PENSION REFORM IN EUROPE:
WHEN WILL IT MAKE A DIFFERENCE?

The Spanish Case

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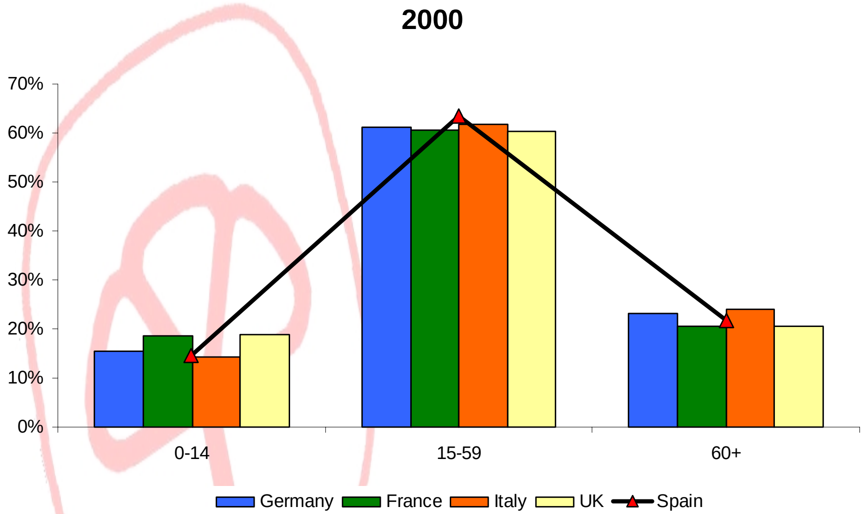
Government and individuals must take urgent decisions about the future of pensions

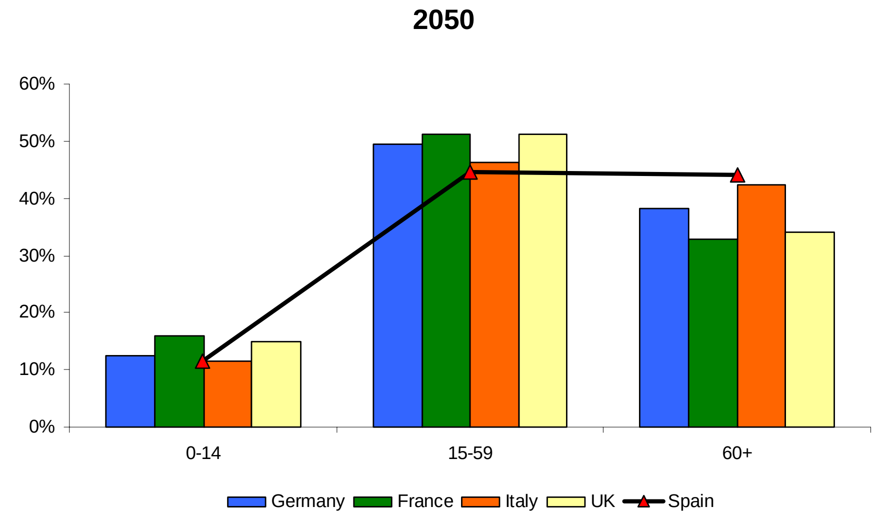
- Spanish retirees rely on a combination of:
  - State pensions, which remain on average the largest source of funds.
  - Life insurance and private pensions, set up by the individuals and/or their employers.
  - Other assets, particularly real estate, shares and bonds.
- State pensions, however, may become unsustainable in the future. It is estimated that, by 2050:
  - Pension expenditure will reach 17.3% of GDP, vs. 9.4% at present
  - The dependency ratio will nearly treble to 60%, from 25% at present
- Therefore, Spanish governments have introduced legal and fiscal measures to foster the development of private retirement savings:
  - Specific pension fund legislation in force since 1987.
  - Externalisation of on-balance sheet corporate pension commitments compulsory since 1999.
  - Recent proposals, if approved by Parliament, will equalise the fiscal treatment of life insurance and pension funds for individual retirement.

Spain: State pensions

- State pensions, which were introduced in 1900, are the oldest and biggest funding source for Spanish retirees.
- Universal ‘pay as you go’ scheme.
- A retiree receives a monthly pension which reflects the amount of contributions paid to the Social Security System over his last 15 working years, as well as the overall span of time over which the individual has paid such contributions:
  - The yearly allowable salary for pensions calculation ranges between EUR 5,400 and EUR 26,300.
  - At least 15 years of contributions to the Social Security System are required to get the minimum State pension allowance. After 35 years of contributions the individual obtains his full pension allowance.
- There is no defined retirement age, although most collective agreements put it around 65 years of age.
- Contributions are calculated on the basis of a reference salary, which presently does not exceed EUR 30,800. The employer pays a contribution of ± 33% of such salary, while the employee pays ± 6% of it.
- Presently, in Spain there are:
  - 15.8 million workers paying Social Security contributions,
  - 1.5 million employers which pay contributions to the Social Security System,
  - 7.2 million retirees.

Population distribution by age groups





Source: United Nations Population Division

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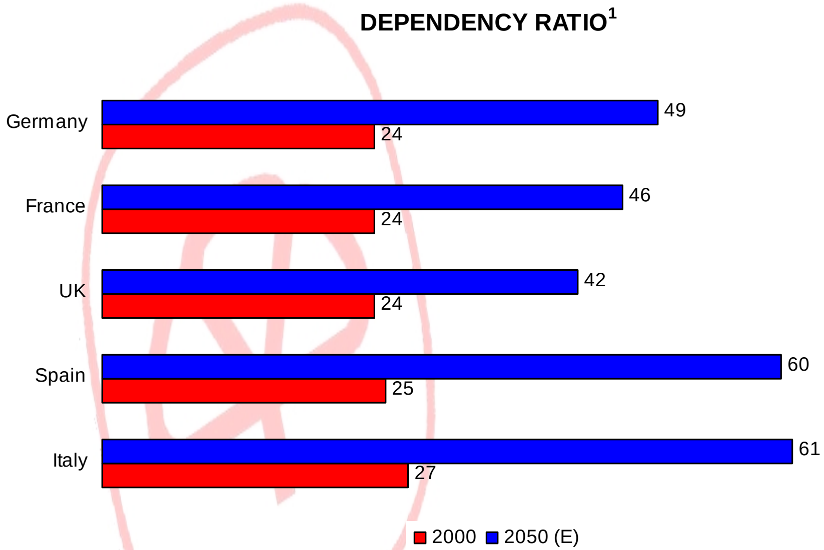
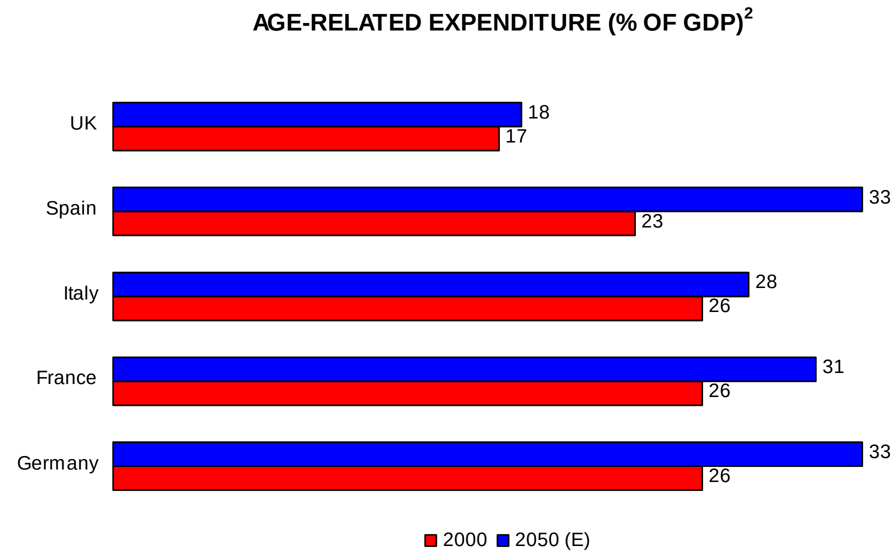
Dependency ratios and age-related expenditure





[1] **Population aged 65+ as a % of the population aged 15 to 64**

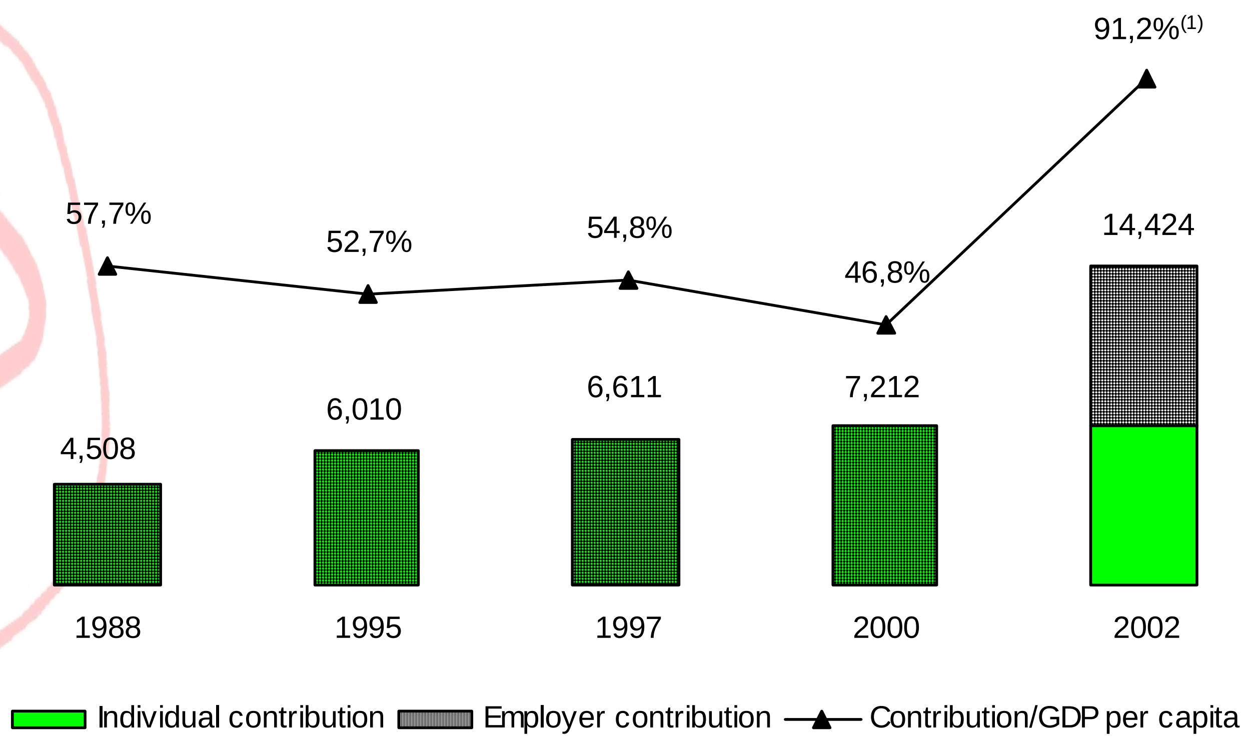
[2] **Includes old-age and early retirement pensions, health care, long-term care for the frail, education, and other benefits**

Source: Economic Policy Comittee (EU), Standard & Poor's

Private pension funds

- Private pension funds legislation was introduced in Spain in 1987, and updated several times since then.
- Individuals can make fully tax-deductible yearly contributions of up to EUR 7,212. After 52 years of age, such contribution increases by EUR 1,202 p/a, to reach EUR 22,838 for those aged 65 or older.
- Spanish private pension funds follow a defined contribution capitalisation scheme.
- Funds are managed off-balance sheet by pension fund management or life insurance companies, which are supervised by the DGS (the insurance industry regulator).
- Savings can be withdrawn upon retirement, or in case of permanent disability or unemployment.
- The sum of all contributions and capital gains is subject to the payment of personal income tax upon withdrawal. Lump sum payments benefit from a 40% reduction in the tax liability, while annuity payments do not.
- Employers can set up corporate pension plans in favour of their employees, with the following features:
  - The maximum yearly contribution can range between 7,212 and 22,838, depending on the age of the employee, thus potentially doubling the amount each individual can save every year.
  - A Governing Board (‘Comisión de Control’), composed by representatives of the employer and the employees, must be set up to supervise the fund.
  - The principle of non-discrimination applies: the same fund must be offered to all employees.
- At the end of 2001 there were EUR 24.2 bn saved in individual pension plans, with 5.2 million participants, and EUR 18.8 bn in corporate pension plans, with 0.6 million participants.

Evolution of maximum allowed yearly contributions into private pension funds

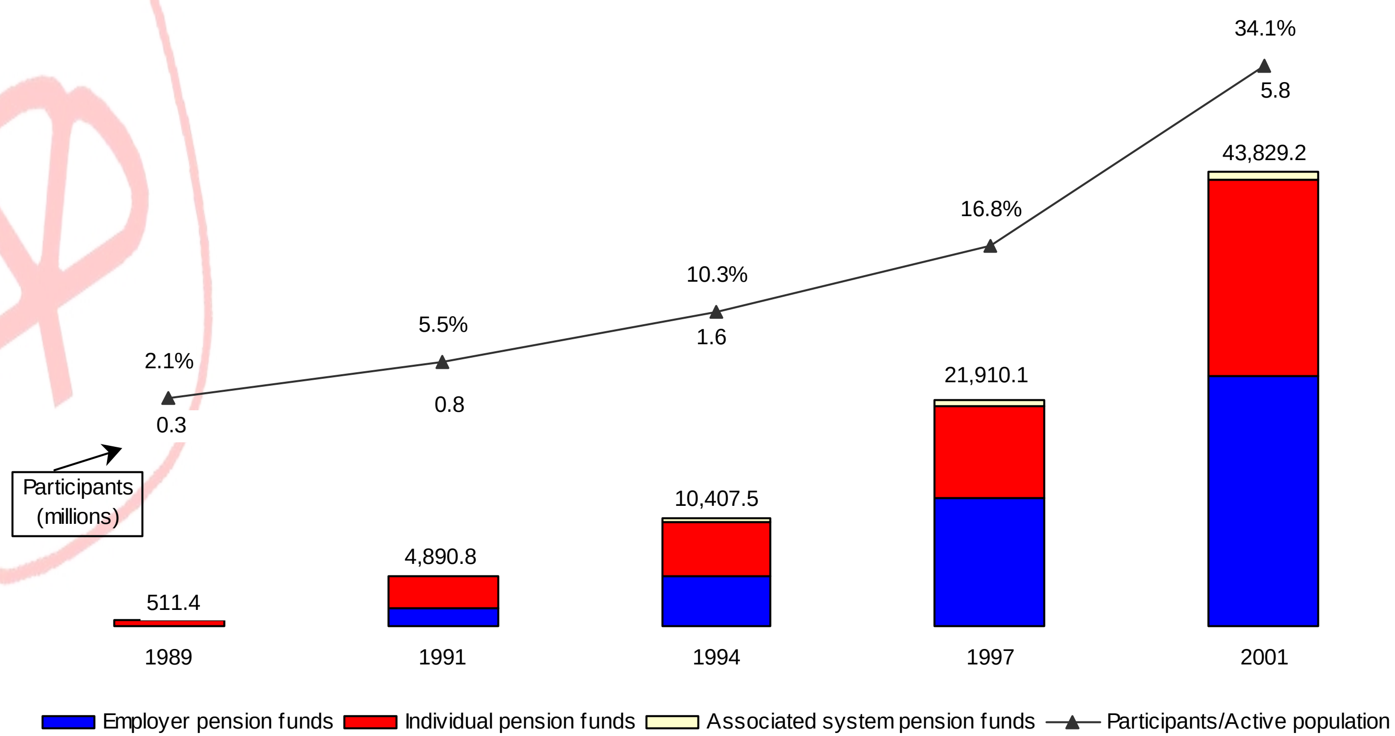


[1] The 2001 GDP per capita was used in the calculation of the 2002 contribution/GDP per capita ratio

Source: Banco de España

Figures in Euros

Pension funds evolution: amounts and participants



Source: Inverco, INE

Figures in Million Euros

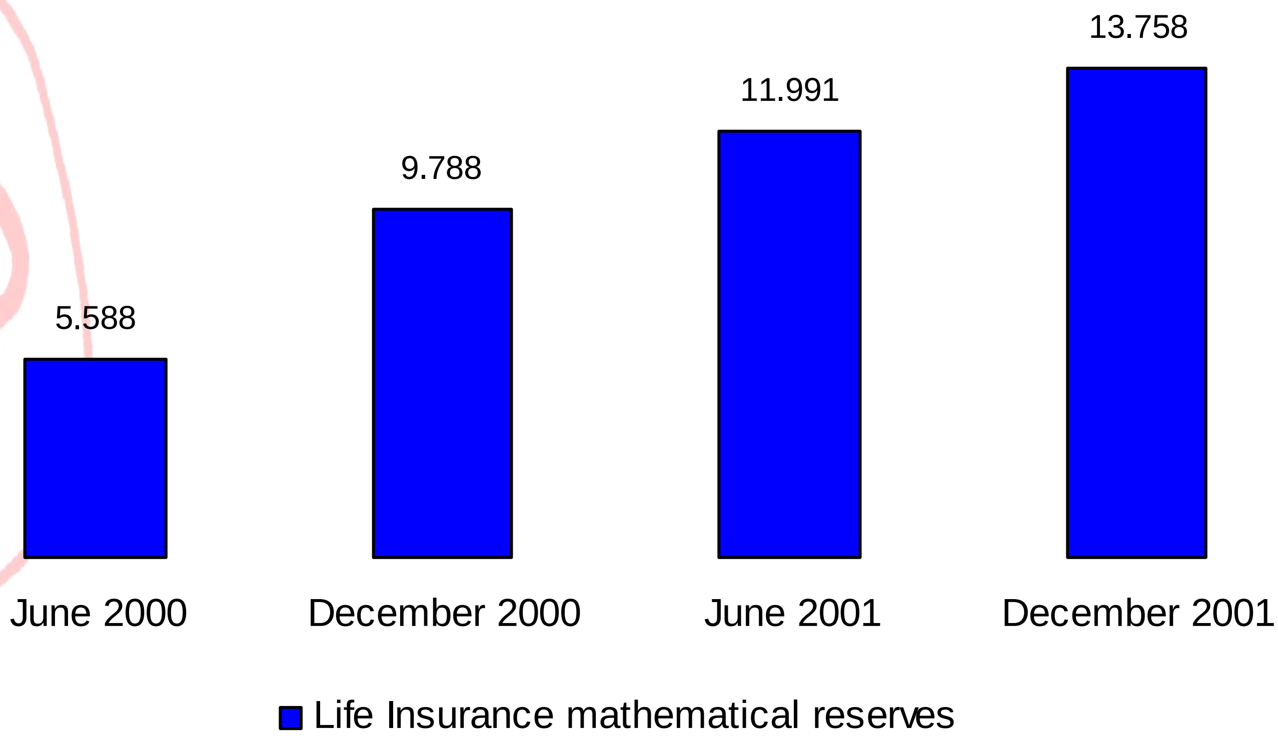
The Toledo Agreements

- In 1993, the Spanish Congress, to assuage the growing social concern about the future of state pensions, established a working-group to analyse the state of the Social Security System, and make proposals to maintain it and guarantee its future.
- The working group made 15 recommendations to ensure the State pension system remained fair, balanced and equitable in the future, as reflected in article 41 of the Spanish Constitution. Among these, the following must be highlighted:
  - To establish a reserve fund, aimed at smoothing out the effects of economic cycles
  - To increase reference salaries for the calculation of social security contributions
  - To improve the collection mechanism, reducing fraud and non-payment
  - To ensure the financial equilibrium of the pay-as-you-go system, to avoid burdening the public sector
  - To maintain the flexible retirement age, but recommend the voluntary extension above 65 years of age
  - To protect the purchasing power of pensions, through automatic revaluation
  - To reinforce the principle of equity
  - To promote complementary individual and corporate pension plans, raising fiscal incentives
  - To continuously analyse the system, to be able to react against any adverse developments.
- Such recommendations were discussed and approved in Congress in 1995 by a vast majority.
- This agreement, known as ‘Pacto de Toledo’, represents a strong commitment of the various political and social groups to guarantee the future of the Social Security System, by applying all measures necessary to adapt it to evolving conditions. Indeed, it has led to the approval of several laws, such as the 2002 law on the flexibility of pensionable age. However, it stops short of a real attempt to reform the system in depth.

Externalisation of corporate pension commitments

- The biggest boost to date for the life insurance and pensions industry came with the compulsory externalisation of on-balance sheet corporate pension commitments (Law 30 of 8 November 1995).
- The deadline for the completion of the externalisation process is 16 November 2002.
- The scope of the law covers all types of on-balance sheet corporate pension commitments in favour of any group of employees, both in activity and retired. Financial institutions were not subject to this obligation, although the vast majority of them opted for externalising.
- To date, most transfers of such commitments have been channelled through life assurance single-premium policies, reaching a total amount of mathematical reserves of nearly EUR 14 billion as of 31 December 2001.
- MAPFRE VIDA has a market share of over 15% of all commitments externalised through life insurance policies.

Externalisation
of corporate pension commitments



Source: ICEA

Figures in Million Euros

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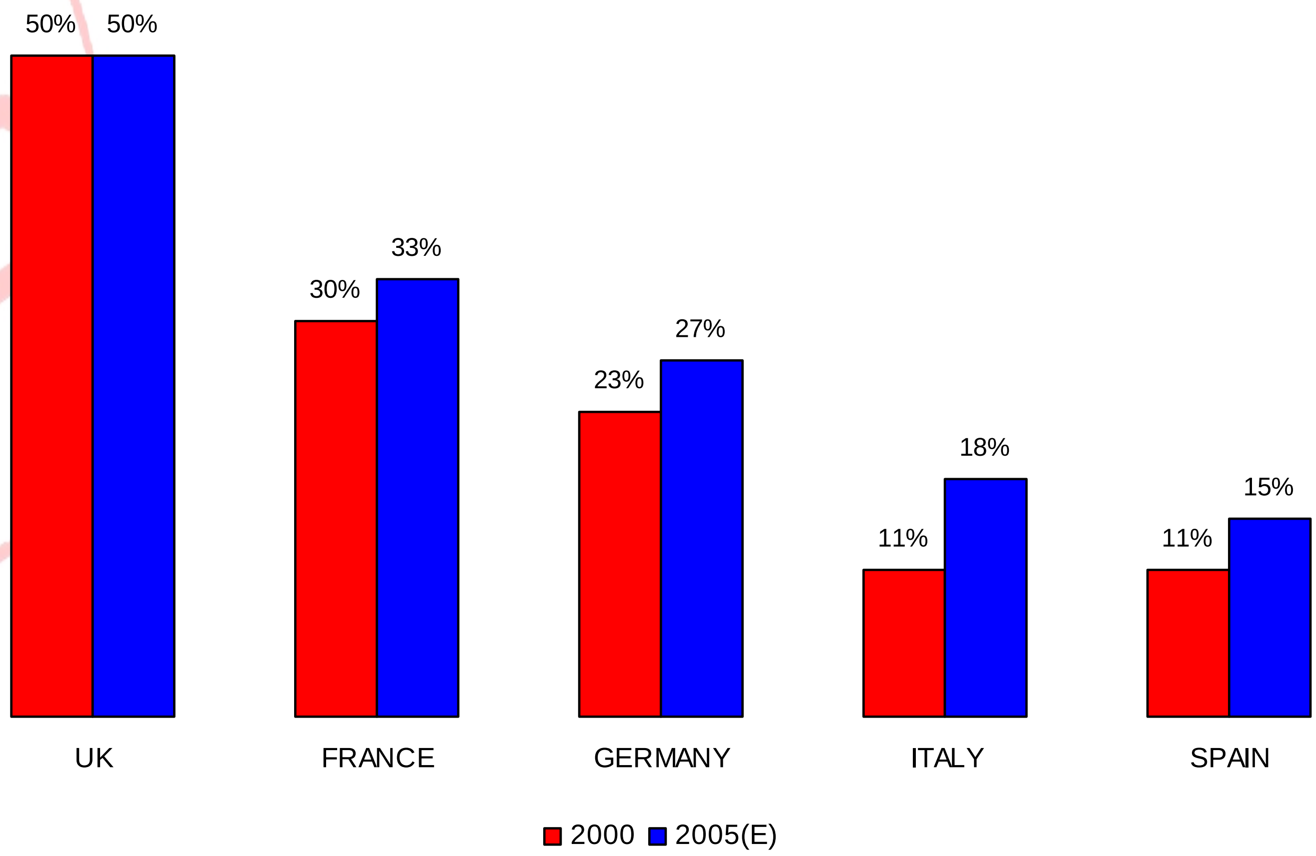
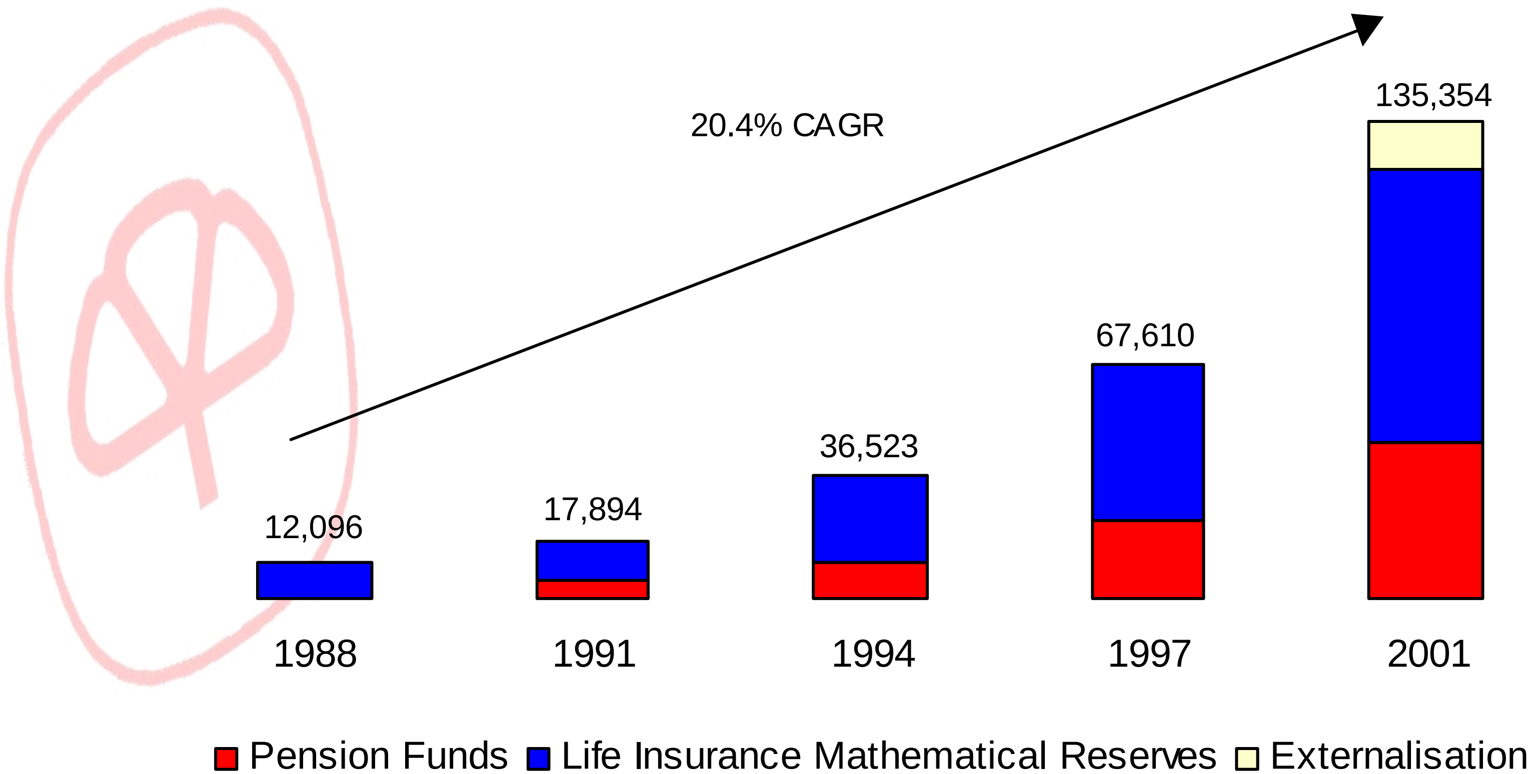
Life Insurance and Pension funds as a % of GDP in Europe's 5 largest economies



Source: Deutsche Bank citing Datamonitor

Evolution of private retirement savings in Spain

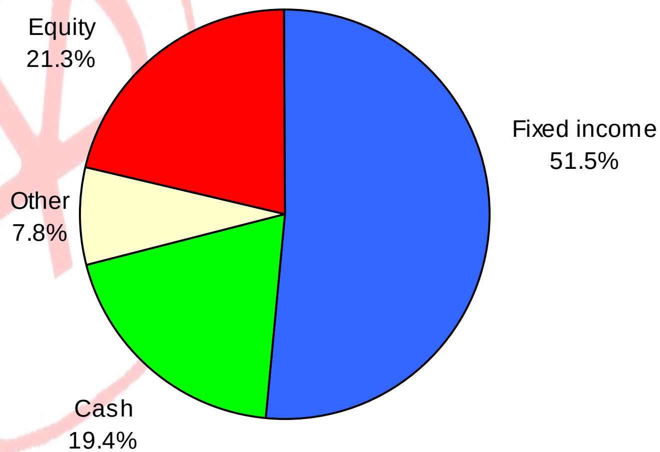


Source: Inverco, DGS, ICEA

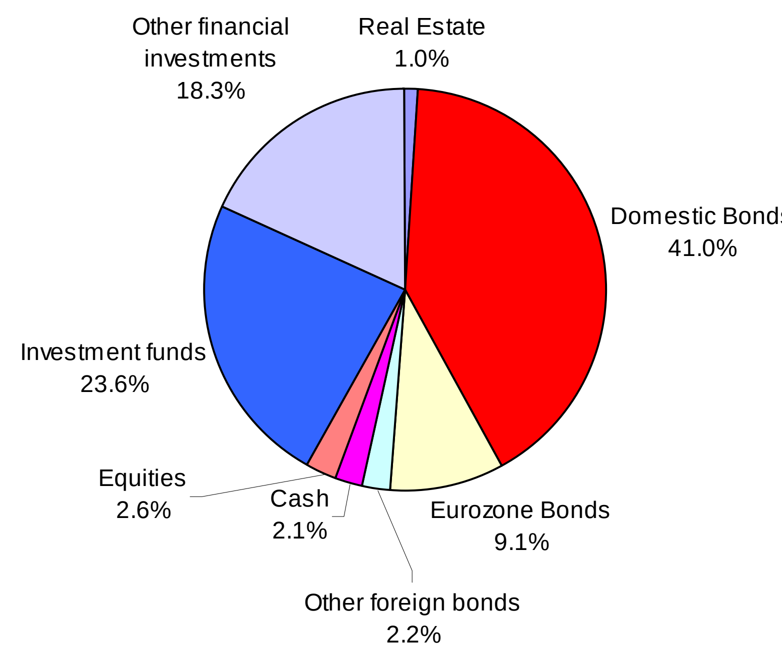
Figures in Million Euros

Breakdown of investments backing retirement assets

PENSION FUNDS



LIFE INSURANCE



Source: ICEA, INVERCO

Year 2000 figures

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Tax treatment of savings in Spain

- For holding periods of up to 1 year, all gains and income are taxed at the marginal rate.
- Gains earned on shares and mutual funds held for more than 1 year are taxed at a flat rate of 18%.
- Income from bank deposits and life insurance is always taxed at the marginal rate, with the following discounts:
  - Bank deposits and life insurance held for more than 2 years: 30%
  - Life insurance only: 65% if held more than 5 years, and 75% if held more than 8 years
- Contributions into individual and corporate pension funds of up to EUR 7,200/year are fully deductible from taxable income.

The 'Lagares' fiscal reform proposal

- In April 2002, the 'Lagares Commission', a group of experts appointed by the government to propose a reform of the Personal Income Tax, published its recommendations.
- Based on these recommendations, the Government has designed a law proposal which will have the following impact on the fiscal treatment of savings instruments:
  - Capital gains from mutual funds, shares and real estate held more than 1 year or more will be taxed at a flat rate of 15%. Gains obtained over shorter holding periods will be taxed at the marginal rate.
  - Income from bank deposits, fixed-income securities and life insurance policies will be taxed at the marginal rate, with a 40% reduction after 2 years. Life insurance policies only will benefit from a 75% reduction after 5 years.
  - Capital gains generated upon the transfer of savings from one mutual fund into another will not be taxed ('umbrella fund' treatment).
  - Individual life insurance retirement products, provided they are subject to the same restrictions that apply to pension funds, will enjoy the same fiscal advantages that are granted the latter.
  - The maximum allowed yearly contribution into pension funds will be raised to EUR 8,000, the yearly increase after 52 years of age to EUR 1,250, and the maximum at 65 years of age to EUR 24,250.
  - Personal tax rates will be reduced, increasing disposable income.
- Such proposal will be presented to Parliament, and may apply from 1 January 2003.
- Conversion of this proposal into law may lead to the following consequences:
  - For most equity investors, it would be more advantageous to invest through mutual funds for holding periods of up to 5 years. For longer investment periods, unit-linked policies would be the best option.
  - More conservative individuals might prefer the safety of life insurance for their pension savings over the market exposure offered by pension funds.

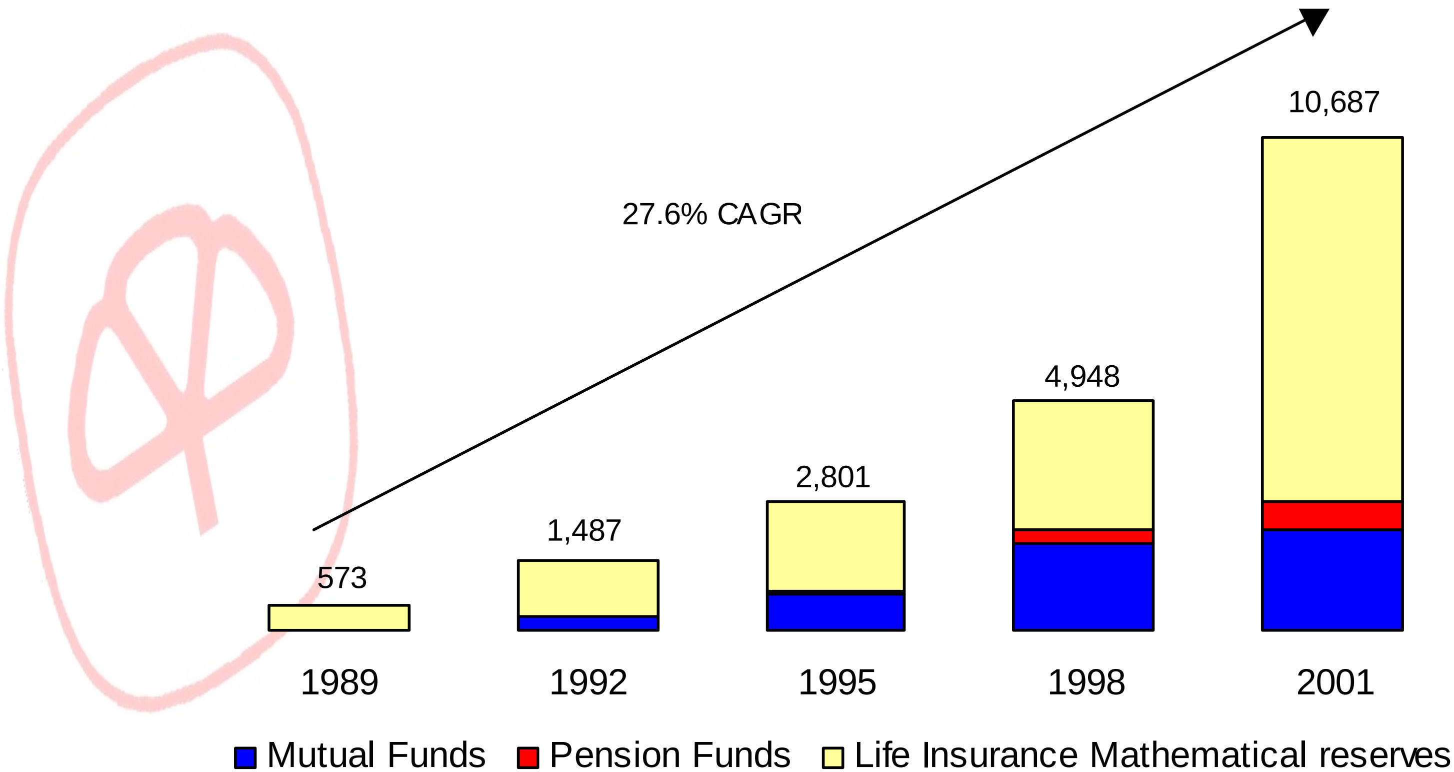
Questions for the future

- Company-based schemes: how quickly will volumes grow after the externalisation process is concluded?
- Will private pension schemes ever be considered ‘officially’ as a partial replacement for state pensions?
- How quickly will the population become aware of the need to save towards a private pension?

Under any scenario,
Mapfre is extremely well positioned

- Leader in life insurance:
  - No. 1 in 2001, with a 11.1 % market share
  - Market share of over 15% in corporate pension externalisations
- Two marketing channels:
  - Agents and specialised advisors
  - Caja Madrid bank branches
- Comprehensive focus on long-term savings
- Active in pension and mutual fund management. Corporación Mapfre owns:
  - 51% of Mapfre Inversión (mutual funds) and Mapfre Vida Pensiones (pension funds)
  - 30% of Caja Madrid's subsidiaries Gesmadrid (mutual funds) and Caja Madrid Pensiones (pension funds)

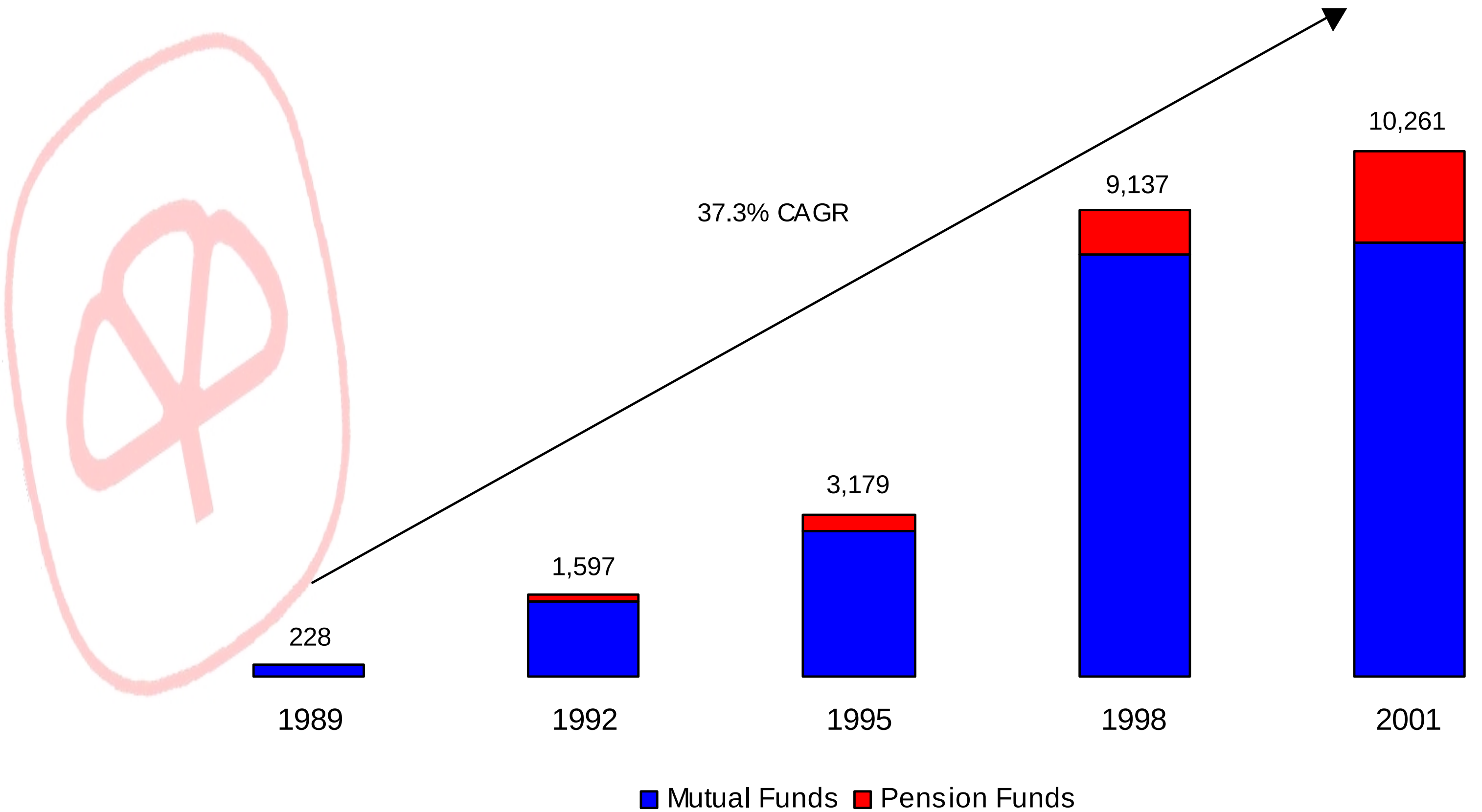
Mapfre-managed long-term savings



Source: Mapfre

Figures in Million Euros

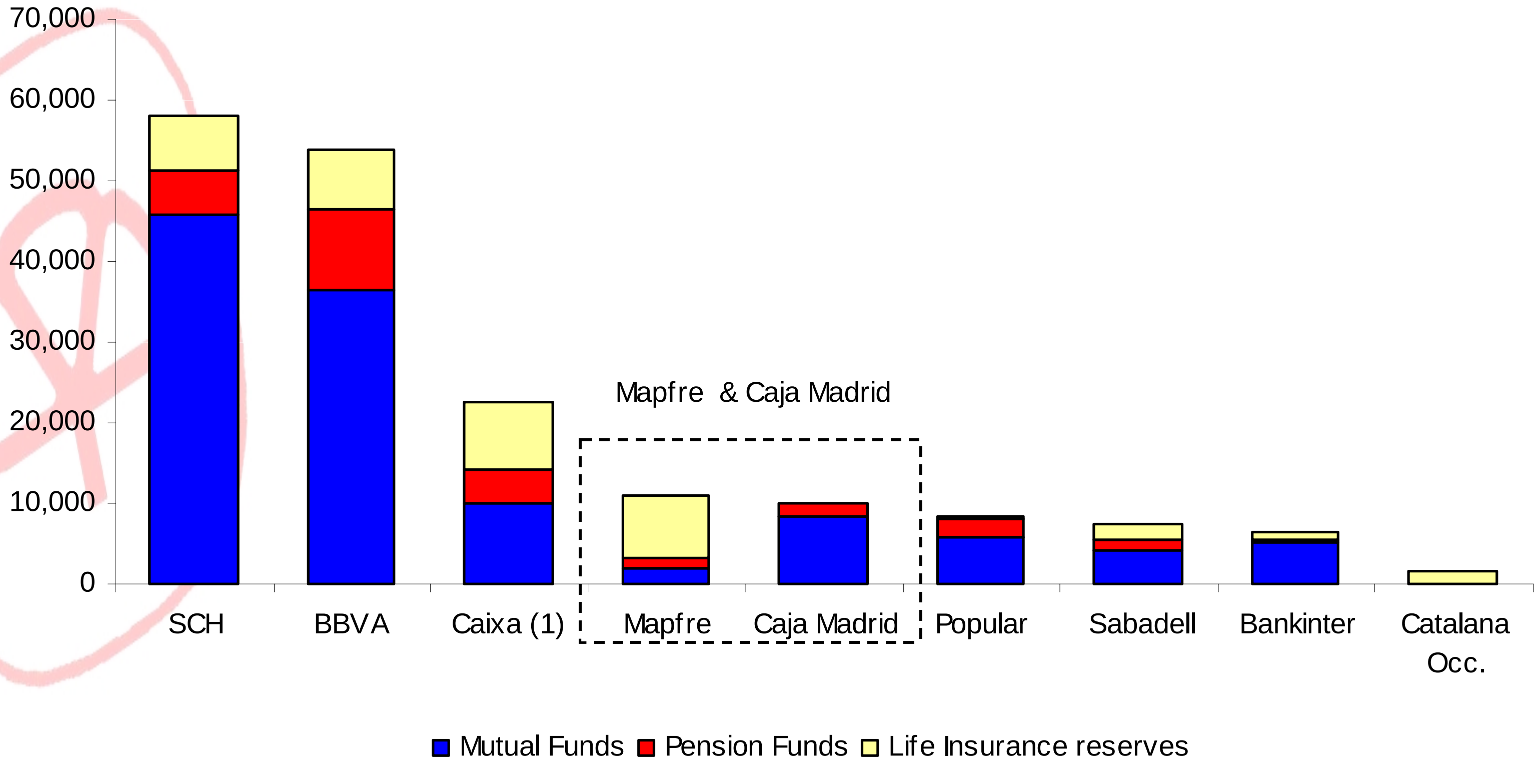
Caja Madrid-managed long-term savings



Source: Gesmadrid, Caja Madrid Pensiones

Figures in Million Euros

Mapfre vs. Spanish asset managers



(1) Caixa is a savings bank, and therefore is not listed

Source: ICEA, Inverco

Figures in Million Euros

Appendix

Mapfre Vida figures

	1999	2000	**2001**	% 01/00
Technical Reserves	4,481.0	6,135.2	**7,822.4**	27.5%
Investment Funds	2,093.9	2,178.4	**2,202.3**	1.1%
Pension Funds	366.9	457.9	**582.2**	27.2%
Funds under administration	6,941.8	8,771.5	**10,606.9**	20.9%
Clients - Investment Funds	172,412	188,193	**194,586**	3.4%
Clients - Pension Funds	47,837	61,611	**82,908**	34.6%
Consolidated Premiums	630.0	1,714.9	**2,647.0**	54.4%
Equity	194.2	312.3	**349.9**	12.0%
Pretax results	75.5	89.7	**96.3**	7.4%
Expense Ratio	13.3	6.2	**3.3**	
ROE	29.4	25.2	**21.2**	

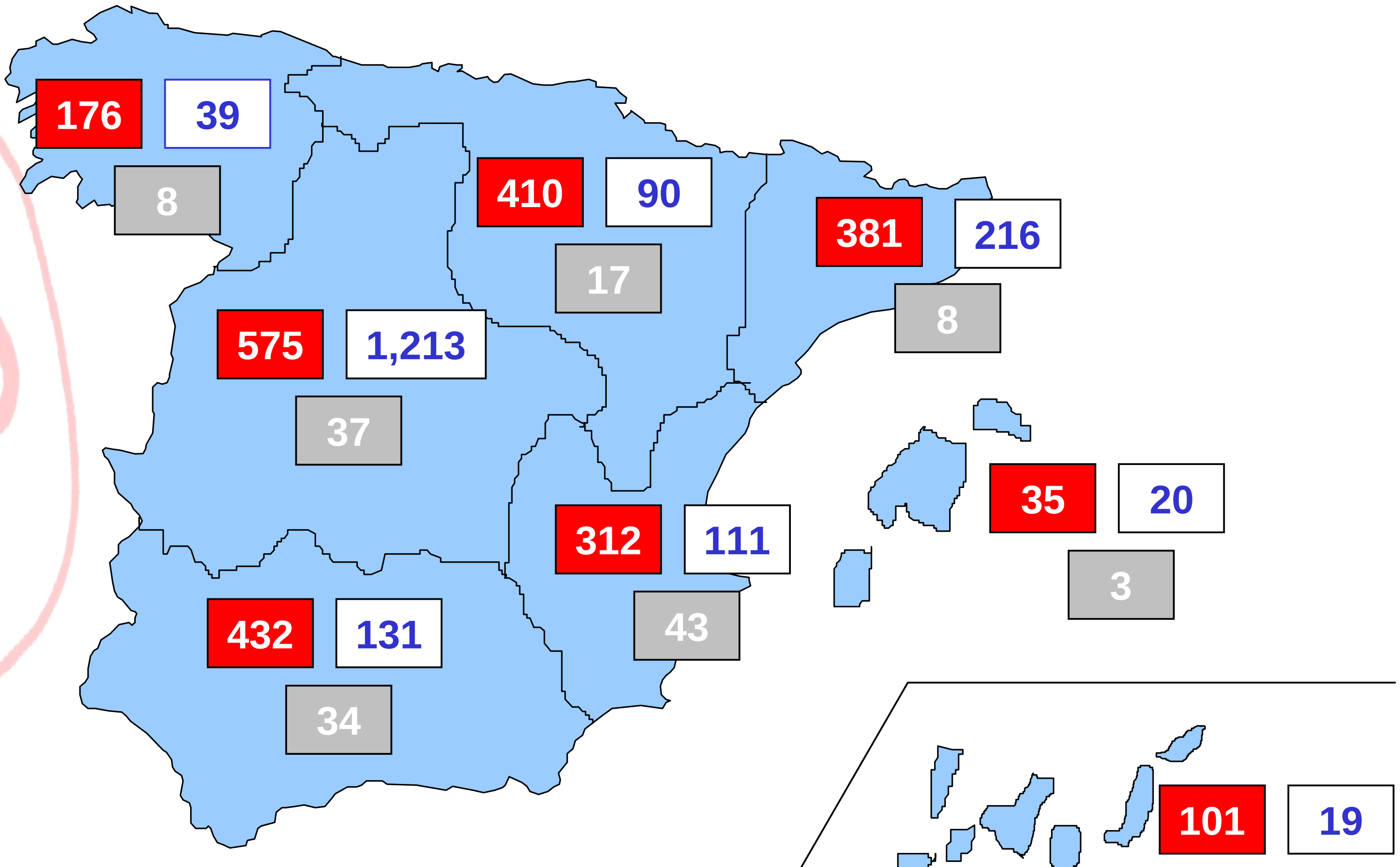
Figures in Million Euros

Tax treatment of savings in Spain

Net tax base Up to…euros	General Rate	Funds and shares + 1 year term	Deposits and Insurance policies + 2 years term (30%)	Insurance policies + 5 years term (65%)	Insurance policies + 8 years term (75%)
Up to 3.678	18.0	18.00	12.60	6.30	4.50
3.678 - 12.873	24.0	18.00	16.80	8.40	6.00
12.873 - 25.134	28.3	18.00	19.81	9.91	7.08
25.134 - 40.460	37.2	18.00	26.04	13.02	9.30
40.460 - 67.433	45.0	18.00	31.50	15.75	11.25
More than 67.433	48.0	18.00	33.60	16.80	12.00

Source: Expansion

Mapfre distribution network in Spain - Year 2001



SISTEMA MAPFRE: 2,422

CAJA MADRID: 1,839

MAPFRE FINISTERRE: 159