Does Your Exchange Rate Policy Respond To Your Expatriates' Needs?

Exchange rate is a persistent and recurring topic within Global Mobility. It is commonly and equally causing headaches to many International HR managing expatriate personnel and their remunerations.

From a macroeconomic perspective the main factors influencing exchange rate fluctuations are far greater than expatriates' concerns and their goods and services basket. These factors are commonly presented as inflation, government monetary policy, economic and political stability, current account deficit.

One of the most notable event of this past year was certainly the sudden soar of Swiss franc (CHF) against the Euro (EUR) after the Swiss National Bank stopped holding the CHF at a fixed exchange rate with the EUR. Overnight Swiss goods and services became 20% more expensive to buy while Swiss companies or individuals benefited from an unexpected increase of their purchasing power within the Euro zone. As an example, Swiss car retailers had to adjust after realising that customers were starting to purchase vehicles in neighbouring countries (primarily Germany). At a micro level of expatriate management this had a huge impact on exchange rate reconciliation calculations for both those assigned to, or from Switzerland.

This, however, only shows an example in so-called "stable" or "biggest" economies, but expatriates are sent all "over the place" where economies and politics are far more exposed, and thus exchange rates are traditionally more prone to go to extremes.

Expatriates cannot do anything at their level and employers must constantly (re) adapt and (re)adjust their practices to reduce the impact on expatriates remuneration.

The impact that the exchange rate actually has on expatriates' remuneration can be classified as 3 major types:-

- **Purchasing power in the host country:**
  If payroll currency depreciates, the cost of living in the host country will increase. If on the contrary it appreciates, the cost of living will decrease
- **Savings and financial commitments in the home country:**
  Many expatriates transfer money back to their home country to cover ongoing financial obligations (i.e. mortgage, diverse types of savings plans) or other personal obligations (i.e. family support)
- **Retirement assets:**
  Currency of their retirement plan may be different than the currency of the country they will retire to. Exchange rate fluctuation may therefore increase or decrease the counter value of their assets or pension at the time of retirement.

The above will have more or less of an impact following to each expatriate remuneration structure: from home to host approach, over to guaranteed net, to the transfer of purchasing power and many others. When adding this to the possible legal obligations for a local salary, it becomes even more challenging to apply a common approach to all home/host country combinations.

Two main categories can however be distinguished:

- **Those for whom their package is fully or partially paid in host currency**
  The impact may arise if the portion they receive does not cover or exceeds their needs. These expatriates usually have a reduced exposure as they are receiving home and host currencies
- **Those for whom their package is expressed in a currency other than the home or the host country**
  These are usually impacted over all 3 previous major fields.

For both these profiles the cost of living allowance (COLA), if any, tends to mitigate the exchange rate effect.

Many of the discussions Mobility Managers have with their expatriates lay over the fact that expatriates are observing a current impact while the COLA they receive reflects a differential corresponding to a previous period. In other words, you are compensating over an oncoming period something that has already occurred. The "good news" is that the exchange rate differential calculation usually works the same way so the combination of both can help companies to better explain and relate one to another.

With this respect, a "true" split pay approach is an interesting configuration where you define at the beginning of the assignment the home and host portion in their respective currency and then annually apply an inflation differential without recalculating a COLA.

This option is very interesting as it disconnects the exchange rate factor throughout the assignment. Exchange rate variations are considered to not have an impact as each portion of the salary is paid in the right currency. The annual package review is made by applying an inflation differential. This system can have its limits for high inflation countries and thus a huge negative inflation differential on the spendable income without considering how people actually adjust their consumption habits.

There is no magic formula (at least not just one) to manage exchange rate impacts, but there are a couple of actions organisations can adopt to make this subject and their policies more pragmatic and adaptable without dramatic changes.

Monitoring:

It can help prevent situations where expatriates are already affected by a fluctuation and decide to prepare their own summary file, with their own rates and already calculate the amount of the differential they should be paid. Keeping close communication on fluctuations and their impacts as well as how, why and when they will be processed is essential. This usually is time consuming or requires an integrated and automated tool to record and calculate these variations.

Clear Communication And Practices:

Upon signing their assignment contract expatriates do have a multitude of personal and professional matters going on. The reference rates are often commented and discussed, but the methodology and its potential financial impact are typically overviewed. Taking the time to run a couple of scenarios and numbers before any assignments helps expatriates better understand situations in the future.

Exchange rate differential methods are often part of expatriate policy(ies) which inevitably demands several validations and the implication of various mobility stakeholders upon modification or update. Consider having a general policy enforced with various practices that help adjust faster under certain circumstances and adapt it to remuneration structures and geographical locations.

Leave The Choice To Expatriates Themselves:

Some expatriates may prefer not to have any type of exchange rate differential calculation applied on their whole or portion of their salary. Flexibility might be given with this regards, but what is almost certain is that in case of a situation similar to the CHF-EUR scenario, companies will need to have a back-up plan. The choice can be reconsidered at the beginning of each year.

Keep Record Of The Balance:

Many companies do not withdraw positive (employee's 'gain') exchange rate differential while on the contrary, they pay upfront any negative (employee's 'loss') differential. Keeping records of the fluctuation allows Global Mobility teams to obtain an ongoing status of an overall balance and to settle it periodically. This would usually be over a standard 3-year assignment period, or any time there is a significant change in the expatriate's situation.

Exclude Some Currencies:

What companies and expatriates hate the most are drastic oscillations and endless discussions around the actual financial impact. Considering to exclude certain currencies "at risk" does not mean the absence of any action but simply removing them from the traditional scheme of a reference rate.

The expatriate community is greater than ever and will continue to rise. What is also sure is that the number of different expatriate status will continue to grow. Cross-borders, commuters, unaccompanied assignments, Local +, young talented graduates, career expats are only a few examples.

When it comes to the exchange rate topic, the "classic" cross-border population is of particular interest.

If you take the example of cross-borders working in Switzerland, here is a group of roughly 300,000 people having their salary fluctuating every single month without any type of differential calculation.

Current situation is idyllic as the CHF is being particularly strong against the EUR but time will come when it will turn the other way around and everyone will see their purchasing power diminish and the cost of their living expenses increase. Last but not least, they all benefit from retirement plans in CHF.

The idea behind this example is not to waive any type of calculation, but to drive towards a more flexible model where a certain variation (ie + or – 5%) is supported respectively by either the expatriate or the company.

The exchange rate topic will certainly continue to bring more surprises over the next few years. But one thing is sure, it could be worse if, imagine for a second, we would still have to deal with French franc, German mark, Italian lira or Slovenian tolar.

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