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Managing Expatriation compensation The currency and inflation challenge

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Global Mobility Regional Business
Development Leader



Agenda

Expatriate compensation

Managing expatriate compensation - overview

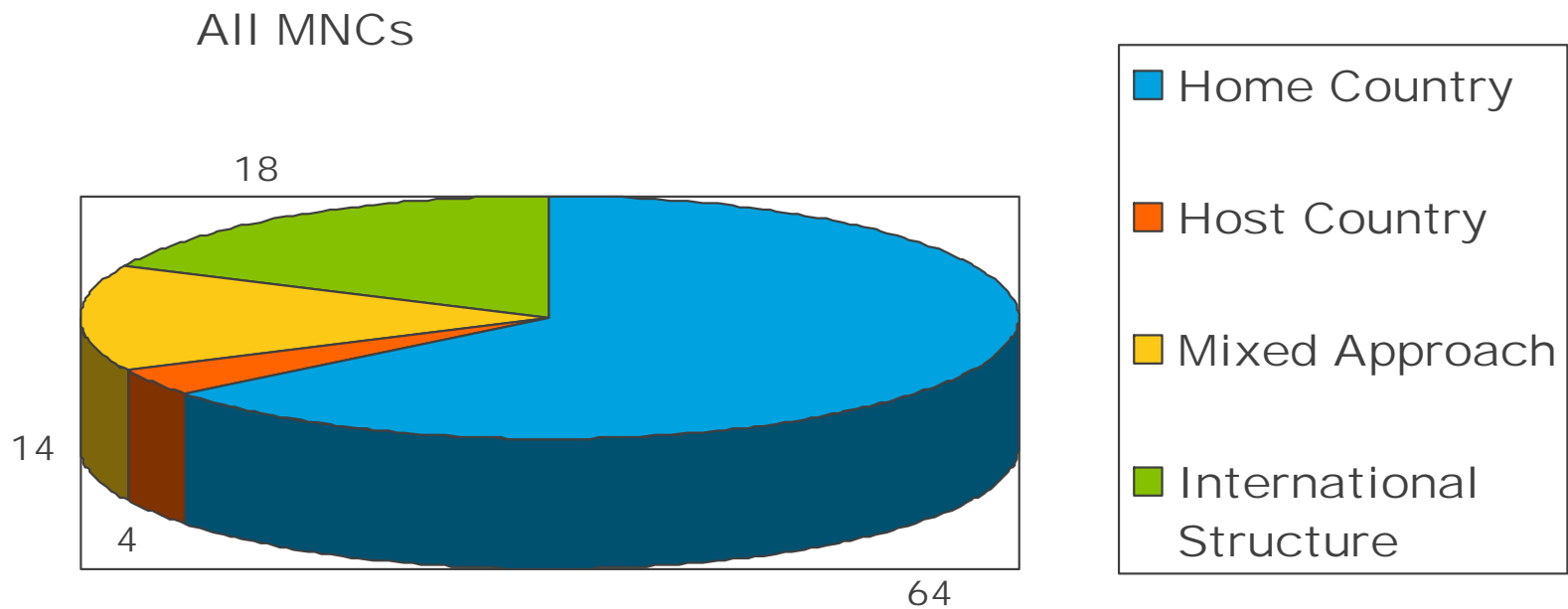
How to define cost of living allowance?

How to manage currency & inflation fluctuations?

Split payment and its challenges

Setting the scene

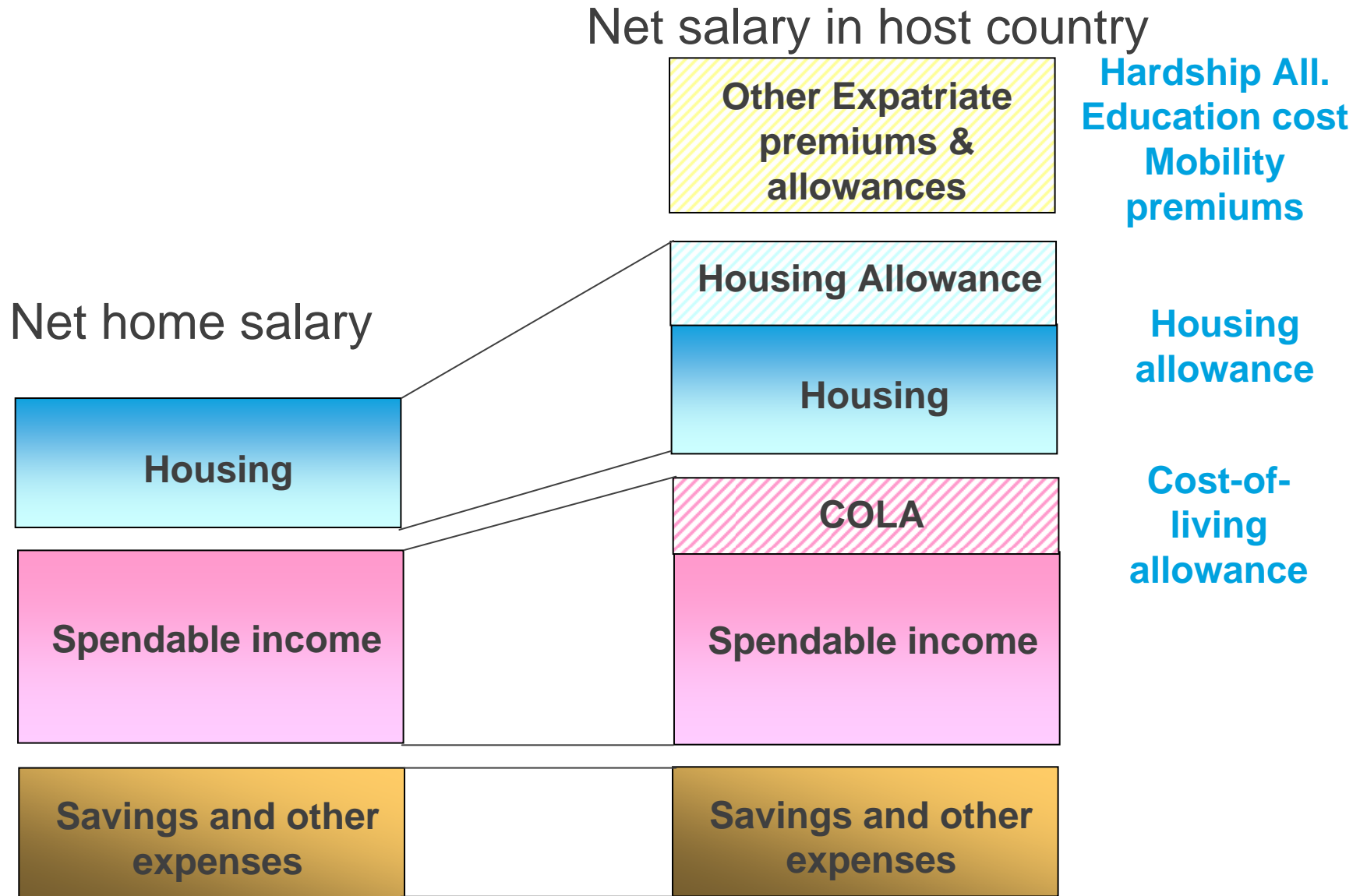
Compensation approaches for long term assignments



International Assignment Survey 2008

Setting the scene

The home country balance sheet calculation



Setting the scene

Exchange rate fluctuations

Country	Currency	August 2007	August 2008	% Change of USD
CZECH REPUBLIC	CZK	20.3709	14.90951	-26.81%
ISRAEL	ILS	4.3263	3.36983	-22.11%
HUNGARY	HUF	182.917	146.96355	-19.66%
BRAZIL	BRL	1.8762	1.59373	-15.06%
SERBIA	RSD	58.01	49.729675	-14.27%
SWITZERLAND	CHF	1.1949	1.025555	-14.17%
CROATIA	HRK	5.3096	4.58368	-13.67%
GERMANY	EUR	0.7265	0.63366	-12.78%
IVORY COAST	XOF	476.522	415.697515	-12.76%
LITHUANIA	LTL	2.5083	2.18868	-12.74%
MACEDONIA	MKD	44.85	39.16476	-12.68%
DENMARK	DKK	5.4065	4.728625	-12.54%
BOSNIA-HERZEGOVINA	BAM	1.4209	1.2575	-11.50%
NORWAY	NOK	5.759	5.09851	-11.47%
AUSTRALIA	AUD	1.1668	1.038065	-11.03%
MOROCCO	MAD	8.1582	7.2827	-10.73%
SWEDEN	SEK	6.7088	5.99337	-10.66%
SINGAPORE	SGD	1.5183	1.35853	-10.52%
ALGERIA	DZD	68.7065	61.882895	-9.93%
JAPAN	JPY	118.365	106.77282	-9.79%
CHINA	CNY	7.568	6.837045	-9.66%



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How to define the cost of living index?

Basket Mercer International Basket	Base City LONDON (GB)	Host City MUMBAI (IN)		
Date of Price Survey	01/03/2008	01/03/2008		
Date of Exchange Rate	01/03/2008	01/03/2008		
Exchange Rate	EUR 1 = GBP 0.750064	EUR 1 = INR 58.451274		
Cross Rate	GBP 1 = INR 77.92838	INR 1 = GBP 0.01283		
Previous 6 months inflation	4.00%	3.50%		
Previous 12 months inflation	4.78%	7.12%		
* Index Categories	Base City	Host City		
		M / M	Efficient	Convenience
<input checked="" type="checkbox"/> 1) Food at Home	100	61	68	83
<input checked="" type="checkbox"/> 2) Alcohol and Tobacco	100	100	109	123
<input checked="" type="checkbox"/> 3) Domestic Supplies	100	66	73	78
<input checked="" type="checkbox"/> 4) Personal Care	100	53	56	67
<input checked="" type="checkbox"/> 5) Clothing and Footwear	100	93	112	112
<input checked="" type="checkbox"/> 6) Home Services	100	32	36	47
<input checked="" type="checkbox"/> 7) Utilities	100	103	113	129
<input checked="" type="checkbox"/> 8) Food away from home	100	59	65	82
<input checked="" type="checkbox"/> 9) Transportation	100	86	92	98
<input checked="" type="checkbox"/> 10) Sports and Leisure	100	67	75	82
Total Index	100	73	81	91

Which portion of the salary to apply the cost of living index?

Annual gross base salary

- Personal income tax
- Social security contributions
- = **Annual net base income**
- Housing (Home Housing Norm)
- Savings
- = **Annual net total spendable income**
- Medical insurance
- Education, hobbies
- Furniture, vacation
- = **Annual net spendable income index related**

Mercer's 10 categories of daily goods and services:

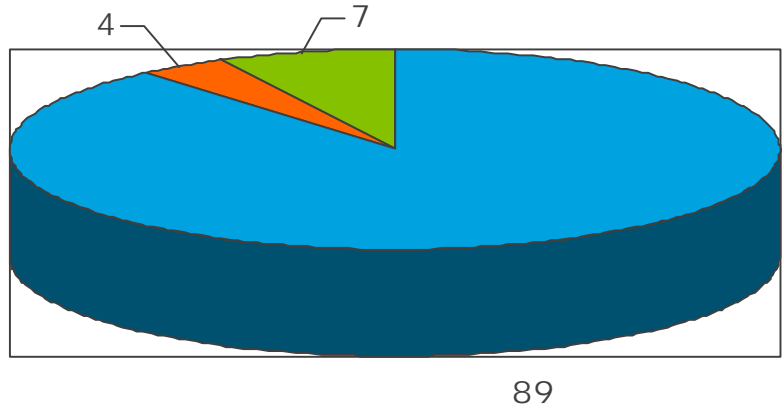
Food at home, food away from home, alcohol & tobacco, domestic Supplies, personal care, clothing & footwear, home services, utilities, transportation, sports & leisure

How to determine the cost of living allowance?

London to Mumbai Married + 2 Children	Possible Variations		
	GBP	GBP	GBP
	Cost of Living / Goods and Services Allowance		
Gross Income	50'000	50'000	50'000
Net Income	37'101	37'101	37'101
Spendable Income Index Related	19'794	19'794	19'794
Total Spendable Income	28'668	28'668	28'668
	Mean to Mean index	Efficient index	Convenience index
COL index (London 100)	73	81	91
COL Allowance (SI Index Related)	-5'344	-3'761	-1'781
COL Allowance (Total SI)	-7'740	-5'447	-2'580
COLA Allowance (Net Income)	-10'017	-7'049	-3'339
Spendable Income plus COLA	14'450	16'033	18'013
Total Spendable Income plus COLA	20'928	23'221	26'088
Net Income plus COLA	27'084	30'052	33'762

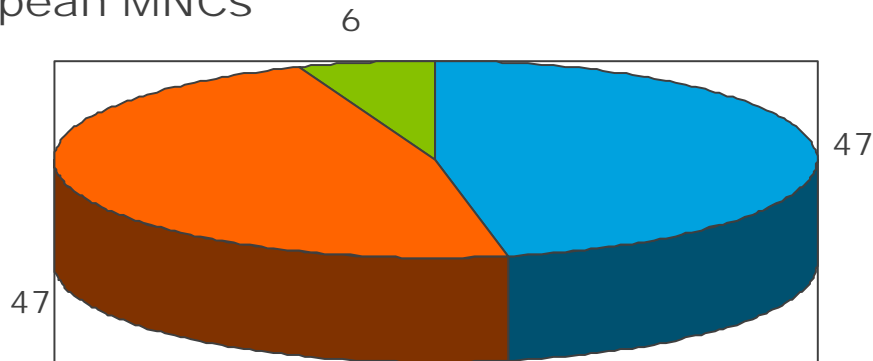
Cost of living allowance Do you apply negative COL Indices?

North American MNCs



- No Never
- Yes for all employees
- Yes selectively

European MNCs



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Cost of living allowance Would you apply negative COLA?

London  Mumbai

Dates	Net spendable income (GBP)	COL index M/M	Exchange rate 1 GBP = INR	Spendable income adjusted to COL index (GBP)	Spendable income adjusted to COL index and exchange rate (INR)
<i>Apply negative COL index</i>					
March 2006	19'283	0.69	77.45183	13'305	1'030'518
March 2007	19'283	0.66	86.15589	12'727	1'096'487 +6.4%
<i>Do not apply negative COL index</i>					
March 2006	19'283	1.00	77.45183	19'283	1'493'504
March 2007	19'283	1.00	86.15589	19'283	1'661'344 +11.2%
<i>Apply capped negative COL index</i>					
March 2006	19'283	0.80	77.45183	15'426 +16%	1'194'803
March 2007	19'283	0.80	86.15589	15'426	1'329'075 +11.2%

+45%





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Effects of currency fluctuations to the COL index

FX -2.9%

Basket	Base City	Host City
Mercer International Basket	LONDON (GB)	SINGAPORE (SG)
Date of Price Survey	01/09/2005	01/09/2005
Date of Exchange Rate	01/09/2005	01/09/2005
Exchange Rate	USD 1 = GBP 0.5431	USD 1 = SGD 1.676
Cross Rate	GBP 1 = SGD 3.08599	SGD 1 = GBP 0.32405
Previous 6 months inflation	2.00%	1.25%
Previous 12 months inflation	2.77%	2.26%

Base City	Host City
LONDON (GB)	SINGAPORE (SG)
01/09/2005	01/09/2005
01/09/2006	01/09/2006
USD 1 = GBP 0.5254	USD 1 = SGD 1.5736
GBP 1 = SGD 2.99505	SGD 1 = GBP 0.33388
2.00%	1.25%
2.77%	2.26%

* Index Categories	Base City	Host City
		M / M
<input checked="" type="checkbox"/> 1) Food at Home	100	78
<input checked="" type="checkbox"/> 2) Alcohol and Tobacco	100	103
<input checked="" type="checkbox"/> 3) Domestic Supplies	100	62
<input checked="" type="checkbox"/> 4) Personal Care	100	58
<input checked="" type="checkbox"/> 5) Clothing and Footwear	100	86
<input checked="" type="checkbox"/> 6) Home Services	100	46
<input checked="" type="checkbox"/> 7) Utilities	100	117
<input checked="" type="checkbox"/> 8) Food away from home	100	78
<input checked="" type="checkbox"/> 9) Transportation	100	120
<input checked="" type="checkbox"/> 10) Sports and Leisure	100	76
Total Index	100	85

Base City	Host City
	M / M
100	80
100	106
100	64
100	60
100	88
100	47
100	121
100	80
100	123
100	78
Total Index	88

COL index +3%

How exchange rate impacts on the cost of living allowance

London  Singapore

Dates	Net Spendable Income (GBP)	COL Index M/M	Exchange rate 1 GBP = SGD	Spendable Income Adjusted to COL Index (GBP)	Spendable Income Adjusted to COL Index and Exchange Rate (SGD)
September 2005	19'283	0.85	3.08599	16'391	50'581
September 2006	19'283	0.88	2.99505	16'969	50'823

COL index fluctuates

You need more GBP to maintain a sufficient purchasing power

Goods and services allowance amount is stable in host location currency

Effects of inflation fluctuations to the COL index

No change to Exchange Rate

Basket	Base City	Host City	Base City	Host City
Mercer International Basket	LONDON (GB)	SINGAPORE (SG)	LONDON (GB)	SINGAPORE (SG)
Date of Price Survey	01/09/2005	01/09/2005	01/09/2006	01/09/2006
Date of Exchange Rate	01/09/2005	01/09/2005	01/09/2005	01/09/2005
Exchange Rate	USD 1 = GBP 0.5431	USD 1 = SGD 1.676	USD 1 = GBP 0.5431	USD 1 = SGD 1.676
Cross Rate	GBP 1 = SGD 3.08599	SGD 1 = GBP 0.32405	GBP 1 = SGD 3.08599	SGD 1 = GBP 0.32405
Previous 6 months inflation	2.00%	1.25%	2.00%	0.75%
Previous 12 months inflation	2.77%	2.26%	2.77%	1.76%

* Index Categories	Base City	Host City	Base City	Host City
		M / M		M / M
<input checked="" type="checkbox"/> 1) Food at Home	100	78	100	78
<input checked="" type="checkbox"/> 2) Alcohol and Tobacco	100	103	100	101
<input checked="" type="checkbox"/> 3) Domestic Supplies	100	62	100	60
<input checked="" type="checkbox"/> 4) Personal Care	100	58	100	59
<input checked="" type="checkbox"/> 5) Clothing and Footwear	100	86	100	87
<input checked="" type="checkbox"/> 6) Home Services	100	46	100	44
<input checked="" type="checkbox"/> 7) Utilities	100	117	100	116
<input checked="" type="checkbox"/> 8) Food away from home	100	78	100	76
<input checked="" type="checkbox"/> 9) Transportation	100	120	100	119
<input checked="" type="checkbox"/> 10) Sports and Leisure	100	76	100	73
Total Index	100	85	100	84

COL index -1%

How inflation/price movements impact the cost of living index

London  Singapore

Dates	Net spendable income (GBP)	COL index M/M	Exchange rate 1 GBP = SGD	Adjusted spendable income with COL index (GBP)	Adjusted spendable income with COL index & exchange rate (SGD)	12 months price movement London	12 months price movement Singapore
September 2005	19'283	0.85	3.0860	16'391	50'581	2.77%	2.26%
September 2006	19'283	0.84	3.0860	16'198	49'986	<u>2.77%</u>	<u>1.76%</u>

Goods and services allowance has decreased by 1% to reflect lower prices movements in Singapore

Effects of currency and price movement fluctuations

- The COL index guarantees 100% purchasing power in the host country against any currency and price movements fluctuations. The COL index will react immediately.
- The adjusted spendable income by the cost of living allowance (SI + COLA) increases yearly due to below variables:
 - Higher price movements in host location
 - Salary increase will consequently increase spendable income part
 - Tax and social security contributions decrease consequently the net income will increase and the spendable income part
 - Family size changes

Exchange rate and inflation impact the cost of living index

London  Singapore

Dates	Annual gross base salary (GBP)	Annual net base salary (GBP)	Net spendable income (GBP)	COL index M/M	Exchange rate 1 GBP = SGD	Adjusted spendable income with COL index (GBP)	Adjusted spendable income with COL index & exchange rate (SGD)
10% salary increase							
September 2005	45'000	33'233	17'729	0.85	3.0860	15'070	46'505
September 2006	50'000	36'507	19'283	0.87	2.9951	16'776	50'246

Goods and services allowance amount has increased by 8% in host location currency



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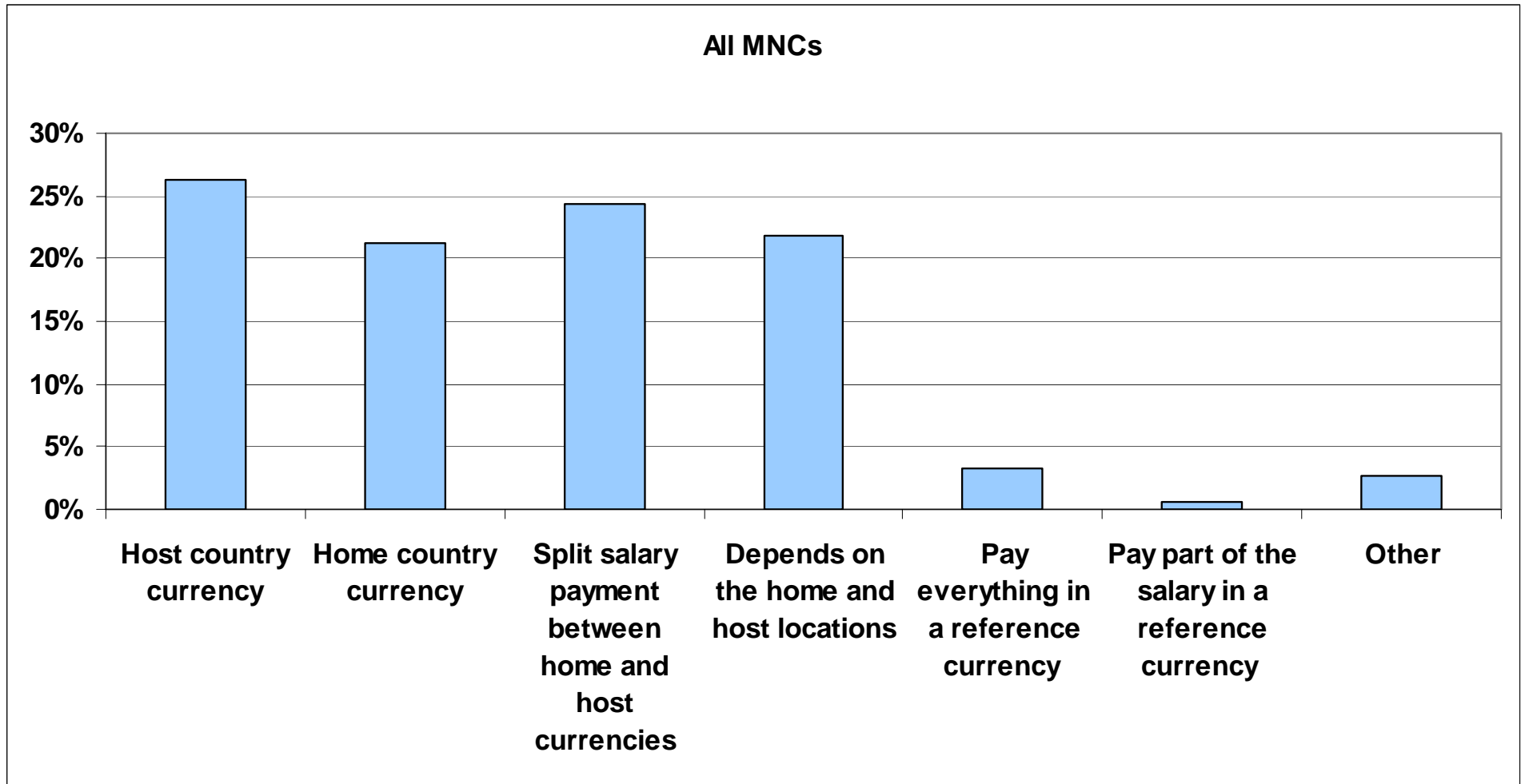
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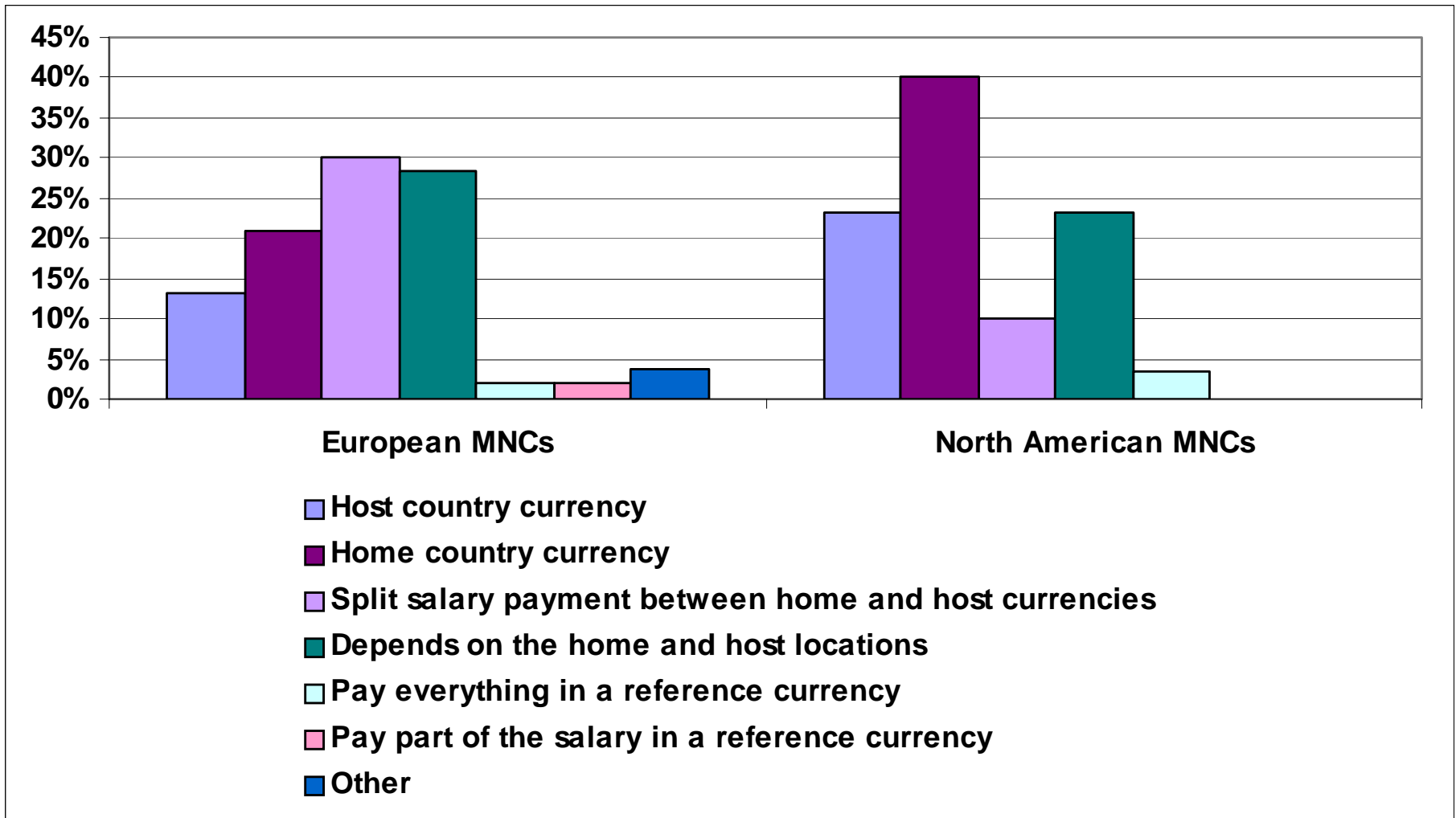
Split payment and its challenges

In which currency do company pay assignee's salary?



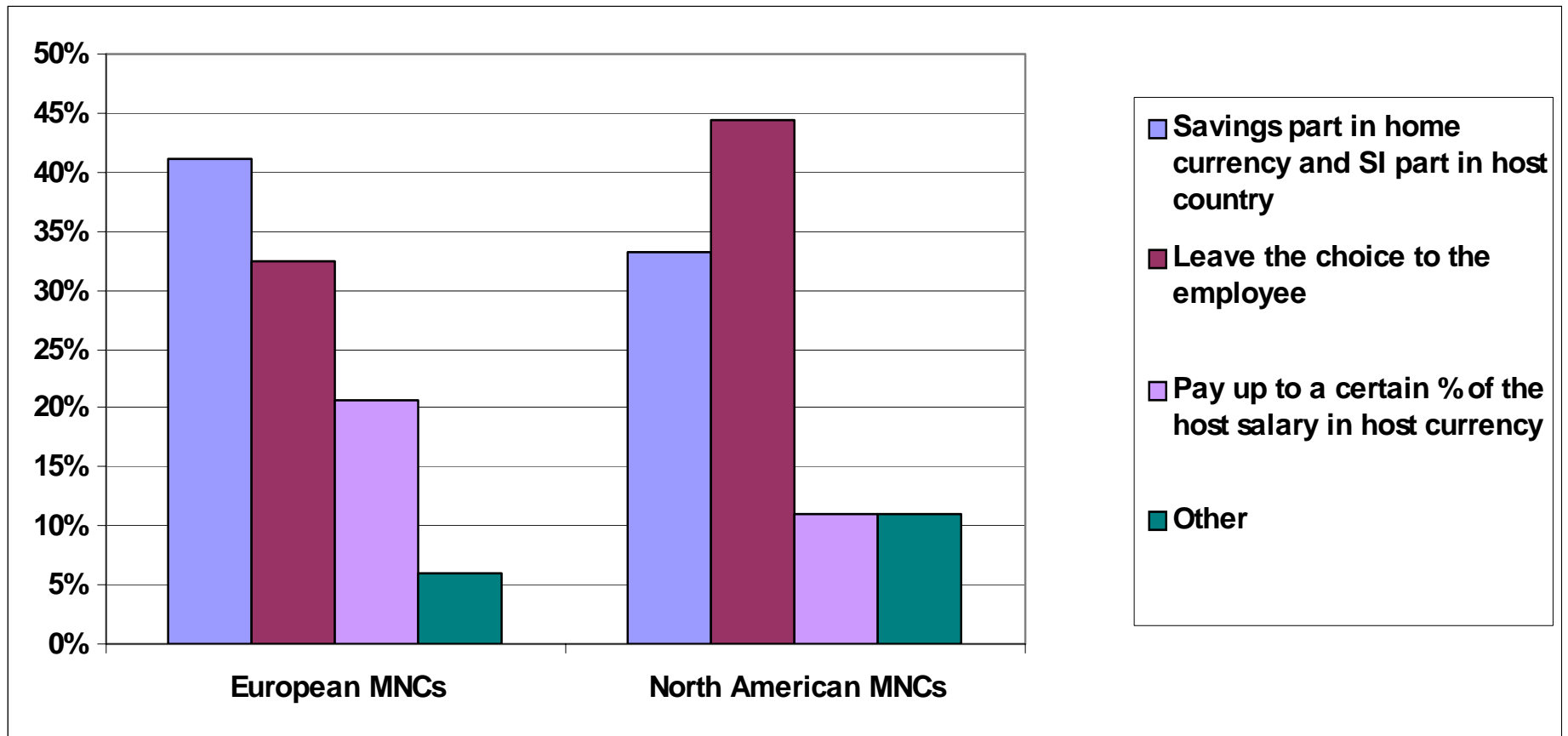
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In which currency do company pay assignee's salary?



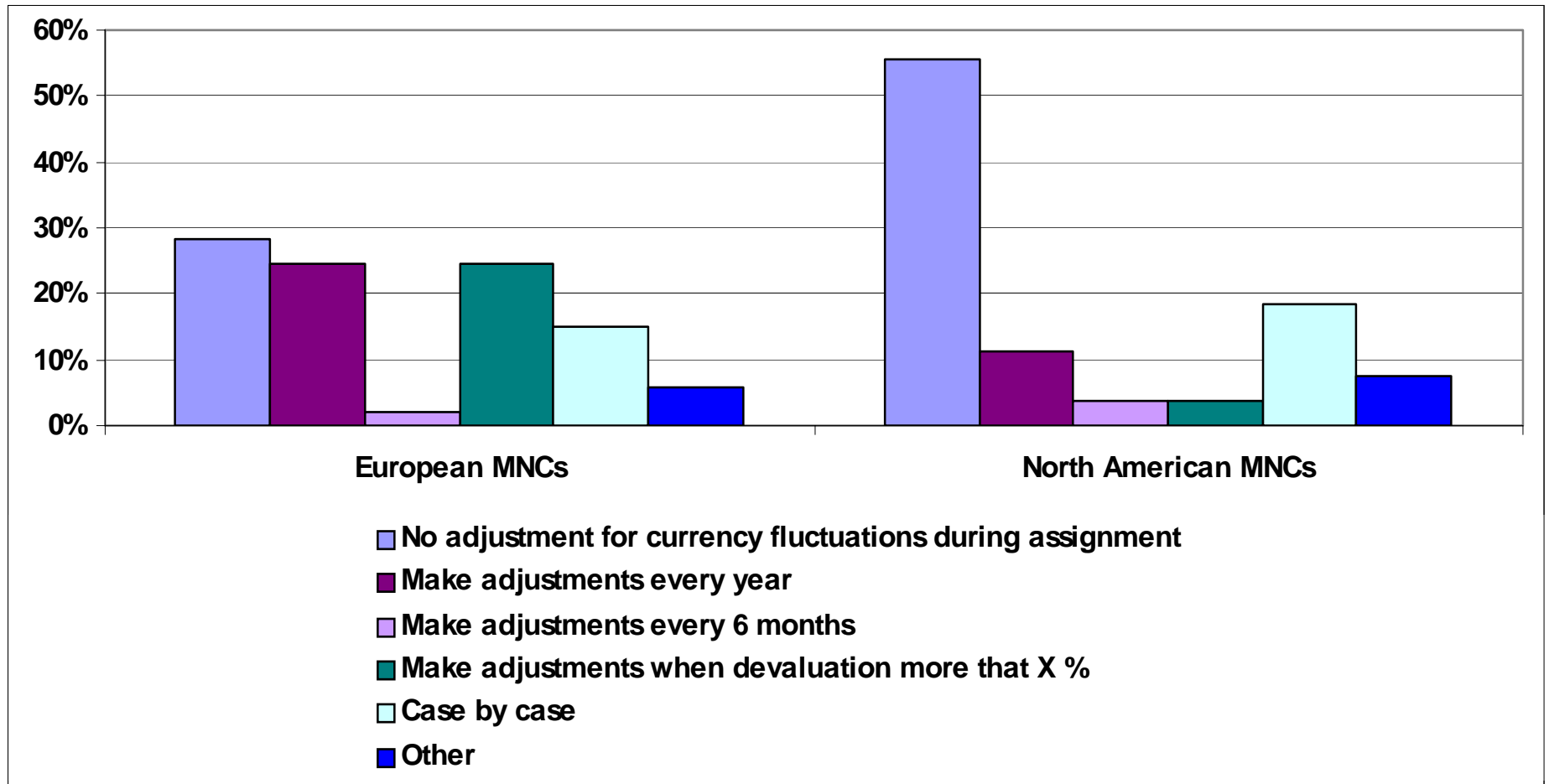
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Do company split assignee's salary payments?



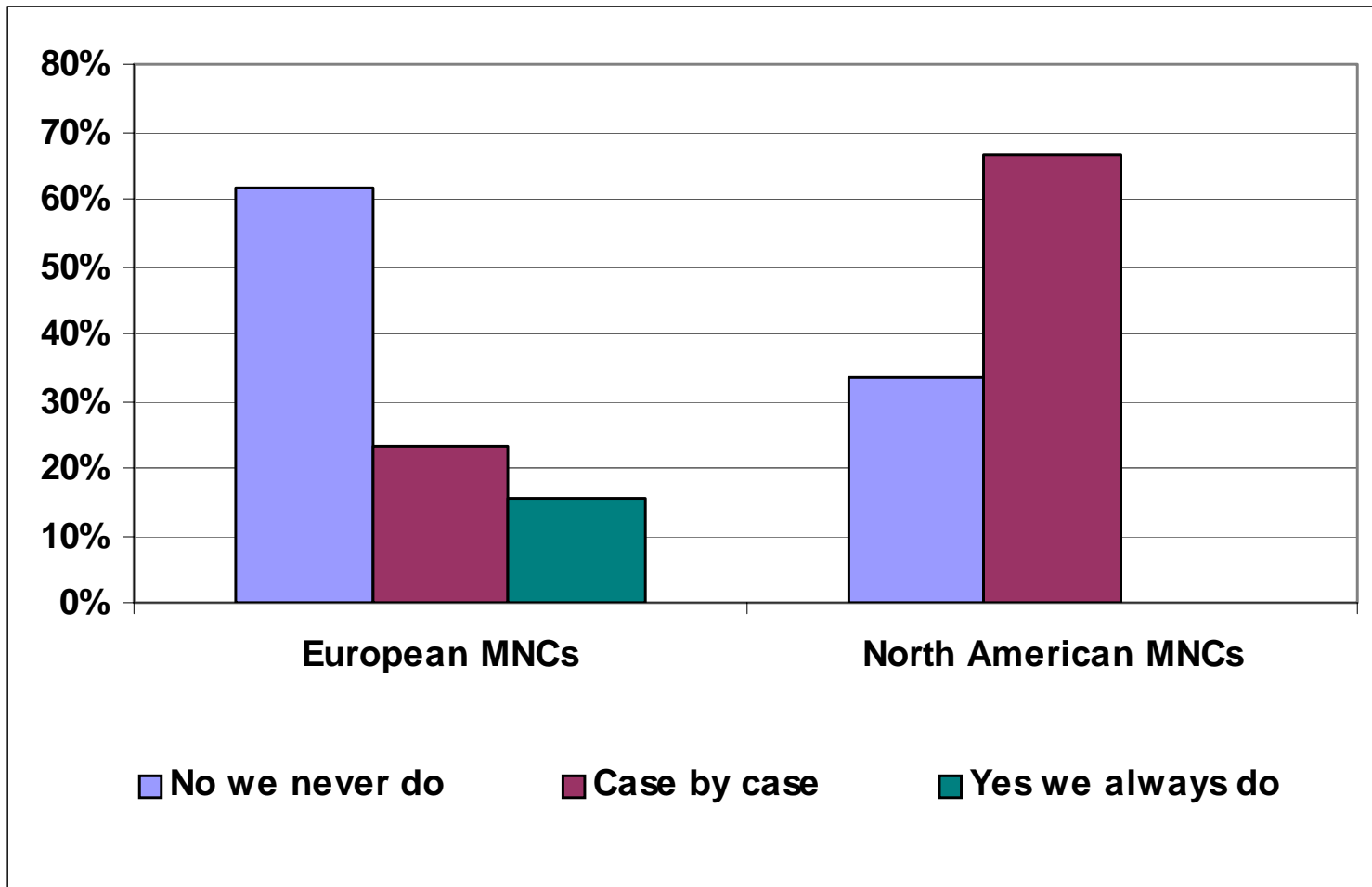
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Do company adjust assignee's salary for currency fluctuations?



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Do company compensate for any loss over the previous year due to currency fluctuations?



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Split payment of expatriate compensation package London to Singapore

Marital Status: Married with 2 children		Home City LONDON (GBP)	Host City SINGAPORE (SGD)	Host City SINGAPORE (USD)
Annual Gross home country reference salary		50'000	138'623	98'138
Annual Net home country pay		37'101	102'861	72'821
Non-Spendable income: Hypothetical Home Housing Costs, Savings and Other expenses		17'307	47'983	33'970
Spendable income index related (daily basket of goods and services)		19'794	54'878	38'851
Cost-of-Living Allowance (COLA): Mean to Mean COL index 92 Exchange rate: 1 GBP = SGD 2.77245		-1'584	-4'392	-3'109
Housing Allowance				
		GBP	SGD	
a)				
	Host location expatriate accommodation costs	52'126	144'516	
b)	Hypothetical home country housing costs	7'374	20'445	
c)	Housing allowance	44'752	124'071	87'838
Expatriation premiums				
	- Quality of Living allowance	-	-	-
	- Mobility premium based on 10% of Gross	5'000	13'862	9'814
Other allowances (according to company policy)				
	- Education allowance	11'903	33'000	23'363
Total annual net host country pay		97'172	269'402	190'726
Split payment		22'307	207'557	

Split payment of expatriate compensation package London to Singapore

Options	Home City LONDON (GBP)	Host City SINGAPORE (SGD)	Host City SINGAPORE (USD)
Total annual net host country pay	97'172	269'402	190'726
Split payment	22'307	207'557	
Green light: no currency fluctuation risks with split payment	22'307	207'557	
Red light: currency fluctuation risks when converted into SGD	Paid all in GBP		
Red light: currency fluctuation risks when converted into SGD & GBP			Paid all in USD
Red light: currency fluctuation risks when repatriate money back to UK	Paid all in SGD		
Green light: currency fluctuation protection	Tracking FX change +/- 10% annually or 5% 6 months period		
Green light: currency fluctuation March 08 to September 08		-4.2%	-3.6%

Recommendations

It is very difficult to estimate which part of the salary will be really spent in the host country and which part will be kept in the home country

Most companies will leave the decision on the split with a certain limit to the expatriate

This approach prevents any future discussion with the expatriate

The responsibility is put on the expatriate's shoulders