Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija

**RATING** AA/Stable/— (VERY STRONG)

An insurer rated ‘AA’ has VERY STRONG financial security characteristics, differing only slightly from those rated higher.

**RELATED RATINGS**

- **Corporacion Mapfre S.A.**
  - Sr unsecured debt
    - Local currency: AA-

- **Mapfre Empresas, Compania de Seguros y Reaseguros, S.A.**
  - Financial Strength Rating
    - Local currency: AA/Stable/—

- **Mapfre Re Compania de Reaseguros, S.A.**
  - Financial Strength Rating
    - Local currency: AA/Stable/—

- **Mapfre Reinsurance Corp.**
  - Financial Strength Rating
    - Local currency: AA-/Negative/—

**HOLDING COMPANY**

None

**GROUP MEMBERS**

None

**DOMICILE**

Spain

**LICENSED**

None

**Company Contact**

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**Major Rating Factors**

*Strengths:*

- Very strong capitalization;

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Very strong operating performance;
Very strong competitive position in core regions of Spain and Latin America; and
Positive management.

Weaknesses:
Possible more aggressive growth/acquisition strategy.

Rationale
The ratings on Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija (Mapfre Mutualidad), the main operating entity of Spanish insurance group Sistema Mapfre (the Mapfre group or Mapfre), reflect the Mapfre group’s very strong capitalization, operating performance, and competitive position in Spain and Latin America, together with its management, which Standard & Poor’s Ratings Services considers as positive for the ratings. These factors are offset by the group’s potentially more aggressive growth/acquisition strategy.

Although the group’s capitalization has weakened slightly, it remains very strong. The consolidated capital adequacy ratio according to Standard & Poor’s risk-based model was within the ‘AA’ range at year-end 2005. Capitalization is reinforced by a very strong quality of capital.

Operating performance continues to be very strong. Although the headline ROE fell to 15.6% in 2005 from 20% in 2004, the underlying trend represents a marginal improvement if the cost of 2005 catastrophe claims is excluded. This very strong performance was underpinned at a technical level by a consolidated combined ratio that showed only a small deterioration to 95.8% (92.4% in 2004).

The Mapfre group has a very strong competitive position. It is present in 38 countries and is the leading Spanish insurance group, with an overall market share of 14.9%. Mapfre is also one of the strongest groups in Latin America, where it is present in 12 countries. Consolidated gross premiums written at year-end 2005 were €10.1 billion, an increase of more than 13% on 2004.

Management is considered positive for the ratings. The management team has an impressive track record of delivering both growth and profitability in recent years. Mapfre’s stated ambition to become one of the five largest European nonlife companies within five years would appear to suggest a resulting shift into a more aggressive growth/acquisition strategy, however, which Standard & Poor’s would view with caution.

Outlook
The stable outlook reflects Standard & Poor’s expectation that the Mapfre group’s operating performance will remain very strong. Competitive pressures, notably in the Spanish motor business, may lead to a slight deterioration in earnings, but the nonlife combined ratio is expected to remain below 97% in 2006 and 2007, and ROE to reduce only slightly from its current high level.

The group is expected to maintain its very strong competitive position by consolidating its market-leading positions in Spain and Latin America. Standard & Poor’s expects gross premiums written to grow by approximately 13% to about €11.4 billion in 2006 and to about €12.5 billion in 2007.

Standard & Poor’s expects capitalization to weaken slightly, but does not expect capital adequacy to fall below the high end of the ‘AA’ range in 2006 and 2007. Standard & Poor’s also expects fixed-charge coverage to be maintained at a minimum of 15x and leverage to be less than 5%.
The ratings may come under pressure if the group, as is expected, makes more aggressive use of its capital in the coming years, particularly following the recently announced corporate restructure. An upgrade is viewed as unlikely until such time as the competitive position attains the levels of diversification of other major European players.

Corporate Profile: A Diversified Multinational Group

Mapfre Mutualidad was established in 1933 as a mutual to provide coverage for work-related accidents. Today, it is the parent and main operating entity of the Mapfre group. Mapfre Mutualidad owns 56% of Corporación Mapfre S.A. (Corporación Mapfre; AA-/Stable/—), the quoted holding company, as well as some direct operations. Corporación Mapfre, in turn, owns the majority of the group’s operating companies—including Mapfre Re Compañía de Reaseguros S.A. (Mapfre Re; AA/Stable/—), Mapfre America (not rated), and Mapfre Asistencia (not rated)—and has a 51% participation in Mapfre Caja Madrid Holding (MCMH), the remaining 49% being owned by Caja de Ahorros y Monte de Piedad de Madrid (Caja Madrid; A+/Positive/A-1).

MCMH owns the main domestic operating companies of the group, including Mapfre Empresas (AA/Stable/—). In May 2006, Mapfre announced its intention to restructure the group, with the mainly motor business currently written by Mapfre Mutualidad being transferred to a new operating unit underneath Corporación Mapfre.

Competitive Position: Diversification Through Geography, Product, And Distribution

Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija (Consolidated) Business Statistics

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<th>Table 1</th>
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<tr>
<td>Year-ended Dec. 31—</td>
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<tr>
<td>Total assets under management</td>
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<td>Annual change in assets under management (%)</td>
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<td>Nonlife gross written premiums</td>
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<td>Nonlife: Annual change in gross written premiums (%)</td>
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<td>Nonlife: Annual change in net written premiums (%)</td>
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<tr>
<td>Net premiums earned</td>
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<td>Life: Gross written premiums</td>
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<td>Life: Change in long-term business provision (%)</td>
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</table>

The Mapfre group has a very strong competitive position (see table 1). It is present in 38 countries and is the leading Spanish insurance group, with an overall market share of 14.9%. Mapfre is also one of the strongest groups in Latin America, where it is present in 12 countries. The Mapfre group’s very strong competitive position is underpinned by its strong and diversified distribution network in Spain and by its increasing expansion outside its traditional markets.

Diversity

Mapfre is very strong in the Spanish nonlife market, which it leads with a share of about 18%, more than twice the share of its nearest competitor. It is also a strong player in the life market, with a market share of about 10%. Mapfre Mutualidad is the largest underwriter of the motor business in Spain and has a market share of about 21%, while Mapfre Seguros Generales (MSG) is the Spanish leader in nonmotor lines. This leadership in personal and small commercial lines is
reinforced by market-leading positions in large corporate/industrial business through the relatively newly formed Mapfre Empresas, as well as in funeral expenses and health business. Mapfre Vida ranked as the largest life insurer in Spain in 2005, as measured by premiums, and the second largest by technical reserves. Mapfre Vida is also the largest asset manager among Spanish insurers. The competitive position is further strengthened by the power of the Mapfre brand, which has seen the group expand its activities into add-on services, such as domestic and roadside assistance, and a gradual entry into care homes and vehicle sales and leasing.

**Distribution**
Historically, the group’s geographical coverage of the entire Spanish territory has been a distinct competitive advantage. The number of points of sale (including branches, agents, and also Caja Madrid bank outlets) is in excess of 4,600 and continues to increase by more than 100 each year, more recently through lower cost franchised agencies. This advantage has been reinforced following a restructuring of the sales activities of the various Mapfre businesses into a single extensive Spanish distribution network.

**International business**
The Mapfre group operates in 38 countries, with a very strong presence in Portugal and Latin America. The group has a natural cultural and linguistic advantage over foreign competitors in Latin America, where it is present through 12 nonlife companies and six life and pensions companies. It is one of the largest foreign players in the area, with an estimated market share of just under 6% in 2005. This presence is being strengthened through expansion of the sales network, which contributed to growth of nearly 30% in Latin American premium volumes in 2005, slightly increasing the region’s share of the group’s total to about 15.5%. The most international of the Mapfre group companies is Mapfre Asistencia, which has a direct presence in all 38 countries.

Mapfre Re is the group’s reinsurance arm. A full analysis of Mapfre Re was published on July 28, 2006, on RatingsDirect, Standard & Poor’s Web-based credit analysis system at www.ratingsdirect.com.

**Prospective**
The Mapfre group is expected to maintain its very strong competitive position by consolidating its market-leading positions in Spain and Latin America. The 2004 acquisition of Musini S.A. de Seguros y Reaseguros has given the group size and expertise in the large commercial lines and transformed it from a motor and personal lines insurer into one that now has a full product offering and has attained critical size. In Spain, the group has yet to realize the full benefits of the unification of its distribution networks. Offsetting this is the challenge to the competitive position arising notably from increased competition in Spanish motor business.

Internationally, the group is expected to expand in selected businesses that can be used as springboards for extending the Mapfre brand. This will be achieved through acquisitions—which are regarded as more likely following the recently announced restructure of the group—and also by exporting Mapfre’s expertise in certain business lines to units in other countries. Notably, the Mapfre group has increased its small representation in China.

Standard & Poor’s expects total gross premiums written for the Mapfre group to increase by about 13% to about €11.4 billion in 2006 and to about €12.5 billion in 2007.
Management And Corporate Strategy: Proven Track-Record

Mapfre’s management is regarded as positive for the rating. It has demonstrated its ability to grow, both organically and by acquisition, without losing its focus on profitability and customer service. Standard & Poor’s views positively the group’s recently announced restructure, but any resulting shift into a more aggressive acquisition strategy would be viewed with caution.

Strategy.
Long-term strategy continues to be centered on the strengthening of the group, albeit without ignoring the principles underlying its mutualist roots. The Mapfre group’s recently announced reorganization is viewed positively by Standard & Poor’s, to the extent that it represents a welcome clarification of the group’s structure. Prospectively, there will be a widening of Mapfre’s geographical focus beyond its core regions of the Iberian peninsula and Latin America, so as to embrace other EU countries and selective expansion in the U.S. and the AsiA-Pacific region. This expansion will be achieved mainly via the direct insurance, reinsurance, and assistance operating units. However, Mapfre’s stated ambition to become one of the five largest European nonlife companies within five years would appear to suggest a resulting shift into a more aggressive growth/acquisition strategy, which Standard & Poor’s would view with caution. While further acquisitions are likely, this is expected to be without compromising the group’s reputation for not overpaying.

Operational management.
Mapfre aims to achieve operational excellence while pursuing a prudent ROE. It has been leveraging its competitive advantages in the Spanish market, and has generated high and, up until 2005, increasing profitability. The group has tight cost-control policies; centralized reporting of underwriting, investment, and planning; and a proven ability to rapidly integrate newly acquired companies with minimal business disruption. Training, transfer of expertise, pricing, a sophisticated reporting system, and a single integrated IT system have allowed the nonlife companies to reach a strong level of earnings. The proposed transfer of the parent mutual’s motor portfolio to sit alongside the other operating units under the quoted holding company is viewed by Standard & Poor’s as a logical step, both operationally and from the point of view of market transparency.

Financial management.
Financial strategy is conservative. The group maintains a good level of capitalization for all subsidiaries, and payout ratios from subsidiaries have been flat at about 27%.

A €275 million senior debt issue by Corporación Mapfre in 2001 was followed by a successful €500 million rights issue in early 2004, primarily aimed at funding acquisitions, a side effect being an increase in the liquidity of Corporación Mapfre’s shares. Standard & Poor’s expects the group to increase its use of debt following the imminent restructure. Although the group’s strength in Latin America exposes it to sovereign risk, the region as a whole represents only 15% of overall revenues and balance-sheet currency risk is well managed.
Operating Performance: Very Strong Earnings At The Peak Of The Cycle

The Mapfre group’s operating performance continues to be very strong (see table 2). Although the headline ROE fell to 15.6% in 2005 from 20% in 2004, the underlying trend represents a marginal improvement if the cost of 2005 catastrophe claims is excluded. Competitive pressures, notably in the Spanish motor business, may lead to a slight deterioration in earnings in 2006 and 2007.

Underwriting earnings.

Hurricane and storm losses in the Gulf of Mexico and Europe caused a relatively small deterioration in the nonlife combined ratio to a still-respectable 95.8% in 2005 (92.4% in 2004). An ongoing significant contributor to underwriting earnings has been the performance of Mapfre Mutualidad, the parent and main operating entity of the group, which has benefited from the improvement of the motor market in Spain, and from having a more sophisticated pricing system than its competitors. The same positive trend applied to virtually all the group’s Spanish operations in 2005, including the large corporate business written by the newly formed Mapfre Empresas. Outside Spain, the recent improvement in Latin American operations was stemmed by the impact of hurricane losses, while the costs of expanding the branch network there mean that their expense ratio remains high. RoEEV was 18.6% in 2005 on an EEV that increased to €1,314.0 million from €1,167 million in 2004. Strong new business margins from Caja Madrid branches (3.9%) reflect the unusual quality of this bank distribution agreement.

Quality of earnings.

The quality of earnings is very strong. While ROE fell to 15.6% in 2005 from 20% in 2004, the strong and steady increase in earnings up until 2004 is particularly impressive when set against the
ever-strengthening equity. Further evidence is to be found in the seven consecutive years of improvement in the combined ratio up until 2004. Although exposures in the Gulf of Mexico introduce an element of volatility, this is regarded as limited, as evidenced by the low three-percentage-point impact of the hurricane losses on the combined ratio. Additional sources of strength are the diversified sources of earnings, with virtually all units again recording strong profit levels, and the low-risk investment strategy, with only 7% of invested assets held in equities.

**Prospective.**

Standard & Poor’s expects the Mapfre group’s operating performance to remain very strong. However, prospective earnings are expected to be significantly influenced by factors relating to the Spanish motor business, which is already being affected negatively by competitive pressures, but which should benefit from the imminent introduction of a “points” system for driving licenses. On balance, these factors may lead to a slight deterioration in earnings, albeit with the nonlife combined ratio remaining below 97% in 2006 and 2007, and ROE reducing only slightly from its current high level.

**Investments: Very Strong And Conservative**

Table 3

| Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija (Consolidated) Investments |
|---------------------------------|-----------|-----------|-----------|-----------|-----------|
| Bonds and other fixed-interest securities | 19,834    | 16,576    | 12,010    | 9,551     | 7,765     |
| Insurance and reinsurance receivables/Total assets (%) | 6.8       | 6.3       | 7.0       | 7.7       | 8.2       |
| Underwriting cash flow ratio (old basis) (%) | 121.7     | 118.4     | 122.0     | 132.5     | 139.3     |
| Cash and bank deposits           | 1,425     | 1,454     | 2,113     | 1,789     | 1,689     |
| Change in cash and bank deposits | -29       | -860      | 324       | 100       | 355       |
| Total investments                | 25,374    | 22,498    | 18,278    | 14,778    | 13,222    |
| Total nonlinked investments (%)  | 98.6      | 98.4      | 97.6      | 96.1      | 94.4      |
| Investment in affiliates (%)     | 0.9       | 0.8       | 2.1       | 2.7       | 3.1       |
| Bonds and other fixed-interest securities (%) | 79.1      | 74.9      | 67.3      | 67.2      | 62.2      |
| Mortgages (%)                    | 0.0       | 0.0       | 0.1       | 0.0       | 0.1       |
| Equities and other variable-interest securities (%) | 6.8       | 6.9       | 6.9       | 7.3       | 8.0       |
| Property (%)                     | 5.4       | 5.4       | 6.0       | 7.3       | 8.3       |
| Cash and bank deposits (%)       | 5.7       | 6.6       | 11.9      | 12.6      | 13.5      |
| Loans and private placements (%) | 0.0       | 0.0       | 1.3       | 1.8       | 2.1       |
| Other investments (%)            | 2.0       | 5.4       | 4.4       | 1.0       | 2.6       |

**Strategy**

Standard & Poor’s regards Mapfre’s investments as very strong (see table 3). Investment strategy is very conservative, with a strong focus on quality and liquidity. Active responsibility for all Mapfre group investments is now centralized within Mapfre’s investment management division, which was previously responsible only for general investment guidelines for subsidiaries within the group.
Credit risk
Credit risk is low, with just under 80% of the predominantly bond-based portfolio rated ‘AA’ or higher. The yield on invested assets remained stable at 5.1% in 2005, a respectable return given the low-risk strategy.

Market risk
Market risk is low, although it may be expected to increase slightly following a raising of the equities exposure cap in 2006 to 25% of the portfolio value. The bulk (79.0%) of the portfolio is invested in bonds, followed by equities (7.0%), cash and bank deposits (6.0%), and property (5.0%). Equity investments are mainly held via mutual funds investing almost entirely in listed companies.

Asset-liability management
Asset-liability management is not regarded as a major issue, except to a small extent in the life and funeral expense classes, where the average duration of assets exceeds liabilities by about two years. There exists a theoretical exposure to interest rate risk arising from life insurance contracts carrying guaranteed rates of return above the risk-free rate of 3%, but these liabilities represent only a very small proportion of the total and in any case are matched by corresponding assets. Liabilities deriving from the pensions externalization process are matched through swaps.

Liquidity: Very Strong
Liquidity is very good, given the high percentage of readily realizable assets. Mapfre invests mainly in highly liquid government and corporate bonds. The ratio of liquid assets to technical reserves continues to improve, standing at 107% in 2005. The current profitability of the group is generating strong positive cash flows.

Capitalization: More Aggressive Use Of Capital Expected
The Mapfre group’s consolidated capitalization is very strong. Although capital adequacy has weakened slightly, the quality of capital remains very strong, reinforced by adequate reserving and a low but conservative use of reinsurance. The group is expected to make more aggressive use of its capital in the coming years, particularly following the recently announced corporate restructure.

Capital adequacy.
The capital adequacy ratio, according to Standard & Poor’s risk-based model, is very strong. While capital generation through earnings remains very strong, risk charges derived from the high levels of premium growth, together with the adoption of IFRS, have caused a weakening in capital adequacy, which now falls within the ‘AA’ range.

Quality of capital
Quality of capital is very strong with minimal reliance on soft capital items such as the loss-reserve discount. Quality of capital is reinforced by the lack of exposure to catastrophe risks in Spain and the relatively low exposure to such risks elsewhere, and also by the low exposure to equity market volatility.
Reserves.
Standard & Poor’s considers the group’s reserves to be adequate, particularly for its Spanish business. Although reserving levels rose slightly in 2005, this was due to the incidence of catastrophe claims, and a return to the historical steady levels of reserving is expected in 2006. While the ratio of nonlife technical reserves to net premiums written in the 60%-70% range may not appear at first sight to be particularly high, this can be explained by Mapfre’s speed of claims settlement and its predominantly short-tail book of business: the reserving policy is in fact conservative, as confirmed by an external actuarial review.

Reinsurance.
The Mapfre’s group use reinsurance is low but conservative, with Mapfre Re being the group’s reinsurer. The reinsurance utilization ratio reduced slightly to a low 10.7% in 2005, having increased in 2004 as a result of the acquisition of Musini’s book of large industrial risks. The ultimate net retention level is conservative, and the retrocessionaires used by Mapfre Re are of excellent quality.

Prospective.
Standard & Poor’s expects capitalization to weaken slightly to the extent that the strong growth in capital is outpaced by risk charges derived from the group’s strong growth in premium volumes in the short to medium term. Nevertheless, capital adequacy is not expected to fall below the ‘AA’ range in 2006 and 2007. Standard & Poor’s expects that the Mapfre group will make more aggressive use of its capital in the coming years, particularly following the recently announced corporate restructure. The cost of any sizable future acquisition may require a capital and/or debt issue in addition to the funds raised from the 2004 rights issue, some of which has already been expended on a series of small acquisitions. Any further debt issue is likely to fall within the existing debt tolerances and is not expected to have a significant impact on capitalization.

Financial Flexibility: Very Strong And Prospectively Even Stronger

Table 4

| Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija (Consolidated) Financial Statistics | —Year-ended Dec. 31— |
| New solvency measure | 1.4  | 1.3  | 1.1  | 1.1  | 1.2  |
| Total adjusted equity/ Total assets (bps) | 1,463 | 1,393 | 1,265 | 1,326 | 1,425 |
| Total adjusted equity | 4,466 | 3,696 | 2,712 | 2,332 | 2,283 |
| Change in adjusted equity (%) | 20.8 | 36.3 | 16.3 | 2.2  | 9.6  |
| Total capital | 5,082 | 4,187 | 3,149 | 2,630 | 2,636 |
| Equity minorities (%) | 43.6  | 45.0  | 60.7  | 67.5  | 75.6  |
| Debt and subordinated debt (%) | 42.9  | 44.2  | 40.7  | 44.3  | 49.3  |
| Reinsurance exposure ratio (%) | 22.5  | 17.8  | 26.4  | 13.0  | 14.1  |
| Investment leverage (including all quasi capital) (%) | 74.0  | 78.7  | 98.4  | 104.2 | 105.0 |
| Debt/capital (excluding policyholder capital) (%) | 12.1  | 11.7  | 13.9  | 11.3  | 13.4  |
| Reinsurance utilization ratio (%) | 10.7  | 11.2  | 9.3   | 8.4   | 6.3   |
| Nonlife: Net technical reserves/gross technical reserves (%) | 73.1  | 74.9  | 74.6  | 83.5  | 84.2  |
| Nonlife: Technical reserves/Net written premiums (%) | 72.9  | 66.8  | 65.3  | 64.4  | 64.1  |
Mapfre Mutualidad de Seguros y Reaseguros a Prima Fija (Consolidated) Financial Statistics (cont.’d)

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<tbody>
<tr>
<td>Nonlife: Loss reserves/Net written premiums (%)</td>
<td>35.2</td>
<td>30.5</td>
<td>29.5</td>
<td>30.7</td>
<td>32.6</td>
</tr>
<tr>
<td>Nonlife: Net claims paid/Net claims incurred (%)</td>
<td>86.2</td>
<td>89.9</td>
<td>91.8</td>
<td>93.5</td>
<td>90.0</td>
</tr>
<tr>
<td>Life: Technical reserves/Net written premiums (%)</td>
<td>750.1</td>
<td>724.0</td>
<td>722.6</td>
<td>438.2</td>
<td>334.2</td>
</tr>
</tbody>
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Bps - basis points.

Mapfre’s financial flexibility (defined as the ability to source capital relative to capital requirements) is regarded as very strong (see table 4), and has been enhanced by the agreement with Caja Madrid, which may be a source of additional capital if needed, as has been demonstrated with the funding of the acquisitions made in 2003. The 2004 rights issue, which was fully subscribed, confirmed that demand exists for Mapfre shares.

As at year-end 2005, the hybrid debt ratio at the group consolidated level was a low 5.9%, while fixed-charge coverage was in excess of 23x (based on IFRS principles).

Financial flexibility is expected to improve following the corporate restructure, as the enlarged Corporación Mapfre should as a result be able to raise capital more effectively.

Accounting

Effective 2005, the Mapfre group has changed the basis of its financial reporting from Spanish GAAP to IFRS. The main impact as at the Dec. 31, 2004, transition date on the consolidated figures of Mapfre Mutualidad is to increase equity by 13% and attributable profit by 10%. Principal differences are due to valuation of investments (IAS 39) and technical reserves (IFRS 4). The group’s relatively low exposure to unit-linked life business, where some products may be redefined as financial products, means that the impact in this area is expected to be negligible.

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