Market Review
October 8, 2012

Spanish Non-Life Insurance Sector Profitable, but Challenges Lie Ahead

Insurers Are Under Pressure to Offer Competitive Rates.

The Spanish non-life insurance sector remained profitable in 2011, but growth remains challenging as it continues to face one of the bleakest economic environments since the 1930s.

Non-life insurers continue to benefit from solid distribution networks that encourage customer loyalty and ensure that the market continues to make underwriting profits. However, Spanish insurers could face deteriorating technical results as they compete on pricing. Insurers are under pressure to offer competitive rates, as the country's troubled economic position suppresses demand for cover and household spending remains under strain.

The fragile economic and financial conditions that Spain is experiencing have resulted in the non-life insurance market facing suppressed demand for insurance, with earned premiums falling 3.4% in 2010 (see **Exhibit 1**), according to figures released by the Dirección General de Seguros y Fondos de Pensiones (DGSFP). Data from the Spanish insurance regulator show that in 2011, non-life earned premium stabilised and increased a modest 0.6% to EUR 31.2 billion, with growth in property and funeral expenses business helping to offset decreases in motor and liability insurance.

Gross and net claims improved in 2011 (see **Exhibit 2**). Financial results as a percentage of net earned premiums (NEP) were sound at 4% but have been declining steadily since 2009.

A.M. Best remains concerned regarding the prospects for Spanish government bonds and financial institutions debt, which have been impacted negatively by Spain's economic and financial deterioration. Although A.M. Best does not expect Spanish government bonds to default, any material write-down would have a significant impact on the risk-adjusted capitalisation of the non-life sector.

Spain's gross domestic product (GDP) is forecast to con-

Exhibit 1
Spain Non-Life & Life – Key Market Indicators (2009-2011)
(EUR Billions)

	2009	2010	2011
Population (Millions)	45.8	46.0	46.2
Gross Domestic Product	EUR 1,047.8	EUR 1,051.3	EUR 1,073.4
Change in Real GDP (%)	-3.7%	-0.1%	0.7%
Inflation (%)	0.9%	2.9%	2.4%
Unemployment Rate (%)	18.0%	20.1%	21.6%*
Insurance Premiums Earned			
Life	EUR 29.2	EUR 27.4	EUR 29.9
Non-Life	EUR 32.1	EUR 31.0	EUR 31.2
Total	**EUR 61.3**	**EUR 58.4**	**EUR 61.1**
Change in Premium Volume (Total) (%)	1.8%	-4.8%	4.6%

* Estimated
Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Dirección General de Seguros y Fondos de Pensiones

Exhibit 2
Spain Non-Life – Profitability (2009-2011)

	2009	2010	2011
Retention (% of Gross Earned Premium)	85.9	85.2	88.6
Gross Claims (% of GEP)	70.7	70.9	68.4
Gross Expenses (% of GEP)	21.5	21.6	21.4
Net Claims (% of Net Earned Premium)	72.8	72.1	70.5
Net Combined Ratio (% of NEP)	93.9	93.8	92.0
Financial results (% of NEP)	4.9	4.6	4.0
Technical-Financial Result (% of NEP)	11.0	10.9	11.4

Source: Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre

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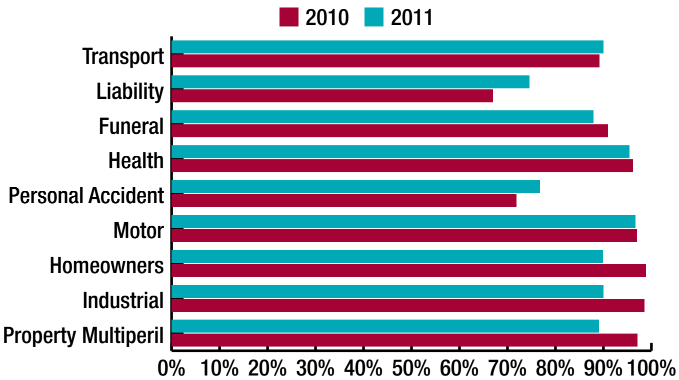
tract by 1.83% in 2012, and unemployment has been increasing steadily, reaching an estimated 21.6% in 2011 (see **Exhibit 1**).

Losses have been subdued as a result of a slowdown in economic activity, which has helped the Spanish non-life insurance market to improve its profitability, with combined ratios falling from 93.8% in 2010 to 92% in 2011.

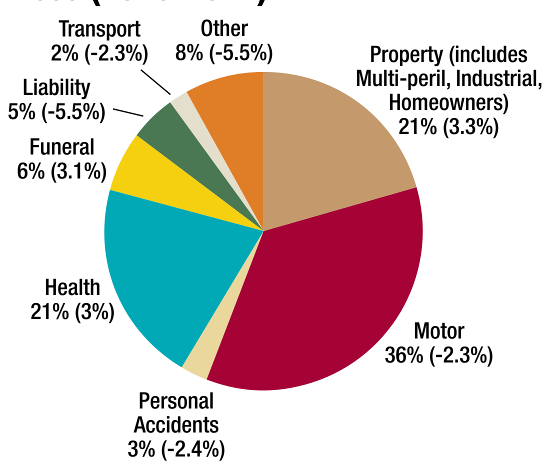
Combined ratios for property multiperil risks improved by 8 percentage points (see **Exhibit 3**) as a result of better claims experience during the year. Property premiums, which represented a fifth of total non-life gross premiums written (GPW) in 2011, showed good growth in rates, resulting in the sector's GPW increasing by 3.3% (see **Exhibit 4**). Homeowners GPW increased by 4.4%, although the number of policies grew by just 1%.

Exhibit 3
Spain Non-Life – Combined Ratios (2010-2011)



*Estimated average of transport lines (i.e. cargo, marine, engineering, agriculture)
Source: Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre.

Exhibit 4
Spain Non-Life – Market Share by Line of Business (2010-2011)



NOTE:
Numbers in parentheses show year-on-year percentage change in premiums in 2011 v. 2010
Source: A.M. Best calculation based on Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre

There was a slight drop in the combined ratio for motor risks (see **Exhibits 3** and **4**), which is the largest line of business, accounting for more than a third (36%) of non-life premium in 2011. The sluggish economy has driven new car sales to a 20-year low and reduced the number of insured vehicles, while policyholders have switched to more basic coverage. Furthermore, usage of vehicles has been constrained in recent years, resulting in lower claims.

Premiums for health and funeral risks grew in 2011, largely as a result of modest rate increases. Funeral expenses coverage, which provides a guaranteed sum to pay for funeral services, is growing from a low base but is experiencing steady demand as consumers value the security of the product in challenging economic times. Funeral expenses are a historical feature of the Spanish insurance market. Originally conceived as a prepaid plan covering funeral expenses for the older generation, it has developed into a more complex insurance product that extends to family groups, offering add-on services such as legal assistance and travel coverage. Increasingly concentrated with a few niche players, it has been used successfully in cross-selling initiatives. Business volumes remain material and profitable.

However, other lines of business are coming under pressure, notably liability, which has been impacted by softer pricing as well as new entrants into the market. With the market still remaining very profitable, this pricing trend is expected to continue.

Rates Remain Under Pressure

Rates across the Spanish market tend to be under pressure, reflecting the favourable loss history of the market and the competitive environment. There is excess capacity, with more than 100 non-life insurers in the Spanish market, while the 10 largest companies controlled 38% of the market in 2011. Competition in certain lines such as liability is aggressive; although insurers are struggling with low investment returns, the non-life market remains among the most profitable in Europe. While the economy is still depressed, claims levels are expected to remain stagnant, which will encourage companies to cut rates further. Companies are also well capitalised and solvency margins remain high, with the non-life market at 2.6 times the minimum regulatory requirement, although this has deteriorated from 3.4 times in 2010.

Spain's insurance market is experiencing structural changes through merger and acquisition (M&A) activity. In July 2011, Mutua Madrileña purchased a 50% stake in SegurCaixa Adeslas, the non-life insurance arm of CaixaBank, making it the largest health insurer in Spain. In June 2012, Grupo Catalana Occidente and INOCSA agreed to purchase Groupama Seguros y Reaseguros, the French mutual Groupama's Spanish subsidiary.

Although the bancassurance sector plays an important part in the distribution of life products, it is less prevalent in the non-life sector, accounting for just 8% of distribution in 2011. The bancassurance model faces a number of challenges in the coming years, particularly with the ongoing legal wrangling surrounding distribution agreements between insurers and recently merged *cajas* (savings banks), as well as the impact of the recent EUR 100 billion bank bailout. However, with life products expected to face fierce competition from banks, it is likely that banks will aggressively try to improve their presence in the profitable non-life market, putting further pressure on rates.

While Spain's non-life insurance market is profitable, the sector faces significant challenges in the event of further erosion of Spain's sovereign creditworthiness and continued negative developments regarding the Eurozone sovereign debt crisis.

A relaxation of underwriting discipline would result in pressure on technical results. Rates across most sectors have been cut to varying degrees, which is likely to impact results that to date have been good. The positive side for insurers is that claims activity should remain suppressed as the economy continues to suffer. However, while technical profitability remains good and insurers have ample capital, further significant competition cannot be discounted.

Despite the difficulties Spanish insurers face, they have proved to be resilient, as their top line and technical profits demonstrate. The main ongoing concern is capitalisation, which remains strong but has declined in recent years, and could be severely impacted in the unlikely event of a sovereign default.

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