

# Pensions update - Spain

## New legislation introduced on 14 December 2007 affecting Company Tax Qualified Pension Plans

At the end of 2002 mandatory funding legislation was introduced in Spain which, with a few exceptions, effectively abolished the use of internal book reserves as a means of financing pension commitments. Instead, the legislation required that, effective 31 December 2002, pension liabilities should be externally funded using one of two approved vehicles: a Company Tax Qualified Pension Plan (CTQPPs) or a Group Life Insurance (GLI) contract.

Spanish legislation also allows the use of two other funding vehicles: the Individual Tax Qualified Pension Plan (ITQPP), a tax efficient vehicle for employee only contributions introduced in the late 80s, and the Plan de Prevision Social Empresarial (PPSE), a hybrid of the CTQPP and GLI vehicles introduced on 1 January 2007.

On 14 December 2007 new legislation was enacted in Spain which introduced further changes to the Spanish pension system. The legislation is almost exclusively addressed at CTQPPs, although it also contains some elements which will affect the other vehicles (GLIs, ITQPPs and PPSEs).

Pension plan stakeholders (sponsors, control committee, fund managers, insurers, actuaries) have twelve months, that is until 14 December 2008, to implement the new legislation.

The legislation covers a variety of areas, including compliance, funding, investment, administration and communication, to name a few. The key highlights of the new legislation are detailed below.

## Investments

This was possibly one of the more awaited and interesting aspects of the legislation since, to date, a CTQPP, whether defined benefit or defined contribution, has only been allowed to operate with a single investment strategy - thus substantially limiting investment flexibility for defined contribution members.

***‘The legislation is almost exclusively addressed at CTQPPs, although it also contains some elements which will affect the other vehicles’***

The new legislation now permits defined contribution CTQPPs to set up two separate ‘subplans’, with employee contributions to one or both ‘subplans’ being determined by reference to common age criteria. Individual employee investment choice is still not permitted.

The interpretation of the legislation is not entirely clear.

- Some consultants have initially interpreted this to mean that there can be at most two sections of the plan with two separate investment strategies. An example of this approach could be: Subplan 1 for those aged under 50, with a fixed 70 per cent equities/30 per cent bonds strategy; Subplan 2 for those aged 50 and over, with a fixed 30 per cent equities/70 per cent bonds strategy. If this is the case then the impact of the legislation is likely to be limited.
- However, the more detailed wording of the legislation appears to suggest that what in fact is referred to as ‘subplans’ could be subfunds. If this were the case, an alternative and much more interesting interpretation of the legislation may be possible. For example: Fund 1 could be a 100 per cent equity fund and Fund 2 a 100 per cent bond fund, with the possibility to vary investment strategy by individual age or by age band using the two subfunds, for example:
  - age 20-30: 100 per cent Fund 1, 0 per cent Fund 2
  - age 30-40: 80 per cent Fund 1, 20 per cent Fund 2
  - age 40-50: 60 per cent Fund 1, 40 per cent Fund 2.

Clearly, some doubts still remain about the interpretation of this aspect of the legislation. However, based on our discussions with local stakeholders (some fund managers as well as consultants) the general view appears to be that the legislation contemplates the alternative and more flexible investment strategy outlined above. In any case, a conclusive answer to this question will probably only be obtained with a ‘live’ case, that is designing a new defined contribution investment strategy on this basis and approaching a local fund manager to implement it.

In addition, the new legislation also introduces more detailed guidance on investments including: diversification and investment (concentration) limits, use of derivatives, use of collective investment vehicles, use of indices in setting investment strategy, and self-investment.

## Fund management

Managers must have prior authorisation to manage a pension fund, and invested assets must be at least €12 million – previously the minimum fund size was €30 million.

## Solvency margin (local funding)

The new legislation introduces a reduction in the minimum solvency margin required for CTQPPs: from 4 per cent to 2 per cent of the liabilities determined on the local funding basis.

## Transfers between funding vehicles

Transfers of assets and liabilities are now permitted:

- from CTQPP to PPSE
- from ITQPPs to CTQPP, GLI or PPSE.

The legislation also imposes strict time limits to effect transfers:

- 20 working days for collective vehicles (CTQPP, GLI and PPSE)
- 5 working days for ITQPP.

## Independent actuary

The control committee of the CTQPP must appoint two separate actuaries: one responsible for the regular/ongoing maintenance of the plan, and an independent actuary responsible for carrying out the triennial financial review of the plan. This requirement has been in place since 2004, but the new legislation incorporates further constraints/limitations on 'independence'.

Furthermore, the results of the plan review by the independent actuary must ultimately be presented in a single report, containing a unique opinion, irrespective of the number of advisors involved in its preparation. This is a new requirement.

## Plan de Prevision Social Empresarial (PPSE)

An employer cannot simultaneously sponsor/run a CTQPP and a PPSE. For this reason, the legislation introduces the option to terminate an existing CTQPP and fund the existing pension liabilities using a new PPSE instead. This change would require the agreement of the control committee of the CTQPP. At least 50 per cent of the employee representatives of the control committee and 50 per cent of the employer representatives of the control committee must agree to the change.

***'Pension plan stakeholders have until 14 December 2008, to implement the new legislation'***

## Information to employees and beneficiaries

For both CTQPP and ITQPP, the plan administrator/manager must provide information to participants and their beneficiaries at least every six months. This includes information on their accrued rights, any material events which may affect those rights, in particular any changes in legislation, and changes to the plan rules or pension fund management/investment strategy.

Note that previously this information had to be provided every three months. This change therefore represents a softening of the information requirements although, if requested by the plan participant or beneficiary, the administrator/manager is required to provide the information on a quarterly basis.

## Further information

For further information please contact your Watson Wyatt consultant or:

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