Statement of Arleas Upton Kea Director Division of Administration Federal Deposit Insurance Corporation on Alternative Personnel Systems the FDIC Experience Before the Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia of the Committee on Homeland Security and Governmental Affairs U.S. Senate
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Chairman Voinovich, Senator Akaka, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on our experiences administering and managing a personnel system at an independent federal corporation.

The FDIC, having long managed a personnel system that is more flexible than most government departments and agencies, has significant insights into the importance of personnel systems that permit a government agency to react to change and achieve its mission. In my testimony today, I will briefly highlight how the FDIC's personnel system has helped us achieve our mission, the importance of flexible personnel policies in today's rapidly changing financial industry and our experience with "pay banding" and "pay for performance."

Background

The FDIC has served as an integral part of the nation's financial system for over 70 years. Established by the Banking Act of 1933 at the depth of the most severe banking crisis in the nation's history, the immediate contribution of the FDIC was the restoration of public confidence in banks. Today, the FDIC's mission remains unchanged. We maintain public confidence in our nation's financial system in three important ways. First, we insure deposits held in our nation's banking system. Second, we examine and supervise banks for safety and soundness and compliance with laws and regulations. Finally, we handle the resolution of failed banks when that becomes necessary. In carrying out its mission, the FDIC does not receive appropriated funds. The FDIC is funded by insurance assessments on the deposits held by insured institutions and by interest earned on the deposit insurance funds.

Benefits of Flexibility in the Use of Temporary Appointments

In the late 1980s and early 1990s, the FDIC faced a banking crisis unprecedented since the Great Depression. With as many as 200 bank failures a year at the peak of the crisis, the FDIC was faced with a massive challenge of handling these failures in a way that maintained public confidence in the financial system. The FDIC successfully responded to that challenge as it has to other challenges throughout its history.

Part of the reason for that success was the flexibility the FDIC had to adjust the size of its workforce rapidly and substantially. In the early 1980's, the FDIC employed 4,000

people. By the early 1990's, the FDIC employed over 23,000 people. Some employees were hired for one year terms that could be renewed annually as justified by the workload. Others were hired for terms of up to four years that could not be renewed. Other government agencies had similar excepted authorities and in some case those authorities may have been abused. As a result, the FDIC and other government agencies no longer have these authorities, except under the most limited conditions.

As significant as the hiring process was, so too was the downsizing that followed over the past decade. Today, the FDIC again employs fewer than 5,000 people. As the workload associated with the banking crisis decreased, these limited term employment contracts were ended. Employees hired under term authorities were essential to the success of the liquidation and resolution activities of the FDIC and performed very well. However, they understood that eventually they would work themselves out of a job. These employees enjoyed certain civil service protections and FDIC benefits and gained marketable skills. The FDIC is grateful to the literally thousands of employees who saw this nation through its banking crisis.

Benefits of Flexible Buyout Authority

To complete the downsizing necessary at the FDIC, more than the nonrenewal of temporary appointments was necessary. For over a decade, the FDIC, whenever possible, consistently chose voluntary departures of employees through buyouts instead of involuntary reductions-in-force (RIFs). The FDIC's greater flexibility to offer generous buyouts proved very useful. Many career employees accepted these offers, greatly reducing the need for involuntary separations.

Benefits of Retraining

Retraining is not always the answer but the FDIC has used this method successfully in order to provide flexibility in the workforce, prepare the FDIC for the future, avoid RIFs, and retrain and retain highly skilled employees. When the FDIC's failure resolution activity declined, we knew we had employees with great ability but no work. To address this issue, the FDIC received authority from the U.S. Office of Personnel Management (USOPM) to waive certain job level requirements and create "Crossover Programs" to allow employees who were trained to handle bank failures to become bank examiner trainees without a significant reduction in pay. These employees began a rigorous retraining program and started new careers at the FDIC's expense. It was a successful program. Two-thirds of these employees became commissioned bank examiners and the FDIC retains the resolution experience should the need arise to redeploy these "crossover employees" to handle bank failures.

Costs of Existing Reduction-in-Force Procedures

Despite all of the above-mentioned efforts, involuntary separations still were necessary. RIFs are difficult to do and do not always provide satisfactory results. They are disruptive to an organization and the outcomes are unpredictable. Seniority and

positions previously occupied heavily influence the results. Performance and skills sets have far less of an impact. This makes it difficult for an organization to ensure that the necessary skill sets are retained to carry out its mission effectively.

RIF rules also are highly complex and truly understood only by a limited number of experts. They involve "bump and retreat" rights which factor in an individual employee's personal career history. Despite outward appearances, this is not a transparent process. For employees subject to these rules, it sometimes appears that luck is a major factor. The FDIC would like to have more flexibility in the RIF process. The current rules are too complex, too tied to seniority and do not sufficiently factor in job performance.

Today's Growing Challenges

The challenges facing the FDIC today are very different from those of the past two decades. The consolidation of the financial services industry has reduced the number of banks, increased the size and complexity of the remaining institutions, and inevitably affected the potential impact of bank failures, particularly large bank failures, on the economy. Since the mid-1980s, consolidation has reduced the number of federally-insured banks and thrifts from over 18,000 to less than 9,000. From 1985 to June 2005, the share of industry assets held by the ten largest insured banking organizations rose from 18 percent to 48 percent. Similar trends are evident in the concentration of industry deposits and revenues. Moreover, globalization, evolving technology, privacy concerns and increased use of nontraditional banking business lines, such as Internet banking, securitization, expanded credit card banking, and sub-prime lending, pose new, and potentially much greater, challenges for the FDIC. These challenges cross all of our business lines: risk assessment for insurance purposes, supervision for safety and soundness and consumer protection, and the resolution of failed institutions.

A Flexible and Skilled Workforce

Our workforce is remarkably dedicated and effective. The employees of the FDIC know the importance of the Corporation's mission and take pride in their accomplishments in serving the public. The FDIC must continue to develop and retain expertise within its ranks to respond to the challenges presented by the changing financial services industry. Part of the challenge that the FDIC faces is maintaining the ability to adapt rapidly to emerging business and regulatory demands in the financial services sector, through changes in the size and composition of its employment levels and skill mixes. The speed with which problems can occur and their potential complexity are much greater than in the past. Like many other federal agencies, we have concerns that the current civil service system, put in place more than a half century ago, does not adequately address the priorities of a 21st century workforce and the realities of the 21st century workplace.

The statutory framework for the FDIC provides a number of human capital flexibilities, either as a direct result of provisions in the Federal Deposit Insurance Act (FDI Act) or

as a result of exclusions from certain provisions in Title 5 of the United States Code, resulting from the Corporation's status as a government corporation. Nevertheless, even with the flexibility already possessed, the FDIC continues to face challenges in ensuring that the Corporation will promote the utmost in performance and excellence from its workforce in the future.

Reshaping the Workforce

Federal employees hired in the 1970's and 1980's had an expectation that they would spend their careers employed within the federal government. That premise of life-long employment was based on a more stable workforce requirements model, one that did not foresee rapid changes in the financial marketplace driven by ever-growing sources of information, technology and globalization. This staffing model is now outdated. Employees no longer necessarily expect to remain with one organization for their entire career. The continuing changes in the financial industry require a staffing strategy that hires for developing knowledge and skill sets. This is common in the area of information technology where rapid change drives the need for a constantly evolving skill mix, but it is no less essential in the financial regulatory environment of the 21st century.

Streamlining the Hiring Process

The FDIC already has taken some steps to streamline the hiring process. Those who apply for positions in the private sector often find a more streamlined, simpler application process that produces a faster response to a job application. We have implemented an automated hiring process which, while not a complete answer, can be a useful tool in recruitment for certain types of positions.

Corporate Employee Program

Over the past year, working with the USOPM, the FDIC has received delegated authority to offer competitive term appointments with the possibility of conversion to a permanent position without further competition to address the variable workload present in our bank examination and resolution functions. This kind of approach should address our need to expand and contract the FDIC's workforce to meet our future work challenges. A staffing plan with a mix of variable term and permanent appointments hopefully will allow the FDIC to handle workload changes without the need for periodic downsizings.

The employees hired into this "Corporate Employee Program" are given introductory training in three critical functions: Safety and Soundness Examinations, Compliance Examinations, and Resolution and Receivership work. The employees are then trained to become "commissioned" in one or more of these functions. If retained by the FDIC at the end of their term appointment, these employees will have a broad range of skills and perspective that will serve to benefit the Corporation. If they are not retained at the end of this period, they will have been given valuable training in financial market activities that will benefit them well in future jobs elsewhere.

The Corporate Employee Program is administered through the FDIC's Corporate University. The Corporate University represents an enhanced effort at the FDIC to assure that employees at all levels in the Corporation receive the training necessary to be effective in today's rapidly changing and complex financial environment.

Need for Additional Employment Flexibilities

The FDIC also needs the ability to hire experts and consultants. The increasingly complex banking and economic issues that are the staple of FDIC research and regulatory activity require the flexibility to hire such individuals. Unlike the rest of the federal government, the general expert and consultant provision in Title 5 does not apply to the FDIC.

The challenge of meeting specific skill needs for a limited time can be met with term appointments and the selective hiring of experts and consultants, but the continuing concentration within the banking industry into fewer, but larger banks poses a different challenge. The failure of one or more large banks will require trained resolution and liquidation specialists in numbers far larger than is economically feasible to maintain on a standby basis. Backup contracts will address much of the workload, but having access to experienced resolutions and liquidation specialists to oversee such contracts would be an additional safeguard in times of crisis. The FDIC needs the authority, on a quick but temporary basis, to rehire large numbers of such specialists who have retired from the FDIC and who possess the necessary skills. Those skills are acquired over several years, making it impossible to hire and train new staff to respond to a major crisis. The FDIC currently is finalizing a delegation of authority from USOPM to waive the dual compensation restrictions in emergency situations.

Compensation

As I referenced earlier, the FDIC has certain statutory flexibilities to manage its organizational structure, staffing levels and human resources programs. In particular, the FDIC has the express statutory authority to set the compensation of its employees. This authority derives from the FDIC's enabling legislation, first enacted in 1933, which provides that the Board of Directors of the FDIC "shall have power . . . [t]o appoint . . . officers and employees . . ., to define their duties, [and] fix their compensation" [emphasis added]. Consistent with this independent pay-setting authority, government-wide pay rates and schedules (set by chapter 53 of Title 5 of the United States Code) specifically exclude employees of government-controlled corporations like the FDIC. Similarly, as a government-controlled corporation, the FDIC is exempt from government-wide position classification requirements (chapter 51 of Title 5). Instead, the FDIC is able to administer its own program of setting occupational groupings, titles and grades. In addition, because the FDIC is a government corporation, its senior executives are not part of the Senior Executive Service in the Executive Branch of government.

In independently defining the duties and setting the pay of its workforce, the FDIC adheres to other laws that impact the manner in which pay is set. In the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress gave the other financial regulatory agencies pay authorities similar to the FDIC and required these agencies (including the FDIC) to seek to maintain "pay comparability" with one another in order to avoid competition for employees. This law does not mandate perfect equality in pay and benefits among the banking agencies, just coordination and earnest efforts toward comparability. The FDIC has the discretion to set pay and is subject to the Federal Labor Management Relations Statute (chapter 71 of Title 5). Employee compensation and benefits at the FDIC are the subject of collective bargaining with the union that represents our bargaining-unit employees -- the National Treasury Employees Union (NTEU). The FDIC first began negotiating pay with our employee union in the early 1990's.

Early Efforts at Pay for Performance

Although free to chart its own pay and classification course, until the last decade, the FDIC generally adhered to the federal pay and classification systems as a matter of administrative convenience. Pay ranges at the FDIC were somewhat higher in grades 1 through 15 and the Corporation had its own executive classification and pay program, but the majority of FDIC employees were evaluated and paid under systems and guidelines that were very similar to those being used across the Executive Branch.

Beginning in the mid-1990's, the FDIC embarked on a path toward a pay-for-performance concept, by implementing relatively minor changes to our programs, such as eliminating within-grade pay steps for grades 1 through 15 and linking a portion of annual pay increases to an employee's annual performance evaluation. These programs were negotiated with the union for application to the bargaining unit and were extended to the managerial and supervisory positions for uniformity and consistency across the agency.

The objective of pay for performance at the FDIC is to be able to make meaningful distinctions in pay based on performance while retaining overall budget control within whatever parameters are determined to be appropriate. Like many agencies we have not always been successful in doing that. A consistent challenge is getting managers and supervisors to make meaningful distinctions between levels of performance.

Initially, the FDIC had a system that tied specific annual pay increases to performance ratings without specifying the total amount that would be spent on employee pay. The result was that most employees were rated well above average and received the higher pay increases which put total pay increases well above our original budgetary expectations.

That system was then modified to specify the total amount that would be spent for pay increases rather than specifying the pay increase allowed for each rating level. The

result was that most employees were still rated well above average but, to stay within budget, the pay distinctions between performance rating levels were not meaningful.

Recent Experience – Pay Banding & Pay for Performance -- Beginning at the Top

In 2001, the FDIC began a complete classification review of our executive and senior management positions to address an agency that had grown top-heavy during a period of significant downsizing. We also desired more flexibility to recruit, retain, promote and reassign management officials to meet changing organizational needs.

Today we have a single, Executive Management (EM) classification band which replaced a five-level executive program that had existed since the late 1980s. The 90 positions in the EM band (positions that are analogous to those in the Senior Executive Service in the Executive Branch) – out of approximately 5,000 total employees at the FDIC – occupy positions that were scored against objective criteria after evaluation by an outside classification and pay consultant. This band provides the FDIC with greater flexibility in hiring from the outside, in moving executives within the agency, and in rewarding high performers -- we are not constrained by rigid pay-setting within multiple grade levels or the difficulty of movement from one grade to the next.

The FDIC next applied the same criteria to the managerial and supervisory positions below the EM level and established two Corporate Management (CM) pay bands, which number approximately 500 positions. These bands replaced what were largely grade 14, 15 and Executive Level I positions in the former classification systems. Again, with these bands, the FDIC has easier movement within management positions, broader pay and promotion flexibility and enhanced ability to recruit from the outside.

Both the EM and CM employees operate under a "pay at risk" philosophy -- there is no guarantee of a pay increase for any of these employees. Any pay increase or bonus for senior managers at the FDIC is tied directly to an assessment of their contributions to defined Corporate, Division or Unit annual performance objectives.

For 2005 pay determinations (based on 2004 contributions), these senior managers were eligible for pay increases within a range of zero to 10 percent while half were eligible for a cash bonus within a range of 2 percent to 8 percent of base pay. To ensure that costs were controlled, there was a budgetary limit on the sum of the executive and managerial pay raises (4.5 percent of total executive payroll) and on the sum of bonuses (2.5 percent of total executive payroll). There are various levels of review to ensure fairness in the process and that meaningful distinctions are made in executive and managerial pay based on performance.

While it is too early to determine with certainty that these programs are fully successful, we believe these programs have produced positive results in a number of important areas. First, consistent with the President's Management Agenda, they have allowed the FDIC to tie managerial pay and recognition directly to the agency's strategic and annual performance plans. Achievement of our strategic goals and objectives is

measured each quarter and reported within the agency. Second, implementing a program that tied group as well as individual performance to specific corporate goals began a change in a culture that historically had longevity as the foundation for reward.

The FDIC continually assesses how these programs are working and annually conducts an anonymous survey of our EM and CM employees to obtain their views of the program. From this survey, we have identified areas for improvement that include better and more frequent individual feedback on progress toward the objectives and more discussion on the linkage between an employee's position and the strategic objectives and standards by which we differentiate between contributors at the EM and CM levels. However, those surveys also show that the concept of true pay for performance and making meaningful distinctions with respect to employee performance is, in fact, taking root at the FDIC. Executives, managers and supervisors do not expect or want to return to a culture that is unable to truly reward the best performers. Nor do they expect or want to return to a time when the level of their own contributions is not the primary basis for a pay increase.

Pay for Performance Below the Managerial Level

Non-managerial positions for both the bargaining and non-bargaining positions are classified under our Corporate Graded (CG) 1 through 15 classification structure. However, there are no step increases within CG grades or pay bands. Pay increases at these grade levels depend, in part, on an individual employee's contribution to defined Corporate, Division or Unit annual performance objectives, not on their length of service.

In 2002, the FDIC and the NTEU negotiated a new compensation agreement that included a new pay system. Effective in 2003, the approximately 3,200 bargaining unit employees were placed under a "Corporate Success Award" (CSA) program. The CSA is a 2-level system whereby all employees with a rating of "meets expectations" on their "pass/fail" performance appraisal receive a 3.2 percent pay raise. Depending on overall corporate success in achieving stated annual corporate objectives, a minimum of the top one-third of contributors – as nominated by direct supervisors and then vetted through a process up to division and office directors – receive an additional 3.0 percent pay raise. This system has been in place for 2003 through 2005 for bargaining unit employees. We are currently in negotiations with NTEU for a new compensation agreement to be effective beginning in 2006.

The approximately 900 non-bargaining unit, non-supervisory employees are under a "Contribution Based Compensation" (CBC) program with no guarantee of a pay increase (5 percent received no pay raise based on 2004 performance). Under CBC, there were five levels of pay raises and lump sum payments depending on the employees' relative level of contribution.

In both of these programs, the relative value of an employee's contribution (the output of performance) is first assessed by their supervisor relative to that of other employees in

the same unit against the defined Corporate, Division or Unit annual performance objectives. Actual pay increases and/or lump sum bonuses (in the case of the CBC program) are awarded on the basis of an overall assessment made at the division and office level. This program requires a forced distribution to ensure that there are meaningful distinctions in employee pay increases based on relative performance. A fixed percentage of employees are placed within each rating category depending on their comparative contributions.

Both of these programs have had mixed reviews and the FDIC is learning from the experience. A pay for performance program was a radical change for the workforce and was not expected to be fully embraced from the beginning. However, the concept of making meaningful distinctions among employees and thus allowing meaningful rewards for high performers is valid. The FDIC is committed to improving these programs for its managers and executives, its non-bargaining unit employees and through collective bargaining with the NTEU.

Lessons Learned

The FDIC has learned a number of lessons from its experience managing an alternative personnel system.

1. Organizations with variable workload demands need flexible, non-permanent appointments in their staffing plans, particularly in the rapidly changing technology and financial fields of the 21st century.
2. Pay flexibility is critical in order to design and implement separation incentive programs to meet changing workforce demographics and employment markets.
3. Be sure to fully fund and give maximum effort to those programs that assist employees in adapting to change, whether that change is preparing to accept a different job, considering a buyout and leaving for other opportunities or working under different pay for performance programs.
4. Be creative in your solutions to downsizing. Setting targets and conducting RIFs is fast and effective, but such actions do not let you consider other, more time-consuming alternatives, such as a "crossover" program or slower, voluntary separations.
5. Pay for performance programs must have sufficient funds to deliver significant reward for significant contributions in the form of pay raises and/or bonuses.
6. Managers must have the will and the means to make meaningful distinctions among employee contributions, and this should be reflected in the levels of compensation.
7. Change by example. Make the change first for executives, then for managers and supervisors. Use the lessons learned at these higher levels to craft a system for the rest of your employees. The FDIC is on the fourth iteration of its pay-for-performance system.
8. Create a pay for performance process that ensures fairness, with appropriate checks and balances.
9. Listen to employee feedback and be willing to adapt and evolve the system.

10. Accept that there will be unintended consequences to whatever program changes are implemented.
11. Develop hiring programs that seek to instill a sense of corporate or agency identity to recruit employees who can serve across organizational or disciplinary lines. Administer these programs at the corporate level to ensure no divisional bias. The FDIC's Corporate Employee Program, administered through its Corporate University, is an example of such a program.
12. Last, and possibly most importantly, train both managers and employees on your new systems.

This concludes my remarks, I will be happy to answer any questions.

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