Spain Looks for New Ways to Save

By Kerry Pechter *Thu, Feb 15, 2018*

Spain plans to reduce the fiscal burden of its national pension by dropping cost-of-living increases. Retirees will need to offset the loss of purchasing power with other savings. But the DC system here is in its infancy. (Photo of Seville's Metropol Parasol by K. Pechter.)

“To go to America,” sighed the smartly dressed young assistant in a Sotheby’s real estate office on Plaza Nueva in Seville, Spain, where tourists from richer countries come to see flamenco, eat tapas and relax in the sun. “That is my dream. Everything here is work, work, work.”

Spain is still working its way out of its 2010-2011 financial crisis. Tourism (82 million people visited this nation of 45 million in 2017) has been a blessing but also a symptom of the country’s bargain prices—which stem from lingering unemployment and depressed wages.

Because of those conditions, most Spaniards are too caught up in day-to-day financial worries to think much about the future. But, like the US, Spain is aging. And a retirement income crisis is coming. The Spanish government intends to all but eliminate future cost-of-living increases to the national pension, so future retirees will need other sources of savings to offset their reduced purchasing power.

Therein lies the tension. Spain’s defined contribution (aka “second pillar”) system is under-developed. That’s partly because so many Spaniards work in small independent businesses. In addition, payroll taxes are already high (employers pay 24% of pay) and the public pension replaces more than 80% of the €27,000 median salary. By 2050, however, the average replacement rate is expected to shrink to 50%.

“Not many private plans have been implemented in Spain, because the statutory scheme has been so good,” Rosa Di Capua, a partner at Mercer (right), told *RIJ*. “People don’t think private plans are necessary, but it’s clear that there will be a need them in the future.”

Similarities and differences

Spain has only 1,290 employer-sponsored retirement plans, according to Inverco, a pension trade group here. Only about 7% of Spanish workers are covered by such plans, according to the European Trade Union Institute. "Occupational pension schemes have very limited coverage in actuality. Almost only large-sized companies tend to provide occupational pension benefits (usually defined contribution schemes)," according to the ETUI.

The amount of money in private retirement savings plans is growing, however. In 2016, according to OECD (Organization of Economic Cooperation and Development) estimates, fund assets in Spain were $164.2 billion or 14% of GDP, up from US $116.4 billion, or 7.8% of GDP in 2011. (For comparison, private retirement savings are worth 72% of GDP in the US and 136% of GDP in the Netherlands).

Defined contribution "has not expanded because companies think that for us this is a new cost, an increase in salary cost. And it's not something that unions are fighting for," Di Capua said. "Also, salaries in the last decade have been so low due to the crisis, that deferring more of the salary isn't realistic."

"The second pillar is quite low," said Diego Valero (below left), CEO of Novaster, a Spanish pension consultancy, in an interview with *RIJ*. "Not many companies have developed an occupational pension for their employees. Big companies or the multinational companies have some pension schemes. In Spain, 90% of the labor force works in medium and small companies, and most of them don't have any complementary savings plans."

If and when DC plans flower in Spain, they will be both similar and dissimilar to US-style DC. Like US plans, they will be tax-deferred, voluntary (Spain's constitution forbids mandatory DC), employer-based, and open to lump sum, systematic or guaranteed distribution at retirement.

But DC in Spain would also have a European flavor. Spanish DC plans would be co-designed by unions and management. An employer match would likely be expected. There would be less liquidity: No counterpart to the rollover IRA exists in Spain, and only this month did the government begin allowing penalty-free, non-hardship access to qualified savings after a 10-year holding period.

One investment option for all

Unlike DC plan participants in the US, Spain's participants can't build their own portfolios. "One of the huge differences between

defined contribution in the US and Spain is in the investment policies," Di Capua told RIJ. Aside from the fact that participants over age 50 must invest 100% in fixed income, all participants in Spanish DC plans invest in the same collective fund.

All of the money is managed by a single investment manager for all participants, with the fund manager typically working for one of the major banks, such as CaixaBank, BBVA or Santander. To break into the Spanish institutional market, a US asset manager like Vanguard or BlackRock would have to manage a tranche of that fund.

"Today the law makes it impossible to have a US or UK type plan where individuals can choose different strategies, mutual funds, and create their own personal portfolio," said Alvaro Molina, (below right) director of institutional investments for Aon Hewitt in Spain.

So far only Endesa, the electrical and gas utility that is 70% owned by the Italian company ENEL, has looked to hire best-in-class fund managers on an a la carte basis, Molina said, and three or four other DC plans have target date funds. Unions tend to be leery of target date funds—union leaders think pension professionals can manage money better than rank-and-file workers.

Winning hearts and minds

"We are trying to offer the market more possibilities for developing DC plans," Novaster's Valero told *RIJ*. "Otherwise the future looks terrible. I am a strong proponent of models like NEST in the UK; I like [Shlomo Benartzi's] 'Save More Tomorrow' idea. We are trying to introduce principles of behavioral economics to the pension industry here. We're trying help companies understand what this means, and how to set up an auto-enrollment scheme. This is our goal.

"Asset managers think the DC market will grow; the question is, 'What is the *best way* to grow?' Most of the industry thinks it's necessary to increase tax incentives [for retirement savings]. But, from my point of view, that's clearly not enough. We need other points of view to reach the companies."

The government is not necessarily helping stimulate tax-deferred savings. It has reduced the limit on deductible contributions to retirement to the lower of €8,000 or 30% of earnings (reduced from €10,000) , compared to $18,000 ($24,000 for those over 50) in the US. Although new regulations also reduced the limit on average commissions on pension funds, a May 2017 **press report** said that investment costs are kept high in Spain by the handful of major banks that control most of the market.

“Everyone knows that the public pension’s average replacement rate will drop to 50% over the next 30 years, but there’s a present bias,” Valero told *RIJ*. “There are no new incentives by the government and no new models, so unfortunately we are in a very bad situation for the immediate future.”

One possibility that Aon Hewitt’s Molina suggested: Create an ad hoc DC plan by making it easy for workers to contribute to personal pensions through their payroll systems at work. Several Spanish banks offer IRA-type individual savings vehicles. **Banco Mediolanum**, for instance, offers a pension-supplement savings program and life insurance that can converts to a life annuity. Investment options tend to be more flexible in these personal pensions than in DC plans.