Currency Risk, A Long-Term Savings Challenge For Mobile Employees

One of the major challenges faced by the career expatriate is currency risk, and especially its impact on long-term retirement savings.

Short-term overseas secondees are often retained in a home pension or savings plan, ensuring that their savings accumulate in the currency that they will return to, but for longer-term, globally mobile employees, the position is much more complex. Acquiring a series of local pensions in different countries and different currencies can severely deplete the eventual returns, damaging retirement expectations. Employers need to be aware of the implications of currency risk, especially if they are providing company-sponsored pensions or savings. While many employers recognise the need for an investment committee to oversee the investment options on a company-sponsored pension, currency risk is often overlooked – with potentially far-reaching results.

Currency risk can, of course, work both for and against a long-term saver. Rarely will someone be unhappy if additional returns are achieved through favourable currency movements, but the opposite can leave the employee feeling let down or, at worst, in a dire financial state upon return home, with plans of retirement in tatters. Before we look at some of the options available to employers to minimise the risks, let's look at an example to fully understand the problem.

Case Study

David was a senior executive of a global pharmaceutical company. He left the UK in 2006 to work across South America establishing operations in Argentina, Chile and Venezuela. Throughout his time there, his employer established a local pension plan for him in each country and contributed a healthy 15% of his basic salary. Upon his return to the UK, David was somewhat disappointed to discover that the result was an accumulated fund in each country as shown in the table. Now this is a simplified example – it makes no allowance for investment growth, inflation or product charges on any of the funds – but the purpose here is only to show the effect of currency risk over the 10-year period on David's pension savings when he returns to the UK.

Country and time	Contribution to pension	Value in local currency	GBP value @21/02/2016
2006 - Argentina	GBP15,000 equivalent	ARS 81,617	3,776
2007 - Argentina	GBP15,000 equivalent	ARS 91,544AP	4,235
2008 - Argentina	GBP15,000 equivalent	ARS 93,129AP	4,308
2009 - Chile	GBP15,000 equivalent	CLP 13,833,806	13,745
2010 - Chile	GBP15,000 equivalent	CLP 12,603,232	12,522
2011 - Chile	GBP15,000 equivalent	CLP 11,605,448	11,531
2012 - Venezuela	GBP15,000 equivalent	VEF 102,276	11,298
2013 - Venezuela	GBP15,000 equivalent	VEF 101,521	11,215
2014 - Venezuela	GBP15,000 equivalent	VEF 155,040	17,127
Total contributions	**GBP135,000**		**GBP89,757**

You will see that currency risk can work both in favour of, and against, an overseas worker. GBP15,000 has turned into GBP17,127 in just over two years due to the strengthening of the Venezuelan bolivar over that particular period. However, overall the effect has been quite devastating, reducing the amount contributed by a third from GBP135,000 to just GBP89,757.

To add to David's concerns, he now has three pots of savings in three countries with which he no longer has any connection and needs to find a way to transfer these to the UK.

You may think that I have chosen these locations deliberately due to their high inflation rates and weak currencies, but let's take another example based entirely in Europe. Had David moved to Switzerland in 2006 and received a company pension contribution equivalent to GBP15,000, it would have increased in value to GBP24,012 by 2016 – a huge 60% return brought about by the strength of the Swiss franc following the financial crisis. A very good result, yes, but had David been Swiss, living in the UK for those ten years and then returning to Switzerland, he would have seen his savings plummet from CHF34,238 to CHF21,387 – a fall in value of 38%.

So what can employers do to help to reduce or mitigate this risk for their employees? One option is to retain the employee in a home pension plan. However, this is not always possible due to home country legislation or the basis of the employee's employment contract, and cost is often a barrier too. Switzerland, for example, does not allow overseas workers to remain in its pension system. Increasingly, companies are looking to localise expatriates in order to control costs that can make retention in a home country plan more complex than overseas secondment. Europeans localised in another European country but retained in the home country pension plan create a cross-border plan that can bring a host of problems with it.

For those companies with a policy of placing overseas workers in local pension plans, at the very least those plans should be able to offer a range of investments based in one of the world's harder currencies, as this should provide some degree of currency hedging. Sadly, many local pension plans do not offer multi-currency investment funds. In fact, many have strict controls over where approved pension monies can be invested, often with requirements that these are restricted to local government bonds.

A more flexible solution, adopted by many multi-national companies, is to set up an international pension plan (IPP). These are long-term offshore saving plans set up by a company specifically for expatriate and mobile employees regardless of their country of residence. These plans can accept contributions in most currencies and the investments can be held in a hard currency, such as US dollars, or possibly in the employee's home currency, thereby removing or reducing the effect of currency risk. Further advantages of these plans are that all of the savings accumulated are held in a single plan, in a stable jurisdiction, making them easier to access in the future, and they can offer a much broader range of investments as they do not need to comply with complex local pension regulations.

Local pensions vary greatly from country to country in terms of the tax position, some giving relief on contributions but taxing income, others with no relief but providing a tax-free income in retirement. Importantly, though, the tax advantages are often partly or wholly negated by factors such as currency risk as we have seen in the examples above, investment restrictions and economic and political instability.

It is important that companies can offer a robust pension solution to employees, wherever they may be working. People are living longer and it's well documented that they are not saving enough for the future. While it was acceptable a few years ago to just give people a higher salary in lieu of a savings plan, now employers are trying to be more responsible with their employees.

Given a choice between a local plan offering tax relief of 15% in a volatile currency, or an IPP with no relief but a strong currency, the latter can easily be seen as the least risky option.

Stewart Allanson
Zurich Corporate Life & Pensions is a leading provider of international pension plans.
For more information, please email: stewart.allanson@zurich.com or telephone on +44 (0) 1242 664443.