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February 18, 2011

The Honorable Bob Blumenfield
Vice Chair, Joint Legislative Budget Committee
1020 N Street, Room 553
Sacramento, California 95814

Dear Assembly Member Blumenfield:

Pursuant to Item 6440-001-0001, Provision 12, of the Budget Act of 2010 (reflecting the criteria specified in Provision 27 of Item 6440-001-0001 of the Budget Act of 2006 Chapters 47 and 48, Statutes of 2006), enclosed is the University of California's report to the Legislature on *2010 Executive Compensation Policies and Practices*.

If you have any questions regarding this report, Associate Vice President Debora Obley would be pleased to speak with you. She can be reached by telephone at (510) 987-9112, or by e-mail at Debora.Obley@ucop.edu.

With best wishes, I am,

Sincerely yours,

Mark G. Yudof
President

Enclosure

cc: Mr. Gregory Schmidt, Secretary of the Senate
Ms. Jody Martin, Joint Legislative Budget Committee
Ms. Tina McGree, Legislative Analyst's Office
Ms. Amy Leach, Office of the Chief Clerk of the Assembly
Ms. Diane Anderson, Legislative Counsel Bureau
Executive Vice President Nathan Brostrom
Vice President Patrick Lenz
Associate Vice President and Director Steve Juarez
Associate Vice President Debora Obley
Executive Director Jenny Kao

Report on 2010 Executive Compensation Policies and Practices

March 2011

Legislative Report

**An investment in UC pays
dividends far beyond what
can be measured in dollars.
An educated, high-achieving
citizenry is priceless.**

UNIVERSITY OF CALIFORNIA**Report on 2010 Executive Compensation Policies and Practices****March 2011**

The University of California submits this legislative report in response to Item 6440-001-0001, Provision 12, of the Budget Act of 2011, which states:

“12. It is the intent of the Legislature that the University of California submit an annual report by March 1 of each year through the 2010-11 fiscal year to the Joint Legislative Budget Committee, legislative fiscal subcommittees, and the Department of Finance on the university's progress in reforming its compensation policies and practices, reflecting the criteria specified in Provision 27 of Item 6440-001-0001 of Section 2.00 of the Budget Act of 2006 (Chs. 47 and 48, Stats. 2006).”

The criteria for this report are in Item 6440-001-0001, Provision 27, of the 2006 Budget Act, which states in part:

“27. ...It is the intent of the Legislature that the University of California submit an annual report on March 1 of each year through the 2010-11 fiscal year to the Joint Legislative Budget Committee, legislative fiscal subcommittees, and the Department of Finance on the university's progress in reforming its compensation policies and practices consistent with the recommendations of the April 2006 report of the Task Force on UC Compensation, Accountability, and Transparency, the Price Waterhouse-Coopers report, and the Bureau of State Audits' May 2, 2006 report.... It is the intent of the Legislature that the report specifically include all of the following:

- (a) Consistent with the task force's recommendations on reporting, annual reports provided to the Board of Regents on total compensation for specified university senior officials...
- (b) Plans and actions taken by the University of California to reform compensation policies and practices...
- (c) Plans and actions taken by the University of California to update its human resources information system...”

The University of California continues to make progress in its review and revision of policies, programs, systems and administrative procedures in response to the recommendations of the Task Force on UC Compensation, Accountability and Transparency as reported in its final review dated October 2009. Although the vast majority of action items identified in the original Task Force report from 2006 have been implemented by the University, two items were identified in their report from 2009 that remain open:

1. Invest in a modern, comprehensive, integrated human resources information system (HRIS) to enable compensation data to be quickly examined and analyzed.
2. Implement the Regents' stated goal to bring all employees' salaries to market by 2015 and identify additional resources to reach market competitive compensation.

The Task Force also identified three recommendations to the Board of Regents in its 2009 report:

1. The compensation system should be simplified, wherever possible, without sacrificing rigorous review, approval and reporting mechanisms.
2. The Regents should consider delegating responsibility for approval of the total compensation of deans to the Chancellor of the respective campus.
3. The Regents must ensure that the effectiveness of UC's compensation program is measured not solely by the level of transparency but by its ability to attract and retain the personnel necessary to lead the institution forward.

In addition to responding to the Budget Act language, this report will provide details of the University's progress toward the two open items and the three recommendations noted above.

ANNUAL REPORTING OF TOTAL COMPENSATION FOR NAMED POSITIONS

Consistent with Provision 27(a) of the 2006 Budget Act

In accordance with the Task Force's recommendation on reporting, the University has continued to use the Regents' approved format for the Annual Report on Executive Compensation. The report on 2010 compensation is currently scheduled to be sent to the Board of Regents in July 2011. The University will forward the relevant portion of this report, as described in the Budget Act language, to the Legislature following distribution the Regents.

REFORM OF COMPENSATION POLICIES AND PRACTICES

Consistent with Provision 27(b) of the 2006 Budget Act

Although not cited as one of the Task Force's open actions, the University continues to review and revise policies, as necessary, and as part of its ongoing, regularly scheduled review process. Consistent with the 2009 recommendation of the Task Force, the Regents approved a new policy which moved the majority of deans and subsequently certain other academic positions from the Senior Management Group to governance under Academic Personnel Policies and delegated authority to the Chancellors for the approval of compensation and other personnel actions. The new policy requires monitoring reports to the Regents every two months of all compensation transactions, and annual reporting of the deans' compensation. This change clearly addressed the issue of conflicts between policies for senior managers and policies for academics, and brought more clarity to those policies for those few remaining senior managers who also hold academic appointments.

During 2010, the Regents also reviewed and approved several new and revised policies and took other actions related to senior management compensation, including:

Outside Professional Activities Policy for Senior Management Group Members – This policy consolidated the requirements for outside professional activities from several separate policies into a single, clear and comprehensive policy document. The new policy clarifies and clearly identifies approval authority, reporting and compliance requirements, and accountable policy officers.

Governance Policy for Incentive Programs for Senior Management Group Members – This new policy is the result of a comprehensive review of all incentive plans for staff members at the campuses, Office of the President and the University's medical centers. The policy establishes a consistent and rigorous process to review and amend the

University's incentive programs, bringing consistent standards, accountability and oversight to the design, goal-setting, and administration of all variable pay plans for senior management.

Amendments to the Principles for Review of Executive Compensation – The amendments to these Principles, which were originally approved by the Regents in 1992, brought the Principles into conformance with new and revised policies, changes to the Bylaws and Standing Orders (see below), and other Regents actions regarding executive compensation and related issues. In addition, at the time of these amendments, the Regents rescinded several outdated policies related to executive compensation that had been superseded by more recent policies, Bylaws and Standing Orders.

In addition, the following policies affecting senior managers are currently in the process of being reviewed and revised, for submission to the Regents for approval in 2011:

Absence from Work (including Transitional Leave/Administrative Leave in Lieu of Sabbatical) – A revised Absence from Work policy for all staff employees was issued in 2010. A draft policy on Absence from Work provisions that apply exclusively to members of the Senior Management Group is now being reviewed is expected to go to the Regents for approval this year. The draft policy includes a provision for Transitional Leave (which includes administrative leave in lieu of sabbatical).

Termination of Appointment – This existing policy was also not identified by the Task Force, but will be revised to provide greater clarity in its provisions and authorities, and presented to the Regents for approval this year.

Finally, the following Regents Bylaw and Standing Orders were amended in late 2009 to provide further clarification and alignment with Senior Management Group compensation policies and other Regental actions regarding executive compensation:

Bylaw 12.8 Committee on Compensation – This Bylaw governs the jurisdiction of the Regents Committee on Compensation. The amendments reflect the new or revised policies that generally require all compensation actions for Senior Management Group members and certain non-Senior Management Group employees above a certain compensation level (the Indexed Compensation Level) to be approved by the Regents.

Standing Order 100.2 Employment Status – This Standing Order deals with employment status, including appointment and dismissal, of Officers of the University (a subset of the Senior Management Group). The amendments clarify that all appointments of Senior Management Group members, including the rehiring of retired employees into Senior Management Group positions, require the approval of the Regents.

Standing Order 100.3 Compensation – This Standing Order deals with compensation for Officers of the University. The amendments reflect the requirement that all compensation actions for members of the Senior Management Group require Regental approval.

Standing Order 101.1 Employment Status – This Standing Order deals with the appointment of employees other than Officers of the University. The amendment reflects the requirement that the rehiring of non-SMG employees whose salaries exceed the Indexed Compensation level requires the approval of the Regents.

Standing Order 101.3 Compensation – This Standing Order deals with compensation for employees other than Officers of the University. The amendments clarify that all compensation actions for Senior Management Group

members and certain non-SMG employees whose salaries exceed the Indexed Compensation level require the approval of the Regents.

The continuing goal of this work is to develop policies that are clear, consistent, transparent, easily understood, and provide guidance on when and how exceptions may occur. The policies have been developed within the new template, which is intended to present policy parameters, approval authorities and compliance and monitoring requirements in a clear and consistent format. The revised policies strengthen internal controls and facilitate greater transparency, compliance and reporting.

HUMAN RESOURCES INFORMATION SYSTEM (HRIS)

Consistent with Provision 27(c) of the 2006 Budget Act

The University continues its ongoing efforts to work within its existing systems framework to improve the availability and accuracy of its compensation data. It has also continued work to ensure that compensation transactions entered into its databases comply with policies and program requirements. In direct response to the Task Force's recommendation, UC has also undertaken a review of its Payroll and HRIS systems with the objective of simplification and standardization. These are large, complex and expensive undertakings, which are expected to take several years to accomplish.

In July 2010, the Regents approved a Resolution Regarding Administrative Efficiencies, which provides, in part, direction to the University in its efforts to achieve better quality compensation data and better mechanisms for collecting and reporting on such data. Among other things, the resolution directs the University to design and implement, where appropriate, common best practice administrative systems, including human resources systems. The goal of this effort is to have ten distinct campuses and their associated medical centers using one efficient administrative framework, including common, integrated HR and Payroll systems. The University is developing a Request for Proposal (RFP) for a competitive bid process that will lead to the selection of an appropriate systems solution for both HRIS and Payroll during 2011.

OTHER PROGRESS ON TASK FORCE RECOMMENDATIONS

Market Competitive Salaries

The University continues to lag the market in total cash compensation for faculty and staff, based on findings contained in the Report on Employee Total Compensation released in October 2009, and found at the link below:

<http://www.universityofcalifornia.edu/news/compensation/comparisons.html>

This analysis shows that faculty compensation remains approximately 10 percent behind the average in the marketplace, and staff compensation ranges from 22 percent below market for the Senior Management Group, to 13 to 19 percent below market for managers, senior professionals and support staff. When benefits values are included in the above analysis, the University's position to market improves. However, as the University implements changes to its retirement plan in order to ensure its sustainability and as the cost of medical benefits continues to increase, the value of benefits will decline, worsening the University's position to market. The report also indicates that there are some employee groups whose cash compensation is competitive with the market: staff at the medical centers and union represented service workers.

Consistent with the recommendations of the Task Force, but acknowledging the significant budget constraints within the University, reviews are underway to identify means by which UC can begin closing the market gap relative to cash compensation. Over the last seven years, the University has provided a salary adjustment program for staff in only three years. This is in stark contrast to union contracts which have continued to provide increases to represented employees during this same seven year period. There is additional pressure on the University to retain top faculty and staff as the labor market improves and competitive pressures from other institutions mount. In addition, as new faculty and staff are brought in to replace retirees or those departing, new hires are commanding market-based compensation which is, in some cases, considerably higher than compensation paid to the existing staff who are performing substantially similar work. In order to maintain the quality of the University of California, we must pay market rates to be able to attract and retain the best qualified faculty and staff.

All the actions detailed above will begin to address the final remaining action items identified by the Task Force along with their additional recommendations, as noted in the opening of this report.

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