The external management of company pension fund assets in Spain

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«The external management of the funds destined to cover a company's pension obligations towards its employees, through a pension plan or life insurance policy managed by a specialised company, is a greater guarantee of efficiency and security for the future beneficiaries.»

The main reason for requiring the external management of a company's pension assets is to give its workers greater security. It is not unknown for a company going through economic difficulties to use its internal pension funds to grant itself a bridging loan in order to overcome this situation; the problem arises when the company is not able to overcome this low point and, in the end, the workers may be left without a job and without the funds that were going to pay their future pensions.

Without reaching this extreme, it is generally recognised that the external management of the funds destined to cover a company's pension obligations towards its employees, through a pension plan or life insurance policy managed by a specialised company, is a greater guarantee of efficiency and security for the future beneficiaries.

The Community Directive 80/987/EEC on the approximation of member state legislation with respect to the protection of salaried workers in the case of employer insolvency states in its article 8: «Member States should ensure that they adopt the necessary measures in order to protect the interests of salaried workers and those persons who have left the company or the employer's place of work, at the date on which the employer becomes insolvent, with regard to their acquired rights, or the rights that are in the process of being acquired, to retirement benefits, including survivors' benefits, with respect to complementary professional and social welfare schemes that exist independently of national Social Security legislation».

The Spanish legal system incorporated the stipulations of various Community Directives, amongst them the above-mentioned 80/987/EEC, through Act 30/1995 on the Regulation and Supervision of Private Insurance.

The 11th additional provision modifying the Pension Plan and Fund Act includes an additional stipulation to this Act which, in the section «Protection of Pension Obligations with Workers», obliges all assets used for this purpose to be externally managed and expressly prohibits their management through internal funds. Later, in its 14th transitory provision, the same Act 30/1995 set a maximum term of three years in order to achieve external management, this was to expire on May 10, 1999. It also set an exception to this obligation to use external management and allowed financial institutions, insurers and securities companies and agencies to maintain the management of any internal funds that they already had, although under much stricter conditions than had been the case until that date.

Other later laws (of 1997 and 1998) modified certain aspects of Act 30/1995, but the indispensable «external management regulation», that was to specify exactly which procedures should be followed for the external management of pension funds and the requirements with which the instruments used for this purpose had to comply was not enacted until October 15, 1999 (Royal decree 1588/1999), leading to a considerable delay in the process. At this time the deadline for moving funds to external management had already been postponed until December 31, 2000, and it would again be postponed to a final dead-

line of November 16, 2002. In many cases, once the «rules of play» were known time was needed to negotiate with the workers, to make a detailed valuation of pension commitments, to receive offers and, finally, to formalise the transaction.

The deadline for the external management of the so-called «retirement bonuses», which involve the payment of a sum on retirement which is equivalent to a certain number of months' pay – depending on the number of years in employment – was extended to the end of 2004 with the proviso that the companies involved be small and medium-sized, legally authorised to handle jointly managed pension plans and that they comply with the condition that the pension obligations are included in the sector's collective agreement.

Both pension plans of the «employment» type and group insurance policies that comply with specific requirements are considered valid instruments for the external management of pension obligations. In practice group insurance policies have been most used in order to externally manage these assets.

There are two main reasons for this preference for insurance policies:

Firstly, unlike the case with pension plans, the insured workers, as contributions are not taxed, do not formally have consolidated rights in the group policy.

Secondly, when funds are externally managed through an insurance policy there is no controlling body, and hence the company taking out of the policy deals directly with the insurer, without the operational difficulties associated with the existence of this body.

A total of 1,064 companies, with somewhat more than 300,000 workers, have transferred their pension obligations to external management. Of

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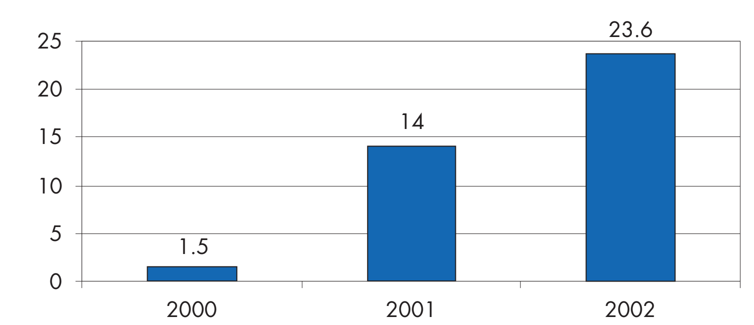
these, 675 have done so through group insurance policies and 389 through pension plans.

The majority of banks, savings banks and insurers have transferred their pension obligations to external management without availing themselves of the 14th transitory provision of Act 30/1995 that allowed them to avoid doing so, whilst complying with certain requirements. The most significant exception is a large bank that has opted to maintain its pension obligations in an internal fund.

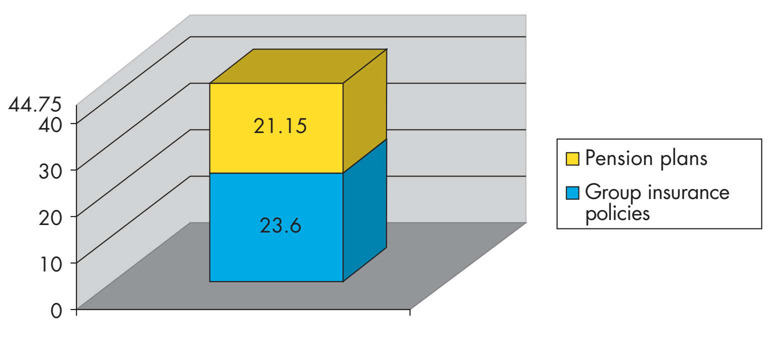
Therefore in Spain at the end of 2002 there were total funds of EUR 44.75 billion destined to cover companies' pension and welfare obligations under external management; this is equivalent to approximately 6.5% of GDP (Graph 2). ■

GRAPH 1. EXTERNAL MANAGEMENT OF PENSION FUNDS THROUGH GROUP INSURANCE POLICIES



Figures in billion of euros.

GRAPH 2. EXTERNAL MANAGEMENT OF PENSION FUNDS 2002



Figures in billion of euros.