




OFFICE OF  
INSPECTOR GENERAL

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

January 27, 2016

**MEMORANDUM**

**TO:** Jeffery Heslop, Chief Operating Officer  
Lacey Dingman, Chief Human Capital Officer

**FROM:** Carl W. Hoecker, Inspector General 

**SUBJECT:** Review of the SEC's Pay Transition Program, 15-ONR-0281-R

The U.S. Securities and Exchange Commission (SEC) Office of Inspector General (OIG) Office of Oversight and Review has completed a review of the SEC's pay transition program (Pay Transition). This memorandum summarizes the results of our review.

**Introduction and Summary**

On December 23, 2014, the OIG received an anonymous Hotline complaint about the implementation and unexpected high cost of Pay Transition. Pay Transition is a program resulting from an agreement between SEC management and the National Treasury Employees Union (Union or NTEU), whereby eligible SEC employees could apply to have their pay reviewed, and possibly adjusted, under the pay matrices the SEC adopted in 2012 to set pay for incoming employees.

The anonymous complaint raised the following three main areas of concern:

- First, the complaint questioned the way the Office of Human Resources (OHR) was implementing Pay Transition, particularly how the OHR was calculating employee experience levels, which determined the amount an employee should be paid. The complaint listed several examples of employees from one regional office who were allegedly credited with more years of experience than was appropriate. The complaint also stated that the OHR "disregarded whether the employees have advanced degrees and professional certifications."
- Second, the complaint questioned an eligibility provision in the Pay Transition Agreement, which required that an employee's approved new salary be 5% or greater than the employee's current salary for the employee to qualify for a salary increase. The complaint suggested that the 5% threshold should be increased to 20% to save resources. The complaint also gave an example of one regional office employee who "didn't make the cut because he was at 4.7% while another employee who was at 5.1% was given the entire underpaid amount instead of just the difference of 5% and 5.1%."

- Third, the complaint predicted that Pay Transition would cost the SEC \$20 million instead of the budgeted \$3 million and questioned where the money was coming from.

During its review, the OIG received four additional complaints regarding Pay Transition. One of those complaints questioned why the OHR had not disclosed to SEC staff that the \$3 million cap was being raised; this complaint suggested that the OHR should have reopened the application open season when the additional funds were added. The complaint also asked whether the OHR vetted the resumes that were submitted with the applications. The remaining complaints alleged that (1) all or nearly all SEC employees received salary increases ranging from \$20,000 to \$40,000, and (2) these salary increases were unwarranted and were instituted with “very little consideration about the financial impact to the agency.”<sup>1</sup>

We performed a review of Pay Transition based on the allegations in the complaints. As discussed in more detail below, we learned that the OHR implemented Pay Transition consistent with an agreement between the NTEU and SEC management, including using agreed-upon pay-setting matrices, following a multilayer application review process that included a provision for third party arbitration, and applying an agreed-upon 5% threshold. In addition, we confirmed that the \$3 million budget that the NTEU and SEC management initially agreed to for the salary adjustments was significantly lower than the actual amount of the approved salary adjustments. The actual approved salary adjustments amounted to about \$21 million per year, which the SEC Chair decided to fully fund. The OHR informed us that the \$3 million cap that was included in the Pay Transition agreement with the NTEU resulted from consultations with SEC senior management. We also learned that the budgeted amount reflected the SEC’s inability to predict how many people would apply and qualify for Pay Transition.

The OHR further informed us that it did not announce the increased Pay Transition budget to the staff because the OHR typically does not announce budgets for its programs. The OHR also informed us that it had extended the open season for Pay Transition by 4 days for all employees, which the OHR had announced to the staff. Furthermore, according to the OHR, about 10 employees were allowed to apply for Pay Transition after the open season deadline because those employees were either on maternity leave or sick leave during the entire open season. Those employees were added to the applicant pool in November or December 2014, and their applications were processed in a similar manner as those of other applicants.

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<sup>1</sup> After we completed our review work and were finalizing this memorandum, the OIG received an additional complaint about Pay Transition and the SEC’s pay-setting system more generally. The complaint raised some specific concerns related to Pay Transition that are included in this review. Other concerns expressed in the complaint about the SEC’s pay-setting system raised matters that are either beyond the scope of this review or that fall within the purview of other agencies.

## Background

Before 2002, SEC staff were paid according to the General Schedule. In 2002, when the SEC was experiencing high staff turn-over, the Investors and Capital Markets Relief Act (P.L. 107-123) allowed the SEC to create its own compensation system, similar to the systems of other Federal financial regulators.<sup>2</sup> As a result of the legislation, also known as the “Pay Parity Act,” the SEC transitioned away from the General Schedule and instituted a compensation system consisting of 17 pay grades. The objective of the pay provisions of the Pay Parity Act was to allow the SEC to provide compensation and benefits at levels comparable with those provided by other Federal financial regulatory agencies.

To implement the Pay Parity Act, the SEC established certain goals for its pay parity effort, which included the following: (1) providing comparability with other Federal financial regulatory agencies; (2) reducing supervisory pay compression; (3) accounting for differences among certain specialized occupations; and (4) increasing the agency’s reliance on merit and performance-based management principles. According to the SEC, focusing on these goals would substantially improve its effectiveness and efficiency by allowing it to keep staff longer and to provide more incentives for them to extend their tenures by improving the link between pay and performance.<sup>3</sup>

Until 2012, the SEC’s new hire pay setting policy was to (1) match current salary, (2) offer up to 6% above current salary with management justification and OHR approval; or (3) offer the maximum rate of pay for the grade.<sup>4</sup> According to the OHR, pay setting was almost exclusively based on an employee’s previous salary rather than a valuation of an employee’s experience as it relates to a particular job.

In May 2012, based in part on recommendations from outside compensation consultants, the SEC began using a structured pay-setting process for new employees and current employees selected for competitively announced positions. The OHR developed pay matrices that set pay based on a candidate’s years of relevant and specialized experience.

According to OHR officials, as the new pay-setting process was being implemented, the OHR received complaints that some SEC employees who were hired before May 2012 would be at a higher salary level if they were newly hired. After negotiations with the NTEU, on August 19, 2014, the SEC and the NTEU executed the *Memorandum of Understanding Between Securities and Exchange Commission and the National Treasury Employees Union* (Agreement). Section 12 of the Agreement, titled “Pay Transition Committees,” contains the Pay Transition provisions.

Section 12(A) of the Agreement states that the purpose of Pay Transition is to benefit employees by comparing actual employee salaries to the salaries that employees would receive if they were newly hired based on the SEC’s current pay matrices. The Agreement also explains how Pay Transition will be implemented for bargaining unit employees.

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<sup>2</sup> 5 U.S.C. § 4802(b) and (c) (2012).

<sup>3</sup> March 6, 2002, SEC Pay Parity Implementation Plan and Report.

<sup>4</sup> October 31, 2012, Towers Watson Final Report to the SEC.

Section 12(B) of the Agreement establishes a committee in each division and office that is composed of two members appointed by the NTEU and two members appointed by management.<sup>5</sup> According to Section 12(B), the committees “will address historical practices in setting initial salaries of employees with similar qualifications and experience.”

Under Section 12(D-E) of the Agreement, eligible applicants<sup>6</sup> may submit an application with an updated resume to the OHR during a 15-day open season. Under Section 12(F) of the Agreement, the OHR then performs an initial analysis, makes a pay-setting recommendation, and forwards the application to a committee for review.

Under Section 12(G) of the Agreement, the appropriate committee reviews the applications and, using pay-setting matrices, determines whether the applicants meet the criteria for a pay adjustment and, if so, the amount of that adjustment.

The pay-setting matrices, which are discussed in Section 12(C) and are attached to the Agreement, “consider an applicant’s relevant education, relevant years of experience, relevant years of specialized experience, and relevant credentials and/or licensing.”<sup>7</sup> The pay matrices set out the following definitions: (1) “Specialized” experience is “[p]rior technical experience that equips a candidate with the skill and knowledge to successfully perform the duties of a position and is directly related to the duties of the position to be filled;”<sup>8</sup> and (2) “Relevant” experience “[i]ncludes prior experience not directly related to the duties of the position but which nonetheless prepares the candidate for success in the position.” Each pay level has several base pay levels that are associated with a range of years of both relevant and specialized experience.

Under Section 12(H-J) of the Agreement, after the committee makes its pay-setting recommendation, the Chief Human Capital Officer (CHCO), in consultation with the applicant’s division or office, provides the final review of all committee recommendations to ensure each applicant’s education, years of experience, years of specialized experience, and relevant credentials/licensing meet the relevant criteria. The CHCO makes a decision on each pay adjustment, but only approves those pay adjustments to base salary that are equal to or in excess of 5% of the employee’s current base salary. The CHCO also has the discretion to return any recommendation to the committee for a one-time reconsideration.

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<sup>5</sup> Divisions and offices with fewer than 30 bargaining unit employees are reviewed by a joint “at-large” type committee with two members appointed by the NTEU and two members appointed by management.

<sup>6</sup> Under Section 12(E) of the Agreement, applicants are not eligible for a pay adjustment if they: (1) have been disciplined in the last year or are currently on a Performance Improvement Plan; (2) received an “unacceptable” performance rating; (3) entered on duty after May 31, 2012, or have had a salary modification under the pay matrix; or (4) are determined by the committee to be eligible for a salary adjustment of less than 5% of their current base salary.

<sup>7</sup> The term “relevant” means relating to the employee’s current position.

<sup>8</sup> The term “directly related” is defined in the pay matrices as “connected to the duties of the position (for example, for a SK-0905-14 General Attorney in the Division of Enforcement, prior experience is directly related if the employee was working as an attorney and conducting investigations, engaging in discovery, taking depositions or testimony, working on securities law matters, or performing duties required for the SK-14 General Attorney position).”

Under Section 12(M-N) of the Agreement, the parties agree to hire and use a third-party neutral arbitrator to decide appeals in cases where the CHCO adopts a recommendation that was not supported by at least one NTEU committee member. The arbitrator's decision is final, binding, and not appealable.

Section 12(O) of the Agreement includes a budget of \$3 million to cover all salary adjustments for bargaining unit employees. Under Section 12(P), if the SEC determines that it has insufficient funds to pay all the approved salary adjustments, the Chair or her designee may declare a "budgetary shortfall," and the SEC will pay each qualifying employee a proportionate share of the \$3 million. Under Section 12(Q), pay adjustments are not retroactive; thus, an employee approved for an adjustment is assigned a new salary that is prospective only.

After the Agreement was approved, the Chair extended Pay Transition to non-bargaining unit employees with a budget of \$750,000. Pay Transition for non-bargaining unit employees was essentially the same as for bargaining unit employees, except that non-bargaining unit employees did not have arbitration rights and the committees reviewing non-bargaining unit employees' applications included only representatives from management.<sup>9</sup>

The SEC published three notices to the staff regarding Pay Transition as follows:

- On August 28, 2014, the SEC and the NTEU announced the Agreement to the staff. The announcement included a Question and Answer section on Pay Transition describing the program and how to apply, and alerting employees that an application "open season" would be announced in the near future and would last 15 working days.
- On September 22, 2014, the SEC announced to the staff that the Pay Transition open season had begun and would run from September 22, 2014, to October 10, 2014. The notice included an explanation of the application process and a sample application.
- On October 9, 2014, the OHR notified SEC staff that the Pay Transition open season would be extended to October 14, 2014. The notice linked to a set of Frequently Asked Questions for Pay Transition and invited staff to submit further questions to the Pay Transition Mailbox.

On August 20, 2015, the OHR informed us of the following:

- 1,622 SEC employees applied for Pay Transition—1,271 bargaining unit employees and 351 non-bargaining unit employees. A total of 1,054

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<sup>9</sup> According to the OHR, there was no written document applying Pay Transition to non-bargaining unit employees. However, pursuant to its standard practice of extending negotiated programs to all employees, the SEC applied Pay Transition to both bargaining unit and non-bargaining unit employees.

employees—842 bargaining unit employees and 212 non-bargaining unit employees—received salary increases (about 65% of the applicants).

- The CHCO reviewed all Pay Transition applications and the CHCO's pay-setting decision for bargaining unit employees was less than the committee's recommendation in 72 instances (about 9%); her decision for non-bargaining unit employees was less than the committee's recommendation in 32 instances (about 15%).

On October 30, 2015, the CHCO informed us that the NTEU and the OHR had resolved all Pay Transition applications and that the program had concluded in October 2015 without arbitration.<sup>10</sup> Pay Transition took effect for all approved applicants as of June 14, 2015.

### **Scope and Methodology**

During this review, we interviewed the CHCO, the Deputy CHCO, an OHR Assistant Director, an OHR Branch Chief, and the SEC's Chief Financial Officer (CFO). We also reviewed relevant documents, including the Agreement with the NTEU that established Pay Transition, the OHR's announcements to SEC staff about Pay Transition, and the committee member training slides for Pay Transition. We focused our review on the Pay Transition Agreement and the process used to implement the Agreement. We did not review any Pay Transition applications or assess any decisions made on those applications.<sup>11</sup>

### **Results of the Review**

#### **A. Pay Transition Implementation**

OHR officials informed us that Pay Transition was the product of significant negotiations, over a 2-year period, between SEC management and the Union. Based upon several employee complaints, the SEC and the Union agreed that some SEC staff were earning less than they would if their salaries had been calculated using the new pay matrices. Before May 2012, the OHR determined pay for new employees primarily based on prior salary. In May 2012, the OHR switched to its current policy of determining pay based on prior experience.

In an interview with us, OHR officials described the process used to evaluate Pay Transition applications, which OHR officials said was consistent with the process detailed in the Agreement, as follows. The OHR initially reviewed all the applications and made an initial pay determination, using the same process the OHR uses for new employees. Under the guidance of an OHR Branch

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<sup>10</sup> According to the OHR, seven non-bargaining unit employees filed grievances related to Pay Transition under SECR 6-25, *SEC Administrative Grievance Procedures* (March 2, 2012). Of those, three grievances were informally resolved and the remaining four were denied (by the Chief Operating Officer in three instances and by the CHCO in one instance where the employee did not request reconsideration by the Chief Operating Officer).

<sup>11</sup> Because we did not perform an audit or evaluation of Pay Transition, we did not follow the Government Auditing Standards or the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspections and Evaluations in conducting this review.

Chief, contractors specifically hired for the Pay Transition Program reviewed the applications. The OHR calculated an applicant's years of relevant and specialized experience, and then determined a salary based on the applicable pay matrices.

According to OHR officials, a significant part of the prior experience determination required the OHR to decide whether an employee's prior experience was "specialized" or "relevant." The OHR noted that specific definitions for the terms "specialized" and "relevant" were included in the pay matrices and were agreed to by the NTEU.

When asked whether the OHR vetted the resumes submitted with the Pay Transition applications, the CHCO said that the OHR treated the resumes the same way the OHR treats resumes from outside applicants, that is, by requiring an attestation of truthfulness. The CHCO further stated that the OHR was not aware of any allegation that resumes submitted for Pay Transition were falsified or embellished. In addition, she said the committee members who reviewed the applicants' resumes were the applicants' peers and managers and would, therefore, likely have detected any discrepancies.

OHR officials also stated that, once the OHR completed its review, all applications (except for a couple, where the employees were disqualified based on disciplinary actions) were referred to committees for review. The committees were divided by each division and office, with separate regional office committees further established at the program level (for example, Division of Enforcement and Office of Compliance Inspections and Examinations). At headquarters, any small offices were grouped together into an "at large" committee.

OHR officials stated that, consistent with the Agreement, each committee included two managers and two Union representatives. Each committee had an alternate member who could step in if a committee member needed to recuse himself or herself because of a conflict, such as if the committee member had applied for Pay Transition and his or her application was under review. OHR officials stated that all committee members attended training during which they were advised of privacy and recusal issues.

According to OHR officials, the committee members were tasked with reviewing each application and making a determination on experience level and pay using the pay matrices. The committees could disagree with the OHR on the number of years of relevant and specialized experience to assign to an applicant and make a different pay recommendation. OHR officials stated that, for the most part, the committees agreed with the OHR's salary calculations. After the committees made their determinations, the applications were forwarded to the CHCO. The CHCO was tasked with resolving any discrepancies between the OHR's determination and the committees' recommendations, subject to arbitration as set forth in the Agreement.

According to OHR officials, the process used for non-bargaining unit employee applications was similar to that used for bargaining unit employee applications, except that committees composed entirely of managers reviewed the non-bargaining unit employee applications and non-bargaining unit employees had no arbitration rights.

OHR officials also stated that the OHR created a SharePoint site to maintain all the information related to the Pay Transition applications. Access to the site was limited (that is, committee members could only see the applications on which they were working), and each step of the process was locked so once information was entered, only a system administrator could change it. The OHR stated that it had double-checked all the Pay Transition calculations and that the CHCO had also personally checked the calculations.

The CHCO informed us that she personally reviewed all the Pay Transition applications. She stated that in most instances, she found that the Union and management committee members had agreed with each other's recommendations. She also stated that she disagreed with some committee decisions that rounded up years of experience and with some committee decisions on whether certain experience was "specialized" or merely "relevant." The CHCO explained that the OHR took the position that, for applicants in attorney positions, work experience gained before the applicant earned a law degree could be considered relevant, but not specialized, experience. The CHCO said there was one exception to this rule that the Chair initiated: an employee's pre-law degree SEC experience could be considered specialized experience.<sup>12</sup>

On October 30, 2015, the CHCO informed us that the OHR and the NTEU had resolved all outstanding Pay Transition applications without arbitration (*see also* footnote 5, *supra*). Pay Transition was concluded in October 2015, with all Pay Transition salary adjustments made effective as of the pay period beginning June 14, 2015.<sup>13</sup>

## **B. The 5% Eligibility Provision**

Section 12(E) of the Agreement included the following language: "Applicants will not be eligible for pay adjustment if the applicant ... is determined by the Committee to be eligible for a pay adjustment of less than 5% of the employee's current base salary." OHR officials explained that Pay Transition was the recommendation of outside compensation consultants, who anticipated that it would apply only to a very limited pool of employees who had the most significant pay disparities. Accordingly, OHR officials stated that during the negotiations with the Union, the OHR advocated for an individual eligibility limit of about 20%, whereas the Union advocated for no eligibility limit. The 5% eligibility limit was the compromise reached with the Union.

OHR officials stated that the OHR received some complaints from applicants who were below the 5% threshold. The CHCO stated that the OHR was not making any exceptions to the 5% rule, which is expressly stated in the Agreement, noting that there would be complaints wherever the line was drawn for receiving a Pay Transition salary increase.

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<sup>12</sup> Under this exception, if an SEC attorney had worked at the SEC prior to attending law school, that prior SEC experience could be considered specialized experience.

<sup>13</sup> For applicants approved for a salary adjustment prior to June 14, 2015, their pay adjustment began in pay period 14. For applicants approved after June 14, 2015 (those that required further review and negotiations with the NTEU), their pay adjustment began in a subsequent pay period but was retroactive to June 14, 2015.



### **C. Pay Transition Budget**

OHR officials stated that the initial \$3 million budget was developed in consultation with several senior SEC officials. The budget was based on a preliminary assessment of the anticipated costs of the program that was conducted by outside compensation consultants. OHR officials further stated that the cost of Pay Transition was “a significant concern” because the total liability would be based on a number of unknown variables (including the number of applicants and the experience listed in each applicant’s resume). OHR officials explained that these unknown factors made it impossible to calculate, and difficult to approximate, the total cost of Pay Transition. According to OHR officials, the \$3 million figure was a cap suggested by SEC management to provide budgetary certainty and was negotiated with, and ultimately agreed to, by the NTEU.

The CFO informed us that he was involved with Pay Transition as an advisor from the beginning. The CFO stated that he was involved because he is both the SEC’s CFO and a member of the Human Capital Advisory Council.<sup>14</sup>

The CFO stated that he believes that \$3 million was the OHR’s initial estimate of how much the program would cost. He stated that the Office of Financial Management did not perform any financial modeling for Pay Transition. The CFO also stated that he had relied on the OHR’s estimates in initially including \$3 million for Pay Transition in the SEC’s fiscal year (FY) 2015 budget. He also said that in December 2014 or January 2015, he learned from the OHR that there was more demand for Pay Transition than first anticipated, and he later learned that the program would cost \$21 million.<sup>15</sup> He said the Chair made the decision to fully fund Pay Transition and that he agreed with the Chair’s decision, which he characterized as “a matter of fairness.”

The CFO stated that the new salaries under Pay Transition would start in June 2015, which is two-thirds of the way into FY 2015. Therefore, he added \$7 million to the FY 2015 compensation budget to cover the salary increases. According to the CFO, the Pay Transition cost for FY 2016 will be about \$21 million (or about 2.1% of the SEC’s compensation budget). The CFO also said that he did not believe it was originally anticipated that the Pay Transition cost would reach \$21 million, as the original vision was to correct only gross disparities in pay and that the \$3 million cap was developed in line with this original vision.

According to OHR officials, the Chair decided to fully fund Pay Transition on May 20, 2015, 7 months after the open season deadline for submitting applications. OHR officials stated that the Deputy CHCO notified the NTEU’s President of the Chair’s decision that same day. The CHCO stated that the OHR did not announce the Chair’s decision to the SEC staff because the OHR typically does not announce the budget for its programs.

According to the CHCO, the budget for Pay Transition should not have impacted any employee’s decision to apply for a salary increase because about 1,600 employees applied and, at

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<sup>14</sup> The Human Capital Advisory Council is a group of representatives from various divisions and offices that meets once a month to discuss upcoming human capital initiatives and programs, and to provide feedback to the OHR on human capital questions.

<sup>15</sup> The \$21 million figure includes salary adjustments for both bargaining unit and non-bargaining unit employees.

the time of the open season, it was unknown (1) how many employees would apply, or (2) how much the program would cost. OHR officials also informed us that the OHR extended the open season for Pay Transition by 4 days for all employees, and about 10 employees were allowed to apply for Pay Transition after the open season deadline because those employees were either on maternity leave or sick leave during the entire open season. Those employees were added to the applicant pool in November or December 2014 and their applications were processed in a similar manner as those of other applicants.

The CHCO also stated that the SEC is not considering reopening Pay Transition and that the Union has not asked for it to be reopened. The CHCO further said that the OHR considers Pay Transition a one-time program that would not be offered again because it took a significant amount of time and resources to implement.

### **Conclusion**

Based on the results of our review, we learned that the process the OHR used to implement Pay Transition was consistent with the Agreement, including application of the agreed-upon pay-setting matrices and use of a multi-level application review process. We also learned that the 5% eligibility provision contained in the Agreement was the result of a compromise between OHR officials and the Union.

In addition, we confirmed that the \$3 million budget set forth in the Agreement to cover the Pay Transition salary adjustments was significantly lower than the actual amount of the approved salary adjustments. The actual salary adjustments amounted to about \$21 million, which the Chair decided to fully fund. We learned that the difference was the result of the SEC's inability to predict how many people would apply and qualify for Pay Transition, and the total amount of all approved pay adjustments.

We also learned that Pay Transition was completed in October 2015, with no party invoking arbitration (*see also* footnote 9, *supra*), and all salary adjustments were effective as of June 14, 2015.

The OIG is issuing this memorandum to management for informational purposes and is not making any recommendations. We previously provided SEC management with a draft of this memorandum for technical comments and incorporated those comments into the final memorandum as appropriate.

cc: Mary Jo White, Chair  
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