

RE-61

TO THE MEMBERS OF THE COMMITTEE ON FINANCE:

ACTION ITEM

For Meeting of September 22, 2005

POLICIES ON UNIVERSITYWIDE AND SENIOR LEADERSHIP COMPENSATION, AND PROCEDURES FOR SENIOR LEADERSHIP COMPENSATION - *powerpoint presentation*

The Advisory Group on University Compensation recommends to the Board of Regents that the Committee on Finance recommend to the Board of Regents the adoption of the following policies and procedures, with the overall goal of aligning the compensation of University of California faculty and staff with their market comparators. These actions shall modify current Regents policies and procedures on compensation. The specific actions are:

- A. To adopt the goals of obtaining, prioritizing, and directing funds, to the extent they are available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015-2016.
- B. To adopt procedures for determining and setting compensation levels for senior leadership that are clear, comprehensive, and accountable, as detailed in Appendix 1.
- C. To augment funding of salaries for amounts in excess of \$350,000 with private funds for 42 senior leadership positions so that market parity is achieved over the next ten years, as detailed in Appendix 2.

The key philosophy driving the plan's objectives is that:

“The quality of our academic, management and staff personnel is essential to maintain the excellence of the University of California and its ability to contribute to the health and vitality of the State of California. Our strategy is to attract and retain the highest quality academic, managerial, and staff talent by offering competitive total remuneration.”

The Board will be asked to approve these actions at its November meeting.

BACKGROUND

The University of California salaries are below comparable market salaries by an average of 15 percent, as of July 1, 2005, with variances by category ranging from 10 percent to -20 percent. Salaries were below the market prior to the recent budget difficulties; the lack of funds for annual salary adjustments in the last two years has exacerbated the lag of University salaries compared to the market. The Advisory Group on University Compensation was formed to consider alternative strategies to address these compensation issues and to consider more efficient and responsive policies and procedures.

At the request of the Advisory Group, the University recently engaged Mercer Human Resource Consulting to assess the competitiveness of the total remuneration offered by the University, to report on the UC total remuneration vis-à-vis the labor markets in which the University competes for talent, and to provide information in a context for use by The Regents in determining short-term actions, longer-term strategies, and policies and procedures for determining comparability and setting salaries.

The Mercer study, which excludes medical centers and national laboratories, concludes that UC cash compensation lags the market median by an average of 15 percent.

University of California Health and Welfare Benefits

UC benefits currently exceed the comparator group significantly. The Retirement portion of these benefits is measured in future dollars and therefore not of immediate value to employees. Younger employees do not place a high value on these benefits. For employees who do not remain with the University over the long term and who leave University employment relatively early in their careers or for senior personnel who join the University late in their careers, the Retirement benefit is of significantly less or, in some instances, no value. Additionally, it is anticipated that the value of both the Health and Welfare benefits and the Retirement and Retiree Medical benefits will be reduced significantly over the next few years, as discussed below.

Active Health & Welfare Benefits

The Mercer study reports that UC's active health and welfare benefits exceed the market median value by 10 percent overall; this is well within a competitive range. For the Management and Senior Professional category of employees, the lead over the median is small (approximately 2 percent); for members of the Senior Management Group, the lead over the median rises to 33 percent as a result of differences in benefits provided, such as the employer-paid senior management group life insurance and the disability provision for senior managers who have served five consecutive years.

Healthcare costs have continued to rise in recent years while University salaries have remained flat. To help mitigate the impact of rapidly increasing healthcare costs and keep participation levels high in the University's healthcare benefit programs, the University adopted a salary-based approach for medical plan premiums so that lower-paid staff members contribute less toward the costs of

their medical coverage. Because it is anticipated that the percent of increase in healthcare costs will exceed the percent of increase in salaries in the coming years, it appears that even if gross salaries improve, University employees may perceive that their net pay is not increasing commensurately. The University will not be able to provide sufficient healthcare contributions to offset the increase in healthcare costs; therefore, the relative advantage to market will be reduced.

Retirement and Retiree Medical

The Mercer study reports that UC's retirement and retiree medical benefits exceed the market median value by 63 percent overall; the leads of the various employment categories range from 15 percent over the market median for non-ladder-rank faculty and other academics to over double the market median for service workers.

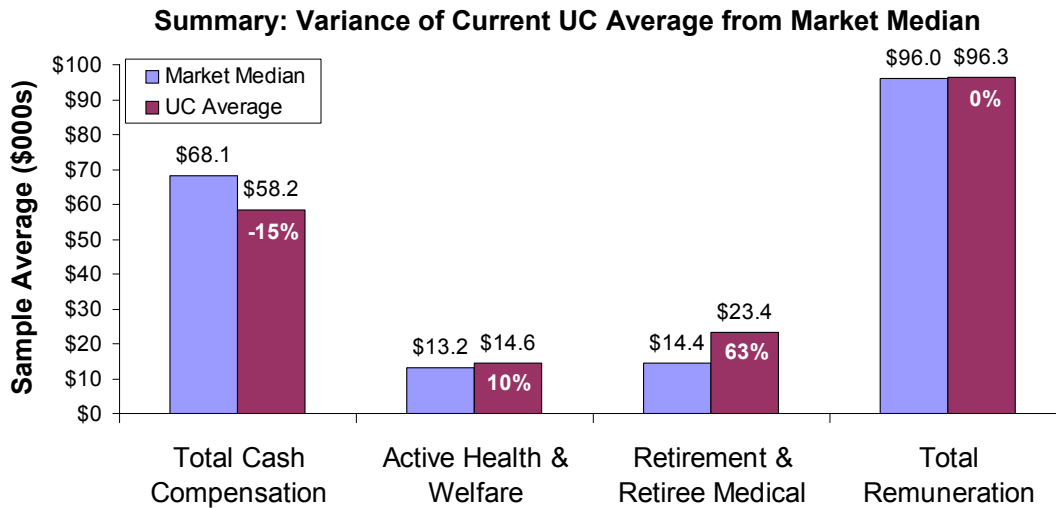
The University of California is among the few institutions continuing to offer a robust retirement plan and the full continuation of the health insurances into retirement. No contributions have been made to the retirement plan by employees since November 1990. Employer and employees are expected to contribute within two to three years, which will reduce the relative value of this benefit to market.

As of January 1, 1990, the University instituted a graduated schedule of eligibility, with the result that employees hired on or after that date must have ten years of service to be eligible for the continuation of healthcare benefits into retirement and must have 20 years of service to be eligible for the full University contribution; however, this has become a very expensive benefit. Given the cost, the University is reviewing this benefit level. Expected adjustments in the next two to three years also may reduce the relative value of this benefit to market.

Total Compensation

The Mercer study reports that overall the total remuneration package provided by the University of California is close to the market median value when benefits are factored into the equation (see Table 1 below). However, as noted above, the value of these benefits is expected to be reduced over the next five years as employee retirement contributions are phased in and the relative value of health insurance coverage declines. Additionally, retiree and retiree health benefits are not recognized as beneficial to many employees for many reasons (the benefit may be far in the future or may not be realized by employees who leave University service). Also, the value of the benefit offerings varies significantly based upon individual and group demographics, which may seriously hinder recruitment efforts.

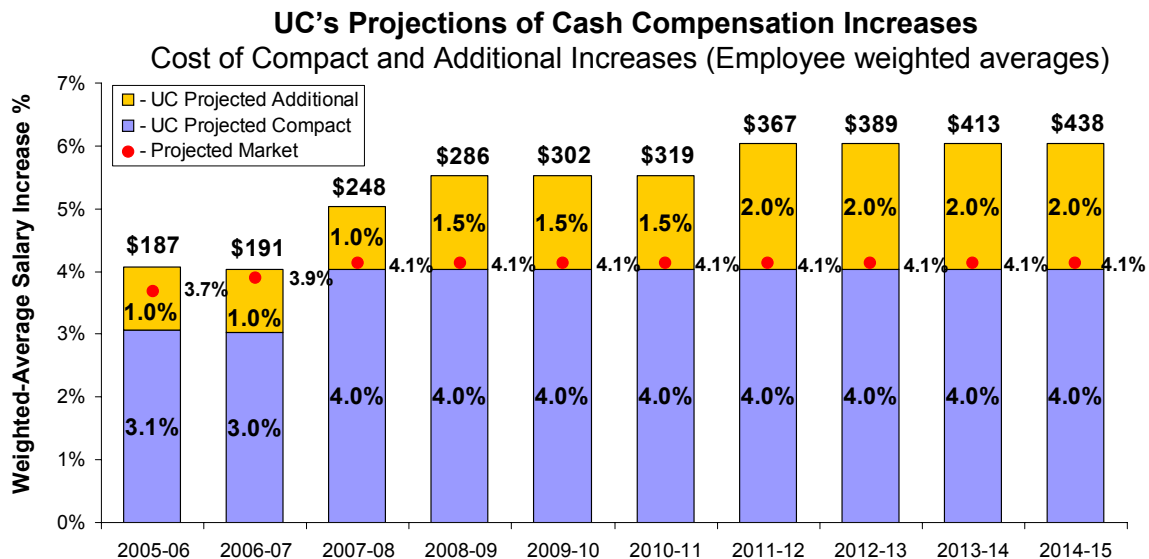
TABLE 1
Total Remuneration Study Findings



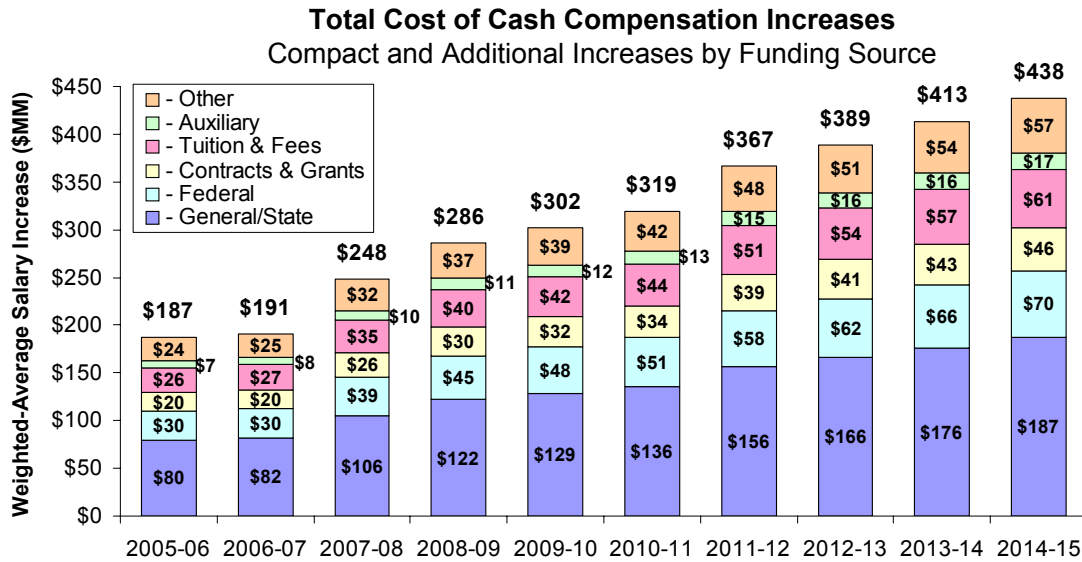
NOTES: Averages reflect the total remuneration study population only and not UC system-wide figures -study did not include labs or medical centers; individual employees fall significantly above and below the UC averages;; totals are not additive due to market median variations and rounding

RECOMMENDATION A: TO ESTABLISH GOALS TO OBTAIN, PRIORITIZE, AND ALLOCATE FUNDS, TO THE EXTENT THEY ARE AVAILABLE, TO INCREASE SALARIES TO ACHIEVE MARKET COMPARABILITY FOR ALL GROUPS OF EMPLOYEES OVER THE TEN-YEAR PERIOD FROM 2006-2007 THROUGH 2015-2016.

The following tables show the proposed goals for *cash* compensation and sources of funds over the next ten years to achieve market comparability. The *total* cost of achieving comparability (in current dollars) is \$2.5 billion using a 4.0 percent growth rate.



NOTE: Salary increase percentages provided by UCOP; total cost based on payroll at Campuses and UCOP as of March, 2005



NOTE: Percent breakdown of funding sources provided by UCOP and remain constant over time

In summary, the recommendations will result in the following actions, which are described in more detail in the policies, priorities, and process for senior leadership discussed in Recommendation B below and Appendix 1.

The University will actively pursue obtaining additional funds from State and all other resources.

The Regents will determine annually the amount of funds available for this purpose to be allocated to each campus and to the Office of the President.

The Regents will set annually Universitywide and campus-specific funding levels and priorities for the use of funds, as recommended by the President, for all groups of employees, considering such factors as total compensation discrepancies, retention, recruitment, performance, and other matters.

RECOMMENDATION B: TO ADOPT PROCEDURES FOR DETERMINING AND SETTING COMPENSATION LEVELS FOR SENIOR LEADERSHIP THAT ARE CLEAR, COMPREHENSIVE, AND ACCOUNTABLE IN ACCORDANCE WITH THE PRINCIPLES IN APPENDIX 1.

The Regents and Senior Management have recognized for some time that the salary review process is ineffective.

- The current process of individual salary review does not provide for a systematic framework in which The Regents can assess Senior Leadership salaries.
- The comparability data currently provided to The Regents do not provide sufficient information to judge the individual positions and appropriate placement within the comparability range.

- An individual approval of salaries does not provide an effective process for assessing overall compensation.
- Failure to adjust the approval levels to reflect the effects of inflation has resulted in an excessive number of individual actions that require Board approval.
- While the Board has benefited from ad hoc compensation studies, routine external salary survey data, and CPEC analyses, there has not been a systemic, continuous external review procedure for individual positions.

Therefore, the Advisory Group on University Compensation recommends that:

- A salary range structure shall be approved by the Board of Regents for all campus and OP positions and shall be established based on recommendations of an external consultant.
- The Board of Regents will approve annual adjustments to the salary ranges based on an external consultant review and recommendations of the ranges and the placement of all targeted positions within this grade structure.
- For all positions of the Senior Leadership Compensation Group whose compensation exceeds the Indexed Compensation Level (ICL), the procedures described in Appendix 1 shall be used. Briefly, these procedures are:

The Indexed Compensation Level (ICL) that was used for 2004-2005 was \$168,000. The ICL shall be adjusted annually based on the CPI and shall be reported annually to the Regents in accordance with Regental Bylaw 12.3(m)(2).

- (1) The salaries for 32 positions specifically listed on Appendix 1 shall be directly approved by The Regents, with advice and recommendations as detailed in Appendix 1.
- (2) The President, for all positions in the Senior Leadership Compensation Group except for the 32 directly approved by The Regents, will, with the advice of the Senior Management Advisory Committee, determine specific salaries for each position within the grade structure approved by The Regents and consistent with the budget funding levels approved for each campus and for the Office of the President, by The Regents.
- (3) All salary increases in any one year that result in any salary over the maximum of the salary range for the position or an increases in excess of 15 percent that places the salary above the midpoint of the salary range for the position shall be individually approved by The Regents.
- (4) An annual report shall be made to The Regents on all positions and salaries for all whose compensation is in the Senior Leadership Compensation Group (i.e., in excess of the Indexed Compensation Level).

RECOMMENDATION C: TO AUGMENT FUNDING OF SALARIES FOR AMOUNTS IN EXCESS OF \$350,000 WITH PRIVATE FUNDS FOR 42 SENIOR LEADERSHIP POSITIONS SO THAT MARKET PARITY IS ACHIEVED OVER TEN YEARS IN ACCORDANCE WITH APPENDIX 2.

State funding for the overall University Compensation program is limited, and the University will be challenged to achieve its long-term compensation goals. Salaries for senior positions at the University of California have one of the highest percentage gaps to market, creating significant challenges in recruitment and retention.

- The University must attract the finest leaders if it is to retain its truly excellent position, and it faces significant competition from other institutions in attracting and retaining key leaders.
- Some friends of the University have expressed an interest in assisting the University by providing funding to assure competitive salaries for select leadership positions.
- As is done at a number of other elite publicly funded universities, the experience of others indicates that strict controls must be established to assure the integrity of any process for supplementing compensation.

Therefore, the Advisory Group on University Compensation recommends that:

Funding for 42 positions be sought from private sources for the salary amounts in excess of \$350,000 annually. Currently, there are eight of these positions whose salary is in excess of \$350,000, although this number will increase as salaries reach comparability over the next ten years. The use of private funding would be in accordance with Appendix 2 for portions of certain leadership salaries in excess of \$350,000. The positions that would be eligible for private funding are:

- The President
- Chancellors
- Deans of Business-Management
- Deans of Engineering
- Deans of Law

This group could be expanded to include Senior Vice Presidents and Executive/Senior Vice Chancellors in future years.

Briefly, policy restrictions include:

- (1) No University official could solicit funds for his/her own salary.
- (2) Only select donors could be approached for these contributions, in a manner approved by The Regents.

- (3) All funds raised through this process would be held by the President and used at his discretion and within the guidelines established by The Regents to augment salaries.
- (4) Donors could designate selected campuses or positions as potential beneficiaries of their contributions, but the donor could not control the salary levels or the timing of the use of these funds.
- (5) These funds would be used to augment salaries of certain Senior Leadership group positions for which the annual salaries exceed \$350,000 for the fiscal year 2006-2007, which amount will be adjusted annually in accordance with Bylaw 12.3(m)(2) based on the CPI and reported to The Regents annually.
- (6) The President has the authority to use the augmentation funds within the salary levels approved by The Regents in accordance with Appendix 1, except for those positions as specified in Appendix I – Senior Leadership Compensation Policy that require direct Regental approval.
- (7) Until private funding is obtained for the augmented portion of the salaries for these positions, current fund sources will continue to be used to provide for the total compensation in accordance with procedures specified in Appendix 1 – Senior Leadership Compensation Policy.

Appendix 1

SENIOR LEADERSHIP COMPENSATION POLICY

1. POSITIONS INCLUDED UNDER THIS POLICY SHALL INCLUDE all positions of the University whose compensation is in excess of the Indexed Compensation Level (ICL), and this group of positions shall be called the Senior Leadership Compensation Group, or SLCG.
2. APPROVAL OF COMPENSATION shall be as follows:
 - a) Compensation of the President and Secretary of The Regents shall be determined by the Board of Regents upon recommendation of the Committee on Finance.
 - b) Compensation of the General Counsel shall be determined by the Board of Regents upon recommendation of the Committee on Finance after consultation with the Office of the President.
 - c) Compensation of the Treasurer shall be determined by the Board of Regents upon recommendation of the Committee on Finance after consultation with the Office of the President, the Committee on Investments, and the Investment Advisory Committee.
 - d) Compensation of the Chancellors, Senior Vice Presidents and Vice Presidents, Medical Center Heads, and the Laboratory Directors, including compensation upon appointment and subsequent changes in compensation, shall be determined by the Board of Regents upon recommendation of the President through the Committee on Finance.
 - e) Compensation of other Officers of the University with annual rates above the Indexed Compensation Level shall be established within the ranges set by the Board of Regents and determined by the President and shall be reported annually to the Board of Regents.
 - f) Compensation of all other Officers of the University with annual rates below the Indexed Compensation Level shall be determined by the President and reported annually to the Board.
3. As provided in The Regents' Bylaws, the Indexed Compensation Level (ICL) shall be adjusted annually in accordance with changes in the Consumer Price Index and shall be reported annually to the Board. The base ICL used for 2004-2005 was \$168,000.
4. For all positions in the Senior Leadership Compensation Group, The Regents shall approve salary ranges annually upon recommendation of the President and/or in accordance with the process specified in item 2a through 2e above. Such recommendations shall be based on comparisons to the Full Comparison Group, the New Comparison Group, the Comparison Eight, the Private Peers, and the Public Peers, and on equity within the University of California. A cash

compensation study shall be conducted annually and shall provide the basis for setting the salary ranges.

5. The methodology for setting the Salary Ranges shall reflect the relationship of the UC campuses to the comparison institutions and to other UC campuses.
6. All salaries for the SLCG except for those 32 requiring direct Regental approval (2a through 2d above) shall be determined by the President within the Salary Ranges and budget levels approved by The Board of Regents and funding levels available from State funds and other University sources, including private funds available, in accordance with Appendix 2. The Board of Regents shall set priorities annually for the use of available funds as recommended by the President, considering factors such as total compensation discrepancies, retention, recruitment, performance, and other matters.
7. Any salary for a member of the SLCG above the approved Salary Range shall be presented to The Board of Regents for approval through the Committee on Finance.
8. Any salary increase in excess of 15 percent of base salary for a member of the SLCG that will result in a salary above the salary grade midpoint for the position must be approved by The Board of Regents.
9. The President may establish procedures and delegate to each of the Chancellors the ability to set salaries for the SLCG within approved ranges for:
 - Non-represented Professional and Support Staff;
 - Management and Senior Professional Staff whose salaries are under the Indexed Compensation Level.
10. The President may establish procedures and delegate to each of the Chancellors the ability to set salaries in accordance with Universitywide guidelines established by the President for certain other non-SLCG employees.
11. All salaries for each position in the SLCG shall be reported to The Regents annually, following the annual merit process. The report shall include the methodology used to set salaries within the ranges and shall provide comparisons within campus and Universitywide for the positions and salaries reported.
12. On recommendation of the respective Principal Officer of The Regents, compensation for the Office of the Treasurer, the Office of the General Counsel, and the Office of the Secretary (excluding the Treasurer, the General Counsel, and the Secretary, whose compensation shall be approved by the Board of Regents in accordance with paragraph 2 above) shall be determined by the President, the Chair of the Board of Regents, and the respective Committee Chair of The Regents. In the event that the parties do not concur, compensation shall be determined by the Board of Regents. If such salaries are in excess of the current Regental ICL threshold, then the Board of Regents shall determine the ranges for such salaries in accordance with item 3 above.

Appendix 2

POLICY ON PRIVATE FUNDING FOR PORTIONS OF CERTAIN LEADERSHIP SALARIES

With the goal of using private funding to augment the salaries of certain Senior Leadership Compensation Group administrative positions designated by The Regents for which the market salary requirements exceed \$350,000, annually adjusted, as of July 1, 2005, The Regents:

1. Authorize the President to raise private funds and allocate such private funds for specific positions as approved and designated by The Regents.
2. Designate the following positions eligible to use private funding for the portion of the salary in excess of \$350,000:
 - The President
 - The Chancellors
 - Deans of Business-Management
 - Deans of Engineering
 - Deans of Law

This group could be expanded to include Senior Vice Presidents and Executive-Senior Vice Chancellors in future years.

3. Establish a process to review and approve the donors to be solicited for the salary augmentation program using these guidelines:
 - Donors may designate the position or positions whose salary/salaries may be augmented with their funds.
 - Donations may be made to an individual campus, but the funds shall be held by, allocated by, and distributed by the President.
 - No donor contribution may augment a salary beyond ranges or levels approved by The Regents.
 - Fundraising efforts shall be focused on providing sufficient resources for multi-year salary augmentation.
 - The President shall submit an annual report to The Regents on private funds obtained for this program and on the use of these private funds for salary augmentation.
 - University officials shall be prohibited from soliciting funds for their own salaries.
4. The University will continue to support salaries for such positions with all applicable funds until private funds become available.
5. The University may support salary augmentation with both current and endowment funds.