Brexit and Mobility: Take action now

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Although the economic and political changes set in motion by the U.K.’s June 23 Brexit referendum will take months, and probably years, to be resolved, global mobility professionals should consider taking action now to address business and assignee concerns. This paper suggests that a proactive review of your firm’s mobility program pay approaches and policies to address volatility may help you uncover opportunities to enhance mobility of assignees both in and out of the U.K.

The U.K.’s June 23 referendum on EU membership famously resulted in a slim majority casting their votes to leave the Union. This result set off a firestorm of economic and political reactions against a backdrop of uncertainty and speculation about the ultimate impacts of the vote. Though some of the dramatic, initial impacts have been tempered somewhat with time, volatility and worries about the future continue.

For those considering what steps to take with respect to their global mobility programs, it’s helpful to first step back and separate what is fact and what is guesswork. We know that the referendum results took many both within and outside the U.K. by surprise, and global financial markets reacted swiftly and dramatically. Global stock markets lost trillions of dollars and the pound sterling plunged in value against other world currencies, including falling to its lowest level in over thirty-one years against the U.S. dollar.

On the political front, Prime Minister David Cameron resigned the day following the vote, and about two weeks later the leader of the opposing pro-Brexit U.K. Independence Party followed suit. Other key Brexit proponents were knocked out of consideration for the top leadership position by political infighting and missteps, eventually leaving only one candidate, Home Secretary Theresa May, to be appointed as Prime Minister by default. May radically reshaped the cabinet, including the placement of key “Brexiters” in positions that will require them to manage the U.K.’s EU departure. This departure will be officially triggered once Article 50 of the EU constitution is invoked, with two years allotted for negotiating the terms of withdrawal.

The rest is clouded by conjecture and ambiguity. When, and even if, Article 50 will be invoked is unknown. Even the process of negotiating departure via Article 50 is untested, with vague language and a lack of clarity about the respective roles of the U.K. and the rest of the EU.

A key concern is that economic growth in the U.K. will slow, and that inflation may rise due to a weaker pound sterling and import tariffs. There are also deep fears that the U.K. may become less competitive and lose its status as a global financial hub. Other worries involve restrictions on free movement of labor between the U.K. and Eurozone due to loss of EU immigrations benefits, not to mention uncertainty regarding the legal residency status of millions of the EU citizens living in the U.K. and vice versa.

Ultimately, Brexit is far more than a national problem. The extent of geopolitical fallout, including the potential breakup of the U.K. and changes in Eurozone membership and influence, may take years to take shape.

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Mobility Professionals — Take Action Now

Given this lack of clarity around the eventual impacts of Brexit, why should global mobility professionals take action now? Put simply, the potential impact is enormous. The U.K. is the second largest economy in the EU and fifth or sixth in the world. According to the website fullfact.org, there are over three million EU-based expatriates in the U.K. and over a million U.K. expats in the rest of the EU. In addition, although the magnitude of the eventual economic impact remains unknown, currency volatility is already affecting assignees both in and out of the U.K.

Not surprisingly, global mobility professionals are fielding many questions from businesses and assignees worried about Brexit-related immigration and economic changes. During AIRINC’s recent webinar on Brexit for Mobility Professionals, almost three-quarters of the webinar audience indicated their most pressing concern was to be better prepared to respond to these questions. Though we cannot yet define the extent to which free labor movement will be curtailed as a result of Brexit, the good news is that there are time-tested solutions to address economic volatility. In fact, many global mobility programs are already well-positioned to respond to challenges relating to currency fluctuation and inflation.

Let’s consider responses to the immediate issue of changes in the value of the pound sterling (GBP), which collapsed to a thirty-one year low against the U.S. dollar (USD) and other major currencies following the Brexit vote. Although it regained some of its value in the following weeks, it continues to be sensitive to political and economic news and few expect the GBP to regain its former value in the months to come.

What does this mean for expats? For those in the U.K. paid in a currency other than GBP, the U.K. suddenly feels “cheaper” as other currencies can be exchanged for more GBP. However, for non-national assignees on local packages in the U.K., more of their salary now needs to be converted to meet financial obligations and savings targets in other currencies.

For U.K. nationals working outside the U.K., those paid in GBP are also feeling the pinch, as they need more currency to convert to host currencies required for day-to-day living expenses. Those on host pay packages, though, are benefiting, as the same amount of host currency allows assignees to repatriate more GBP.

Mobility Program Pay Approaches

The pay approaches used to compensate expatriates therefore have large impacts on assignees and your organization’s mobility costs. As a reminder, the home balance sheet is intended to protect the assignee’s home living standard. The assignee receives his or her home salary (typically in home currency), is tax equalized, and cost of living allowances are flexed over time to ensure there are no losses nor windfalls relating to currency and inflationary volatility at host. Not so with host-based pay arrangements, where assignees typically receive the host rate of pay, are paid in host currency, and pay host income taxes. Although compensation arrangements may include host housing or other plus elements, home-host balancing elements are not included. Most critically, assignees can over time either gain or lose financially relative to their home countries.

This distinction is important for assignments involving the U.K. AIRINC’s 2016 Mobility Outlook Survey confirms about four-fifths of surveyed organizations use the home balance sheet for most moves, but host-based pay is most prevalent for European-headquartered...
firms, and is also most commonly used in financial and business services industries. Moreover, host-based pay arrangements tend to be used as a low-cost alternative to the home balance sheets (generally for transfers between stable economies), and therefore rarely include currency-protection schemes.

With these facts in mind, it’s clear that the large numbers of assignees on host-based packages in the U.K. have experienced a financial shock as funds earmarked for home spending and savings lost over ten percent of their value overnight. This has broader implications regarding recruitment and retention for mobility programs that rely heavily on host-based pay approaches; potential assignees may reasonably have concerns about committing to local pay arrangements in the face of great uncertainty and volatility.

We are therefore suggesting that mobility program pay approaches be critically assessed in light of Brexit:

» Facilitate the right kind of mobility
» Bolster mechanisms to protect assignees against volatility, as well as to avoid mobility program overspending

Prior to Brexit, clients had already been experiencing considerable currency volatility in recent years, not only in unstable economies such as Venezuela but more surprisingly with stable world currencies such as the Euro, which tend to impact a much larger number of assignees. As a result, in Europe we have already witnessed a slight shift from host pay and towards a more robust balance sheet methodology. — Kay Hall, AIRINC’s London-based Vice President for EMEA

We are therefore suggesting that mobility program pay approaches be critically assessed in light of Brexit. There are two areas of focus: First, ensure that your pay approaches will continue to facilitate the right kind of mobility. Second, consider adding or bolstering mechanisms to protect assignees against volatility, as well as to avoid mobility program overspending.

Assessment of pay approaches for mobile employees is a topic which is too broad to be covered in detail in the context of this Brexit discussion. However, it is worth noting that pay approaches should be selected to align with each organization’s unique mobility needs. A proactive review of pay approaches may uncover opportunities to modify or enhance current approaches to ensure business and talent goals continue to be met. These opportunities will vary depending on each firm’s context for mobility. A firm sending junior staff to the U.K. on one- to two-year career development assignments may determine that the host pay approach is attractive to the target population, whereas a firm with assignees filling largely strategic roles abroad may find a home-based approach with a robust currency-protection program will better serve its need to ensure current and future mobility for its business-critical staff.

A key benefit of the home-based pay approach is that it is comprised of separate balancing elements which serve different purposes and which can be flexed as conditions change over time. COLA makes up the gap between total funds required to buy goods and services at host and the normative amount the assignee has to contribute from pay, or spendable income. As exchange rates change, the assignee’s spendable income is worth more or less in host currency terms which either narrows or widens the gap. This means the COLA needs to contract or expand to ensure the assignee has the right amount of home currency required to purchase host goods and services.
Conclusion

In brief, currency volatility can easily be addressed by adjusting COLA up or down. A very important point is that as long as COLA adjustments are made in a timely manner, decreases and increases in COLA do not financially hurt or advantage the assignee; they simply ensure the assignee has the right amount of home currency to maintain goods and services spending in host currency.

Given the GBP's dramatic loss in value, companies that do not regularly review exchange rates and revise COLA should strongly consider instituting such a process. This will not only protect assignees against currency losses, but will also eliminate windfalls which are costly to the organization.

Companies will probably wish to increase COLA without too much delay for assignees paid in GBP. But what about reducing COLA for those paid in other currencies? Let's take the example of U.S. nationals assigned to the U.K., whose dollars now buy about ten percent more GBP than before the Brexit vote. As a result, the U.S. assignees now need far less COLA. In fact, at an average salary an assignee family would require about USD500 less per month. Reducing COLA will actually save the company far more due to tax gross-ups – about USD900 per month for this scenario, or over USD10,000 for the year for one assignee and family. Leaving COLA at unnecessarily high levels for an extended period also has other negative consequences, as assignees tend to become accustomed to the large cash windfalls, which in turn raises expectations regarding the level of appropriate company support. It can also make it difficult to explain the lack of COLA increases should the GBP gain back some of its value.

Note that the best way of avoiding the impacts of currency fluctuation is to deliver pay in two currencies because the assignee need not convert funds from one currency to another. Determining the appropriate split can be done by establishing how much host currency is required for goods and services, and any other spending at host, such as housing and/or utilities, and paying the remainder of net pay in home currency to take into account funds spent or saved at home, such as home housing, home leave, education for dependents, and investments. Of course, individual assignees may have spending and savings needs which diverge from the statistical average; some organizations allow assignees to occasionally shift the proportions of the split, though subject to caps and with limitations on how frequently the split may be modified. Many organizations manage split pay well, but the majority of firms continue to pay in home currency only because split pay arrangements can require complex administration.

Almost eighty percent of our Brexit webinar audience members confirmed that they either have a routine currency protection program already in place or plan to make COLA adjustments as a result of Brexit. For companies considering a more robust currency protection program, the key questions to be answered are when and how often currency protection should be triggered.

Some rules of thumb are listed below:

- For mobility programs with monthly or quarterly exchange rate updates or split pay, continue with the current program but communicate to assignees to reassure them that you are aware of the current currency volatility and educate them about how your program is designed to protect against loss or excessive gain.

- For programs with less frequent updates, consider adding more frequent updates or at minimum monitoring exchange rate changes and revising when exchange rate change thresholds are triggered. We suggested reviewing on at least a quarterly basis. Our currency benchmark confirmed that the majority of firms using this approach revise COLA when currency changes are between five and eight percent.

- Avoid “baking in” windfalls when host currency weakens; reduce COLA as necessary.
For organizations that use host-based pay approaches, a more difficult decision awaits. We have already discussed how currency protection is not common, but given the extraordinary and unanticipated circumstances, companies may wish to consider a one-time adjustment or a regular program of currency protection. It could be argued that this is unnecessary since assignees agreed to their host pay arrangements with full knowledge of the potential risks, and changing policy for Brexit could set a costly precedent for assignments in and out of other countries. These arguments need to be balanced against the likelihood that in future there may be great reluctance to accept host-based arrangements in the U.K., and the incorporation of a currency protection policy could be an effective way of assuaging some potential concerns.

Of note, the relative proportion of funds at risk for host-based assignees is smaller than for home-based, as home spending and savings are generally less than goods and services spending at host. Statistically, proportions vary by nationality, income, and family size; home currency requirements tend to run about twenty to thirty-five percent of salary depending on obligations and investments at home. Mechanically, currency protection can be handled via split pay as described above, or by protecting a designated portion of package — say, thirty percent — and either reimbursing losses only (meaning the employee keeps the gains) or netting gains and losses over a particular tracking period and delivering a retroactive makeup payment at the end of that period. Your client engagement representative will be glad to discuss the best-fit options for your organization.

Hopefully the practical tips suggested above provide food for thought for those seeking to respond to today’s volatility, ongoing uncertainty, and future challenges. Fortunately, global mobility professionals are adept at managing mobility in a highly diverse and changeable world. **The best defense against volatility and uncertainty is to ensure your mobility program is well-designed and up-to-date.** This will help facilitate the mobility needed to meet business goals, and will help your organization weather the Brexit storm no matter the outcome.

![Image of checklist with a checkmark]

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