**FOR AGENDA**

EBAP/10/24

STRICTLY CONFIDENTIAL

March 30, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **2010 Review of Staff Compensation**

Attached for consideration by the Executive Directors is a paper on the 2010 review of staff compensation, which is tentatively scheduled for discussion on **Monday, April 12, 2010,** together with a paper providing background information on staff recruitment and retention experience in CY 2009—selected indicators (EBAP/10/25, 3/30/10). A draft decision appears on page 12.

It is not intended that this paper will be published on the Fund's external website.

Questions may be referred to Mr. Clarke (ext. 34086) and Mr. Vicini (ext. 34474) 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

**2010 Review of Staff Compensation**

Prepared by the Human Resources Department

In consultation with the Finance and Legal Departments
and the Office of Budget and Planning

Approved by Shirley Siegel

March 30, 2010

Contents Page

## I. Introduction

1. **This paper presents proposals for the 2010 staff compensation review**. The proposals have been developed based on the indexation formula applicable in interim years of the compensation cycle approved by the Executive Board in April 2006 as part of the Employment, Compensation, and Benefits Review (Box 1).[1] The paper also reviews the comparatio methodology, as anticipated during last year's compensation round (Annex).

2. **The remainder of the paper is organized as follows**: Section II presents the results of the indexation formula for 2010, which determines the increase in the salary structure for Grades A1–B5. Section III discusses the determination of merit pay and looks at the comparatio and how it evolved in 2009, as well as the comparatio methodology and what changes might be considered in the future. Section IV contains a draft decision for approval by the Executive Board.

### Box 1. The Compensation Cycle

**The Fund's compensation system operates on a three-year cycle**. In the first year of the cycle, decisions on staff compensation are based on customized surveys of A1–A8 and A9–B2 salaries in the United States, with the results of the A9–B2 payline tested for international competitiveness against salaries in France and Germany. It is expected that in the 2012 full market review, Japan will be included as an additional international comparator. Salaries at B3–B5 are set in relation to A9–B2 salaries. In the second and third years of the cycle, the entire A1–B5 salary structure is adjusted on the basis of an indexation formula, which is comprised of published indices of salary movements in the U.S. public and private sectors. In comparator-based years, the salary structure can be adjusted either uniformly or on a grade-by-grade basis. In indexation-based years, as in 2010, the entire structure is adjusted uniformly by the percentage indicated by the formula, subject to certain safeguards.

## II. Indexation Formula

3. **The indexation formula comprises a public and a private sector index**. The public sector component is the announced percentage salary increase for the U.S. Civil Service, including locality pay for the Washington metropolitan area, for the current year. The private sector component is the percentage change forecast for the current year in the annual WorldatWork Salary Budget Survey for the category of exempt salaried employees.[2] The two components are given equal weight in the indexation formula.

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[1] See *Employment, Compensation, and Benefits Review—Proposed Decisions* (EBAP/06/38, 3/31/06).

[2] Under the U.S. labor framework, "exempt salaried employees" are defined as those categories that are not eligible for overtime payment.

4. **The indexation formula generates a 2.6 percent increase in the salary structure for 2010**. The public sector component for 2010, as reported by the U.S. Office of Personnel Management, is 2.42 percent.[3] The private sector component for 2010 is 2.8 percent, as reported by WorldatWork.[4] Weighted equally, the combination of the public and private sector salary increases indicates a 2.6 percent increase in the Fund's salary structure, equal across all grades, effective May 1, 2010.

5. **The application of the formula is subject to safeguards**. In adopting the indexation approach for interim years, the Executive Board recognized the inherent risk that increases indicated by the formula could deviate from salary movements in the Fund's comparator markets, with potentially adverse consequences for the Fund's competitiveness. To mitigate this risk, the system contemplates the possibility that management may propose an upward adjustment to the salary increase indicated by the index under certain conditions (EBAP/06/38, paragraph 43):

- compelling evidence to suggest that movements in the index are unrepresentative in a material way of general salary trends in the U.S. comparator market;
- changes in U.S. tax policy that make it likely that there will be significant increases in net salaries at the Fund at the time of the next comparator-based review; or
- movements in the euro–dollar exchange rate that create significant competitiveness problems for staff recruitment and warrant remedial action prior to the next comparator-based review.

6. **No safeguard adjustments are proposed for the 2010 compensation review**. On salary developments, there is no compelling evidence to suggest that the 2.6 percent structural increase indicated by the indexation formula is unrepresentative in a material way of general salary trends in the U.S. With respect to U.S. tax policy, the effective tax rates applicable to the Fund's comparator market for A1–B5 salary ranges have not materially changed relative to their 2009 levels. Moreover, no changes in U.S. tax policy are currently planned that would lead to significant increases in net salaries at the Fund at the time of the next comparator-based review in 2012.[5]

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[3] The approved salary increase is published on the agency website at www.opm.gov/oca/10tables/html/dcb.asp.

[4] The headline number is published under Resource Center at www.worldatwork.org.

[5] Prospective changes in the Alternative Minimum Tax cannot be ruled out, although neither the direction nor magnitude of any such changes are known at this time.

7. **The U.S. dollar has appreciated *vis-à-vis* the euro during the reference period**. Using the reference period and exchange rate definition embodied in the international competitiveness test that is applied in comparator-based reviews every three years, exchange rate movements suggest that the risk of significant competitiveness problems has eased during the last 12 months.[6] In particular, the combined U.S. dollar nominal exchange rate and purchasing power parity rate appreciated by 4.8 percent *vis-à-vis* France, and by 4.2 percent *vis-à-vis* Germany (Table 1).

**Table 1. Euro/Dollar and Comparator Market Purchasing Power Parity Movements**

| | | France | | Germany | | France and Germany 1/ | |
|---|---|---|---|---|---|---|---|
| | €/$ | PPP | €/$ and PPP Avg | PPP | €/$ and PPP Avg | PPP | €/$ and PPP Avg |
| Nov. 2007–Oct. 2008 | 0.6700 | 0.9038 | 0.7869 | 0.8477 | 0.7588 | 0.8758 | 0.7729 |
| Nov. 2008–Oct. 2009 | 0.7335 | 0.9160 | 0.8248 | 0.8485 | 0.7910 | 0.8823 | 0.8079 |
| Change (percent) | 9.5 | 1.3 | 4.8 | 0.1 | 4.2 | 0.7 | 4.5 |

1/ France and Germany are weighted equally.

8. **These exchange rate movements suggest that the international competitiveness of the Fund's payline is within the target range**. Using the market compensation levels from last year's survey, but with updated exchange rates, the Fund's payline is now about 14 percent on average above the combined French and German market—well within the 10–20 percent target range that is applied in comparator-based reviews (Table 2).

[6] In comparator-based reviews, and by extension in indexation-based years, the period average exchange rate over the 12-month reference period (November–October) is compared with the period average rate for the same period in the previous year. The exchange rate definition is the simple average of the nominal euro–dollar exchange rate and the purchasing power parity rate for France and Germany.

**Table 2. Fund Payline Relative to the French/German Comparator Market 1/ 2/**

| Grade | Staff | 2009 | 2010 3/ |
|---|---|---|---|
| A9 | 63 | 1.7 | 6.0 |
| A10 | 85 | 5.0 | 9.6 |
| A11 | 158 | 11.8 | 16.6 |
| A12 | 199 | 3.6 | 8.1 |
| A13 | 275 | 11.5 | 16.3 |
| A14 | 510 | 13.3 | 18.3 |
| A15/B1 | 265 | 10.5 | 15.3 |
| B2 | 127 | -1.4 | 2.8 |
| Total staff | 1,682 | | |
| Staff weighted average | | 9.3 | 14.1 |

1/ Based on 2009 staff count and 2009 tax tables.

2/ French and German markets are weighted equally.

3/ Considers only exchange rate and purchasing power parity changes; both 2009 and 2010 are based on 2009 market compensation data.

9. **Recruitment experience during the last 12 months has been favorable**. As explained in the companion paper, the Fund's recruitment and retention experience in 2009 was shaped by two main factors: the global financial and economic crisis, which gave rise to the need for additional staff as well as an increased supply of qualified candidates; and the effects of the downsizing that was initiated in 2008.[7] For these reasons, recruitment reached an all-time high in 2009, as 281 new staff members were brought on board. Overall, the salaries and benefits the Fund offered to potential candidates in 2009 were broadly competitive, although starting grades and salaries were reported as a potential issue for some mid-career economists.[8]

10. **Accordingly, it is proposed that the salary structure be increased by 2.6 percent**. The increase indicated by the indexation formula would be applied uniformly to the salary range midpoints for Grades A1–B5, as shown in the Attachment.

[7] *Staff Recruitment and Retention Experience in CY 2009—Selected Indicators*, (EBAP/10/25, 3/30/10).

[8] See *Staff Recruitment and Retention Experience in CY 2009—Selected Indicators*, (EBAP/10/25, 3/30/10, paragraph 10).

## III. Merit Pay

11. **Two factors contribute to the determination of the merit pay budget**. The first factor is a structure adjustment that aligns the midpoints of the Fund's salary ranges with the indicated level of compensation in the comparator markets. As discussed in Section II, a structural adjustment of 2.6 percent is proposed this year based on the indexation formula. The second factor is a comparatio adjustment that ensures that actual staff salaries are aligned, on average, with the range midpoints and, through them, the indicated level of comparator pay (Box 2). The comparatio adjustment and the resulting merit pay budget are the method by which the Fund provides resources needed for staff salaries to progress, based on performance, within salary ranges.

### Box 2. Maintaining Competitive Staff Salaries

The structure adjustment and comparatio adjustment work in tandem to maintain staff salaries at competitive levels relative to the Fund's comparator markets:

- The **structure increase** adjusts the Fund's payline (i.e., the midpoints of its salary ranges) to the level indicated by the comparator markets. The size of the structure increase is based on a full comparator review every three years and on the indexation formula in the intervening years.

- The **comparatio** is an indicator of the extent to which actual salaries are above, below, or in line with the intended market levels. The comparatio measures the ratio between average staff salaries and the Fund's salary range midpoints, with the midpoints representing the target level of salaries in the comparator markets. A comparatio of 100 indicates that average salaries are equal to the average of the range midpoints.

- The **comparatio adjustment** ensures that average actual salaries remain broadly competitive and provides resources for in-range, performance-based salary progression. In the absence of a comparatio adjustment, average salaries that are set at the average of the midpoints (i.e., comparatio = 100) at a point in time would fall below the average of the midpoints over time (comparatio < 100), pulling average salaries below indicated market levels. Over time, the level of the comparatio typically falls as a result of the normal dynamics of staff turnover: as staff separate during the year, the comparatio will tend to decline as departing staff are replaced (through external recruitment or internal promotion) by staff with salaries lower in the range. The comparatio is therefore a technical mechanism to offset the decline in average salaries relative to the average of the midpoints during the year. All else being equal, maintaining a comparatio of 100 from year to year would indicate that average staff salaries are growing in line with the rate of increase in the salary structure.

- The **merit pay budget** is normally determined as the sum of the structure increase and the comparatio adjustment. The entire amount is distributed to staff on the basis of performance.

**Comparatio**

12. **Over the past year, average Fund salaries have fallen 2.8 percent below average payline midpoints (Table 3)**. As of January 1, 2010, support staff salaries were on average 1.8 percent above midpoints; this reflects mainly the freeze last year of the A1–A8 salary structure, in the context of its separation from the A9–B5 structure, while the merit increase was distributed uniformly across all grades. In contrast, professional and managerial staff salaries (Grades A9–B5) fell, on average, to 3.3 percent below midpoints.

**Table 3. Comparatio as of January 1, 2010 1/**

| Grades | Number of Staff 1/ | Total Payroll as of January 1, 2010 | Total of Notional Payroll at 2009 Midpoints | Comparatio |
|---|---|---|---|---|
| A1–A8 | 486 | 31,370,660 | 30,802,560 | **101.8** |
| A9–B5 | 1,872 | 277,089,590 | 286,565,000 | **96.7** |
| A1–B5 | 2,358 | 308,460,250 | 317,367,560 | **97.2** |

1/ Includes staff on leave without pay, study leave, short-term external assignments; excludes staff in Offices of Executive Directors and on separation leave.

13. **The decline of the comparatio in 2009 was larger than usual**. Comparatio adjustments in the last 10 years have averaged 1.8 percent. As shown in Table 4, the larger gap between actual salaries and salary midpoints this year is due mainly to high turnover of staff, which was driven mainly by the downsizing; the combined effect of appointments and separations of staff during 2009 lowered the comparatio by 1.2 percent, while normal turnover typically lowers the comparatio by about 0.3 percent. In addition, promotions lowered the comparatio by 0.8 percent, similar to previous years.[9] The remaining 0.8 percent of the decline reflects a combination of technical factors mainly related to the grade-by-grade re-shaping of the payline last year (see Annex for more detail).

[9] The impact of promotions on the comparatio is 1.2 percent for CY 2009. Of this, 0.4 percent was taken into account in the 2009 salary increase, which incorporated an estimate of the impact of the May 1, 2009 promotions on the comparatio (see *2009 Review of Staff Compensation* (EBAP 09/42, Table 12, footnote 1)).

**Table 4. Comparatio Decline in 2009 1/**

| | | |
|---|---|---|
| Turnover | | 1.2 |
| Separations | 0.6 | |
| New hires | 0.7 | |
| Promotions | | 0.8 |
| January–December | 1.2 | |
| January–May 2/ | -0.4 | |
| Other | | 0.8 |
| Total | | 2.8 |

1/ Numbers may not sum due to rounding.

2/ Estimate built into 2009 comparatio adjustment.

14. **Going forward, the January 1 comparatio will determine the May 1 comparatio adjustment**. Unlike previous years, the comparatio calculation this year does not include an estimate of the impact of promotions expected to take place on May 1 (the start of the new financial year). Under the new promotion system that is being introduced for A1–B3 staff, there will be only one promotion cycle, in November, well into the next financial year.

15. **It is proposed that the part of the comparatio adjustment resulting from the downsizing be phased in over three years**. The larger-than-usual number of separations under the downsizing exercise, which was initiated two years ago, has exacerbated the normal impact of turnover on the comparatio over the last two years. From May 2008 to December 2009, 400 staff left active duty as part of the downsizing, lowering the comparatio by 0.8 percent.[10] In other words, if those staff were still on the payroll, the comparatio would be 2.0 percent below 100, rather than 2.8 percent. Since these separations reflected a structural change with a sizable one-time impact on the comparatio, it is proposed—in line with previous practice—not to fully adjust the comparatio immediately, but instead to phase in the adjustment attributable to the downsizing separations over three years in order to smooth the impact on the normal operation of the comparatio.[11]

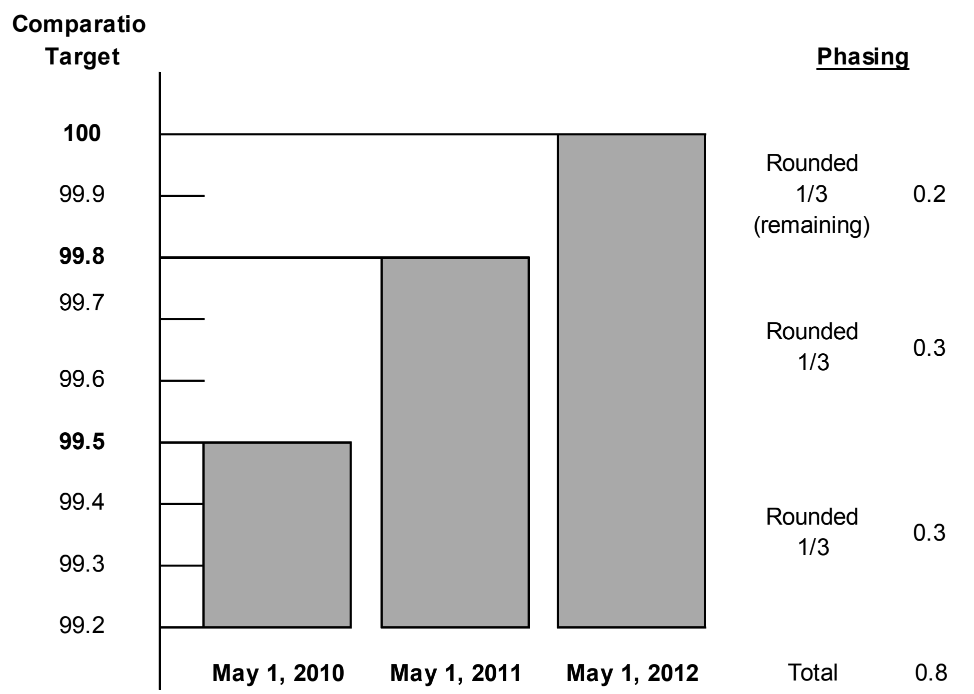
[10] The total impact of 0.8 percent comprises 224 separations in CY 2009 (0.6 percent) and 176 separations in CY 2008, (0.2 percent).

[11] For instance, in 2001, when the conversion of a large number of contractual employees to regular staff produced an unusually large reduction in the comparatio, indicating an unusually large comparatio adjustment, it was decided to phase in the comparatio adjustment. Consequently, the comparatio was allowed to remain

(continued)

16. **The comparatio target for this year would therefore be set at 99.5**. In effect, one third of the 0.8 adjustment attributable to the downsizing (0.3) would be added to the comparatio, which would otherwise be set at 99.2 (see Figure 1). The remaining two thirds (0.5 percent) would be phased in over the next two years, meaning that the May 1, 2011 comparatio target will be increased by 0.3 percent and brought to 99.8, and the May 1, 2012 comparatio target would be increased by 0.2 percent, back to 100.

**Figure 1. Phasing the Comparatio Adjustment Over Three Years**




## Merit pay

17. **On this basis, the Fundwide average merit increase is proposed at 4.9 percent**. This combines the structure adjustment of 2.6 percent arising from the application of the indexation formula, plus a comparatio adjustment of 2.3 percent. The necessary budgetary appropriation is included in the proposed decision on the administrative budget, which is scheduled for discussion by the Executive Board in April 2010. In keeping with standard

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below 100 in recognition of this unintended impact of the conversion exercise. See *Staff Compensation—2001 Review (*EBAP/01/15, paragraph 42).

practice, it is proposed that the decision on the 2010 review of staff compensation become effective upon the adoption of the administrative budget for FY 2011.

**Comparatio methodology**

18. **Staff has reviewed the comparatio approach in light of earlier questions raised by some Executive Directors**. As explained in the Annex, some changes are being considered outside the existing compensation system that would redirect resources from the comparatio adjustment (which is distributed to all eligible staff as performance-based merit increases) to targeted salary adjustments (such as for staff being promoted and, where needed to attract talent in highly competitive markets, for new hires). In addition, a change in the calculation methodology for the comparatio could be considered to ensure consistency with the method used elsewhere in the compensation system. In this vein, three main changes are under consideration:

- ***Higher promotion increases***. As noted, promotions affect the comparatio by lowering average salaries in the grades into/from which staff enter/exit.[12] This mainly reflects the fact that promotion increases awarded at the Fund are modest, generally in the range of 2–5 percent, while the difference between midpoints averages 12 percent. Higher promotion increases to reflect the assumption of greater responsibility would reduce this effect, and thus distribute to promoted staff part of the resources that would otherwise go to comparatio adjustments that are distributed to all staff who receive a merit increase. As part of the ongoing strategic HR reforms, an increase of the amount of promotion increases is being considered.

- ***Increased starting salaries for new hires***. Appointments of new staff tend to lower the comparatio, because new staff are normally hired with salaries below the salary range midpoints. Higher starting salaries for new hires would therefore tend to reduce the size of the comparatio adjustment in subsequent salary rounds. Greater flexibility in determining competitive starting salaries for new recruits with skills and experience that are in high demand in the market is being considered as part of the agenda of the ongoing reform of recruitment policies and practices.

[12] In the Fund, staff members can be promoted in three different ways: (a) through a career-growth promotion, when a position spans more than one grade and the promotion is within the position's grade band; (b) through selection to a vacant position at a higher grade; and (c) through a reclassification of the position to a higher grade beyond the current grade band (typically through a job audit).

- ***Refined calculation methodology***. Currently, the comparatio is calculated using *payroll-based* averaging of comparatios at individual grades.[13] However, this method is not consistent with the *staff-weighted* averaging used in determining the structure adjustment in the triennial comparator-based compensation reviews, and (as explained in the Annex) would introduce a distortion in the comparatio, which could lead to a higher or lower comparatio adjustment than needed to align average salaries to the market. From an HR perspective, the staff-weighted averaging method is preferable. In order to attract and retain staff at all levels, the Fund has an interest in ensuring that salary differences from the market are weighted equally across all staff. The staff expects to conclude its review of the comparatio methodology following this year's compensation round. Using consistent, staff-weighted averaging throughout the compensation system is therefore being considered, and the staff intends to come back to the Executive Board with a proposal in time for implementation in the 2011 compensation round.

19. **The review also explored alternatives to the comparatio adjustment**. On balance, the staff would not recommend a departure from the basic principles of the Fund's rules-based compensation system—in particular, that salary increases for individual staff are performance-based, and that the level of staff compensation is linked to compensation in comparator markets with a view to attracting staff of the highest caliber and widest possible geographical representation.

[13] The payroll method was recommended to and adopted by the Board in 2007 in an effort to simplify the presentation of the comparatio to the Board, taking into account practices in other organizations (see *Staff Compensation—Indexation and Merit Pay* (EBAP/07/37, 3/20/2007)).

## DRAFT DECISION

It is recommended that the Executive Board approve the following draft decision:

1. With respect to the 2010 compensation exercise, the salary structure for Grades A1–B5 shall be increased by 2.6 percent with effect from May 1, 2010, as indicated in the salary ranges provided in the Attachment.

2. The Executive Board approves the proposal regarding the determination of the merit pay allocation for Grades A1–B5 as set out in paragraphs 15–17 of EBAP/10/24.

ATTACHMENT

Proposed Salary Structure from May 1, 2010
(In U.S. Dollars)

| Grade | Minimum | Midpoint | Maximum |
|---|---|---|---|
| A1 | 27,730 | 34,670 | 41,600 |
| A2 | 31,050 | 38,800 | 46,560 |
| A3 | 34,760 | 43,450 | 52,140 |
| A4 | 38,940 | 48,670 | 58,410 |
| A5 | 43,650 | 54,560 | 65,480 |
| A6 | 48,820 | 61,030 | 73,240 |
| A7 | 54,730 | 68,400 | 82,080 |
| A8 | 61,300 | 76,630 | 91,960 |
| A9 | 63,500 | 79,370 | 95,240 |
| A10 | 73,550 | 91,940 | 110,330 |
| A11 | 84,110 | 105,130 | 126,160 |
| A12 | 96,130 | 120,150 | 144,180 |
| A13 | 110,240 | 137,800 | 165,360 |
| A14 | 131,140 | 163,930 | 196,730 |
| A15/B1 | 148,690 | 185,860 | 223,030 |
| B2 | 174,690 | 213,990 | 253,300 |
| B3 | 207,120 | 238,190 | 269,250 |
| B4 | 238,510 | 271,550 | 304,590 |
| B5 | 277,490 | 312,740 | 347,980 |

# ANNEX

## **The Comparatio System** [1]

Contents Page



[1] The primary author of this review is Eric Vanhee.

1. **This Annex reviews the Fund's comparatio system in response to questions about the methodology and role of the comparatio raised by some Executive Directors at the time of the 2009 compensation review**. Section I presents the comparatio as a common tool of compensation systems. Section II explains the role it plays in the Fund's compensation system. Section III explores alternative approaches to keeping average salaries close to established comparator-based target levels. Section IV looks at various changes that are under consideration, which will directly or indirectly impact the comparatio.

## I. The Comparatio

2. **The comparatio is a common compensation tool used in the private and public sectors and other international financial institutions**. It is typically used to control salaries around salary range midpoints, prevent salary inflation, and determine merit increase budgets. The comparatio has been widely used in the private sector as a salary administration tool for many years. It is the most common alternative to the step increase system that allows in-grade salary progression in traditional civil service systems.[2]

3. **More specifically, the comparatio is an indicator of the extent to which actual salaries are above, below, or in line with the intended market level**. The Fund's salary structure consists of 19 salary ranges, corresponding to grades Al through B5. Each salary range has a maximum and a minimum salary, and the salary halfway between the two is referred to as the grade midpoint or intended market level. A line connecting the grade midpoints is referred to as the Fund's payline.

4. **The comparatio is calculated as the ratio of total actual salaries to total notional salaries based on salary midpoints**. For example, a comparatio of 95, 100, or 105 would mean that total actual salaries are, respectively, 5 percent below, equal to, or 5 percent above total notional salaries calculated at the intended market level.

5. **The comparatio usually declines in the 12 months between salary reviews**. If there were no staffing changes during the year, the comparatio would not change, and average staff salaries would grow, year over year, in line with the rate of increase of the salary structure. In practice, several factors contribute to the decline of the comparatio:

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[2] The World Bank and Inter-American Development Bank use essentially the same mechanism as the Fund. The United Nations has a service-incremented salary scale, in which within-grade increments are awarded annually on the basis of satisfactory service. The U.S. government (general schedule) applies a system in which individuals receive a combination of a general increase, salary steps (based on experience), and bonus pay. In the private sector, the comparatio is commonly used for salary analysis but less so for the determination of merit budgets, which tend to be set at the discretion of senior management.

a. ***Separations*** of staff (e.g., due to retirement) usually contribute to the decline of the comparatio, as staff who separate tend to have salaries in the upper levels of their salary ranges, or at least higher than staff who replace them;

b. ***Promotions*** of staff also reduce the comparatio owing to the relatively small promotion increases awarded at the Fund. Because promotion increases (2–5 percent) are much smaller than the average difference between grade midpoints (12 percent), they typically lower the comparatio of the promoted staff members, the grades from/to which the staff member was promoted, and the staff overall;

c. ***Appointments*** of new staff tend to lower the comparatio, because starting salaries are usually set below the salary range midpoint of each grade.

6. **Changes in the workforce can also result in one-time changes in the comparatio**. For example, a reduction in force often results in the exit of more senior and higher-paid staff, resulting in a decline in the comparatio. A reorganization that entails an upgrade of existing positions/staff would typically lead to a decline in the comparatio because upgraded staff's salaries would usually be raised by less than the difference between grade midpoints. Finally, a large inflow of new staff, as took place in 2000 when 215 contractual employees were converted to staff, would exacerbate the effect on the comparatio of appointments.

7. **The comparatio adjustment is used to bring actual average salaries in line with salary range midpoints**. This adjustment recovers the decline in average salaries that occurs during the course of the year, bringing average salaries in line with range midpoints, and serves two additional purposes: (i) it provides the resources that allow staff to advance in their salary ranges through performance-based merit increases; and (ii) it provides a framework that helps prevent increases of average salaries within salary ranges.

## II. The Comparatio Adjustment and the Annual Salary Increase

8. **The current mechanism for determining the merit pay budget is grounded in the Fund's rules-based salary system**. This system, which was endorsed by the Executive Board in the context of the 2006 Employment, Compensation, and Benefits Review, aims to ensure that average salaries are kept in line with the Fund's comparator market. An adjustment to correct for in-year erosion of average salaries is an integral technical feature of the Fund's rules-based compensation system.[3] The comparatio adjustment complements the

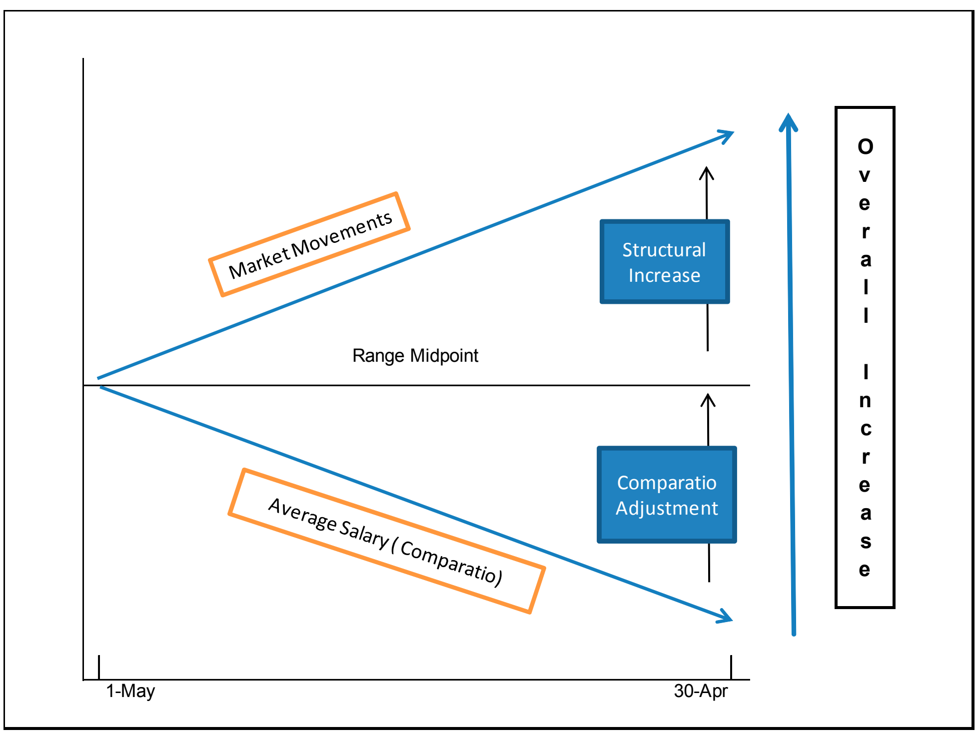
[3] The comparatio has been the subject of periodic interest by the Board, and has been discussed comprehensively in 1996 and most recently in 2007. See *Staff Compensation—The Comparatio* (EB/CAP/96/1) and *Staff Compensation—Indexation and Merit Pay* (EBAP/07/37).

structural increase by ensuring that actual average salaries remain competitive and aligned to the Fund's payline. The comparatio approach is thus key to enabling the Fund to maintain competiveness in a rules-based compensation system.

9. **The comparatio adjustment is thus an integral part of the merit increase**. The combination of a structural and comparatio adjustment ensures that, on average, the actual salaries of staff—and not just the salary structure—are maintained at the intended level relative to actual compensation in the Fund's comparator markets (Figure 1). In a nutshell, the structure adjustment ensures that the target is right (aligned with comparators), and the comparatio adjustment ensures that actual average salaries are right (aligned with target).

10. **An underlying goal is to ensure that increases in Fund salaries broadly correspond, on average, to the year-to-year increases in comparator market salaries**. Limiting the comparatio adjustment to less than the amount needed to restore a comparatio of 100 would result in a progressive erosion of the competitiveness of compensation at the Fund, even if the salary structure was maintained at fully competitive levels in relation to the comparator market. To prevent such an erosion of competitiveness, the comparatio is normally maintained as close to the target of 100 as practicable.

**Figure 1. Main Element of Annual Salary Increase**



## III. Alternative Approaches

11. **Most public sectors and some international organizations have salary ranges divided into a number of "steps."** In these systems, the annual salary increases for employees generally have two components: an increase in the salary structure and a more or less automatic step increase that raises the level of individual salaries within their ranges. The step increases take place over the course of the year, with each employee typically receiving a step increase on the anniversary of employment. Step increases serve the purpose achieved by the comparatio in the Fund, namely, to prevent the decline of average salaries within the salary ranges. Specific step increase methodologies vary between fully automatic to fully merit-based (Box 1) and allow individual progression through salary scales, commensurate with career development in the organization. Figure 2 maps the alternative systems in terms of their focus on seniority versus performance-based pay.

### Box 1. Step Increase Methodologies

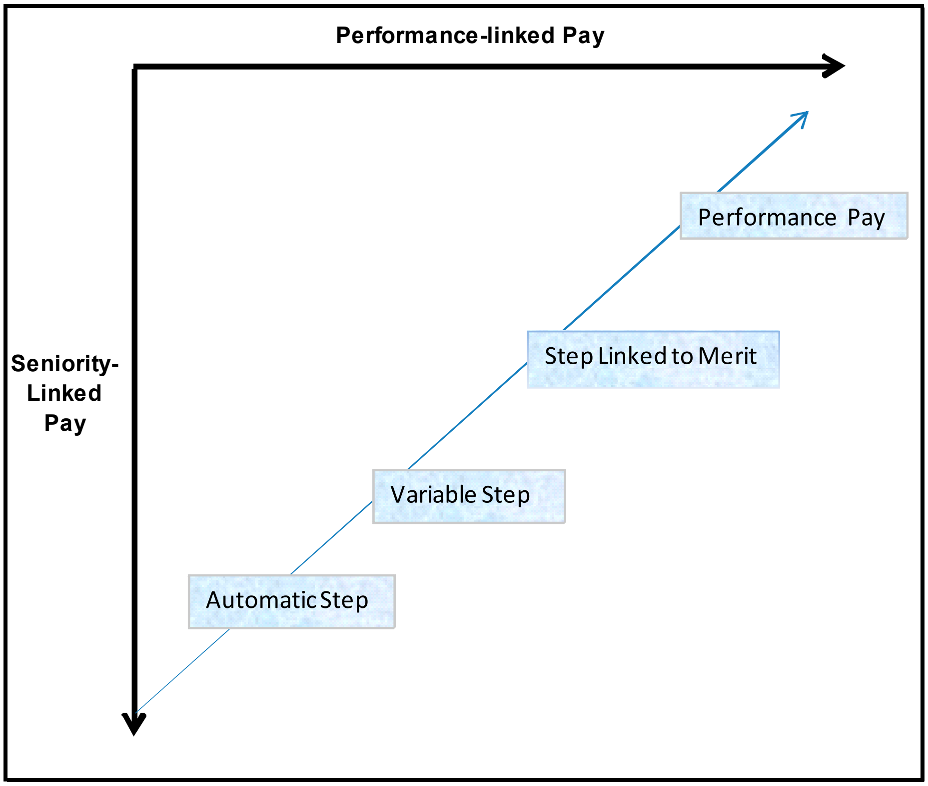
The most common step increase methodologies are:

- An **automatic step system** consists of a series of increments set at various percentage points within a salary range. In this system, within-grade increments are typically awarded to staff based on seniority. This methodology is applied mainly for routine jobs with limited performance variability and where performance is not measured. It is usually applied in organizations where the desire for stability and security is high.

- A **variable step system** is based on the same principle as the automatic step system. The key difference is the opportunity to reward employee performance and/or skill acquisition by granting more than one step. Within-grade increments are usually awarded to staff based on experience and satisfactory performance. In addition to variation in the number of steps, the timeframe for granting step increases may also vary.

- **Steps linked entirely to merit** provide automatic step increases up to the job midpoint, with merit determining subsequent steps. Thus, the employee must "re-earn" increases when pay is above midpoint by repeating performance above standard. Steps and ranges are updated regularly to maintain a competitive position.

**Figure 2. Base Pay Increase Systems**




12. **The practice of other international and public sector organizations is mixed**. The Fund's approach to the distribution of salary increases is in line with those of the World Bank, the Inter-American Development Bank, and the Federal Reserve Board, while it differs from those of the U.S. Federal Government and the United Nations.

- At the ***World Bank*****,** the annual merit increase aligns, on average, staff salaries to the market reference points of the new salary structure (structure increase plus comparatio adjustment). The system is pay-for-performance based, broadly similar to the Fund. Merit amounts are allocated based on unit distributions of performance and position in range.

- At the ***Inter-American Development Bank***, the annual merit increase is also determined by two elements: (i) the structure adjustment; and (ii) the comparatio adjustment. The structure adjustment ensures that the IDB's payline is adjusted broadly in line with the changes of the comparator market. The average salary increase aligns total staff salaries, on average, to the level of the grade midpoints after the structure adjustment. The system is pay-for-performance based, and merit amounts are allocated based on unit distributions of performance and position in range.

- At the ***United Nations***, the system for determining the annual merit increase is quite different from the Fund system. The salaries of staff in the professional and higher categories are made up of three main elements: a base floor (minimum) salary, a post adjustment, and within-grade steps. Base salary and post adjustments together form post-specific salary scales which are reviewed periodically to reflect changes in market conditions and/or cost of living. In addition, within-grade increments (steps) are awarded annually on the basis of satisfactory service.

- At the ***Federal Reserve*** **Board**, the salary increase budget and structure adjustment are based on market reviews. The system is performance-based, distributing divisional merit pools that equal the sum of the division's salaries multiplied by the budget increase percentage. Except for the top performance level, a single percent increase is available for each performance level across the organization.

- The ***U.S. Federal government*** provides automatic increases mainly through a combination of a structural increase (base and locality pay) and time-based steps. The increase of the salary structure is typically tied to the development of the Employment Cost Index produced by the Bureau of Labor Statistics. Step increases are granted incrementally based on time and acceptable performance.

- In the ***private sector***, salary increase budgets are typically established based on the financial results of the firm. These compensation systems are often accompanied by bonus pay, which makes comparisons with the Fund's system difficult. As noted, the comparatio is widely used as an analytical tool to measure the divergence in actual salaries from target levels.

13. **On balance, the comparatio approach is better aligned to the Fund's human resources and budget goals than the step approach**. Performance-based pay has long been a key feature of the Fund's compensation system. This approach provides appropriate incentives for strong performance, and allows significant differentiation in pay and recognition of performance outside the promotion system. The Fund system is consistent with the general trend in global compensation toward a stronger linkage between the design of pay programs and performance.[4]

[4] "In terms of base pay management, organizations are increasingly focused on ensuring any increases applied are delivered to those employees who have the most impact on business results." *Worldatwork, Workspan Magazine, February 2010 Edition. Performance Related Pay in the Context of Global Crisis, by Pat Gurren, page 33.*

## IV. Improving the Operation of the Comparatio

14. **While the comparatio is an integral technical feature of the Fund's current rules-based compensation system, its operation can be difficult to understand**. This has sometimes led to the misperception that Fund salary increases are larger than published increases in other public organizations. To avoid this misperception, the Executive Board has since 2007 been provided with more information on the factors impacting the relationship between staff salaries and comparator markets, and on the compensation system more generally.

15. **The current review has highlighted the need to consider a technical change in the comparatio methodology**. As discussed in this section, consideration should be given to changing the current "payroll method" for calculating the comparatio to the "staff-weighted average method".

### A. Harmonize Comparatio and Structure Adjustment Calculation Methodologies

16. **Different methodologies are currently used to calculate: (i) the structural increase (with a staff-weighted average); and (ii) the comparatio (with the payroll method).**[5] This difference can lead to a higher or lower measured decline in the comparatio in the year following full compensation reviews, when grade-by-grade adjustments are made.

**Box 2. Merit Increase, Methodologies for Distribution**

- The **staff-weighted average** (currently used to allocate the structural increase) measures the average of the percentage differences between the Fund range midpoints and the corresponding reference point in the U.S. market payline at each grade, weighted by the proportion of staff in each grade.

- The **payroll method (**used to establish the comparatio**)** is the ratio of (1) the sum of reference points in the market at each grade multiplied by the number of staff in each grade and (2) the sum of Fund range midpoints for each grade multiplied by the number of staff in each grade.

17. **The payroll method places a heavy weight on the comparatio in higher grades**, **whereas the staff-weighted average method weights the gap between salary and midpoints equally for each staff member irrespective of his/her grade**. A result of this feature is that the payroll–based comparatio in years following the triennial comparator-based salary review tends to be lower (resulting in a higher comparatio adjustment) whenever

[5] The payroll method to calculate the comparatio was approved by the Board in 2007, as result of recommendations from an internal working group that focused on presentation and simplicity of the comparatio based on experience outside the Fund. See *Staff Compensation—Indexation and Merit Pay* (EBAP/07/37).

the payline is "tilted" upward as was the case in 2009.[6] The difference between payroll and staff-weighted methods is exacerbated this year, because the A1–A8 salary structure was frozen in 2009 while actual A1–A8 salaries were increased by the Fund average amount (producing positive comparatios in the lower grades, which then receive a smaller weight with the payroll method than the staff-weighted method). Table 1 shows the 2010 calculation using both methodologies.

**Table 1. Comparatio as of January 1, 2010 Under Different Methodologies**

| Grade | Midpoint | Staff Count | Average Salary | Weighted Salary | Weighted Midpoint | Staff Weighted Comparatio |
|---|---|---|---|---|---|---|
| A03 | 42,350 | 3 | 35,927 | 107,780 | 127,050 | 84.8 |
| A04 | 47,440 | 26 | 44,621 | 1,160,140 | 1,233,440 | 94.1 |
| A05 | 53,180 | 79 | 52,126 | 4,117,960 | 4,201,220 | 98.0 |
| A06 | 59,480 | 125 | 60,211 | 7,526,380 | 7,435,000 | 101.2 |
| A07 | 66,670 | 136 | 68,908 | 9,371,530 | 9,067,120 | 103.4 |
| A08 | 74,690 | 117 | 77,666 | 9,086,870 | 8,738,730 | 104.0 |
| A01–A08 | | 486 | 64,549 | 31,370,660 | 30,802,560 | 101.5 |
| A09 | 77,360 | 57 | 81,749 | 4,659,710 | 4,409,520 | 105.7 |
| A10 | 89,610 | 84 | 89,439 | 7,512,880 | 7,527,240 | 99.8 |
| A11 | 102,470 | 206 | 102,526 | 21,120,300 | 21,108,820 | 100.1 |
| A12 | 117,110 | 182 | 112,865 | 20,541,400 | 21,314,020 | 96.4 |
| A13 | 134,310 | 286 | 127,240 | 36,390,710 | 38,412,660 | 94.7 |
| A14 | 159,780 | 523 | 151,360 | 79,161,360 | 83,564,940 | 94.7 |
| A15 | 181,150 | 230 | 174,981 | 40,245,550 | 41,664,500 | 96.6 |
| A09–A15 | | 1,568 | 133,694 | 209,631,910 | 218,001,700 | 96.6 |
| B01 | 181,150 | 53 | 181,599 | 9,624,740 | 9,600,950 | 100.3 |
| B02 | 208,570 | 115 | 204,100 | 23,471,490 | 23,985,550 | 97.9 |
| B03 | 232,150 | 56 | 228,038 | 12,770,130 | 13,000,400 | 98.2 |
| B04 | 264,670 | 60 | 258,715 | 15,522,880 | 15,880,200 | 97.8 |
| B05 | 304,810 | 20 | 303,422 | 6,068,440 | 6,096,200 | 99.5 |
| B01–B05 | | 304 | 221,900 | 67,457,680 | 68,563,300 | 98.4 |
| **A01–B05** | | **2,358** | **130,814** | **308,460,250** | **317,367,560** | **97.8** Staff Weighted Methodology |

**Payroll Methodology**

$$\frac{308{,}460{,}250}{317{,}367{,}560} \times 100 = \mathbf{97.2}$$

Difference = 0.6%

[6] This tilting of the payline results in higher increases of salary midpoints in higher grades, and thus—with the same average increase across all grades—in a lower comparatio in higher grades than in lower grades. In this context, payroll weighting produces a lower average comparatio (a higher comparatio adjustment) than staff-weighted averaging.

18. **From a human resource management perspective, staff weighting can be seen as preferable**. In order to recruit and retain staff at all levels, the Fund has an interest in ensuring that salary differences from the market are weighted equally across all staff irrespective of grade level. The staff expects to conclude its review of the comparatio methodology following this year's compensation round and will put forward a proposal to the Board in time for implementation in the 2011 compensation review.

### B. Other Human Resources Reforms

19. **Promotions of staff affect the comparatio by lowering average salaries in the grades into which staff enter**.[7] This mainly reflects the fact that promotion increases awarded at the Fund are modest, in the range of 2–5 percent. The low salary increases for promotions during the year translate into a larger comparatio adjustment at the end of the year, which is distributed to all staff through performance-based merit increases.[8]

20. **In many organizations, the percentage difference between midpoints is reflected in salary increases awarded with promotions**. In the Fund, promotion increases range from 2–5 percent, but the differential between midpoints averages 12 percent, which means that many staff fall below the new grade midpoint when promoted. Promotion policy is currently under review, and one of the changes being considered would raise the size of promotion increases to better reflect the assumption of higher responsibilities. If the Fund were to move toward larger promotion increases, the amount available for annual merit increases (through the comparatio adjustment) would be reduced, with an unchanged overall budget.

21. **Appointments of new staff tend to lower the comparatio**. New staff are normally hired with salaries below the salary range midpoints while staff who retire or separate tend to have salaries that are in the upper levels of their salary range. Higher starting salaries for new hires would therefore tend to reduce the size of the comparatio adjustment in subsequent salary rounds. Greater flexibility in determining competitive starting salaries for new recruits with skills and experience that are in high demand in the market is being considered as part of the agenda of the ongoing reform of recruitment policies and practices.

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[7] In the Fund, staff members can be promoted in three different ways: (a) through a career-growth promotion, when the promotion is within the position's grade band; (b) through selection to a vacant position at a higher grade (typically to managerial positions, or across grade bands in lower grades); or (c) through a reclassification of the position to a higher grade beyond the current grade band (typically through a job audit).

[8] The balance between merit and promotion increases varies across organizations; promotion increases in the Fund are smaller than typically provided in the U.S. private sector.