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Clawbacks or golden handcuffs

Financial penalties are one way to lock in employees on international assignment, but carefully structured bonuses are an easier sell to potential expats

BY STEPHEN CRYNE

When an employee is relocated or assigned, one of the greatest risks to the employer's operation is that the person will leave for greener pastures. And in a tight labour market for specialized skills, employers are looking for innovative ways to keep people on the team.

It's not unusual for an employer to spend tens of thousands of dollars on moving an employee. According to the Canadian Employee Relocation Council's (CERC) *2003 Employee Relocation Policy Survey*, which looked at policies in 88 large organizations, the average cost of a move in Canada is more than $40,000. That cost jumps exponentially when it involves a senior executive with a family on an overseas assignment.

From the outset an assignment must be meaningful, be a part of career progression and provide a lifestyle that meets the employee's needs. All of this is of course very individual, and success requires careful pre-selection of candidates to ensure congruence between the individual and corporate objectives. All okay so far, but what happens when the employee gets a better offer after the move? What are employers doing to discourage people from jumping ship?

One of the most effective options open to employers is financial. The use of penalties seems to be on the increase. According to the CERC survey, there was a 20 per cent increase in the number of firms using "clawbacks" since 2001.

Recovering costs in failed assignments

For overseas assignments, clawback provisions, or employee-initiated termination polices as they're more commonly known in the international expatriate compensation arena, are quite different than those in domestic relocation policies.

In a domestic policy, the clawback clause allows the corporation to recover some of the relocation-related expenses incurred in moving an employee and family to the new location (typically for a permanent relocation).

Because expatriate assignments are not permanent, employees typically return at some point to the original location or another assignment location. Therefore, a clawback agreement in an international expatriate policy usually states what the corporation will and will not do when employees leave employment of their own initiative.

According to the CERC survey, companies insert clawback provisions that vary with the assignment (See charts).

While many companies have provisions within relocation policies that deal with the standard situations, according to Montreal-based relocation consultant Linda Ward O' Farrell, "It's the sticky issues where employers need creativity and flexibility."

Relocation can be sticky

Family bliss is often difficult to achieve in a stable career based in Canada; throw in a teenage son or daughter and a foreign assignment and it gets more complicated. That's when the sticky issues that Ward O'-Farrell alludes to arise.

In one case, a senior executive moved part of his family to Brazil, leaving a teenage daughter at home with friends to finish high school. Several months into the assignment the daughter became pregnant and was immediately reunited with the family in Brazil. While this was not too difficult for the company at the time, the situation became even more complicated when it was discovered that the executive had a dalliance with one of the local staff, prompting the wife, daughter and grandchild to return to Canada.

Despite having a policy in place, the employer was forced to deal with a very difficult set of exceptions to its policy. In this instance the company absorbed the cost, but placed it against the employee's overall repatriation allowance. Had the assignment not been completed, an agreement on repatriation expenses would have become very complicated and messy.

According to Jeff Biteen, a senior manager with PricewaterhouseCoopers LLP, "It's with the high-demand personnel where it becomes increasingly difficult to have a clause that recovers the costs on a termination. It's not an issue where the assignment goes bad because of the market or the company changes something in its operation, but it's a different matter when the investment banker with specialized inside knowledge crosses the street to the competition. Employers need something with teeth."

Putting in a clawback clause can be a disincentive to getting people to take the assignment, so Biteen favours the "golden handcuff" approach, "where it just becomes financially too expensive for the individual to leave." This involves the development of a bonus structure geared towards completion of the assignment that's loaded on the back end.

Ward O'Farrell agrees: "While it makes sense to have a clawback provision to discourage early returns and voluntary terminations, it can also discourage people from accepting the assignment in the first place." If a clawback is going to be in the policy, it needs to part of the overall risk assessment process, and it can be avoided with better candidate screening, she advises.

Flying home economy, not business class

According to Michelle Steinowicz, a relocation consultant with Runzheimer International, in cases where an employee initiates termination during an international assign-

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RELOCATION

Consider termination scenarios before assignment begins

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ment, "most corporations will pay for airfare for the employee and their family (economy fares only, even if employee was eligible for business class) and for limited shipment of household goods back to the original location. Some companies have taken a tougher stance and will not ship household goods or even provide for airfare for the family (and sometimes even the employee) but this is more the exception rather than the rule."

The best approach is to have a termination policy included in all international expatriate policies, which clearly outlines expectations for various termination types (termination with cause, termination without cause, employee initiated termination). One of the practical challenges in having a clawback provision in the policy is the ability to enforce it. Employees are under no obligation to disclose their reasons for terminating, and for that reason the policy needs to be clear and consistent.

Another point that should not be overlooked is that the employer has a moral obligation, and possibly a legal obligation, to return the employee home in case of a company-initiated termination.

Termination of the assignment by the employer is equivalent to completion of the assignment and the policy for return upon completion should be followed. In addition, it may be difficult and expensive to terminate an employee offshore because of local employment laws that often include expatriates. Employers may be wise to terminate the assignment, bring the employee home and then terminate employment under home country rules.

Tax issues to consider

Another item that is sometimes included in the policy is the future tax liability of the employee.

Most employees are tax equalized when on international assignment, meaning they are responsible only for the amount of tax they would have paid in their home country — no more and no less. If an employee chooses to terminate employment while on assignment, there may be some outstanding income tax liability for several years, depending on the host country.

The corporation needs to make it clear to the employee that the income tax burden may not be fully settled for a few years and employee will need to pay any excess not covered by the corporation from the date of termination onwards.

Perhaps the best approach overall is to make sure that everything that can be done is done in the pre-selection screening, a difficult and time-consuming process, particularly where there are pressures to get the person in place quickly. This of course comes back to the issue of planning and the important role that relocation programs and workforce planning have in strategic plans of any organization.

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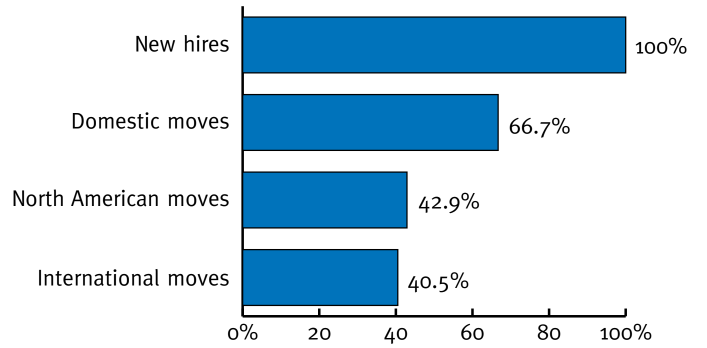
WHEN AN ASSIGNMENT GOES WRONG

The use of clawback provisions

Canadian corporations were asked about the use of financial penalties for employees who fail to complete relocation assignments.

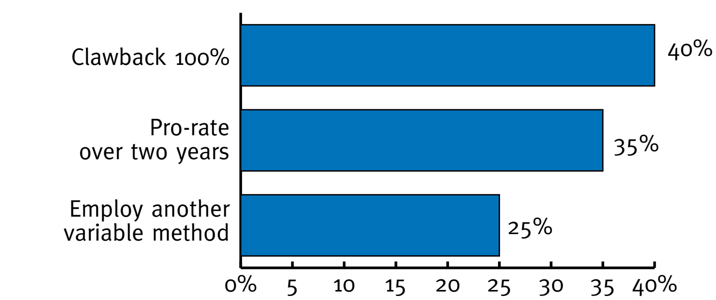


Source: CERC Employee Relocation Policy Survey 2003

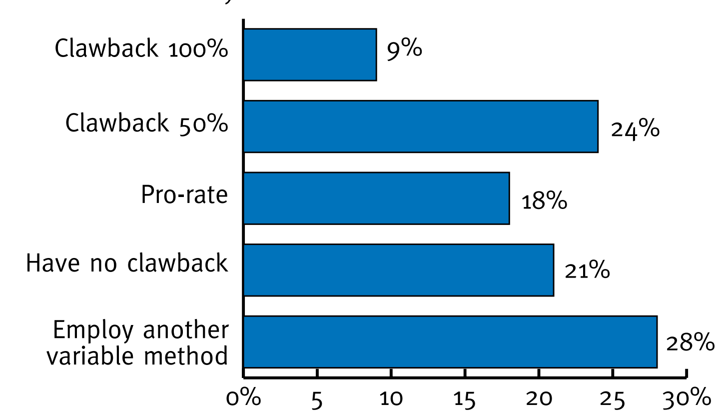
How firms are applying clawbacks to failed relocations

The average duration that an employee must remain with the organization following relocation is two years. The portion of the clawback varies by organization.

Within the first year:



Within the second year:



Source: CERC Employee Relocation Policy Survey 2003