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# **The Spanish Insurance Market in 2006**

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## 1. SUMMARY

**The Spanish insurance sector** performed well again in 2006, posting premium volume of 52,584 million euros, a nominal increase of 7.8%, slightly surpassing the growth figure of the previous year (7.7%). If we take into account inflation specific to this sector, the real growth was 4.4% (4.1% in 2005).

Besides the growth in volume of premiums, the result also improved, with the technical account at 10.9% of gross earned premiums (9.8% in 2005). This result came in spite of a two-point increase in the loss ratio to 76.5%. The result as a percentage of earned premiums net of reinsurance was 9.9% (9.1% in 2005). According to figures from the General Directorate of Insurance, the non-technical account had a net result of nearly 4,000 million euros, 12.5% more than the previous year, generating a ROE of 22.1%.

The economic and social environment in which insurance activity was carried out favored this evolution. The Spanish economy finished the year with 3.9% growth, a higher rate than in previous years. Domestic demand was the main engine behind this growth, backed the favorable situation of the labour market. Real estate promotion and public works continued to grow at a good pace, although some indicators are starting to show a certain slowdown. The population grew by 600,000 people, reaching 44.7 million inhabitants.

As for stock markets, 2006 was a positive year. The main stock indices in general ended up near the maxima of the last five years or at record highs, such as the Dow Jones index, the IBEX 35, Latin American markets and some Asian markets. Among markets in developed countries, the yield obtained by the Spanish markets stands out, doubling the European average.

The solvency level for the insurance market as a whole was 2.7 times the required minimum. In Non-Life the ratio was 3.7, and in Life it was 1.9.

**The Life class** continued the upward tendency that began in 2004 and grew 9.4%, one point more than the previous year. By modality, the number of policies with exclusively death coverage, which account for more than two-thirds of the total, or 22.3 million, rose 14%. Policies with savings guarantees fell slightly compared to 2005. As was the case in 2005, Individual Life insurance was the class that posted the largest growth in premiums, rising 6.6%.

As for volume of managed savings, Life insurance closed the year 2006 with 130,700 millions in technical provisions, up 5.2% from 2005. The rise was satisfactory but slightly smaller than the increase posted in the previous year.

Life insurance linked to assets, such as unit-linked and index-linked policies, experienced a strong rise in the number of insured and ended the year on a strong note, with a 10.6% increase in the volume of provisions.

The year 2007 is shaping up as a good one, especially in indexed insurance, private savings plans known as PIAS and yields. Risk insurance can

maintain its growth, although with greater difficulty as a result of higher interest rates and lower demand for mortgages.

The result of the technical account for Life fell 31% with respect to 2005, closing at 563 million euros. The loss ratio (as a percentage of net earned premiums) rose nearly 7 points to 88.1%, while the variation in Life insurance provisions declined nearly eight points. The technical result (excluding revenue and expenditure from technical account investments), was negative but remained at levels similar to those of earlier years: -23.9 % of net premiums. The investment result grew 5.5% to 5,906 million euros.

Production in **Non-Life classes** was 30,112 million euros, which amounts to 57.3% of the total volume of premiums, maintaining the trend of slower growth seen in earlier years. The variation in premiums was 6.6% (compared to 7.2% in 2005). As is the case in the rest of Europe, the Non-Life sector is experiencing fierce competition, leading to lower rates in most classes and a rise in the kinds of coverage offered.

Revenue from Motor insurance grew one point more than in the previous year, rising at a nominal rate of 4.8% and a real rate of 2.8%, excluding inflation in this branch. This was due mainly to a rise in the number of vehicles insured, as the variation in rates was negative. Multi-Peril premium production totaled 5,060 million euros, increasing its share of this segment, even though in recent years there has been slower growth in all modalities of this branch. The annual rate of variation in Health insurance remains within the 9-10% range, with a 9.8% rise (4.7% in real terms), two tenths more than in 2005. Third-Party Liability premiums rose 8.2%, slightly below the increase seen the previous year (8.6%).

As for the rest of the Non-Life classes, all saw rises in volume of premiums except for Fire, Aviation, Assistance and Agricultural.

The result of the Non-life technical account was 3,452 million euros, or 13.7% of net earned premiums, 11% more than the previous year. The loss ratio (as a percentage of gross earned premiums) fell around a point and a half to 68.2%. This was due to a large extent to a decline in provisions for prestaciones. Operating costs rose 19.7%, half a point higher than the previous year, due to a relative rise in acquisition costs. The balance of revenue and expenditure from investments hardly changed from 2005. Finally, the combined ratio was 91.5% (92% in 2005).

In 2006, **investments** in the sector rose to approximately 164,000 million euros, of which 88.1% corresponded to financial investments, 3.2% to material investments and the rest to treasury. The main component of investment was fixed-yield, which increased its share of the total by eight-tenths of a point to 60.2%. Within fixed-yield, it is worth noting that revenue from the “rest of the euro zone” rose from 28.5% in 2005 to 36.5% in 2006.

Total yield for assets as a whole was 5% slightly above the figure for the previous year (4.9%). The most profitable assets were material investments with a yield of 12.4% (book value) followed by variable-yield at 10%.

In July 2006 came into force the Law 26/2006 on **Mediation in Private Insurance and Reinsurance**. Its goal is to incorporate EU Directive

2002/92 on Mediation into Spanish law and adapt Spanish legislation to the reality of the market, recognizing new mediation figures and seeking to encourage transparency in favour of consumers. It also introduces novelties in the remuneration system for mediators.

In November 2006 the Spanish Parliament approved the Law to Promote Personal Autonomy and Care for Dependent People, which went into effect in January 2007. In recent years coverage of dependency has been seen as a possible niche market for the insurance sector in the future. With the approval of the Law, companies' range of activity is limited for now to insuring co-payments or double coverage, similar to that which already exists in Health insurance in Spain, which addresses difficulties stemming from access to services in the state-run health care system.

## 2. ECONOMIC CONTEXT

### 2.1 The world economy

The world economy posted a high rate of growth in 2006 (5.1%, according to the IMF), surpassing the previous year's rate by two tenths of a point. Rates of growth in the different geographic areas was more balanced than in previous years. The gradual slowing of the U.S. economy has been offset by robust growth in the euro zone – driven by countries such as Germany and Spain – the consolidation of Japan's recovery and consistently high rates of growth in major Asian countries such as China and India. Furthermore, an increase in world trade (8.9% in 2006) and steadily high prices for major commodities for much of the year benefited emerging economies, such as those in Southeast Asia or Latin America.

Other factors that characterized 2006 from an economic standpoint have been major swings in both directions in the price of oil, which allows inflation rates to moderate over the course of the year, financial conditions that were favourable for companies, even though central banks kept up with the process of normalizing official interest rates (rises of 1 point in the United States, and 1.25 points in Europe), a cycle which Japan joined with its first interest rate hike in six years; moderate increases in bond yields; and a notable depreciation of the dollar against the euro.

As for stock markets, 2006 yielded an overall positive result. Its indices generally finished near the maxima of the past five years or at record levels, such as the Dow Jones index, the IBEX 35, Latin American markets and some Asian markets. In general, investors made very satisfactory returns on their money – around 15% on average — in Europe and the United States, and somewhat less in Japan. Among developed markets, excellent returns were obtained by the Spanish market, double that of the European average.

After a bull market that ended in mid May, stock markets cashed in on a context that was increasingly positive for variable-rate yields, at a time of abundant liquidity and lack of investment alternatives. Investors welcomed the consolidation of a macroeconomic picture that was solid at the global level, an easing of interest rate jitters, corporate earnings that were again surprisingly good, a more than 20 percent drop in oil prices from maximum levels and an increase in corporate deals that paid high premiums on stock prices. In this way, the buoyancy of the market gained strength and accelerated in the last part of the year. Investors' optimism translated into a fall in volatility to historic lows.

The positive behaviour of financial markets spread only partially to collective investment. Although the net worth of investment funds reached a record high (254,000 million euros) with 8.8 million participants, the rate of growth (3.5 %) was the lowest since 2002 due to greater competition from other financial products. Pension funds posted a good year, with double-digit rises in net worth.

## 2.2 The Spanish economy

The Spanish economy finished the year with GDP growth of 3.9%, an increase from previous years and 1.3 percentage points higher than the average of the euro zone. Backed by a strong labour market, domestic demand was the main cause of this robust performance, fueled by sustained consumer spending and investment. On the down side, one would have to point out growing financing needs – a consequence of a bloated current account deficit – and inflation that is still far from the European Union average.

**Table 1.**  
Principal  
Macroeconomic Figures

| <i>Interannual variation rates in %</i>         | <b>2005</b>  | <b>2006</b>  |
|---|--------------|--------------|
| <b>DEMAND</b>                                   |              |              |
| Final consumption expenditure                   | 4.5          | 4.0          |
| Final consumption expenditure by households     | 4.2          | 3.7          |
| Final consumption expenditure by the NPISH      | 5.6          | 6.7          |
| Final consumption expenditure by the Pub. Admin | 5.5          | 4.8          |
| Gross Fixed Capital Formation                   | 6.9          | 6.8          |
| Equipment                                       | 9.2          | 10.4         |
| Construction                                    | 6.1          | 6.0          |
| Other products                                  | 6.4          | 4.6          |
| Domestic demand <sup>1</sup>                    | 5.3          | 5.1          |
| Exports of goods and services                   | 2.6          | 5.1          |
| Imports of goods and services                   | 7.7          | 8.3          |
| Foreign demand                                  | -1.6         | -1.3         |
| <b>SUPPLY</b>                                   |              |              |
| Fishing and agricultural classes                | -8.6         | 2.4          |
| Energy classes                                  | 5.2          | 1.4          |
| Industrial classes                              | 1.0          | 2.9          |
| Construction                                    | 5.6          | 5.0          |
| Services  | 4.1          | 4.1          |
| <b>GDP at market prices</b>                     | <b>3.6</b>   | <b>3.9</b>   |
| <b>GDP at current market prices<sup>2</sup></b> | <b>908.5</b> | <b>981.0</b> |

(1) Contribution to GDP growth

(2) Billions of €

Source: INE, CNTR.

Although growth in the Spanish economy is still backed by domestic demand, this slowed moderately in 2006, while net overseas demand increased its contribution to GDP thanks to a recovery in the export sector, in both goods and services.

Household spending on consumption and investment posted significant growth, although it rose at a slower rate than in previous years, increasing at an average annual rate of 3.7%, half a point less than in 2005. This expansion of consumption, which has grown more than gross disposable income has, has meant that for the third year in a row the rate of household savings has gone down.



Exports of goods posted a notable recovery with a growth rate of 6.2%, although this was still behind the rise in imports at 8.4%. This recovery was fuelled by robust growth in international trade.

In terms of supply, the construction sector continued to lead in growth, followed by services and industry. The rise in exports of goods was one of the factors that helped the Gross Added Value of the industrial sectors post a 3.3% increase after years of stagnation.

As for the labour market, data from the government's Survey of the Workforce show that the working population rose by 687,500 jobs in 2006, reaching 19.7 million. Meanwhile, the workforce posted annual average growth of 3.3% to 21.5 million. As a result of this evolution, the number of unemployed was 1.8 million, with the jobless rate at 8.5 % of the workforce, seven tenths less than in 2005.

For yet another year, inflation was influenced by oil prices, which rose until the summer and fell in the final months of the year. At the end of the year inflation stood at 2.7%, one point less than in 2005, while the yearly average of 3.5 % was a tenth of a point higher than in 2005. Meanwhile, the year-to-year rate of core inflation (excluding prices of fresh foods and energy) fell a tenth of a point to 2.5%, below the main inflation rate.

Spanish economic growth in 2007 is forecast to be somewhat less than in 2006, coming in at 3.4%<sup>1</sup>. This scenario is one in which domestic demand continues to be the main engine of growth, due mainly to robust private consumption and above all investment in equipment. But interest rate hikes that have been occurring since 2005 will lead to a drop in private consumption.

A drop in prices in the first half of the year, with a year-on-year inflation rate of 2.4%, and general stability in the euro zone have reduced Spain's inflation differential with the rest of that zone, leaving it at 0.6 percentage points.

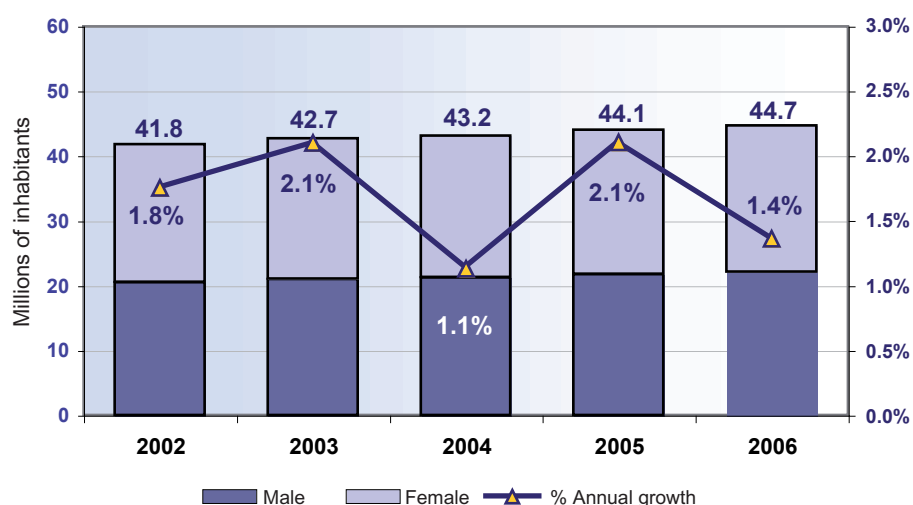
<sup>1</sup> Report on the cyclical position of the Spanish economy. Finance Ministry. 28 March, 2007.

### 3. SOCIAL AND ECONOMIC VARIABLES RELATED TO INSURANCE

#### 3.1 Population

The resident population of Spain as of 1 January, 2007 was 44.7 million inhabitants, an increase of 600,434 over 2005.

Chart 1.  
Evolution of Spanish  
Population



Source: INE.

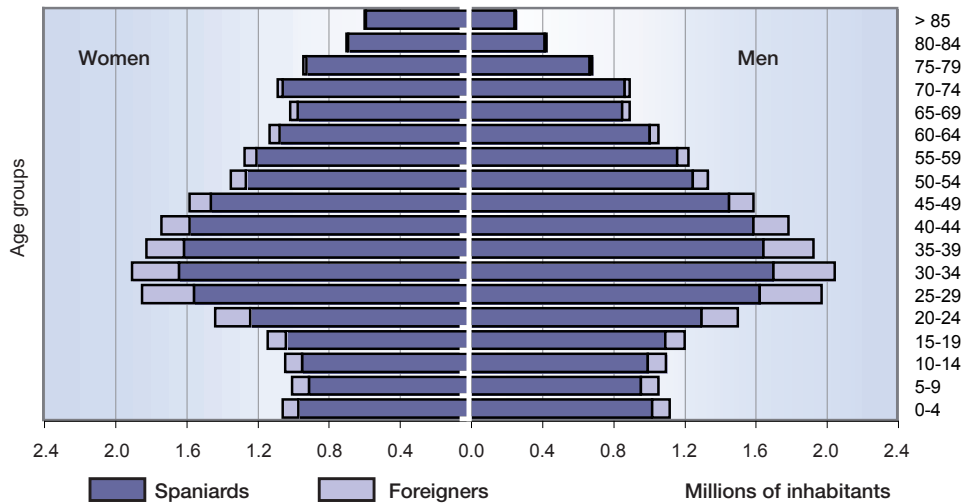
The number of Spaniards entered in municipal registries rose by 0.5% and that of foreigners by 11.1%. The latter account for 9.3% of the total population. By nationality, the largest groups of foreigners are Moroccans, followed by Ecuadoreans, Romanians, Britons and Colombians.

The regions with greatest population increases were Catalonia, Valencia and Madrid. In general, the largest population rises continue to occur on the Mediterranean coast and in the regions of Madrid and Catalonia, while regions in central and northern Spain see their proportion of the national population decline.

Meanwhile, the fertility rate, which measures the average number of children per woman of child-bearing age, reached in 2006 its highest level since 1991, hitting 1.37 compared to 1.35 in 2005.

According to provisional data on Natural Population Movement published by the National Statistics Institute, the gross birth rate (number of births per 1,000 inhabitants) rose in 2006 to 10.92 from 10.75 in 2005, with an important contribution from foreign-born mothers. In 2006 the number of children born to foreign mothers rose 12.7% from 2005 and accounted for 16.5% of all births in Spain. Meanwhile the mortality rate (number of deaths per 1,000 inhabitants) fell to 8.42 compared to 8.93 the previous year. The vegetative growth of the population (difference between numbers of births and deaths) was 109,835 inhabitants, a rise from 2005.

It is well-known that Spain has one of the world’s most aged populations. In 2006, estimated life expectancy at birth was 77.3 years for men and 83.8 for women. Those over 65 years of age make up 16.7% of the population, and this sector is 17.4 % larger than the population of young people under the age of 15.



**Chart 2.**  
Distribution of the Spanish Population by age group and sex. Year 2006

Source: INE.

### 3.2 Automobile

In 2006 a total of 2.3 million vehicles were registered in Spain, an increase of 1.9% from 2005. 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 29 million vehicles, almost 5% more than in 2005. In the past decade the number of licensed vehicles on the road has swelled by nearly 50%, going from 19.5 million in 1996 to 29 million today.

Although these figures are still provisional, if we compare them with the Insured Vehicles Informative File (FIVA), which in late 2006 had 27,085,809 vehicles registered, the number of uninsured cars on the road remained at 1.9 million. However, the Consorcio de Compensación de Seguros cites the figure of less than one million vehicles without insurance, or 3 percent of the total licensed vehicles on the road. This figure is reached if from the earlier data one subtracts those vehicles which are not in use but still registered.

### 3.2.1 Road accidents

In 2006 the number of fatalities in road accidents was 2,630<sup>2</sup>, 8.5% less than in 2005, in which 3,016 people died, 1,428 suffered serious injuries and 1,449 had minor injuries. The number of fatalities dropped 9.5%, reaching the lowest level since 1969. The introduction of the points-based driving license in Spain in July 2006 has had a significant effect in curbing road accidents: in the first half of the year, the number of fatalities dropped by 3.5%, while in the second half of the year the decline was 15%.

Below are some characteristics of accident rates, as analysed by the General Traffic Directorate:

- The number of fatalities recorded between midnight and 7:00 a.m. is down 13.7%.
- The number of fatalities in passenger cars declined 13.4%, and that of pedestrians fell 10.4%.
- The number of deaths on motorcycles is stabilizing, with just a 2.2% rise.
- The number of fatalities has declined in all age brackets except between 35 and 44 years of age, which rose 2%. The group with the largest decline is that of young people.
- The number of drivers involved in fatal accidents is down in all age brackets except between 45 and 54 years of age.
- The most frequent accident is that of cars going off the road.
- The percentage of drivers and passengers who died that were not using safety equipment (safety belt or crash helmet) has fallen due to greater awareness of the need to use these devices.
- Speed and distraction at the wheel are still the key factors in causing road accidents.

The figures for the first year of the penalty points system for drivers licenses, which were presented by the Interior Ministry in July 2007, show that from July 2006 to July 2007, 467 fewer people died than in the same period of the previous year, which amounts to a 14.3% decline. The points-based driver's license, along with other preventive measures implemented in recent years by the General Traffic Directorate, has allowed Spain to go from being among the countries with the highest road accident rates to reaching the European Union average of 91 deaths per million inhabitants in 2006.

<sup>2</sup> Road Safety Report. General Traffic Directorate. Excluding urban areas and with monitoring up to 24 hours after the occurrence of an accident.

### 3.3 Housing

As of 31 December, 2006 the total number of homes in Spain was 23.8 million units<sup>3</sup>, according to estimates of the Housing Ministry that update the Census of 2001. Of these, 68.5% were main residences and 31.5% were used as second homes or for other purposes. Compared to 2005, this total has increased by 648,697 homes, after deducting from the houses built in 2006 the ones that were demolished.

Analysing the behaviour of the housing market in 2006, we observe that the construction sector continues to grow at a good pace, although some indicators start to show a certain slow-down. In 2006, municipal authorities granted licenses for the construction of 760,314 homes, 135,076 more than in 2005, an increase of 21.6%. This growth might be influenced by the proximity of the introduction in April 2007 of the Technical Building Code, which raises quality standards in buildings.

As for housing sales, in 2006 a total of 955,187 real estate transactions took place, a rise of 5.9%, just under the 6.3% increase posted in 2005. Housing prices rose 9.1%, which was 3.7 points less than the previous year, the largest decline in the last five years.

The average price for a square meter of urban real state in late 2006 was 284.6 euros, an increase of 6.5% from the same period of the previous year. In towns with more than 50,000 inhabitants, the national average fell by nearly 0.6 points to 673.2 euros. The highest prices were reached in Barcelona and Madrid, with 1,303 and 1,023 euros, respectively.

In 2006 1.8 million mortgages were taken out for rural and urban properties, a rise of 6.3% from the figure for 2005. The average home mortgage 140,275 euros, up 12.6% from the previous year. The average interest rate of the loans was 3.83%, 0.34 points higher than the average interest rate of 2005, and the average duration of the mortgages was 25 years (24 in 2005).

Another significant variable of the housing market in Spain, one about which not much information was available until recently, is rental housing. A recent Housing Ministry survey on *ownership and use of housing by Spanish households*, contributes interesting data about this sector:

- The number of homes being rented in late 2006 was 1,791,475.
- The autonomous regions of Catalonia (25.7%), Madrid (18.5%) and Andalusia (13.9%) account for 58.1% of all rental housing. By provinces, Barcelona and Madrid account for 39.8%.
- The average rental price in 2006 was 7.20 €/m<sup>2</sup> and 7.16 €/m<sup>2</sup> if the property was rented between 2004 and 2005, which represents an increase of 0.6%. This price stability reflects the existence of greater supply, government policies that aim to encourage rentals and the start of a cultural change with regard to renting as opposed to buying.

<sup>3</sup> Unfinished homes are not included.

### 3.4 Health

After a year in which Spain's new anti-tobacco law was in effect, the assessment from the Health Ministry is positive. A statement from the National Committee to Prevent Smoking (CNPT) reports a 5% drop in the number of smokers, in other words half a million less than a year ago. Consumption of tobacco is also down 5%, which means 210 million fewer packs of cigarettes smoked, while levels of nicotine in the atmosphere have plummeted 83% in the workplace. On the negative side, the committee reports problems in the restaurant and entertainment industry because only 40,000 of 300,000 properties are totally smoke-free or have properly sealed-off smoking areas.

On another issue, the Health Ministry's 2007 National Catalogue of Hospitals said that as of 31 December, 2006 there were 788 hospitals (783 in 2005), 487 privately owned and 301 state-run. The number of hospital beds totalled 159,671, compared to 159,559 at the end of 2005. The state-run hospitals had 66% of them, or 105,289 beds.

## 4. PRINCIPLE CHARACTERISTICS OF THE INSURANCE MARKET

### 4.1 Insurance activity

#### 4.1.1 International markets

With real growth of 5% over the previous year, premium volume around the world rose in 2006 to 2.95 trillion euros (3.7 trillion USD)<sup>4</sup>. Of this 59% corresponded to Life insurance, which rose 7.7% thanks to a strong stock market and an increase in demand for Life insurance products. Non-Life posted a moderate rise of 1.5%, a result of increasingly tough price competition. Meanwhile, earnings and the level of solvency were better than in previous years as a result of a smaller number of catastrophes and greater rigour in underwriting policies.

Growth of insurance in emerging markets surpassed that of industrialized countries by a significant margin. In the former, the rise was greater in the Life class, with a 21.1% jump, compared to a 6.6% increase in the markets of developed countries. In the Non-Life class the difference was also significant: emerging markets recorded growth of 10.8%, while in the industrialized countries it was only 1%.

Premium production in the European Union (EU-25) reached one trillion euros<sup>5</sup>, which accounts for 34.2% of world production. After discounting the effects of inflation, growth in the market was 4.9%, slightly above the 4.6% figure posted in 2005.

Life insurance, which represents 68% of all policies, posted real growth of 4.6%, below the 6.5% figure observed in 2005. It is worth noting that the Life class did very well in the countries of eastern Europe, with an average increase of 26%, far higher than the largest western markets, which grew 4.3%.

The Non-Life class rose 5.3%, due in large part to the privatization of the public health care system in the Netherlands. If this operation were not taken into consideration, the growth would be of approximately 1%, six tenths of a point less than the previous year, a reflection of the aforementioned intensification of price competition in the Non-Life class.

Motor insurance declined in more than half of the countries of Europe, and the result of this was an overall drop of 1%. The main cause was growing saturation of the market, which drives premium prices down. This saturation stems to a large extent from the practice utilized by more and more companies of applying reduced rates or maintaining the premiums of good drivers, including those who don't drive much or have few accidents.

The market with the greatest premium volume is that of the United Kingdom, with 23.8% share of the total number of premiums. Next come France, Germany, Italy and the Netherlands. Spain is in sixth place with a

<sup>4</sup> Swiss Re (2007). "World insurance in 2006: premiums came back to life". *Sigma*, n° 4.

<sup>5</sup> CEA (2007). "European Insurance in figures".

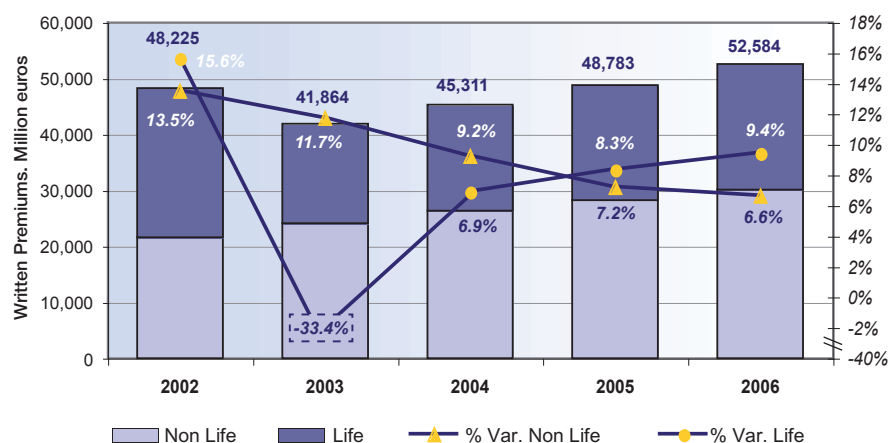
4.9% share. It is also the sixth-largest market by size in the Life and Non-Life classes.

Insurance penetration in the economy in 2006 reached 8.8% (EU-25), up one-tenth of a percentage point from the previous year. The average premium per inhabitant rose 6.2% (it increased 8% in 2005), to 2,174 euros, of which 1,354 euros corresponded to premiums for Life<sup>6</sup> insurance.

#### 4.1.2 The Spanish insurance market

The Spanish insurance sector performed well again in 2006, posting premium volume of 52,584 million euros, a nominal increase of 7.8% that is just slightly more than the growth recorded in the previous year (7.7%). If we take into account the inflation specific to the insurance sector, the real growth was 4.4% (4.1% in 2005), exceeding the 3.9% growth rate of GDP.

Chart 3.  
Evolution of the Insurance Sector.  
Premium Volume



Source: ICEA.

The Life class continued the upward trend it began in 2004 and grew 9.4% (compared to 8.3% in 2005). Volume in Non-Life classes totalled 30,112 million euros, which amounted to 57.3% of total volume of premiums. In this segment, too, the trend of recent years continued. In this case it was one of a slowing of growth. Premium volume rose 6.6%, compared to 7.2% in 2005).

<sup>6</sup> The average premium is calculated by dividing premium volume by number of inhabitants. It is a good indicator of the level of development of a country's insurance sector. But in using this figure one must take into account the fact that the premium volume includes premiums from insurance taken out by persons as well as legal entities and companies.



The distribution of premium volume by classes is summarized as follows:

| <i>Million euros</i>         | 2006          | 2005          | % of Total    | %Δ 2005/2004  |
|------------------------------|---------------|---------------|---------------|---------------|
| <b>Life</b>                  | <b>22,472</b> | <b>20,538</b> | <b>42.7%</b>  | <b>9.4%</b>   |
| <b>Individual</b>            | <b>17,829</b> | <b>16,585</b> | <b>33.9%</b>  | <b>7.5%</b>   |
| <b>Group</b>                 | <b>4,643</b>  | <b>3,953</b>  | <b>8.8%</b>   | <b>17.5%</b>  |
| <b>No Vida</b>               | <b>30,112</b> | <b>28,245</b> | <b>57.3%</b>  | <b>6.6%</b>   |
| <b>Motor</b>                 | <b>12,223</b> | <b>11,659</b> | <b>23.2%</b>  | <b>4.8%</b>   |
| Third party Liability        | 6,823         | 6,641         | 13.0%         | 2.7%          |
| Other Guarantees             | 5,401         | 5,018         | 10.3%         | 7.6%          |
| <b>Multi-Risk</b>            | <b>5,060</b>  | <b>4,647</b>  | <b>9.6%</b>   | <b>8.9%</b>   |
| Household                    | 2,653         | 2,388         | 5.1%          | 11.1%         |
| Commercial Premises          | 593           | 555           | 1.1%          | 6.8%          |
| Condominiums                 | 557           | 509           | 1.1%          | 9.4%          |
| Industrial                   | 1,159         | 1,107         | 2.2%          | 4.7%          |
| Others                       | 97            | 88            | 0.2%          | 10.2%         |
| <b>Health</b>                | <b>4,921</b>  | <b>4,482</b>  | <b>9.4%</b>   | <b>9.8%</b>   |
| Healthcare Assistance        | 4,196         | 3,842         | 8.0%          | 9.2%          |
| Reimbursement                | 461           | 402           | 0.9%          | 14.8%         |
| Benefits                     | 264           | 238           | 0.5%          | 10.8%         |
| <b>Third party Liability</b> | <b>1,903</b>  | <b>1,758</b>  | <b>3.6%</b>   | <b>8.2%</b>   |
| <b>Burial Expenses</b>       | <b>1,451</b>  | <b>1,370</b>  | <b>2.8%</b>   | <b>5.9%</b>   |
| <b>Accidents</b>             | <b>902</b>    | <b>848</b>    | <b>1.7%</b>   | <b>6.4%</b>   |
| <b>Engineering</b>           | <b>821</b>    | <b>747</b>    | <b>1.6%</b>   | <b>10.0%</b>  |
| Construction Multi peril     | 242           | 229           | 0.5%          | 5.6%          |
| Machinery Breakdown          | 200           | 167           | 0.4%          | 19.8%         |
| Ten-Year Construction        | 379           | 350           | 0.7%          | 8.2%          |
| <b>Transport</b>             | <b>632</b>    | <b>612</b>    | <b>1.2%</b>   | <b>3.2%</b>   |
| Marine                       | 208           | 197           | 0.4%          | 5.7%          |
| Goods                        | 302           | 281           | 0.6%          | 7.4%          |
| Aviation                     | 122           | 134           | 0.2%          | -9.3%         |
| <b>Credit</b>                | <b>576</b>    | <b>544</b>    | <b>1.1%</b>   | <b>5.9%</b>   |
| <b>Agricultural</b>          | <b>514</b>    | <b>525</b>    | <b>1.0%</b>   | <b>-2.1%</b>  |
| <b>Pecuniary Losses</b>      | <b>307</b>    | <b>195</b>    | <b>0.6%</b>   | <b>57.8%</b>  |
| <b>Assistance</b>            | <b>256</b>    | <b>263</b>    | <b>0.5%</b>   | <b>-2.7%</b>  |
| <b>Fire</b>                  | <b>166</b>    | <b>202</b>    | <b>0.3%</b>   | <b>-17.8%</b> |
| <b>Rest</b>                  | <b>173</b>    | <b>202</b>    | <b>0.3%</b>   | <b>-14.4%</b> |
| <b>Legal Defence</b>         | <b>97</b>     | <b>94</b>     | <b>0.2%</b>   | <b>3.6%</b>   |
| <b>Surety</b>                | <b>83</b>     | <b>74</b>     | <b>0.2%</b>   | <b>12.2%</b>  |
| <b>Theft</b>                 | <b>27</b>     | <b>24</b>     | <b>0.1%</b>   | <b>12.5%</b>  |
| <b>Total</b>                 | <b>52,584</b> | <b>48,783</b> | <b>100.0%</b> | <b>7.8%</b>   |

Table 2.

Distribution of volume of premiums by classes

Source: ICEA.

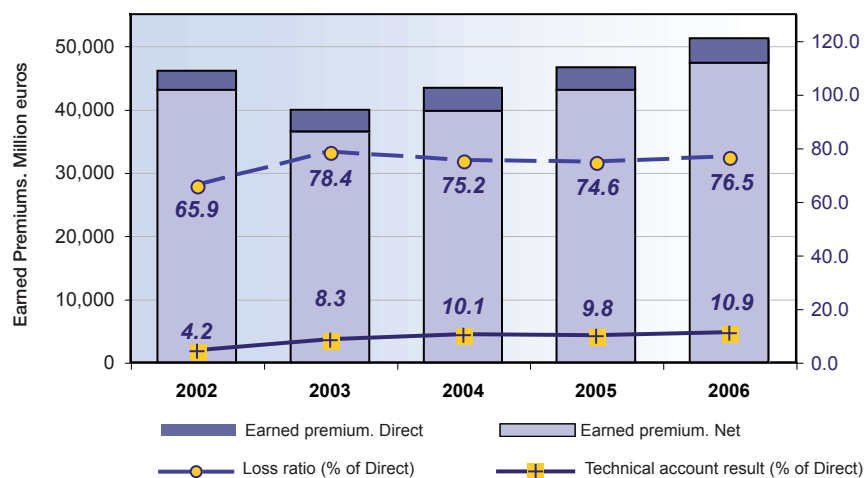
Non-Life classes were again influenced heavily the Motor sector, which, with a volume of 12,223 million euros, accounted for a 40.6% share of Non-Life business. Revenue from Motor insurance grew one percentage point more than in the previous year, at a nominal rate of 4.8% and a real rate of 2.8% after deducting the effects of inflation in this class. This was due mainly to an increase in the number of vehicles insured, since policy rates actually fell. Multi-Peril policies saw premium volume of 5,060 million euros and gained a higher share within the Non-Life classes, even

though in recent years there has been slower growth in all areas of this branch. The annual rate of change in Health insurance remained within the 9-10% range, with a rise of 9.8% (4.7% in real terms), two tenths of a point less than in 2005. Third-Party Liability insurance rose 8.2%, slightly below the growth posted the previous year (8.6%).

According to ICEA and Unespa, the strong growth in Life insurance was due in large part to certain special transactions carried out at the end of the year, without which premium growth would have been 1.5%. As for volume of managed savings, Life insurance closed the year 2006 with 130,700 million euros in technical provisions, up 5.2% from 2005. Individual Life was the class that grew the most at 6.6%, and was also the one with the largest volume of managed savings, 84,973 million euros, compared to 45,721 million euros for Group policies.

Besides growth in premium volume, the result improved despite a two-point rise in the loss ratio to 76.5%. The result equalled 10.9% of earned premiums (9.8% in 2005) and 9.9% of earned premiums net of reinsurance (9.1% in 2005). The result of the non-technical account was 8.48% (8.07% in 2005).

Chart 4.  
Evolution of premium and technical result.  
Total for Sector



Source: ICEA.

The result of the Non-Life technical account rose to 3,452 million euros, which represent 13.67% of net earned premiums, 11% more than the previous year. The loss ratio (as a proportion of gross earned premiums) fell about 1.5 points to 68.2% due in part to a smaller variation in the reserve for outstanding claims. Operating expenses grew half a point to 19.7% due to the relative increase in acquisition costs. The balance of investments hardly changed with respect to 2005. Finally, the combined ratio on net earned premiums was 91.5% (it was 92% in 2005).

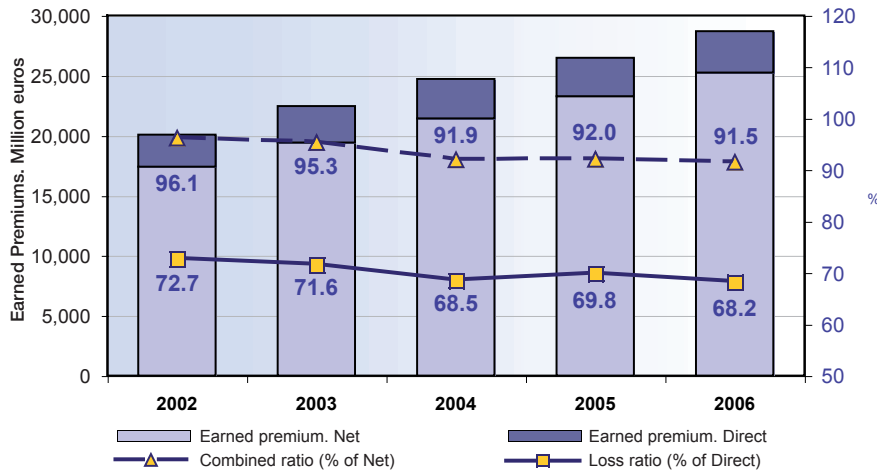


Chart 5. Evolution of loss ratio. Non-Life

Source: ICEA.

The result of the Life<sup>7</sup> technical account dropped 31% in comparison with 2006, totalling 563 million euros. The loss ratio (on net earned premiums) rose almost 7 points to 88.06% and the technical result (without considering the balance of investments in the technical account), although negative, remained at levels similar to those of previous years, or -23.9% on net premiums. The result of investments grew 5.5% from the previous year, reaching 5,906 million euros.

The level of creditworthiness of the market as a whole was 2.7 times the required minimum. In Non-Life the ratio was 3.7, while in Life it was 1.9.

The penetration of insurance in the economy (premiums as a percentage of GDP) showed a slight improvement in Life and a slight decline in Non-Life, and remained at levels similar to those of earlier years, or 5.4%- This is well below the European average of 8.8%.

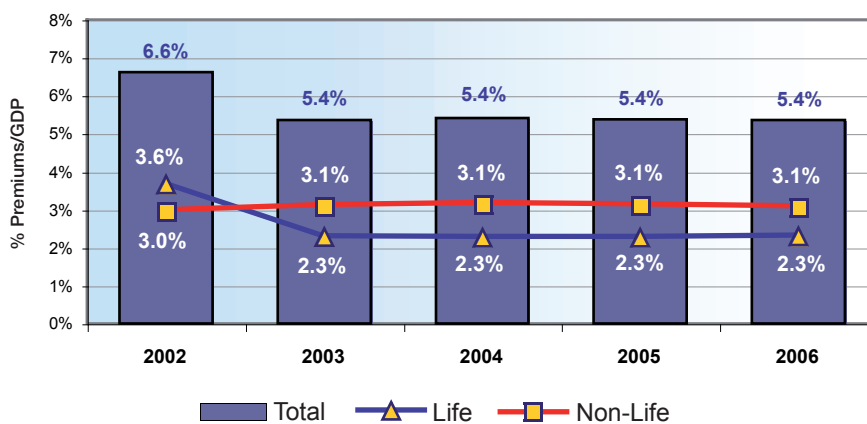


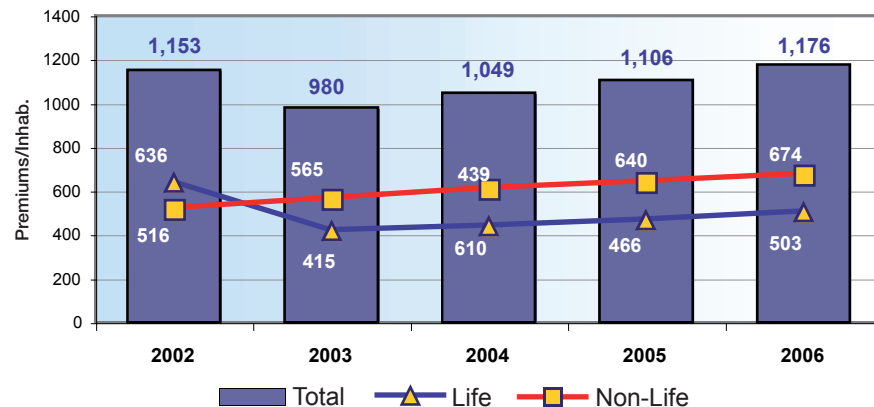
Chart 6. Penetration

Source: done by FUNDACIÓN MAPFRE

<sup>7</sup> General Directorate of Insurance and Pension Funds (2007). Report for 2006. Provisional data.

Density (or average premium per inhabitant) rose 6%, in line with growth of the European market (6.2%). However, Spaniards' average expenditure of 1,176 euros on insurance is far below the average for Europe as a whole, which is 2,174 euros. The big difference lies in Life insurance: while Spain has a density of 503 euros, for the European Union as a whole the average expenditure is 1,354 euros.

Chart 7.  
Density



Source: done by FUNDACIÓN MAPFRE

Finally, we should note that in 2006 the *Ley de igualdad*<sup>8</sup>, or Law of Equality, made its way through Parliament and was approved in March 2007. It is important to address the content of articles 70 and 71 of this law because of their relevance for the insurance market, especially for Health insurance. The Law stipulates<sup>9</sup>:

- In access to goods and services, no company can probe into the background of a pregnant women who is seeking said goods or services, except for the purpose of protecting her health.
- A ban on insurance contracts or similar financial services which establish differences in premiums and benefits by considering gender a factor to take into consideration when calculating these figures.
- However, situations can be established in which exceptions to the previous paragraph are allowed, when gender is a determining factor in the evaluation of risk through pertinent and reliable actuarial figures and statistics. For this purpose, the proper changes have been made to the Regulations for Oversight and Supervision of Private Insurance<sup>10</sup>.
- In any case, the costs associated with pregnancy and childbirth shall not be used to justify differences in premiums and benefits for persons considered individually.

<sup>8</sup> Organic Law 3/2007, of 22 March, mandating effective equality for women and men.

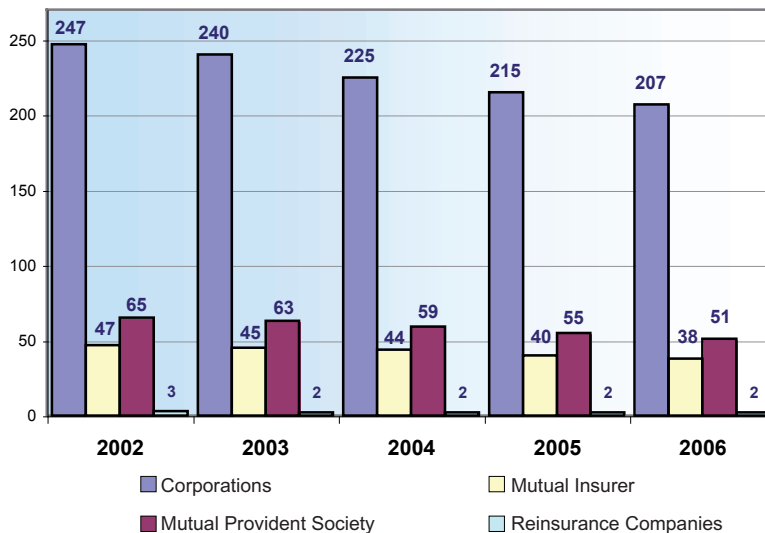
<sup>9</sup> Through these articles the Spanish legal system incorporates the regulations related to the use of actuarial factors as contained in Directive 2004/113/EC, by which the principle of equality is applied in treatment of men and women in access to goods and services and the supplying of them.

<sup>10</sup> Royal Decree 1361/2007, 19 October, which modifies the Regulations for Oversight and Supervision of Private Insurance.

### 4.1.3 Competitive structure of the sector

#### Business Moves

The process of concentration in the insurance market continues to move forward. In 2006 19 companies stopped operating and there were five new sign-ups at the administrative registry of insurance organizations. The result was that at the end of the year, the number of registered companies was 298, compared to 312 registered in 2005.



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

Source: Spanish Insurance and Pension Funds General Directorate.

Besides the companies that continue to operate, in the registry there are 63 companies in the process of winding-up, 29 of which are being liquidated voluntarily. In the other 34 cases this is being undertaken by the Consorcio de Compensación de Seguros.

The presence of foreign capital in Spanish companies rose a bit more than two points in 2006 to reach 27.64% of the share capital in the sector (45 companies with foreign capital invested). A total of 92% comes from the European Union, and Switzerland is the country with the greatest presence (7.58%), followed by Belgium (4.32%), France (3.71%) and the United Kingdom (2.26%).

As for access of foreign companies to the Spanish market, at the end of the year there were 54 branches of European companies and 2 from other countries. A total of 516 European companies registered to operate under the freedom to provide services regime.

In 2006 the General Directorate of Spanish Insurance and Pension Funds handled six portfolio transfer procedures in all classes and seven takeover operations.

As part of these operations, it is worth noting that in 2006 MAPFRE carried out a corporate restructuring that involved merging all the Group's activities into a listed holding company called MAPFRE S.A.

One major transaction carried out in Europe in 2006 was AXA's purchase of WINTERTHUR from the financial group CRÉDIT SUISSE for 8,600 million euros. In Spain the union of these two companies has helped AXA improve its positioning, rising in both the Life and Non-Life ranking, as will be explained further on in this report.

Also worth pointing out is the takeover of BANESTO SEGUROS by SANTANDER SEGUROS, making the latter Spain's leading company in bancassurance with premium volume of 2,557 million euros. The new merged company operates under the name SANTANDER SEGUROS.

In December 2006 CAJA CASTILLA LA MANCHA and MAPFRE reached an agreement to develop jointly this savings and loan's Life insurance and pension plan business. Under the accord, the two entities will share ownership of CCM Vida y Pensiones. CCM Vida y Pensiones ended 2005 with premium volume of 190 million euros.

In December 2005 MUTUA MADRILEÑA announced an agreement to acquire 100% of ARESA, and the purchase took effect in February 2006. The acquisition will allow the Madrid insurer to enter the field of Health insurance, in which ARESA was ranked eighth in 2005, with nearly 125 million euros in premiums.

Other business deals carried out in 2006:

- The mutual insurer PELAYO incorporated the business of its MUNAT unit through a portfolio transfer procedure.
- In April the European Commission authorized the joint acquisition of SEGUROS NAVARRA by the Spanish unit of the AEGON group and CAJA DE AHORROS Y MONTE DE PIEDAD DE NAVARRA (CAN).
- GENERALI España, chosen in a tender offer in which several insurance companies took part, was awarded the Life insurance business of CENTRO ASEGURADOR, a company awaiting liquidation. Under this accord GENERALI assumes coverage of a more than 17,000 insured parties through payment of a single premium of nearly 300 million euros.
- ETERNA ASEGURADORA, which belongs to the OCASO group, acquired the Burial Expenses portfolio of AXA AURORA IBÉRICA.
- BBVA absorbed SENORTE VIDA Y PENSIONES.
- ZURICH FINANCIAL SERVICES announced in December it had signed an agreement to acquire 100% of ACC SEGUROS Y REASEGUROS DE DAÑOS, a company that specializes in the Surety class.
- Also in December, the French group CNP agreed to acquire from OLD MUTUAL 94% of the capital of SKANDIA VIDA, since traditional Life insurance was not part of the main business activities of SKANDIA, which focuses on investment funds and unit-linked products.

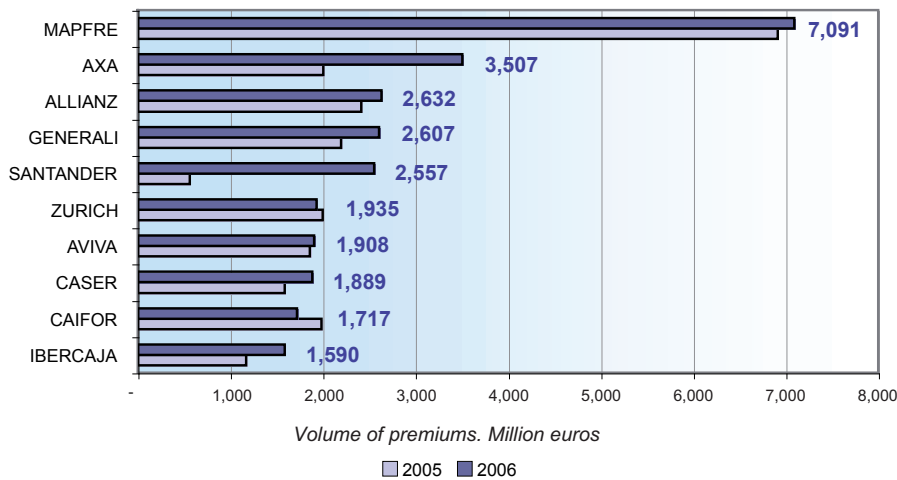
- The French mutual insurer GROUPAMA completed in 2006 the purchase and integration of AZUR VIDA Y AZUR MULTIRRAMOS, units of the French group of the same name.

**Ranking of insurance groups**

As a result of the business transactions carried out in 2006, the ranking of the top 10 Spanish insurance groups underwent major changes. MAPFRE is once again the leader, with a market share of 13.5%. It is followed by AXA, which after acquiring WINTERTHUR rises two spots to second place with a market share of 6.7%. ALLIANZ and GENERALI move to third and fourth, respectively, both with market shares of 5%.

Another important change is that the top 10 groups now include SANTANDER SEGUROS, which goes from 25<sup>th</sup> place in 2005 to 5<sup>th</sup> place now, with a market share of 4.9%. Besides the absorption of BANESTO SEGUROS, this important change is due to a major increase in revenue: it exceeds by more than 1,600 million euros the sum of the premiums issued by both companies in 2005. Meanwhile, a drop in premium volume at BBVA SEGUROS caused it to drop out of the top 10.

One direct effect of the changes mentioned above is a greater concentration of insurance among the top 10 groups, whose market share has gone from 49.8% in 2005 to 52.2% in 2006.

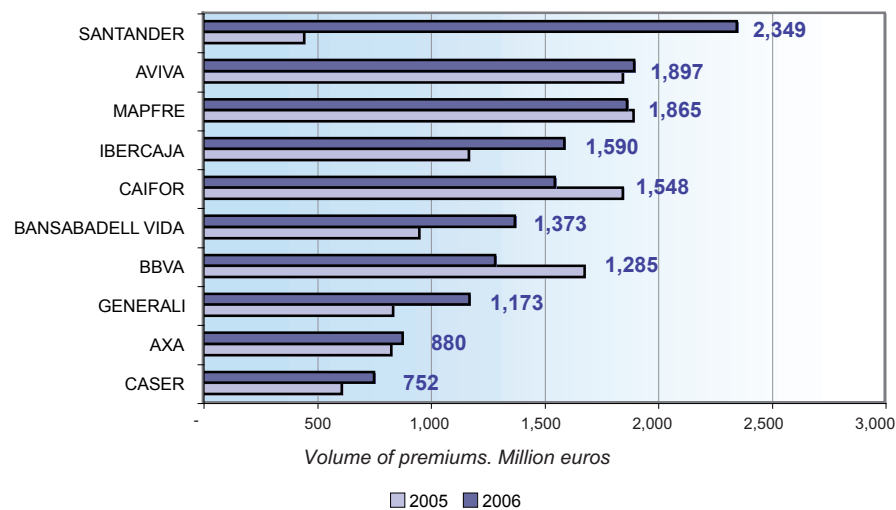


**Chart 9.**  
Ranking of insurance groups by volume of premiums. Total for sector

Source: ICEA.

The changes that have occurred in the Life ranking also stem from the business deals mentioned earlier. The most significant of them is the rise of SANTANDER SEGUROS to the top position, with a market share of 10.5%. AXA is this ranking for the first time, occupying 9th place. The 10 groups that make up the list hold among them a market share of 65.5%, nearly five points more than the previous year.

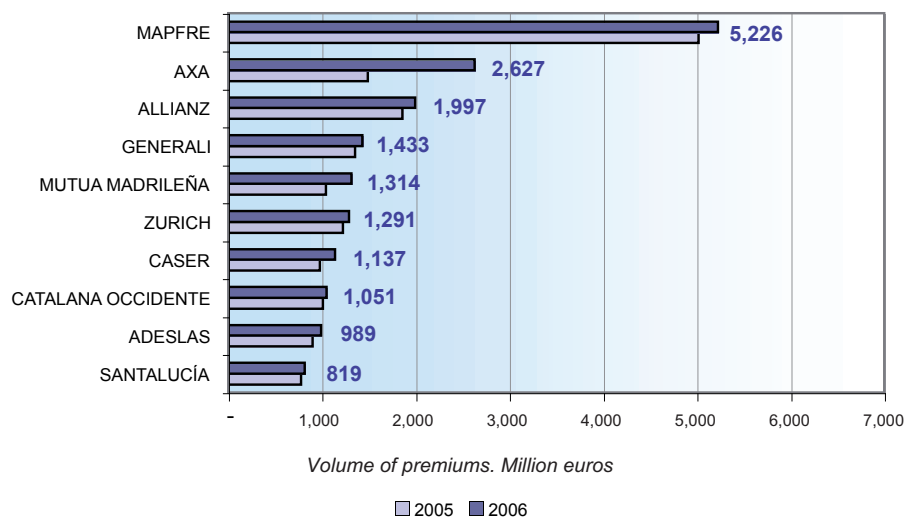
**Chart 10.**  
Ranking of insurance groups by volume of premiums. Life



Source: ICEA.

The Non-Life ranking is largely unchanged from the previous year, although the deal stands out and places the group in second place, behind MAPFRE, with a market share of 8.7%. SANTALUCÍA joins the ranking for the first time, taking over 10th place. The level of concentration in this branch of the insurance business has risen three percentage points with respect to the previous year, to 59.4%.

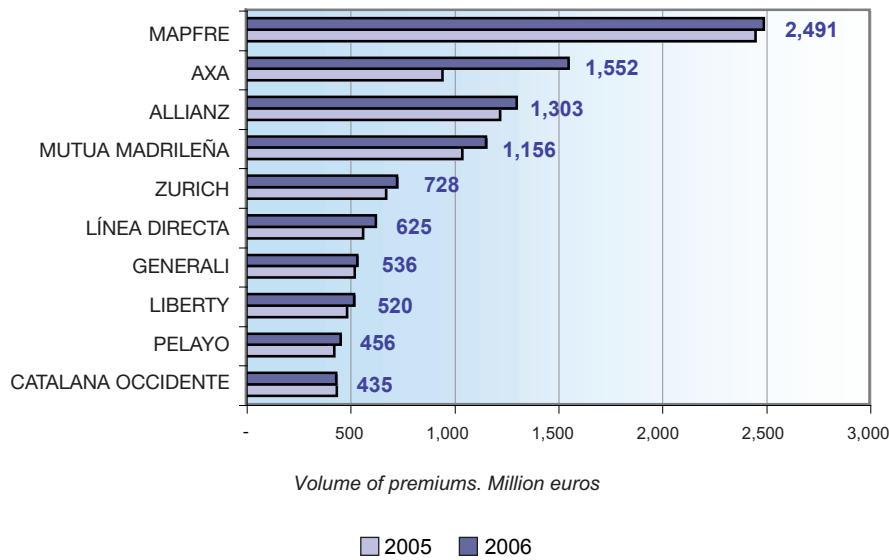
**Chart 11.**  
Ranking of insurance groups by volume of premiums. Non-Life



Source: ICEA.

As for Motor insurance, MAPFRE continues to lead the ranking. The AXA group has gained more than four points of market share and risen to second place, followed by ALLIANZ and MUTUA MADRILEÑA, which were in second and third place, respectively, in 2005. LIBERTY takes up the spot left vacant by WINTERTHUR, surpassing Pelayo and CATALANA OCCIDENTE in volume of premiums and occupying eighth place.





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

Source: ICEA.

#### 4.1.4 Investments

In 2006, investments in the sector totalled approximately 164,000 million euros<sup>11</sup>, of which 88.1% corresponded to financial investments, 3.2% in material investment and the rest in treasury. All this investment represented 3.6% of premium volume.

The main tranche of this investment was in fixed-yield products, whose share of the total rose eight tenths of a point to 60.2%. Within this fixed-yield category, it is worth noting that income from the “rest of the euro zone” rose from 28.5% in 2005 to 36.5% in 2006.

One must also note the scant importance of variable-yield tools in the portfolio of Spanish insurance companies – it amounted to just 4.7% — compared to European insurers, which in 2005 earmarked 31% of their investment for variable-yield tools.<sup>12</sup>

<sup>11</sup> ICEA (2007). “Investments by insurance companies. Statistics for 2006” Report n° 1.028, July.

<sup>12</sup> CEA (2007). “European Insurance in figures”. CEA statistics n° 31.

Table 3.  
Investments.  
Composition and Yield

| Type of asset                      | Life          |              | Non-Life      |              | Total         |              |
|------------------------------------|---------------|--------------|---------------|--------------|---------------|--------------|
|                                    | Composition   | Yield.       | Composition   | Yield.       | Composition   | Yield.       |
| <b>Cash</b>                        | <b>7.8%</b>   | <b>2.6%</b>  | <b>12.4%</b>  | <b>2.5%</b>  | <b>8.7%</b>   | <b>2.6%</b>  |
| <b>Financial investments</b>       | <b>91.6%</b>  | <b>5.0%</b>  | <b>75.4%</b>  | <b>6.1%</b>  | <b>88.1%</b>  | <b>5.0%</b>  |
| <b>Fixed income</b>                | <b>65.3%</b>  | <b>5.0%</b>  | <b>41.5%</b>  | <b>4.0%</b>  | <b>60.2%</b>  | <b>4.8%</b>  |
| National                           | 25.6%         | 5.5%         | 16.0%         | 4.6%         | 23.5%         | 5.1%         |
| Public debt                        | 15.9%         | 5.4%         | 9.4%          | 4.7%         | 14.4%         | 5.2%         |
| Corporate debt                     | 9.7%          | 5.5%         | 6.6%          | 4.3%         | 9.0%          | 4.9%         |
| Rest of euro zone                  | 36.5%         | 4.5%         | 25.1%         | 3.6%         | 34.1%         | 4.6%         |
| Rest of the world                  | 3.2%          | 7.6%         | 0.5%          | 4.1%         | 2.6%          | 4.1%         |
| <b>Mid- and long-term deposits</b> | <b>8.5%</b>   | <b>4.4%</b>  | <b>0.7%</b>   | <b>5.0%</b>  | <b>6.9%</b>   | <b>4.3%</b>  |
| <b>Policy advances</b>             | <b>0.5%</b>   | <b>3.2%</b>  | <b>0.5%</b>   | <b>6.4%</b>  | <b>0.5%</b>   | <b>5.6%</b>  |
| <b>Mortgage lending</b>            | <b>0.3%</b>   | <b>0.4%</b>  | <b>0.1%</b>   | <b>5.2%</b>  | <b>0.3%</b>   | <b>0.8%</b>  |
| <b>Equity</b>                      | <b>1.3%</b>   | <b>14.5%</b> | <b>17.4%</b>  | <b>9.6%</b>  | <b>4.7%</b>   | <b>10.4%</b> |
| <b>Investment funds</b>            | <b>4.8%</b>   | <b>5.3%</b>  | <b>10.0%</b>  | <b>11.0%</b> | <b>5.9%</b>   | <b>7.2%</b>  |
| <b>Other investments</b>           | <b>10.9%</b>  | <b>4.2%</b>  | <b>5.2%</b>   | <b>2.6%</b>  | <b>9.7%</b>   | <b>4.2%</b>  |
| <b>Property</b>                    | <b>0.6%</b>   | <b>14.6%</b> | <b>12.2%</b>  | <b>12.1%</b> | <b>3.2%</b>   | <b>12.4%</b> |
| <b>Total</b>                       | <b>100.0%</b> | <b>4.8%</b>  | <b>100.0%</b> | <b>6.4%</b>  | <b>100.0%</b> | <b>5.0%</b>  |

Source: ICEA.

Total yield for the whole of the assets was 5%, slightly more than the figure for the previous year (4.9%). The most profitable assets were material investments, with a yield of 12.4% (book value), followed by variable-yield products at 10%. Investment funds improved their performance in 2006 to reach a yield of 7.2%, although their share declined two tenths of a point to 5.9% of the investment total. Fixed-yield investments earned 4.8%, a tenth of a point less than the previous year.

Eighty percent of the investments corresponded to the Life class. Analysing the structure of the portfolio by kind of business, one observes interesting differences. Fixed yield makes up the main part of both businesses but has a greater weight in Life at 65.3%, compared to 41.5% for Non-Life. This is due to the characteristics intrinsic to each branch (whereas in Non-Life the contracts tend to be annual, in Life the commitments tend to be of longer duration, including in many cases a guaranteed interest). The average duration of Life portfolios is between four and eight years in the majority of cases (62% of entities), while in Non-Life most companies last less than four years.

The presence of variable-yield tools and material investments is quite minor in the Life class, at 1.3 and 0.6%, respectively. However, in Non-Life 17.4% of assets are invested in variable-yield products. Another distinctive feature is the volume of treasury, which in Life is 8.7% and in Non-Life 12.4%.

## 4.2 Distribution of insurance

In recent years, distribution of insurance in Spain has broken down into three groups of channels: intermediaries (agents and brokers), bancassurance and direct marketing without intermediaries (company offices, telephone sales, electronic marketing and others). In 2006 the volume of premiums handled by intermediaries was 46.7% of the total, while banks and savings and loans distributed 36.7%.

The breakdown of shares by type of channel has varied over time as the circumstances of the insurance market changed. In the years in which pension commitments were externalized, the Life branch posted major growth and surpassed Non-Life in Premium volume. During that period, distribution through credit entities enjoyed exceptional development, to the detriment of other sales channels. After the process ended in 2002, consolidated trends start to be observed.

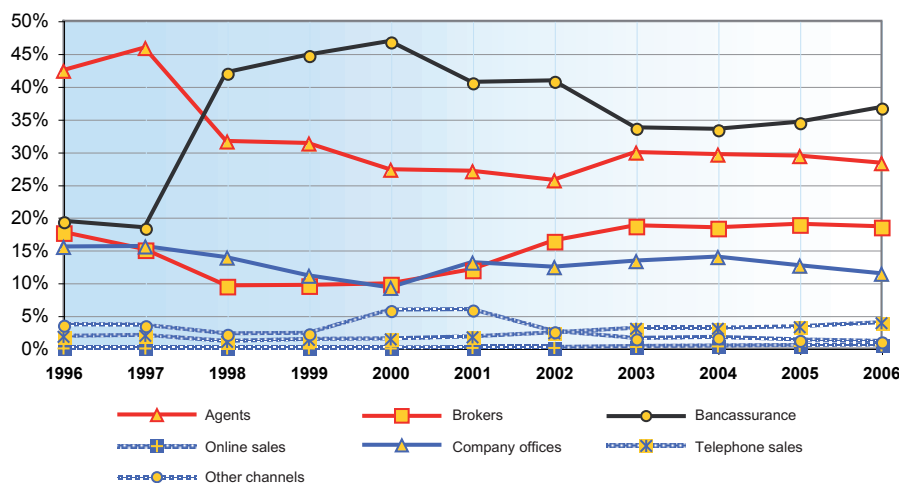


Chart 13.  
Evolution of insurance  
distribution channels

Source: ICEA.

The weight of each of these groups of channels is very different if analysed by branch of business. In Life, for instance, it is bancassurance that takes care of distribution, especially individual Life, having reached in 2006 a 71% share of business volume, followed by intermediaries (22%). In Non-Life it is agents and brokers who dominate, their business volume accounted for 68% of premiums. Next came company offices, with a 16% share.

In Motor insurance intermediaries are the dominant distribution channel, although others should be pointed out such as telephone sales (14.86%) or online sales (1.57%), which are carried out mainly in this branch of insurance.

In Multi-Peril, intermediaries are also the main distribution channel, handling 76% of the premiums. Agents take care of the lion's share, except in industrial products, which are mainly marketed by brokers. Banks and savings and loans are the second most important channel, standing out in Household insurance, where they have a 30.9% share.

In Health insurance, the channel that contributes most to the marketing of its products are company offices, especially in Healthcare Assistance, with 58.3% of premiums. But in Reimbursement and Benefit it is agents channel who dominate, with 54% of total volume.

It is worth pointing out that in July 2006, the Law 26/2006 Mediation of Private Insurance and Reinsurance took effect. It was approved after a long and controversial parliamentary process. The need to enforce European Union rules, and to adapt to the reality of a market in which new forms of mediation have appeared in recent years, made it necessary to draft a new law that would replace the existing legislation, Law 9/1992.

The Law explains the fundamental principles on which it is based:

- Introduction of new forms of mediation, such as agents associated with several insurance companies, bancassurance operators (exclusive or linked) and reinsurance brokers.
- The principle of equal treatment for the different classes of intermediaries, establishing equivalent professional prerequisites for all of them.
- The principle of transparency, aimed at protecting consumers. For this purpose the law:
  - Establishes a single information outlet where all intermediaries are registered. All insurance intermediaries must sign up here before working. Once signed up, they must advise the control board of any change in their status.
  - Regulates the information that insurance intermediaries must provide beforehand to clients: identity, address, registry in which they are signed up, stakes in insurance companies, procedure for filing complaints and claims, handling of personal data, etc.
  - Obliges insurance brokers to explain why they propose a given policy to a client. This is what has come to be called objective analysis.

Finally, the new law introduces changes in the system of payment of intermediaries. The insurance agency contract must be paid, and specify the commission or economic rights of the agent. In the case of brokers, with an eye to guaranteeing their independence, the law stipulates that they shall not receive from insurance companies any compensation other than commissions (which amounts to banning so-called *rappel* for production). The law allows a broker to charge clients a fee, under a prior accord and so long as it is billed directly to the client, separately from the premium bill. If the broker receives commissions from the insurance company in addition to this fee paid by the client, the premium bill should state the amount of the commission and the name of the broker receiving it.

When the deadline for adapting to the new legal rules ran out in July 2007, 116,704 exclusive agents, 2,809 brokers (940 persons and 1,869

legal entities), 21 bancassurance operators and 21 reinsurance brokers registered at the DGSFP<sup>13</sup>.

### 4.3 Activity of the Consorcio de Compensación de Seguros

The Consorcio de Compensación de Seguros is a particularly important organization in the Spanish insurance market. So it is essential that we discuss its activity in 2006<sup>14</sup>. In this section we will refer only to two of its main activities, coverage of Extraordinary Risks and, in relation to Traffic risks, direct Third-Party Liability Motor Insurance and the guarantee fund, although its activities are in fact much broader.

With regard to coverage of Extraordinary Risks, the Consorcio's main source of income for meeting its obligations are surcharges paid by policyholders and passed on by insurance companies to the Consorcio. This coverage is linked to the taking out of an insurance policy in certain classes in which current law obliges the inclusion of guarantees against these risks. The Consorcio, in exchange for providing these coverage, receives a surcharge that companies include in the corresponding premium and which is calculated by applying the established rate to the insured capital. The surcharges paid in 2006 for this reason totalled 578.6 million euros.

| Thousands euros            | Net earned premium |                | Net losses     |                |
|----------------------------|--------------------|----------------|----------------|----------------|
|                            | 2006               | 2005           | 2006           | 2005           |
| <b>General activity</b>    |                    |                |                |                |
| <b>Extraordinary risks</b> | <b>578,645</b>     | <b>508,032</b> | <b>228,768</b> | <b>193,121</b> |
| Property                   | 521,010            | 469,255        | 202,941        | 188,114        |
| Persons                    | 23,670             | 21,479         | 17             | 3,145          |
| Loss of benefits           | 33,966             | 17,298         | 25,811         | 1,863          |
| <b>Traffic risks</b>       | <b>237,148</b>     | <b>238,925</b> | <b>155,588</b> | <b>141,164</b> |
| Guarantee Fund             | 194,776            | 191,118        | 106,875        | 84,520         |
| Private vehicles           | 28,011             | 33,674         | 31,840         | 42,762         |
| Official vehicles          | 14,361             | 14,133         | 16,873         | 13,882         |

Table 4.  
General Activity of the  
CCS

Source: Consorcio de Compensación de Seguros

As for claims, the most frequent events in 2006 were floods and atypical cyclonic storms<sup>15</sup>. A total of 42,728 claims were filed for compensation over Extraordinary Risks in property, so the Consorcio has classified the year as an adverse one<sup>16</sup>. The total of losses processed in 2006 was 228.7 million euros.

<sup>13</sup> DGSFP (2007). Situation of process of adaptation of intermediaries to Law 26/2006. Data from communications received on time and which surpassed automatic validations.

<sup>14</sup> The information in this chapter comes from the Annual Report by the Consorcio de Compensación de Seguros.

<sup>15</sup> According to the Regulations on Extraordinary Risk Insurance, the atypical cyclonic storm includes violent tropical cyclones, intense, cold squalls, tornadoes and extraordinary winds (with gusts exceeding 135 Km/h.).

<sup>16</sup> A year is considered exceptional when the number of claims for compensation exceeds the average for recent years, now calculated as being 28,140 per year.

The most relevant loss events in 2006 were:

- In September, tropical storm Gordon hit, affecting in particular certain areas of Galicia. Although more than 1,800 insurance claims were filed, their average, cost was not high.
- From July to October, there were three floods and an atypical cyclonic storm in Catalonia. These led to more than 6,000 insurance claims, with a total cost of 80 million euros.
- From October to December there five cases of flooding with a total estimated cost of 48 million euros.
- In 2006 most insurance claims stemming from tropical storm Delta were processed. The storm hit the Canary Islands in November 2005. The total claims paid amounted to 57.6 million euros, and including the claims that are still pending the total cost is 77.9 million euros.
- As for damage stemming from terrorism, special attention should go to the attack on 30 December, 2006 at Terminal 4 at Madrid-Barajas airport. The estimated cost from this loss event is 41 million euros, including damages to the terminal itself and cars in the parking lot that was destroyed in the attack.

Another of the Consorcio's functions is to assure mandatory Third-Party liability insurance for motor vehicles when drivers cannot secure private coverage. The Consorcio also assures the Third-Party Liability insurance of vehicles owned by the Spanish central government, regional governments, local governments and other public entities that request such coverage. Besides the mandatory insurance, since January 2003 insured parties have the option of raising coverage limits by taking out a voluntary guarantee.

In the last few years both the number of insured vehicles owned by private citizens and premium volume have declined because of the recent flexibilization of the rules by which insurance companies underwrite risk. The changes have broadened access to insurance for two-wheeled vehicles. Meanwhile, the fleet of government-owned vehicles has remained stable and even grown slightly in the last few years. Altogether the Consorcio has taken in 42.3 million euros in net acquired premiums for reinsuring privately owned and official state vehicles. Compared with the 47.8 million euros corresponding to 2005, this amounts to an 11.4% decline. As for the claims ratio, that of privately owned vehicles is declining while that of state-owned vehicles is rising, although in both cases the technical result was negative.

As for the Guarantee Fund, the Consorcio fulfills the function mandated by the Law on Third-Party Liability and Motor Insurance with regard to compensation for damage caused by unknown, uninsured or stolen vehicles, or in cases in which the insurance company has been declared bankrupt, in suspension of payments or in a situation of insolvency, with liquidation ordered or assumed by the Consorcio itself. The revenue comes from surcharges that insurance companies charge on bills for policies issued and from half of the amounts imposed as fines for vehicles without

the mandatory coverage. In 2006 this revenue totalled 195 million euros, compared to 191 million in 2005.

The reporting of losses in these coverages is growing more slowly, but this is still the main component of the Consorcio's activities. Loss events caused by uninsured vehicles are declining, but still account for the largest single share of the total.

One novelty that should be noted is that following the approval of Law 12/2006, which modified the Legal Status of the Consorcio, coverage of Extraordinary Risk has been extended to the Life class in contracts that guarantee exclusively or mainly the risk of death. At the same time, there is a broadening of the contingencies covered by the system with regard to permanent or temporary disability, both in Life and Accident insurance.

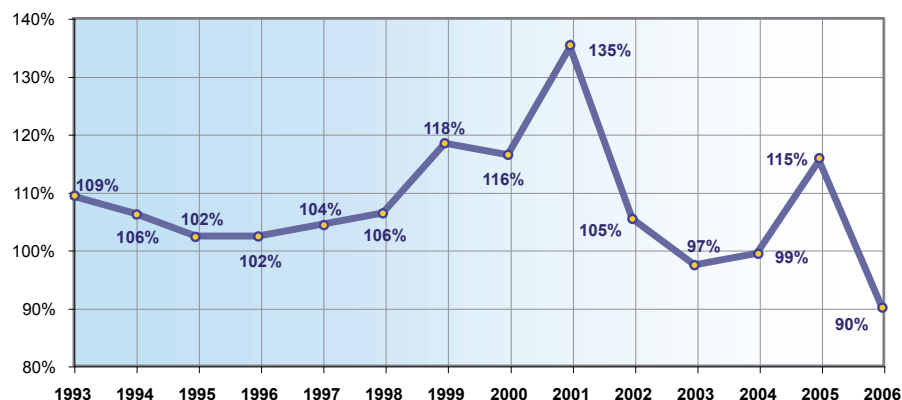
Finally, we should mention that coverage for loss of benefits stemming from Extraordinary Risks, which was completely incorporated into the system in December 2005, has been improved substantially with approval of Royal Decree 1265/2006 which modified the Regulations for Extraordinary Risks.

## 4.4 Reinsurance

In 2006 the world reinsurance market evolved in a satisfactory way, mainly because there were no major catastrophes<sup>17</sup>, and no individual loss events that affected earnings negatively.

The combined ratio came in at historic lows due to this absence of significant natural disasters and an improvement in financial yields. So this allows one to expect the reinsurance market to finish the year with earnings substantially better than those posted in 2004 and 2005, both of which saw major and frequent catastrophes that involved major losses.

**Chart 14.**  
International  
Reinsurance Market.  
Evolution of combined  
ratio



Sources: Standard & Poor's and AM Best. 2006 data estimated.

The market was characterized by an improvement in conditions and prices in zones and classes of insurance that are normally exposed to catastrophes, and by stability or slight reduction in conditions and prices in non-exposed zones and classes, making it likely that in 2007 reinsurers will increase pressure aimed at gaining market share and revenue in line with their high capitalization and expectations.

In general, reinsurers are seeing a drop in premium growth, due in part to voluntary limitation of their exposure to catastrophes in some areas – a result of a greater capacity to analyse their exposure and a reformulation of the models they use – and to an increase in retentions and changes from proportional reinsurance to non-proportional by some assigners.

<sup>17</sup> The year 2006 had the third-lowest insured catastrophic losses in history, estimated at 15,900 million USD. The most costly category was that of natural catastrophes, as was the case in previous years, although the amount estimated for 2006, 11,800 million USD, is much smaller than that of 2005. See Swiss Re (2007). "Natural Disasters and Major Anthropogenous Disasters in 2006", Sigma n° 2, p.3.



In 2006, new capital continued to pour into the reinsurance sector from large investment funds, either as “*sidecars*”<sup>18</sup>, catastrophe bonds or the creation of new reinsurance companies in the Bermuda market.

The Spanish resinsurance posted a good year in 2006, pressing on with a trend that began in 2002. Premiums ceded to reinsurance grew 10.4% at the end of the third quarter of 2006, above the 8.8% growth in direct business at the same point in the year. These cessions involved a volume of premiums of 3,340 millions euros. Taking into account the 35,865 million euros in earned premiums from direct insurance, they amount to a retention percentage of 92.5% for the whole sector.

Burial Expenses, Legal Defence, Health and Life Risk are the classes in which the percentage of retained business is greatest, as well as Motor and Household with retention levels above 90%. At the other extreme, classes such as Fire, Transport, Ship Hulls, Credit and Industrial Multi-Peril exceed the rate of 50% in cession to reinsurance. The rise in retentions and availability of capacity have contributed to a downward price trend in some branches and stability in others.

The year 2006 was also one of development and modernization of the market, with publication of numerous bills both in Spain and the European Union that will have a significant impact on the sector’s evolution and future.

- Law 26/2006 of 17 July, on Mediation of Private Insurance and Reinsurance, has established an EU legal framework which allows insurance intermediaries to work freely throughout the Union, regulating new ways of mediating such as the insurance agent and the reinsurance broker.
- Solvency II will bring about a new model of solvency capital, in which a proper reinsurance policy can also lead to a significant drop in capital requirements.
- Transposition of the 5th EU Motor Directive has meant a change in the Law on Third-Party Liability and Motor Vehicle Insurance, raising the need to revise the current scale. This, along with the introduction of a driver’s license based on penalty points, is having and will continue to have an effect on the Motor class of insurance.
- The inclusion of facultative reinsurance clauses would mean the establishment of a minimum-standards framework agreement, achieving greater legal security, transparency and confidence.

The Law on Environmental Responsibility<sup>19</sup>, the Law on Dependency<sup>20</sup> and the express mention of triennial insurance as part of construction

<sup>18</sup> A sidecar is a reinsurance company financed through hedge funds and formed with the special purpose of providing extra retrocession capacity in catastrophic coverage to reinsurance companies that insure property and *cola corta* business lines. See Fructuoso, M<sup>a</sup> José (2006). “Hedge Funds and Insurance Coverage”, in the magazine *Gerencia de Riesgos*, n<sup>o</sup> 94. Madrid: FUNDACIÓN MAPFRE, p. 25-41.

<sup>19</sup> Law 26/2007, 23 October, on Environmental Responsibility.

<sup>20</sup> Law 39/2006, 14 December, on Promoting Personal Autonomy and Attention to Persons in a Situation of Dependency.

insurance have brought about new opportunities, and will continue to do so in the near future, for all parties operating in the market, and are requiring reinsurers to come up with an active response and take on a lead role, by moving first in the markets in which they operate.

## 5. MOST NOTABLE FEATURES OF THE YEAR BY CLASSES

### 5.1 Life

In general terms, Life insurance closed the year with positive results, with managed savings among all insurance companies rising to 130,700 million euros for an increase of 5.2% –satisfactory but slightly below that of the previous year–. One should also highlight a big increase in the number of insured, which rose 9.5%, or more than 2.6 million people, taking the total to nearly 31 million insured. This illustrates the point we made earlier about improvement in the penetration of this business the whole of the Spanish economy.

By classes, the number of policies with strictly Life coverage, which account for more than two-thirds of the total, 22.3 million to be exact, rose 14%, while policies with savings guarantees dropped slightly compared to 2005. Continuing the trend of accelerated growth that began in 2004, the volume of premiums grew 9.4%, one point more than the previous year.

Million euros

| Class                 | Provisions     |                  | Premium       |                  |
|-----------------------|----------------|------------------|---------------|------------------|
|                       | 2006           | % Δ<br>2006/2005 | 2006          | % Δ<br>2006/2005 |
| Death                 | 3,705          | 18.4             | 3,403         | 17.1             |
| Retirement            | 91,362         | 4.0              | 10,861        | 2.1              |
| Insured Pension Plans | 689            | 37.3             | 198           | 3.4              |
| Other Savings         | 34,940         | 6.7              | 8,009         | 17.7             |
| <b>Total Life</b>     | <b>130,695</b> | <b>5.2</b>       | <b>22,472</b> | <b>9.4</b>       |

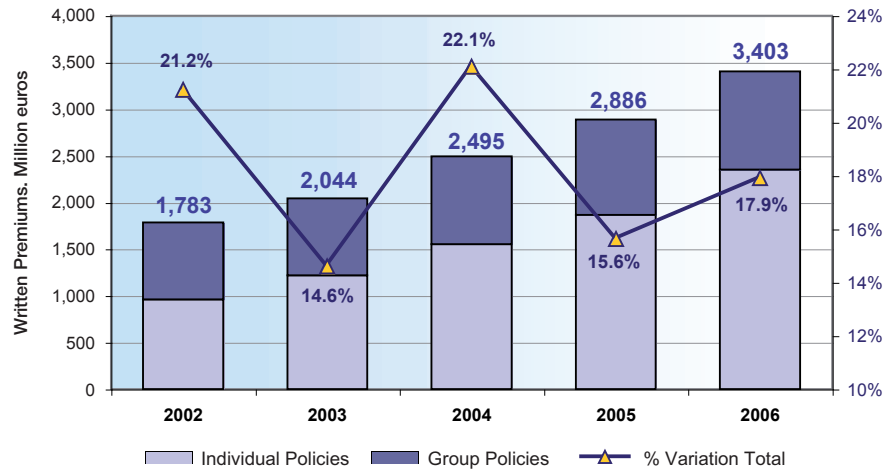
Table 5.  
Composition of Life  
business insurance

Source: ICEA.

As was the case in 2005, Individual life posted the highest growth, or 6.6%, representing a volume of managed savings of 84,973 million euros, well above Group policies with 45,721 million euros, a rise of 2.6%.

In line with recent years, the positive evolution of Risk-Life insurance was also confirmed, especially Individual policies, whose rise in premiums was nearly 22% in 2006. The significant collection of premiums in this type of policies was conditioned, among other factors, by the strong performance of the mortgage market.

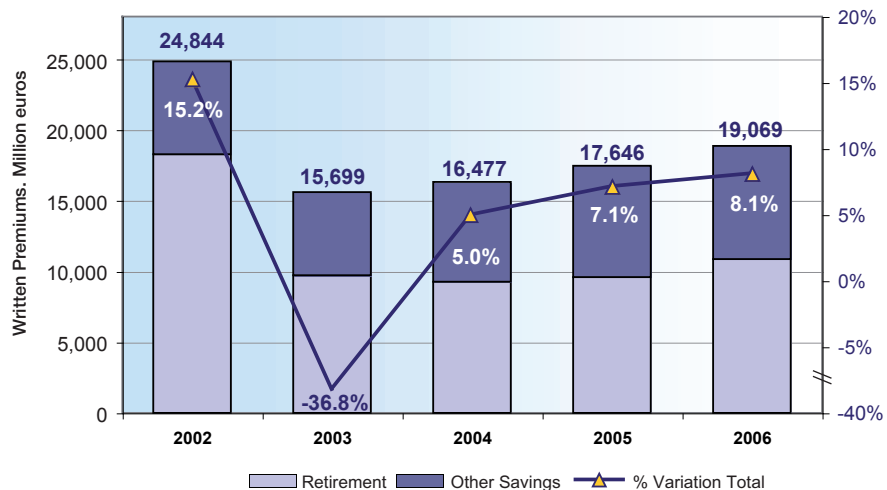
**Chart 15.**  
Evolution of Risk-Life insurance.



Source: ICEA.

Within individual Life insurance policies, retirement products again prevailed over non-pension savings options. But policies with guaranteed interest rates (28.9% of total managed savings), even though they had lower growth than other asset-linked products, dominated in the administered individual business segment, as deferred capital and annuities represented 28.2% and 25.7%, respectively.

**Chart 16.**  
Evolution of Life Savings Insurance



Source: ICEA.

As regards asset-linked Life insurance policies – such as the “unit-linked” and “index-linked” products, they experienced a sharp rise in the total number of insured and ended the year on a positive note, with an increase in their volume of provisions of 10.6%, mainly due to the favourable result of this kind of products both in the intermediary channel and in bancassurance.

Insured Pension Plans (called PPA's in Spanish) grew 37% in 2006, reaching a savings volume of 689 million euros with more than 144,000 insured.

In the case of Group Life insurance policies, their composition remained stable with respect to 2005, with modalities offering immediate and deferred income maintaining their predominant position, accounting for 86.7% of all managed savings.

Assets. Million euros

| Instruments                                  | 2006           | 2005           | % Δ<br>2006/2005 |
|--|----------------|----------------|------------------|
| <b>Investment Funds</b>                      | <b>262,738</b> | <b>252,301</b> | <b>4.1%</b>      |
| <b>Life Insurance (technical provisions)</b> | <b>130,695</b> | <b>124,181</b> | <b>5.2%</b>      |
| Individual                                   | 84,973         | 79,376         | 7.1%             |
| Insured Pension Plans                        | 689            | 502            | 37.3%            |
| Group  | 45,722         | 44,805         | 2.0%             |
| <b>Pension Plans</b>                         | <b>81,192</b>  | <b>72,910</b>  | <b>11.4%</b>     |
| Individual's Plan                            | 49,903         | 43,709         | 14.2%            |
| Employment Plan                              | 30,165         | 28,194         | 7.0%             |
| Associated Plan                              | 1,124          | 1,007          | 11.6%            |
| <b>Mutual Provident Society</b>              | <b>23,080</b>  | <b>21,301</b>  | <b>8.4%</b>      |

Table 6.  
Savings/Retirement  
Instruments

Source: ICEA.

As for the performance of the different distribution channels, the pattern was similar to that observed in 2005. In general, bancassurance companies represented 54% of the managed savings sector with a rise of 5.4%, followed by the intermediary channel with 42% and a growth rate of 5.4%. On the contrary, direct sales closed the year with a decline of 1.38%.

Management of Individual insurance policies was more concentrated in the bancassurance channel (57%), with a similar result for Group policies.

Investment funds performed well in 2006, thanks to a rising stock market. With respect to the domestic scene, the best performers were Mixed Fixed-Income funds with an increase of 15.7% in net worth, followed closely by Guaranteed Fixed-Income, which rose 15.1%. In 2006, all fund categories had positive yields, the most noteworthy being International Variable Income funds (from the euro zone), and the Spanish Variable Income funds, which achieved an accumulated yield over the year in excess of 20%.

The total value of Investment funds reached 254,306 million euros, an increase of 3.5% over 2005. The total number of participants came to 8,819,809, an accumulated increase of 264,787 participants (growth of 3.1%). The most significant increase corresponded to the category of international funds (up 19.8% more than in 2005).

The evolution of Pension plans was equally satisfactory, closing the year with a volume of assets amounting to 81,200 million euros, an increase of 8,283 million euros. This marked an 11.4% rise with respect to 2005. The number of participant accounts totalled 9,869,947 for an increase of 5.8%, while the estimated number of participants stood at around 7,500,000.

The prospects for 2007 point to a positive year with regard to classes of indexed insurance and incomes. Risk insurance might maintain their growth, although with greater difficulty as a result of the rise in interest rates and lower demand for mortgages.

In any case, at the end of the year one will have to evaluate the effect of the reform of Spain's personal income tax system and the consequences it might have in mid- and long-term guaranteed-interest products. Meanwhile, one will have to wait to confirm the excellent prospects for development that the whole sector has placed in the new Individual Plans for Systematic Saving (called PIAS in Spanish) and in the Business Insurance Plans.

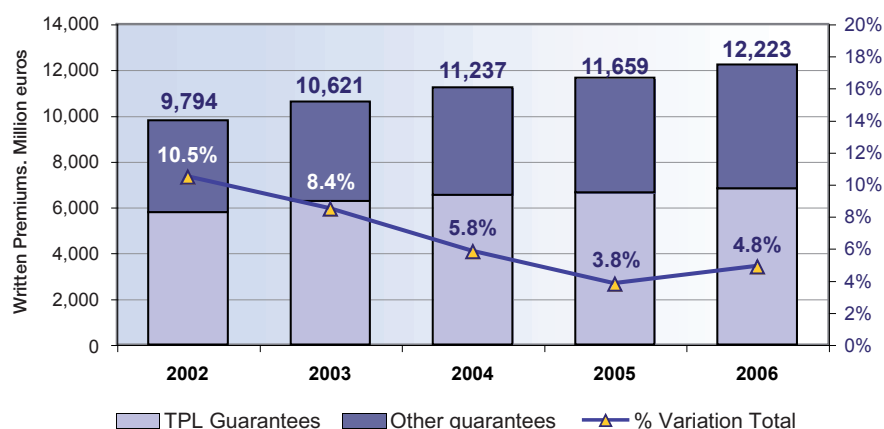
With respect to Pension Plans, they are expected to continue a satisfactory rate of growth, as they are still the only savings tool that allows people to made deductions from their personal income tax, despite changes introduced by the new tax law in the way these plans are handled tax-wise.

Investment Funds, even though markets are moderately optimistic, will confront a situation of possible volatility and strong competition from other products such as deposits.

## 5.2 Motor Insurance

Accounting for 40.6% of premiums, Motor Insurance is still the leader among Non-Life classes, although this status is being eroded by pressure on rates and higher growth among other Non-Life classes: 40.6% in 2006, 41.3% in 2005 and 42.8% in 2004.

Chart 17.  
Motor Insurance.  
Evolution of premiums



Source: ICEA.

Written premiums in 2006 reached the figure of 12,223 million euros, an increase of 4.8% over the previous year. This growth is fundamentally due to a sharp increase in the number of insured vehicles (up 5.2%, to

27.1 million vehicles), mainly mid-range vehicles, and to greater coverage being taken out for each insured vehicle. The variation in rates has been negative, with an important decline estimated at more than 5%, mainly in New Production.

The claims frequency improved significantly, going from 47.1% to 45.8%<sup>21</sup>, due to the entry in force of the new Spanish driving license based on a system of penalty points, and other measures related to highway safety which have led to a drop in the frequency of grave Personal Injury claims. The average cost per claim rose two percentage points to 633 euros (claims that ended up with payments), although most classes other than third-party liability experienced much higher rises in average cost.

The loss ratio rose one point with respect to 2005, and acquisition expenses also rose, as a result of which the technical result to earned premiums ratio was 14.1%. This is a major drop (2.5 percentage points) compared to the previous year, although this ratio still means a very high yield for this class.

The decline in the result stems mainly from the combined effect of a drop in rates and a rise in acquisition expenses. As a result, the combined ratio continues the rising trend that began in 2004 and increases two points to 93.9%.

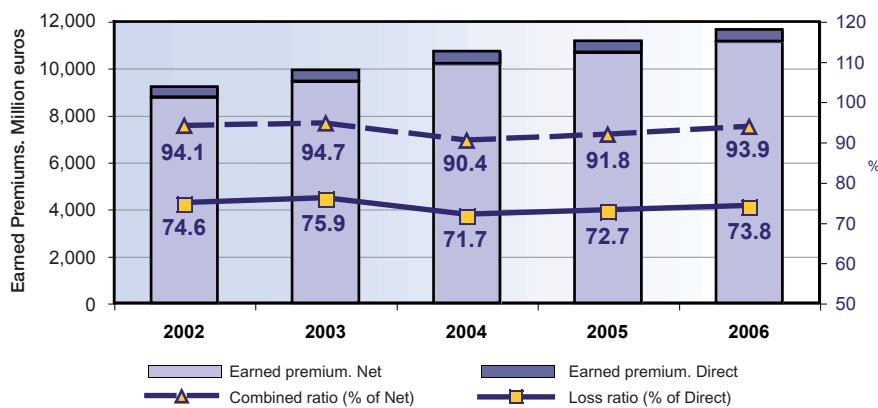


Chart 18. Motor insurance. Evolution of loss ratio

Source: ICEA.

In 2006 the sector continued to see a trend toward concentration of companies, with the number of firms offering Auto insurance declining from 55 in 2005 to 50 currently and the top 10 groups accounting for a 80.2% market share, up from 75.6% the previous year.

Strong growth also continued in companies specializing in direct sales, with increases in excess of 10% at the main ones, and other new companies joined this channel of distribution.

En 2007 is likely to see very moderate growth in premiums (around 3%) and continued worsening of the Profit and Loss Account, due to

<sup>21</sup> Figure from ICEA. Percentage of incurred losses corresponding to policies in force at the end of the year.

fierce competition and the lack of technical rigour applied to rating and underwriting in this branch.

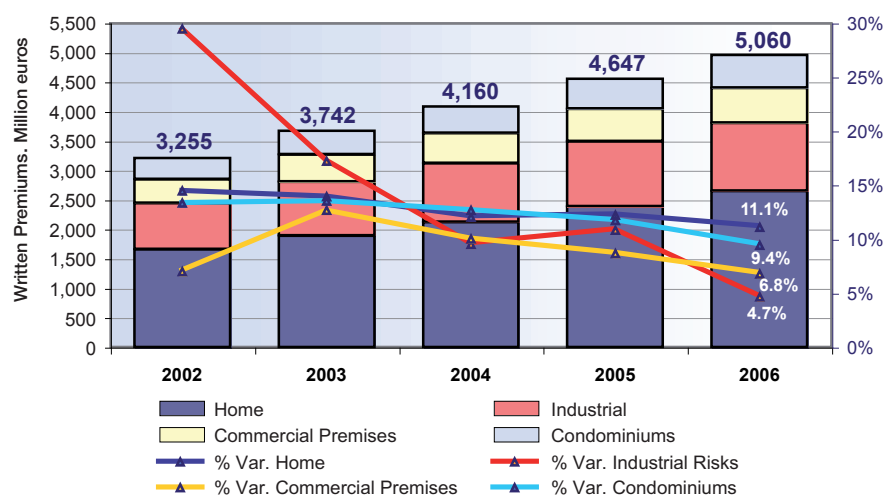
As for the principal innovations on the legislative front, in 2006 the Spanish Parliament continued to process the Bill that transposes the so-called Fifth Directive, the European Union regulation relating to mandatory third-party Motor Insurance, to Spanish legislation. Also, Law 21/2007 which modifies the text on Third-Party Liability and Insurance in Motor Vehicles was approved in 2007 and published in the Official State Bulletin on 12 July. Besides improvements in claims management and attending to needs of accident victims, the Law raises the maximum amounts of coverage of mandatory insurance, setting them in the case of damage to persons at 70 million euros per loss, regardless of the number of victims. Furthermore, maximum coverage for property damage rises to 15 million per loss.

### 5.3 Multi-Peril Insurance

This is a very mature and competitive market. Written premiums in 2006 reached the figure of 5,060 million euros for an increase of 8.9%. This growth was lower than in previous years and six points below that posted in 2003. Still, Multi-Peril insurance still holds second place with Non-Life classes in terms of premiums, with a market share of 16.8%, half a point higher than in 2005 (16.3%).

Analysing the data by type of business, we find that the increases continue the declining path of recent years. The possible cause of this stems from a reduction in rates by most insurance companies and broader coverage offered to confront strong competition. There is nothing to suggest that 2007 will alter this trend, keeping in mind the clear showdown in the construction industry.

Chart 19.  
Multi-Peril Insurance



Source: ICEA.



By type of business, Household insurance shows the strongest growth at 11.1% compared to 12.3% the previous year, followed by Condominiums with a 9.4% rise, more than 6 points lower than the growth figure for 2001. Industrial insurance fell more than 6 points with respect to 2005 and nearly 25 points compared to 2002, ending up with 4.7% growth. Finally insurance for Commercial Premises also followed the downward trend of recent years and posted growth of 6.8%, down nearly 6 points from 2003.

The loss ratio fell more than two points from 2005 to 61.1%, the lowest in six years along with that of 2004 (57.9%). It is very likely that the low loss ratio of 2006 was favoured by the weather, mainly by a lack of rain. Operating expenses continued their downward trend, falling near half a point to 28.1% of earned premiums. The fall in the loss ratio, along with control of expenses and selection of risks, led to a rise in the technical account result, which reached 13% of earned premiums, nearly two points higher than in 2005.

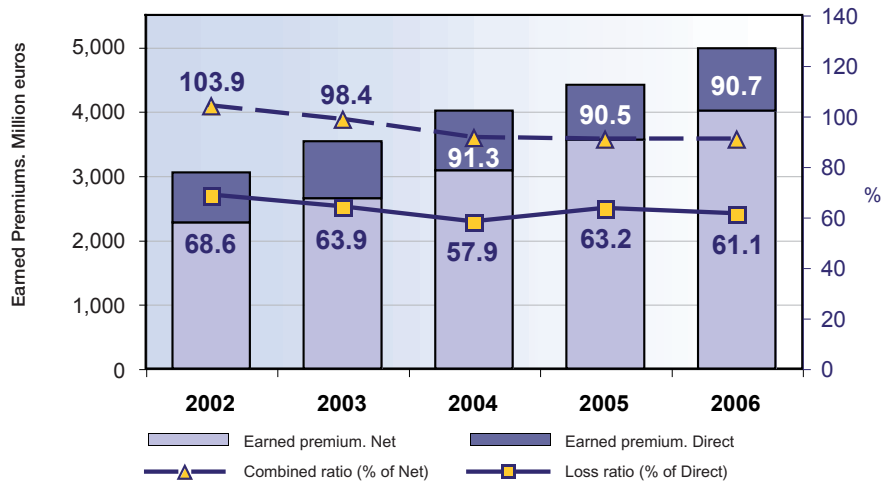


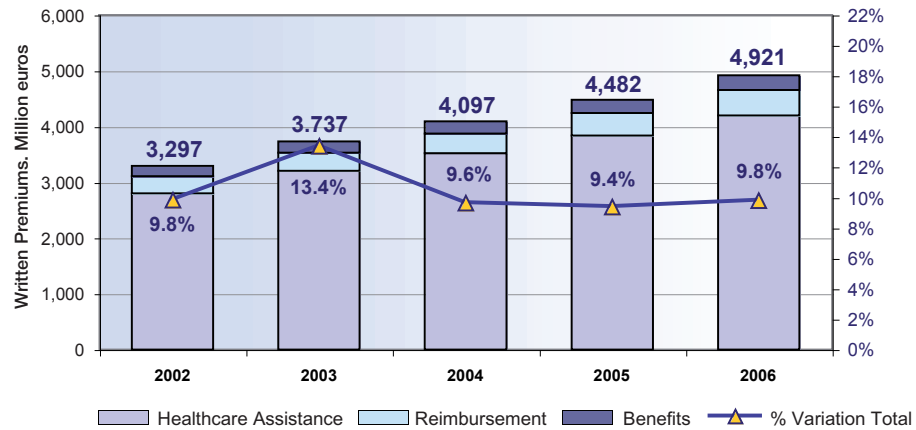
Chart 20.  
Multi-Peril Insurance.  
Evolution of loss ratio

Source: ICEA.

## 5.4 Health

In 2006 the volume of premiums reached 4,921 million euros, an increase of 9.8 % that was in line with the relative values of growth seen in the sector in recent years. If we consider the inter-annual variation in the prices of medical policies, which in 2006 was 4.9%, this gives us a real growth figure from new business of 4.9%, the same as the figure of the previous year. As for the number of insured, there has been no significant change in recent years, with the number steady at around 9.5 million.

**Chart 21.**  
Health Insurance



Source: ICEA.

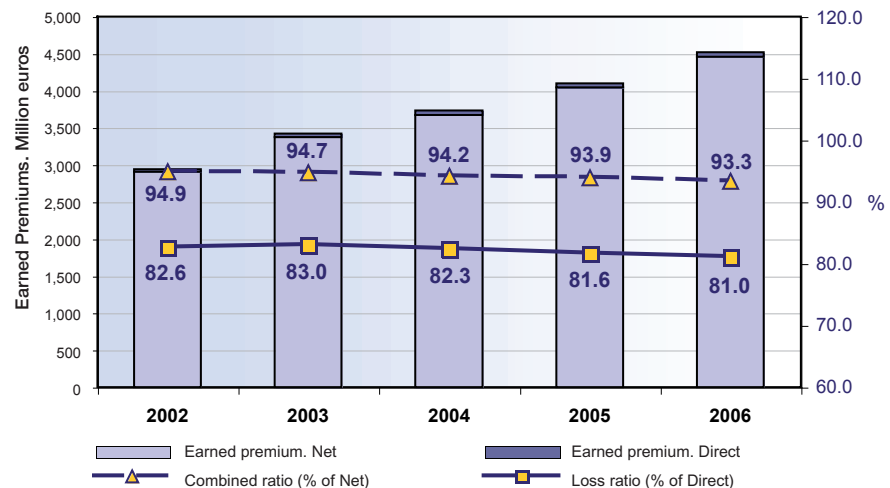
In comparison with the rest of the Non-Life classes, Health is third in premium volume, after Motor and Multi-Peril.

By kind of business, again it is group policies that are the most dynamic. Health insurance is taking hold in Spain as one of the non-monetary forms of compensation that companies can offer their employees. For their part, insurance companies are waging a price war in this sector and the battle may take its toll in future earnings reports, having a negative effect on the results of the technical account.

As we stated in last year's report, in addition to company policies the opportunities for development within the sector entail identifying population segments that require specific products and enhancing the products that are sold now, through services that contribute added value.

Healthcare assistance accounts for 85% of the class, followed by Reimbursement of Expenses, then Benefits and Compensation.

**Chart 22.**  
Health Insurance.  
Evolution of Loss Ratio



Source: ICEA.

As for the evolution of the technical account, the following graph shows an improvement in the last few years, basically as a result of the reduction in the loss ratios thanks to better mechanisms for controlling spending at insurance companies. In 2006 the loss ratio declined by six tenths of a point with respect to the previous year. As for administration and acquisition expenses, they rose slightly, as did investment income as a result of the rise in interest rates. The combined ratio fell slightly, as it has been doing in recent years.

In November 2006, the Spanish Parliament approved the Law to Promote Personal Autonomy and Care for Dependent People. The legislation went into effect in January 2007. The Dependency Law, as it is known, is seen as the fourth pillar of the welfare state in Spain, alter pensions, education and health. It features a system of universal application based on a *Beveridge-style* model of coverage that is financed through taxes and with a catalogue of economic and assistance benefits.

With the Dependency System, the State provides older people and those who are incapacitated and cannot get by on their own the following social services: house calls, remote assistance, day and night centres, residential living and technical aids. The system also features a series of model state-financed care centres for dependent persons. In the event the state cannot provide the services that a dependent person needs, this person can receive funding to acquire this service on the private market. There is also economic aid for care-providers in the family or for hiring a personal assistant. As for the tax benefits applied when private dependency insurance is purchased, the Law promotes regulation of tax treatment of private instruments for dependency coverage in such a way as to facilitate co-financing by the beneficiaries of the services.

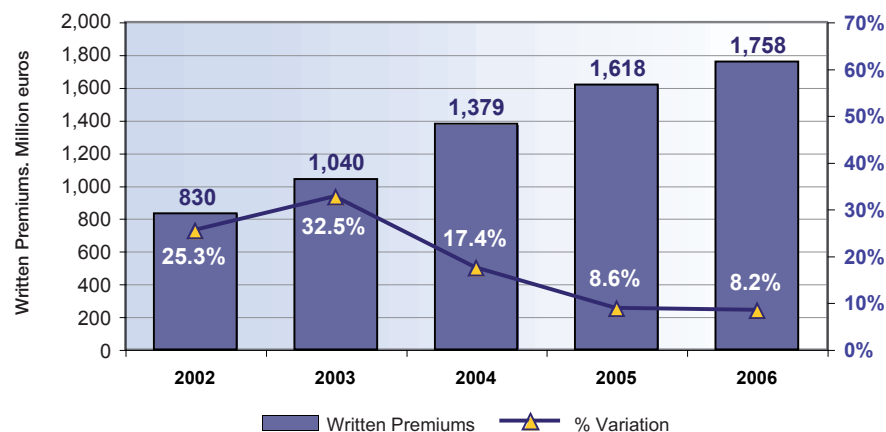
The Law foresees later development of certain aspects of the legislation, such as approval of the Dependency Evaluation Scale, the services a person is entitled to depending on the degree and level of dependency, the amount of economic benefits, and determining of the contributions that beneficiaries will make in order to finance services. Some of these unresolved issues, which are of particular interest to the insurance sector, have been cleared up in 2007 following approval by the Territorial Council on Dependency (made up of the Government, Regions and Local Administrations) of the rules that regulate them.

Coverage of dependency has been seen as a possible market niche for the private insurance sector in the future. With the approval of the Law, the operating margin for insurance companies is limited for now to insuring co-payment or a double coverage, similar to the one that already exists in Health insurance in Spain, to confront difficulties stemming from access to state-covered services.

## 5.5 Third-Party Liability Insurance

Growth in Third-Party Liability Insurance has slowed in recent years, and after several periods of double-digit annual increases, it reached 8.2% in 2006, with a volume of premiums of 1,758 million euros.

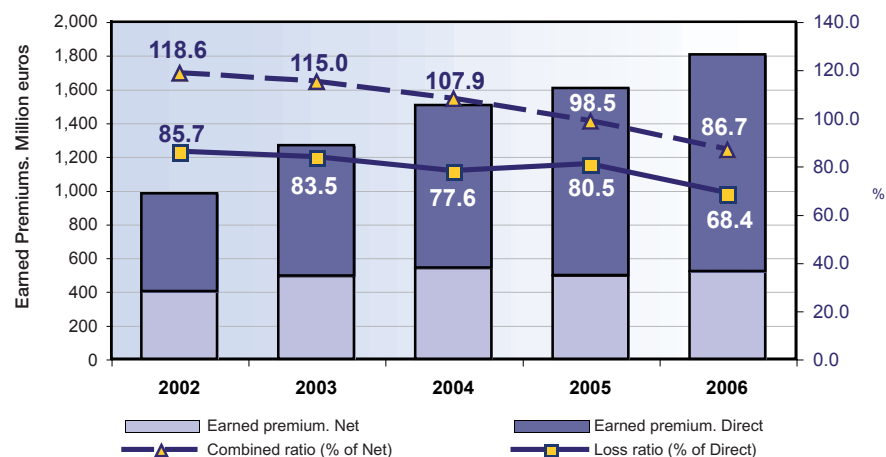
**Chart 23.**  
Third-Party Liability  
Insurance. Evolution of  
premiums



Source: ICEA.

The loss ratio fell 12 points to 68.4%. A small rise in other management costs make for a combined ratio of 86.7%, also 12 points better than in 2005 (98.5%) and 32 points better than the figure for 2001.

**Chart 24.**  
Third-Party Liability  
Insurance. Evolution of  
Loss Ratio



Source: ICEA.

These good results stem from fierce competition to lure large industrial clients, certain segments of Third Party Liability, Directors & Officers insurance and policies for non-health care professionals. All of these are classes in which the appearance of new companies has led to a substantial drop in premiums (around 20%).

In the same sense, health-care risks, which in recent years had been characterized by rigid supply, are loosening up due to new possibilities for insurance companies. It has been announced that a "Healthcare Scale" will be devised to harmonize indemnity amounts for people affected by medical malpractice. This would add an extremely important tool for managing this kind of insurance, in particular policies held by state health-care entities, which are concentrated in the hands of just a few companies.

In insurance for Social Administrators and Professional Liability, new companies with large capacity are appearing. This is contributing to a lowering of rates and increase in coverage and insured capital.

Albeit late, the process of adapting Spanish legislation to the EU's Environmental Responsibility Directive has concluded with the approval of the Law on Environmental Responsibility. Its scope goes beyond what is called for in the European text, even protecting coasts and rivers, calling for mandatory financial guarantees and the devising of an instrument for evaluating environmental damage. The guarantee can take the form of an insurance policy and/or bank endorsement or technical reserve, and must be in force the whole time the activity is under way. However, this obligation will not begin until April 2010 in order to let the market prepare for offering such guarantees.

Important legislation for the insurance industry was passed in 2006::

- Law 32/2006 which regulates subcontracting in the construction industry. It aims to reduce the workplace accident rate.
- These were enacted in 2007 but debated at length in 2006: the Law on professional societies, which establishes a specific regime of responsibility for this sector, and the Law on effective equality between men and women, which will have major effects on workplace discrimination lawsuits.

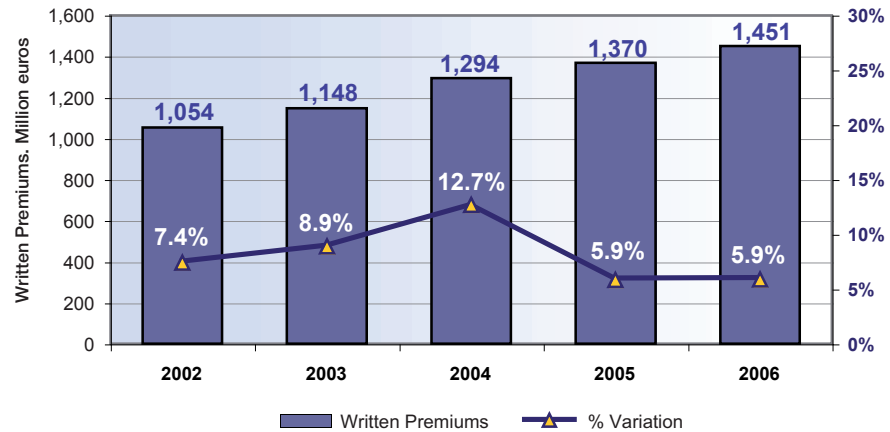
To sum things up, the year 2006 saw good results in this class of insurance, with growth above the rate of inflation, and new possibilities for doing business (Environmental Guarantees, EPL, Professional Liability) but the sector was also threatened by greater competition.

## 5.6 Burial Expenses

Insurance for burial expenses has achieved great penetration in Spain by providing coverage to more than 20 million insured. This insurance applies to more than 200,000 of the 380,000 who die every year in this country. These data give an idea of the social function and importance of this kind of insurance. Thus, government authorities want to make sure the sector is transparent and solvent.

Due to the maturity of this class, the growth in premiums – 5.9% in written premiums – stems mainly from vegetative growth in the portfolio, due above all to increases in funeral prices and the evolution of the needs of the insured population. In this regard we should mention the growing demand for cremation, which has experienced tremendous growth since the 1970s – in 1973 a total of 50 cremations were carried out, compared to 75,583 in 2006, or 20% of all the people that died that year.

**Chart 25.**  
Burial Expenses  
Insurance. Evolution of  
premiums

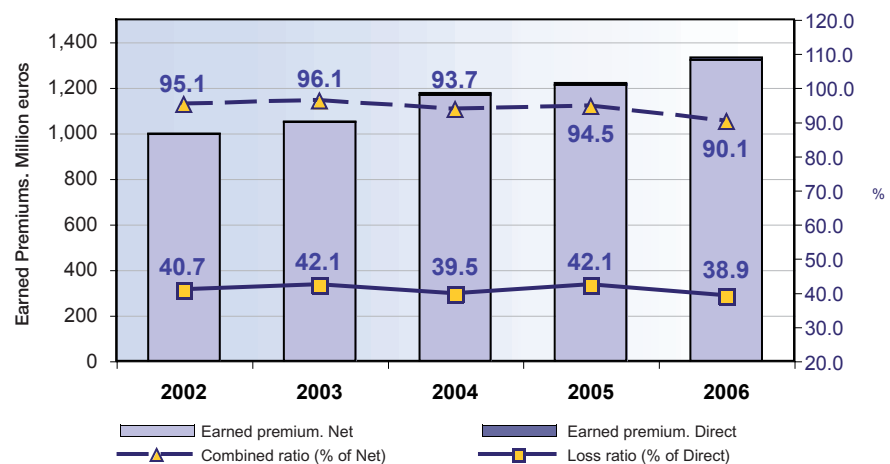


Source: ICEA.

New production aims to meet the needs of new and increasingly important population groups, such as foreign residents, who make up 9.3% of Spain's registered population. They are offered all kinds of services, including repatriation.

The technical result in 2006 was 16.8%, five points better than the figure for the previous year. The result has been improving year after year due mainly to efforts to cut operating costs, which in this class are well above the average for Non-Life insurance, especially acquisition costs. The loss ratio declined two points to 38.9%, the lowest of any Non-Life Branch, also contributing to improving results. The combined ratio was 90.1%, four points less than in 2005.

**Chart 26.**  
Burial Expenses  
Insurance. Evolution of  
Loss Ratio



Source: ICEA.

## 5.7 Personal Accident Insurance

In 2006 personal accident insurance (excluding Motor insurance protection for vehicle passengers) posted growth of 6.4%, fourth tenths more than in the previous year, reaching 902 million euros. This represents 11% of all premiums within the Non-Life sector.

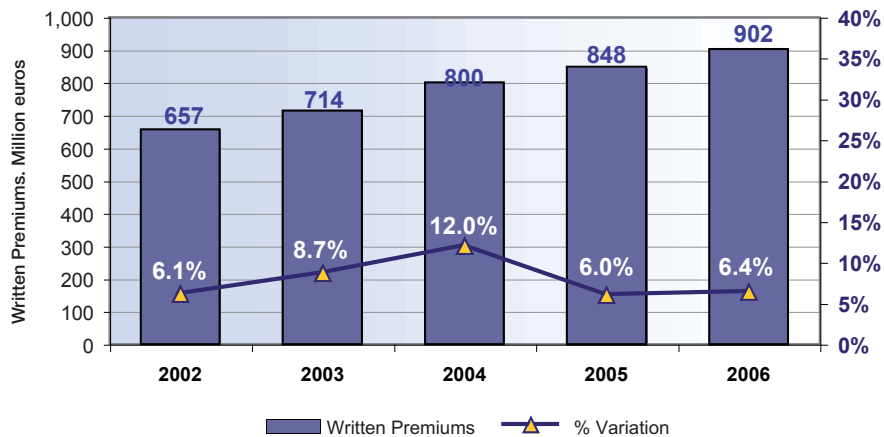


Chart 27.  
Accident Insurance.  
Evolution of premiums

Source: ICEA.

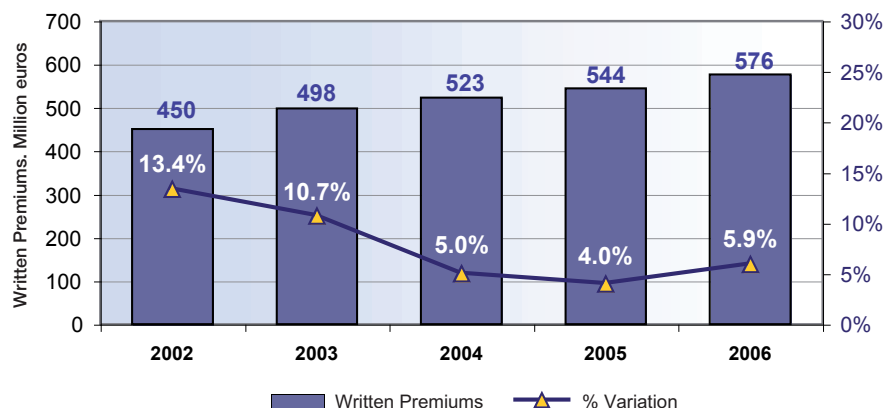
The loss ratio fell nearly four points to 43.3%. Operating costs also declined, despite a small increase in acquisition costs, reaching 28.6%. The combined ratio on net earned premiums went from 85.2% in 2005 to 76.2% in 2006.

## 5.8 Credit and Surety Insurance

Premiums written for Credit policies in 2006 reached 576 million euros, an increase of 5.9% compared to 2005 and change in the trend of lower growth that has been observed over the past five years.

Credit insurance is in a phase of full maturity as seen in products, coverage and companies: along with three national companies, all major international groups operating in this sector are present in Spain. They are attracted by a market that is growing more than those of other European countries.

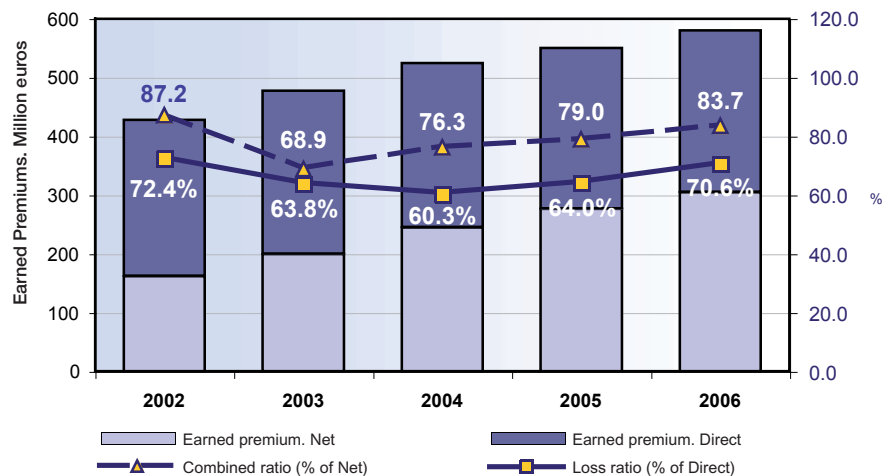
**Chart 28.**  
Credit Insurance.  
Evolution of premiums



Source: ICEA.

This explains intense competition that manifests itself in downward pressure on premium rates and an increase in cover conditions. This is not justified by an improvement in economic conditions but rather a desire to gain market share. A consequence of this is an increase in insured capital and risks covered, lower growth in premiums and a rise in the loss ratio.

**Chart 29.**  
Credit Insurance.  
Evolution of loss ratio



Source: ICEA.

The loss ratio rose to 70.6% of earned premiums, an increase of 6.6 points compared to 2005, when the increase was 3.7 points from the previous year. This figure seems to point to a change in the tendency of the economic cycle, which could affect the most commercially aggressive companies. Operating costs stayed practically unchanged, representing 31% of earned premiums. The technical account result fell 2.5 points to 11.5%, compared to 14% in the previous year and 15.9% in 2004. As a result of all this, the combined ratio worsened to 83.7%, as opposed to 79% in the previous year.



Although the loss ratio has risen steadily for in the past three years, one does not discern in the market a clear trend toward high premium volume. This is explained by the strong economic and business environment during this period. But in certain sectors signs are emerging that the economic cycle might change. This would produce an increase in the loss ratio, which in turn would lead to a toughening of policy conditions.

In this context, companies will continue adapting to the new realities of the market, some by dimension, expansion and geographic positioning, and all by incorporating improvements in technology, operations, management and monitoring of risk and customer service for insured parties.

In the near future, the factors we have mentioned make for a not very favorable picture in terms of how loss ratios will evolve. The expectation is for growth percentages similar to the current ones and in line with Spain's neighboring countries.

Surety insurance posted growth of 12.2% in 2006, reaching premium volume of 83 million euros. This is due mainly to the fact that real estate promoters and builders not only did not show down their growth, but rather increased it. Premium rates showed a performance similar to that of 2006, although a certain downward pressure from the market has begun to be detected.

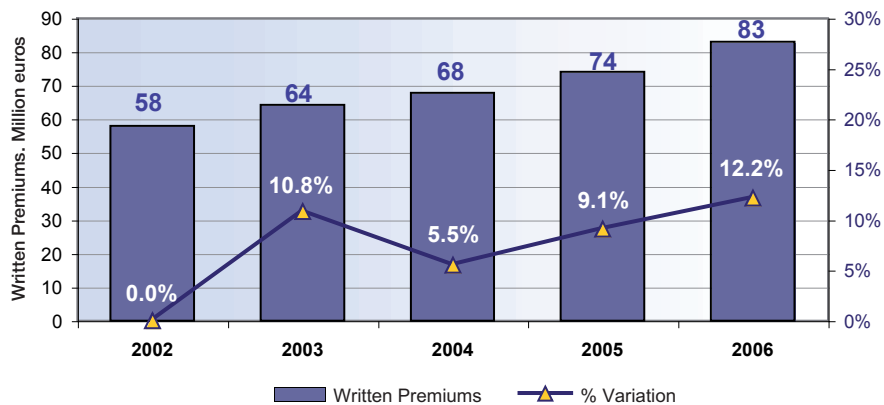
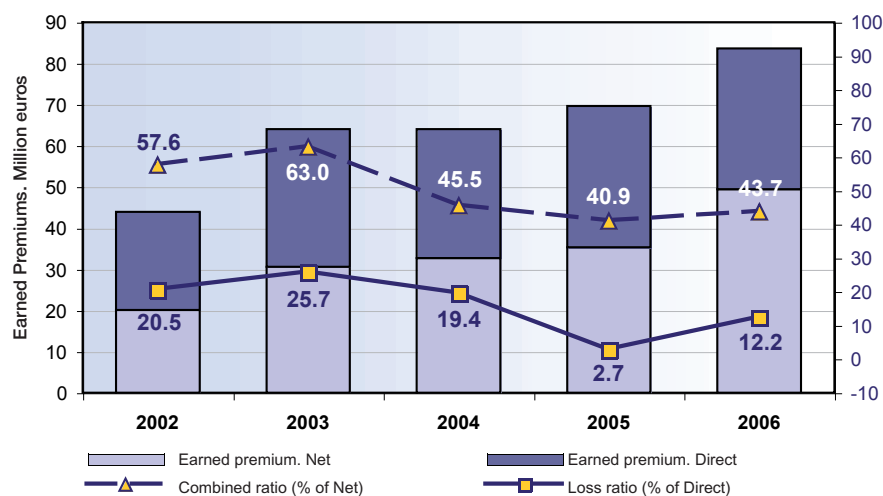


Chart 30.  
Surety Insurance.  
Evolution of premiums

Source: ICEA.

As for the loss ratio, the figure of 12.2% is very good. It breaks with the downward trend of the past three years. This might signal a certain change in the economic cycle, and for this reason it will be necessary to show the utmost prudence in underwriting and try to raise rates, especially in insuring amounts advanced for the purchase of housing. A decline has been observed in administration costs. This can be attributed in part to the sector's efforts to seek efficiency through technological improvements in their information systems, mainly in on-line communications with third parties. In light of what we have said earlier, the technical result, at 61.4%, can be considered quite satisfactory.

Chart 31.  
Surety insurance.  
Evolution of loss ratio



Source: ICEA.

In 2007 growth in premiums is expected to fall. The loss ratio might also worsen. In both cases, the cause is the decline in the real estate sector, which in the past few years has made the greatest contribution to the sector in terms of premiums.

## 5.9 Other Industrial Insurance

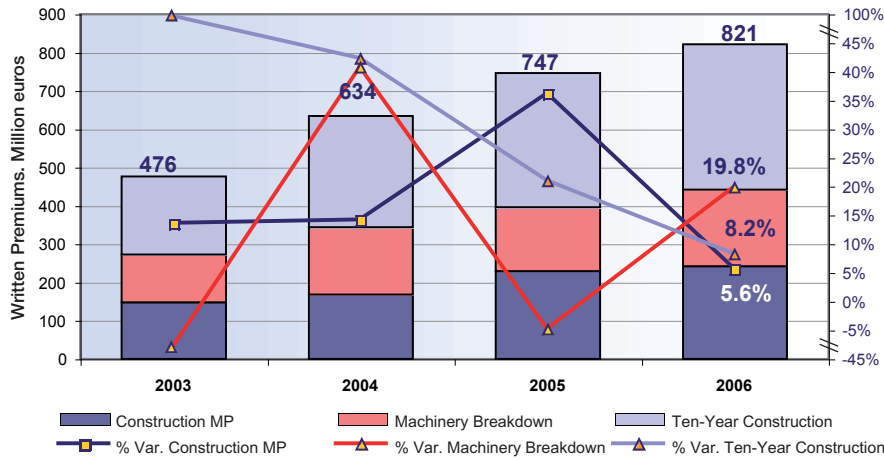
In this section we discuss Engineering (Machinery Breakdown, Construction Multi-Peril, Ten-Year Construction Insurance, Erection, Electronic Equipment and Product Warranty), and Transport (Marine, Goods and Aviation), as Third Party Liability and Multi-Peril were covered in other parts of this report.

### 5.9.1 Engineering

The Engineering sector (Machinery Breakdown, Construction Multi-peril, Ten-Year Construction, Erection, Electronic Equipment and Product Warranty) continues a process of slower growth that began in 2004, going from 747 million euros in 2005 to 821 million, a rise of 10% (down from 17.8% in 2005).

Ten-Year Construction Insurance maintains growth that is closely linked to the real estate sector, so growth in premiums is easing year to year. Volume of premiums reached 379 million euros, a rise of 8.2% over the previous year (it was 20.9% in 2005). It is worth pointing out that competition is fierce, and this causes rate changes and higher commissions.

As for Construction Multi-Peril Insurance, as in the earlier case, growth stems to a large degree from the evolution of construction, both at the state and private level. There is also strong competition that leads to rate changes, especially in building. Growth in premiums was 5.6%, far below the extraordinary growth rate of 36.1% the previous year, which was driven by a rise in volume in public works projects.



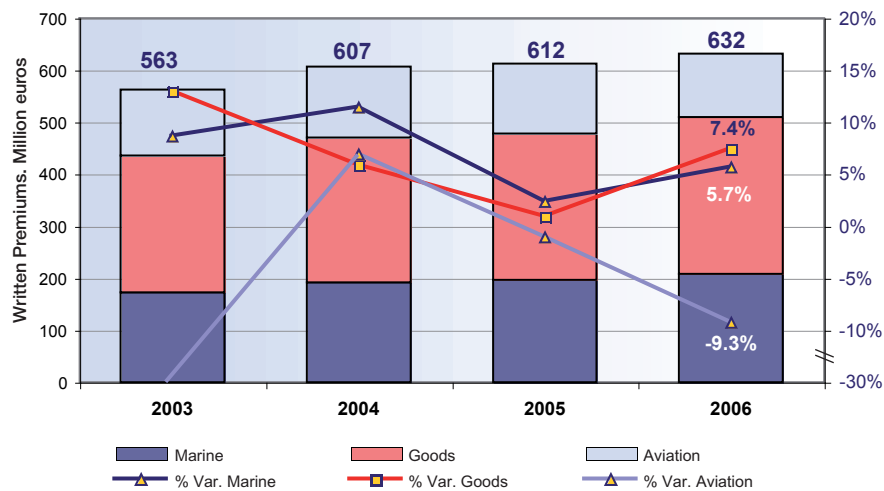
**Chart 32.**  
Engineering Insurance.  
Evolution of premiums

Source: ICEA.

The Machinery Breakdown class posted high growth of 20% in 2006 (compared to -5% in 2005), driven by the fleet of machinery that serves the construction industry and leasing/renting transactions by financial entities. Erection insurance fluctuates depending on the assembly of industrial plants and in recent years has been influenced by development of renewable energies, which have caused a downturn in this class of insurance.

### 5.9.2 Transport

Transport insurance is characterized by a highly saturated market in which it is difficult to expect high levels of growth. The sector in general rose from 612 million euros in 2005 to 632 million euros in 2006, an increase of 3.2% compared to 0.9% in 2005. As we can see, modest signs of recovery are emerging in the transport sector, with a tendency to stabilize.



**Chart 33.**  
Transport Insurance.  
Evolution of premiums

Source: ICEA.

Except for Aviation, premium volume rose in every segment of this class. Marine insurance rose 5.7%, a significant improvement over the previous year. Even though this is a sector with fierce competition, rates fell only slightly (less than in previous years) although this effect was attenuated by construction of ships and insurance rates for leisure vessels, which are included in the Marine segment.

Goods insurance, which account for 48% of the Transport branch, posted a moderate rise of 7.4%, suggesting slow recovery in this class. It is worth noting that while Marine insurance maintains a healthy technical account, that of Goods is approaching levels less favorable than in recent years.

Aviation, due to the volatility of the market in which it operates, suffered a drop of 9.3% in premiums from the previous year. We should note that this is a very limited market, subject to international trends and risks of change, which along with strong competition and falling rates, explains the decline.

The loss ratio worsened in all branches, so the joint loss ratio rose four tenths to 49.8%

### 5.10 Multi-Peril Agricultural Insurance

The Spanish System of Multi-Peril Agricultural Insurance, which is more than 25 years old, is a model of cover for damages caused to agricultural, livestock, aquacultural and forest facilities, in which 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 a mandatory underwriter of some lines of business, and the State and Regional Administrations subsidize part of the premium. The system of agricultural insurance has proven efficient in repairing economic damage caused by weather, accidents and livestock diseases, helping maintain the agricultural and livestock sector.

In 2006, the number of policies taken out was 470,705 distributed thusly: 52% agricultural insurance and 48% for livestock. The insured sum was 9,064.31 million euros, corresponding to 25,524,161 tons of agricultural production, 87,213 hectares of protected crops and forest, and 208,614,261 animals. The level of insurance for agriculture and livestock stands at around 40%. By kinds of production, penetration is 40% in agriculture, 4% in protected crops and forests, and 58% in livestock insurance. Highlights are the high level of insurance of winter grains (80%) and fruit trees (76%).

As for premiums, the volume of accrued net premiums in 2006 reached 590.9 million euros, up 18.27% from the previous year. This accounts for 2.1% of Non-Life earned premiums in 2006<sup>22</sup>. Premium subsidies from public administrations in 2006 came to 60.25%.

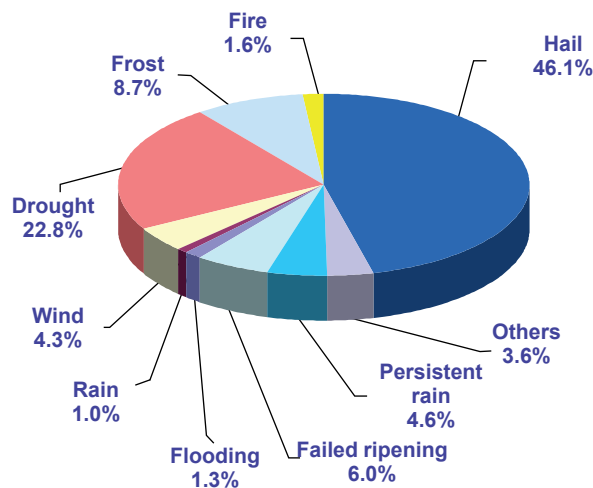
<sup>22</sup> The concept of “accrued net premiums” or “acquired premiums” is similar to the concept of “earned premiums”, according to the Plan de Contabilidad de Entidades Aseguradoras.

MAPFRE led the main insurance companies operating in Multi-Peril Agricultural insurance in 2006, with a market share of 23.44%.

The loss ratio in 2006 was 74.59%. The main weather phenomena that had a negative effect on harvests were:

- Heavy frost in the first quarter of the year affected citrus crops in the Levante region. Also in Levante and in the same period, rain damaged production of winter tomatoes.
- In the second quarter there were losses from failed ripening in fruit trees in the Ebro river valley and especially in Extremadura, and heavy rain damaged the apricot crops in Alicante and Murcia. Hail in June caused heavy damage to olive trees in Jaen and Granada and to tomatoes and fruit trees in Extremadura. Drought and high temperatures affected herbaceous crops, with repercussions in the management of adjustments.
- In the final phase of the season, summer hail harmed fruit production in Catalonia, while rain in September and November damaged vegetable crops in the Rioja and Navarra regions and table grapes in Alicante and Murcia.

The effects of adverse weather in 2006 led to 1.3 million hectares of land being damaged and the filing of 89,037 claims.

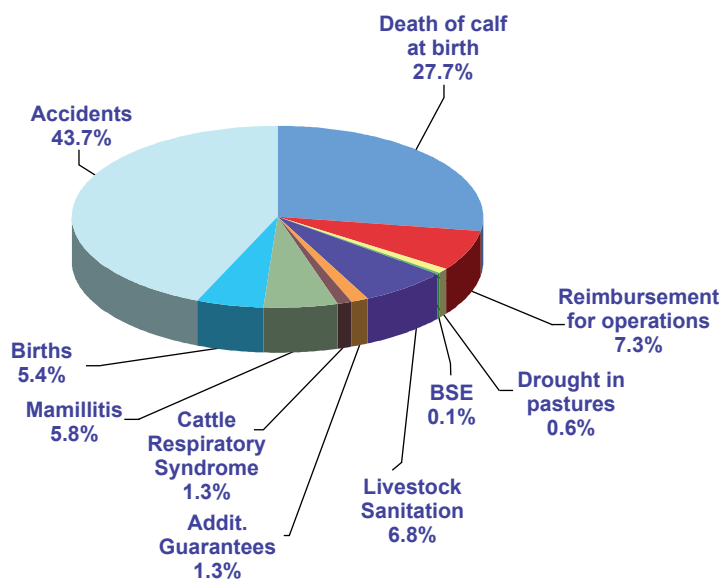


**Chart 34.**  
Agriculture insurance.  
Distribution of losses  
by risk

Source: AGROSEGURO. 2006 Annual Report.

In the livestock sector, the number of losses was 932,200, of which more than 800,000 corresponded to insurance covering collection and destruction of dead animals.

**Chart 35.**  
Livestock insurance.  
Distribution of losses  
by risk



Source: AGROSEGURO. 2006 Annual Report.

Summing up, AGROSEGURO has had to face more than a million claims handled and paid 414.05 million euros in compensation in 2006.

In 2007, some lines of coverage are extended and improved, such as:

- Inclusion of wind coverage in the general rate.
- Incorporation of raspberry production in insurance for strawberries.
- Inclusion of damage to wood because of frost in citrus insurance.
- Broadening of coverage for Foot and Mouth Disease and Sanitation for some species of animals.

At the same time new products will be launched, such as insurance for pig farms, policies for tropical and subtropical fruit, fire coverage (reforestation costs and loss of cork) for cork trees and a combined rate for horticultural production in the Canary Islands.



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