U.S. Securities and Exchange Commission

Pay Parity Implementation Plan and Report

U.S. Securities and Exchange Commission

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Executive Summary

The SEC has faced a staffing crisis for years, primarily due to our inability to compensate our employees adequately.[1] With the enactment of legislation that allows the SEC to create a compensation system similar to the systems of other federal financial regulators, the Commission finally will be in a position to implement a permanent solution to our serious recruitment and retention problem - provided the SEC receives the funding to do so.

This report describes the SEC's careful approach to implementing a new compensation system. When drafting our system, we worked to strike a delicate balance among many interests, including the concerns of Congress and the goals the Administration. The Commission intends to implement a modest system that encompasses several key principles - providing comparability with the other feder financial regulators; addressing problems with supervisory pay compression; accounting for differences among certain specialized occupations; and including substantial merit and performance-based components.

In developing this plan, we took best practices from all areas and learned from th experiences of the other financial regulatory agencies. We believe that the reasonable approach described in this Report can be implemented relatively quick to relieve our staffing problems. At the same time, we recognize that the full benefits of pay parity will involve an on-going, long-term effort.

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Background

Public Law 107-123, the Investor and Capital Markets Fee Relief Act ("Pay Parity Act"), requires the Securities and Exchange Commission ("SEC" or "Commission") to submit a report to the Committee on Governmental Affairs and the Committee on Banking, Housing, and Urban Affairs of the Senate, the Committee on Government Reform and the Committee on Financial Services of the House of Representatives, and the Office of Personnel Management ("OPM") describing the Commission's plan to implement Section 4802 of Title 5 of the U.S. Code.

This provision of law provides the Commission with the authority to appoint and fi the compensation of such officers, attorneys, economists, examiners, and other employees as may be necessary for carrying out its functions under the securities laws as defined under Section 3 of the Securities Exchange Act of 1934 (15 U.S.C 78c). Consistent with the Commission's ongoing efforts to improve its ability to attract and retain staff, this law places the SEC on equal footing with its sister federal financial regulatory agencies. The SEC has worked closely with Congress and the Administration throughout this process of resolving the agency's ongoing staffing crisis and appreciates greatly the support that it has received.

This report describes the Commission's plan to implement the "pay parity" provisions of the Pay Parity Act. It provides evidence and supporting documentation justifying the Commission's pay parity plan. It also discusses the associated budgetary costs and benefits of full implementation. The SEC will repoı annually on the effectiveness of the Commission's pay parity efforts as part of the Annual Performance Plan requirements under the Government Performance and Results Act of 1993 (GPRA).

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Evidence Justifying Pay Parity

Regulatory Environment

The SEC, an independent federal regulatory agency, was created in 1934, at the depths of the Great Depression, a time when investors' confidence in our nation's capital markets was at an all-time low. The SEC's mission was then, and is now, t administer and enforce the federal securities laws in order to protect investors an maintain fair, honest, and efficient markets. Today, the SEC employs approximately 3,000 employees in 11 regional and district offices and its District (Columbia headquarters.

The SEC oversees our nation's securities markets with a modest staff and limited resources, operating in conjunction with the states and self-regulatory organizations. This cooperative structure enables the Commission to leverage its resources to fulfill its mission. The SEC regulates a securities industry that has grown to enormous proportions. The SEC currently oversees an industry consistin of an estimated 8,000 brokerage firms employing nearly 700,000 brokers; 7,500 investment advisers with approximately $20 trillion in assets under management; 5,240 investment companies; and over 14,000 reporting companies. The Commission also has oversight responsibility for 9 registered securities exchange the National Association of Securities Dealers, the National Futures Association, 1 registered clearing agencies, and the Municipal Securities Rulemaking Board. In addition, the SEC expects the number of entities it oversees to increase significantly as a result of the passage of the Commodity Futures Modernization Act, which for the first time allows the trading of a new class of securities - future contracts on single stocks and narrow-based security indexes. Over 54 million U.S households, 52% of all households, own mutual funds. In 2000, over $34 trillion i stocks and options traded hands through the U.S. securities markets.

The atmosphere in which the Commission has regulated the securities industry since the Commission's inception changed in 1999, when Congress passed the Gramm-Leach-Bliley Act (P.L. 106-102), eliminating many of the 70-year-old statutory barriers between participants in the securities, insurance, and banking industries. As the banking, securities, and insurance worlds continue to evolve in light of the Gramm-Leach-Bliley Act, Commission staff have begun to work increasingly closely with staff from those federal banking regulatory agencies that are not subject to Title 5 of the U.S. Code. These agencies, including the Federal

Reserve Board ("FRB"), Office of the Comptroller of the Currency ("OCC"), Office c Thrift Supervision ("OTS"), Federal Deposit Insurance Corporation ("FDIC"), and National Credit Union Administration ("NCUA"), all are permitted by statute to pay salaries in excess of the Title 5 ceilings. Those higher salaries give the banking agencies a significant recruitment advantage over the Commission and were enacted during the savings and loan crisis of the 1980s. The pay parity provisions of the Pay Parity Act "level the playing field" by ensuring that the Commission will be able to compete and continue to attract highly qualified staff who might otherwise decline employment with the SEC. In addition, pay parity will help the Commission retain highly qualified staff. While it is one thing for SEC staff to mak salary comparisons with the private sector, it is quite another for them to see thei government counterparts making up to 40 percent more than they are.

Current Challenges

The SEC today faces some of the most complex and difficult issues that it has eve considered. No segment of American business has been more transformed by the rapid pace of technological change in recent years than the securities industry. New technologies, new participants, and new financial products are reshaping our markets, and the SEC is straining to keep pace.

Today, more Americans have a stake in our markets than ever before. Twenty years ago, less than 6 percent of Americans owned mutual funds. Today, 54 millic households, representing approximately 52 percent of all U.S. households, own mutual funds. Between 1990 and 2001, assets in mutual fund portfolios increasec from $1.1 trillion to $6.7 trillion, while assets managed by investment advisers increased four times, from $4.9 trillion to $20 trillion. An historic threshold was crossed in 1995 when, for the first time, the value of mutual funds held by Americans exceeded the amount on deposit at commercial banks - today, the valu is almost double. These legions of new investors are purchasing, directly or indirectly, from a larger and more diverse pool of securities than ever before. The dollar amount of securities filed for registration with the Commission increased more than five-fold between 1990 and 2001, rising from $379 billion to $2.3 trillion, while the number of foreign companies registered with the Commission more than tripled, from 434 to approximately 1,400.

As recent events have reinforced, Americans have an unprecedented need for the SEC to continue to be able effectively to fulfill its mission of protecting investors and maintaining fair, honest, and efficient markets. Whether through college savings plans, retirement accounts, or as an alternative to low-yielding bank savings accounts, our collective investment in securities continues to grow, and w are increasingly dependent on the success and integrity of our markets.

Technical advances also breed new challenges. While the increasing use of technology presents new opportunities for the securities markets, securities firms, and investors, it also presents challenges for the Commission to monitor the increasing trading volume and the complex computer systems that manage it. As of the end of the second quarter of 2001, the combined average share volume on the New York Stock Exchange and Nasdaq rose to over 3.17 billion shares, representing a more than 20 percent increase from the comparable period in 200(Advances in technology also have fundamentally changed the way markets and market participants operate. Recent advances now permit a variety and combination of services that blur the distinction between markets, intermediaries, and service providers. For example, electronic communication networks that did not exist several years ago now account for 35 percent of the daily share volume Nasdaq securities. In addition, while online brokerages and day trading were unknown just a few years ago, there are more than 200 online trading firms operating in the U.S., with approximately 19.3 million online brokerage accounts.

The increasing globalization of securities markets creates further challenges for th SEC. Interest by U.S. market participants in foreign securities is on the rise, and foreign securities commonly are found in the portfolios of U.S. investors, either directly or indirectly (*e.g.*, through mutual funds). Today, the technological mean: exist to permit U.S. persons to trade directly on foreign markets, and widespread use of the Internet allows investors on opposite sides of the world to negotiate securities transactions with relative ease. As a result, the Commission is devoting substantial resources to adapting its regulatory framework to the globalization of the securities markets, with the goal of facilitating cross-border transactions while maintaining our high standards of investor protection and the integrity of the U.S. markets. We also are working increasingly with our foreign regulatory counterparts, both on policy matters and in the enforcement context.

Staffing Crisis

Against the backdrop of an ever expanding and diversifying securities industry, ar the development of more highly complex and specialized financial instruments, th SEC has struggled to resolve its ongoing staffing problems since the 1980s. At the request of Congress, in December 1988 the Commission submitted an in-depth study of several possible means to address its ongoing staffing problems. Since this first submission and recognition of the SEC's difficulties, the SEC has worked diligently within the existing compensation and benefit flexibilities offered under current law. Some of the efforts that will be discussed in this document have provided temporary relief for the Commission, but none has resolved the Commission's need for permanent, systemic pay relief.

While a portion of the agency's recruiting and retention problems undoubtedly are correlated with the overall strength of the economy during the 1990s, the followir table highlights the magnitude and structural nature of the Commission's staffing crisis.

Table 1: SEC and Government-wide Turnover Rates
Fiscal 1994 to 2001
SEC Turnover Rate, 1994-2001

Fiscal Year	Permanent Employees	Attorneys	Accountants	Securities Compliance Examiners	GS-14s	GS-15
1994	9.59%	13.90%	6.91%	5.51%	11.27%	11.45%
1995	11.39%	15.15%	9.38%	14.29%	9.61%	12.98%
1996	9.52%	11.32%	8.96%	10.31%	10.50%	9.59%
1997	11.94%	16.01%	12.13%	10.78%	14.82%	15.83%
1998	12.46%	15.19%	12.87%	10.48%	14.77%	11.36%
1999	13.72%	13.50%	13.72%	14.92%	14.35%	14.43%
2000	13.83%	17.47%	13.76%	13.93%	14.75%	11.48%
2001	8.48%	9.86%	7.00%	9.34%	8.73%	10.96%

Government-Wide Turnover Rate, 1994-2001

Fiscal Year	Permanent Employees	Attorneys	Accountants	Financial Institution Examiners*	GS-14s	GS-15
1994	7.83%	6.51%	6.44%	8.31%	6.93%	8.63%
1995	12.33%	11.95%	8.11%	7.05%	7.84%	8.64%
1996	7.03%	6.66%	6.61%	13.77%	5.60%	7.02%
1997	7.62%	7.41%	7.14%	8.05%	6.21%	7.95%
1998	7.07%	7.05%	8.01%	5.56%	5.59%	7.02%
1999	7.08%	6.78%	6.62%	5.58%	6.08%	7.59%
2000	6.82%	8.18%	7.68%	6.12%	5.89%	7.19%
2001	6.42%	6.61%	5.80%	5.15%	5.54%	6.61%

* The SEC is the only government agency that uses Securities Compliance Examiners. Financial Institution Examiners in other agencies perform similar work to Securities Compliance Examiners.

As this table shows, the SEC has had significantly higher turnover rates than the rest of the federal government in almost every one of its employment classifications for each of the last eight years.[2] In addition, where the gap betwee the Commission's turnover rate and the government-wide averages appears smaller, this is only because the Commission was allowed to provide "special pay" temporarily to certain staff. As is discussed in the next section, however, the benefits of "special pay" have proven short-lived and incomplete.

Retention Difficulties. Commission employees, particularly attorneys and examiners, have been leaving the agency at an alarmingly fast rate. Over the last four years, more than 1,300 employees (over 40 percent of the staff) have left th SEC, including 600 attorneys.

Tenure rates of our employees have decreased dramatically in the past several years. Short tenures limit our institutional memory and disrupt the consistency ar continuity we need when pursuing cases and regulatory matters. In the Northeast Regional Office (New York) alone, 65 percent of the attorneys have been on boarc fewer than 3 years. In the Division of Corporation Finance, 22 percent of our accountants have been on board fewer than 3 years. In the Division of Enforcement, 12 of the 28 branch chiefs (42 percent) have been in their positions for fewer than 10 months .

The average tenure of examiners leaving the SEC has declined from 2.9 years in 1992, to an all-time low of 1.9 years by 1999. As part of the SEC's examination program for investment advisers and investment companies, we attempt to examine every firm once every five years.[3] Through examinations, we monitor regulated entities for compliance with federal securities laws and refer potential violations to the Division of Enforcement for possible action. Examinations performed by experienced staff are critical to our ability to protect investors and maintain confidence in the markets.

A significant reason for this high level of turnover is the discrepancy between SEC salaries and those paid elsewhere. Since 2000, private sector salary offers for senior professional staff departing the SEC have ranged from $185,000 to $250,000 for attorneys and from $180,000 to $200,000 for GS-15 accountants.

Not surprisingly, and with few exceptions, departing employees overwhelmingly cite the higher salaries offered by private sector firms as their primary reason for resigning. Obviously, the SEC could never pay salaries equal to those provided by law and accounting firms, nor should it. Public service always entails an element (sacrifice on the part of government employees. However, there is an immense difference between employees who leave for the large salaries paid by the private sector, and employees who leave because their SEC salary is not high enough to provide a competitive standard of living, especially when compared with their counterparts performing virtually identical work at the other financial regulatory agencies.

Recruitment Difficulties. It continues to be challenging to find the mix of experience and skills required to be successful as an attorney at the SEC. Of the almost 500 third-year law students we interviewed on over 45 campuses during the fall of 2001, only about one-third of them were considered highly attractive candidates for entry-level attorney positions. Approximately 50 percent of these students declined a call back interview. For those who interviewed and received jc offers, the declination rate was greater than the acceptance rate. Law students, particularly of the caliber that SEC seeks to hire, cite salary discrepancy and the inability to repay law school debt at SEC salary levels as the major reasons for declining our job offers.

It also is difficult for the SEC to recruit experienced attorneys. These candidates are hard to attract because law firms and other securities industry entities pay attorneys with the combination of experience the SEC needs at salaries much higher than what we can offer. This salary discrepancy remains our biggest obstacle in attracting qualified staff. When we do receive resumes from attractive candidates, we often are unable to convince them to accept the attorney positions even when we offer appointments above the minimum step coupled with recruitment bonuses. This requires our recruiting committees to work countless hours screening, interviewing, and then marketing the positions only to be turned down due to the salaries.

In order to fill staff accountant vacancies in our Divisions of Corporation Finance and Enforcement, the SEC has had to run continuous advertisements and job vacancy announcements that often yielded fewer than 10 applicants. Again, due t the nature of the work in these divisions, we must recruit and hire accountants with specialized securities industry experience. Candidates with the years and typ of experience we seek are highly marketable elsewhere. The discrepancy in salary is too great to attract some highly talented accountants to join the SEC.

Recruitment, Retention, and Work-Life Efforts

The Commission has worked diligently over the last several years to take advantage of the existing flexibilities available under Title 5. In particular, the SE(has gained special rate pay authority on two different occasions; used recruitmen bonuses, retention allowances, and superior qualifications appointments; and undertaken various quality of life efforts. In addition, in 1998, the Commission received the authority under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), to increase the salary levels that it can pay its economists. The Commission's experience with these various tools is as follows.

Special Pay. In 1992, the SEC obtained the authority from the OPM to pay staff attorneys and accountants with at least two years of securities industry experienc special pay rates at approximately ten percent above base pay. Over the short term, this grant of authority did reduce the Commission's recruitment and retention problem, although our turnover rates still remained above the government-wide averages.[4] However, its effectiveness was eroded quickly with the implementation of annual government-wide locality pay increases. In 1994, locality pay became available and the special pay differential began to disappear because employees receiving the special rates cannot, by OPM regulation, receive locality pay raises each year.

The SEC's fiscal 2001 budget also included funds to reinstate a special pay differential for securities industry attorneys and accountants, and added the differential for experienced securities compliance examiners.[5] New special pay rates were approved by OPM in March 2001. While we believe these rates have contributed to reduced staff turnover in fiscal 2001, they are well less than the differential between the SEC and the other federal financial regulators and again are subject to the locality pay erosion.

Recruitment Bonuses. Since 1992, we have provided over 245 recruitment bonuses averaging 10 percent of base pay. Over 180 (74 percent) of these bonus(have been provided within the last one and one half years, as our difficulty in attracting key staff has increased dramatically. Recruitment bonuses, by their nature, are one-time payments that do not address the serious structural problem with the Commission's salary scale.

Superior Qualifications Appointments. In fiscal 2000 and 2001, most of our attorney, accountant, and compliance examiner hires were appointed at higher than Step 1 of their grade as the only way we could attract these high quality candidates to the SEC. However, such appointments mean that these individuals will now run more quickly into in-grade pay ceilings that are significantly lower than those at the banking agencies.

Retention Allowances. Since 1993, over 120 employees have received retentior allowances. Currently, 53 employees receive allowances that range from 5 to 20 percent of their base pay. In fiscal 1999, three employees receiving retention allowances left the SEC; in fiscal 2000, ten employees receiving retention allowances left the agency; and in fiscal 2001 seven employees receiving retentio allowances left the agency. Like recruitment bonuses, these payments are merely stopgap measures that do not address the structural, long-term problems with th(Commission's uncompetitive pay scale.

Economist Special Pay. Although SLUSA granted the Commission authority to pay higher salaries to certain economists than those permitted under Title 5, this authority was capped at levels significantly lower than those at which the banking agencies pay their economists. Even with this limitation, however, higher pay has slowed economist attrition at the SEC. Since 2000, when the new pay scale went into effect, the SEC has had a net gain of eight economists. The economist pay provisions of SLUSA were repealed by the Pay Parity Act

Transportation Benefits. In 1993, the SEC began providing transportation subsidies of $21 per month to eligible staff in an effort to encourage them to use public transportation. The SEC increased the subsidy to $42 per month in 1999, and further raised it to $65 per month in 2000.[6] Approximately two-thirds of the staff currently receive the transportation benefit. We believe this benefit has not had an appreciable affect on the length of time that employees choose to stay wit the Commission, as it is translates into an increase of less than one percent for th average mid-level professional.

Compressed Work Schedules. The SEC has allowed staff to request alternate work schedules for many years. During the past five years, pilot compressed work schedules following the "5-4-9" model have been implemented in certain SEC offices. In February 2001, a "5-4-9" pilot program was introduced for the entire agency. The SEC currently is negotiating a contract with its employee union that will, among other things, address alternative work schedules.

Fitness Center. The SEC's Headquarters fitness center opened in 1992. Approximately 475 employees currently are members of the Headquarters fitness center and 100 employees belong to the center at our Operations Center, paying only a small monthly fee. The fitness center also sponsors wellness programs for ‹ employees. However, to our knowledge, at least one of the banking agencies, and possibly more, provide a comparable fitness facility and programs at less cost to most users.

Emergency Child Care. In 1999, the SEC made arrangements with a contractor to provide emergency child care for employees in several locations.

Critical Pay. Current law allows certain "critical personnel" to be paid at rates up to that paid to the Vice President. Government-wide, this authority is colloquially referred to as the "Nobel Laureate" provision because an employee essentially needs to be of Nobel Laureate caliber to be approved for critical pay by OPM. No more than a handful of employees currently receive this level of pay across the entire government, and none of them works for the Commission. As such, and aft various discussions with OPM regarding this authority, this is not a tool that the SEC has attempted to employ.

Pay Banding. The Commission has not implemented pay banding. Implementing such a system would provide more flexibility to reward outstanding performers, bı only up to the pay levels at the top of the band. Many of our staff already are beir paid close to the ceiling of what we would be able to give them under a pay banding system. Therefore, this would be at best a partial solution that fails to address the main problem, leaving our top performers well short of the pay of the counterparts at the banking agencies.

GAO Human Capital Report

In September 2001, the General Accounting Office ("GAO") issued a final report entitled *Securities and Exchange Commission: Human Capital Challenges Require Management Attention* ("GAO Personnel Report").[7] The GAO report confirmed the Commission's view that "inadequate compensation is the primary reason that employees leave the agency" (GAO Personnel Report at 27), and documented tha the SEC has exhausted existing compensation options available, such as offering recruitment bonuses and retention allowances, in an attempt to alleviate this problem (GAO Personnel Report at 16-19). The GAO made several recommendations that could help the SEC maintain an adequate level of retentior after pay parity is achieved. These recommendations included formalizing employee surveys, augmenting the Commission's annual performance plan, and involving human capital leaders in decision making (GAO Personnel Report at 28-29). The Commission welcomes the GAO's suggestions and is taking steps to implement them.

GAO Report on SEC Operations

In March 2002, the GAO issued a final report on SEC operations ("GAO Operation: Report").[8] GAO found that the growth in size and complexity of the U.S. securitie: markets has caused the SEC's workload to increase. GAO recommended the SEC "explore short- and long-term recommendations to address its current challenges In the short-term, SEC should ensure that it explores ways to use all of its available resources to address its recruiting and retention problems" (GAO Operations Report at Highlights). The GAO also states that while they have not reviewed our specific plan, "developing a plan to implement pay parity is a vital step in improving SEC's staff recruiting and retention efforts" (GAO Operations Report at 35).

GAO Self-Funding Study

The Pay Parity Act requires the GAO to conduct a study of the impact, implications and consequences of converting the SEC to a self-funded basis. This study should include analysis of the impact of conversion to self-funding on the SEC's operations, including staff quality, recruitment, and retention, as well as the implications for Congressional oversight of the Commission, fees, and appropriations.

Competition and Comparisons

Congress has decided, by passing the Pay Parity Act, that the SEC's consistent struggles throughout the past decade warrant an exemption from the pay and benefit provisions of Title 5. While all federal agencies compete with the private sector for qualified employees, the SEC competes with a vibrant securities industr for qualified personnel. In addition, the SEC is unique in that it also competes directly for qualified personnel with a strong interest in financial services law with the federal bank regulatory community. The SEC is at an extraordinary disadvantage in this competition because, unlike the banking regulatory agencies, the pay and compensation provisions of Title 5 limit the Commission's salaries an benefits. The exemption that these agencies enjoy allows them to provide their staffs with appreciably more compensation than we can. For example, while the maximum salary that a second-year attorney at the SEC can earn in fiscal 2002 is $72,000, an FDIC attorney with similar levels of experience, technical skills, and responsibilities can be paid as much as $97,800, nearly 36 percent more.

As discussed above, and as confirmed in the GAO Report, the Commission has exhausted nearly every available flexibility available under Title 5 without successfully developing a permanent solution to its staffing problem. From a management perspective, it has proven difficult, if not impossible, to recruit and retain sufficient highly qualified employees to conduct regulatory, and examinatio activities similar to, or side-by-side with, employees of the other federal financial regulators who may be earning up to 40 percent more.

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Costs and Benefits of the Plan

Costs of Recruitment and Turnover

The SEC incurs significantly higher direct costs as a result of its recruitment and retention problems - such as the costs of recruiting outreach, hiring a recruiting director, advertising positions, managers' time spent arranging and conducting interviews, processing applications, and training. The SEC hired 482 employees in 1999, 459 employees in 2000, and 454 employees in 2001 to fill vacancies.[9] Give our experience that it costs thousands of dollars to hire and train each new employee, the SEC has directly spent millions of dollars over the last three years just to maintain current staffing levels.

Beyond these direct expenses, the SEC incurs indirect costs that, while difficult to quantify, may have an even greater effect on the agency and its productivity. The

SEC's difficulty in recruiting employees causes the agency to face a high cost of foregone work. Based on conversations with Commission division directors, the Commission conservatively estimates that new hires are at most 50 percent productive by the end of their first year, and 80 percent productive by the end of their second year. During this time when new hires are "moving up the securities learning curve," the productivity of managers and co-workers is appreciably reduced. As a result of this high level of turnover, many Commission managers ar constantly hiring and training new staff and struggling to ensure they meet their other obligations, while knowing all along that the people they are training are likely to leave for higher paying jobs once they approach or reach full productivity.[10] This means that the agency is disadvantaged further because managers and other experienced people have another reason to leave beyond the lack of competitive salaries: lack of adequate compensation in view of the continuous and excessive rigor of their workload.

Given the direct costs and the additional non-quantifiable costs, one of the SEC's goals is to reduce substantially and consistently its turnover rates and increase th tenures of our employees, especially attorneys, accountants, and securities compliance examiners. The only realistic way that the SEC can accomplish this go is to implement a new pay and compensation system, modeled after those of its sister financial regulatory agencies. Once implemented, the SEC intends to monit its pay parity system very closely and to make adjustments as necessary. The Commission also plans to balance our needs for keeping staff with our concurrent need for new ideas and innovative approaches to regulation. Towards this end, w have developed a system that ensures the SEC becomes a place where both new employees and more experienced individuals can come to hone their skills and serve the public.

Budgetary Resources

The SEC receives its funding through the annual budget request of the President and the subsequent Congressional appropriations process.[11] These budgetary amounts, while authorized and appropriated by Congress, come from fees collect by the Commission pursuant to Section 6(b) of the Securities Act of 1933, and Sections 13(e), 14(g), and 31 of the Securities Exchange Act of 1934.

The SEC has been fully funded by offsetting fee collections since 1998. Under the Pay Parity Act, the fees estimated to be collected by the SEC total $1.33 billion in fiscal 2003. All of these fees are classified as offsetting collections and are available, to the extent provided by Congress, to fund the activities of the Commission.

The fee provisions of the Pay Parity Act are designed to increase the SEC's fundin certainty by establishing a stable, multi-source, long-term funding structure that should generate sufficient fees to fund the SEC and meet the annual resource needs of the SEC's appropriators. In addition, the Pay Parity Act is designed to reduce transactionfees paid by investors and lower the costs of capital formation for SEC registrants.

Estimated Cost

The SEC currently estimates the additional cost of implementing pay parity to be $76 million in fiscal 2003.[12] The SEC anticipates that the funding to accommodat this increase will be provided exclusively out of the amounts the SEC is scheduled to collect annually under the Pay Parity Act and appropriated by Congress.

Although not yet finalized, this cost estimate is comparable to that developed by the Congressional Budget Office during its preliminary scoring of the Pay Parity Ac in April 2001. At this funding level, the Commission believes it can implement a pay system that will enable the Commission to meet its staffing objectives while also ensuring the appropriate use of merit and performance-based principles and remaining mindful of the need to use public resources responsibly.

The ongoing costs of maintaining pay parity will be revised as part of the Commission's annual Congressional budget submission to ensure that adequate funds are provided for cost-of-living increases, inflation, and changes in the agency's staffing levels. In addition, once implemented, the Commission will repo regularly on the cost and effectiveness of the agency's compensation structure an turnover rates as part of our GPRA Annual Plan.

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Overview of the Plan

Goals

The objective of the pay provisions of the Pay Parity Act is to allow the SEC to provide compensation and benefits at levels comparable with those currently bein provided by the other federal financial regulatory agencies. In determining what compensation and benefits levels are appropriate, the SEC has contracted with th Hay Group and consulted with OPM, the Office of Management and Budget ("OMB"), and Congress.

The specific goals of the Commission's pay parity effort are to:

- provide comparability with the other federal financial regulatory agencies,
- reduce supervisory pay compression,
- account for differences among certain specialized occupations, and
- increase the agency's reliance on merit and performance-based managemer principles.

The SEC believes that focusing on these goals will substantially improve its effectiveness and efficiency by allowing us to keep staff longer and to provide moı incentives for them to extend their tenures by improving the link between pay an(performance.

At this time, our plan does not account for increased benefits. In order to move quickly toward stemming our staffing problems, our initial focus is on salaries. Wi additional study and funding, it may be appropriate to provide additional benefits.

Structure

Comparability. In seeking comparability with the other federal financial regulato agencies, the SEC and its compensation consultant conducted various analyses of the salary and benefits structures that they provide their employees. The researct shows that there is a range of approaches available and that differences do exist among how each agency has decided to compensate its staff and how successful they have been. To ensure that the SEC acts responsibly, we are taking a rather conservative approach that will place the agency's proposed salary structure toward the lower end of those that we analyzed. We believe this will allow us the opportunity to ascertain over time how well our system is working before we get locked into a structure that might not meet our goals.

The Commission's proposed pay scale (attached) has 20 levels, each with up to 3 steps. Most staff will be placed within levels 1 through 17, as opposed to the current 15 general schedule grades. The two additional levels are supervisory levels, as described below. Levels 18 through 20 are the executive levels with broad pay ranges, instead of the current 6. The step structure is designed to mak extra steps available to attorneys, accountants, and securities compliance examiners with securities industry experience, also described below. Our goal is t apply this new structure so that we can have a broader range of salaries available to aid in hiring new employees and to provide incentives to staff to improve their performance.

Supervisory Pay Compression. The pay scales are designed to alleviate the problems we have faced for years with respect to supervisory pay. Many SEC divisions and offices use a branch structure where the branch chief supervises sta who are at the same grade level. For example, GS-14 branch chiefs frequently supervise employees who also are at the GS-14 level (and some GS-15s supervis other GS-15s.) In addition, it is not uncommon for subordinate staff to be at high steps than their supervisors, and therefore paid more. Under the current pay structure there are very limited incentives to become a manager. A "promotion" t supervisory status often means more responsibility with no increase in pay. In the new pay scale, those employees who currently are GS-14s and GS-15s will be spli into two groups (supervisory and non-supervisory). The supervisory levels will be approximately six percent higher than the equivalent non-supervisory levels. Wit 31 steps, however, there still is plenty of room to compensate non-supervisory staff within their levels.

Table 2: Proposed Supervisory Levels

GS-Scale	Proposed Scale
GS-14 (non-supervisory)	Level 14
GS-14 (supervisory)	Level 15
GS-15 (non-supervisory)	Level 16
GS-15 (supervisory)	Level 17

By creating this new supervisory differential within the current GS-14 and GS-15 level, we will compensate our managers more appropriately.

Accounting for Specialized Occupations. Our general plan is to convert employees into the system by applying an approximately six percent salary increase to employees' base pay and then accounting for a locality adjustment. In the Washington, D.C. locality, this equates to an approximate 8 percent minimum increase over an employee's current salary, while in New York City and Salt Lake City it equates to minimum increases of 11 percent and 4 percent, respectively.

For our experienced attorneys, accountants, and securities compliance examiners, however, the increases may be more substantial. As employees who currently receive special pay rates are working from a higher base, this conversion method will provide greater increases to those employees in positions and localities where we have been having attrition and retention difficulties and lesser increases to those where our turnover problems have been more manageable. There also will be the 4 highest steps within a level to which only employees in those job series may advance.

The increases that attorneys, accountants, and securities compliance examiners receive will replace the amounts they currently are receiving through special pay rates.

The SEC does not intend to provide larger across-the-board increases to all staff. We do not believe that such increases are appropriate in all cases or would receiv the needed widespread support.

Merit and Performance-Based Management. Section 4802(f) of Title 5 of the U.S. Code provides that pay parity "shall be administered consistent with merit system principles." The Commission also takes seriously the goals of the President's Management Agenda and plans to include a merit and performance-based component to its compensation plan. In particular, we do not plan to award automatic increases. How employees move within a particular level will be based on a rigorous merit system and not the amount of time they have spent at each level or step.

Our proposed system of merit increases will require supervisory recommendation, review by a second level board, and final approval of office heads. The recommendations for pay increases will be based on a narrative justification written by a supervisor. A supervisor may recommend multiple increment increas or bonuses for superior performance. Increases will not be the outcome of a numerical calculation of an employee's performance rating that automatically generates pay increases. Throughout the year, special act awards may be recommended for notable achievements outside employees' normal duties

The Commission feels strongly that with pay parity comes a responsibility to manage performance and appropriately compensate staff.

Transition

The timing of the SEC's transition to our proposed pay system depends on fundin and the resolution of technical concerns with our payroll administrator. We also w need to negotiate aspects of the compensation system with the union that represents many Commission employees.

Funding. The Commission requested funding for pay parity ($76 million) in our fiscal 2003 budget request to the OMB. The Commission also met with OMB staff on several occasions and provided background materials justifying our approach. Notwithstanding enactment of pay parity, our request was rejected and the Administration did not include funding for pay parity in the President's fiscal 2003 budget request to Congress.

As a first step, however, the Administration expressed its willingness to allow the SEC to request a reprogramming of approximately $25 million in excess prior yea fee collections to begin pay parity in fiscal 2002. The Commission believes it is essential to begin a new pay parity system this fiscal year so that our employees see the tangible benefit of staying at the Agency. This request is pending before the Commission's appropriations committees. In order for pay parity to assist the Commission in attracting and retaining a qualified workforce, ongoing funding is required.

Payroll and Personnel Administration. At a technical level, Commission staff have begun conversations with our payroll administrators at the Department of th Interior. However, until funding is secured to implement pay parity and the new pay scales are finalized, it is unclear how much additional programming is require to convert staff into the new system. In addition to payroll processing issues, our personnel management staff will be working on other transition matters, includinc updating classification systems and personnel files.

Negotiation Requirements. The Commission will have to negotiate with the National Treasury Employees Union (NTEU) that represents many SEC employees before we implement aspects of the new compensation system for staff in the bargaining unit. In view of the limited funds that may be available to implement pay parity, our mandate to implement a reasonable system similar to the other federal financial regulators, and our analysis showing the appropriateness of the proposed pay structure, we do not anticipate the negotiated aspects of the scale will deviate significantly from what we describe in this report.

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Ongoing Reporting

Pursuant to the Pay Parity Act, the Commission will include reporting on the plan and the effects of its implementation in our annual performance plan and report submitted pursuant to GPRA. The Commission already includes measures relating to attrition rates and work-life efforts in our GPRA documents.

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Attachments

➤ Click to view attachments

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1 *See* U.S. General Accounting Office, *Securities and Exchange Commission: Human Capital Challenges Require Management Attention*, at 6, GAO-01-947 (Washington, D.C.: Sept. 17, 2001) ("By an overwhelming majority, current and former SEC attorneys, accountants, and examiners we surveyed cited compensation as their primary reason for leaving the SEC").

2 The turnover rates experienced by the other federal financial regulators tend to be at or slightly below the government-wide average. One of the SEC's goals is to lengthen the tenures of our employees by achieving turnover rate: closer to the government-wide average.

3 The SEC is likely to be unable to meet this performance goal in fiscal 2003 without staff retention and/or additional staff.

4 See Table 1: SEC and Government-wide Turnover Rates, Fiscal 1994 to 2001

5 The SEC's fiscal 2001 appropriation included roughly $19 million to reinstate "special pay." The Commission intends to apply this amount toward the cost of fully implementing pay parity in fiscal 2003. On its own, however, it is insufficient to provide the Commission any additional relief.

6 Federal agencies were just provided with the option of further raising monthl transportation subsidy amounts to $100. The Commission currently does not have funding available in its base to implement this increase. In addition, while providing an incentive for employees to increase their reliance on mass transit, the Commission does not believe that this potential increase will entice any employees to lengthen their time of employment with the agency.

7 GAO-01-947, *supra* note 1.

8 U.S. General Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, GAO-02-302 (Washington, D.C.: Mar. 5, 2002).

9 The SEC has not received a staffing increase in either of the last two years, and the President's fiscal 2003 budget request proposes no funding for additional staff.

10 As will be discussed, the SEC's current pay schedule does not provide an incentive for staff to become managers.

11 The other federal financial regulatory agencies are not subject to the regular appropriations process. As noted above, the Pay Parity Act directs the Genera Accounting Office to undertake, and to submit to Congress within six months of the date of enactment, a study of the impact, implications, and consequences of converting the SEC to a similar self-funding basis.

12 The Commission also has requested a reprogramming of $25 million to implement pay parity in fiscal 2002.

http://www.sec.gov/news/studies/payparity.htm

Proposed SEC Salary Structure*

GRADE	1	2	3	4	5 …	21	22	23	24	25	26	27	28	29	30	31
1	$15,642	$15,872	$16,105	$16,341	$16,581 …	$20,938										
2	$17,588	$17,846	$18,108	$18,374	$18,644 …	$23,542										
3	$19,189	$19,471	$19,757	$20,047	$20,341 …	$25,686										
4	$21,541	$21,857	$22,178	$22,504	$22,834 …	$28,830										
5	$24,101	$24,455	$24,814	$25,178	$25,548 …	$32,257	$32,731	$33,212	$33,700							
6	$26,865	$27,259	$27,659	$28,065	$28,477 …	$35,956	$36,484	$37,020	$37,564							
7	$29,854	$30,292	$30,737	$31,188	$31,646 …	$39,958	$40,545	$41,140	$41,744	$42,357						
8	$33,062	$33,547	$34,040	$34,540	$35,047 …	$44,252	$44,902	$45,561	$46,230	$46,909						
9	$36,518	$37,054	$37,598	$38,150	$38,710 …	$48,876	$49,594	$50,322	$51,061	$51,811	$52,572					
10	$40,215	$40,805	$41,404	$42,012	$42,629 …	$53,825	$54,615	$55,417	$56,231	$57,057	$57,895					
11	$44,185	$44,834	$45,492	$46,160	$46,838 …	$59,141	$60,009	$60,890	$61,784	$62,691	$63,611	$64,545	$65,493	$66,455	$67,431	$68,421
12	$52,957	$53,735	$54,524	$55,325	$56,137 …	$70,884	$71,925	$72,981	$74,053	$75,140	$76,243	$77,362	$78,498	$79,651	$80,820	$82,007
13	$62,974	$63,899	$64,837	$65,789	$66,755 …	$84,289	$85,527	$86,783	$88,057	$89,350	$90,662	$91,993	$93,344	$94,715	$96,106	$97,517
14	$72,311	$73,373	$74,450	$75,543	$76,652 …	$96,784	$98,205	$99,647	$101,110	$102,595	$104,101	$105,629	$107,180	$108,754	$110,351	$111,971
15 (GS 14 Supervisory)	$76,650	$77,775	$78,917	$80,076	$81,252 …	$102,593	$104,099	$105,627	$107,178	$108,752	$110,349	$111,969	$113,615	$115,281	$116,974	$118,691
16 (GS 15)	$82,580	$83,792	$85,022	$86,270	$87,537 …	$110,526	$112,149	$113,796	$115,467	$117,162	$118,882	$120,628	$122,399	$124,196	$126,020	$127,870
17 (GS 15 Supervisory)	$87,535	$88,820	$90,124	$91,447	$92,790 …	$117,160	$118,880	$120,625	$122,396	$124,193	$126,016	$127,866	$129,743	$131,648	$133,581	$135,542
18 (SES)	$98,039	$99,478	$100,939	$102,421	$103,925 …	$131,221	$133,148	$135,103	$137,087	$139,100	$141,142	$143,214	$145,317	$147,451		
19 (SES)	$109,804	$111,416	$113,052	$114,712	$116,396 …	$146,969	$149,127	$151,317	$153,539	$155,793	$158,080	$160,401	$162,756	$165,146		
20 (SES)	$122,980	$124,786	$126,618	$128,477	$130,363 …	$164,603	$167,020	$169,472	$171,960	$174,485	$177,047	$179,647	$182,285	$184,961		

* This table describes the overall framework of the proposed structure and does not include locality differentials. Total salary is capped at $193,600 in 2002, including lump sum payments and locality pay.

Proposed SEC Locality Pay Percentages

Atlanta	6.97%
Boston	21.13%
Chicago	18.66%
Fort Worth	8.71%
Denver	13.05%
Los Angeles	21.13%
Miami	11.04%
New York	21.13%
Philadelphia	14.63%
Salt Lake City	6.80%
San Francisco	21.13%
Washington D.C.	13.17%