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EBAP/94/94

November 30, 1994

To: Members of the Executive Board

From: The Secretary

Subject: Informal Seminar on the Staff Compensation System

Attached as background information for the informal seminar on the staff compensation system, which is scheduled for Friday, December 2, 1994, is a paper that describes the main features of the system.

Mr. J. Kennedy (ext. 34665) is available to answer technical or factual questions relating to this paper prior to the seminar.

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INTERNATIONAL MONETARY FUND

Principal Features of the Fund's Compensation System

Prepared by the Administration Department

November 30, 1994

Staff compensation is a key element in the effective functioning of the Fund. In order for the Fund's work to command the respect and meet the needs of member countries, the Fund must maintain the highest standards of quality in its staff. Moreover, the Fund must be able to recruit its staff on as wide a geographical basis as possible, as required by the Articles of Agreement. At the same time, as a public sector international organization, the Fund must keep administrative expenditures under close control, including salaries and benefits for its staff, which constitute a major proportion of these expenditures. The present procedures for establishing salaries in the Fund attempt to achieve these goals by linking salaries to the compensation paid in outside markets.

The present procedures were developed from the work of the Joint Bank/Fund Committee of Executive Directors on Staff Compensation (JCC) established in 1984. The JCC Report, which was issued in 1988, served as the basis for discussions in the Executive Boards of the Fund and Bank of a new staff compensation system. In April 1989, the Executive Boards of the two institutions gave their final approval to the new system, which has been in place since that time. The principal features of this system are described below.

A. Overall objectives of the system

The design and operation of the compensation system has been guided by two fundamental objectives:

> First, the Fund's compensation -- its salaries, benefits, and allowances -- are intended to support the recruitment, retention, and motivation of the high caliber staff needed to command the respect and meet the needs of member countries, and to ensure, as required by the Articles of Agreement, that the Fund is able to recruit and retain staff on as wide a geographical basis as possible.
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> Second, the Fund's salary structure is intended to provide internal equity, so that staff in jobs of comparable content and weight are paid in the same salary range and that equitable salary differences are maintained between jobs of different content and weight.

Additional principles that guided the development of the current system include:

> Reflecting the principle of parallelism, the major elements of the compensation systems of the Fund and Bank should be the same, while allowing for those differences that are justified by differences in the staffing needs of the two organizations.
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> The major elements of the system should be set so that the conduct of the annual reviews is largely automatic, while still allowing for management and the Executive Board to exercise judgment in deciding the amount of any salary increase.
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> The system should pay due regard to the cost of staff compensation, which accounts for the largest administrative expenditures of the Fund.

B. The Fund's grade and salary structures

1. Job grades

During the mid-1980s, the duties and responsibilities of all positions in the Fund were evaluated and then grouped into 19 job grades so that positions with broadly similar "job content" are placed in the same grade and that positions in each successively higher grade have progressively greater duties and responsibilities. The 19 grades are identified as Grades A1-A15 and Grades B1-B5. 1/ Grades A1-A8 denote support staff positions; Grades A9-A15 are professional positions; and Grades B1-B5 cover senior staff positions with managerial responsibilities.

The grade structure plays two important roles in the Fund's compensation system. First, it is the foundation for the Fund's salary structure, in which a salary range is established for each job grade. With jobs in different functional streams having been evaluated on a consistent basis, the linkage of job grades and salary ranges helps to ensure that staff throughout the Fund are paid on a consistent basis that reflects their responsibilities within the organization. Second, it provides a means of comparing Fund jobs to jobs in the outside market. The same job grading methodology that was used in the Fund -- that of Hay Management Consultants -- has also been applied in a large number of private and public organizations in the United States and Europe. The common methodology helps to ensure that like is compared to like in relating the Fund's salaries to those of other employers.

2. Salary ranges and structure

Each of the 19 grades in the Fund's grade structure has its own salary range. The salary ranges reflect the minimum and maximum remuneration

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1/ The "A" and "B" grades overlap at A15 and B1; the salary ranges for Grades A15 and B1 are the same.

applicable to each job grade. In the Fund's structure, the "midpoint" of each range, i.e., the salary that is half way between the minimum and the maximum, represents the "going rate" for a solid performer in the range.

At present, the width of each salary range for Grades A1-A15 is approximately 50 percent, i.e., the maximum is 50 percent greater than the minimum. The width of the salary ranges for Grades B1-B5 declines from 50 percent in the case of Grade B1, to 20 percent for Grade B5. In Grades A2-B2, the midpoint of each salary range is approximately 12 percent higher than the midpoint of the adjacent, lower range. In the three highest Grades, these differences between midpoints are 10-12 percent.

The 19 salary ranges comprise the Fund's salary structure. The present salary structure including the minimum, maximum, and midpoint of each range is shown below. To construct the salary ranges, the range midpoints are first determined on the basis of the market comparisons described below. For Grades A1-B1, the maximum is then set 20 percent above the midpoint, and the minimum 20 percent below the midpoint to allow scope for salary progression within the range.

Table 1. Fund Salary Structure Effective May 1, 1994

Grade	Minimum	Midpoint	Maximum
A1	16,350	20,430	24,520
A2	18,300	22,880	27,450
A3	20,500	25,630	30,760
A4	22,970	28,710	34,460
A5	25,730	32,170	38,610
A6	28,800	36,000	43,210
A7	32,260	40,330	48,400
A8	36,150	45,190	54,230
A9	40,480	50,600	60,720
A10	45,340	56,680	68,020
A11	50,780	63,490	76,190
A12	56,880	71,090	85,310
A13	63,700	79,620	95,550
A14	71,350	89,180	107,020
A15/B1	79,900	99,880	119,860
B2	91,330	111,880	132,430
B3	109,390	123,060	136,740
B4	121,420	136,590	151,760
B5	139,080	152,990	166,900

C. How the salary structure is set

The salary structure is reviewed periodically -- normally annually, in April, with any increase being effective on May 1 -- by the Executive Board, and is adjusted, as necessary. The approach and procedures followed in conducting these reviews and adjustments, which are the same as those followed by the World Bank, are summarized below.

1. The "comparator market"

The central feature of the Fund's compensation system is the concept of the "comparator market", which is intended to ensure that the compensation paid to Fund staff members is competitive with that paid by certain chosen employers outside the Fund. The comparator market established by the JCC consists of private and public sector employers in the United States, France and Germany. In determining the organizations that should be covered in these markets, the JCC followed three principles:

> The organizations should be relevant and appropriate, i.e., the market should require the same types of skills, level of education, and professional training as the Fund and Bank,
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> The market should be composed of organizations from which the Fund and Bank might recruit and which, in turn, might seek to recruit Fund or Bank staff, and
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> The market should be reliable and stable in the sense that the organizations comprising it will provide consistent data from year to year.

Data on current salary levels in the comparator markets are, as envisioned by the JCC, collected annually for the Fund and Bank by an independent management consulting firm, Hay Management Consultants.

The basic approach followed in relating the Fund's salaries to the comparator market is, first, to set the midpoint of each salary range of the Fund's salary structure in relation to a selected, competitive level of compensation paid in the market, and, second, to adjust and, on an ongoing basis, administer the salaries of individual staff so that they, on average, approximate the midpoints of their respective ranges. By means of these two steps, the system serves to set both the Fund's salary structure and the salaries actually paid, as noted above, to the staff members with good, solid performance at the "going rate" in the outside employment market.

Different procedures are followed in establishing and adjusting the salary ranges for different categories of staff--support, professional and senior staff. These are described separately in the following paragraphs.

2. Professional staff (Grades A9-B2)

The primary comparator market. The United States market is the primary comparator market for establishing professional staff compensation at the Fund. The U.S. market is used for this purpose because most staff members are based in the U.S. and spend the largest share of their income there. The U.S. comparator market consists of three equally weighted sectors: (i) the private industrial sector, (ii) the private financial sector, and (iii) the public sector.

> The private industrial market used by the Fund as a comparator market consists of a wide range of U.S. industrial organizations with annual revenues in excess of $1 billion, who participate in the "ACCESS" database, a database prepared by the consulting firm of Hay Management Consultants.
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> The second comparator market, the private financial market, consists of a broad selection of U.S. financial organizations with assets in excess of $5 billion, who also participate in the Hay "ACCESS" database. It comprises mainly large commercial banks and diversified financial organizations.
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> Finally, the public sector includes six U.S. federal government agencies with a weight of 60 percent and the Federal Reserve System with a 40 percent weight.

In order for the Fund to correctly compare the salaries paid in these three sectors to its own salaries, it needs to be sure that it is comparing like with like. To this end, the Hay consultants exclude from the comparator market data for jobs or functions which are clearly unrelated to the Fund (or Bank), as well as jobs that rely heavily on commission-type payments. In addition, the mix of skills and functions in the private sector comparator market is weighted to provide a broad reflection of the skills and functions important to Fund and Bank positions.

Relationship to the market. An important question in setting the salaries of professional staff is to determine the level of pay in the comparator market to which Fund should be aligned. Having decided to include a fairly broad range of organizations in the comparator market, the JCC then concluded that it is appropriate to "pitch" Fund salaries at the 75th percentile of the market. 1/ This means that, grade, by grade, the Fund's salaries would be set at the point where 25 percent of all outside employees comprising the comparator market would be paid above the level of Fund staff and 75 per cent of the outside employees would be paid below the level of Fund staff.

1/ For technical reasons, the reference benchmark for salaries in the U.S. public sector is the average plus 10 percent rather than the 75th percentile. These two approaches typically yield similar results.

In the comparator market, pay is measured as the direct cash compensation of the employees. This includes all cash payments, of which the principal categories are (i) base pay, which is paid as a part of "guaranteed" remuneration, and (ii) variable payments outside of base pay, such as bonus pay. 1/ Because salaries in the comparator market are paid on a gross, pre-tax basis -- while those at the Fund are paid on a net-of-tax basis -- outside salaries must be netted down before they are compared to Fund pay. For this purpose, the Fund uses the current year's tax rate that is applicable, on average, to a married taxpayer with a non-working spouse and two dependents.

In order to establish the 75th percentile of the comparator market, the Hay consultants determine the 75th percentile at each grade for each of the three sectors of the comparator market, and then combines the results -- equally weighted -- to give the overall result for that grade. The equivalent of the Fund's spouse and dependency allowance for two children is then subtracted from the market data to make the results comparable to the midpoints of the Fund's salary structure, which does not include spouse and dependents' allowances. The result is the "payline" for the U.S. market at Grades A9-B2.

International competitiveness. Once the current level of professional salaries in the primary U.S. comparator market has been determined, the Fund then uses France and Germany as test markets for determining whether the U.S. market is sufficiently competitive to be used as the sole basis for calculating the compensation paid to its professional staff. This approach was adopted by the JCC in recognition that a "margin of international competitiveness" is required over and above the level of salaries in the major non-U.S. markets if the Fund's compensation is to be sufficiently competitive to induce recruits from those markets to accept expatriate employment. Maintaining an appropriate margin of international competitiveness is, thus, the key feature by which the compensation system ensures that the Fund can recruit and retain a high caliber international staff.

Like the U.S. comparator market, these international test markets are composed of one-third private industrial organizations, one-third private financial organizations, and one third-public sector organizations. Specific organizations included in the market are selected on the basis of the same criteria as comparators in the U.S. market. Data on salaries are also generally obtained through the Hay "ACCESS" databases for France and Germany. As with the U.S. market, the benchmark level of salaries in the French and German markets to which Fund salaries are related is the 75th percentile.

1/ To minimize the effects of the volatile nature of variable cash payments from year to year, and to provide a more realistic measure of actual salary expectations in the market, the Fund uses a five-year rolling average of the variable cash payments.

All direct cash compensation is taken into account in the French and German markets, and the gross pay of the comparators is netted down on the basis of each country's current year's tax rates for a married taxpayer with a non-working spouse and two dependents. French and German salaries are then converted to U.S. dollars on the basis of the arithmetic average of nominal exchange rates and purchasing power parity exchange rates over the most recent 12-month period. 1/ The JCC recommended the combination of these two rates to take into account, in a balanced manner, both the current nominal rate (as the most common conversion method considered by staff or potential recruits) and the differences in the domestic purchasing power of salaries.

The net salary data for France and Germany are combined, with an equal weight for each country, to provide a single international market against which the competitiveness of the U.S. market is tested. For this purpose, the JCC defined a "testing range" comprising a margin of between 10 and 20 percent over the combined French and German markets. A margin of this order is considered necessary to attract qualified personnel to relocate abroad and assume expatriate status.

If the U.S. market payline falls within this testing range, the U.S. market is considered appropriately competitive for Fund salaries to be related to it alone. However, if the U.S. payline is either <u>less</u> than 10 percent or <u>more</u> than 20 percent above the French/German payline, the compensation system calls for an evaluation of the international competitiveness of the Fund's salary structure. 2/

In deciding whether any action is required to restore international competitiveness, and on the nature and the extent of any such action, the Fund takes a number of considerations into account. They include the extent to which the margin has eroded or been surpassed, the Fund's experience in recruiting and retaining staff members from a broad nationality spectrum, and exchange rate developments.

Since 1989, adjustments to the salary levels indicated by the U.S. payline have been necessary to maintain an appropriate margin of international competitiveness. The margin was initially set at 11.6 percent in 1989, and it was raised to 12.4 percent in 1990. However, maintaining this margin in 1991 would have required (because of a large decline in the value of the U.S. dollar and tax increases in Germany) an increase that was considered excessive; the margin was accordingly set at 4.5 percent. Subsequently, the margin has been restored to about 10 percent (10.2 percent in 1993 and 10.1 percent in 1994). In reaching this margin *vis a vis* France

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1/ The timing of the annual salary review has meant that the exchange rates are those for the 12 months ending in October of each year. The purchasing power parity rates are based on 1990 OECD rates for the OECD member countries.

2/ The overall differences are the average of the differences in each grade, weighted by the number of staff in the grade.

and Germany, the Fund's 1994 midpoints were set only 2.7 percent above the U.S. market payline.

Setting the level of the Fund's midpoints

In practice, the Fund's salary range midpoints have been set at a level that does not directly follow either the payline for the U.S. market or the payline for France and Germany. This is because U.S. and French and German organizations follow different pay practices. The U.S. tends to pay lower entry-level salaries and then to increase pay more steeply at successively higher grades. France and Germany, on the other hand, tend to pay higher entry-level salaries and to provide smaller increases at successively higher grades; their payline is accordingly flatter than that of the U.S.

Compared to the U.S. in 1994, Fund salaries at Grades A9-A11 averaged about 20 percent above the market -- a margin that reflects the key importance of recruitment at these entry levels -- but Fund salaries at Grades A14-B2 trailed the U.S. market by about 10 percent. Compared to France and Germany, Fund salaries at Grades A9-A11 averaged about 8 percent above the market, and Fund salaries at Grades A14-B2 led the market by about 9 percent.

3. Senior staff (Grades B3-B5)

The compensation for staff at Grades B3-B5 is not directly set in relation to a comparator market. Rather, the midpoints for these grades were established by interpolation between the midpoint of the salary range for Grade B2, which is based on the comparator market, and the salary of the Managing Director (while leaving room for the salaries of the Deputy Managing Directors). The procedure followed in 1989, the first year of the compensation system, was to set the midpoints of Grades B3, B4, and B5 10, 11, and 12 percent, respectively above the midpoints of the adjacent, lower midpoint. With this progression between grades, the midpoints of Grades B3 and B4 approximated the midpoint of the next higher, which allowed for reasonable salary differentiation among these levels. Subsequently, the range midpoints for Grades B3-B5 have been adjusted annually by the same factor as Grades A9-A15.

4. Support staff (Grades A1-A8)

There are a number of difficulties in specifically defining an appropriate comparator market for the A1-A8 staff of the Fund. The Fund's entry-level Administrative Assistants, for example, typically have considerably greater experience when hired than entry-level secretaries employed by commercial organizations. Moreover, some of the duties of Fund assistants, such as mission work, are rare among outside employers. The international environment of the Fund, with the widespread use of languages other than English, also makes it difficult to compare Fund salaries on the basis of comparable job content with those of outside organizations. Recognizing these difficulties, the JCC recommended that the midpoints of the A1-A8 salary ranges be set by downward extrapolation from the A9-B2 salary structure. The reasonableness of the A1-A8 salaries established on this basis is, however, tested against the Washington area private sector market for secretaries. The testing range in this market is the 75th and 90th percentiles. At the present time, the A1-A8 midpoints are approximately aligned with the 75th percentile of that market.

D. How the Fund adjusts staff salaries

The foregoing discussion described the way in which the Fund's salary structure is set and adjusted on the basis of a selected comparator market relationship. By applying these procedures in the annual reviews of staff compensation, the Fund seeks to align the midpoints of its salary ranges and, on an overall basis, its salary structure with pay in the comparator market. A second, important element in the annual compensation reviews is then to determine the adjustment needed in staff members' salaries.

To remain competitive, it is necessary for the actual pay of staff, and not just the salary structure, to be maintained in the selected relationship to the market. Moving only the midpoints of the salary structure to coincide with the market would not necessarily achieve that aim because actual average salaries of staff are typically different from the salary range midpoints. Accordingly, the JCC recommended that the overall salary increase should be the amount needed each year to bring staff salaries to a level equal, on average, to the midpoints of the salary structure (and thereby the comparator markets). The JCC further recommended that the distribution of this overall increase should be designed so that average salaries tend towards the midpoints while allowing sufficient differentiation in individual increases to clearly recognize differences in performance. By administering staff salaries in this fashion, the system maintains both the salary structure and the salaries of the staff in the desired relationship to the market.

1. The "comparatio"

The overall salary increase needed to raise staff salaries to the level of the range midpoints is determined by reference to what is known as the "comparatio". The comparatio for a salary range is the relationship between average salaries within that range and the midpoint of the range. In a single grade, it is calculated by dividing the average actual salary paid to staff in that grade by the grade midpoint. Hence, the comparatio is at 100 when average salaries equal the midpoint; a comparatio of 105 would mean that average salaries in the grade were 5 percent above the midpoint. For the salary structure as a whole, the overall comparatio is calculated by weighting the comparatio at each grade by the number of staff in that grade.

2. Overall salary increase

In order to determine the amount of an annual salary adjustment, the Fund first calculates the percentage increase needed to adjust the salary structure to take into account changes in the comparator markets and the need to maintain international competitiveness, as described above. It then uses the overall comparatio to determine whether any additional increase is needed to bring average salaries into line with the new midpoints of the adopted salary structure and the current level of pay in the comparator markets.

Specifically, the Fund compares actual average Fund salaries with the newly-established midpoints of the salary structure. If the overall comparatio is less than 100 measured against the new structure, the amount needed to raise the comparatio to 100 is added to the structural increase.

For example, if, the comparatio was 98 when measured against the old structure, a 3.0 percent structural increase would lower the comparatio to 95.15 measured against the new structure. The average salary increase needed to restore the comparatio to 100, so that average salaries equal the new midpoints, would accordingly be 5.1 percent (100/95.15 = 1.051).

Normally, and this has been the case since the new compensation system was introduced, the overall salary increase is larger than the structural increase. This is because staffing changes -- appointments, separations, and promotions -- which occur throughout the year tend, in combination, to lower average salaries relative to the midpoints of the existing structure. The erosion in the Fund's comparatio during the year is typical of other organizations, and most organizations, like the Fund, provide average salary increases that are larger than their structural increases. In other cases, including some civil services, the erosion in the comparatio is offset through "step increases" provided to employees during the year.

3. Merit salary adjustment guidelines

Once the Executive Board has agreed on the amount of the overall salary increase, the increase is then available for distribution to staff members in accordance with guidelines covering merit increases. The merit salary adjustment guidelines are established by the Administration Department and communicated to the directors of departments, bureaus, and offices.

The amount of the merit increase provided to individual staff depends on two factors. The first is their performance during the prior year. The second, which reflects the JCC's recommendation that salaries should be maintained as close as possible to the range midpoints, is the level of the individual's salary within the range. The range of potential merit increases is indicated in a matrix which combines these factors. The matrix for 1994, when the structural increase was 0.6 percent and the overall increase was 2.7 percent, is shown below.

Performance Rating	First Quartile (Lowest 1/4th of the Range)	Second Quartile	Third Quartile	Fourth Quartile (Highest 1/4th of the Range)
1 (Outstanding)	3.5 - 5.0	3.0 - 4.5	2.5 - 4.0	2.0 - 3.5
2	2.0 - 4.5	1.5 - 4.0	0.5 - 3.0	0.0 - 2.0
3	0.0 - 2.0	0.0 - 1.5	0.0 - 1.0	0
4 (Unsatisfactory)	0	0	0	0

In the salary structure, the midpoints are designed to represent the full performance level of pay for jobs in each grade so generally the salary of the solid performer should be positioned around the midpoint. This is reflected in the guidelines for the distribution of merit pay by tapering the potential amounts of merit increases at successively higher quartiles within the ranges. The tapering, which allows larger increases for staff with salaries below the midpoint, is designed to advance such staff, subject to fully satisfactory performance, relatively rapidly up to the midpoint, so as to bring their pay to the full performance level and the intended relationship to the comparator market. Salary progression for staff paid above the midpoint, on the other hand, is designed to be progressively more difficult, because these staff are already paid above the full performance level of their job and the salary level indicated by the market.