THE 10 MOST 'POPULAR' MISTAKES ABOUT EXPAT PENSIONS

'What not to do'

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Patrick has more than 20 years of experience regarding International Pension Consultancy. Both collective and expats. Patrick is passionate about quality and adding value. He is a trusted advisor of a number of especially German and Japanese Global Companies. As well as of many Expats of whom most are of Board level.

Number 10: Intergovernmental Pension Plans and Transfer of Value?

Many Expats work for intergovernmental organizations like NATO/ESA/UN/etc.

Regarding the pension plan of these organisations, we often see that they have a regime of their own and completely outside of the realm of the nation where the Expat is residing. The pension plan is in that respect special that there often is also no distinction between Pillar 1 (State Pensions), Pillar 2 (Workplace Pensions) and Pillar 3 (Private Pensions/Annuities).

The situation that goes wrong too often, is that new Expats at such organisations, directly and without being properly informed, transfer already acquired workplace pension claims to the new workplace pension plan. Being under the impression that there is a guaranteed Defined Benefit (DB) pension plan. Maybe even at Final Pay conditions.

However, often the pension plan at such an organisation does only have a DB nature if you as employee meet all conditions.

Often it is the situation that DB only applies after several years of employment at the organisation and that until that moment, there is only a modest not guaranteed Defined Contribution (DC) and thus investment based pension claim.

The situation that is to be prevented, is that already acquired guaranteed DB pension claims are transferred to the new plan before it is clear that the new claim will also be of a guaranteed DB nature.

Otherwise the already existing guaranteed DB claim will be changed into a not guaranteed DC claim and if the expat leaves the organisation it remains like that. Which would mean

that the previously existing highly valuable and costly guarantee with possibly existing (conditional) indexation is lost in the process.

In other words, please calculate *beforehand* as of what date it is certain that the new claim wil indeed be of a guaranteed DB nature so that existing DB claims remain their nature.

Number 9: UK Offshore Pensions And QROPS Require Action?

Many Expats who have worked in the UK in the past are being contacted by very active financial consultancy organisations about the ‘need’ to move their pension claims.

These Expats are in general being told that they should move their UK or Offshore based pension claim and that they should be transformed into a ‘QROPS’. Which stands for Qualifying Recognised Overseas Pension Scheme.

The essence of a QROPS is that for Expats who have UK pension claims but do not any longer live in the UK, have the possibility to move their pension claim outside of the UK with full agreement of the UK government and without tax penalties.

Such a transfer is only possible if strict conditions are met and if the transfer goes to a indeed by the UK government recognised pension plan. If all conditions are met, the plan will go to the new legal regime and have no more links with the UK.

QROPS are most often based on The Isle of Man, Malta, Guerney and Gibraltar. (South-Africa has i.e. lost its QROPS status.) Mind you, not every pension plan in those locations qualifies as a QROPS. There are also many kind of International Pension Plans (IPP’s) which are located offshore but are not QROPS.

Expats are often being told that there are many benefits about a switch into a QROPS. In reality that might be possible but each possible alternative needs to be analyzed carefully. We will now mention the most relevant aspects:

‘Huge’ IncomeTax Benefits

It is often stated that a transfer to a QROPS will lead to huge income tax benefits as the new location has many Double Tax Agreements (DTA’s) which means that you will have no double taxation and even many tax benefits and lower rates which you do not have right now.

This sounds nice but analyzing reports with such messages we have often seen that there not only were no tax benefits but it was even thus that the advised new situation had a much *higher* tax exposure compared to the existing situation.

It often turned out that the advisor has not carefully checked the proposed new tax situation and had only stated that ‘QROPS lead to huge tax benefits’.

‘Huge’ Inheritance Tax Benefits

In the same trend it is often stated that the new situation will have less taxation and regulation compared to the UK situation. UK inheritance law is indeed rather strict but this does not automatically mean that a new situation provides advantages.

‘Huge’ Investment Benefits
As with promised tax benefits, it is often stated that the new plan will have much better investments.

We have seen that in reality often the proposal did not explain why the new investments would be better than the existing ones. It often did not state exactly what kind of new investments were proposed and also did not mention the exact amount of annual and total costs.

‘Free’ Consultancy
We have often seen that Expats who requested a second opinion from our company had received a report from another company which stated that the report was ‘free of charge’.

This might sound nice but common sense does tell that companies in general have a business model meaning they get paid. In this instance we have often seen that the firm providing the ‘advice’ would earn very substantial amounts of money on the implementation of the investment plan.

So please pay attention when the service is offered ‘free of charge’. It is not the best indication that that is the provider you should use.

Conclusion
Be aware of your own advisor and make sure you have been advised correctly.

Number 8: You Have Cash ‘Pension Plans’?

Too many Expats are guided into a Cash ‘Pension Plan’ which has very substantial negative effects.

Why does the Cash ‘Pension Plan’ exist?
Most countries have certain legal and tax requirements which have to be met in order to have the benefits of a formal Workplace Pension Plan.

The i.e. positive aspects of a Workplace Pension Plan:

- Substantial/huge income tax benefits;
- Low costs due to collective coverages;
- Complete coverages at one stop shop;
- Governmental oversight;
- The chance to if so desired acquire additional coverage and optimize tax benefits;
- No (substantial) additional advisory costs as the plan already exists.

The possible negative aspects of a Workplace Pension Plan:

- Mandatory participation;
- Own contributions (even though often tax deductible);

- Limited availability to the capital due to sometimes strict pay-out regulations;
- Due to the sometimes complexity of pensions, HR often depends on the advice of consultants, who are not always independent/capable;
- Due to many scandals in the past it is not always clear that the employee can trust the quality of an existing pension plan.

The main reason for HR Departments to offer a Cash 'Pension Plan' to Expats:

- They prefer Expats to have direct access to these funds and decide for themselves;
- They prefer not to be bothered by many kind of regulations regarding international pension plans;
- They have not received adequate advice and thus do not really understand the impact of this kind of plan.

Why is a Cash 'Pension Plan' the worst option for Expats?

- In essence due to the fact that the annually deposited premium is taxed directly in a Cash 'Pension Plan' whereas in a Real Pension Plan there will only be taxation as of pension age. Which means that only in a Real Pension Plan there is a compounded return on investment of money for often *several decades* that in a Cash 'Pension Plan' is being paid *annually* to the tax authority. A huge difference;
- A Cash 'Pension Plan' does not provide any Next of Kin coverage whereas a Real Pension Plan can provide this at low costs.

Conclusion

In case a Cash 'Pension Plan' is offered we advise you to kindly decline and opt for a Real Pension Plan with all related benefits.

In case an Expat might welcome the additional annual funds of a Cash 'Pension Plan', please take into account that there are many much cheaper ways to improve your cash balance on the short term.

Number 7: International Transfer of Value Advisable Or Not?

As Expats often relocate many times, they often have several pension claims in several countries. We too often see that these claims are not handled in the best manner which can be a very expensive mistake for the Expat.

A possible transfer of value of pension claims means that you carefully pay attention to the following aspects:

- The first question is if a transfer is allowed from a legal and tax persective;
- If so, the next question is if a transfer is desirable for the Expat;
- Thus you have to compare the current situation with the situation after a possible transfer. As this means comparing many legal/tax/actuarial/investment/risk/product specifications, it seems advisable to use the services of a specialist.

Number 6: Your Personal Risk Profile Has Been Established Correctly?

As of 2000 the trend is that Workplace Pension Plans have an investment based or Defined Contribution (DC) nature. Thus the kind and amount of investments are very relevant.

For this to be implemented correctly, the first step to take is to make sure that the Personal Risk Profile of the Expat has been analyzed carefully. We too often see that this has not been handled correctly and too often at great cost.

In order to prevent such mistakes, we have drafted our own four pages form in order to carefully establish the exact risk profile of each Expat. Feel free to visit our site where you can find this form.

Number 5: Your Investments Are In Order And Even Perfect?

Even if the risk profile has been established in a correct manner, we see way too often that the investment implementation is not correct. Which not only can lead to a too low pension capital but can also mean that the risk exposure is much higher than it should.

Especially in the difficult current market conditions, with historically low interest rates and the presure on Bonds as the interest rate is slightly in a positive trend, we see that Expats have problems with handling their investments in the correct manner.

Feel free to use our investment brochures which you can find on our website and whose essence is:

- Start with analyzing your own *risk profile*;
- Then select the fitting *investment categories*;
- Then you make sure that for each investment category you select a *number of investment funds* in order to reduce risk as much as possible by *spreading* your investments;
- We indeed prefer *investment funds over investment objects* as they tend to reduce risk at lower cost;
- *Check your investments every few years* in order to make sure you still have the funds with the highest expectations;
- As of 10 years before your expected retirement age *pay annually carefull attention to what amount of risk you like to have.*
- Finally *Life Cycle Funds*, which are mixed funds that in time automatically reduce risk, can be fine but please check this *beforehand* and also if the related costs are not (way) too high.

Number 4: Additional Coverages And (Tax) Benefits Are Used?

Tax benefits and the in general deferred taxation of pension claims is a very important aspect of getting the best pension capital at retirement age.

We too often see that Expats participate in Workplace Pension Plans that offer a level of coverage which is substantially lower than the maximum allowed pension claims. Thus the Expats missed out on substantial pension and tax benefits.

Therefore please make sure that when you join a new Workplace Pension Plan, that you know to what extent you can choose to have additional coverages.

In case that is not possible but the offered Workplace Pension Plan has a coverage much lower than the legally allowed maximum coverage, it is advisable to see if it is possible to get another Workplace Pension Plan that does use all tax benefits.

Number 3: Your Disability Coverages Have Been Optimized?

In general pension coverage is about three kind of coverages:

- Old Age Pensions;
- Next of Kin Pensions;
- Disability Pensions/Insurances.

The Disability coverage requires additional attention which it often does not receive. This is a shame as the coverage is relevant and often very expensive.

When looking into this coverage, please look at the overall coverage options and compare the coverage/premium ratio of each option:

- Pillar 1: Is there a State Pension related coverage?
- Pillar 2: Is there a Workplace Pension Plan related coverage?
- Pillar 2: Is there besides the Workplace Pension Plan a Corporate Group Insurance Coverage?
- Pillar 3: Are there attractive Private Insurance Plans?

Furthermore special attention is deserved for the possible included *Indexation Clause*. This means that as of the moment the disability coverage starts paying-out, that there will be a certain amount of (conditional) annual indexation in order to keep up with inflation.

These kind of clauses are the most expensive clauses around and it seems advisable to very carefully check what you require in this respect.

Number 2: Do You Have Too Expansive Additional Clauses?

In many Workplace Pension Plans and related insurances there often is the option to choose for several additional coverages on an individual base.

Many Expats use these options as they are often advised by consultants.

Please make sure that before you accept such clauses, that you have a correct oversight of the related existing coverages for each topic and that you have compared each coverage with other options.

Insurance companies often state that a clause is not expensive as the additional costs only amount to a few percentages. But as those costs often do not generate additional pre tax compounded return on investment for several decades, those costs can be extremely expensive.

Number 1: Should You Have Private Pensions/Annuities?

Besides State Pensions and Workplace Pensions, Private Pensions/Annuities can also provide pension coverage.

Please make sure that you have an accurate oversight of all related aspects as we too often see Expats with Private Plans that have a negative coverage/costs ratio.

Aspects that require additional attention:

- Are the related costs not too high due to the fact that it regards an individual plan and thus the costs are not shared by others?
- Does the plan provide a pay-out flexibility that exceeds that of other pension plans and which additional flexibility might come in handy as of retirement age?