this section reviews the major elements of the proposals.

27. The Steering Committee is proposing a four-year cycle for salary adjustments. Under this proposal, the Fund would re-examine its market relationship at regular four-yearly intervals and determine whether adjustments are needed, thus helping to ensure that strains that may emerge in the system are addressed in an orderly and timely manner. In summary, the system would operate as follows:

- *In year 1 of the cycle*, a comprehensive review would be undertaken. This review would involve level comparisons with the U.S. and international comparator markets; benchmarking against key reference markets for the Fund, such as academia, international financial centers, and selected international organizations; the established Quadrennial Benefits Survey; and comparative analysis of total compensation.

- *In years 2 and 4 of the cycle*, the salary structure would be adjusted in line with a market index of U.S. private sector salaries and U.S. civil service salaries. This would substantially reduce data collection and computation requirements.

- *In year 3 of the cycle*, a more narrowly defined review would be conducted on the basis of level comparisons with the U.S. and international comparator markets.

28. Regarding the exercise of discretion by the Executive Board, the Steering Committee proposes new rules regarding the circumstances under which a consideration of international competitiveness would take place and the scope for possible adjustments to the U.S. market-indicated increase. These proposals are described in Section III.D of the companion paper.

29. The Steering Committee is also proposing a set of measures to align Fund grades and salaries more closely to the market. The first step is to align the Fund payline more closely to the market by steepening the Fund payline between Grades A12 and B2, and bending the Fund payline downward from Grade A12 to Grade A9. Steepening the payline would make the Fund more competitive in markets in which the Fund has experienced some difficulties in recruitment, notably in the financial sector. The latter shift would align the salary structure more closely with the level of market salaries for specialized career stream occupations.

30. Once closer market alignment has been established, the reemergence of a wedge between Fund and market salaries at any grade should be avoided to the extent possible. To that end, the Steering Committee proposes that structural salary adjustments be made on a grade-by-grade basis for the A9–B2 payline, at least during years when salary reviews are undertaken. To avoid distortions in the salary structure (e.g., a salary range for Grade A9 that is higher than the salary range for Grade A10), which could result if market salary increases for adjacent grades differed significantly, a smoothing mechanism would be applied.

31. The second step requires a review of current job grading relativities within and across occupational groups. This review would help to ensure that Fund grades and positions are compared on a consistent, like-to-like basis with the intended equivalent grades and positions in comparator markets. Neither the Steering Committee nor Watson Wyatt are confident that this starting position is firmly established. The scope and timing of such a job grading exercise would depend on the position of the Executive Board on a more fundamental issue: whether the Fund should maintain a single payline or adopt a system of "functional" paylines. A functional payline system would involve: identifying separate market paylines for various occupations or groups of occupations to capture occupational differences in the market level of salaries; and establishing either separate salary structures corresponding to each market payline or, within a common salary structure, separate policy paylines.

32. Both a single payline approach and an approach incorporating separate functional paylines have advantages and disadvantages. Some considerations to be taken into account in weighing the alternatives include:

- *Functional paylines* would permit the Fund to establish a closer market alignment for each of its major occupational groups, and thereby avoid material overpayment for any occupation. Functional paylines would also facilitate the maintenance of close market alignment over time by allowing the Fund's annual

salary adjustments to capture in separate salary ranges any market differences in rates of salary growth across occupations.

- *A single payline* is also able to provide substantial grade and salary differentiation across occupations. Adjustments to the current grading structure could go a long way toward a closer alignment of Fund and market pay across occupations. The movement of occupational groups or positions to lower grades in the Fund would reduce the internal rate of pay for them by 12–15 percent per grade, and it would have a corresponding effect on market relativities by lowering the equivalent market grades and salary levels to which Fund positions are related.

- *Grading relativities* have been difficult to maintain: at the margin it is easier to make exceptions in special cases rather than adhere to the intended grading relativities. Market-based differentiation through functional paylines could be viewed as a more objective basis for variations in salary levels than internal grade differentiation, although the establishment of grade equivalencies to allow for comparisons between the Fund and the market would also involve judgment.

- Grade and salary differentiation across occupations have proved in the past to be a source of *divisiveness among staff*—a common problem in large organizations with staff in diverse occupations. The variation in salary adjustments between occupational groups, which could be expected to result from functional paylines, could be a similar source of contention.

- Functional paylines would require a different approach to the *Fund's relationship with comparator markets*, and many challenging technical problems would have to be solved. The greater the number of separate paylines, the greater the complexity. The existing, broad-based comparator market does not always include the market segment from which the Fund recruits staff in specific occupations. It would thus be necessary to provide a new, relevant reference point for determining the pay of individual occupations. Salary relativities across occupations also differ between the U.S. and the French/German comparator markets. The development of differentiated functional paylines would therefore require the identification of multiple occupational markets and some consideration of how to set relativities, given the different characteristics of each labor market.

- Adjustments to the current grading structure would require extensive preparatory work, as would the design and implementation of functional paylines. Neither could be completed in less than a year.

33. The Steering Committee has concluded that this issue requires more thorough analysis and the advice of experts familiar with the implementation of functional paylines in other institutions. Meanwhile, the modifications to the Fund’s payline proposed by the

Committee would serve to mitigate pay anomalies among occupational groups. Therefore, the Committee recommends that:

- The Fund should retain for now the single-payline structure, with modifications to the paylines and procedures proposed in this report.

- Management should commission an independent study by a panel of outside experts on the specific issue of whether functional paylines should be introduced in the Fund. Such a study should produce a recommendation during 2006.

- Following the study, the Fund should decide whether to adopt a system of functional paylines. If at that point the Fund decides to retain the single-payline compensation system, it should address pay anomalies among occupational groups through a regrading exercise by FY 2008.

34. As regards the salary structure for Grades A1–A8, since 1989 this has been based on the downward extension of the structure for Grades A9–B2. The annual A1–A8 structural increase has been set equal to the corresponding increase for the higher grades. This practice was adopted because the Joint Compensation Committee was unable in 1989 to identify an appropriate A1–A8 comparator market. Nevertheless, the present compensation system calls for a check of the competitiveness of the extended A1-A8 payline against the 75th percentile and the 90th percentile of a comparator market comprising private sector secretarial positions in the Washington, D.C. metropolitan area. The extended A1–A8 payline has been positioned within this testing range in most of the past 17 years.

35. In line with its recommendation to formalize the existing practice of recruiting staff in Grades A1–A8 locally, the *Watson Wyatt report* recommended that the level of the A1–A8 salary structure be determined and adjusted on the basis of a Washington area comparator market. They further recommended that the principles governing the A1–A8 market relationship should be consistent with those for Grades A9 and above: the A1–A8 market should encompass the full range of secretarial and non-secretarial occupations in which Fund staff are employed; it should include all sectors from which the Fund secures A1–A8 staff (the private and public sectors, Washington-based international organizations, and embassies); and the Fund's salary structure should be set at the 75th percentile of the market.

36. The Steering Committee agrees in principle that the A1–A8 salary structure be directly based on a comparator market comprising employers in the local, Washington metropolitan area, or the Washington-Baltimore or mid-Atlantic region. The current mechanical link between the A1–A8 and A9–B2 salary structures would therefore be discontinued, although the relationship between them would continue to be a consideration in light of staff members' progression from the lower to higher grade levels. The Committee also agrees that the A1–A8 market relationship should, in principle, be defined on a basis that is similar to the market relationship for Grades A9 and above: (a) pitching the market at the 75th percentile, and (b) broadening the market to include non-secretarial, as well as

secretarial, positions and public sector (federal government), as well as private sector employers.

37. The Committee is mindful, moreover, that the salary structure for Grades A1–A8 should provide a sufficient quality premium to support the recruitment and retention of diverse international staff who are able to meet the Fund's high performance standards and to work effectively in the Fund's organizational culture. The specific relationship between the Fund and the market for Grades A1–A8 will accordingly need to be determined after market data become available. Defining an appropriate market poses substantial challenges, given that survey data for the local market are not sufficiently robust for the broader range of positions in the Fund and the difficulty of obtaining survey data for embassies and international organizations. These problems will be addressed in the coming months with a view to implementing the system on May 1, 2006.

38. As the Fund moves to adopt revised systems for employment, compensation, and benefits, a mechanism is needed for determining the administrative budget in a way that ensures that total administrative expenses are constrained within the budget, while the compensation system continues to be comparator-driven and rules-based with limited Board discretion. It has typically been possible to accommodate the cost of the annual staff salary award within the provisional overall budget envelope, without any subsequent late upward adjustment to the budget figure. Since FY 2002, Fund policy has been to allow zero, or close to zero, real growth in the Fund's annual administrative budget. To determine a nominal budget envelope consistent with the zero real growth policy, a so-called Fund cost deflator has been used in recent years.

39. Executive Directors have noted several shortcomings with the Fund cost deflator, especially its treatment of personnel costs and its mixture of forward- and backward-looking indices. In the context of the current review, staff have explored different formulations of a deflator for personnel costs. As explained in Section IV of the companion paper, work on the technical merits of different forward- and backward-looking approaches, and different indices of personnel costs, has not yet yielded robust conclusions. Further work on finding the most appropriate indices is required, and proposals on a specific deflator will be brought forward to the Executive Board at a later date.

V. EXPATRIATE BENEFITS

40. The Fund has in place a system of expatriate benefits designed to induce qualified personnel to relocate from their home countries and to remain at the Fund over a long-term career (Section V of the companion paper covers expatriate benefits). Expatriate benefits in some form are necessary for the Fund to recruit and retain high-quality staff from all over the world. This need is met in two ways: a general incentive incorporated in the compensation system, represented by the margin of competitiveness over pay levels in France and Germany; and allowances for eligible expatriate staff for home leave and education of their children. In the view of the Steering Committee, the main elements of the current framework

should be maintained, but changes are recommended to ensure that allowances continue to fulfill their intended objectives. No changes in eligibility requirements are proposed.

41. The Steering Committee has noted the views expressed by Executive Directors and staff regarding the significant challenges that spouses/partners of expatriate staff members face in adjusting to life and work when they move to Washington. Difficulties in obtaining work permits, meeting local professional certification requirements, and conducting job searches effectively in a new environment received particular emphasis. Against this background, the Committee recommends the introduction of well-targeted measures that can provide effective assistance to spouses/partners in this regard. As an initial measure, Management has called on HRD to develop proposals for providing financial assistance for education/training expenses for spouses of new staff relocating from abroad, targeted at helping them integrate into the local labor market. Well-designed interventions along these lines—learning from best practice in other organizations—could be particularly helpful in attracting mid-career professionals from abroad to the Fund.

Eligibility

42. Like other international organizations, the Fund uses a visa test to establish expatriate benefits eligibility—being a citizen or permanent resident of the duty station country makes staff ineligible for expatriate benefits. Initially, Fund policy denied expatriate benefits to holders of U.S. immigrant visas. After successive policy changes over time that provided expatriate benefits to U.S. permanent residents ("green card holders"), the Executive Board approved a change back to a visa test in 1985, grandfathering the green card holders who were already eligible for the benefits.

43. The eligibility policy was modified in 2002 to permit staff members holding U.S. permanent resident status to give up that status in exchange for a G-4 visa, in order to qualify for expatriate benefits. There is a long history behind the current policy on eligibility for expatriate benefits, which has evolved over many decades on the basis of numerous reviews by the Executive Board.

44. The issue of eligibility of U.S. permanent residents has been raised during the review. The Steering Committee considers that extending eligibility for expatriate benefits to green card holders would be inconsistent with their situation and unnecessary to meet the Fund's staffing objectives. As explained in the companion paper, the current rules give individuals who have opted to become U.S. permanent residents a choice between two options: (i) the security of future residence and employment in the United States, and (ii) access to expatriate benefits from the Fund. An intermediate option for green card holders would not be consistent with the logic underlying the provision by the Fund of expatriate benefits.

45. The Steering Committee rejected the recommendation of Watson Wyatt that the Fund should either eliminate or reduce expatriate benefits for new A1-A8 staff. The Steering Committee questioned the appropriateness of such a move, given the likelihood that the provision of expatriate benefits is an important factor in the Fund's ability to recruit high-

quality, diverse staff at these levels. Given the proposed changes to the A1-A8 salary structure, and the Fund's interests in both enhancing staff diversity and maintaining the high-quality of its staff at all levels, the Committee felt it would be prudent to continue offering expatriate benefits to eligible A1–A8 staff.

Home Leave

46. The home leave policy currently entitles eligible staff to a cash payment every two years, designed to enable the staff member and all eligible dependents to travel to the home country by business-class air transportation. The cash payment is augmented by a home leave allowance ($1,210 for staff and $605 for each eligible dependent), ground transportation, "in and out" allowance and overnight allowance. Staff members must certify that they and their family members have spent seven days in the home country.

47. In the Steering Committee's view, home country travel provides critical support for the recruitment and retention of a diverse international staff, and therefore the Committee recommends maintaining the essential elements of the current policy. At the same time, the following features of the allowance should be addressed:

- The Fund is the only international organization still providing home country travel using the business class cost standard. This practice exposes the Fund to reputational risk, as it carries the implication that the Fund is somehow immune to budgetary pressures faced by other public sector bodies, and is therefore difficult to justify to the national administrations and legislatures of Fund members.

- The current policy benefits expatriate staff in an unequal manner, depending on the vagaries of the business travel market—generating sizable windfall gains for nationals of some countries that are unrelated to any HR policy objectives.

- This benefit could be of more value to expatriate staff if restrictions on its use were liberalized (e.g., permitting staff to pay for parents or other family members residing abroad to travel to Washington for a reunion).

48. In order to address these issues, the Steering Committee recommends:

- Reduce the class of travel to full-fare economy, retaining the frequency of travel as well as travel leave.

- Permit the staff member more flexibility to apply the allowance toward travel costs associated with their expatriation in the manner of their choice.[6]

[6] The proposed full-fare economy allowance exceeds restricted economy fare levels by ratios typically in excess of 2:1, and hence will continue to provide staff with opportunities for obtaining significant savings that can be used for travel or other purposes.

- Streamline administration by (i) eliminating site-specific payments for ground transportation, in/out allowances, and overnight allowances; and (ii) for staff working part-time or on leave without pay, maintaining a fixed eligibility date and making pro-rated payments rather than adjusting eligibility dates and making full payments.

- Increase the amount of the home leave allowance to $2,000 for staff and $1,000 for each eligible dependent.

Education Allowances

49. The education allowance policy provides for reimbursement of tuition, room and board, travel and a number of miscellaneous fees such as books, tutoring and mandatory charges by the school. The policy provides assistance for children studying at the primary or secondary level in the duty station country, the home country or a third country. Children studying at the university level are only eligible to receive assistance if they are studying in the home country or a third country.

50. Education allowances also provide critical support for the recruitment and retention of a diverse international staff, even if not always used. At any particular point in time, the education allowance benefit is being used by one-third of eligible staff; other staff have used it in the past or may use it in the future. Staff value the assurance that they will have assistance toward meeting the cost of the schooling that they consider appropriate or necessary for their children to facilitate their repatriation. The specific policies on education allowances followed by other international organizations vary considerably among themselves and with respect to the Fund's practice. It is difficult to compare the reimbursement levels under the Fund's policy with those of other organizations because of differences in education systems, the structure and level of schooling, and staffing patterns.

51. The Steering Committee considers appropriate the main elements of the current policy but feels that benefits in some areas may be more than adequate to meet the Fund's recruitment and retention objectives. Recommendations in this area seek to narrow the coverage and in some cases reduce the level of benefits, notably with respect to reimbursement for the cost of university education.

52. In the view of the Steering Committee, the Fund has less responsibility for assisting parents with the education of their children at the tertiary (university) level than it does at primary and secondary levels. Children studying at primary/secondary schools—even if they may eventually repatriate to the home country—have a greater need to be in close proximity to their parents. As Fund employment necessitates the relocation of these younger family members to Washington, the Fund has a responsibility for helping parents meet the costs of their education. At the tertiary level, however, the familial bonds begin to weaken, and it is more common for children to pursue university level education away from home.

53. Accordingly, given the fact that children often live away from the family home when studying at the university level, it is appropriate for parents to bear the expense of their room and board. For this reason, the Steering Committee is of the view that room and board at the tertiary level should not be reimbursed for new staff.

54. Moreover, consistent with the above analysis, the Steering Committee view is that education allowances at the tertiary level should be provided only in respect of home country education. This reflects the underlying rationale of the allowance, which is to facilitate the child's repatriation to the home country. This is also the rationale for the Fund's current policy of not reimbursing tertiary education in the duty station country. The Steering Committee is of the view that neither the proposal to eliminate coverage of room and board at the tertiary level nor the proposal not to cover education in third countries would significantly undermine the competitiveness of the overall Fund compensation package.

55. The Committee recommends the following changes:

- At the primary, secondary, and tertiary levels, the policy should be streamlined to reimburse only tuition, tutoring, and, if applicable, room and board (susbsistence). Reimbursement or allowances would not be paid for books, local transportation or other non-tuition expenses, even if these are mandatory school charges. Staff would continue to be required to obtain certification by the school of full-time attendance.

- The allowance for travel between the duty station and the school location (one round-trip in restricted economy class and one round-trip in unrestricted economy class) would be replaced by two round-trips in restricted economy class. The separate certification requirement for the education travel allowance would be discontinued.

- The current ceiling would be retained but the current mechanism for determining changes in the ceiling would be simplified. Future increases in the level of the education allowance ceilings (all levels) would be determined by the annual change in the CPI-U expenditure category for "Tuition, other school fees and childcare."[7] The adequacy of the education allowance ceilings would be reviewed every four years.

56. For *new staff only*, the Steering Committee recommends the following changes:

- At the university level, eligible new staff would receive reimbursement for each child studying at the college level in the home country, provided that the home country is outside the staff member's duty station; the policy would not cover a

[7] Education allowance ceilings for primary/secondary schools outside the U.S. would continue to be determined by using the U.S. ceiling multiplied by the applicable UN Post Adjustment Index.

child studying in a third country. Reimbursement would cover only tuition costs; the rate of reimbursement would be 75 percent (as for existing staff) up to the applicable ceiling. New staff eligible for this allowance would also be entitled to the separate education travel allowance but would not receive reimbursement for room and board or subsistence.

- A limit of 50 percent of net salary would be established for the maximum education allowance that could be provided to eligible new staff during an academic year. Within this limit, the prevailing nominal ceiling would remain the binding constraint. This measure is intended to define a reasonable limit on the contribution that education allowances can make to the total compensation of expatriate staff, which can in extreme cases amount to a multiple of salary.

57. In order to improve the usefulness of the education allowances, it is proposed that the existing policy be broadened. The policy would permit staff who utilize two schools (one full-time and one part-time) to include the cost of tuition at both schools in their application for education allowance. The staff member would be reimbursed under the existing policy, subject to the applicable ceilings. This would permit staff members whose children are enrolled in weekend schooling for purposes of maintaining the ability to reintegrate with the home country school system to obtain assistance under the education allowance policy.

Financial Implications

58. The financial implications of the proposed changes to expatriate benefits are set out in Table 1. In some cases, such as the proposal to include weekend schooling under the ceiling for education allowances, it has not been possible to estimate the financial implications of changes. For all other proposals, the estimates reflect the annual impact and do not take into account dynamic effects such as changes in behavior in response to the new incentive structure.

Table 1. Expatriate Benefits: Estimated Annual Impact of Proposals [1/]
(In millions of dollars)

Proposal	Estimated Impact
Home Leave	
Reduce cost-standard from business class to full-fare economy class	-$6.9
Eliminate miscellaneous travel allowances provided for home leave travel	-$1.6
Increase the home leave allowance to $2,000 for staff member and $1,000 for each dependent (from $1,210 and $605, respectively)	+$1.6
Education Allowance	
Eliminate reimbursement of miscellaneous expenses	-$0.7
Reduce education travel entitlement from one restricted economy class fare and one unrestricted economy to two restricted economy class fares	-$0.25
Eliminate tertiary education benefit for education in a third country and exclude room and board (or subsistence) from coverage (new staff only) [2/]	-$0.18
Limit total education allowance to 50 percent of staff member's net salary (new staff only) [2/]	-$0.02
Total Annual Savings (year 1)	-$8.05

1/ Estimates are based on FY 2005 outturn.
2/ This is the estimated impact in the first year. Savings will grow over time, inter alia, as grandfathered staff separate and new staff are appointed.

VI. Staff Retirement Plan

59. The Steering Committee has examined whether the present defined benefit design of the Staff Retirement Plan (SRP) should be retained and how to reinforce the alignment of SRP benefits with the Fund's prospective staffing strategy. Watson Wyatt recommended that the Fund retain the basic defined benefit design, but consider the introduction of a mixed plan including both defined benefit and defined contribution components. Other proposals were to: revise benefits to better support the employment strategy and exit policies; reconfigure early retirement benefits (e.g., age 50–55) to encourage separation of poor/plateaued performers; improve lump-sum withdrawal benefits for shorter service; and introduce a supplementary savings plan, with or without Fund contributions.

60. The Steering Committee recommends retaining the present defined benefit design of the Plan. Defined benefit plans continue to be the main retirement vehicle in a large majority of international organizations, as well as public sector retirement plans and private sector plans in many industrial member countries, although there is a trend to move toward defined contribution designs. The defined benefit design of retirement plans are regarded as better suited to the staff of international organizations, which often forego benefits from national pension systems in their home countries.

61. The Steering Committee also recommends increasing the level of short-service benefits and reconfiguring it to more closely resemble defined contribution plans. The present rate of accrual of withdrawal benefits—12 percent and 10 percent of highest average gross remuneration per year of service—provides a reasonable return on participants' contributions. It is not, however, competitive with short-service defined contribution plans in the United States, and its value is relatively low relative to the deferred SRP pension. The benefit should be raised to strengthen the Plan's support for shorter-term and mid-career employment and diminish the incentive to secure a pension benefit. The form of the benefit could also be modified so that it more closely resembles a defined contribution plan (i.e., by accumulating the participant's contributions, plus a matching amount by the Fund, plus interest/investment returns).

62. To facilitate voluntary separation, the Steering Committee recommends modifying medium- and long-service benefits for participants appointed in both early- and mid-career and separating in early and late 50s:

- For staff (including Economist Program participants) appointed early in their careers (e.g., before age 35), the main changes to present benefits that are considered necessary are (a) reducing the backloading of benefits in order to facilitate early retirement between ages 50 and 55, and (b) enhancing benefit portability for staff who leave in their 40s. Raising the level of pensions at somewhat earlier retirement ages and shorter service could be coordinated with targeted separation incentives as part of a strengthened exit policy.

- For mid-career appointees (e.g., staff appointed between ages 35 and 45), the main changes to present benefits that are considered necessary are (a) reducing the backloading of pension benefits that encourage retention beyond age 60, (b) improving short-service benefits to support recruitment of staff for limited terms, and (c) enhancing benefit portability for both incoming and outgoing staff.

63. The Steering Committee recommends that support for mid-career recruitment and separation be strengthened through enhanced support for benefit portability, including: (a) allowing the purchase of SRP service credits when staff join the Plan; (b) arranging additional transfer agreements with international organizations; and (c) establishing a voluntary savings plan to enhance portability and to assist mid-career hires accumulate retirement savings faster.

64. With respect to possible funding for a voluntary savings plan, the Fund could consider redesigning the separation grant as the Fund's contribution. The separation grant is a payment to separating staff members in the amount of 2 weeks of net salary for every year of Fund service after July 1, 1979. Staff must complete 5 years of service to be eligible for the grant, and the maximum amount payable is one year of salary (based on 26 years of service). Staff who do not resettle outside the duty station country are eligible for two-thirds of the separation grant.

65. Watson Wyatt recommended that the present SRP, which is based on gross, pre-tax remuneration, be changed to a net-of-tax plan, with tax allowances payable in accordance with actual taxes on benefits. Subject to a detailed study to confirm the administrative feasibility of a net pension system, the Steering Committee recommends making such a change for future participants.

66. A separate paper on proposed changes to the SRP and the possible introduction of a voluntary savings plan will be developed for consideration by the Executive Board through the Pension Committee.

VII. Other Recommendations

A. Medical Benefits Plan (MBP)

67. The Steering Committee recommends that the general design of the Medical Benefits Plan (MBP) be retained. However, in light of rising healthcare costs, the Plan could adopt more cost effective measures without compromising the quality of the Plans comprehensive medical and dental coverage. A separate paper will be developed on proposed changes for the MBP for consideration by the Executive Board. This paper will consider plan design changes, benefit levels, and contribution levels, and will examine, inter alia, the scope for promoting increased participation in Preferred Provider Organizations (PPOs) and greater use of cheaper medical and drug services.

B. Integrated Disability Program

68. The Fund currently has six separate programs that provide sick leave and disability coverage. These are: sick leave; extended sick leave at full or partial pay; extended sick leave at partial pay; total and permanent disability under the Staff Retirement Plan; worker's compensation; and Separation Benefit Fund (SBF) for medical reasons. The Fund also provides a long-term disability insurance for contractual employees. Despite the multiplicity of programs, there are significant gaps in the coverage. For example, there are no specific provisions or incentives for rehabilitation, partial permanent disability, and temporary total disability that is not permanent but may be a long-term situation.

69. The current disability programs can also be overly generous. Disability programs are typically income replacement programs, not retirement income programs. Long-term disability (LTD) pensions normally cease at a typical retirement age, such as 62 or 65, when

pension programs would begin. Some pension plans credit the period under which the staff member was receiving LTD as service credit for the purposes of calculating the pension.

70. The Steering Committee recommends that the Fund consider a different approach to sick leave and disability management. A separate paper will be developed on proposed changes for disability management for consideration by the Executive Board. This paper will consider plan changes that would:

- integrate the various programs the Fund currently provides;
- eliminate the current coverage gaps in the existing programs;
- smooth out the benefit levels; and
- reduce distinctions between occupational and non-occupational illness and injury.

C. Tax Allowances

71. Tax allowances are provided to create broad equivalency in pay between (primarily) U.S. nationals and non-U.S. nationals not subject to income tax on their Fund salaries. The system uses average tax deductions for given salary levels to provide a tax allowance. While this system estimates tax liability on an average basis, the staff member's liability may be different from the tax allowance received, and there is a "safeguard" arrangement intended to ensure that income taxes paid on Fund salary in excess of the tax allowance can be claimed. However, as more U.S. nationals are required to pay the Alternative Minimum Tax (AMT), the manner in which this issue is handled within the tax allowance system needs to be examined.

72. The AMT, which has the effect of increasing the income taxes above the level indicated by the regular rates and deductions, is affecting a growing number of U.S. staff (and U.S. taxpayers in general). The AMT is not currently incorporated in the regular calculation of tax allowance; it is instead handled on an individual basis under the safeguard arrangement, for which all U.S. staff are eligible.

73. To ensure that U.S. staff members are being paid tax allowances consistent with the actual income taxes payable on Fund income, it is necessary to determine whether the AMT should be factored into the regular annual tax allowance calculations (and also the average tax rates applied in the compensation system to net down the gross pay of U.S. comparator organizations), and whether payments through the alternative safeguard arrangement appropriately reflect both the impact of the AMT and the arrangement's original purpose. A consultant is currently studying this issue and expects to provide input before the end of the financial year. Staff will consider the consultant's recommendations and develop formal proposals for consideration by Management in a timely manner.

VIII. GRANDFATHERING AND TRANSITIONAL ARRANGEMENTS

74. The grandfathering and transitional arrangements described in Table 2 are intended to address both legal and human resources considerations attendant to changes proposed in this document.[8] In this context, the term "grandfathering" refers to situations in which a proposed change would apply to new staff only and not to staff whose letters of appointment are dated on or before the effective date of the change. The term "transitional arrangements" refers to situations in which, while a change in the terms and conditions of employment would apply to existing staff, special arrangements would accompany the implementation of the change. These special arrangements would modify or ameliorate the application of the change to existing staff for a limited period, and would lapse or become unnecessary either at a particular point in time or when certain conditions no longer exist.

IX. NEXT STEPS

75. The proposals presented in this paper and the companion paper raise a number of issues for the consideration of the Executive Board. Some of the proposed changes will require the approval of decisions by the Executive Board, while others may be implemented by management. In particular, the adoption of a new staff compensation system and changes to expatriate benefits would require formal Board approval, while changes in performance management and certain aspects of the employment framework have traditionally been implemented by management. Of course, the views of the Executive Board are sought on all of the proposals set forth in these papers.

76. As indicated in theses papers, however, some detailed aspects of proposals—particularly in the area of the compensation system—will need further elaboration before formal decisions can be adopted. At this stage of the process, the views of Executive Directors on the proposals will be reflected in a summing up that will be prepared on the basis of the Executive Board discussion of this paper and the companion paper. A follow-up staff paper will then be prepared, taking into account both the Executive Board's discussion of these two papers and the Steering Committee's resolution of those aspects of proposals that have not yet been fully elaborated. The follow-up paper will be accompanied by the relevant Executive Board decisions.

77. Accordingly, the views of Executive Directors are sought on the wide range of issues and proposals set out in this paper and the companion paper:

- The attention of Executive Directors is drawn in particular to the issues and proposals presented on **staff compensation**. The effect of these proposals would be to introduce

[8] For an overview of the legal principles concerning the Fund's power to change the terms and conditions of staff employment, see the note by the Legal Department that was circulated to the Executive Board on December 30, 2004 as background to the paper entitled *Review of the Fund's Employment Framework, Compensation, and Benefits* (EBAP/04/151, 12/6/04).

on May 1, 2006 a new compensation system that, while retaining some features that for the most part have been in effect since 1989, differs in important respects from the current system. Changes are also recommended in the relationship between the compensation system and the budget. An independent study of a possible move from a single salary structure for all staff to a system of functional paylines is proposed. These issues are discussed in Section IV of the overview paper and Sections III and IV of the companion paper.

- Proposed changes in the **employment framework** are set out in Section III of the overview paper and in Section I of the companion paper.

- Proposals to enhance **career and performance management** are described in Section III of the overview paper and Section II of the companion paper.

- The case for changes in **expatriate benefits** is addressed, together with related issues of eligibility for benefits and assistance for spouse employment, in Section V of the overview paper and Section V of the companion paper.

- Plans for considering possible changes to the **Staff Retirement Plan**, the **Medical Benefits Plan**, and the introduction of an **integrated disability program** are detailed in Section VII of the overview paper.

Table 2. Grandfathering and Transitional Arrangements

Area of Change	Grandfathering and Transitional Arrangements
Employment Framework:	
Extend total length or initial fixed-term appointment to four years for staff hired for open-ended positions.	Terms of existing staff appointments (including those on fixed-terms) would not change.
Introduce renewable three-year term appointments for staff appointed/promoted to B4, comparable to system in place for B5s.	Terms of existing appointments for staff currently at B4 would not change.
Compensation System:	
Change the shape of the Fund's payline by making it steeper between Grades A12 and B2, and bending it downward for Grades A9–A12.	Transitional arrangements would be needed for staff whose salaries are above or near ceilings of new ranges for A9–A12 (or lower grades that are affected) that would ensure (i) no salary reduction in absolute terms, and (ii) some scope for future salary increases, even at reduced levels, until new grade range "catches up" with salary.
Selective regrading of positions, with possibility of downgrading affected incumbent staff.	Similar transitional arrangements as above would apply to downgraded staff in terms of salary administration. Alternatively, downgraded staff could be fully grandfathered in their existing salary ranges (for as long as they were incumbents in the downgraded positions).
Expatriate Allowances:	
Home Country Allowance:	As a transitional measure, existing staff would receive one additional home leave allowance using the business-class standard and the other elements of the current policy (apart from any entitlement that they may have already reached but have not yet applied for).
Reduce class of travel to full-fare economy.	
Education Allowance:	
With respect to tertiary education, eliminate the third country option and exclude room and board (or subsistence) from the costs covered by the allowance. Reimburse the cost of tertiary education in the home country at 75% of tuition costs up to the applicable ceiling.	Existing staff would be grandfathered, i.e., these changes would not apply to them.
Total education allowances would be subject to an annual limit of 50 percent of net salary.	Existing staff would be grandfathered, i.e., this change would not apply to them.
Staff Retirement Plan:	
Change basis of calculation from gross to net-of-tax, with tax allowances to be paid with respect to pension payments that are subject to national income tax.	Existing participants in the SRP as of effective date of change would be grandfathered as to both past and future service accruals.