



The Spanish Insurance Market in 2005

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6. **Legal changes**

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1. Executive summary

The Spanish insurance sector performed well in 2005, both as regards growth and results, to a large extent due to the favourable evolution of the economy. The total volume of premiums amounted to 48,775 million euros, a rise of 7.6% and well above the rate of growth experienced by the GDP (3.4%).

Life insurance closed the year 2005 with positive results, with a total savings figure of 124,181 million euros being managed by the insurance companies as a whole. The increase was similar to that achieved the previous year (6.8%), with revenue of 20,532 million euros from premiums, which represents an increase of 8.3%. As in 2004, individual Life policies experienced a greater progression than group policies. Following the trend of the last few years, the favourable evolution of Risk-Life Insurance policies has continued apace, especially those of an individual nature, with an increase in premiums of over 19%. The significant level of revenue from premiums in this sector has been boosted – among other factors – by the outstanding growth in mortgage loans.

Life insurance attained a result of 4.2%, similar to that of the previous year. There was a decrease in the investment figure, duly compensated by the favourable evolution of the loss ratio, which reached 81% in 2005, and the operating expenses.

Seven of the top ten Life insurance groups mainly distribute their products through the bancassurance channel, this being the largest proportion observed in any European insurance market.

Once again, the prospects for 2006 point towards a favourable evolution, although we shall have to wait in order to be able to confirm these expectations, once we witness the repercussion on the insurance market of the new draft law on Personal Income Tax. As regards Risk-Life Insurance, there is no reason to suppose that the evolution will be very different from that experienced to date, given that it is likely we shall continue witnessing an important expansion of the mortgage and consumer credit sectors. This factor, together with the launching of new products and the offer of complementary services for the same, must surely indicate a further bolstering of this already highly popular plan formula.

Non-Life insurance increased by 7.2% in 2005, reaching a volume of premiums of 28,243 million euros. Within the Non-Life classes, Motor insurance still accounts for the greatest volume, with a share of 41.3%, although this importance is being eroded by the greater growth of other Non-Life classes.

The written premiums for **Motor insurance** in 2005 rose to 11,659 million euros, an increase of 3.8% with respect to the previous year. This growth was fundamentally due to the steep increase in the number of insured vehicles (up 4.7% to a total of 25.7 million vehicles), particularly top-of-the-range models, and by greater cover being taken out for each vehicle, since the tariff variation was actually negative, with an average decrease of around 1%.

2006 is likely to see very moderate growth in premiums (the estimate is for less than 3%) and a worsening of the Profit & Loss Account, especially if, given the profits for this class in 2005, there is any decrease in the technical rigour applied to underwriting and rating procedures. It is hoped that the introduction of the penalty points system for driving licences on July 1st 2006 will result in less accidents, particularly from 2007 onwards.

Multi-Peril policies are still gaining ground in the Non-Life classes, having risen 10.4%, although differences are detected according to the lines of business. Home and Condominium have experienced the greatest increases, benefiting from the advance of the construction sector, although an intensification of the competition is starting to be noticed. Commercial Multi-Peril achieved a growth of 8.7%, two points less than in 2004. This is because, having consolidated the restructuring of the technical margin, undertaken over the last few years by means of increases in the average premium of the portfolio, it is now more difficult to grow, given the saturated level of insurance. The most moderate growth rate occurred in Industrial Multi-Peril (6.3%), due to the high complexity of the product and to the sensitivity of customers to price levels.

Health insurance continues the positive trend observed in previous years, achieving a growth of 9.6%. By modalities, group policies reveal the most dynamic active contracting behaviour. In addition to the company policies, the development opportunities within the sector call for the identification of population segments that require specific products, as well as the incorporation of new services that provide added value to the products currently on the market.

On the other hand, **Third-Party Liability insurance** has also experienced a healthy growth rate (9.5%), although this was much lower than that achieved in recent years. The trends witnessed at the start of the year were thus confirmed: a reduction in the level of premiums corresponding to major risk policies with a good loss ratio, as well as in the Third-Party Liability policies for Directors and Officers (D&O). Nevertheless, this has not been the case for other insurance modalities with a heavy loss load: Public Administrations and Professional Liability. As for the Healthcare Sector, there is still a certain dearth in the insurance on offer, although new operators with capacity available for these segments have appeared.

The remaining Non-Life classes have experienced positive growth in their premiums, with the exception of Theft, Machinery Breakdown and Aviation.

The technical result of Non-Life classes dropped slightly, now standing at 14.1% (14.5% in 2004). The combined ratio¹, which had dropped 9.2 points in the period 2001-2004, experienced a slight rise, reaching 92%. By classes, the combined ratio experienced very different results. In line with what happened to Non-Life classes as a whole, the Motor insurance ratio increased by 1.4 percentage points to 91.8% (90.4% in 2004), whereas, in the case of Multi-Peril, it decreased and ended up below the average, at 90.5% (91.3% in 2004). The Health insurance combined ratio also

¹ Calculated on earned premiums net of Reinsurance.

diminished, dropping from 94.2% in 2004 to 93.9%. Third-Party Liability insurance, with 98.5%, improved its ratio significantly with respect to 2004 (107.9%).

2. Spanish economy

According to the results of Spain's Quarterly National Accounts, the GDP recorded an estimated average annual growth rate of 3.4% in 2005, three tenths more than the previous year and two points more than growth within the Eurozone, which stood at 1.4%², as opposed to 1.8% the previous year.

Interannual variation rates in %

| DEMAND | 2004 | 2005 |
|---|--------------|--------------|
| Final consumption expenditure | 4.8 | 4.4 |
| -Final consumption expenditure by households | 4.4 | 4.4 |
| -Final consumption expenditure by the NPISH | 5.0 | 4.3 |
| -Final consumption expenditure by the Pub. Admin. | 6.0 | 4.5 |
| Gross Fixed Capital Formation | 4.9 | 7.2 |
| -Equipment | 3.7 | 9.5 |
| -Construction | 5.5 | 6.0 |
| -Other products | 4.4 | 7.6 |
| Domestic demand ¹ | 4.9 | 5.3 |
| Exports of goods and services | 3.3 | 1.0 |
| Imports of goods and services | 9.3 | 7.1 |
| Foreign demand | -1.8 | -1.9 |
| SUPPLY | | |
| Fishing and agricultural classes | -1.1 | -0.7 |
| Energy classes | 2.0 | 4.4 |
| Industrial classes | 0.3 | 0.6 |
| Construction | 5.1 | 5.5 |
| Services | 3.6 | 3.9 |
| GDP at market prices | 3.1 | 3.4 |
| GDP at current market prices² | 837.3 | 904.3 |

(1) Contribution to GDP growth

(2) Billions of €

Source: INE. CNTR, first quarter of 2006

From the expenditure standpoint, the growth of Spanish economy is still being boosted by domestic demand, as a result of a significant rise in investment – especially in equipment goods, encouraged by the low interest rates – and the rising employment rates. The result is a four-tenths rise in the interannual figure (despite a decreasing trend being observed in the interquarterly results throughout the year). However, the net foreign demand (exports minus imports) slightly increased its negative contribution to the GDP, although both the improvement in export figures in the second half of the year and the reduced pressure from domestic demand on imports have been mitigating this negative effect.

² Bank of Spain. Economic bulletin. May 2006

On the supply side, almost all the major activity sectors made positive contributions to the growth of the GDP. The greatest growth rate corresponded to the construction sector, representing 10.4% of GDP in 2005. The dynamism is explained, fundamentally, by the house-building sector, although, according to the Housing Ministry, house prices decelerated in 2005, with an interannual growth rate of 12.8%, 4.5 decimal points less than in 2004. Construction is followed by the energy, services and industrial sectors. The primary classes suffered a reduction in their gross added value, adversely affected by the drought, yet less so than in the previous year.

For the first time in thirty years, and as a result of the dynamism experienced by the economy, a surplus was recorded for the Public Administrations as a whole – amounting to 1.1% of GDP – compared to the deficit of 0.1% in 2004.

Inflation has undergone a somewhat irregular evolution, due to the influence of energy prices, increasing by three tenths with respect to 2004 and now standing at 3.4%.³ Underlying inflation⁴ evolved in a much more moderate fashion and, in January 2006 stood at 2.9%.⁵ In both cases, the figures are higher than those for the Eurozone, which registered an inflation rate of 2.2%⁶, with the consequent loss of competitiveness this entails.

The labour market also benefited from the healthy behaviour of the economy. Although the increase in the working population – principally as result of immigration and the rising incorporation of women into the job market – dropped by one tenth to 3.5%⁷, employment (working population) rose dramatically from 3.9% in 2004 to 5.6% in 2005. As a result, unemployment dropped sharply to 9.2%, the lowest unemployment rate registered since 1979.

Bank interest rates remained relatively stable throughout 2005. The EURIBOR at one year closed the year 2005 at 2.8%, as opposed to 2.2% at the end of 2004. The return on Spanish public debt dropped, with ten-year bonds standing at 3.4%, two tenths less than at the end of 2004. This context favoured the performance of the Spanish stock-exchange indexes, which maintained the upward trend first detected in 2003 throughout most of this year. The principal Spanish stock-market indicator, the IBEX 35, rose 18.2% during 2005 and the total return for shareholders increased by almost 4% (the IBEX 35 with Dividends grew by 22%). Most noteworthy is the activity of capital risk entities, whose investment and managed fund figures practically doubled those recorded a year earlier.

³ Bank of Spain. Economic bulletin. May 2006.

⁴ Underlying inflation is calculated by excluding from the general CPI figure unprocessed foods and energy, whose prices are exposed to greater volatility.

⁵ With respect to the prices of unprocessed foods, the sharpest increases in 2005 corresponded to mutton, followed by pulses, fresh vegetables and beef. As regards energy, the prices of heating and automotive fuels explain the variation.

⁶ Bank of Spain. Economic bulletin. May 2006.

⁷ Data according to the Working Population Survey (EPA) undertaken by the INE (Spanish National Statistics Institute). It must be clarified that, in the first quarter of 2005, several changes were introduced in the EPA's methodology. Data prior to 2005 have since been revised by the INE and adapted to the new methodology.

In the currency markets, the nominal effective exchange rate of the Euro depreciated during 2005 by an average of 7% against the industrialised nations as a whole, which helped to alleviate the monetary and financial conditions.

According to the Spanish Economics Ministry⁸, the prospects for 2006 are good, with forecasts pointing to an annual average increase for the GDP of 3.3%. Such growth will present a more balanced composition and will be accompanied by a decreased impact from domestic demand (via deceleration of consumption and investment in construction) and an improvement in exports, encouraged by the expected recovery of the European economy during 2006 and by the depreciation of the Euro against the dollar in 2005. Inflation is likely to improve, as energy prices are expected to behave more favourably.

Projections for the Eurozone⁹ reckon that the real average growth of GDP during 2006 will be between 1.7% and 2.5%. As for inflation, the hypotheses assumed by the experts produce figures of between 1.9% and 2.5%.

⁸ Stability Programme 2005-2008.

⁹ Macroeconomic projections prepared by BCE (European Central Bank) experts for the Eurozone. March 2006.

3. Economic and social variables related to insurance

Population

According to data from the National Statistics Institute (INE), the resident population in Spain as of January 1st 2005 came to 44.1 million inhabitants, a rise of 2.1% with respect to the previous year. The male population grew more than the female, with increases of 2.3% and 2% respectively.

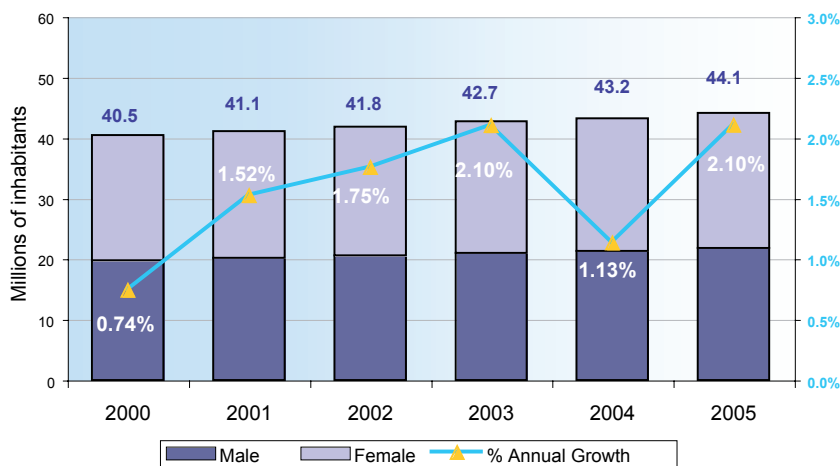


Chart 1.
Evolution of Spanish population

Source: INE. Review of municipal Register 2005

As has been the case in recent years, the population rise is due in part to the arrival of immigrants to our country. The number of foreigners entered in the municipal registers rose by 22.9%, whereas the number of Spaniards only increased by 0.5%. As a result, the proportion of foreign nationals in the country is now 8.5% of the total population and reaches over 14% for each of the five-year age groups between 25 and 34 years old. By nationalities, the most numerous were the Moroccans (13.7% of the foreign population), followed by the Ecuadorians (13.3%), Romanians (8.5%) and Colombians (7.3%). The most notable relative growth rates, with respect to 2004, correspond to Bolivians (87.1%), Romanians (52.6%), Brazilian (44.5%) and Chinese (40.4%). Just like last year, the areas with the greatest concentration of foreign population are the Mediterranean coastline, the archipelagos and the central part of the peninsula.

The vegetative growth of the population in 2005 stood at 78,597 inhabitants, below the figure of 82,657 inhabitants registered in 2004. This reduction is the result of a mortality rate in excess of the birth rate. The former went from 10.65‰ in 2004 to 10.73‰ in 2005, whereas the birth rate now stands at 8.92‰, compared to 8.71‰ in 2004, despite the fertility rate of the foreign mothers, which continues to rise. It is worth noting the recovery in the average number of children per woman of fertile age, which rose to 1.34 in 2005 (from 1.33 in 2004), this being the highest value seen since 1993.

Despite the mitigating effect of immigration in recent years, the Spanish population is still immersed in one of the fastest, most significant aging

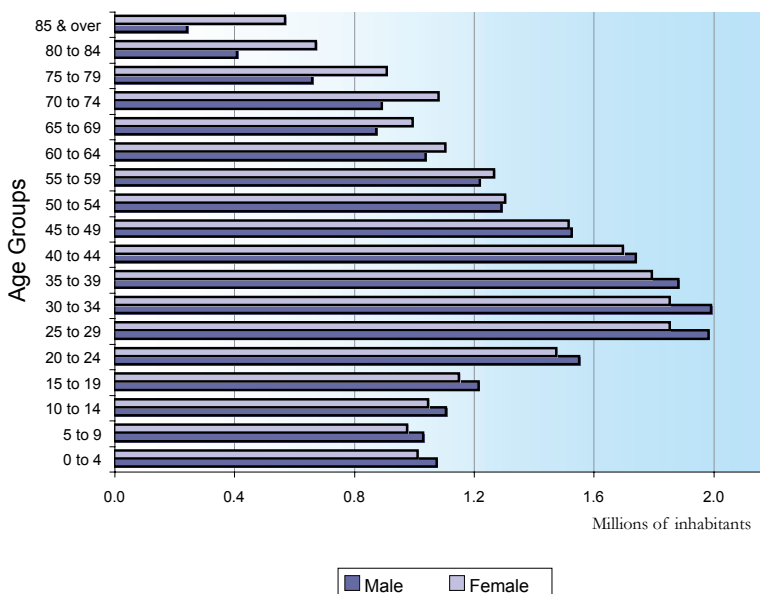
processes of all the European countries. Among the factors that can explain the process, the following stand out:¹⁰

- The increased life expectancy of the Spaniards: at the start of the 20th century, the life expectancy of newborn children in Spain was under 35 years, the lowest in Europe. Almost a century later, this country has one of the longest life expectancies in the whole world, at around 80 years.
- The drop in the fertility rate, characteristic in any demographic transition (although a late arrival in our country, it is developing very fast), motivated by the increasing incorporation of women to the workplace and by the increased age at which they are getting married.
- The sharp drop in the mortality rate over the last century in the whole of Europe, particularly in Spain.

A consequence of this aging process is an increase in the dependent population¹¹, whose needs currently constitute one of the challenges for social policies in developed countries. The White Paper on “caring for people in a situation of dependency in Spain”, presented in December 2004, estimated the dependent population in 1999 to be one million people.

Looking at chart 2, some conclusions can be drawn on the future evolution of this dependent population. During the present decade, there will be a highly increase in the number of elderly people (over 75) due to the so-called “aging

Chart 2.
Distribution of the Spanish population by age group and sex. Year 2005



¹⁰ SANCHEZ, E.; DE PAZ, S.; ZAFRA, J.M. (2005): “El envejecimiento de la población: nuevo reto para la industria aseguradora”, *Gerencia de Riesgos magazine*, FUNDACIÓN MAPFRE, No. 91, pp. 63-73.

¹¹ In order to explain the situation of dependency, the generally accepted definition is that given by the Council of Europe: “that state in which people find themselves when, for reasons relating to the lack or loss of physical, psychic or intellectual autonomy, they require assistance and/or significant aid in order to undertake common activities of their daily lives, in particular those related to personal care”

on aging” process and, at the same time, a slight reduction in the number of people aged between 65 and 75, given that the generation approaching retirement age is, in relative terms, not very numerous (those born during the Spanish civil war and the post-war period, i.e. between 1935 and 1945).

Automobile

During 2005, a total of 2,319,601 vehicles were registered in Spain, an increase of 7.9% on the 2004 figure. After deducting the number of vehicles definitively scrapped, the number of licensed vehicles on the road increased by 1.3 million, reaching a total of 27.7 million vehicles, 5% more than in 2004.

Comparing the data from the General Traffic Directorate (DGT) and the Insured Vehicles Informative File (FIVA), the number of uninsured cars rose to 1.9 million in 2005, which represents 7% of the total number on Spanish roads, a figure slightly higher than the 6.8% registered the previous year.

In 2005, the number of fatalities in road accidents was 4,400¹², 341 less than in 2004 and 1,000 down on the 2003 figure. So far as accidents on the open road are concerned, if we exclude urban areas and monitor the figures within 24 hours of the occurrence of the accident, there were 2,875 fatal accidents¹³, in which 3,329 people died, 1,501 were seriously injured and 1,423 suffered minor injuries. The DGT has been highlighting this significant reduction in accident figures, which are the lowest recorded in the last 30 years. The results can be summarised as follows: accidents dropped by 5.3%, fatalities were down by 5.2%, the seriously injured fell by 8.2% and minor injuries by 9.1%.

The most frequent cause of fatal accidents is still that of cars going off the road (especially at night), this being the cause of 39% of all deaths. The most habitual risk factors are distraction and excessive speed, present in 27% and 22% of all accidents respectively. As for age groups of drivers, the accident rate dropped most sharply for those aged 18-20. By vehicle type, the number of deaths in heavy vehicles fell by 16.7%, while motorcycle deaths rose by 17.6%. Most noteworthy is the fact that 30.5% of those who died in private cars were not wearing their seatbelts and that 52% of those who died while riding a moped were not wearing a crash helmet.

It is expected that this downward trend in accident and victim figures that started in 2004 will continue apace in 2006, through the use of radars to prevent excessive speed (it is expected that the number of fixed radars will rise from 125 in 2005 to 300 in 2006), awareness campaigns to warn of the risks of drink driving and the need to use safety measures, raising the minimum age for riding mopeds to 16 (it is currently 14) and, above all, thanks to the introduction of the penalty points system for driving licences (which came into force on July 1st 2006), designed to discourage repeat offenders.

¹² Provisional data provided by the Interior Minister when appearing before the non-permanent Committee on Road Safety of the Spanish Parliament on 28/06/2006.

¹³ Data from DGT.

Housing

Without a shadow of a doubt, construction has been the most dynamic sector of the Spanish economy throughout the prolonged period of growth that began in the mid-nineties. Although it is still advancing at a healthy pace, it is tending to lose ground, due to the gradual reduction of the increase rate of the residential segment, as reflected by the estimations of the National Accounts Office and other indicators such as the mortgage loans taken out, the average house prices and approvals granted to works, whose growth in 2005 were less than those registered in 2004.

Thus, house prices rose 13.9% in 2005, 3.4 points less than in 2004. This points to the start of a deceleration process, confirmed by the downward slide of its growth rate throughout the year. By type of dwelling, the annual variation rate for second-hand homes (14.6%) is greater than that for new homes (12.7%).

The total capital for urban property mortgages¹⁴ rose by 30.3%, as opposed to 35.8% in 2004. As regards the ownership of such mortgaged properties, 59% of the capital lent for homes corresponded to natural persons, and the rest to legal persons.

On looking at the approvals granted to works by the Professional Associations of Technical Architects, the increase in total surface area in 2005 (approvals for new works) was 5.3%¹⁵, one point less than the 2004 figure, which is due to the halving of the growth rate in the residential segment, which rose by 4.8% in 2005, partially offset by a strong recovery in the non-residential sector, with an increase of 7.6% in the past year, in striking contrast to the nearly 10% drop in 2004.

Business Creation

According to data from the INE, a total of 137,843 business corporations were created in 2005, an increase of 6.2% over the previous year's figures. The subscribed share capital for their incorporation increased by 16.3%. At the same time, the number of dissolved companies dropped by 18.9%. Of these, 82.5% wound up voluntarily and 12.4% were taken over in mergers.

Health

The most remarkable event during the year was the passing of the "Law on health measures to tackle nicotine addiction and regulate the sale, supply, consumption and advertising of tobacco products" in December 2005.

By virtue of this Law, which came into force on January 1st 2006, smoking is prohibited in the workplace and the legal age for buying and selling tobacco is raised from 16 to 18 years old. Bars and restaurants with a surface area of more than 100m² will be able to prepare areas for smokers and smaller premises will have to indicate clearly at the entrance – and in

¹⁴ Interannual rate of variation as of December 2005, according to INE mortgage statistics

¹⁵ Tax and Economics Ministry. Report on Economic Situation. February 2006

their publicity – whether or not smoking is allowed inside. On the other hand, tobacco advertising is prohibited in all the media, as is the gratuitous or promotional distribution of tobacco products and the sponsorship of any acts or events. In addition to introducing this Law, the Ministry is carrying out diverse actions, such as boosting programmes aimed at the prevention and control of nicotine addiction.

Following the directives of WHO and European Union, the Spanish Ministry of Health and Consumer Affairs published its “National Plan to Prepare for and Respond to an Influenza Pandemic” in May 2005. The objective of this plan is to guarantee that the response and the measures adopted by the health administrations in the face of a possible pandemic manage to mitigate the impact of the disease on the population and guarantee effective operation of the health and social services.

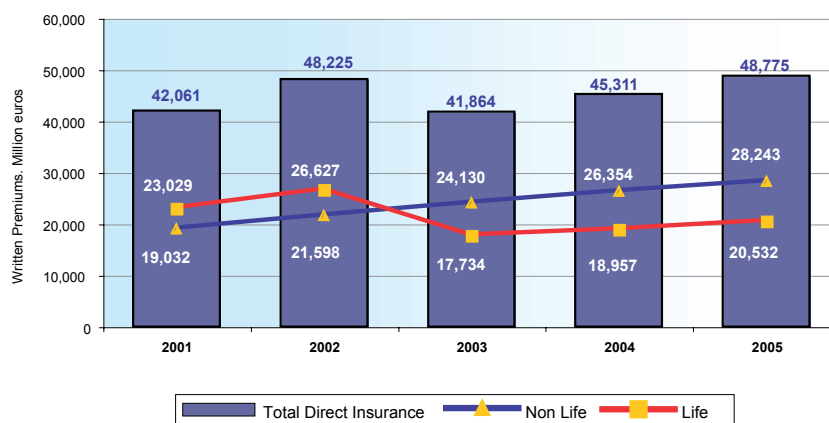
4. Principal characteristics of the insurance market

Volume of premiums and results

The Spanish insurance sector performed well in 2005, both as regards growth and results, to a large extent due to the favourable evolution of the economy.

Throughout 2005, the sector continued the growth trend evident in the previous two years. The total volume of premiums amounted to 48,775 million euros¹⁶, up by 7.6%, once again exceeding the growth rate of the GDP (3.4%). Spanish insurance thus recovers the exceptional results achieved in 2002.¹⁷

Chart 3.
Evolution of the
insurance sector.



Life insurance rose 1.4 points to reach 8.3%, whereas the Non-Life classes, whose relative proportion of the total is greater (57.9%), increased by 7.2%, two points down on 2004, with this slowdown being reflected in the total growth figure for the sector. As for the proportion of ceded reinsurance, this dropped during 2005 to 12.1%¹⁸ (13.4% in 2004).

¹⁶ Written premiums. Report on "Evolution of the Insurance Market". ICEA

¹⁷ November 2002 was the deadline for companies to externalise their pension commitments. The high number of operations undertaken during the year, mainly by small and medium-sized enterprises, generated a considerable volume of business, which significantly boosted performance within the sector.

¹⁸ Percentage calculated from the data on earned premiums furnished by ICEA in its "Economic Report on the Insurance Sector".

The distribution of the volume of premiums by classes is summarised in the following table:

| | 2004 | 2005 | % of Total | %Δ 2005/2004 |
|------------------------------|---------------|---------------|---------------|-----------------|
| Life | 18,957 | 20,532 | 42.1% | 8.3% |
| Individual | 15,224 | 16,420 | 33.7% | 7.9% |
| Group | 3,733 | 4,112 | 8.4% | 10.1% |
| Non-Life | 26,354 | 28,243 | 57.9% | 7.2% |
| Motor | 11,237 | 11,659 | 23.9% | 3.8% |
| Third party Liability | 6,540 | 6,641 | 13.6% | 1.5% |
| Other Guarantees | 4,696 | 5,018 | 10.3% | 6.9% |
| Multi-Peril | 4,160 | 4,591 | 9.4% | 10.4% |
| Household | 2,128 | 2,389 | 4.9% | 12.3% |
| Commercial Premises | 511 | 555 | 1.1% | 8.7% |
| Condominiums | 456 | 510 | 1.0% | 11.9% |
| Industrial | 999 | 1,062 | 2.2% | 6.3% |
| Others | 67 | 75 | 0.2% | 12.6% |
| Health | 4,097 | 4,490 | 9.2% | 9.6% |
| Healthcare Assistance | 3,523 | 3,850 | 7.9% | 9.3% |
| Reimbursement | 355 | 402 | 0.8% | 13.2% |
| Benefits | 219 | 238 | 0.5% | 8.6% |
| Third party Liability | 1,618 | 1,771 | 3.6% | 9.5% |
| Burial Expenses | 1,294 | 1,371 | 2.8% | 6.0% |
| Accidents | 800 | 847 | 1.7% | 5.9% |
| Engineering | 634 | 744 | 1.5% | 17.5% |
| Construction Multi peril | 168 | 229 | 0.5% | 36.1% |
| Machinery Breakdown | 176 | 165 | 0.3% | -6.1% |
| Ten-Year Construction | 290 | 350 | 0.7% | 20.9% |
| Transport | 607 | 612 | 1.3% | 0.9% |
| Marine | 192 | 197 | 0.4% | 2.4% |
| Goods | 279 | 281 | 0.6% | 0.9% |
| Aviation | 136 | 134 | 0.3% | -1.1% |
| Credit | 523 | 544 | 1.1% | 4.0% |
| Agricultural | 393 | 513 | 1.1% | 30.5% |
| Assistance | 226 | 264 | 0.5% | 16.5% |
| Fire | 239 | 247 | 0.5% | 3.4% |
| Rest | 211 | 201 | 0.4% | -4.8% |
| Pecuniary Losses | 123 | 195 | 0.4% | 57.9% |
| Legal Defence | 93 | 94 | 0.2% | 0.4% |
| Surety | 68 | 74 | 0.2% | 9.1% |
| Theft | 32 | 27 | 0.1% | -15.0% |
| Total | 45,311 | 48,775 | 100.0% | 7.6% |

Table 2.
Distribution of volume of
premiums by classes.

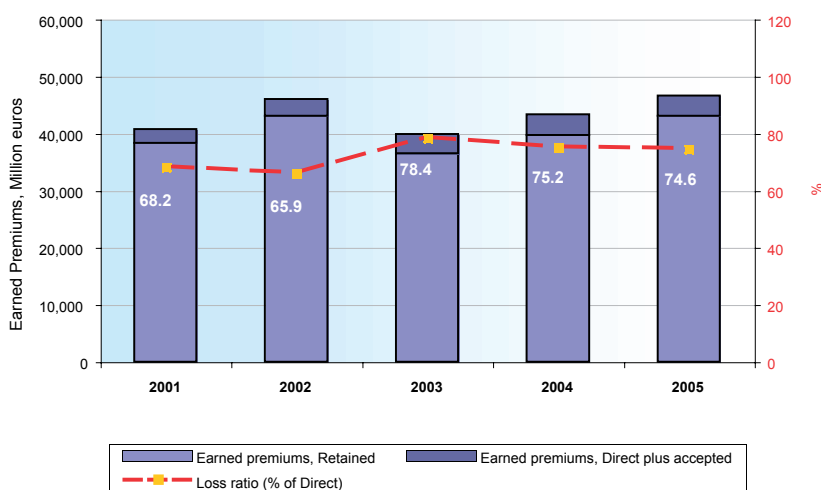
Source: ICEA. Report on "Evolution of the insurance market".

Within the Non-Life classes, Motor insurance still represents the greatest volume of business, accounting for 41.3% (42.6% the previous year). This results in the evolution of the Non-Life segment being highly dependent on the phase of the cycle in which the Motor class finds itself. The growth in premiums in this class has been slipping since 2001, the year in which the rate of growth stood at 10.5%, and reached 3.8% in 2005. On the contrary, Multi-Peril policies are still gaining ground and grew by 10.4% in 2005, aided by the expansion of the construction sector. Health insurance continues the positive trend of previous years, achieving a growth rate of 9.6%. As regards Third-Party Liability insurance, this has also enjoyed good growth (9.5%), although this figure was much lower than that seen in recent years.

Life insurance continues evolving favourably, with an increase of 6.8% in managed savings and 8.3% in volume of premiums. Risk-Life Insurance grew by 15.6%, particularly individual policies, to a large extent due to the high rise in mortgage loans. Life Savings insurance policies reached 7.1%, boosted by savings products not targeted at retirement. Asset-linked products were favoured by the development of the financial markets and ended the year with a growth rate in their volume of provisions of 7.3%.

As for the result of the insurance sector as a whole, a slight worsening with respect to the previous year can be observed, reaching 9.8% of earned premiums (10.1% in 2004). The loss ratio continues to improve, now standing at 74.6%.

Chart 4.
Evolution of loss ratio.
Total for sector



Source: ICEA. "Economic report on the insurance sector".

The result for the Non-Life classes also suffered slightly, now standing at 14.1% (14.5% in 2004). The loss ratio reached 69.8% (68.5% in 2004) and the combined ratio on net earned premiums increased by one tenth to reach 92%.¹⁹

¹⁹ The combined ratio was calculated on the basis of the technical account information that appears in the "Economic report on the insurance sector", published by ICEA. The formula applied is: (Loss ratio + Variation of other technical provisions + Participation in bonus and rebates + Operating expenses + Other technical expenses - Other technical income) / Earned premiums. All items refer to retained business, net of ceded reinsurance.

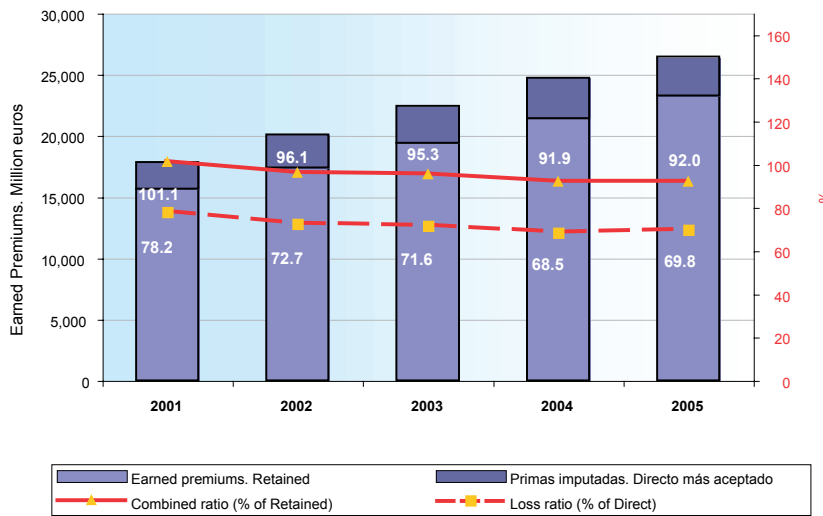


Chart 5.
Evolution of loss ratio.
Non-Life

Source: ICEA. "Economic report on the insurance sector".

Life insurance obtained a result of 4.2%, similar to that of the previous year. There was a worsening of the balance of investments, compensated by the favourable evolution of the loss ratio, which reached 81% in 2005.

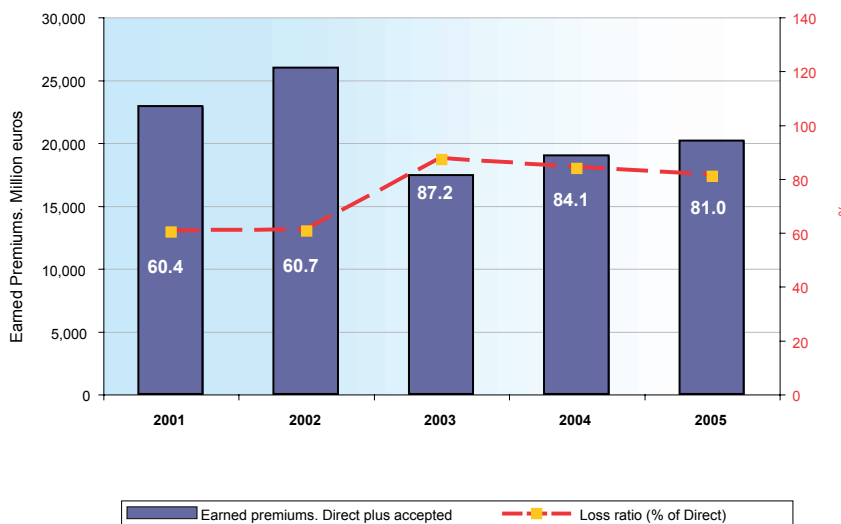


Chart 6.
Evolution of loss ratio.
Life

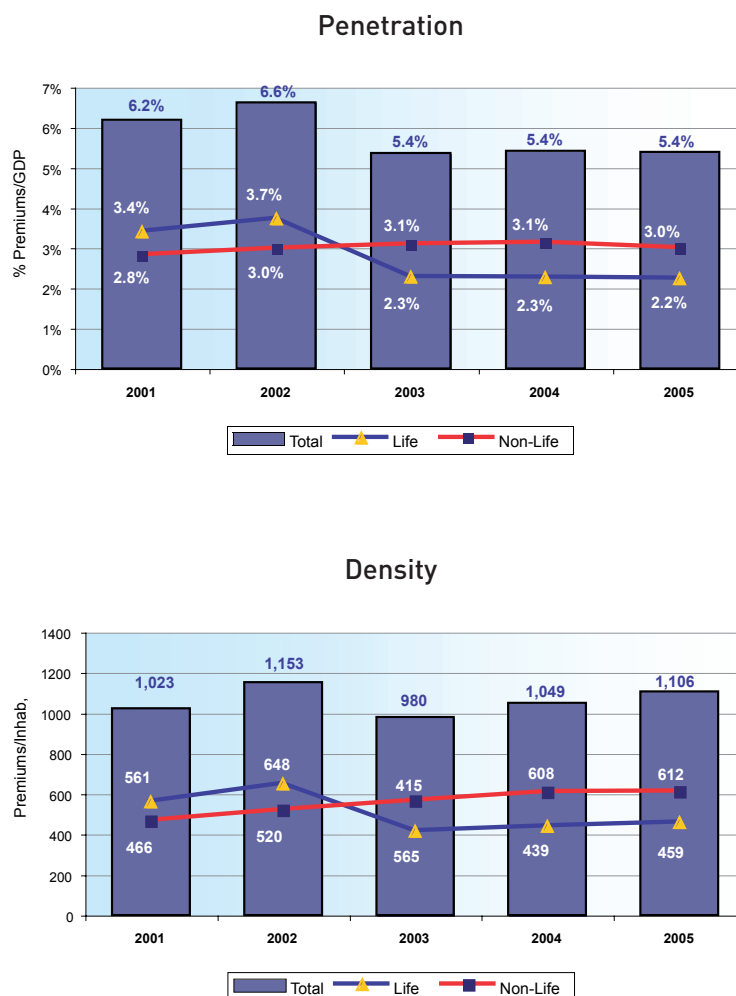
Source: ICEA. "Economic report on the insurance sector".

The penetration²⁰ of insurance in the economy reached 5.4% in 2005, a figure similar to that of the last two years, both in the Life and Non-Life classes. On the other hand, insurance density²¹ keeps increasing, now standing very close to the levels observed in 2002 at 1,106 euros/inhabitant.

²⁰ Percentage represented by premiums over GDP.

²¹ Percentage represented by premiums over the population.

Chart 7.
Penetration
& Density of
Insurance



Source: ICEA. Report on "Evolution of the insurance market".
Instituto Nacional de Estadística.

Competitive structure of the sector

The concentration process that has characterised the insurance sector in recent years accentuated during 2005. By the end of the year, the number of operating Spanish companies in the administrative registry of insurance organisations was 312, compared to 330 registered in 2004, which equates to a reduction of 4% in the number of companies. In addition to the aforementioned, 57 registered companies are currently going through a winding-up process, whether this be voluntary (22 companies, 17 of which are Mutual Provident Society) or undertaken by the Consorcio de Compensación de seguros (35 companies).

As regards the access of foreign companies to the Spanish market, at the end of 2005 there were 48 branches of companies from the European Economic Area and 2 from other countries operating in Spain. By nationalities, the most numerous were the United Kingdom (18 companies), France (12 companies) and Germany (7 companies). Although 471 companies registered to operate under freedom to provide services regime, not all of them actually do operate in Spain.

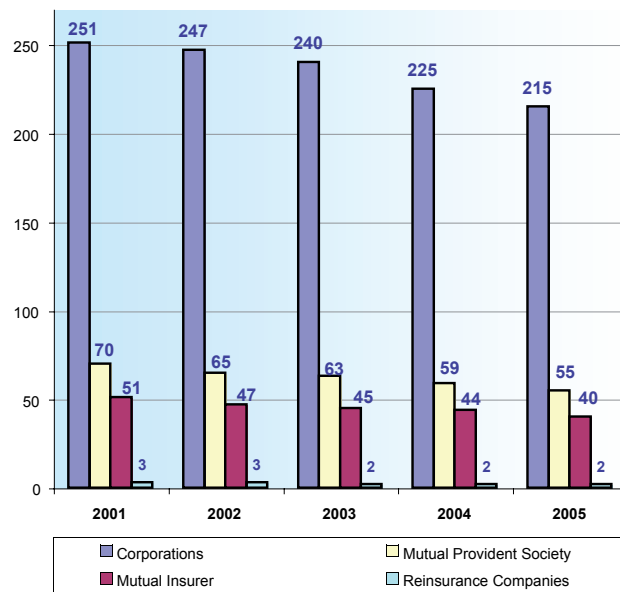


Chart 8.
Evolution of the number of private insurance companies according to their legal structure

Source: Spanish Insurance and Pension Funds General Directorate

In 2005, foreign capital in Spanish insurance companies represented 26.5% of the share capital in the sector²², with 22.6% corresponding to companies from the European Union.

The degree of concentration in the sector is much greater in the Non-Life classes, in which one third of the companies account for 93.9% of the premiums. In Life, in order to reach a similar percentage, it is necessary to add up the production of half of the companies operating in this class.

During 2005, the Spanish Insurance and Pension Funds General Directorate handled seven portfolio transfer procedures, eight takeover operations and one full demerger. Most of the operations have taken place between companies of the same insurance group, with a view to simplifying its structure, or between companies within the same class, especially in the Health sector.

This is the case of ADESLAS, which, at the end of 2005, completed the takeover of LA NUEVA UNIÓN DE SEGUROS, or ARESA, which acquired throughout 2005 the companies BARCELONA ASEGURADORA, IGUALATORIO MÉDICO COLEGIAL DE BURGOS, EL PENSAMIENTO and SEGUROS CAPISA. At the end of the year, MUTUA MADRILEÑA announced an agreement to acquire a 100% stake in ARESA and this acquisition took effect in February 2006.

In November 2005, the Dutch group AEGON announced the acquisition of 50% of SEGUROS NAVARRA, a life insurance company that is a subsidiary of the savings bank Caja de Ahorros de Navarra. This acquisition was completed in May 2006. In December, BAYERISCHE VIDA transferred its portfolio to ERGO VIDA, which also received from FIATC the policies it had co-insured with BAYERISCHE.

²² Provisional data. Spanish Insurance and Pension Funds General Directorate. Report 2005.

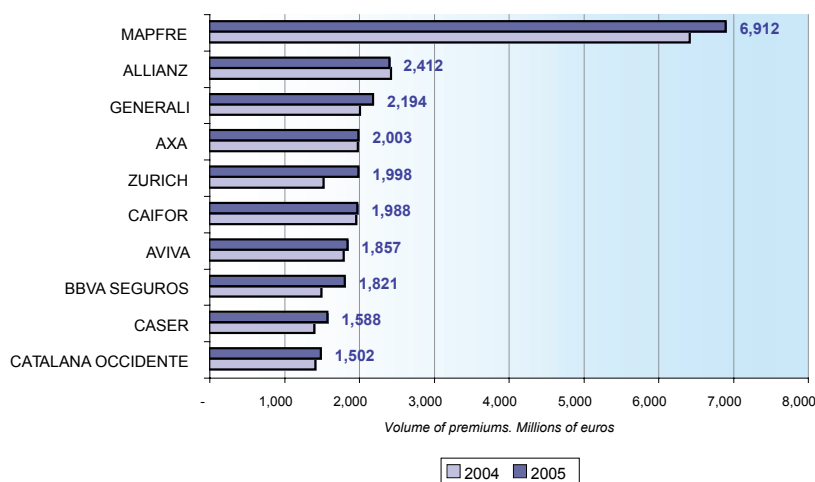
In September, the CATALANA OCCIDENTE Group acquired an additional 7% of the shares in ATRADIUS, the world leader in credit insurance, thus raising its stake in this company to 24.98%.

Ranking

During 2005 the ranking of the top ten insurance groups was still headed by MAPFRE, whose growth in premiums was similar to that of the sector as a whole (7.5%) and gave them a market share of 14.2%. ALLIANZ saw a decrease in their volume of premiums, but held on to second place, with a market share of 4.9% and a reduced gap ahead of the Italian group GENERALI, which remained in third position.

Most noteworthy was the performance of ZURICH, which increased its market share to 4.1% and jumped two places in the overall ranking.

Chart 9.
Ranking of insurance groups by volume of premiums. Total for sector



Source: Prepared in-house on the basis of ICEA data.

The top ten insurance groups accumulated a volume of premiums in 2005 amounting to 22,528 million euros, which represents 49.8% of the sector, almost the same as in 2004 (49.7%).

The level of concentration in the Life class increased slightly, with the result that the top ten groups accounted for 60.6% of the sector, whose volume came to 20,532 million euros. Another feature here is that seven of the top ten Life insurance groups distribute their products mainly through the bancassurance channel, this being the largest proportion observed in the European insurance markets.²³ According to the latest data published by ICEA, this channel distributed 64.3% of the Life insurance premiums in 2005.

The top positions in the Life ranking varied little, given that MAPFRE, CAIFOR and AVIVA continue to lead this class, with very little difference between their market shares, around 9%. However, there were changes in the lower positions, with the entrance of ZURICH and CASER in ninth

²³ Update of the analysis that makes Fitch Ratings in their report "European Bancassurance Markets: a differentiated World" (2006) with data 2005.

and tenth place, respectively. Most striking is the remarkable growth of the Swiss group -over 100%, which explains its jumping two places in the overall ranking- as a result of its boosting of the marketing activities for the products distributed through the banking channel.²⁴

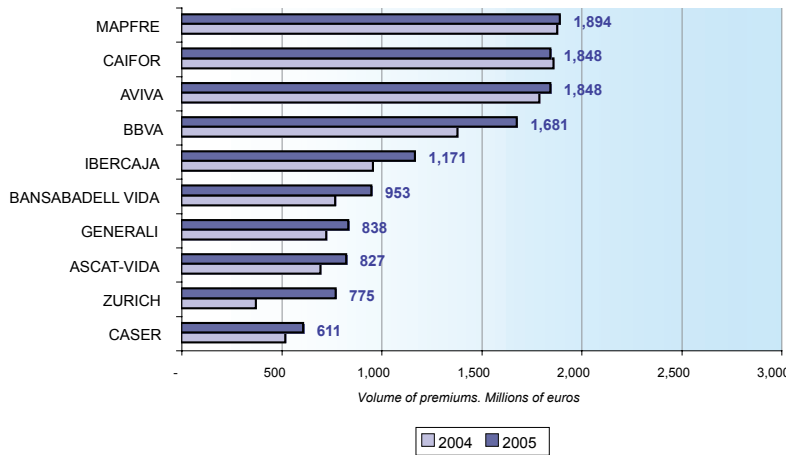


Chart 10.
Ranking of insurance groups by volume of premiums. Life

Source: Prepared in-house on the basis of ICEA data.

As for the Non-Life classes, the top ten insurance groups underwrote a volume of premiums amounting to 15,917 million euros, increasing their 2004 market share by four tenths to achieve 56.4% in 2005. The top spot is held by MAPFRE, with a share of 17.8%, followed at a distance by ALLIANZ and AXA. The only noticeable change corresponds to MUTUA MADRILEÑA, which increased its turnover by 16% and jumped from eighth to sixth position, with a three-tenths increase in its market share bringing it to 3.7%.

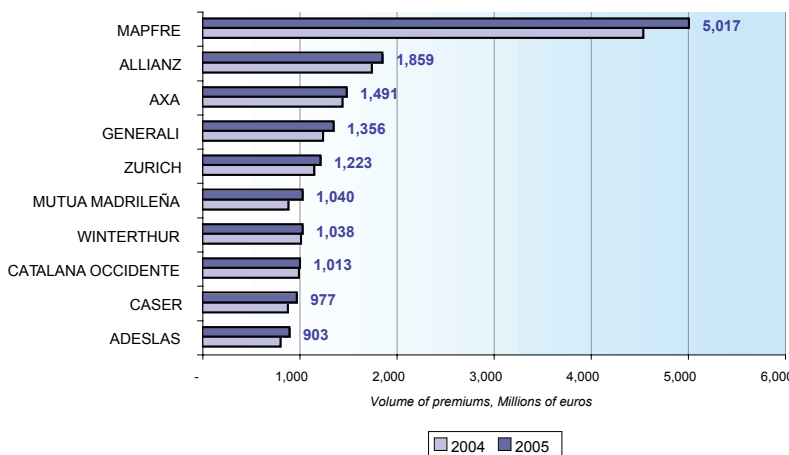


Chart 11.
Ranking of insurance groups by volume of premiums. Non-Life

Source: Prepared in-house on the basis of ICEA data.

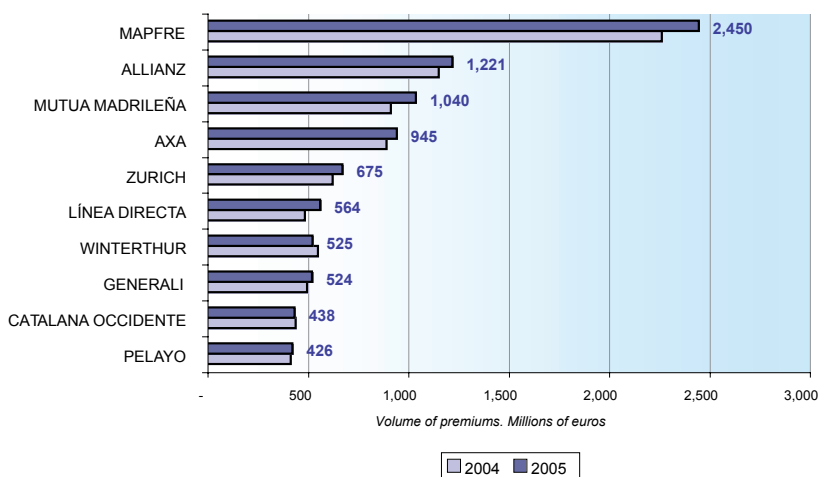
Almost all the groups that go to make up the Non-Life ranking are also present in the Motor insurance ranking, which was once again topped by MAPFRE, followed by ALLIANZ, with market shares of 21% and 10.5%

²⁴ Extracted commentary of the annual report of the Group (year 2005).

respectively. AXA yielded third place to MUTUA MADRILEÑA, which achieved a share of 8.9%. Finally, due to a rise in premiums of 15.5%, LINEA DIRECTA gained two places in the ranking to finally take sixth position.

The top ten Motor insurance groups increased the level of concentration, finally accumulating 75.6% of the total number of premiums within the class, worth 11,659 million euros.

Chart 12.
Ranking of insurance groups by volume of premiums. Motor



Source: Prepared in-house on the basis of ICEA data.

European context

In 2005, the European Union (EU 25) countries collected a total of 925,103 million euros, 6.7% more than in 2004 (4.6% discounting inflation). 61.6% of the premiums corresponded to Life insurance, which grew by 8.7%, more than the Non-Life classes, which achieved an increase of 3.8%.

The country with the greatest volume of premiums is the United Kingdom, followed by France, Germany and Italy. With a 5% share of the total volume of premiums, Spain occupies sixth position, following Holland very closely. In Non-Life, it is in fifth place, whereas it occupies seventh place in Life.

The level of insurance penetration in Europe²⁵ was 8.5%, similar to that observed the previous year. 5.1% corresponds to Life insurance, which rose by one tenth, ahead of Non-Life insurance, which dropped by the same amount. The average premium per inhabitant rose to 1,698 euros, with 1,040 euros of this corresponding to Life insurance premiums.

Reinsurance

The year 2005 witnessed the greatest frequency and intensity of catastrophic losses in the history of reinsurance. The storm at the beginning of the year in Scandinavia, the storms and floods that affected Central Europe

²⁵ Data referring to the 33 countries that make up the European Insurance Committee (CEA).

during the summer and, above all, the hurricanes Katrina, Rita and Wilma – which, in the second half of the year, devastated the south and southeast of the U.S.A. and different areas of the Caribbean and Mexico – all had an adverse influence on the results of the different operators.

The most noteworthy was the Katrina hurricane, which turned out to be the greatest loss ever assumed by the insurance and reinsurance markets, producing losses far in excess of initial estimates from the insurance and reinsurance companies. The indications gleaned from simulation models and accumulation control were clearly outstripped by reality, which will require the assumptions upon which these tools were based to be revised in many cases.

As was the case in 2001, following the World Trade Center attack, there has been an influx of new capital for the creation of new reinsurance companies, as well as for increasing the equity of others already in existence, principally in the Bermudas market. This situation does not facilitate the maintenance of reinsurance prices. Although corrective measures have been applied at specific moments in those markets affected by the catastrophes, an homogeneous behaviour has not been observed in the other markets.

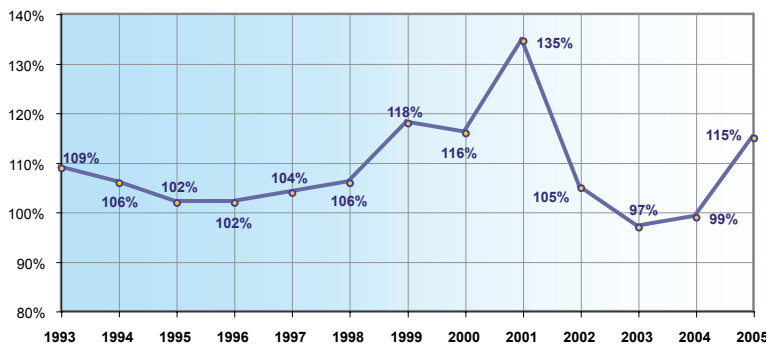


Chart 13.
International
Reinsurance market.
Evolution of combined
ratio.

Source: Standard & Poor's and AM Best. Estimated 2005 data

Unlike the rising cycle of prices that began in the wake of the World Trade Center attack, in 2005 the rates stayed at reasonable technical levels in most of the markets, but symptoms have appeared that could lead to a certain degree of deterioration in conditions for 2006. The markets and businesses not affected by catastrophes have maintained acceptable technical results and, in addition, there has been a slight improvement in financial performance, thanks to the evolution of interest rates and the stock markets.

Given the results that were published during the last quarter of 2005, the rating agencies have put the whole sector under observation with negative prospects, and it is likely that a new phase of strong pressure will commence, so that the reinsurers can maintain their present rating levels. The agencies have published new criteria which they will be applying during 2006 and they will undoubtedly help to maintain suitable levels of capitalisation and force the sector to improve its management of assumed risks.

5. Most notable features by classes

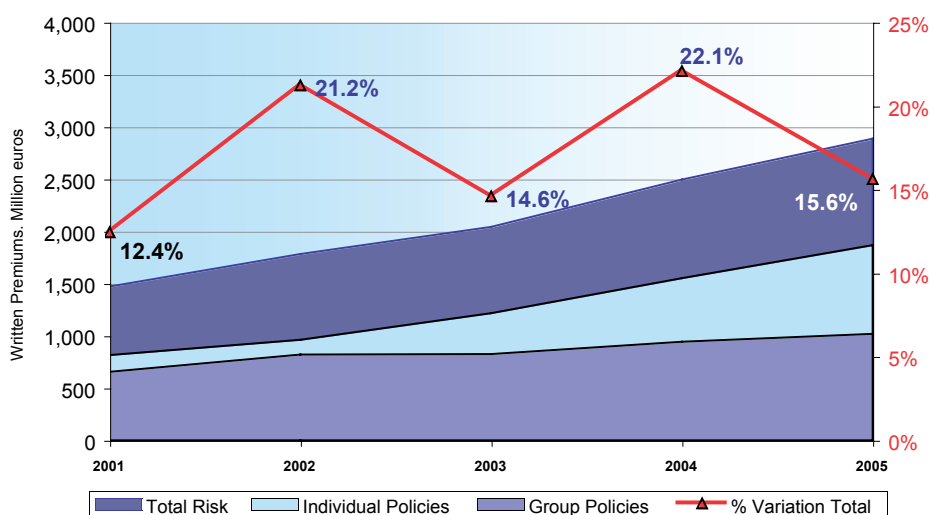
Life Insurance

In general terms, Life insurance closed the year 2005 with positive results, which entail an increase of 6.8% in managed savings and 8.3% in volume of premiums (a greater rise than that experienced in the Non-Life classes, as stated earlier). It is also worth highlighting the progress achieved in the number of insured, which rose by 6.3% to reach the figure of 28.3 million insured, over two thirds of whom corresponded to modalities exclusively with death cover.

As was the case in 2004, individual Life insurance experienced much greater growth than the group life insurance sector, which barely increased by 1% with respect to the previous year. The individual business achieved a growth rate of 10.3%, while accumulating 64% of the total managed savings and 74% of the portfolio of insured parties.

Following the same pattern as in recent years, there was further confirmation of the favourable evolution and rising trend of Risk-Life Insurance, especially those of an individual nature, whose increase in premiums in 2005 was over 19%. The significant collection of premiums in this type of policies was conditioned, among other factors, by the remarkable rise in mortgage loans.

Chart 14.
Evolution of Risk-Life insurance



Source: ICEA. Report on "Evolution of the insurance market".

Within the individual Life insurance policies, retirement products continued to prevail over non-pension savings options. Nevertheless, those policies with guaranteed interest rates (34% of managed savings) were the prevailing option among the administered individual business segment, given that the deferred capital and annuity modalities represented 27.1% and 22%, respectively.

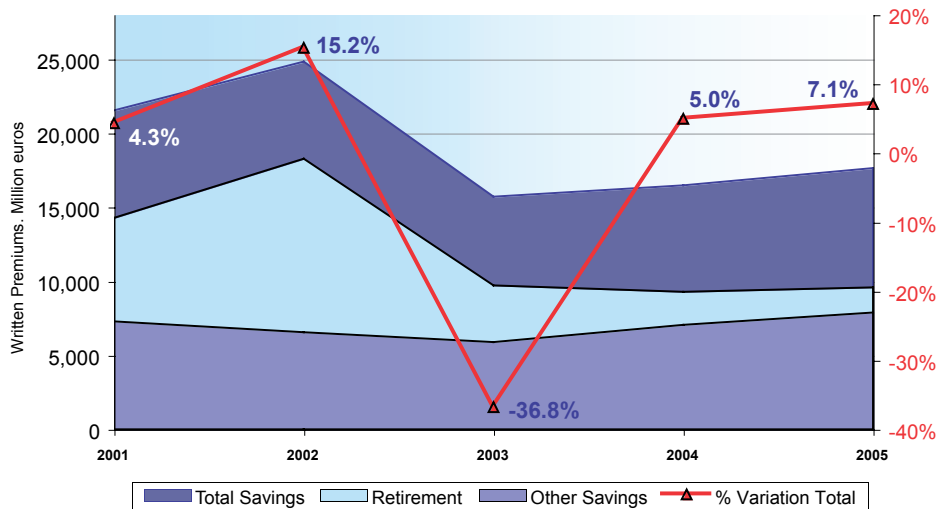


Chart 15. Evolution of Life Savings Insurance

Source: ICEA. Report on "Evolution of the insurance market".

As regards asset-linked Life insurance policies – such as the unit-linked and index-linked products – although they suffered a slight decrease in the total number of insured, they ended the year on a positive note, with an increase in their volume of provisions of 7.3%, principally as a result of the favourable result of this type of products in the intermediary channel – a rise of 14.8%.

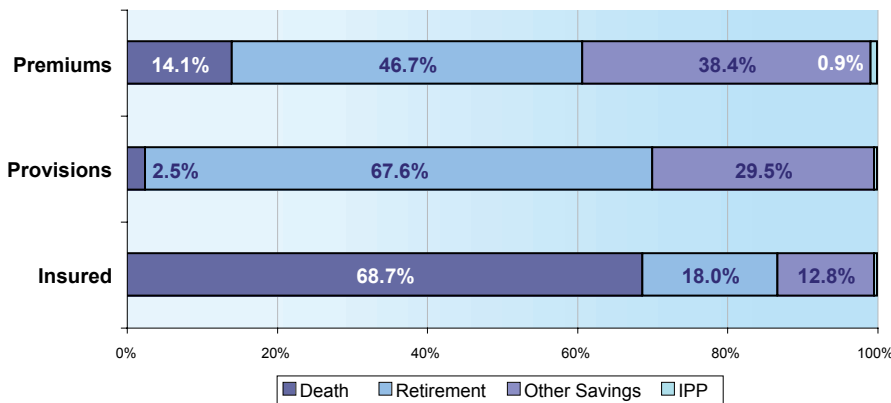


Chart 16. Life Insurance. Distribution by type of product.

Source: ICEA. Report on "Evolution of the insurance market".

The Insured Pension Plans (so-called PPAs) grew over the last year at a rate of nearly 65%, reaching a savings volume of 450 million euros and over 120,000 insured.

In the case of Group Life Insurance policies, their composition remained stable with respect to the situation in 2004, with those modalities offering immediate and deferred income maintaining their predominant position, accounting for 87.2% of all managed savings.

As for the performance of the different distribution channels, the pattern was similar to that observed in 2004. In general, the bancassurance

companies represented 54% of the managed savings sector²⁶, with a rise of 8.2%, followed by the intermediary channel with 42% and a growth rate of 6.2%. On the contrary, direct sales closed the year with a reduction of almost 7%.

Management of Individual Insurance policies was essentially split between the bancassurance channel (57%) and the intermediaries (39%), with a similar result for Group policies (48% bancassurance and 46% intermediaries).

Investment funds performed very well in 2005, thanks to the remarkable evolution of the stock markets and the new products on offer. With respect to the domestic scene, the best performers were the Mixed Fixed-Income funds, with an increase of 31.5%, followed by the Variable Income funds, which rose by nearly 27%. In 2005, all fund categories produced positive yields, most noteworthy being the International Variable Income funds (from emerging countries and Japan, fundamentally, with accumulated yields of 54% and 40% respectively), as well as the Spanish Variable Income funds, which achieved an accumulated yield over the year in excess of 20%.

The total value of Investment funds reached the figure of 244,205 million euros, an increase of 11.2% with respect to 2004. The total number of participants came to 8,477,425, with an accumulated increase of over 500,000 participants (up by 7.2%). The most significant increase corresponded to the Guaranteed Variable Income Funds category, with 168,815 new participants (10.3% more than in 2004).

| <i>Assets. Million euros</i> | | |
|-------------------------------------|----------------|--------------------------|
| Instruments | 2005 | % Δ 2005/2004 |
| Investment Funds | 244,205 | 11.2% |
| Life Insurance | 124,181 | 6.8% |
| Individual | 79,376 | 9.6% |
| Insured Pension Plans | 449 | 71.8% |
| Group | 44,805 | 2.1% |
| Pension Plans | 72,629 | 15.6% |
| Individual's Plan | 43,502 | 17.6% |
| Employment Plan | 28,149 | 12.6% |
| Associated Plan | 978 | 16.7% |
| Social Insurance Mutualities | 23,623 | 8.6% |

Table 3.
Savings/Retirement
Instruments

Sources: ICEA, INVERCO & Spanish Confederation of Social Insurance Entities
Financial study of the Social Insurance Mutualities. Spanish Confederation of Social Insurance Entities.

²⁶ In volume of premiums, the bancassurance companies registered 13,212 million euros, a figure that represents 64.3% of the Life Insurance class.

The evolution of Pension Plans was equally satisfactory, closing the year with a volume of assets amounting to 72,629 million euros, which entailed an increase of 9,822 million euros, this representing an increase of 15.6% with respect to 2004. The number of participant accounts rose by 7.6% to 9,250,729, whereas the estimated number of participants stood at around 7,400,000.

In principle, the prospects for Life insurance in 2006 would seem to indicate a favourable evolution; however, we shall have to wait and see whether these expectations for the insurance market are affected by the new draft law on Personal Income Tax.

In this sense, there is no reason to expect the evolution of Risk-Life Insurance to be very different from that evidenced to date, given that it is most likely we shall continue seeing considerable expansion of both mortgage loans and consumer credits. This factor, together with the launch of new products and offers of complementary services for the same, must surely augur even greater consolidation of this savings formula that has been so well received.

With respect to Pension Plans, the forecasts point to a growth rate similar to that of the last few years, given that, although the draft law on IRPF (Personal Income Tax) Reform has reduced the maximum limits, these will take effect from fiscal year 2007. Given these factors, the growth rates will practically remain unaltered, as barely 5% of new production exceeds the limits set forth in the new draft law.

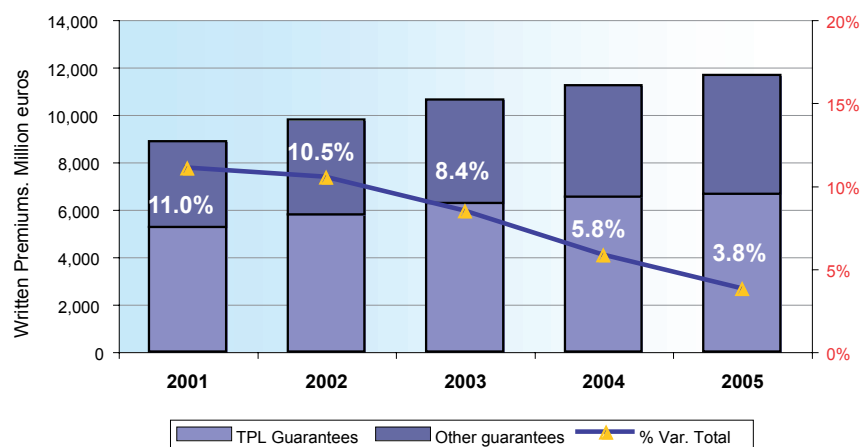
Finally, Investment Funds are looking forward with moderate optimism to 2006, with growth expected to be around 9%. Considering that the stock markets have managed to string together three consecutive years with excellent results, so far as yield is concerned, it is to be expected that the guaranteed variable income funds, as well as the mixed funds, will gain ground within the sector as a whole and be the principal driving force, given the less positive evolution of the fixed income funds.

Motor Insurance

The Motor insurance class still heads the 2005 ranking for Non-Life Insurance, given that it accounts for 41.4% of written premiums, although this lead is being eroded by increased growth in other Non-Life classes.

Written premiums in 2005 reached the figure of 11,659 million euros, with an increase of 3.8% over the previous year. This growth is fundamentally due to the sharp increase in the number of insured vehicles (up 4.7% to 25.7 million vehicles), especially top-of-the-range models, and by greater coverage being taken out for each insured vehicle, since the variation in tariffs has been negative, with an average decrease of around 1%.

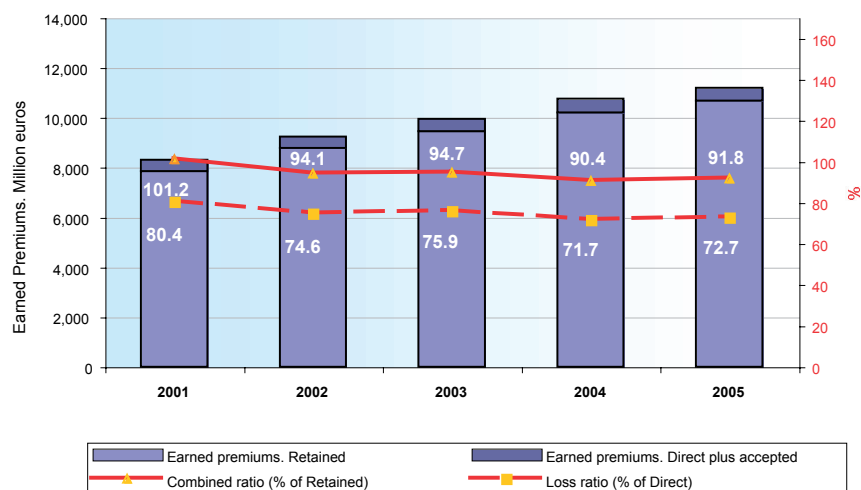
Chart 17.
Evolution of Motor
Insurance



Source: ICEA. Report on "Evolution of the insurance market". INE.

The claims frequency has not changed with respect to 2004, remaining at 47.1%²⁷, whereas the average cost per claim²⁸ increased slightly, from 620.1 euros to 622.4 euros in 2005. Therefore, the loss ratio for the class rose one point, reaching 72.7%. Acquisition expenses turned around the decreasing trend of the last three years, increasing by four tenths to 13.9%. As a consequence, there was a slight worsening of the technical result to earned premiums ratio, now standing at 16.6% (17% in 2004), with a combined ratio of 91.8%.

Chart 18.
Evolution of loss ratio.
Motor Insurance



Source: ICEA. "Economic report on the insurance sector".

The sector witnessed a continued trend towards greater concentration of companies in 2005, with the top ten Motor insurance groups accounting for 75.6% of the market share, compared to 73.5% the previous year. Likewise, the increased rate of production achieved by companies specialising in

²⁷ ICEA data. Percentage of incurred losses corresponding to policies in force at the end of the year.
²⁸ ICEA data. Average cost per claim ending in some payment, independently of the year of occurrence. Neither the provision figures nor the expenses attributable to benefits are included.

direct sales was maintained, with growth exceeding 15% within the major firms.

2006 is likely to see very moderate growth in premiums (under 3% is the estimated rate) and a worsening of the Profit & Loss Account, particularly if, given the profits for the class in 2005, there is any relaxation in the technical rigour applied to underwriting and rating.

As regards the principal innovations on the legislative front, it is expected that the introduction of the penalty points system for driving licences on July 1st 2006 will lead to a reduction in the loss ratio, although principally from 2007 onwards. Moreover, certain economic elements – such as the increased cost of fuel – may also influence this reduction.

Finally, we must mention the fact that, by June 11th 2007, member States are obliged to incorporate into their respective national legislation the provisions of Directive 2005/14/EC, relating to mandatory third-party Motor insurance. The “Fifth Directive”, as it is commonly known, will introduce a whole raft of improvements – related to the modernisation of claims management and attending to victims’ needs – and stipulates a substantial increase²⁹ in the minimum cover provided by the mandatory insurance currently in force.

Multi-Peril Insurance

Within the Non-Life classes, second place went to Multi-Peril Insurance policies, with a market share of 16.3%. During 2005, the class evolved positively, although somewhat slower than in 2004. Written premiums reached the figure of 4,591 million euros, which represents an increase of 10.4% (11.2% in 2004), caused mainly by the implementation of restructuring policies within the sector, with a view to updating tariffs and enhancing risk selection processes.

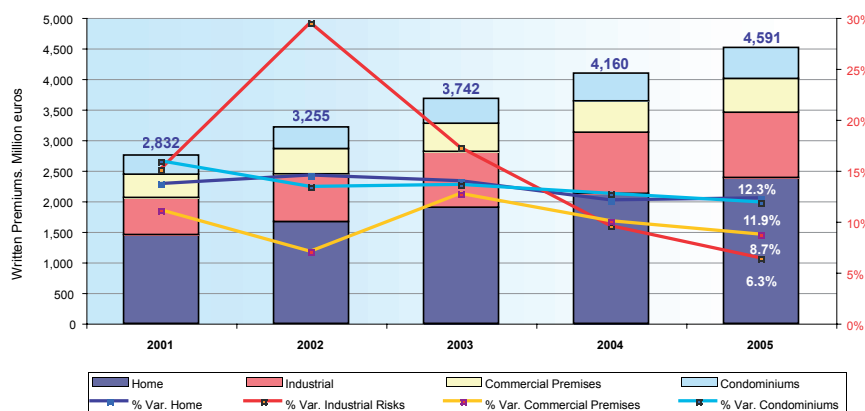


Chart 19. Evolution of Multi-Peril Insurance

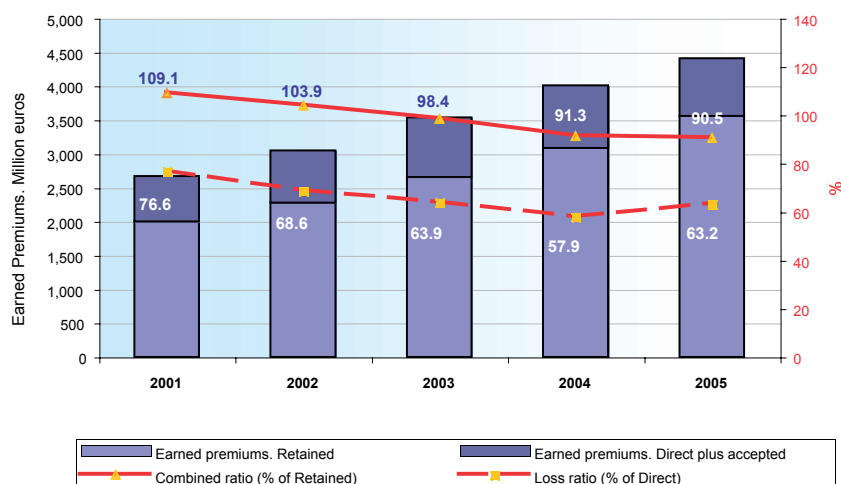
Source: ICEA. Report on “Evolution of the insurance market”.

²⁹ Specifically, Directive 2005/14/EC stipulates that the mandatory minimum indemnity for personal damages should be one million euros per victim or five million per loss, whatever the number of victims involved in the car accident. As for material damages, the minimum insured cover will be one million euros. These numbers will be revised every five years.

An analysis of the data by type of business reveals remarkable differences, both in terms of growth and claims behaviour. The greatest rate of growth corresponds to Home insurance, with a 12.3% rise and over 14 million homes insured, followed closely by Condominium policies, up 11.9%. Industrial policies dropped almost three points with respect to 2004 and practically 10 points with respect to 2003, now standing at 6.3%. In the same vein, yet with a more moderate reduction, is Commercial insurance, whose 8.7% growth is two points below the 2004 figure.

The different growth rates can be explained by the substantial difference that exists between the products for each type of business. In the Home and Condominium segments, where growth is favoured by the performance of the construction sector, it is difficult to introduce new features and so efforts focus on updating and extending cover options. Even so, moves are underway to introduce guarantees for pecuniary losses (e.g. providing landlords with protection against possible non-payment of rent), and cater for cover that has traditionally been excluded, such as theft or accidental collapse (the latter a topical issue, following the metro tunnel collapse in the 'El Carmel' district of Barcelona). In addition, an intensification of competition is observed that could lead to more aggressive pricing policies. With regard to Commercial Multi-Peril, now that the restructuring of the technical margin undertaken in recent years – by means of increases in the average premium of the portfolio – has been consolidated, it is proving more difficult to grow, especially taking into account the high level of insurance penetration that exists. The growth rate of Industrial Multi-Peril insurance has been lower, due to the high complexity of the product and to the sensitivity of clients to price levels.

Chart 20.
Evolution of loss ratio.
Multi-Peril Insurance



Source: ICEA. "Economic report on the insurance sector".

Last year's results were positive, but they were affected by an upturn of 5 points in the loss ratio³⁰, which, at 63.2%, is still at a reasonable level. To offset this, the evolution of technical investments was favourable, with

³⁰ Ratio calculated on earned premiums, direct and accepted business.

an improvement in the balance between expenditure and revenue of more than one point. Another determining factor of the loss ratio is the effort made to reduce operating expenses, which maintained their downward trend and fell by half of one point over the last year, reaching 28.5% of earned premiums. Thus, the technical account result went from 14.6% in 2004 to 11.3% in 2005.

In stark contrast to the said rise in the loss ratio, there was a striking fall of eight tenths in the combined ratio³¹, which now stands at 90.5%. The explanation for this can be found in Industrial Multi-Peril, which experienced an increase in the loss ratio way above the average in 2005. The data show that this deviation was absorbed to a large extent by the reinsurance market, through non-proportional contracts, with the result that the business retained by the insurance companies was not particularly affected.

Health Insurance

The year 2005 was marked by the continuing trend observed in the different figures in recent years. The volume of premiums reached 4,490 million euros, which corresponds to an interannual variation of 9.6%. Compared to the other Non-Life classes, Health merits third place in terms of volume of premiums, accumulating a market share of 16%.

These growth rates have been repeated in this sector over the last few years. If we consider the interannual variation in the prices of medical policies, which was 4.9% in 2005³², this gives us a real growth figure from new business of 4.7%, which is also in line with the results in previous years.

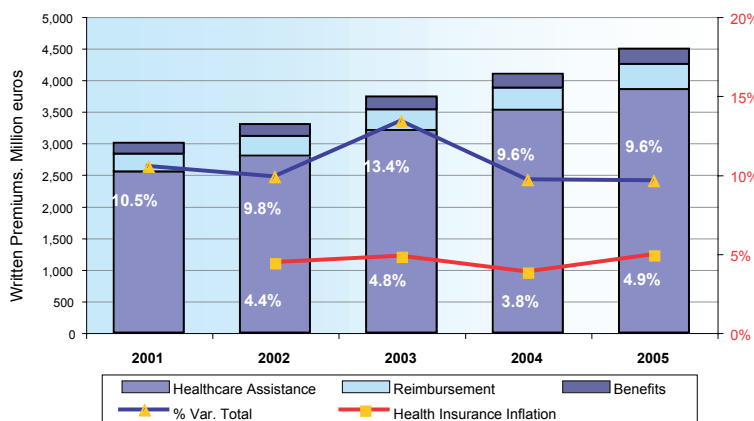


Chart 21.
Evolution of Health Insurance

Source: ICEA. Report on "Evolution of the insurance market".
National Statistics Institute.

³¹ Ratio calculated on earned premiums, retained business (net of ceded reinsurance).

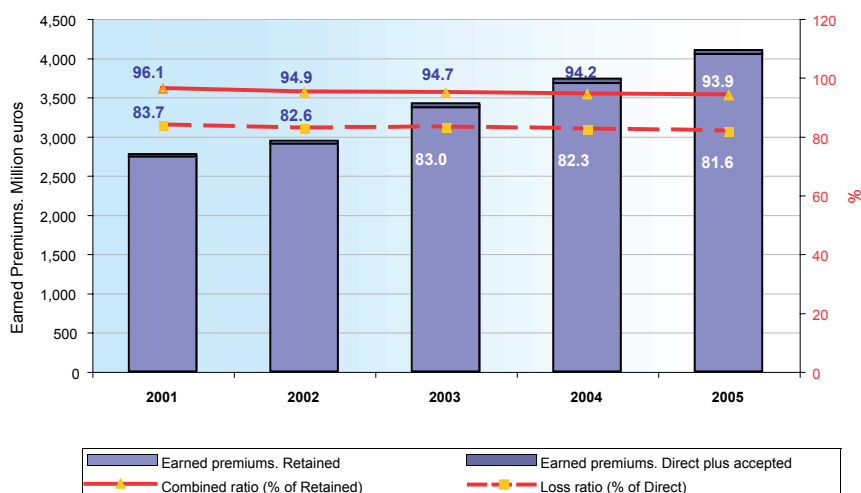
³² According to the annual average variation of the Consumer Price Index by subclasses furnished by the INE.

Healthcare Assistance continues increasing in importance within the Health class, with a share of 87% in 2005, followed by Reimbursement of Expenses and Benefits and Compensation.

As regards contracting modes, group policies would appear to be the most dynamic. In addition to company policies, the opportunities for development within the sector entail a clear identification of population segments that require specific products, as well as the inclusion of new services that provide added value to the products that are currently commercialised.

Concerning the evolution of the technical account, there has clearly been an improvement in its result over the last few years, basically as a result of the reduction in the loss ratios. In 2005, the loss ratio dropped by seven tenths, with respect to the previous year. As for administration expenses, they increased slightly, while acquisition expenses fell. The combined ratio has revealed very similar values in recent years, albeit with a downward trend.

Chart 22.
Evolution of loss ratio.
Health Insurance



Source: ICEA. "Economic report on the insurance sector".

During 2005, there were important advances towards a definitive configuration of the Dependency cover that will significantly affect Health insurance companies in the coming years. In December, the Government passed the law to Promote Personal Autonomy and Care for Dependent People, which is seen as the fourth Pillar of the Welfare State in Spain, after pensions, education and health. For the insurance companies, this is an important landmark, as it will finally determine the breadth and depth of public cover and, therefore, the possibilities for commercialising insurance products, as well as the possible fiscal incentives for contracting such private insurance policies.

Third-Party Liability Insurance

Although the volume of written premiums has increased substantially in recent years, one can also observe a considerable deceleration in growth, which stood at 9.5% in 2005, this being the first time that the rate of variation within Third-Party Liability did not reach a two-digit figure. Despite this, the class still occupies fourth place in the Non-Life insurance ranking, with a share by volume of premiums of 6.3%.

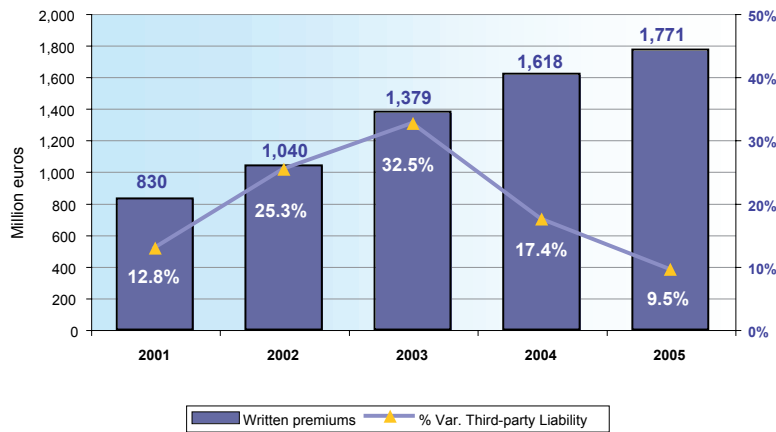


Chart 23.
Evolution of Third-Party Liability Insurance

Source: ICEA. Report on “Evolution of the insurance market”.

Third-Party Liability is one of the Non-Life classes that entails the greatest level of business ceded to reinsurance (the percentage of retention oscillated between 30% and 40% during the analysed series), as can be seen from the following chart. The loss ratio for the direct plus accepted insurance increased by almost three points with respect to the previous year to reach 80.5%, whereas the combined ratio, calculated on retained business, stood at 98.5%, compared to 107% in 2004.

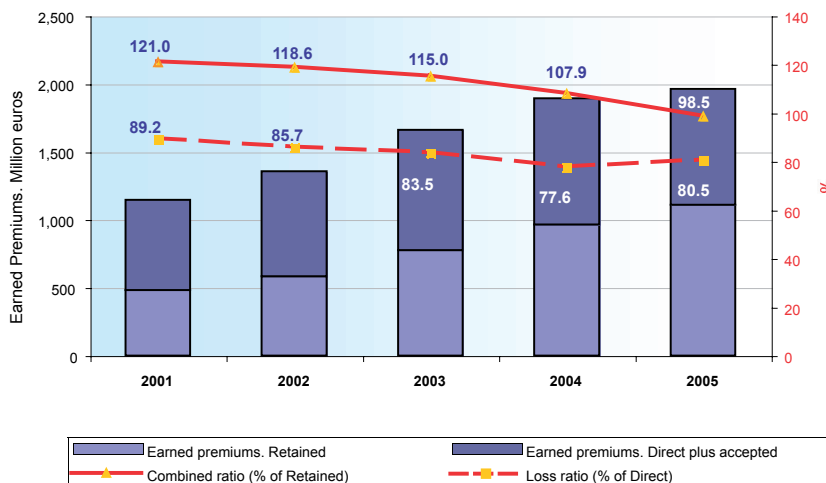


Chart 24.
Evolution of loss ratio. Third-Party Liability Insurance

Source: ICEA. “Economic report on the insurance sector”.

On the other hand, at the close of this year, the trends observed at the start of the year were confirmed: a reduction in the level of premiums corresponding to major risk policies with a good loss ratio, as well as in the Third-Party Liability policies for Directors and Officers (D&O). Nevertheless, it is not possible to state categorically that this has been the case for other insurance modalities with a heavy loss load: Public Administrations and Professional Liability. As for the Healthcare Sector, in both the private and public sectors, there is still a certain dearth in the insurance on offer, although new operators with capacity available for these segments have appeared.

Indeed, in relation to healthcare risks, work has started on the drafting of a specific "Scale" of indemnities for victims of medical malpractice. Perhaps the system of assessing the injuries people suffer in traffic accidents could be taken as an example, in order to increase the efficiency of claims management in such cases of malpractice and reduce the frequency of resorting to the courts.

Directive 2004/35/EC on environmental liability, with regard to the prevention and remedying of environmental damage, lays down the deadline of April 30th 2007 for member States to incorporate these regulations into their national legislations. In Spain, work has already begun and the process is currently at the "initial draft law" stage. This initial draft envisages a system of mandatory financial guarantees, wherein the Insurance policy takes on a highly relevant role, despite the fact that the insurance sector has been incessantly expressing its reserves with regard to this insurance modality, which the sector feels should be put on hold.

Another recurrent theme is the continuous adoption of regulations that make it mandatory to take out Third-Party Liability insurance and which pose serious technical problems when it comes to complying with their requirements. With a view to responding to these shortcomings, a Working Group has been created between the professional association of insurance companies, UNESPA, and the Spanish Federation of Municipalities and Provinces (FEMP) in order to analyse the situation and put forward initiatives in an attempt to resolve this situation.

Finally, it is worth highlighting the Ruling of May 30th 2005, handed down by Section Nine of the Provincial Court of Barcelona, which managed to construe in a somewhat preposterous fashion the "Serial Losses" clause, habitually used in Product Liability policies. The Court awarded a global indemnity figure of around 11 million euros to the 117 parties affected by the explosion of defective firecrackers, when the insured sum contracted as the maximum limit was in fact 150,000 euros. This case has not only caused great concern within the insurance sector, but has led to the insurer for the firework manufacturer filing for voluntary bankruptcy and receivership.

In short, the insurance market in general, and the Third-Party Liability class in particular, has entered a phase where there are new insurers appearing on the scene, who are free to set up operations here and are ready and willing to operate in certain risk categories in which, to date, the other players in the traditional market have not shown much interest.

Burial expenses Insurance

Burial expenses insurance accounts for 5% of all Non-Life premiums and covers 60% of the population, which means handling approximately 56% of all deaths that occur in Spain.

The written premiums for Burial expenses insurance in 2005 amounted to 1,371 million euros, with 70% of the market share being in the hands of three companies. The growth in written premiums was 6% with respect to 2004.

Given the volume of the population insured, the growth rate is due, above all, to the updating of the insured sums. As regards its evolution and adaptation, it is worth mentioning the development of specific products for the immigrant population (who accounted for 8.5% of Spain's total population in 2005), as well as the transformation of the traditional Burial Expenses class into an authentic platform of services. All manner of services are provided, not simply those directly linked to the interment – where the most noteworthy issue is the increasing tendency to opt for incineration – but also those related to the death itself, such as handling the paperwork, offering psychological aid, educational and domestic personnel, etc. In short, this is a sector in constant evolution and, instead of specialised companies, now calls for multi-class companies that can increasingly cater for the welfare and service aspects of this field.

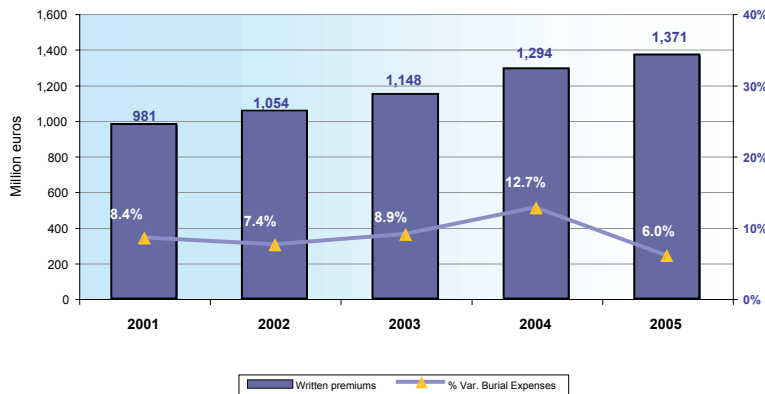
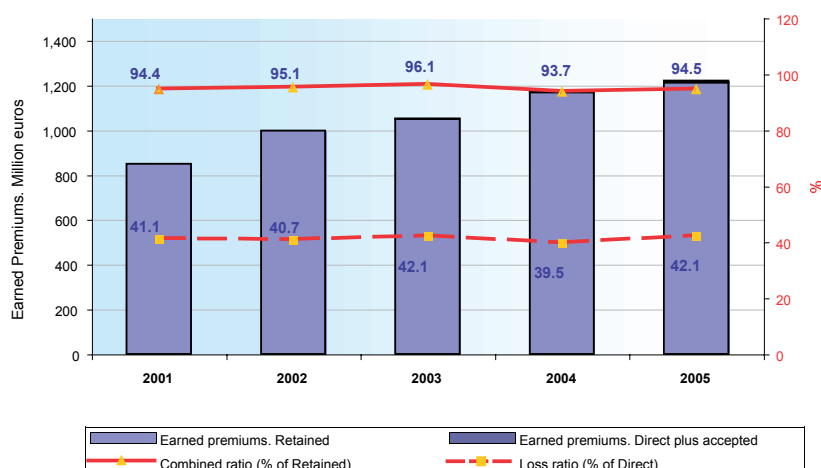


Chart 25.
Evolution of Death
Insurance

Source: ICEA. Report on "Evolution of the insurance market".

The technical result came to 11.6%, an improvement of one point over the 2004 figure and the best result of the last five years, principally due to the efforts required to manage to reduce the acquisition and administration expenses. The loss ratio reached 42.1% of earned premiums.

Chart 26.
Evolution of loss ratio.
Death Insurance

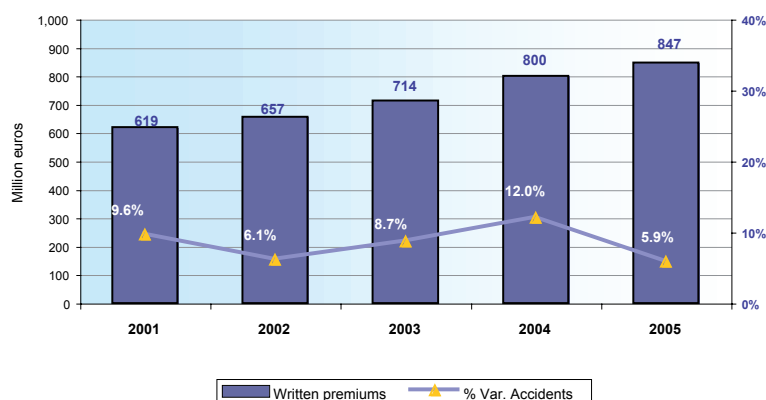


Source: ICEA. "Economic report on the insurance sector".

Personal Accident Insurance

The volume of written premiums in the Accidents class during 2005 came to 846.8 million euros, which represents 3% of all premiums within the Non-Life segment. With respect to the previous year, growth was 5.9% and thus ended the accelerated growth rate observed in the previous two years.

Chart 27.
Evolution of Accident
Insurance



Source: ICEA. Report on "Evolution of the insurance market".

The loss ratio for the class has undergone a slow, continued reduction in recent years, dropping from 53.8% in 2001 to the current 47.1%. Operating expenses fell slightly and, therefore, the technical result improved by two points, now standing at 24.2%. The combined ratio on net earned premiums reached 85.1%.

Credit & Surety Insurance

During 2005, premiums written for Credit policies amounted to 550 million euros, an increase of 4% with respect to 2004. When comparing

the increases in premiums over the last few years, a clear slowdown can be observed year on year.

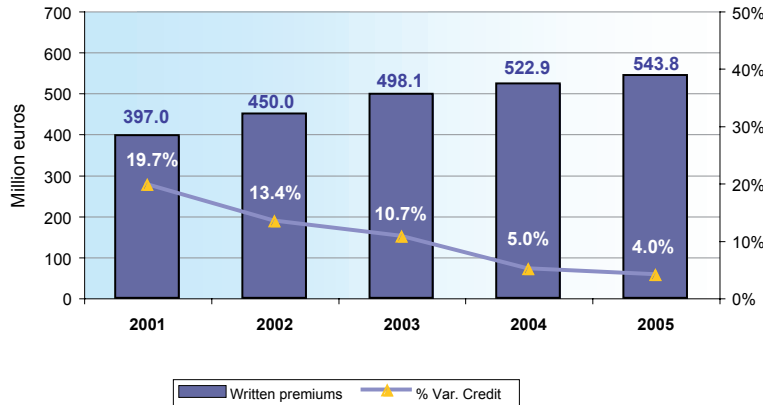


Chart 28.
Evolution of Credit Insurance

Source: ICEA. Report on "Evolution of the insurance market".

Credit insurance is in a phase of total maturity, with a market characterised by stiff competition between the three national companies and all the major international Credit insurance groups, in an economic environment that is still favourable. On the one hand, this has led to an aggressive, rather unjustified reduction in premium rates to levels never seen before and, on the other hand, to an increase in cover conditions. Both factors explain an upturn in the loss ratio and the aforementioned downward growth trend in premiums.

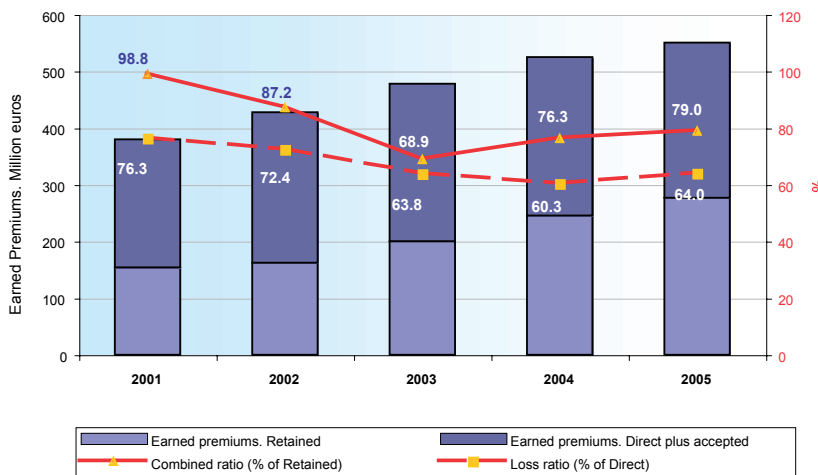


Chart 29.
Evolution of loss ratio. Credit Insurance

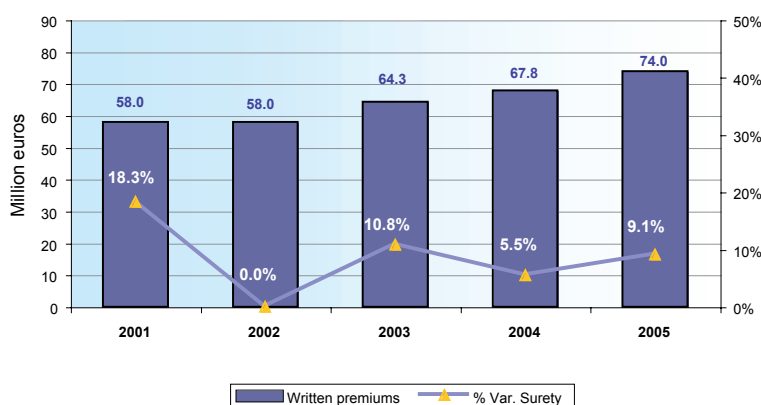
Source: ICEA. "Economic report on the insurance sector".

The loss ratio reached 64% of earned premiums, which represents an increase of 3.7 points with respect to 2004 and a reverse of the falling loss ratio trend initiated in 2003. Operating expenses practically stayed the same, representing 31% of earned premiums. As a result of all the foregoing, the combined ratio now stands at 79%, as opposed to 76.3% the previous year.

Should the downward trend in tariffs mentioned above be accompanied by the expected upturn in default and insolvency rates, as was the case in 2005, the prospects for the coming year are not so favourable; indeed, the percentage growth rates are expected to be lower than at present and more in line with our European neighbours. Great attention must be paid to cost containment, the evolution of the loss ratio, as well as to the application of policies of maximum effectiveness, as regards the recovery of outstanding debts.

As for Surety insurance, 2005 saw an increase of 9.1% with respect to the previous year. The fundamental cause of this growth may lie in making better use of the capacities of the reinsurance market to cater for the needs of major promoters.

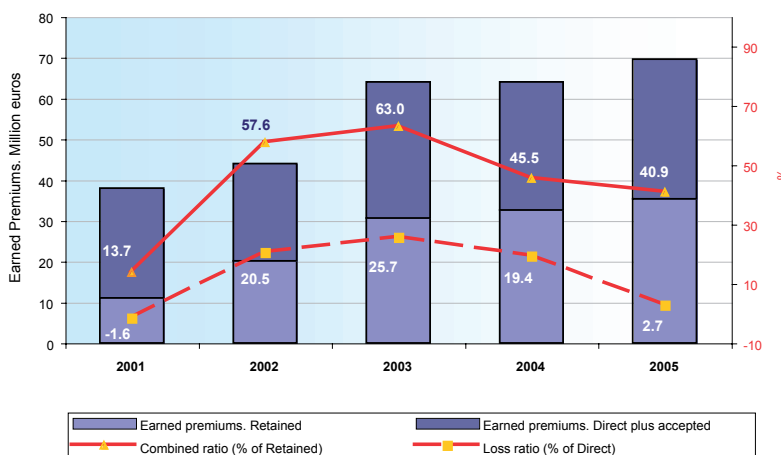
Chart 30.
Evolution of Surety Insurance



Source: ICEA. Report on "Evolution of the insurance market".

With respect to the premium rates, no significant variations have been observed and it is expected that they will evolve very similarly in 2006. The loss ratio can only be described as excellent, reflecting the buoyant economic situation being enjoyed by the construction and real estate promotion sectors. Operating expenses were at very similar levels to those of the previous year, a fact which, together with the aforesaid reduced loss ratio, enabled a highly favourable technical result to be achieved.

Chart 31.
Evolution of loss ratio.
Surety Insurance



Source: ICEA. "Economic report on the insurance sector".

As regards next year, the real estate sector will grow, despite the slight deceleration in growth already observed, and this will probably enable the Surety insurance sector to maintain the current trend.

Other Industrial Insurance

In this section, we shall analyse the Engineering (Machinery Breakdown, Construction Multi-Peril, Ten-Year Construction Insurance, Erection, Electronic Equipment and Product Warranty) and Transport (Marine, Goods and Aviation) classes, given that Third-Party Liability and Multi-Peril were commented on earlier in this report.

With the exception of Machinery Breakdown, the Engineering sector has maintained a high rate of growth, thus continuing the trend of previous years. This increase in the volume of premiums is headed by Construction insurance, with 229 million euros, which represents an increase of 36.1% on the previous year, mainly due to the increase in the volume of public works.

Next in line as regards growth is Ten-Year Construction Insurance, which, although still boosted by the development of the real estate market, has seen its growth fall to 20.9%, with a volume of 350 million euros. This class reveals a moderate loss ratio, although we must be prudent, given that this is a long-term policy and we shall have to wait a few years to discover the true results.

Machinery Breakdown insurance has seen the upward trend end and, in fact, has dropped 6.1% on the previous year's figures, which results in a volume of premiums of 164.9 million euros.

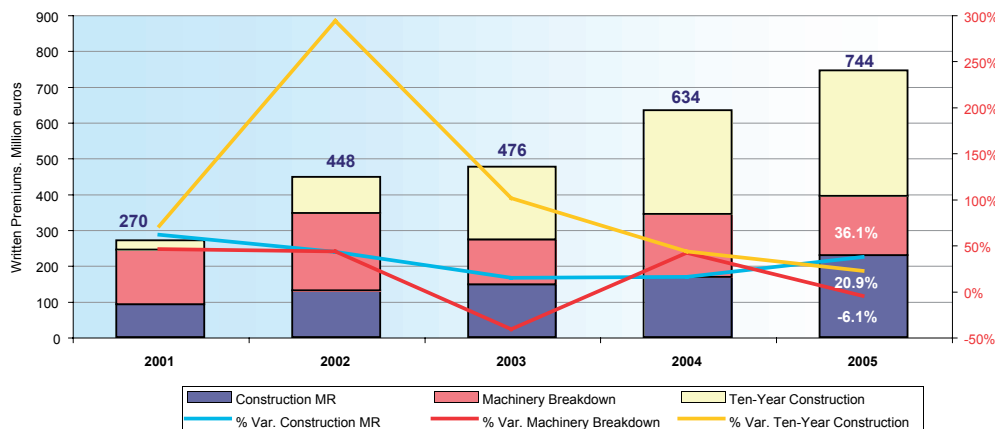


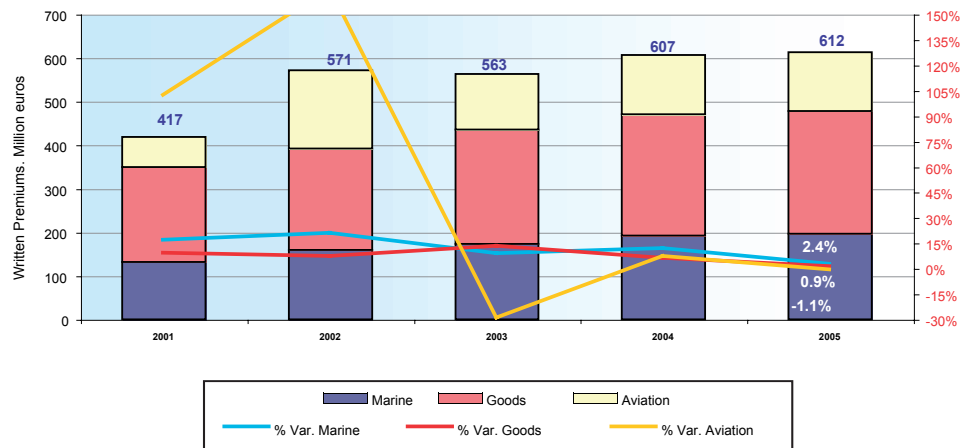
Chart 32. Evolution of Engineering Insurance

Source: ICEA. Evolution of the insurance market

Characterised by having to perform within a highly saturated market, Transport insurance has experienced a foreseeable deceleration in its growth over the last year, growing from 607 to 612 million euros, which represents an increase in volume of premiums of 1%.

By classes, the greatest growth corresponds to Marine insurance, which achieved an increase in premiums of 2.4%. The figure is not so high, to a large extent due to the fierce competition observed in recent years and to the consequent fall in premium rates. Nevertheless, it is interesting to note the transfer of competition from the Marine sector to Goods insurance, a segment with less concentration, where the companies are adopting measures in order to gain a foothold in the market. Also worth noting is the changing trend within Aviation insurance, which dropped slightly by 1%.

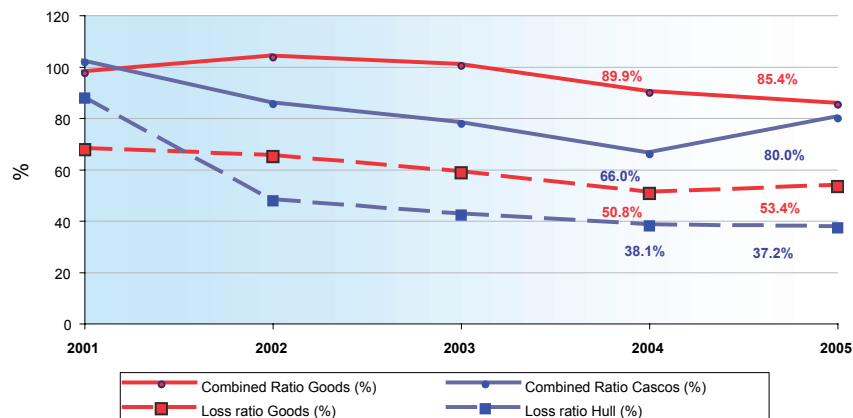
Chart 33.
Evolution of loss ratio.
Transport Insurance



Source: ICEA. Evolution of the insurance market

As for the technical result in this class, the moderate loss ratio in both Goods and Hull insurance has continued, although a slight upturn can be detected in the loss ratio for Goods, rising from 50.8 % to 53.4%. In the same fashion, the combined ratio in Hull insurance rose from 66% to 80%.

Chart 34.
Evolution of loss ratio.
Transport Insurance



Note: percentages of earned premiums, net of reinsurance for the combined ratio.
Source: ICEA. Economic report on the insurance sector.

Multy-Peril Agricultural Insurance

The Spanish System of Multy-Peril Agricultural Insurance is a model of cover for damages caused to agricultural, livestock, aquacultural and forest production facilities, in which both private and public institutions participate jointly. The insurance companies support the risk of this activity by pooling resources in a co-insurance arrangement known as Agroseguro. The Consorcio de Compensación de Seguros acts as a direct insurer and an mandatory underwriter of some lines of business, and the State and Regional Administrations subsidise part of the premium. Farmers are free to sign up to the system if they wish, this is purely voluntary. 2005 marked the 25th year of operation of Agroseguro, which came about with the adoption of Spanish Law 87/1978.

Insured production in 2005 amounted to 27,254,476 tonnes and corresponds to an insured capital sum of 9,879 million euros, 10% above the 2004 figure. The level of insurance for agricultural and livestock production stands at around 40%, the most noteworthy being the high level of cover sought for winter cereals (70%), fruit trees (80%) and the highly particular banana sector in the Canary Islands (100%).

The volume of accrued net premiums in 2005 came to 492.48 million euros, 12.3% more than in 2004, which constitutes 2% of the Non-Life earned premiums in 2005.³³ The premium subsidies from public administrations in 2005 came to 58%.

Multy-Peril Agricultural Insurance premiums from the main insurance companies operating in this class were as follows in the year 2005:

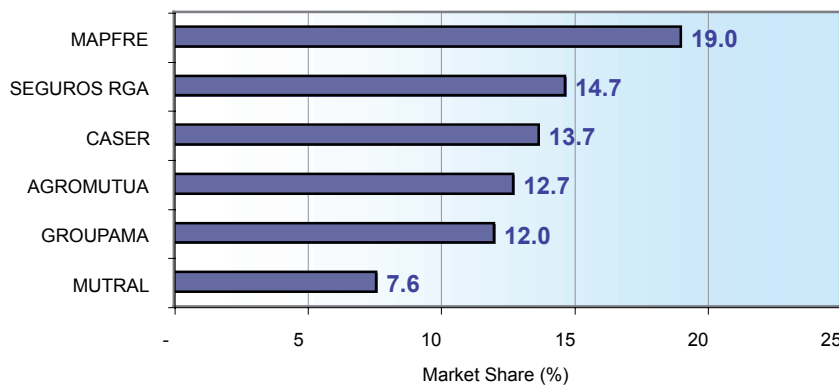


Chart 35.
Multi-Peril Agricultural Insurance premiums from the principal insurers in 2005

The number of policies contracted in 2005 was 514,767, 16% more than in 2004. The distribution by groups of product lines is: 59% for agricultural insurance, 9% for livestock insurance and 32% for the removal and destruction of animal corpses.³⁴ The number of animals insured in 2005

³³ The concept of “accrued net premiums” or “acquired premiums” is similar to the concept of “earned premiums” published by ICEA in its “Economic Report of the Insurance Sector”.

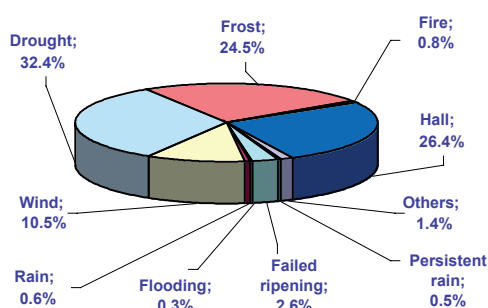
³⁴ Hereinafter MER (Specific Risk Materials) and MAR (High Risk Materials). They cover, respectively, the expenses stemming from the transportation and destruction of cattle that die on the farm and those stemming from the transportation and destruction of non-bovine animals that die on the premises (pigs, poultry, etc.).

was 187,137,779, 106% more than in 2004 (90,567,594). This increase can be explained by the introduction in 2005 of new lines of MER/MAR insurance and the elevated number of policies taken out.

The loss ratio during 2005 was 122.2%, the highest ever recorded by the system since its creation. The principal reasons for this high loss ratio are the following:

- The periods of frost at the end of January and various dates in February and March, which affected citrus and other fruit trees in Levante, the south-eastern provinces and Andalusia.
- The severe drought that affected cereals and indemnities for pasture drought insurance all over Spain.
- The Canary Islands' two principal crops were significantly affected: the tomatoes, due to the low winter temperatures and, above all, the virosis plague; and the bananas, by the tropical storm Delta that occurred at the end of November.

Agricultural Risks



Livestock Risks

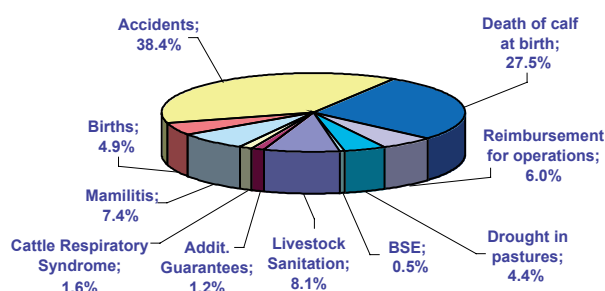


Chart 36.
Distribution of losses by risk. Year 2005

Source: AGROSEGURO. 2005 Annual Report

An increase is expected in 2006 in the number of Multy-Peril Agricultural Insurance policies taken out, due to the high rate of losses in 2005 and by the extension and enhancement of cover provided by some policies. The sector is also expecting the launch of new products, such as insurance for beef-producing operations, including Foot-and-Mouth Disease cover, insurance for egg-laying hen operations, or the extension of the geographical limits of the MER/MAR insurance to new regions within Spain.

6. Legal changes

We shall now summarise the contents of several regulations approved in 2005, both at a national and EU level, as well as some draft regulations currently being proposed, which are deemed to be of special interest to the insurance sector.

Spanish Law 20/2005, of 14th November, on the creation of a Register of Insurance Contracts with death cover. Published in BOE No. 27 of 15th November 2005.

This Law envisages the creation of a public Register, dependent on the Ministry of Justice, in which all insurance contracts offering Life coverage, entered into in Spain, must be duly recorded.

The aim of this register is to provide the information necessary to enable any possible interested parties to discover whether a deceased person had taken out a policy with death cover, as well as the insurance company with which this was done. Any possible beneficiaries may thus contact this company in order to confirm whether they are indeed named as beneficiaries and, if so, seek the benefit forthcoming under the policy from the said company.

Specifically, the register must include those insurance contracts providing Life insurance with death cover, as well as Accident policies that cover the contingency of the death of the Insured, whether they are individual or group policies. Duly excluded are the following: those policies that implement the pension commitments of companies vis-à-vis their employees and beneficiaries, as regulated under Royal Decree 1588/1999; those policies in which, in the event of the death of the Insured, the Policyholder and the beneficiary are the same person; and those contracts entered into by social insurance mutualities acting as an instrument for company social security payments, mutualities of professional associations and mutualities whose sole purpose is to provide teaching or educational benefits or subsidies.

The insurance companies are obligated to communicate certain data to the Register, duly identifying the insured party and the type of cover provided under the policy. Moreover, they must report when the benefit forthcoming under a certain contract entered in the Register has been satisfied, with non-fulfilment constituting an administrative infringement.

Spanish Law 5/2005, of 22nd April, on the supervision of financial conglomerates, duly amending other laws affecting the financial sector. Published in BOE No. 97 of 23rd April 2005.

The significant concentration and consolidation moves within the European financial sector have led to the creation of intersectoral groups (financial conglomerates) whose activities cover services traditionally offered by banks, insurance companies and investment companies. In the light of this, the European Commission decided to prepare draft regulations in order to seek an adequate response

to the appearance of new risks and the aggravation of those already in existence, as a result of the intensification of the ties and links between these three sectors. In addition, these regulations would correct the differences that exist between the different sectoral legislations involved.

This decision thus led to the adoption of Directive 2002/87/EC by the European Parliament and Council, dated 16th December 2002, in relation to the supplementary supervision of credit institutions, insurance companies and investment services companies within a financial conglomerate.

Spanish Law 5/2005 transposes Directive 2002/87/EC to the Spanish legal system and thus responds to the fundamental goal of establishing a specific prudential scheme applicable to financial conglomerates.

Chapter I focuses on the design of a new supervision system, to which all the companies that go to make up a financial conglomerate must adhere, and the following three chapters contain a series of modifications to the specific legislations that govern the credit institutions, the stock market and the insurance sector, with a view to achieving a suitable level of consistency among them.

Royal Decree 1332/2005 of 11th November, which elaborates upon Spanish Law 5/2005 of 22nd April, on the supervision of financial conglomerates, duly amending other laws affecting the financial sector. Published in BOE No. 280 of 23rd November 2005.

This Royal Decree completes the transposition of Directive 2002/87/EC, partially implemented by Spanish Law 20/2005, as outlined above.

The principal aspects it deals with are summarised below:

- Chapter I duly establishes the scope of application of the regulations.
- Chapter II sets forth the elements the supplementary supervision will entail: capital adequacy policies, intra-group operations, risk concentration and management, internal control mechanisms and the reputation and experience of directors at mixed financial holding companies.
- Chapters III and IV sets forth various aspects relating to the coordinator of this supervision.
- Chapter V defines the regulatory powers enjoyed by the various supervisors in order to develop the supplementary supervision methods for those groups whose parent company is a regulated entity or a mixed financial holding company with registered offices outside the European Union.
- The final provisions set forth the revision of sectoral rules (banking, investment and insurance), making them regulatory and seeking a suitable level of consistency between them all.

Royal Decree Law 16/2005 of 30th December, duly amending the transitory regime for adapting the control commissions of employment pension plans and regulating the adaptation of certain retirement pension commitments. Published in BOE No. 313 of 31st December 2005.

This Royal Decree Law regulates aspects related to the composition of the control commissions for the employment system pension plans and the minimum requirements for the adoption of agreements on certain matters.

Moreover, it extends the period for externalising certain retirement pension commitments – the so-called “retirement awards” – until December 31st 2006 and regulates certain technical conditions of insurance contracts and pension plans entered into to implement the same.

Following this analysis of the legislation introduced during 2005, we shall now comment briefly on the evolution of certain draft regulations that are of particular relevance to this sector.

Draft Law on Private Insurance and Reinsurance Mediation

With the goal of transposing Directive 2002/92/EC on Insurance Mediation, and following discussion on several draft versions, the Draft Law on Private Insurance and Reinsurance Mediation was introduced before the lower house of the Spanish parliament on July 26th 2005 and the law was finally passed, with modifications thereto, on June 22nd 2006.

One of the principles that inspired this directive was customer protection and, in this sense, the idea is to demand greater and more specific information of insurance mediation professionals in their dealings with customers. The second underlying principle is that of establishing a community-wide legal framework that can enable insurance intermediaries to exercise freely in any EU member state.

The principal innovations, with respect to the current text of Spanish Law 9/1992 on Insurance Mediation, can be summed up in the following points:

- Creation of the concept of the tied insurance intermediary: natural or legal persons who may carry on the activity of insurance mediation with several insurance companies.
- The bancassurance operator is seen as an extension of the insurance agent concept and this figure is specifically mentioned and regulated, as a form of mediation performed via the distribution networks of the credit institutions.
- For the first time, reinsurance brokerages are regulated; they were ignored by the previous law, which felt that this operator did not require legal protection, given that no power imbalances existed.
- The payment system for insurance intermediaries is regulated, as part of the drive for the aforementioned transparency.

- The 'Qualified Insurance Intermediary' diploma is abolished and this requirement is replaced by proof of prior training.

Draft Law to Promote Personal Autonomy and Care for Dependent People. Published in BOCG No. 84-1 of 5th May 2006.

The year 2005 saw significant progress made in drafting the definitive description of Dependency cover, which will significantly affect Life and Health insurance companies in the coming years. In December, the Government passed the *Law to Promote Personal Autonomy and Care for Dependent People*, which is seen as the fourth Pillar of the Welfare State in Spain, after pensions, education and health. A new universal, subjective right is thus established, which will permit access to dependency benefits under equal conditions for all and with the participation of the various Public Administrations.

Finally, it is worth mentioning some community rulings adopted during the past year on insurance matters, such as Directive 2005/14/EC, known as the "Fifth Motor Insurance Directive", and Directive 2005/68/EC, which regulates the activity of reinsurance companies within the European Economic Area.

Directive 2005/14/EC of the European Parliament and of the Council of 11th May 2005, amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC, and Directive 2000/26/EC of the European Parliament and of the Council, relating to Third-Party Liability insurance in respect of the use of motor vehicles. Published in OJEU L 149 of 11th June 2006.

The goal of this Directive is to enhance the protection of motor accident victims and fill some gaps in the current legislation, taking into account the growing volume of cross-border traffic.

Among the principal elements of the text are the improvements introduced to insurance cover in the event of some prolonged stay outside the country in which the vehicle is registered, the increased minimum amounts covered in the case of bodily injuries or material damages and the abolition of any insurance cover exclusion clause when the driver is under the influence of alcohol or in cases of an accident caused by an unidentified vehicle.

The new Directive allows for taking out temporary policies in a member state other than the Insured's home country (when staying in other countries to study, work or enjoy a second home).

The Directive also refers to measures to facilitate the possibility of insurance cover for a certain period of time, whenever vehicles are imported from one member state to another, even though the vehicle is still not registered in the destination member state.

It establishes that the minimum indemnity cover for personal injuries should be one million euros per victim or five million euros per loss, whatever the number of victims involved in the car accident might be. As for material damages, the minimum insured cover will be one million euros. These figures are to be revised every five years.

Finally, the Directive envisages that each State should have an electronic database that centralises information on any car accident and that there should be no problem transferring such data to the victims involved, the insurance companies or their legal representatives.

Directive 2005/68/EC of the European Parliament and of the Council of November 16th 2005 on reinsurance, amending Council Directives 73/239/EEC and 92/49/EEC and Directives 98/78/EC and 2002/83/EC. Published in OJEU L 3231 of 9th December 2005.

This Directive regulates access to the reinsurance activity and the exercise thereof by reinsurance companies that solely undertake reinsurance activities and are (or wish to be) established in a member State, with a view to setting up a prudential regulatory framework for reinsurance activities within the European Union.

The Directive continues the approach adopted by community legislation with regard to direct insurance, undertaking the basic, necessary and sufficient harmonisation to ensure mutual recognition of the authorisations and prudential supervision systems, thus making it possible to grant one single administrative authorisation that is valid throughout the EU and the application of the principle of supervision by the member State of origin.

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