2

Developments in the environment and the sector

2.1 Introduction

The total funds managed in the life insurance sector rose by 1.9% in 2010

Throughout 2010 the international economic situation was characterised by a certain recovery to the levels prior to the deceleration experienced at the end of 2007, although this growth was different from country to country. This economic recovery was felt mostly in Japan, then in the USA and then in Europe. In spite of this, market tensions were kept bubbling due to the debt crisis in Greece, whose effects extended to Portugal and the rest of the peripheral European countries. Proof of this was the evolution of the differential of sovereign bonds of the peripheral countries against the German bond, which started in August. As far as interest rates are concerned, these remained low just like in 2009, mostly as a result of the uncertainties about the sustained recovery of the economy. The overall behaviour of the securities market moved towards recovery, although this was less than in 2009.

In Spain the economic evolution doggedly continued to behave worse than most OECD countries. The main figures, i.e. GDP, the number of unemployed and the fiscal deficit, deteriorated in comparison to the previous two years.

In this situation, total premiums for the Spanish insurance sector fell by 3.8%, which in fact comes to 57,587 million euros. Of these 45% affected life business and 55% non-life business. This behaviour entailed a downturn in the evolution of the sector because even in 2009 there was an increase of 1.2% despite the crisis.

In life business there was a drop of 8.4% with respect to the volume of managed funds in 2009: risk business grew by 2.8% and savings contracted by 10%. This is essentially due to several factors: the stagnation of the second pillar in our country, the aggressive competition among financial entities to attract deposits and lastly, the economic uncertainty linked to the high rate of unemployment. All of this brought about a change in tendency with respect to the last few years in which life business had growth rates of 15.3% in 2008 and 5.7% in 2009.

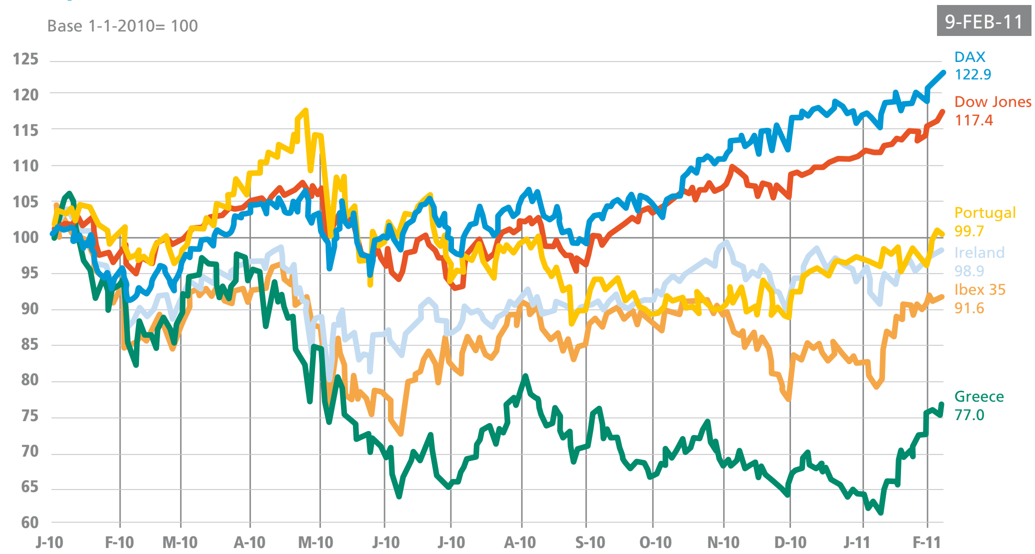
The total funds managed in the life insurance sector rose to 146,633 million euros, 1.9% more than in 2009, although they conducted themselves differently: The individual business grew by 3.4% and group business fell by 1.1%.

In the non-life area, the amount of managed funds was 31,819 million euros, in line with that of the previous year, although this was a downward trend as the 2009 non-life market contracted by 2.5%. As regards areas where growth did take place, health and multi-risk insurances achieved better results with increases of 4.2% and 3% respectively. The motor insurance area did well to moderate its fall and had a bearing on the general improvement in the non-life sector.

In pension plans, the volume of managed funds came to 84,757 million euros, similar to that of the previous year. This behaviour was mainly due to the revaluation of savings thanks to the favourable evolution of the financial markets and a 3% increase in pension plan contributions.

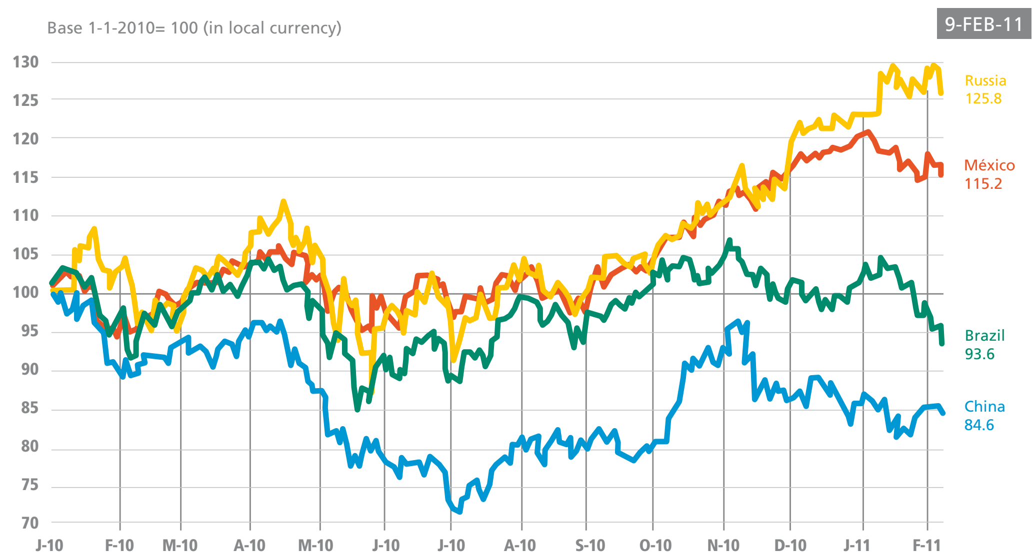
2.2 The economic situation and family savings

European stock markets & Dow Jones



Source: Study Services of "la Caixa"

Emerging stock markets



Source: Study Services of "la Caixa"

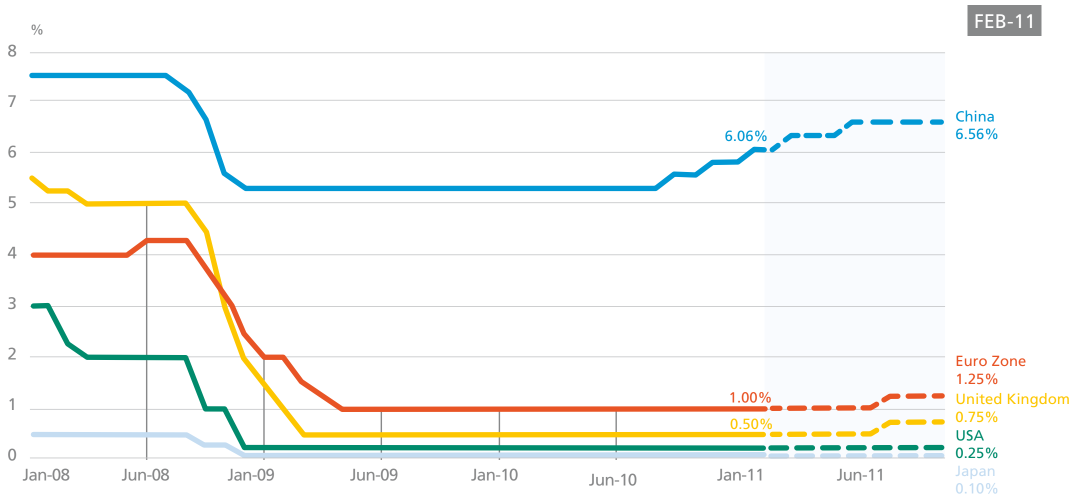
Stock markets

The evolution of the capital markets in 2010 was somewhat bumpy in different countries: the stock market indexes of countries like Germany, The United States, Russia, Mexico and Asian countries except Japan and China, recovered gradually, above all in the last quarter. However, the countries most affected by the crisis ended up with negative profitability. The unfavourable evolution of the stock markets, especially the Ibex-35, contributed to diminishing the value of savings managed in life-insurance and pension plans with stakes in variable income.

Interest rates

Throughout 2010, interest rates remained stable

Interest rates

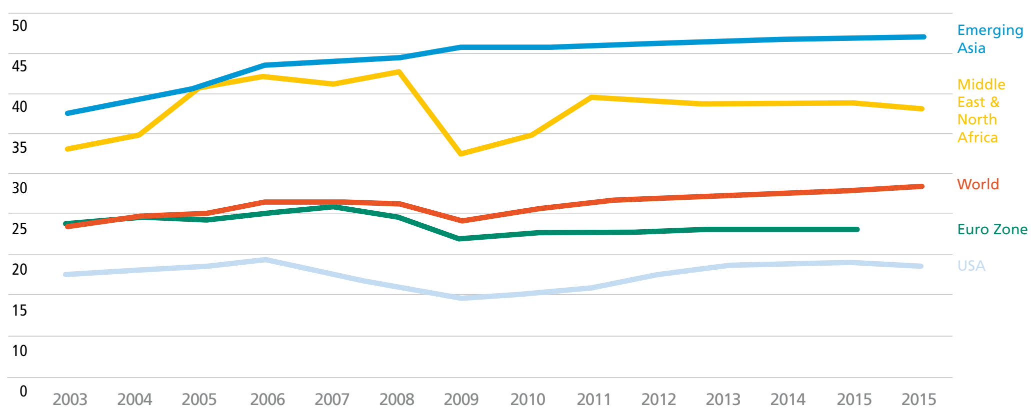


Source: Study Services of "la Caixa"

Maintaining interest rates was a constant task in 2010. The European Central Bank kept them at 1% and the Federal Reserve at 0.25% throughout 2010. The upward trend of long-term interest rates gave rise to opportunities to offer attractive profitability in long-term investment savings products such as annuities, guaranteed pension plans and pension plans, all of which invest long-term and enjoy better chances of remuneration for customers.

Family savings in Spain

Evolution of the savings rate



Throughout the first six months of 2010, the rate of family savings stood at similar levels to that in 2009, as a result of the drop in private consumption and investment in homes. This situation made it possible for the rate of family savings to reach historic highs as a knock-on effect of the crisis. On the other hand, the rate of family savings, understood as gross available income, fell to around 14% as a consequence of the bad employment figures and the fall in family income, as well as a slight rebound in consumption.

Savings in Spanish families went from 195,000 million euros in 1985 to 1.73 billions in 2010, a figure that represents 164% of the GDP. In 2010, the net flow of savings was 24,000 million euros, almost half of the amount in 2009.

Spanish family savings: funds managed 2010

	1990 Millions €	1990 %	2010 (e) Millions €	2010 (e) %	AverageAnnual Growth 10/90	Growth 10/90
Deposits	217,891	61%	855,000	49%	7%	3%
Variable income	44,021	12%	320,000	19%	10%	-12%
Investment Funds	7,941	2%	128,500	8%	15%	-13%
Life insurance	7,095	2%	146,633	8%	16%	2%
Pension Plans	3,215	1%	84,757	5%	18%	0%
Fixed income	25,523	7%	57,000	3%	4%	13%
Others	50,062	15%	139,610	8%	5%	-1%
TOTAL	355,748	100%	1,731,500	100%	8%	-2%

Source: ICEA for Life Insurance and Inverco for the rest. In millions of euros.

In the first six months of 2010, the rate of family savings stayed at the same level as in 2009, in the second half of the year they fell

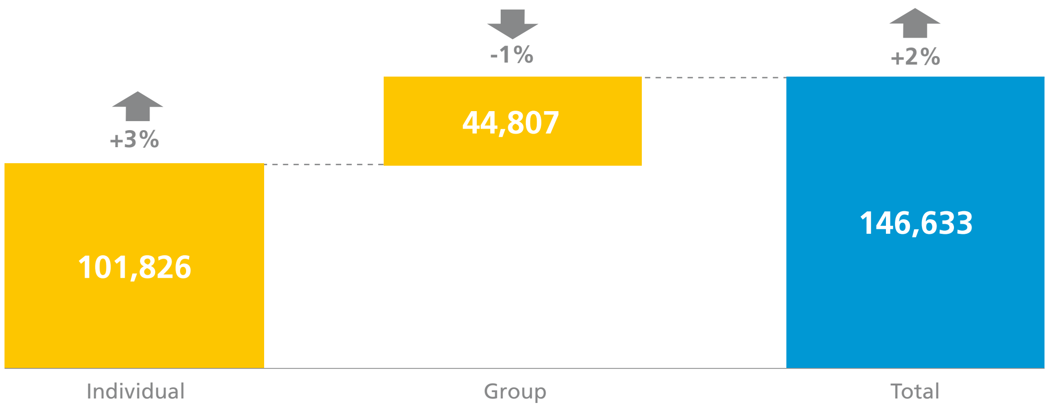
The behaviour of life insurance and pension plans was in line with that over the last few years. Both represent 13% of all family savings with year on year increments since 1990 of 16% for life insurance and 18% for pension plans. This means that along with investment funds, these are the products that accrued most growth in the long term.

In the other savings instruments, deposits head the table with 49% of family savings, which is in line with the trend over the last three years.

2.3 Evolution of the insurance and pension plan sector

Life insurance in 2010: Volume of funds managed

in millions of euros



Source: ICEA

Life insurance

In Spain, 32.8 million people are covered by life insurance. 71.1% of these have life-risk insurance and 28.8% have life-savings insurance

The amount of savings deposited in life insurance at the end of 2010 came to 146,633 million euros, which represented an increase of 1.9% over that in 2009. There was a certain sluggishness in the sector mainly due to the individual business, which only rose by 3.4% in 2010 as against 8.9% in 2009. The tendency to save in families in the second half of 2010 dropped slightly and there was some very strong competition from other savings instruments on the market.

For its part, group and company business continued its downward trend, just like in 2009, and ended up with an overall fall of 1.1%.

More than two thirds of all savings deposits, some 101,826 million euros, were directly related to individual insurance while the rest were deposits from group and company insurance.

In our country 32.8 million people were covered by life insurance of one sort or another, a figure similar to that in 2009. Of all the policyholders, 71.1% or 23.3 millions were covered by life-risk insurance and 28.8% or 9.4 millions had life savings insurance. Similarly, 24.5 million people were individual policyholders and 8.3 millions were group and company policyholders. The average savings managed per insured person stood at 15,013 euros, similar to the level in 2009. The group and company insured person had a higher average, some 25,847 euros, although this was a little below the figure for 2009. The average savings for individual insurance was 12,662 euros, slightly over that in 2009.

Likewise, the intrinsic activity of the life-savings insurance business, without taking into account the revaluation of reserves, threw up a negative result of 2,361 million euros. To this figure, which corresponds to the positive balance of the premiums, discounting surrenders and cost of services, we must add the revaluation attained by the mathematical reserves as a result of the evolution of the financial markets: 5.249 million euros. With this added on, the volume of savings in life insurance rose to 2,888 million euros, mostly due to the positive trend of the stock markets.

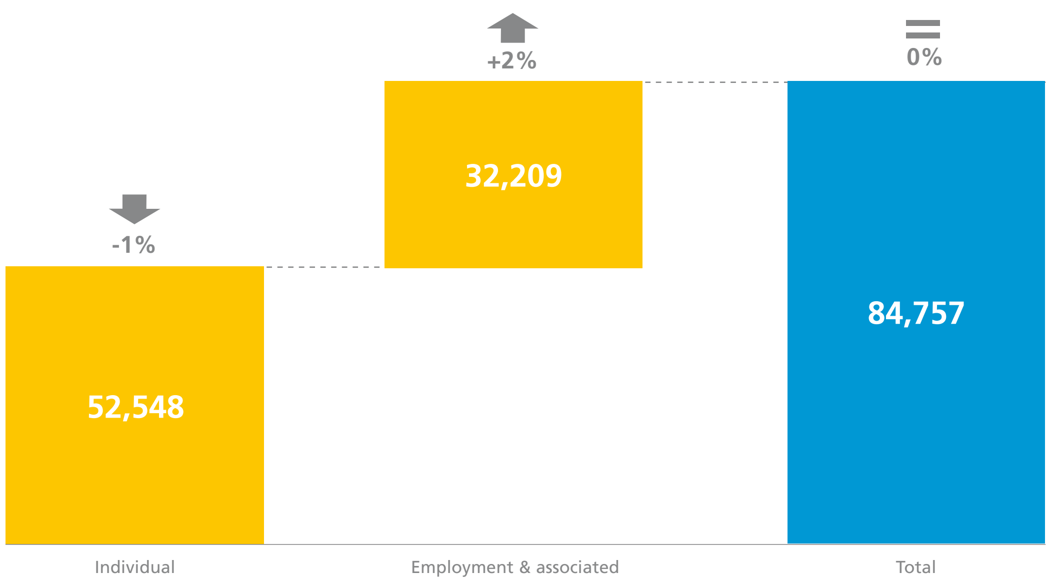
If we carry out a more precise analysis on a product by product level, we clearly see that the Guaranteed Pension Plans (or PPA as per the Spanish acronym) accumulated a total of 6,266 million euros, a noteworthy growth of 32.7% and reached a total of 621,700 insured people. This was the result of positive interest rate curves. The Individual Systematic Savings Pension Plans (or PIAS as per the Spanish acronym) also took off with the last fiscal reform and took in a total of 2,128 million euros in savings, a growth of 24.6% with respect to 2009, and had 546,170 policyholders. Lastly and worthy of note was the outstanding behaviour of annuities and temporary annuities that reached the figure of 2,836,681 policyholders, an increase of 2.4% with 73,130 million euros in mathematical reserves. This product offered excellent financial-fiscal conditions that, together with the favourable situation of long-term interest rates, turned it into the best supplement to the state retirement pension and a wonderful investment alternative.

In 2010 the life-risk insurance rose by 2.8% and took in premiums of 3,692 million euros. The individual segment grew to 2,673 million euros, 5.4% more than in 2009 and the group and company segment dropped to 1,019 million euros, 3.5% less than the previous year. Overall, the number of insured persons stayed around the 23.3 million mark. From a segment point of view, individuals represented 72% of the market, up just 0.4%, and group and company business dropped by 2.4%. One possible explanation for this behaviour lies in the sluggishness of the real estate market given the link between life-risk insurance and mortgages, as well as the fact that companies were less able to contract those products as a result of the persistent crisis. Also, services for claims came to 1,211 million euros in 2010, a fall of 4.2%. Of this figure, 59% came from individual contracts and 41% from group and company contracts.

Pension plans

Pension plans in 2010: Volume of funds managed

in millions of euros



Source: INVERCO

2010 saw the volume of savings managed in pension plans reach 84,757 million euros, which was in line with the level in 2009. Of all the managed savings, 62% were deposited in individual pension plans and the other 38% were in employment and associated plans.

From the total amount of managed savings in pension plans, 62% are deposited in individual pension plans and the other 38% are employment and associated plans

Individual pension plans gave up almost 1% of managed savings in 2010 thereby inverting the trend in 2009 when they grew by 8%. Group and company pension plans increased by 1.7% due to the revaluation of managed funds, although growth was below the 7.8% attained in 2009.

The gross contributions to the individual and group and company pension plans were above those in the previous year. They rose by 2.7% to 5,755 million euros as against 5,606 million euros in 2009. In spite of this, the cost of services increased to 4,232 million euros, much higher than the 4,009 million euros in 2009. This left the net contribution at 1,523 million euros in 2010 when in 2009 it stood at 1,598 millions. The net flow continues its downward trend with respect to previous years.

The structure of the pension fund portfolio was practically constant in 2010 with just a slight increase in the percentage of fixed income from 59% to 61%. Variable income went down from 19% to 18% due mostly to the correction on the stock markets. As for the treasury, this stayed at 11%, the same level as in 2009.

Over the last 15 years, the portfolio underwent some deep changes. On the one hand, the percentage of variable income went up from 3.7% in 1995 to 18% in 2010. Fixed income fell from 73.8% in 1995 to 61% in 2010. Similarly, there was a rise in international investment assets that reached 15% in 2010 when they did not even exist in 1995, although this exposure was substantially reduced with respect to 2009 when it peaked at 17%.

In 2010 the number of participated accounts rose from 10.53 millions to 10.85 millions, a jump of 3%. Leaving out the participated accounts that have more than one pension plan, the total number of people at the close of 2010 was estimated at 8.5 million people; in other words 47% of the working population had a pension plan.

Although the number of participated accounts enjoyed an uninterrupted rise over the last 15 years, the situation in our country, with respect to that of other countries that are economically close to ours, still offers growth opportunities. Lastly, it is worth stating that the average age of those with participated accounts stood at 45. 29% were under 40, 30% were aged between 41 and 50, 29% were between 51 and 60 and 12% were over 61.

Non-life insurance

During 2010 health insurance rose by 4.4% over the 2009 figure

Non-life insurance

In millions of euros

	2008	2009	2010	% increase 10/09
Motor Insurance	12,318	11,642	11,526	-1%
Multi-risk Insurance	5,895	6,053	6,242	3%
Health Insurance	5,838	6,134	6,399	4%
Other Non-life Insurances	8,529	7,836	7,567	-3%
Total	**32,580**	**31,665**	**31,734**	0%

Source: ICEA

In 2010 the non-life area accumulated 31,819 million euros in premiums, which meant it maintained the amount collected in 2009, which halted the downward trend of 2.5% experienced that same year.

Motor insurance fell by 0.9% in 2010 as against the drop of 5.4% in 2009. This behaviour significantly affected the non-life area. The improvement in this line, in relation to the strong fall witnessed in 2009, undoubtedly explains why the total volume of premiums for all non-life products was not affected as motor insurance with 36.3% of all non-life products had the greatest number of premiums. Claims in this sector remained stable and were in line with those of the previous year.

The average cost of claims in motor insurance was hardly affected. The fire guarantee showed the greatest volatility, especially in second category vehicles where high rates raised their head with respect to 2009. The claims rate of 75.8% stood below that of the previous year with one's own damage guarantee presenting higher rates even beyond 100%.

Health insurance, which makes up 20.1% of all the premiums in the sector, managed a growth rate of 4.2% with premiums reaching 6,324 million euros. Healthcare rose by 4.4% over the 2009 figure to 5,353 million euros while the medical expenses reimbursement model grew a little more with a 4.9% hike to reach 703 million euros. Finally, the medical insurance providing subsidies and compensations fell by 1.5% to 267 million euros. Individual insurance took up 75.3% of all health premiums with a growth of 2.6%. Group and company medical insurance covered the other 24.7% of premiums and jumped 9.6% with respect to 2009.

Multi-risk insurance with 6,242 million euros in premiums, an increase of 3.2% over the 2009 figure, continued in third place by volume of premiums after motor and health insurance. Worth mentioning is the multi-risk home product, in which the banking channel holds major importance, and reached 35% of all insurance sold. The ratio of claims remained stable in comparison to previous years as it recovered from the freak atmospheric phenomena in 2009.

The other non-life areas fell by 3.4%.

2.4 Legislative news

New laws were approved in 2010 and some of them affected the insurance industry. The most important ones were the following: The State Budget Law for 2011, Law 39/2010, of 22nd December; The "Omnibus Law", Law 25/2009, of 22nd December, a modification of several laws to be adapted to the Law on free access to the activities of services and the exercise thereof; The Law 10/2010, of 28th April, on the prevention of Money laundering and the financing of terrorism; The Royal Decree-Law 10/2010, of 16th June, on urgent measures to reform the labour market; The Consumption Code of Catalonia, Law 22/2010, of 20th July, published on 23rd July in the DOGC (The official gazette of the Catalan Government where all laws are published) and lastly; Decretos Forales (Council Decrees) that approved new tables of withholding tax for any work done for the "Foral" regions of the Basque Country.

Regarding the modification set out by the State Budget Law for 2010, of note is the limitation of the 40% reduction on income from irregular work.

On the other hand, the aim of the "Omnibus Law" is to eliminate beurocratic "difficulties" at a working level of the Administration and to be used as a guide to fixing prices. In this sense it affects many aspects of a services activity.

In money laundering an obligation was introduced to apply a series of due dilligence measures (normal, simplified, strengthened) that will have to be taken into account in any insurance activity, as well as the possibility to delegate the application of normal due diligence measures to third parties who are also subject to the same law.

As far as the Labour Reform is concerned, its aim is to achieve a more stable and better quality employment. In this way, the internal flexibility instruments are reinforced thereby favouring the adaptability of working conditions and the mechanisms of labour intermedition are improved.

Finally, the Consumption Code of Catalonia tries to systemise and draw up into a single regulation the whole range of disperse regulations currently in use on this topic. On certain aspects it collides with and poses interference with the specific insurance, distance marketing legislation and it even contradicts European regulations. Therefore, there are serious doubts as to how it is going to be put into practice.