# Country Case 16

# Spain

## Real returns 2022

Conventional Occupational Pension Plans (Pillar II): -13.52%

Equity Pension Plans (III): -18.09%

Mostly Bonds Pension Plans (Pillar III): -14.31%

Mostly Equity Pension Plans (Pillar III): -15.43%


Resumen

Los trabajadores españoles ahorran poco para complementar su pensión. Más del 70% de su riqueza total son viviendas y las pensiones de Seguridad Social sustituyen más del 80% del salario previo a la jubilación. Como resultado de estos y otros factores, la "industria de las pensiones" (Pilares II y III) en España es pequeña y menos eficiente que si fuese tan grande como las de los Paises Bajos o el Reino Unido. Los activos de los Planes de Pensiones convencionales, a 31 de diciembre de 2022, equivalían al 8,71% del PIB de ese año y las reservas técnicas de los productos asegurados para la jubilación alcanzaban otro 14,11% del PIB, en total un 22,82% del PIB. La gestión de estos activos no es barata, aunque puede llegar a ser muy competitiva en los esquemas del Pilar II. La Fiscalidad de los activos y rentas de ambos pilares en España responde al régimen EET, común en la OCDE, si bien en 2021 y 2022 se deterioró considerablemente para los vehículos del Pilar III, habiéndose producido una cierta corrección en 2023. En el periodo 2000–2022, el rendimiento (neto) acumulativo medio de los esqemas del sistema de Planes de Pensiones, una vez descontada la inflación, y antes de impuestos, varia de +4.5% para planes de pensiones de empleo, hasta -32.9% para planes individuales invertidos en fondos de pensiones de renta fija.



Summary

Spanish workers don't save for their retirement. "Bricks & Mortar" make more than 70% of a typical Spanish household's portfolio and Social Security old-age benefits replace more than 80% of lost labour income at retirement. So, why Spanish employees should save for their retirement? As a result, the Spanish pensions industry (Pillars II and III) is small and less efficient than that of the Nederland or the UK. Pension Funds' assets at end 2022 reached 8.71% of GDP that year, and if insured retirement or retirement-like vehicles' mathematical reserves were added to this, an extra 14.11% could be found, adding to a grand total of 22.82% of GDP. These and other reasons imply that asset management in this low-scale industry cannot be cheap. To be sure, Pillar II assets are as cheap to manage as in advanced markets or more, but this is not the case with Pillar III assets. Taxation of retirement assets and income in Spain responds to the EET regime, as in most OECD countries, although 2021 and 2022 have witnessed a serial deterioration of fiscal terms granted to Pillar III schemes. Over the period 2000–2022, the (net) cumulative return of conventional pension plans, after correcting for inflation and before taxes, ranges from +4.5% for occupational pension plans to -32.9% for individual pension plans invested in bonds.

# Introduction: The Spanish pension system

It is well known that Social Security contributions, even if they are immediately spent on current benefits and not accumulated as savings by workers, may return relevant yields when retirement benefits are finally received. This happens everywhere, also in Spain. Estimations of the implicit rate of return for Spain are around 6% real per year. This means that Social Security, as a matter of fact, has returned every euro paid in contributions around 12 years after retirement when the average retiree has yet another 10 years of remaining life. This implicit return is difficult to beat by marketed retirement products, even if these are by default sustainable when they are of the DC variety.

Since 2020 Spain has witnessed several major pensions reforms that complemented, and partly reversed, reforms adopted in 2011-2013. Automatic benefits' inflation indexation was adopted in 2021 by law and 2013's Benefits Revalorization Index (IRP, Spanish acronym) and Sustainability Adjustment Index (FS, Spanish acronym, a correction factor for Life Expectancy changes) were abolished. By Budgetary laws in 2020 and 2021, tax deductibility of contributions to Pillar III pension products was greatly reduced from €8 000 (in 2020) to €2 000 (in 2021) and €1 500 (in 2022). This latter measure impacted severely in contributions to Pillar III vehicles. Also in 2022 Pillar II products were additionally regulated to introduce a new kind of "Simplified Occupational Pension Plans" that could be promoted by Employers' Associations, Trade Unions, Professional Trusts and Mutual Funds and Self-employed workers Associations. Independent workers could also join sectoral Employers' Associations Pension Plans. Finally, a major reform took place in 2023 to reinforce the sustainability of Pillar I (Social Security) with a series of measures consisting in higher and additional payroll taxes on workers and employers to cope with massive retirement of the baby-boom cohorts. This legislation let the door open to further tax increases if needed.

Debates were hot along these lines of reform as many analysts and experts feared that the combination of these measures could not ensure sustainability. Inflation adjustment mechanism was deemed a powerful cost increasing factor, what was shown and also hotly debated as 2022 inflation hit almost 9% mark. An increase of 8,5% for all pension benefits was finally due in January 2023 after the automatic mechanism enacted in December 2021 played its role.

The figures we present in this chapter tell a story that bears a sharp contrast with the above description of Social Security internal rate of return. Long term (since 2000) net (of fees), real (after inflation) and before taxes, returns of the standard retirement plans (Pillars II and III) in Spain has been -0.20% in annual cumulative terms (-0.42% for Pillar III schemes and 0.11% for Pillar II schemes). This mostly due to a particularly bad performance in 2022 and despite the good good results observed in 2019 and 2021.

In this chapter, we have decided to offer the reader a comprehensive overview of Spanish private pensions, including conventional pension plans and insured pension products. However, due to data limitations, we can only compute real net returns for conventional pension plans. As shown in Table ES.1, we distinguish four categories: occupational pension plans, first, that belong to Pillar II of the pension system; and three categories of individual pension plans in Pillar III, which differ from each other with regard to the allocation of assets into equity vs. bonds.

The real net returns of these four categories of pension plans is presented in details in the penultimate section of this chapter. However Table ES.2 already gives the reader an overview of the

Table ES.1 – **Long-term and pension savings vehicles analysed in Spain**

| Product | Pillar | Reporting period *Earliest data* | *Latest data* |
|---|---|---|---|
| Conventional Occupational Pension Plans (Pillar II) | Occupational (II) | 2000 | 2023 |
| Mostly Bonds Pension Plans (Pillar III) | Voluntary (III) | 2000 | 2023 |
| Mostly Equity Pension Plans (Pillar III) | Voluntary (III) | 2000 | 2023 |
| Equity Pension Plans (III) | Voluntary (III) | 2000 | 2023 |

situation of Spanish private pensions over the long term: 2022 was, for Spanish pension savings, a terrible year that is set against a backdrop of already low long-term returns.

Table ES.2 – **Annualised real net returns of Spanish long-term and pension savings vehicles (before tax, % of AuM)**

| | Conventional Occupational Pension Plans (Pillar II) | Mostly Bonds Pension Plans (Pillar III) | Mostly Equity Pension Plans (Pillar III) | Equity Pension Plans (III) |
|---|---|---|---|---|
| Reporting period | 2000-2022 | 2000-2022 | 2000-2022 | 2000-2022 |
| 1 year (2022) | -13.5% | -14.3% | -15.4% | -18.1% |
| 3 years (2020–2022) | -3.6% | -5.7% | -3.9% | -0.6% |
| 5 years (2018–2022) | -1.6% | -3.7% | -1.8% | 1.3% |
| 7 years (2016–2022) | -0.7% | -2.7% | -0.7% | 2.4% |
| 10 years (2013–2022) | 1.3% | -0.8% | 1.5% | 5.2% |
| Whole period | 0.2% | -1.7% | -1.3% | -0.6% |

*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

## Pension system in Spain: An overview

The Spanish pension system is composed of three pillars:

- Pillar I — Public, with a pay-as-you-go major branch of compulsory, earnings related pensions (old-age, invalidity, and survivors' benefits) and a minor, means-tested assistance branch for over 65 years old individuals (old-age and invalidity).
- Pillar II — Voluntary, defined benefit and defined contribution occupational, employer-sponsored pension plans (restricted de facto to large companies) and other qualified pension vehicles (insured and non-insured).
- Pillar III — Voluntary, individual defined contribution pension plans and a variety of other qualified retirement savings vehicles (insured and non-insured).

A more detailed description of these three pillars is presented in Table ES.3.

Table ES.3 – Overview of the Spanish pension system

| | Pillar I | Pillar II | Pillar III |
|---|---|---|---|
| | National Social Security | Employer-sponsored Pension Plans | Individual Pension Plans |
| Participation | Mandatory | Voluntary | Voluntary |
| Type of funding | Financed by social contributions (employees 4.8%, employers 24.1% of pensionable wage) | Financed normally by employers' contributions (no standard rate); Matching is rare. | Financed by insured persons |
| Type of benefit entitlement | Final Wage formula (variable % of a 25/29 years average of actualized pensionable wages) | Both DB and DC benefits | DC benefits |
| Management | The scheme is managed by the Social Security Administration (INSS) | Managed by licensed Asset Managers under sponsor companies' Social Partners supervision | Managed by Plans' Sponsors (Financial institutions, Insurers or Associations) |
| Products | Contributory State Pension, Non-contributory State Pension and Minimum Basic Income (Ingreso Mínimo Vital, means tested, as from July 2020) | Company Pension Plans (standard vehicle), Simplified Employment Pension Plans (new since 2022, sectoral & associative), Company Group Insurance and Company Insured Pension Plans | Individual Pension Plans (standard vehicle), Insured Pension Plans and Pension Mutual Societies (Mutualidades de Previsión Social) and other minor (insured) pension and pension-like vehicles |
| Average benefit | Average contributory retirement pension (14 payments per year): €1 579 per month (old-age, newly retired employees, average January-May 2023) Average non-contributory pension (per year): €6 402 (old-age and invalidity) + €525 for rented housing | Employer-sponsored standard Pension Plans (14 payments per year): €893 per month (retirement, income only benefits, 2021)[a] Only 37.38% of total beneficiaries opt for income only retirement benefits and amounts payed were 42.48% of total benefits paid | Individual standard Pension Plans (14 payments per year): €164 per month (retirement, income only Plans, 2021)[b] 64.62% of total beneficiaries opt for income only retirement benefits and these amount to 34.38% of total benefits paid |
| Coverage | Social Insurance is compulsory for all workers. There are 6.4 million old-age pensioners (as of May 2023). All persons 65 and over are eligible for Social Assistance | Barely 11.7% of employees were covered by Employer-sponsored standard Pension Plans in 2021. Only 48.1 thousand beneficiaries received income only retirement benefits in 2021 | Below 24.4% of population aged 16 to 64 was covered by Individual Plans in 2021. Up to 339 thousand beneficiaries received income only retirement benefits in that year |
| Tax treatment | Contributions are tax exempt and benefits are taxable (ET)[d] | Contributions and returns are tax exempt and benefits are taxable (EET) | Contributions and returns are tax exempt and benefits are taxable (EET) |
| Net replacement ratio[c] | 74.3% (Q1, 2023) | 44.2% (2021) | 8.1% (2021) |

*Data:* Social Security, INE, INVERCO, DGFSP

[a] Employer-sponsored Pension Plans are the standard employee pension vehicle. Besides these, Group Insurance has a far larger popularity, although average assets are one fifth that of the Pension Plans. Income-only benefits are rare as average assets are low for most participants.

[b] Individual Pension Plans are the standard personal retirement vehicle for independent workers and employees and other eligible persons.

[c] This ratio is a gross, effective, average "benefit ratio" rather than a standard OECD type replacement ratio.

[d] As of 2023, social security contributions are tax deductible without limit (however, pensionable wage is capped); contributions to Pillar II schemes are deductible up to € 10 000 (€ 5 750 for self-employed workers); contributions to Pillar III schemes are deductible up to € 1 500.

## Pillar 1

The *Instituto Nacional de la Seguridad Social* (INSS), or National Institute for Social Security, is the Department for Pensions at the core of the Spanish *Ministerio de Inclusión, Seguridad Social y Migraciones* (MISSM). The Spanish Social Security covers all workers against old-age, invalidity, and survivorship (widowhood and orphanhood). It has two separate branches: an insurance, contributory and earnings related branch and a non contributory, assistance, flat means-tested benefits branch, sharply differentiated not only by law but also by its size, nature, and functions.

The insurance branch of Social Security is, by far, the dominant scheme in the Spanish pension's arena (all public and private vehicles considered). It is contributory, compulsive for all workers, either employees or self-employed workers, and firms and is financed through social contributions that, within each current year, are used to pay for current pensions. The financial method of the system is thus of the PAYG variety. The pension formula is a "defined benefit" one where only last years' pensionable wages, age at retirement and a number of equivalent full contribution years are considered (besides penalties/bonuses for early/delayed retirement) and not effective contributions paid.

As of December 31, 2022, The INSS was paying 9.99 million pensions (to about 9 million pensioners) at a rate of € 1 095 each per month (14 payments in a year, all pension categories, all pensioners). Within these figures, slightly more than 6.3 million pensions went to the old age category at an average rate of € 1 260 per beneficiary and month (14 payments in a year). Direct total expenditure in earnings-related Social Security benefits in 2022 amounted thus to around € 152 billions, that is 11.45% of that year's GDP.[1]

As for workers' coverage, as of December 31, 2022, 20.29 million workers were affiliated to the national Social Security scheme. Out of these, 15.8 million (77.9%) were wage earning workers covered by the Social Security General Regime and 3.3 million (16.3%) independent workers covered by the Self-employed Workers Regime. The remaining few, a mere 5.8% of workers, belonged to different sub-regimes within Social Security.

There were also 2,8 million registered unemployed workers, 56.4% were covered by Social Security through social contributions paid on their behalf by the *Servicio Público del Empleo Estatal* (SEPE), the Spanish Employment Agency for as long as they received unemployment benefits.

Besides social insurance pensions, the Spanish Social Security, through its assistance branch, as of December 31, 2022, paid 445.4 thousand pensions of which 267 thousand were old-age pensions and the rest were invalidity pensions. The average pension under this scheme was €5 899.60 a year (2022 average), a total amount of almost € 2.63 billions, or 1,98% of that year's GDP. Non-contributory (assistance) pensions are subject to means (income and assets) tests and are clearly a minor scheme since autonomous regions in Spain offer a wide range of basic benefits to those individuals and households in need.[2] These benefits are paid by the Social Security thought fully financed out of general taxation. These benefits can be complemented by other personal

[1] In 2022, Spanish GDP grew by 5.5% in volume in one year (as in 2021) and continued its recovery from a strong decrease of 10.8% in 2020 with respect to 2019 because of Covid-19 administrative restrictions to economic activity. Direct earnings-related benefits in 2019 amounted to 10.9% of that year's GDP. Social Security expenditure over GDP in 2020 was 12.5%.

[2] Since June 2020, Social Security is offering a new individual Minimum Basic Income. As for December 2022 there were 1.54 million beneficiaries.

characteristics (housing, dependent spouse and other health or disability conditions).

Within the contributory pensions scheme, social contributions received by the Social Security administration, that amounted to € 136.3 billion, provided in 2022, for 89.84% of total cost of direct Social Security contributory benefits. For 2023 the total contribution rate is 28.9% of gross contribution wage. This rate splits in 24.1 pp paid by employers and 4.8 pp paid by workers. The self-employed must pay the whole 28.9% rate on their pensionable earnings. Contribution wages track effective wages closely through a scale with a minimum (as of 2023) of € 1 260 and a maximum of € 4 495.50 per month. Employees cannot choose their contribution wage but self-employed can do it and most of them do choose the minimum contributory earnings base corresponding to their earnings bracket. This results in their ex-post retirement benefits being too small. Many of these benefits will have to be latter complemented with an assistance top to reach the statutory minimum retirement pension benefit. This resulting, paradoxically, in a larger internal rate of return for minimum earnings-related old age pensions recipients, over their past contributions, compared to retirees receiving higher or maximum earnings-related pensions payable by Social Security.

## Pillar II

As shown in the introductory Table ES.3, Social Security old-age benefits in Spain replace pre-retirement wages with one of the highest rates in the world and against a rather high pay-roll tax mostly paid by employers.[3] So, there is little margin left for occupational and individual retirement accounts to step substantially into the retirement arena. And, indeed, what we observe in Spain is a very limited landscape for marketed retirement solutions even though the modern regulation for these products was enacted around 1987.

Pillar II in Spain embraces employer-sponsored retirement schemes for wage earners.[4] These products are financed through contributions mostly paid by employers, with employees rarely participating on a matching basis.

There is a variety of retirement vehicles that employers may offer to their employees, or available for self-employed workers as well. Amongst them, tax-qualified Pension Plans are the standard and most prevalent vehicle. Other company sponsored retirement schemes include a variety of insured schemes. Pension Plans are capitalisation retirement accounts of either Defined Benefit or Defined Contribution type to which employers contribute with a percentage of their wage. Workers can also contribute. Contribution rates to occupational Plans may vary considerably, but their average rate can be estimated at around a modest 2.6% of average gross wage,[5] or around € 619.71 per covered employee and year (2020). Normally, only workers in large firms are offered with these deferred wage benefits.

Employers are not obliged by law to offer this coverage to their employees, although some may be obliged by Collective Bargaining agreements in an industry or sector, which is rare. And indeed, very few companies, but the large ones, offer them to their workers as less than 1.95 million participants where registered through 2021, to a total salaried workers of 16.6 million

[3] This said, however, pay-roll taxes to Social Security or other welfare programs are deferred wages and, were they to be entirely supported by employees, gross wages should be accordingly updated to accommodate this wedge.

[4] "Associated pension plans", a very minor category used by cooperatives' members are classified as "other personal pensions" together with individual pensions within Pillar III vehicles by the regulator.

[5] Estimation based on data from INVERCO and INE.

that same year, a mere 11.7%. Also, in 2021, only 48.1 thousand retired employees received old-age, income-only benefits from standard pension plans. Average annual equivalent benefit was € 11 628.65 (before taxes) and the equivalent benefit rate (against average annual gross pay) was 43.6%.[6] As of December 31, 2022, total assets under management (AuM) to these accounts totalled € 34.4 billion (€ 3.4 billion below AuM one year earlier), that is, a tiny 3.14% of Spanish GDP in that year.

Pillar II retirement accounts are fiscally qualified by the government. Contributions by employers or employees are tax deductible up to an absolute limit of € 10 000 per person per year.[7] Benefits, no matter whether retrieved in form of monthly income, as a lump-sum or otherwise, are taxed under the current personal income taxation rules.[8] When benefits are retrieved in form of an income stream, beneficiaries are obliged to buy an annuity (life or term) or a drawdown. Nearly half of beneficiaries opt for a lump-sum given the tiny pension pots they manage to accumulate during their working lifetimes.

Often, in Spain and in many other countries, and this is a crucial issue to understand for our industry, layman savers and minor even experts refer to the fiscal treatment explained before as "incentives" or even "a fiscal gift". The truth is that having contributions tax exempted and taxing benefits (tax deferral) is the world EET standard (Exempt contributions, Exempt returns on those and Tax benefits), rather than the opposite or, even worst, double taxation of pensions if both contributions and benefits were to be taxed. Tax deferral, as opposed to an "incentive", is not a gift from government or from the rest of society, is a just treatment for income won after decades of work efforts and thrift.

## Pillar III

Pillar III embraces personal, individual Pension Plans and other retirement schemes, the former being again the dominant type within a large variety of types (see Table ES.3). These plans are personal, voluntary and "complementary" to both Pillar I and Pillar II arrangements. These schemes were equally treated, as Pillar II schemes, from the tax point of view up to 2020. But, as already mentioned, Law 11/2020 radically changed this status quo by reducing tax deductibility of contributions to €2 000. In 2021 a new change in the 2022 Budget Law established that €1 500 can be tax-free as the new extant general limit. One of the lowest thresholds in the OECD.

This double tax shock to Pillar III retirement savings is already having devastating effects difficult to compensate in the sort to medium term. As a result of these fiscal shocks, contributions through 2022 decreased by 25,3% over contributions made in 2021 wich had already fallen by 21.7% over contributions made through 2020. An accumulated fall of 41.5%. One salient feature within this category is that contributions by participants are delayed until the end of the year using balances left in their income-expenditure flows at that point in time to profit from tax deductibility.

[6] Detailed data on benefits is only available up to 2021.

[7] Up from € 8 000 as for December 2020. This absolute limit breaks down to €1 500 as the general limit for Pillars II and III schemes and an additional limit of € 8 500 from employers plus employees' social contributions to Pillar II schemes. The Spanish Government has enacted in mid 2022 new legislation that regulates new Pillar II schemes called Simplified Pension Plans to which both employees and the self-employed can contribute. The above fiscal limits also apply to these schemes for employees, but now self-employed workers have an additional (to the general) limit of € 4 250 tax deductible.

[8] Spain has a Dual Personal Income Tax that differenciates income from investments from labor income. Pension benefits (both principal and interest), however, are fully taxed as labor income.

In what concerns other features, however, Pillar III Personal Pension Plans are virtually the same product as employer-sponsored Pension Plans, albeit quite more expensive to manage. In 2021, only 339 thousand people received income-only benefits. Average annual benefit for income-only recipients was €2 296 (gross). As of December 31, 2021, Pillar III included 7.5 million retirement accounts that belonged to around 6.5 million individuals (or 24,4% of Spanish population 16-64 years old). AuM for these plans in 2022 totalled € 80.2 bln (€ 9.1 bln. down from one year earlier), that is, a mere 6.0% of Spanish GDP.

## Household savings

Personal (financial) saving in Spain is not a salient feature of its economy's financial side. Financial saving is so low because Spaniards love to save *autrement*. That is, in "bricks & mortar". This said, households are still able to spare some money by the end of the year and have so far managed to accumulate a financial buffer. Only a small part of these assets, however, are dedicated to a retirement target. One of the reasons for this lies in the fact that Social Security forces Spanish workers to "save" through pay-roll taxes paid in large part by their employers on their behalf. This reduces both disposable income and the share of it that households could save. Besides, in exchange for heavy pay-roll taxation (28.9% of gross contribution wages, as of 2023) only for retirement and associated contingencies), public pensions replace wages after retirement at around a 74% average, effective benefit rate (see Table ES.3).

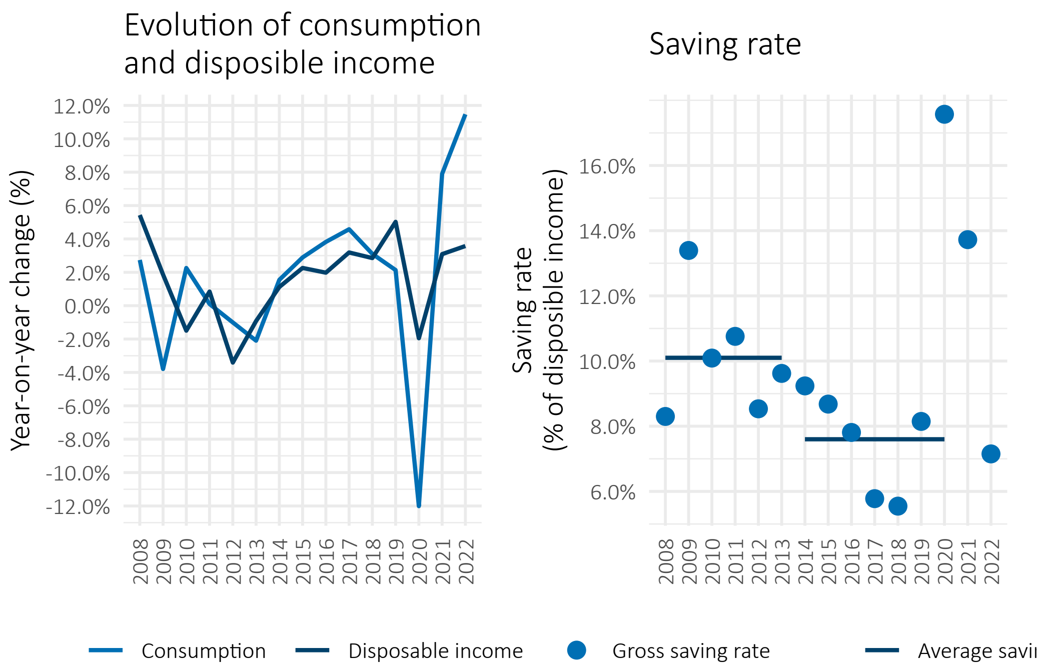
These factors reduce the desire and/or capacity to save for retirement of Spanish workers. Social contributions paid by employers (24.1 percentage points of the total rate) are commonly considered to be "deferred wage" translating into a correspondingly lower gross pay received effectively by workers as compared to the gross pay they would receive had them to pay the full contribution rate.

As for real estate, it is well known that it is hardly a retirement asset at all. Yet many home-owners, that in Spain tend to own more than one house or apartment, think that they could use their houses as a source of retirement income. However realistic this may be, the fact is that an astonishing three fourths of Spanish households' total wealth is made of "bricks & mortar", its value representing near four times the value of Spanish GDP. Housing, in a way, is *the* retirement asset in Spain and retirement solutions providers would better think on how to develop sound retirement income products based on housing assets rather than hope for households to start accumulating proper retirement assets. This would not happen at least for a generation and provided that radical changes help a development of brand new markets for retirement solutions in Spain.

The above, basically the same text we wrote last year, tended to be the picture before Covid-19. And so continued to be in 2022, but for few important differences. First comes the fact that households, who were given by the government the possibility to withdraw part of their retirement savings to cope with financial hardship at home and/or at their businesses, did not actually use this window. Total AuM at Pension Funds (both Pillar II and III) have not decreased in over 2019, even if dynamics of total AuM has been driven by yields performance rather than by net inflows of contributions. These net flows, actually, have been negative for most of the last years due to gradual decline en number of persons covered both in the occupational en the individual schemes.

The overall picture on households' gross disposable income (GDI) (year-on-year change), Consumption (year on year change) and Gross Savings (rate over Disposable Income) is shown in ??. During the crisis (2009-2013), the savings rate oscillated amply around an average of about 10% of GDI. 2009 and 2013 were precisely the most recessive years of the period. Pre-crisis years (since mid-90s in the last century) savings rate was low, reflecting the strong dynamics of private consumption, fuelled by cheap loans and intense employment creation, coupled with wage increases. After 2008, the deep recession of 2009 and a second (and large) recession in 2011-2013, led Spanish households to increase their savings ratio above 13% in 2009, and keep it around 10% in the recessive years. Meanwhile, wages stagnated, and employment continued to fall bringing the unemployment rate above 25% in the through of the second recession, at mid-2013.

Figure ES.1 – Evolution of households' spending and (financial) saving rates




*Data:* Banco de España.

Expansive years (2015-2018), when consumption was growing vigorously the savings rate dipped to a bottom 5% of disposable income in 2018. In 2019, consumption (and the economy) decelerated and savings bounced to just above 8%. As for 2020, we have seen a more than doubling of the savings rate observed in 2019, to a high of 17.6%. Covid-19 effectively restrained consumption in 2020 to a 2015 standard (a yoy 12.0% fall) while disposable income suffered far less (a yoy 2.0% fall). In 2021 and 2022, we have seen positive rates of change for these three indicators, notably a far larger increase in consumption than in disposable income and a fall in the savings rate to 13.7% in 2021 and a 7.2% rate fully in line with that observed in pre Covid-19 years.

By the end of 2022, (gross) financial assets owned by Spanish households—and non-profit institution serving households (NPISHs)—amounted to € 2.7 trillion, according to the Bank of Spain financial balance sheets statistics. That amount represented slightly more than 3.3 times households' GDI and slightly above 2 times Spanish GDP. But households did not increase their holdings of financial assets compared to 2021.

If we take a closer look at the distribution of (gross) financial assets owned by Spanish households in 2021–2022, as shown in Table ES.4, one can immediately observe that the “cash and bank deposits” class of assets, with almost 1.1 trillion euros at end 2022, takes up to an impressive 39.6% of total financial assets held by Spanish households, above the share observed one year earlier. “Equity” being the second most important financial asset in households’ portfolios at € 832.6 billion and 30.5% of total financial assets, or slightly above one percentage point up from a year earlier. Clearly, the Covid-19 recession had an impact in both preference for liquidity and precautionary savings, but this impact will be, if at all, slowly reversed. In fact, nothing of the large extra savings realized in 2020 and 2021 went to accumulation of pension rights. These actually decreased by 17 billions in 2021-2022, due both to markets’ performance and negative net flows of contributions

Table ES.4 – **Financial assets held by Spanish households 2021–2022**

| | 2021 | | | 2022 | | | |
|---|---|---|---|---|---|---|---|
| | € bln. | % | % of GDI | € bln. | % | % of GDI | Change (%) |
| Cash and bank deposits | 1 034.345 | 37.9% | 131.0% | 1 078.289 | 39.6% | 131.9% | 4.2% |
| Investment Funds | 418.576 | 15.3% | 53.0% | 386.563 | 14.2% | 47.3% | -7.6% |
| Shares | 799.612 | 29.3% | 101.3% | 832.633 | 30.5% | 101.8% | 4.1% |
| Pension rights | 189.721 | 7.0% | 24.0% | 172.783 | 6.3% | 21.1% | -8.9% |
| Insurance | 198.295 | 7.3% | 25.1% | 159.820 | 5.9% | 19.5% | -19.4% |
| Other | 86.687 | 3.2% | 11.0% | 95.866 | 3.5% | 11.7% | 10.6% |
| **Total** | **2 727.236** | **100.0%** | **345.5%** | **2 725.954** | **100.0%** | **333.4%** | **0.0%** |
| **Pro memoria: GDI[a]** | **789.318** | **n.a.** | **n.a.** | **817.536** | **n.a.** | **n.a.** | **3.6%** |

*Data:* Banco de España.
[a] GDI: Gross Disposable Income.

Spanish households significantly reduced their investment funds and insurance holdings in 2022. Equity holdings, however profited of a large increase (+€ 33 billions) as reflected in the table above. Pension entitlements reduced their share of total financial assets by 0.7 percentage points.

With respect to households’ GDI, it increased a healthy 3.6% in a clearly recovered economic and financial year, but total financial assets barely changed with respect to 2021 and kept a relative nominal size of 3.3 times households’ GDI an just above 2 times Spanish GDP in 2022.

## Long-term and pension savings vehicles in Spain

Even if, due in part to the overwhelming presence of Social Security, the room for Pillars II and III is not a very large one in Spain, there is a large variety of marketed retirement products. The most standard retirement vehicles, as said above, are Pension Plans (occupational and individual) and Insured Pension Plans. Most retirement vehicles in Pillar III are provided by financial institutions and insurers that also act as managers and depositories of Pillar II occupational pension plans.

The latter are basically provided by employers. Also, several professional associations have since long created *Mutualidades* (Mutual Funds) that offer complementary (mostly Pillar III) coverage to *mutualistas* (members), with some of those Mutual Funds also operating as regulated alternative schemes to Social Security's self-employed schemes (Pillar I) for these occupational groups.

Table ES.5 – Retirement vehicles in Spain (Dec. 2022)

| | AuM/Reserves (€ mln.) | Participants (thousands) | Assets/Reserves per participant |
|---|---|---|---|
| **Conventional Pension Plans**[a] | **115 646.30** | **9 375.75** | **12 334.62** |
| Pillar II | 34 633.97 | 1 915.93 | 18 076.87 |
| *Occupational Pension Plans* | *34 633.97* | *1 915.93* | *18 076.87* |
| Pillar III | 81 012.33 | 7 459.82 | 10 859.82 |
| *Individual Pension Plans* | *80 233.17* | *7 408.15* | *10 830.40* |
| *Associated Pension Plans*[b] | *779.16* | *51.67* | *15 078.14* |
| **Insured Retiremet Vehicles** | **187 214.23** | **14 349.28** | **13 046.94** |
| Pillar II | 36 721.34 | 6 908.14 | 5 315.66 |
| *Income (Acc. & Pay-out Phases)* | *22 325.51* | *468.22* | *47 681.67* |
| *Retirement Group Insurance* | *8 890.44* | *3 856.33* | *2 305.41* |
| *Other Pillar II Insured Vehicles* | *5 505.39* | *2 583.59* | *2 130.91* |
| Pillar III | 150 492.89 | 7 441.14 | 20 224.43 |
| *Annuities (Life & Term)* | *63 647.26* | *1 663.51* | *38 260.82* |
| *Defferered Capital Pensions & Savings* | *41 122.45* | *2 080.68* | *19 763.95* |
| *Unit/Index- Linked* | *17 022.18* | *1 363.37* | *12 485.35* |
| *PIAS*[c] | *13 644.66* | *1 071.29* | *12 736.66* |
| *Insured Pension Plans* | *11 034.00* | *858.30* | *12 855.64* |
| *SIALP*[d] | *4 022.34* | *403.99* | *9 956.53* |
| **Total** | **302 860.53** | **23 725.03** | **12 765.44** |
| Pillar II | 71 355.31 | 8 824.07 | 8 086.44 |
| Pillar III | 231 505.22 | 14 900.96 | 15 536.26 |

*Data:* INVERCO and UNESPA; *Calculations:* BETTER FINANCE.
[a] Non insured retirment vehicles.
[b] Retirement vehicles sponsored by labour associations and regulated as Pillar III.
[c] *Plan Individual de Ahorro Sistemático* (PIAS), "Systematic Individual Savings Plans"
[d] Seguro Individual de Ahorro a Largo Plazo (SIALP), "Long Term Individual Insurance"

Current laws regulating modern Pillars II and III were enacted around 1987–1988. Occupational pensions, that were directly provided by employers to their employees before then, were gradually taken out of P&L accounts and entrusted to newly created entities that have their own legal personality (*Planes de Pensiones*) and their assets integrated into standard vehicles also created by those laws (*Fondos de Pensiones*). As recently as June 2022, however, the Spanish Parliament passed passed Law 12/2022 by which Public Occupational Pension Funds were created and brand new private Simplified Occupational Pension Plans were regulated allowing self-employed workers to join occupational schemes for the first time in Spain.

Notwithstanding the fact that Spanish households preferred to hold their financial assets in form of bank deposits and cash, equity kept their place in 2022 at a 30.5% share of total financial assets, well above Investment Funds (see Tables ES.4 and ES.5). In 2022, total investment in this class of assets increased by 4.1%. Investment Funds suffered a 7.6% decrease. Pension funds had a nominal 8.9% decrease, well offline with their performance in 2021 and 2019.

Table ES.6 – **Total assets managed by Group Investment Institutions 2010-2022 (€ mln.)**

| | Group Investment Funds | | | | | | |
|---|---|---|---|---|---|---|---|
| | Investment funds | | Investment trusts | | | | |
| | Financial | Real estate | Financial | Real estate | Foreign IF | Pension funds | Total |
| 2010 | 138 024 | 6 123 | 26 155 | 322 | 48 000 | 84 750 | 303 374 |
| 2011 | 127 731 | 4 495 | 24 145 | 316 | 45 000 | 83 148 | 284 835 |
| 2012 | 122 322 | 4 201 | 23 836 | 284 | 53 000 | 86 528 | 290 171 |
| 2013 | 153 834 | 3 713 | 27 331 | 868 | 65 000 | 92 770 | 343 516 |
| 2014 | 194 818 | 1 961 | 32 358 | 826 | 90 000 | 100 457 | 420 420 |
| 2015 | 219 965 | 421 | 34 082 | 721 | 118 000 | 104 518 | 477 707 |
| 2016 | 235 437 | 377 | 32 794 | 707 | 125 000 | 106 845 | 501 160 |
| 2017 | 263 123 | 360 | 32 058 | 620 | 168 000 | 110 963 | 575 124 |
| 2018 | 257 514 | 309 | 28 382 | 734 | 168 000 | 106 886 | 561 825 |
| 2019 | 276 557 | 309 | 29 446 | 725 | 195 000 | 116 419 | 618 456 |
| 2020 | 276 497 | 311 | 27 599 | 886 | 220 000 | 118 523 | 643 816 |
| 2021 | 317 547 | 311 | 29 247 | 913 | 287 000 | 127 998 | 763 016 |
| 2022 | 306 196 | 312 | 16 182 | 990 | 245 000 | 115 641 | 684 321 |
| YoY 21-22 | -3.57% | 0.32% | -44.67% | 8.43% | -14.63% | -9.65% | -10.31% |

*Data:* INVERCO.

In 2022, savers both through Investment Funds and Pension Funds experienced truly bad yields amid very complicated international geostrategic conditions after Covid-19 impact in 2020 and 2021. Investment Funds received significant net investments that however could not match heavy negative yields and the end-of-year value of AuM decreased significantly, as shown in Table ES.7. Pension Funds, additionally, suffered negative net investments and heavy negative yields to see the volume of AuM decrease by almost € 13 billions. Negative investments to Pension Funds, moreover, exceeded by quite an amount in 2022 those of 2021.

In this chapter, we unfortunately cannot compute the real net returns for all categories of products. We therefore focus on pension plans: The occupational pension plans of Pillar II on the one hand, and three types of Pillar III pension plans. Figure ES.2 shows the AuM of these four categories of products since 2000.

### Pension plans

Pension Plans (*Planes de Pensiones*) are the standard retirement saving vehicle in Spain, albeit only one of many different retirement vehicles that are currently being marketed in the country. They can be promoted by employers on behalf of their employees, by professional associations on behalf of their members or by financial institutions for the general public (workers included).

Table ES.7 – Flows of funds for Investment Funds & Pension Funds 2012–2022 (€ mln.)

| | Investment funds (national, financial) | | | | Pension funds | | | |
|---|---|---|---|---|---|---|---|---|
| | BoY assets | Net invest-ments | Net yields | EoY assets | BoY assets | Net invest-ments | Net yields | EoY assets |
| 2012 | 127 731 | -10 263 | 4 854 | 122 322 | 83 148 | 70 | 3 310 | 86 528 |
| 2013 | 122 322 | 23 048 | 8 463 | 153 833 | 86 528 | 239 | 6 003 | 92 770 |
| 2014 | 153 833 | 35 573 | 5 412 | 194 818 | 92 770 | 898 | 6 789 | 100 457 |
| 2015 | 194 818 | 24 733 | 413 | 219 964 | 100 457 | 526 | 3 535 | 104 518 |
| 2016 | 219 964 | 13 820 | 1 652 | 235 436 | 104 518 | 264 | 2 063 | 106 845 |
| 2017 | 235 436 | 21 410 | 6 277 | 263 123 | 106 845 | 451 | 3 667 | 110 963 |
| 2018 | 263 123 | 8 410 | -14 019 | 257 514 | 110 963 | -170 | -3 907 | 106 886 |
| 2019 | 257 514 | 1 693 | 17 350 | 276 557 | 106 886 | 799 | 8 734 | 116 419 |
| 2020 | 276 557 | 1 161 | -1 221 | 276 497 | 116 419 | 1 176 | 928 | 118 523 |
| 2021 | 276 497 | 25 723 | 15 327 | 317 547 | 118 523 | -270 | 9 745 | 127 998 |
| 2022 | 317 547 | 17 219 | -28 615 | 306 151 | 127 998 | -907 | -11 450 | 115 641 |

*Data:* INVERCO; *BoY*: begining of year, *EoY*: end of year.

Insurance companies also promote *Planes de Previsión Asegurados* (PPA) ("Insured Retirement Plans") for the general public and *Planes de Previsión Social Empresarial* (PPSE) ("Insured Employer Retirement Plans"). These insured vehicles are essentially equivalent to their non-insured counterparts and share with them the same regulatory standards.

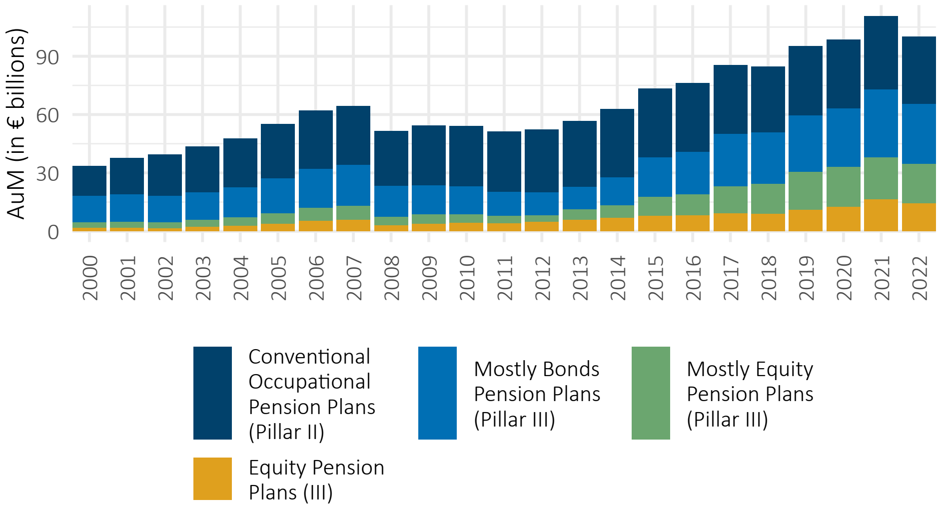
Pension Plans are voluntary and complementary to Social Security pensions. Their benefits are not integrated in whatsoever way with Social Security benefits. Plans created after 1987 legislation are DC plans but many of previously existing occupational plans, that had to be latter segregated from their parent companies and transferred to Pension Funds, continue to be DB plans, accounting for roughly half the volume (but decreasing) of assets managed into the occupational sub-class.

Pension Plans integrate for the sake of management and by law into Pension Funds (*Fondos de Pensiones*) to reach scale and financial synergy. This is the case of small Pillar II, occupational plans and of virtually all Pillar III, or individual retirement plans and associated plans. Pension Funds are legal entities, linked or not to financial institutions, obliged by law to contract out their managing and depositary functions with specialized, licensed agents.

Pension Plans in Spain, like in most countries, are tax qualified (EET) retirement vehicles. All payments by participants (or in their behalf) are tax-exempt up to a limit, so that compounded interest may play its full magic over larger savings during many years. Benefits are taxed (see below). In exchange for this tax treatment, funds cannot be cashed before retirement, unless some major contingencies happen (redundancy, sickness, or long-term unemployment), albeit some extra flexibility has been added recently (see below). Accrued rights, however, can be switched by participants to different plan promoters at no cost within the individual plans scheme.

Table ES.8 below presents the number of participants (accounts rather, see note at the bottom of the table) to Pension Funds as of 31st December 2010 and 2022. The past decade has witnessed

Figure ES.2 – AuM of Spanish conventional pension plans




*Data:* INVERCO; *Calculations:* BETTER FINANCE.

a worrying trend in the number of accounts/participants and things are not likely to improve in the current one unless strong action is taken.

As of December 2022, slightly less than 9.4 million accounts were integrated in the whole scheme. The individual accounts sub scheme totalled barely 7.4 million accounts, 79.0% of total number of accounts.

Table ES.8 – Number of participants to Pension Plans 2010–2022

| | Dec. 2010 | | Dec. 2022 | | |
|---|---|---|---|---|---|
| | Accounts | % of total | Accounts | % of total | Change 10–22 |
| Associate schemes (Pillar III) | 78 072 | 0.7% | 51 675 | 0.6% | -33.8% |
| Company schemes (Pillar II) | 2 149 334 | 19.8% | 1 915 927 | 20.4% | -10.9% |
| Individual schemes (Pillar II) | 8 601 775 | 79.4% | 7 408 147 | 79.0% | -13.9% |
| Total | 10 829 181 | 100.0% | 9 375 749 | 100.0% | -13.4% |

*Data:* INVERCO.

The most salient feature displayed in the above table is the drop in the number of participants' accounts since 2010, a 13.4% rather uniformly distributed on time, shared by all sub schemes but especially relevant (in absolute terms) in the individual plans sub scheme, that lost 1.2 million participants' accounts in the period.

Correspondingly, as Table ES.9 shows, the number of pension plans displays an almost regular decrease all through the present decade. Number of plans totalled 2 964 in 2010 and 2 286 at the end of 2022, a 22.9% drop, a fairly regular though time decrease averaging over sub schemes, but most relevant again (in absolute terms) for the individual plans sub scheme. Associated schemes (inside Pillar III, according to the regulator classification) are a minority.

These data hide the fact that the average size of Pension Plans increased in the period from 3.2 thousand accounts per plan in 2010 to around 4.1 thousand accounts per plan, likely making the system more efficient. Even if one cannot get rid of the feeling that the whole scheme reached a ceiling some time ago and is now well set for a continuous and regular decline unless a "big bang" happens in this industry.

Table ES.9 – Number of Pension Plans by type of scheme 2010–2022

| | Individual schemes | Company schemes | Associated schemes | Total |
|---|---|---|---|---|
| 2010 | 1 271 | 1 484 | 209 | 2 964 |
| 2011 | 1 342 | 1 442 | 198 | 2 982 |
| 2012 | 1 385 | 1 398 | 191 | 2 974 |
| 2013 | 1 384 | 1 350 | 187 | 2 921 |
| 2014 | 1 320 | 1 330 | 178 | 2 828 |
| 2015 | 1 257 | 1 312 | 172 | 2 741 |
| 2016 | 1 189 | 1 305 | 164 | 2 658 |
| 2017 | 1 107 | 1 291 | 156 | 2 554 |
| 2018 | 1 079 | 1 293 | 151 | 2 523 |
| 2019 | 1 027 | 1 284 | 146 | 2 457 |
| 2020 | 976 | 1 282 | 141 | 2 399 |
| 2021 | 903 | 1 286 | 136 | 2 325 |
| 2022 | 861 | 1 294 | 131 | 2 286 |
| **Change 2010-2022** | **-32.26%** | **-12.80%** | **-37.32%** | **-22.87%** |

*Data:* INVERCO.

Pillar II schemes (employer-sponsored) represented, as of December 2022, 20.4% of total accounts and 55.6% of total plans (accounts per plan). AuM within Pillar II plans represented 29.9% of the system's AuM (Table ES.10), a diminishing share. This, in turn, implies that average retirement assets per account are also larger within the Pillar II schemes than within Pillar III. Actually, € 10 831 per account in the latter versus €18 076 per account in the former.[9]

Coming to total AuM for the whole Pension Plans and Funds industry, as of December 2022, this indicator showed a heavy fall of 9%, due mostly to assets' yields in the year albeit net investment was also negative for the second year in a row (see Table ES.7). Note, however, that total AuM for Pension Plans today barely reach 9% of GDP.

[9] Using standard mortality tables for Spain and assumptions about returns, these reduced amounts would yield very low instatnt lifetime annuities. The annuity a typical individual account could buy retiring at 65 amounts to around € 55 per month (twelve payments) and increases up to around €90 per month in the case of the typical occupational account. This said, retirement savings under these two varieties tend to be sensibly larger at retirement age but won't even double the figures mentioned in the main text. Also, within the occupational variety, around half a million accounts belong to civil servants and most of these accounts have assets below one thousand euros per account. That's why benefits at retirement are normally cashed in as a lump-sum. On the other hand, some employer-sponsored plans, covering dozens of thousands of employees in manufacturing and financial and advanced services (notably in the Basque Country, manufacturing), hold rather large average retirement accounts.

Table ES.10 – Evolution of Pension Plans' Assets under Management by type scheme 2009–2022

| | AuM (€ mln.) | % of total | AuM (€ mln.) | % of total | AuM (€ mln.) | % of total | Total AuM (€ mln.) |
|---|---|---|---|---|---|---|---|
| 2009 | 53 228 | 62.6% | 30 784 | 36.2% | 992 | 1.2% | 85 004 |
| 2010 | 52 552 | 62.0% | 31 272 | 36.9% | 926 | 1.1% | 84 750 |
| 2011 | 51 142 | 61.5% | 31 170 | 37.5% | 835 | 1.0% | 83 148 |
| 2012 | 53 160 | 61.4% | 32 572 | 37.6% | 795 | 0.9% | 86 528 |
| 2013 | 57 954 | 62.5% | 33 815 | 36.5% | 1 001 | 1.1% | 92 770 |
| 2014 | 64 254 | 64.0% | 35 262 | 35.1% | 940 | 0.9% | 100 457 |
| 2015 | 68 012 | 65.1% | 35 548 | 34.0% | 958 | 0.9% | 104 518 |
| 2016 | 70 487 | 66.0% | 35 437 | 33.2% | 921 | 0.9% | 106 845 |
| 2017 | 74 378 | 66.9% | 35 843 | 32.3% | 903 | 0.8% | 111 123 |
| 2018 | 72 247 | 67.5% | 33 957 | 31.7% | 829 | 0.8% | 107 033 |
| 2019 | 79 850 | 68.6% | 35 710 | 30.7% | 859 | 0.7% | 116 419 |
| 2020 | 82 014 | 69.2% | 35 681 | 30.1% | 827 | 0.7% | 118 523 |
| 2021 | 89 323 | 69.8% | 37 792 | 29.5% | 883 | 0.7% | 127 998 |
| 2022 | 80 233 | 69.4% | 34 634 | 29.9% | 779 | 0.7% | 115 646 |

*Data:* INVERCO.

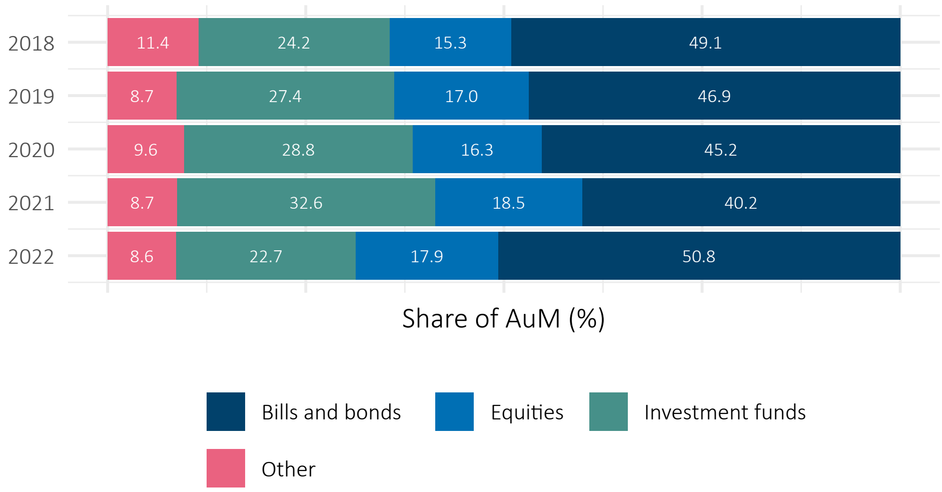
It can also be seen that around 69.4% of total AuM in these retirement vehicles belong to the Individual plans sub-scheme, representing a mere 6% of GDP. This category of assets has decreased its nominal value an 10.2% over the previous year, compared to a 8.4% decrease for occupational pension plans' assets.

Typically, Pension Funds offer a variety of risk profiles that participants generally adhere to for some time until they decide to switch, as they age, for instance. This is generally the case of individual schemes, where participants can switch regularly between schemes albeit these schemes remain relatively specialized as for their risk profile as participants come and go. The above implies that all standard asset classes must be present in overall portfolios at minimum and maximum thresholds, ranging from mostly bond-based schemes to mostly equity-based schemes. Occupational schemes, however, are set with the risk profile established (if at all) by their sponsors and fund managers (or control boards, where employers and workers representatives sit) will have certain freedom to change the risk profile of the fund according to market conditions. Over a large period of time then, both participants, with their regular scheme choices, and managers and social partners may induce relevant changes in the asset allocation of pension funds.

Figure ES.4 shows that Spanish Pension Funds (Pillar III) allocate 82% of their assets to a combination of mixed (bond + equity-based) and mostly equity-based schemes. Mostly-bond-based schemes have a reduced stance (14% of Pillar III assets) but, indeed, in 2022 funds have switched towards safer investments than in 2021 (see Table ES.11) due to rising interest rates.

On a short-term perspective (Table ES.11), asset allocation structure of Pension Funds (all schemes) is obviously more stable even if there has been a sharp contrast with respect to 2021 concerning assets' returns. At the end of 2020, despite current terrible economic conditions, allocative decisions did not change dramatically the picture seen by end 2019. But at the end of 2022 very significant changes towards Investments Funds & Trusts and out of domestic and private bonds

Figure ES.3 – Allocation of Spanish conventional pension funds' assets




*Data:* INVERCO.

could be observed.

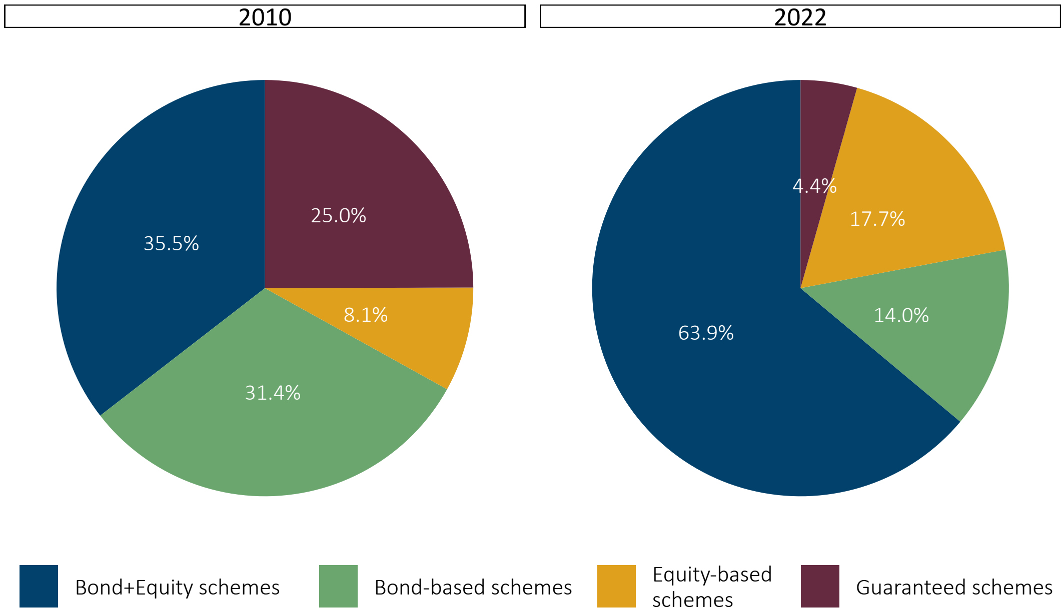
Table ES.11 – Pension Funds' Asset Allocation 2018–2022

| | IVQ18 | IVQ19 | IVQ20 | IVQ21 | IVQ22 |
|---|---|---|---|---|---|
| Equity | 15.3% | 17.0% | 16.3% | 17.5% | 17.9% |
| Investment Funds & Trusts | 24.2% | 27.4% | 28.8% | 32.6% | 22.7% |
| Domestic Government Bonds | 18.7% | 14.9% | 13.3% | 10.1% | 8.3% |
| Foreign Government Bonds | 12.7% | 14.0% | 13.2% | 13.1% | 18.1% |
| Securities and Private Bonds | 17.7% | 17.9% | 18.7% | 16.9% | 24.2% |
| Other (Liquid Assets) | 11.4% | 8.7% | 9.6% | 9.7% | 8.6% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

*Data:* DGFSP

As shown in Figure ES.5, when a mid-term perspective is adopted, the increasing role of riskier assets in Pension Funds' allocation strategy is the result of a gradual switch from bonds in the last few years after sovereign debt became less and less attractive in an ultra-low interest rate scenario. A bet that, that in 2019, rewarded those who undertook it. 2020, as said, for all its complexity in economic terms, has really been a continuation of the basic allocation structure of the previous year with 2021 showing a continuation of the trend towards Investment Funds and Trusts. This trend suddenly reversed as interest rates started to increase due to inflationary pressures provoked by geopolitical conditions after the Russian invasion of Ukraine. Foreign

Figure ES.4 – Investments by asset class (Pillar III schemes) 2010–2022




bonds and private securities gained important shares in Pension Funds portfolios against mostly investment funds in 2022.

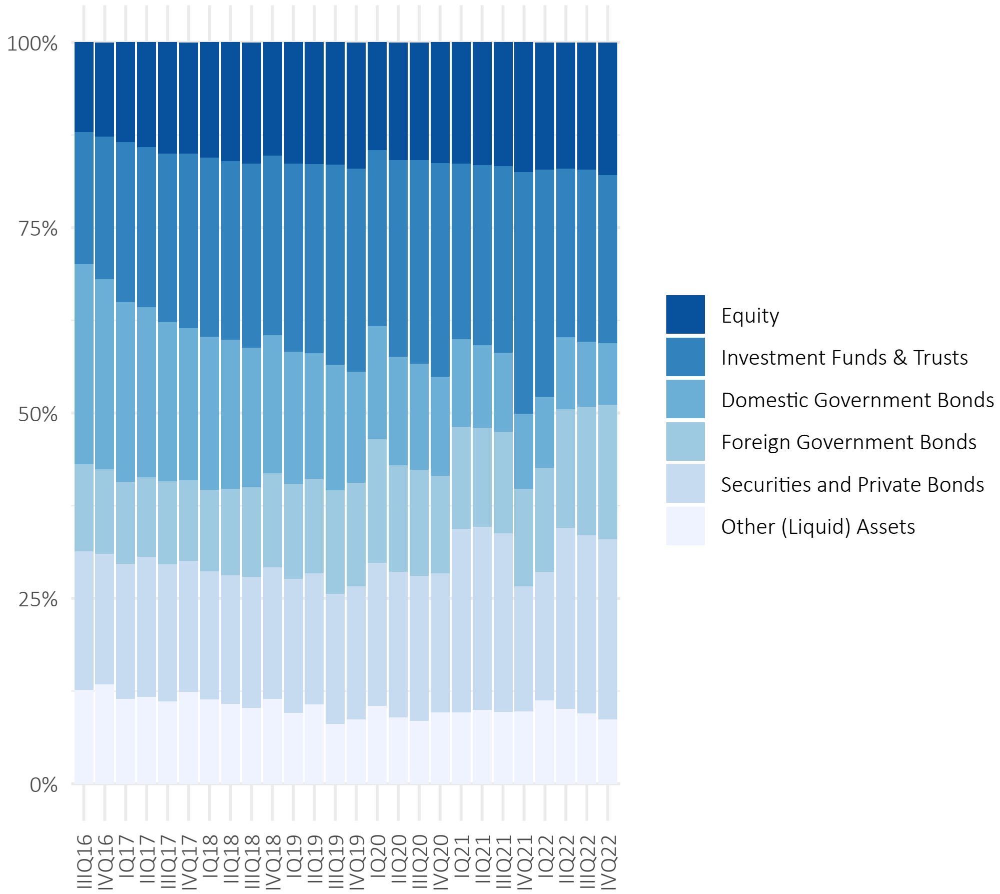
## Life insurance

Measured by own AuM, the Insurance Industry is a major retirement income products provider in Spain, both for Pillar II and, specially, Pillar III. Also, a substantial part of standard Pension Funds' assets is managed by insurers. A salient feature of this trade is the large variety of retirement and quasi-retirement vehicles that are marketed by the industry, in Spain and everywhere.

Some of these vehicles are indistinguishable from genuine retirement or pension plans (if we forget about the insurance part of any retirement solution) and quite a few are genuine life insurance solutions marketed since very old times by the industry and turned into retirement vehicles through a progressive assimilation with the standard vehicle (Pension Plans) firstly regulated in Spain in 1987/1988 (*vid supra*). This assimilation has been fuelled by converging fiscal treatments for all these products even if some of them continue to have distinctive features of their own.

Very often, market practitioners make the distinction between "financial" and "insurance" solutions when describing the nature of a given retirement solution. It must be said that if a given retirement product is a true, integral "retirement solution", it must contain insurance DNA in its composition. What is also true, instead, is that this insurance part must not necessarily be the heaviest part of any retirement product. Any retirement solution can contain an insurance part all through the accumulation and decumulation cycles of the most comprehensive product one might imagine o just the time span past the life expectancy point of the cohort the buyer belongs

Figure ES.5 – Pension funds' asset allocation 2017–2022




*Data:* DGFSP

to. In between that span, a retirement product may or may not embody insurance features but just financial ones. Insurance-only retirement products tend to be safer and thus costlier for the buyer than financial only products (no insurance features on them, thus). This balance implies per se a rather large array of products, but not necesarilly a "very large one". As retirement products are not easy to understand by the common buyer, a very large array of products in the market does not makes things easier for the retirement industry.

According to UNESPA, the Spanish Insurers Association, the total life and saving technical reserves/assets under management of the entire Spanish insurance sector at the end of 2022 amounted to € 187 bln. (reserves), having spotted a 1.69% decrease over 2021, and € 55.9 billions of third parties' assets under management (-9.56 % with respect to 2021). As for the number of insured persons, 2022 ended with 14.3 million, and a -1.66% yoy change. The number of participants in conventional Pension Plans whose assets were managed by insurers amounted in 2022 to 4.3 million (see Table ES.12).

Table ES.12 – Insured Retirement and other Retirement-like schemes 2022

| Broad category | Type of scheme | Persons insured (thousands) | | | Technical provisions (€ mln.) | | |
|---|---|---|---|---|---|---|---|
| | | Pillar II | Pillar III | Both pillars | Pillar II | Pillar III | Both pillars |
| Deferred capital | Insured Pension Plans (PPA) | – | 858.3 | 858.3 | – | 11 034.0 | 11 034.0 |
| | Company Retirement Plans (PPSE) | 39.0 | – | 39.0 | 377.2 | – | 377.2 |
| Pension Accruals and Insured Saving Vehicles | Risk | 2 305.3 | – | 2 305.3 | 531.1 | – | 531.1 |
| | PIAS[a] | – | 1 071.3 | 1 071.3 | – | 13 644.7 | 13 644.70 |
| | SIALP[b] | – | 404.0 | 404.0 | – | 4 022.3 | 4 022.3 |
| | Deferred capital | 198.2 | 2 080.7 | 2 278.9 | 2 945.0 | 41 122.5 | 44 067.5 |
| | Annuities[c] | – | 1 663.5 | 1 663.5 | – | 63 647.3 | 63 647.3 |
| | Income (acc. phase) | 178.2 | – | 178.2 | 13 246.5 | – | 13 246.5 |
| | Income (pay-out phase) | 290.0 | – | 290.0 | 9 079.0 | – | 9 079.0 |
| | Unit/Index-Linked | 41.1 | 1 363.4 | 1 404.5 | 1 652.1 | 17 022.2 | 18 674.3 |
| Other Retirement-like Group Insurance | Risk | 3 459.4 | – | 3 459.4 | 1 077.3 | – | 1 077.3 |
| | Defered capital | 294.1 | – | 294.1 | 2 770.5 | – | 2 770.5 |
| | Pensions (acc. phase) | 18.4 | – | 18.4 | 1 084.9 | – | 1 084.9 |
| | Pensions (pay-out phase) | 48.6 | – | 48.6 | 2 834.7 | – | 2 834.7 |
| | Unit/Index-Linked | 35.9 | – | 35.9 | 1 123.0 | – | 1 123.0 |
| **Total** | | **6 908.1** | **7 441.1** | **14 349.3** | **36 721.3** | **17 022.2** | **18 674.3** |
| *YoY change (in %)* | | *1.67%* | *-4.55%* | *-1.66%* | *-3.29%* | *-1.30%* | *-1.69%* |

| Pro memoria | Persons insured (thousands) | AuM |
|---|---|---|
| Pension plans managed by insurers | 4 327.3 | 55 932.31 |
| *YoY change (in %)* | *-0.49%* | *-9.56%* |

*Data:* UNESPA;
[a] *Plan Individual de Ahorro Sistemático* or Regular Individual Saving Plan;
[b] *Seguro Individual de Ahorro a Largo Plazo* or Individual Long Term Saving Insurance;
[c] Life and Term Annuities, including tax-qualified asset's conversions into annuities in the year.

### Insured Retirement Plans (PPA)

The *Planes de Previsión Asegurados* (PPA)—"Insured Retirement Plans"—are the insured counterpart of standard Pension Plans previously discussed. Among all insured retirement (or retirement-like) vehicles, PPAs are the most proper for this purpose. Their features concerning taxes, redeemability or other are thoroughly the same as with Pension Plans, but for the fact that interest and principal risks are taken by the insurer, at a cost naturally. In particular, a known and certain interest rate is attached to this product. Once retirement happens, the insured person gets a life annuity (a lump-sum is also a popular option). In a way, technically at least, a PPA is basically a pure deferred annuity. Table ES8 shows that, by December 2022, 858.3 thousand individuals had adopted this Pillar III retirement vehicle, with total technical reserves amounting to € 11 bn, a mere € 12 856 per contract.

### Company Retirement Plans (PPSE)

These are employer-sponsored Group Insurance aiming a complementary retirement benefits, basically a deferred capital product. They are the insured counterpart to the employer-sponsored Pension Plans (Pillar II), albeit more flexible as they adapt better to SMEs conditions. Table ES8 shows that, as of December 2022, only 39 thousand workers have been opted-in in this Pillar II retirement vehicle by their employers, with technical reserves amounting to € 377 million, again a mere € 9 676 per account. In 2022, the number of participants increased by a healthy 6,33%.

### Regular Individual Savings Plan (PIAS)

*Plan Individual de Ahorro Sistemático* (PIAS)—"Regular Individual Saving Plans" are, again, insured saving plans to which individuals can contribute regularly. If certain conditions are met and savings are not removed after a long period of time, accumulated assets must be converted into a permanent income at very low (and decreasing with age) fiscal cost (on interest or capital gains). Table ES8 shows that, as of December 2022, more than 1 million individuals have adopted this Pillar III retirement vehicle, with technical reserves amounting to € 13.4 billion, or € 12 737 per account.

Long-Term Individual Saving Plans (SIALP) Seguro Individual de Ahorro a Largo Plazo (SIALP)—"Long-term Individual Saving Plans" are PIAS-like retirement vehicles. The major difference with a PIAS being that they can be cashed both as an annuity or as a lump-sum. As of December 2022, 404 thousand individuals had contracted this product totaling € 4 bn technical reserves, barely € 9 957 per account.

## Charges

Since inception (1987/1988), the current Pension Plans market in Spain has been characterized by large average charges. This said, there are three aspects that need to be dealt with at the outset: (i) the Spanish retirement solutions market has always been and continues to be ridiculously small and this entails a heavy toll on scale and thus on efficiency, (ii) Pillar II schemes bear internationally competitive low fees that, given market size, must be cross subsidized with significantly higher fees charged in Pillar III markets, and (iii) fees have been decreasing in the last years due to intense regulatory pressure on companies.

Data discussed below is eloquent enough about the consequences for savers that stem out of these market conditions. Average fees have been oscillating down in the last decade at around 1% of AuM . Using this figure as a proxy for TER (or total cost ratio for investors), and under basic assumptions, typical investors could bear a life-long RiY rate, because of charges, amounting to 13% of their final of labour life savings.

As for the insurance part of the retirement market, little is known referring to data directly usable for harmonized comparison, although all relevant data are available in raw from the regulators and the industry itself. The large variety of retirement and pension products available in this market segment, and their varied features complicates enormously the task, however. The work to be done in order to produce directly comparable data cannot be made in the context of this chapter and any initiative to reach that goal should be most welcomed.

Even if regulation itself accounts for part of the extra burden that management and depositary fees pose on consumers, the fact is that too large a chain of intermediaries (managers, commissioners, and retailers) end up by adding to the overall cost for the participant or the insured person. Recently, and regularly, management and depositary fees have been limited by law. These regulations however allow variable fees to be set based on yields, within certain limits.

Figure ES.6 and Table ES.13 show the evolution of effective average fees charged on Pillars II and III Pension Funds to Plan participants by both managers and depositories. Note that to management fees, as said before, some retailing fees (not known) may also be added.

The most salient feature of the data in the graph is clearly and immediately appreciated at first sight: Pillar II assets (employer-sponsored pension plans) are considerably cheaper to manage (up to almost 6 times cheaper in recent years) whereas depositary fees, that are comparatively lower in both pillars, continue to be 4 times cheaper in Pillar II as compared to Pillar III. The question remains whether just market scale grants such a large difference and, ultimately, large fees (Table ES.13).

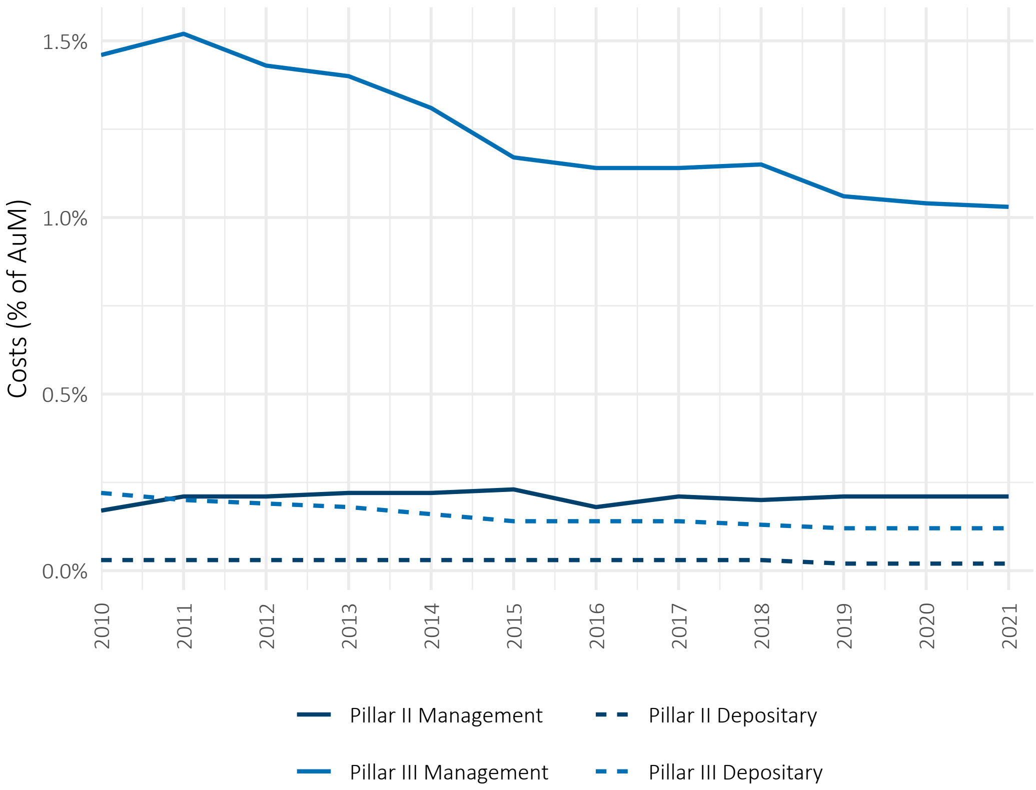
Table ES.13 – Charges in Pension Funds 2018–2022

| | Pillar II | | | Pillar III | | |
|---|---|---|---|---|---|---|
| | Management | Depository | Total | Management | Depository | Total |
| 2010 | 0.17% | 0.03% | 0.20% | 1.46% | 0.22% | 1.68% |
| 2011 | 0.21% | 0.03% | 0.24% | 1.52% | 0.20% | 1.72% |
| 2012 | 0.21% | 0.03% | 0.24% | 1.43% | 0.19% | 1.62% |
| 2013 | 0.22% | 0.03% | 0.25% | 1.40% | 0.18% | 1.58% |
| 2014 | 0.22% | 0.03% | 0.25% | 1.31% | 0.16% | 1.47% |
| 2015 | 0.23% | 0.03% | 0.26% | 1.17% | 0.14% | 1.31% |
| 2016 | 0.18% | 0.03% | 0.21% | 1.14% | 0.14% | 1.28% |
| 2017 | 0.21% | 0.03% | 0.24% | 1.14% | 0.14% | 1.28% |
| 2018 | 0.20% | 0.03% | 0.23% | 1.15% | 0.13% | 1.28% |
| 2019 | 0.21% | 0.02% | 0.23% | 1.06% | 0.12% | 1.18% |
| 2020 | 0.21% | 0.02% | 0.23% | 1.04% | 0.12% | 1.16% |
| 2021 | 0.21% | 0.02% | 0.23% | 1.03% | 0.12% | 1.15% |

*Data:* DGFSP; no data available for 2022.

Within this context, industry transparency requirements at the international scale are starting to provide a framework within which generate a comprehensive understanding and common

Figure ES.6 – Effective charges in Pension Funds (% of AuM), 2010–2021




*Data:* DGSFP.

ground for comparison about the cost and the advantages of complementary retirement vehicles as these solutions became increasingly necessary to help cushion the hard landing of Social Security benefits everywhere.

All Pillar III vehicle providers are obliged to advance a KID to their customers. These KIDs are firmly rooted on PRIIPs regulation that is not binding however for pension products. Pillar II products are not obliged to advance a KID to their customers, albeit they must of course provide information akin to this package regularly.

## Taxation

With charges and returns (*vid infra*) taxation is one of the hottest issues around retirement products. But it shouldn't be. Think twice.

Income must be taxed, this everyone admits, but not double taxed. This is unjust and inefficient. One could also admit easily that labor and capital income can be differently taxed, or that tax bases can convey certain policy objectives. But definitely not that the same income concept is taxed twice.

In the absence of ordinary tax deductibility (or tax deferral) of income saved for retirement purposes, as practiced by virtually all countries, that part of income saved for years for future retirement, and the interest earned on that income, would be taxed twice when benefits are received and, correspondingly taxed.

This treatment is often referred to as "tax incentives" or, more plainly, "tax gifts", and questioned by certain social or political agents as unjust or regressive tax benefits. Nothing less true. The conventional tax treatment to which pension assets and products are subject is generally and admittedly the best way to avoid what otherwise would be a case of unacceptable double taxation of personal income. Tax deferral is, moreover, a way to increase the power of capitalization even if this requires further regulations that few countries have. Not Spain, indeed.

The pensions industry must be clear and strong on this if their members want to be perceived as truly looking after the best interest of those who entrust their savings to them. As much as they must be clear and strong, by the way, on transparency, open competition and best efforts concerning charges and returns.

Normally, taxing retirement vehicles means exempting income as it is saved (as well as interest earned on this income) and taxing benefits as they are cashed in. That's the "Exempt-Exempt-Tax" or EET paradigm most commonly used in the world. Another way to avoid double taxation of income set apart for retirement purposes is to tax contributions and interest and make benefits tax exempt (TTE), but this paradigm is rarely used. In truth, neither pure extreme is actually being used as all countries have some limits to deductibility and also some limits to benefits exemption.

Normally too, tax allowances at accumulation of savings are justified because these retirement savings can't be cashed or converted into non-retirement savings before retirement age. This a legitimate way to justify EET schemes. But again, tax authorities only have to claim unpaid taxes back when savings conversion occurs instead of forcing savers to stay fixed on their products.

Taxing retirement savings and benefits remains in the literature and in practice a much debated issue, just because we don't realize that the best and most fair taxing schedule for these bases should be exactly the same tax regime that Social Security social contributions and SS benefits enjoy, that is full (or almost full) and unlimited (or almost unlimited) EET. Even if standard Pension Plans set the tax norm for many other retirement vehicles, there remain important differences, especially at the pay-out phase, among the pension plans and insurance vehicles. Some of these peculiarities are analysed below.

## Pension plans

Tax exemptions during accumulation are important for participants. This is well reflected in the Spanish market as most of the payments into these vehicles happen at the end of the year when investors seek to improve their final tax bills by deciding up to what limit they want to bring their contributions to retirement saving plans. This has contributed to locate the only and most important attractive of saving for retirement into the tax treatment of this kind of investments. The absolute limit up to which income saved for retirement under a Pension Plan is tax exempt in Spain is currently € 10,000 for occupational Plans up by € 2 000 with respect to 2019) and € 1 500 for personal Plans (down by € 6 500 in 2019). When the absolute limit of € 10,000 for Pillar II schemes is reached, participants can't put a single cent on their personal schemes.

The Budgetary Law for 2022 (December 2021) deepened the move initiated by the Budgetary

Law for 2021 (December 2020) that eliminated equal tax treatment for Pillars II and III schemes, with personal retirement savings resulting clearly discriminated. The reason behind seems to be the need to reinforce occupational Plans, something that should not be done at the expense of personal Plans, however. And something that has not brought more participants to the former.

The new Simplified Occupational Pension Plans introduced in 2022, however can enlist for the first time independent workers and these enjoy a deduction limit of up to € 5 275. When withdrawal of benefits at retirement occurs, there are three possible cases:

1. Benefits are retrieved as a lump-sum: after a deduction of 40% from this sum the rest is taxed at the current marginal personal income tax rate as this income is considered labour income, even if the participant has never worked. No distinction is made between principal and interest earned during accumulation phase, despite the fact that Spain has a dual personal income tax.

2. Benefits are retrieved as a life (or term) annuity: this income is also considered labour income and taxed at the current marginal personal income tax rate, again with no distinction whatsoever between principal and interest part of benefits.

3. Benefits are retrieved both as a lump-sum and an annuity ("mixed income"): both tax regimes apply, each of them to the corresponding part of the retirement benefit in the first year.

This said, depending on which Spanish region a retiree has his or her fiscal residence, the tax bill may change. Spain has its Personal Income Tax scheme split between the Central Government and its seventeen Autonomous Regions. (plus autonomous cities of Ceuta and Melilla). While the Central Government sub scheme applies uniformly for the whole nation (but for the two "Foral" (historical) regions of Navarre and the Bask Country), the regional sub schemes have different income brackets and marginal tax schedules, as it is shown in Tables ES10 and ES11 below. As it can be seen, in non historical regions, the extant (for the 2022 tax year) top marginal rate varies between 18.22% (past a € 35 394 upper limit) in Región de Murcia and 29.50% (past a € 175 000 upper limit) in Comunitat Valenciana. A rather large difference both in terms of tax rate and taxable earnings.

## Life insurance products

Since 1999 premiums paid into insured saving are taxed. Retirement lump sums or income from these vehicles are not taxed except in its interest and capital gains' part (thus a TEET regime ). These capital gains are integrated into the savings tax base and subject to a tax rate schedule of 19% up to the first € 6 000, 21% from € 6 000 to € 50 000 and 23% beyond € 50 000. When benefits are paid as annuities, the tax rate depends on the life of the annuity and the age of the annuitant when payments began. In case of annuitant's death, with remaining capital reverting to them, heirs will have to pay inheritance tax, which may vary considerably depending on the region where they have their fiscal residence, as this tax lies within the regional jurisdiction.

## Insured Retirement Plans (PPA)

This vehicle has a similar tax treatment as standard Pension Plans, Contributions to these plans are tax exempted up to an annual limit of € 10 000 and benefits are taxed as labour income con-

Table ES.14 – Personal income tax scale and rates – Central government*

| Tax base from... | ...to | Nominal marginal rates† |
|---|---|---|
| €0 | €12 450 | 9.50% |
| €12 450 | €20 200 | 12.00% |
| €20 200 | €35 200 | 15.00% |
| €35 200 | €60 000 | 18.50% |
| €60 000 | €300 000 | 22.50% |
| €300 000 | n.a. | 24.50% |

*Data:* Agencia Tributaria.
* Spain has several government levels and PIT is roughly split in half between Central and Regional Governments
† Only Central Government and only labor income, interests and dividends are thoroughly taxed at 19

Table ES.15 – Personal income tax – Autonomous regions, 2022

| Region* | Top income bracket (ordered) | Top marginal tax rate beyond top income bracket |
|---|---|---|
| Región de Murcia | €35 394 | 18.22% |
| Castila y León | €53 407 | 21.50% |
| Madrid | €55 597 | 20.50% |
| Catilla-La Mancha, Galicia, Ceuta y Melilla | €60 000 | 22.50% |
| Andalucía | €60 000 | 22.50% |
| Cantabria | €90 000 | 25.50% |
| Canarias | €120 000 | 26.00% |
| La Rioja | €120 000 | 27.00% |
| Extremadura | €120 200 | 25.00% |
| Aragón | €130 000 | 25.50% |
| Illes Balears | €175 000 | 25.00% |
| Principado de Asturias, Cataluña | €175 000 | 25.50% |
| Comunitat Valenciana | €175 000 | 29.50% |

*Data:* Agencia Tributaria.
* Two historical Autonomous Regions (Navarra and The Basque Country) are exempted from the Common Tax Regime; Two Autonomous Towns are included (Ceuta and Melilla).

sidering the recipients age at retirement. Capital gains are subject to a dual income tax scheme. The tax regime of this vehicle thus can be said to be of the EET kind.

## Regular Individual Savings Plan (PIAS)

PIAS are a more flexible vehicle than Pension Plans and PPAs, also from the point of view of taxation. They are not straight retirement vehicles, however. As a retirement saving vehicle, annual contributions to it are fully tax deductible up to a limit of € 8 000 per year. There is also a global capital limit for this type of saving plan: € 240 000. Savers can only own one PIAS. At the pay-out phase, if income is received as a lump-sum, taxation intervenes as usual through the dual income tax for labour income (principal) and capital gains income (returns).

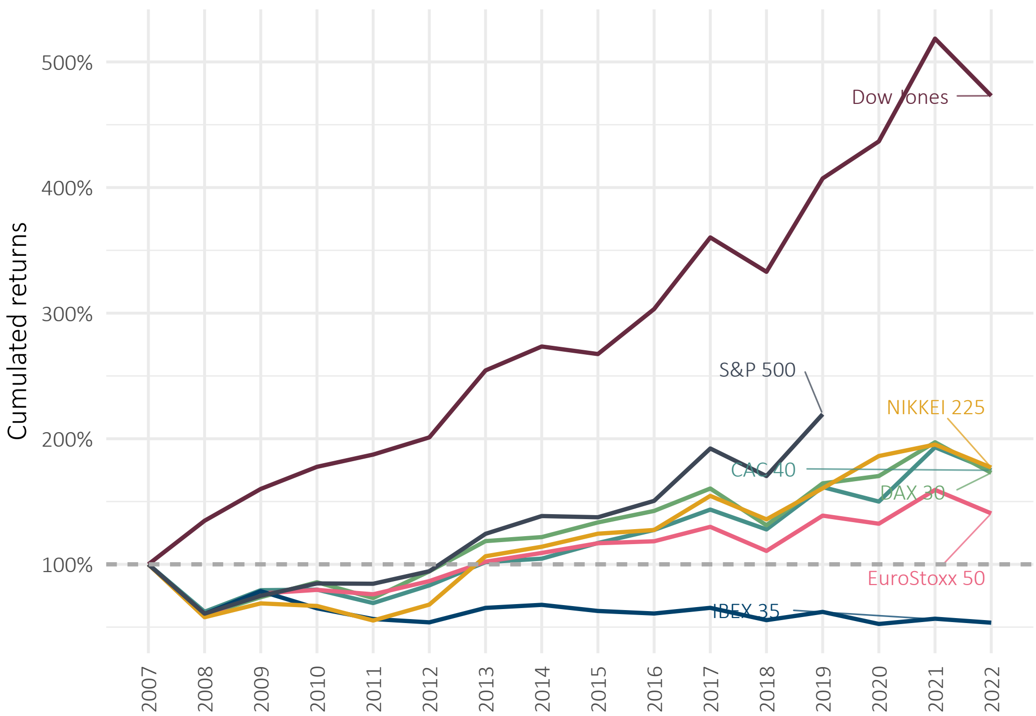
But if retirement income is retrieved as a life annuity, capital gains are 100% exempt and principal is taxed at rapidly diminishing (with time while saving prior to retirement) rates schedule. PIAS can be cashed in well before ordinary retirement age, but when cashed after age 65 the tax rate is 20% falling to 8% when cashed after age 70.

The € 240 000 limit for total saving under a PIAS is relevant here for, as from 2015, individuals aged 65 or more who liquidate any asset they may own (financial, real estate, art works, etc.) to buy a life annuity have related capital gains fully exempted from the dual income tax.

# Performance of Spanish long-term and pension savings

Spanish capital and debt markets returns In 2008 major world stock indexes suffered a 40% loss with respect to the previous year. That was a catastrophe. All asset classes linked to stock suffered accordingly. Hundreds of thousands of workers in advanced countries had to postpone their retirement because these losses would mark the value of their retirement incomes for the rest of their lives nearing many of them to poverty at old age. Most of these stock markets recovered the 2007 line by 2012–2013, But the Spanish stock market has not even past the 2008 bottom-line. This can be seen in Figure ES.7.

Figure ES.7 – Major stock markets performance 2007–2022




*Data:* UNESPA and Infobolsa

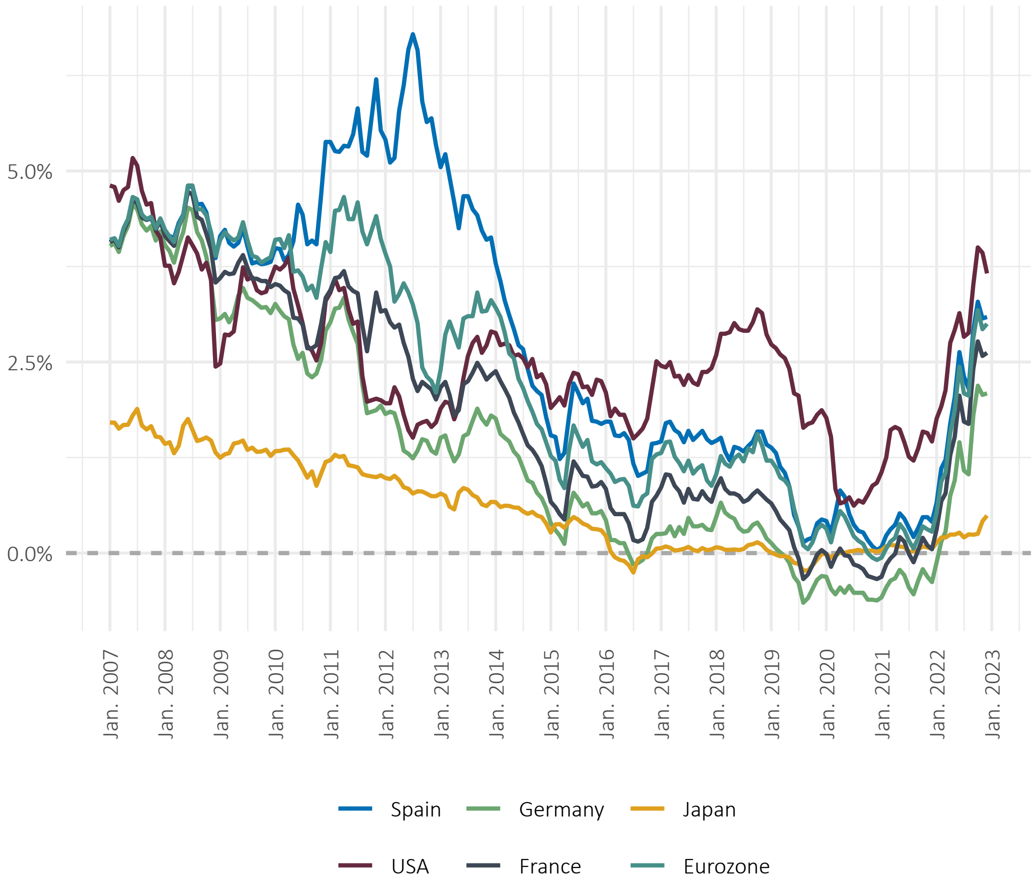
Happily enough, some would say, Spanish workers have their retirement savings well away from the stock market. In fact, Spanish workers have no (relevant) retirement assets at all as we have been arguing so far. Spanish workers have no relevant retirement savings because they have a rather large (expected) Social Security implicit wealth as pension benefits replace labour income above 80% (OECD) and, additionally, they have almost universal and large stocks of bricks & mortar.

If 2020 wasn't a good year for stocks returns for obvious reasons, 2021 was exceedingly better so that most exchanges surpassed 2019 levels taking most markets to all time highs since the beginning of the financial crisis. 2022, however, witnessed a very bad year for returns with major exchanges dropping around 10%. The Spanish IBEX however dropped by a more limited 5.56%.

In the period 2007-2022 the DOW JONES index, for instance, grew by a 373% (a cumulative annual rate of 10,92%), or a 72.85% in the case of the German DAX 30 (a 3.72% per year). The Spanish IBEX 35, in 2022, displayed a dismal 57% of its 2007 value, that means a cumulative -4.08% per year.

Sovereign debt markets in advanced countries, on the other hand, have not been less turbulent. Spanish 10y bond yields reached intervention levels in August 2012, at 679 bp. Only an EU financial sector rescue package saved the Spanish sovereign market, and perhaps the Euro, at a cost naturally (see Figure ES.8).

Figure ES.8 – Major Sovereign Bond Yields (yoy, monthly, 10 years) 2007-2022




*Data:* Banco de España

Since May 2015, the ECB succeeded calming lenders and sovereigns entered into a considerably quieter environment. By mid 2019 European and Japanese 10y bonds yields reached around 0 or negative levels. Spanish 10y bonds yields were quoted at 3.09% in December 2022 (0.04% in December 2020 and 0.41% in December 2021) versus a 2.09% quote for Germany's 10y bond, an exact 100 bp risk premium for Spain.

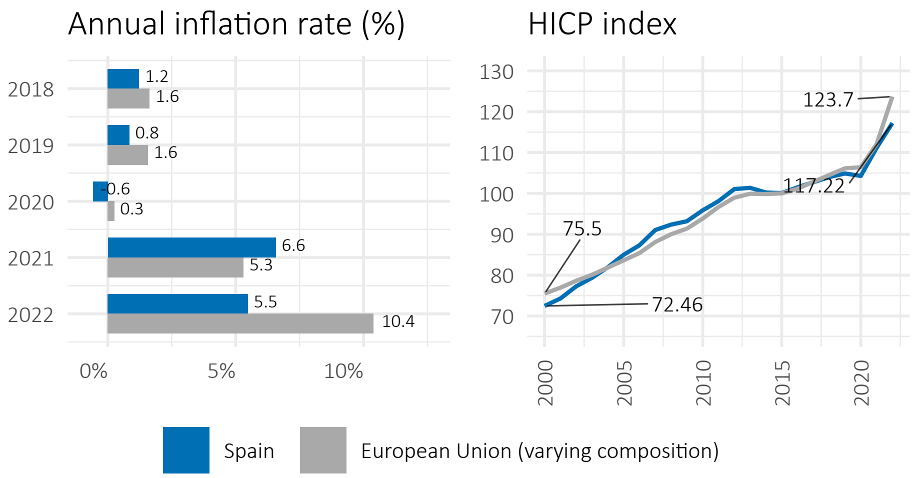
Figure ES.8 clearly shows both the assets price depreciation and corresponding increasing in interest rates that Central Banks intervention has brought since inflation started to hit Western economies at the beginning of 2022. As it is well known, interest rates have not ceased to increase during 2023.

Contrary to the conditions that prevailed in 2021, both for stocks and bonds, in 2022 general deterioration of stocks markets and heavy depreciation of bonds' values, assets in which retirement savings are regularly invested, marked one of the worst years for the pension assets management industry since the Great Recession with nominal returns oscillating around -10% in almost all portfolios. Add to this an overall inflation rate not seen in decades (see Figure ES.9).

Figure ES.9 – Inflation in Spain

Period 2000–2022

| | Annualised | Compounded |
|---|---|---|
| *Spain* | 2.3% | 68.3% |
| *European Union (varying composition)* | 2.3% | 67.5% |




*Data:* Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

## Real net returns of Spanish long-term and pension savings

One of the salient features of the Spanish retirement vehicles market is the large variety of solutions marketed and the small size of the overall market, let apart the small significance of some of its segments. This may seem hard saying, but a way must be found to substantially enlarge the number of workers covered and the size of per account assets and reserves. There is some hope that the newly adopted regulation on "Simplified Employment Pension Plans" helps to this purpose.

As it is shown in the figures displayed in this section, savings, that until 2021, managed to maintain their purchasing power with few exceptions performing better, ended 2022 with their real returns clearly below par with inflation. Undoubtedly, even if a crude one, the key factor pushing or keeping Spaniards into the complementary retirement savings system is tax deferral (and the locking-in effect it creates), and not as much the real, after management fees, returns of these retirement assets.

All the evidence produced in this section belongs to the standard Pension Plans system, not to insured retirement vehicles, due to data limitations. All data comes basically form the website of INVERCO, the Spanish body representing Mutual Investment Institutions and Pension Funds.

Notice, nevertheless, that retirement products insurance comes at an additional cost (with respect to purely financial vehicles) due to the intrinsic nature of both guaranteeing assets' value, on the one hand, and covering longevity risk, on the other hand. Even if insurers are good performers, also as assets managers, and enjoy the very long-term premiums of the underlying matching assets they invest in, they also need to beat the insurance extra cost that these products entail.

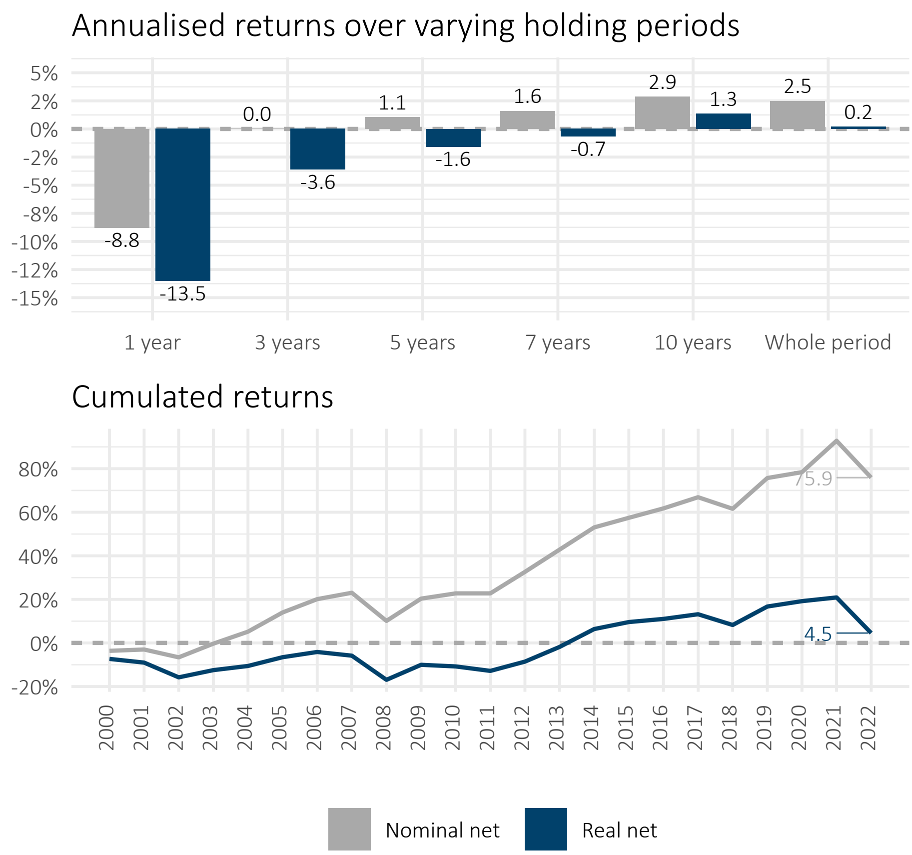
Figures ES.10 to ES.13 display the returns of Pillars II and III Pension Funds. Returns are labelled "gross", "net" and "real". "Gross" means before management and depositary fees and commissions (retailing and other transaction costs are disguised here), "net" means after management and depositary fees and commissions. Both gross and net returns are nominal. "Real" means after inflation. At first glance, positive net nominal returns dominate the landscape since 2009, and even net real returns, with some years at really good returns on assets invested. On historical basis, average cumulative real returns continue to be clearly positive (INVERCO).

2018 was a bad year for investments returns of all sorts, particularly the stock market. But returns in 2019 overshot. This saga continued in 2020-2021 as the markets suffered everywhere due to the Covid-19 collapse of activity and the corresponding rebound in 2021. But 2022 has been a very bad year for nominal returns on every asset with heavy losses against inflation. A more vivid landscape emerges when overall returns are followed through time with the help of cumulative returns computations as presented in the lower pane of each figure.

In the period 2000–2022, cumulative nominal net returns for conventional occupational pension funds reached 75.9%—a drop by more than 10 pp from end-2021—and annualised returns over the period amounted to 2.5%. After correcting for inflation, the cumulative *real* return is reduced to 4.5% (0.2% annualised). Over the past 10 years, the nominal *gross* annualised return was 3.1% per year; the 2.9% annualised nominal *net* return and 1.3% *real* return therefore imply that each year, on average, 0.2pp of returns were given to managers, while 1.6pp of returns each year were destroyed by inflation.

The situation is worse for the Pillar III funds. Funds that mostly invest in bonds have only managed to offer a cumulative nominal return of 12.9% over the past 23 years, amounting to 0.5% annual average return (see Figure ES.11). Those investing mostly between 30% and 75% in equity fared slightly better, with a 24.6% cumulative nominal net return (1% annualised, Figure ES.12). Those investing over 75% of their assets in managed a 46.3% cumulative nominal net return (1.7% annualised, Figure ES.13), owing to the particularly strong performance of equity markets in 2019

Figure ES.10 – Returns of Spanish conventional occupational pension funds (before tax, % of AuM)



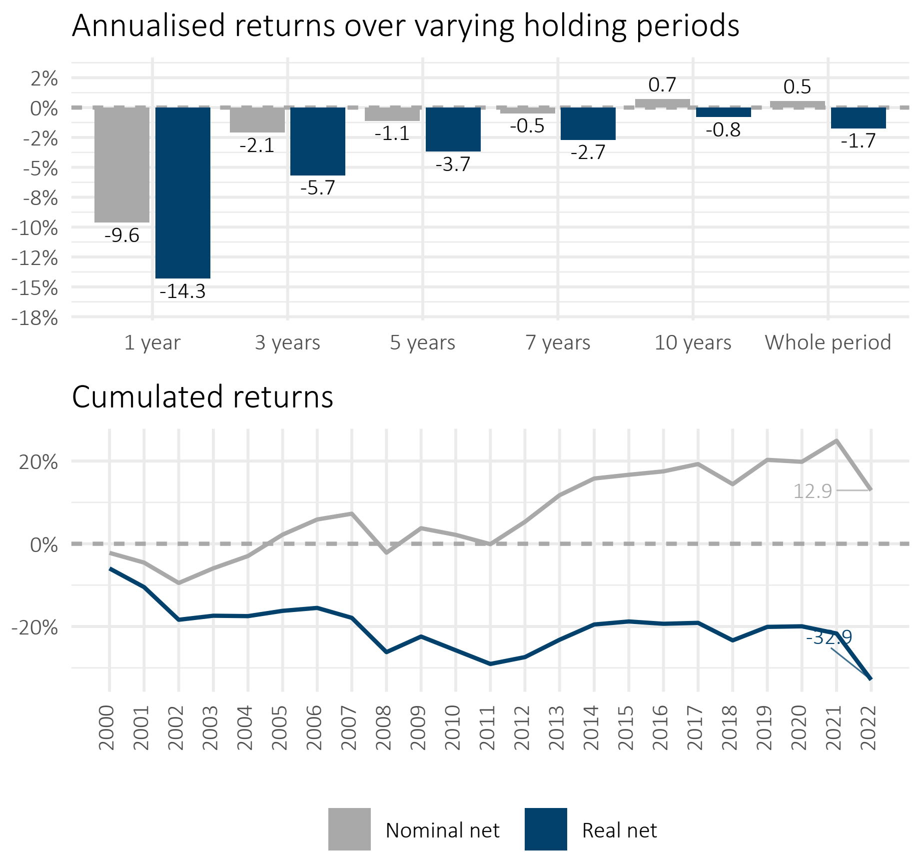

*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

and 2021. Nevertheless, after correcting for inflation, all three categories of funds present a negative real performance, ranging from -13% for equity funds to an abysmal -32.9% for bond funds.

Over the period 2013-2022, bond, mixed and equity Pillar III pension funds lost respectively 1.3, 1.3 and 1.2pp of their average annual nominal gross returns to costs and charges, and 1.5, 1.5 and 1.6 to inflation. This comparison confirms the already mentioned observation that costs of Pillar III funds, being much higher than those of occupational pension funds, constitute a major negative performance factor.

Occupational Pension Funds (Pillar II) are much cheaper to manage, as seen before, and obtain a larger net nominal return as seen in Figure ES.10. But their gross performance is not better than that of individual plans once compared in the longer term. Among Pillar III funds, we observe that, for the same level of costs, the "best" performance is obtained by those funds that are mostly invested in equity, although they were for a long period of time the worst performing of the three categories of funds. Figures ES.14 and ES.15 offer a comparative perspective.

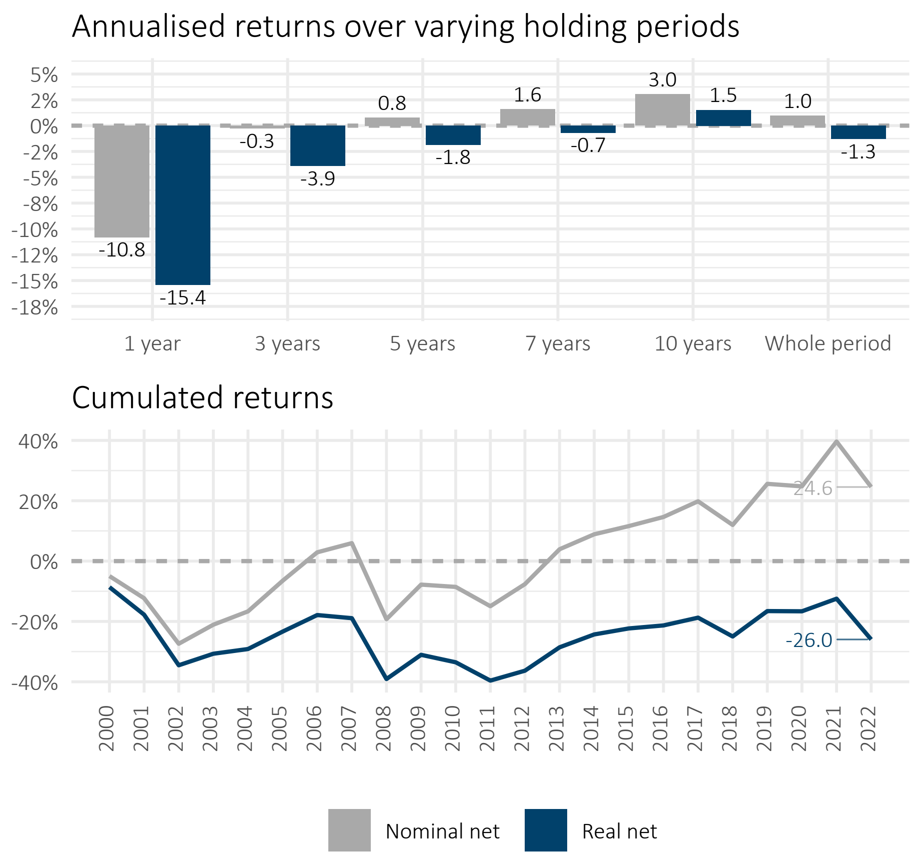
Figure ES.11 – Returns of Spanish mostly bonds Pillar III pension plans (before tax, % of AuM)




*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

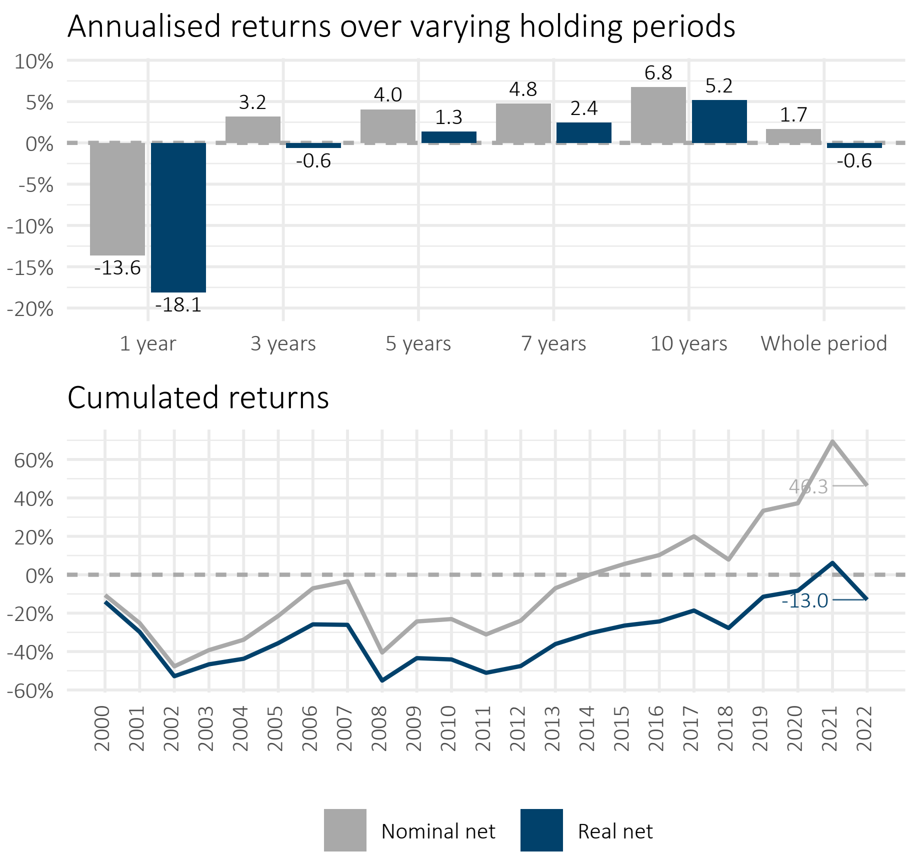
Given the performance of Pillar II (Figure ES.10) and Pillar III (Figures ES.11 to ES.13) pension funds and the overall system performance just discussed, the conclusion emerges Spanish pension funds either barely manage to operate above inflation (for occupational funds), or do not manage to at least preserve the purchasing power of pension savings (individual funds).

Figure ES.12 – Returns of Spanish mostly equity Pillar III pension plans (before tax, % of AuM)



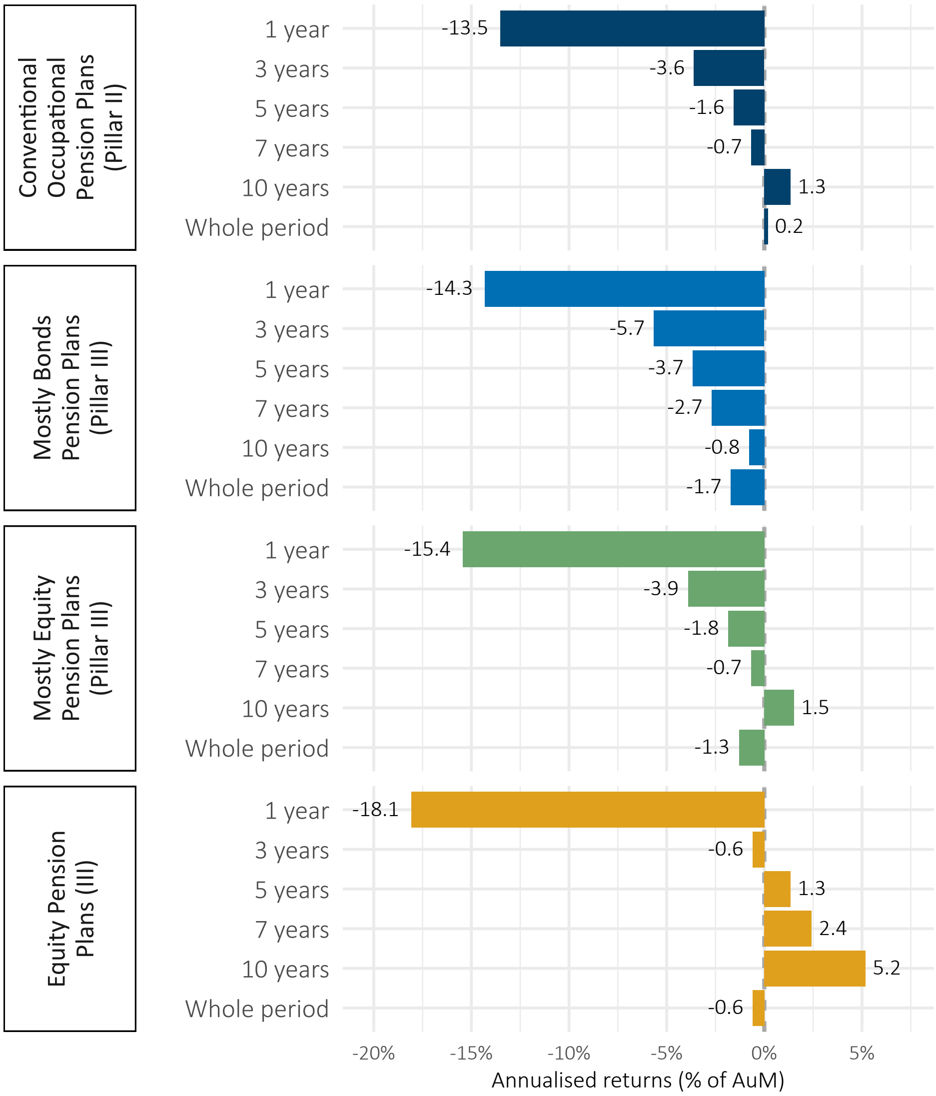

*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

Figure ES.13 – Returns of Spanish equity Pillar III pension plans (before tax, % of AuM)



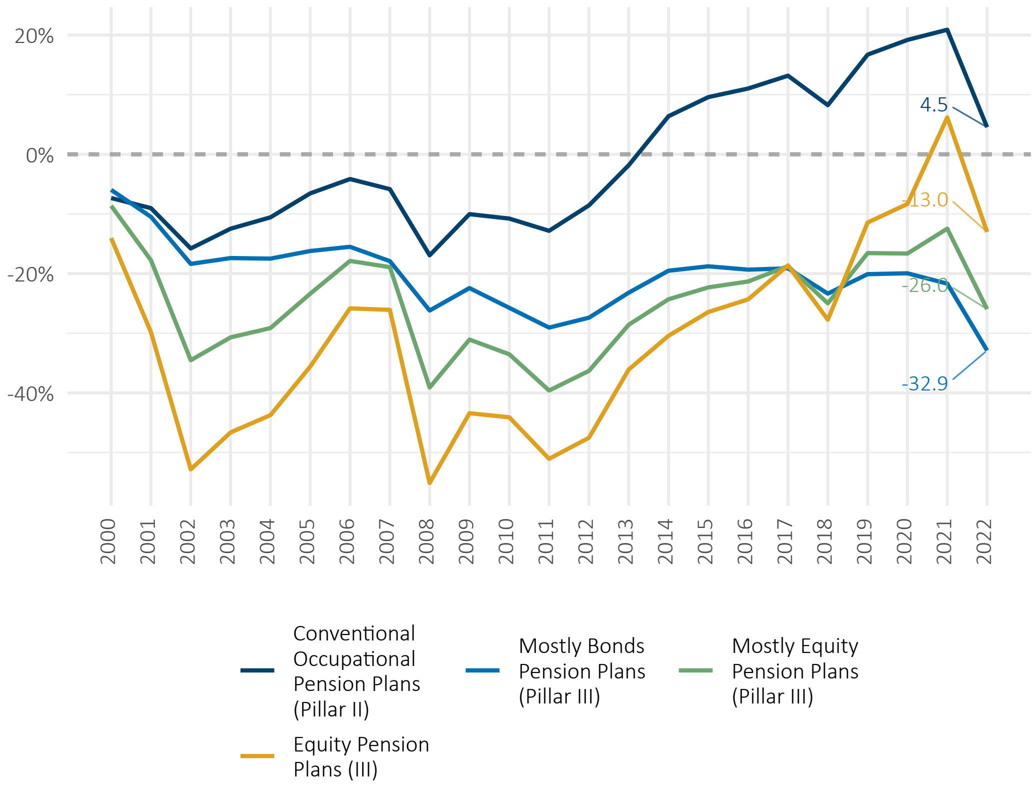

*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

Figure ES.14 – Annualised returns of Spanish long-term and pension vehicles over varying holding periods (before tax, % of AuM)




*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

Figure ES.15 – Cumulated returns of Spanish long-term and pension savings vehicles (2003–2022, before tax, % of AuM)




*Data:* INVERCO, DGSFP, Eurostat; *Calculations:* BETTER FINANCE.

## Do Spanish savings products beat capital markets?

In this section, we compare the performance of the four categories of pension funds analysed in this chapter with the real returns of four hypothetical capital market portfolios over the period 2000–2022. Acknowledging the different asset allocation of the four types of fund, we have set the equity-bond balance of each benchmark portfolio at different levels; however the underlying indices are the two pan-European indices of the "default" benchmark (see introductory chapter). The composition of the benchmark portfolios is summarised in Table ES.16

Table ES.16 – Capital market benchmarks to assess the performance of Spanish pension vehicles

| Product | Equity index | Bonds index | Allocation |
|---|---|---|---|
| Conventional Occupational Pension Plans (Pillar II) | STOXX All Europe Total Market | Barclays Pan-European Aggregate Index | 50.0%–50.0% |
| Mostly Bonds Pension Plans (Pillar III) | STOXX All Europe Total Market | Barclays Pan-European Aggregate Index | 30.0%–70.0% |
| Mostly Equity Pension Plans (Pillar III) | STOXX All Europe Total Market | Barclays Pan-European Aggregate Index | 50.0%–50.0% |
| Equity Pension Plans (III) | STOXX All Europe Total Market | Barclays Pan-European Aggregate Index | 75.0%–25.0% |

*Note:* Benchmark porfolios are rebalanced annually.

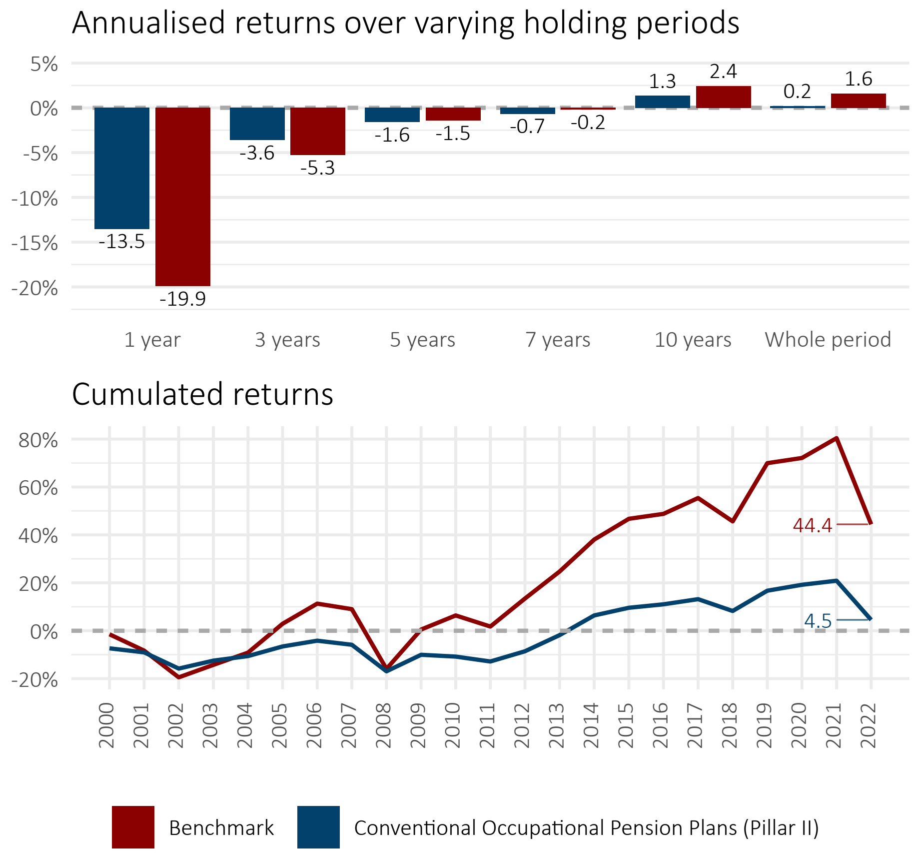
As shown in **??**, over the 23-year period, conventional occupational pension funds fail to beat a 50% equity–50% bond benchmark by an average 1.4pp per year, or 39.9pp cumulated.

## Investment strategies

Returns discussed in the previous section are indeed varied. Their diversity, of course, is rooted in a couple of basic factors: (i) the assets in which retirement funds are invested in and (ii) the strategies managers deploy, given the portfolio, in order to get a high return for their customers. As clues for the reasons behind the varied results just discussed, several standard facts emerge irrespective of managers' capacity to beat the records: (i) long-term and short-term debt have yielded more than mixed debt, (ii) debt is less volatile than stocks and thus less risky, and (iii) managers' fees are far smaller for Pillar II vehicles than for Pillar III ones. The superior returns of guaranteed funds however defy common sense as these are more conservatively invested and should bear some extra cost due to the guaranty over the principal they embody.

So, to what extent managers have been responsible for the rather poor results that pension funds have obtained in Spain since 2000? To answer this question, one should go fund by fund and manager by manager, which is not the purpose of this chapter (Fernandez & Fernández Acín, 2019), but few general comments can be made. Guaranteed funds, that accounted for 4.09% of Pillar III total assets in 2022 (19.47% in 2010) have been much more profitable for participants

Figure ES.16 – Performance of Spanish conventional occupational pension plans against a capital market benchmark (returns before tax, after inflation, % of AuM)




*Data:* COVIP, Eurostat; *Calculations:* BETTER FINANCE.

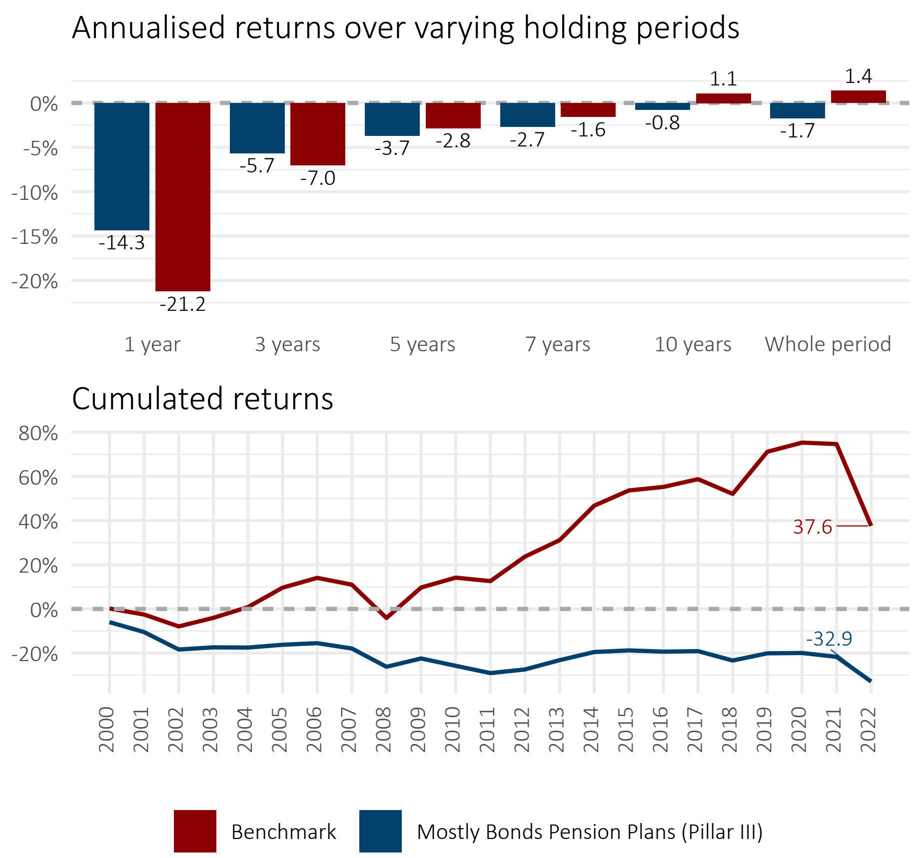
than the rest, while presumably they are more expensive to run due to the insurance coverage they include On the other hand, Pillar III vehicles are considerably more charged by management fees than their Pillar II counterparts.

Managers in Spain may be restricted by the rigid asset structure in the established portfolios within Pillar III while being rather freer in what concerns Pillar II vehicles (albeit they may eventually be the same). But the fact is that gross (before charges) returns in these two broad categories differ only by a small margin in favour of Pillar III funds in the last decade (2013–2022). The large difference in net returns in favour of Pillar II funds being thus, as already mentioned, almost entirely attributable to managing fees, much lower within Pillar II than within Pillar III funds.

All categories or retirement vehicles in Spain invest rather shyly in foreign assets with only few funds specialising in this class. Superior returns in foreign assets however are by no means assured and this investment strategy has extra costs.

Guaranteed funds' managers, finally, which enjoy considerably more freedom than their non-

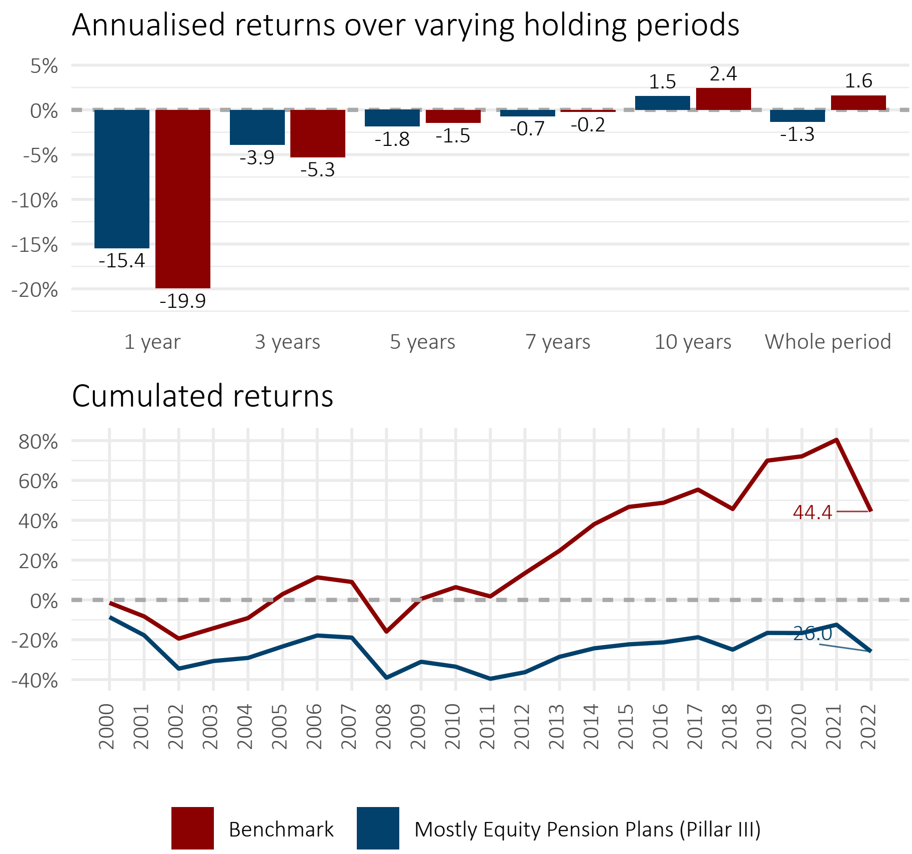
Figure ES.17 – Performance of Spanish mostly bonds Pillar III pension plans against a capital market benchmark (returns before tax, after inflation, % of AuM)




*Data:* INVERCO, Eurostat; *Calculations:* BETTER FINANCE.

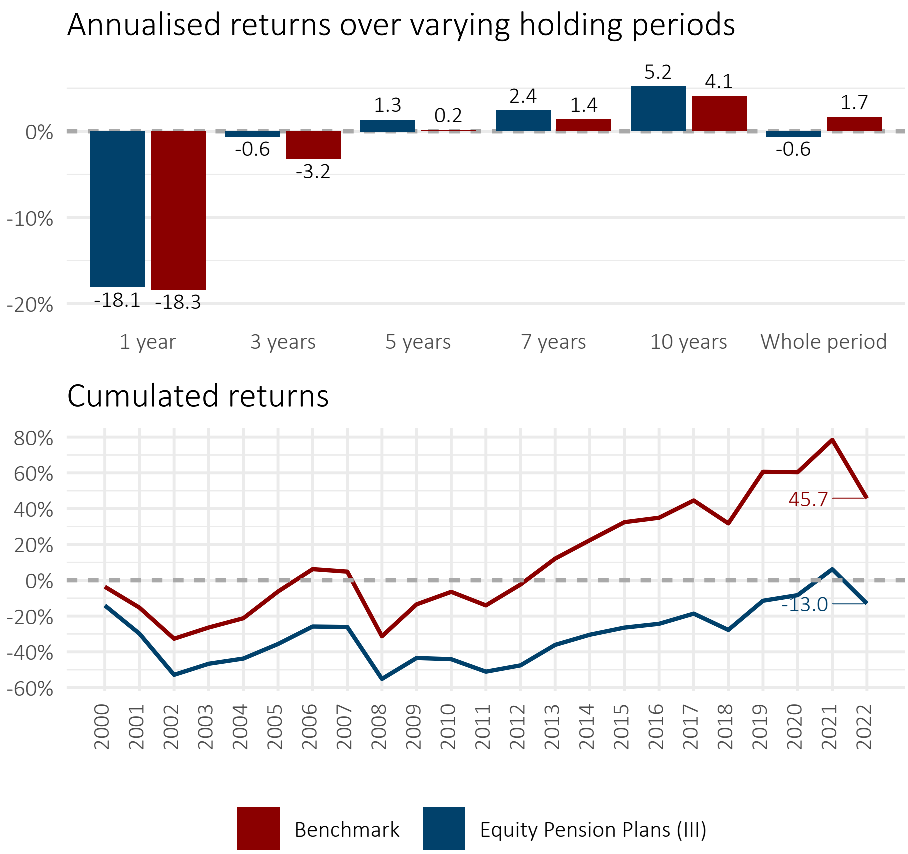
guaranteed counterparts (besides being the same managers eventually), not having to face internal control bodies like their Pillar II counterparts, seem to have profited from this conditions to obtain larger returns for their vehicles' participants.

Figure ES.18 – Performance of Spanish mostly equity Pillar III pension plans against a capital market benchmark (returns before tax, after inflation, % of AuM)




*Data:* INVERCO, Eurostat; *Calculations:* BETTER FINANCE.

Figure ES.19 – Performance of Spanish equity Pillar III pension plans against a capital market benchmark (returns before tax, after inflation, % of AuM)




*Data:* INVERCO, Eurostat; *Calculations:* BETTER FINANCE.

# Conclusions

Spanish retirement assets, through standard Pension Plans are a mere 8.71% of GDP. Insurance retirement (and retirement-like) assets and provisions, a large array of different products not equally qualified as retirement vehicles, could add another 14.11% GDP points to standard Pension Plans. This, by all standards, is a small pensions industry even if some 9.5 million individuals participate in Pension Plans and some 14.3 million individuals are covered by insurance retirement or quasi-retirement vehicles. Assets, technical provisions, or other retirement rights amount, on average, (2022) to € 12,765 per contract or account making the whole system an insufficient complement to Social Security retirement benefits. This unfortunate complementary pensions landscape is rare among advanced countries.

The retirement vehicles market in Spain, however, has a rich structure of agents, products and retirement schemes that, on paper, should be able to cover the entire work force and beyond. Two tightly related factors prevent this from happen: the pervasive presence of Social Security pensions, whose old-age benefits replace lost labour income at retirement by around 80% and has a high cost for both employers and employees, and the reluctancy of employers to sponsor company retirement schemes for their employees because of additional costs reasons, particularly among SMEs.

This chapter of the Better Finance Pension Report 2023, apart general descriptions of the landscape in Spain, has gone with a certain detail through some of the most salient features of our Pillars II and III arrangements on, basically, three crucial dimensions: (i) charges, (ii) taxes and (iii) returns.

On charges, we find that these are rather large on average, but only because the Individual schemes are considerably costlier to manage than occupational ones. The latter keep their charges very low in line with what is observed in other more advanced and developed markets or even lower. Thanks to intense regulatory effort in the last few years, charges in Pillar III schemes have decreased clearly. A continuation of this trend, without a significant increase in market size, continues to look far less affordable for managers than before. Scale is at the core of this.

On taxation, Spain has an EET, tax-deferral regime for retirement assets and incomes, which is the standard in most countries in the world. Spain also has deductability of contributions to retirement vehices (up to certain limits), an even more followed standard in most countries in the world. This is the right way to avoid unacceptable double taxation. No tax expert would have any doubt about the importance of keeping the current deductability of contributions and thus tax deferral. Tax deferral empowers the accumulation of pension rights and may also turn to be a good business for thax authorities in the longer run. Spain however has gone backwards in 2021 and 2022 strongly limiting the deductatility in Pillar III schemes. This has been corrected in part in 2022 with the new legislation regulating the “Simplified Employment Pension Plans” to which independent workers can join in much better tax conditions than if they remain in Pillar III schemes.

Tax deductability cum deferral should not be seen as gifts or favours, but as the best policy that can be performed to encourage long term savings for retirement. Some ceilings to tax deductibility may be too low or even arbitrary. Less understandable is still the push among some political and social agents to fully dismantle tax deductability.

This said, tax deferral in Spain is seen by most agents participating in the retirement market, be they workers, insured persons or even managers and retailers, as the only reason to buy/sell these products. A cultural trait that may explain, jointly with other reasons discussed in this report, the poor development of Pillars II and III in our country.

On real returns, it must be admitted that performance to date is losing its long-term battle to beat inflation. A result that many will find too poor. Nominal gross returns for more than two thirds of participants are loaded with heavy charges, as mentioned before, but gross (before charges) returns are not that terrible. Again, it is taxes that come in to help many participants to reach the conclusion that it is still worth putting their money into this vehicles, despite the illiquid nature of most of them. Participants' revanche, however, takes the form of a strategic game in which they allocate just enough money every year to these investments as to exhaust the fiscal margin, no more. And this just for those participants able to allocate some extra money aside for their retirement regularly, as roughly half of total participants cannot afford to put more money into their complementary pension pots. Since after the Great Recession. Meanwhile, many millions of workers that do not participate in complementary pension schemes may think, perhaps, that Social Security will walways be there to give them retirement benefits with a much higher implicit rate of return (on their contributions) free of management fees and inflation linked. Also, perhaps, ignoring that someone will have to pay an increasing part of their bills.

## References

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