TFA 44 (1992-1994) 401-496

SPAIN: AN OUTSIDER'S VIEW FROM WITHIN

BY D. PAUL, B.SC., F.F.A. AND R. B. SIMLER, B.SC., F.I.A.

(Presented to the Faculty of Actuaries 21 March 1994)

"There is hardly another country, except Turkey, which is so little known, and so misjudged by the rest of Europe, as is Spain."
Karl Marx (1818-1883)

1. INTRODUCTION

1.1 *General Overview*

We both started working in Spain at the end of 1991: one of us in a joint venture life company between a Spanish health insurer and a U.K. life office, and the other in an international actuarial consultancy.

At the time of writing this paper we can only claim in the region of "4 man years" of experience of Spain. Therefore we do not pretend to offer an authoritative view of Spanish insurance or pensions, or of its actuarial profession. Clearly such a text would be better prepared by Spanish actuaries, or other long-standing practitioners of the Spanish market.

What we have tried to do in this paper is give the reader an impression, a rough sketch, of the Spanish actuarial landscape, but as seen through the eyes of "incomers". Our hope is that, as well as providing a small source of reference on Spain, our paper will interest anybody who has entered, or is contemplating entering, into a foreign domain, to operate commercially or professionally. While each and every country will present its own detailed challenges, we think that there will be many similarities for anyone making a first step outside their familiar U.K. regime.

Since we are covering a wide range of topics, in a domain perhaps unfamiliar to the reader, we have consigned some of the factual and background information to Appendices at the end of the paper. Besides permitting a better flow to the narrative, this should also make sections of information more accessible to the reader who simply wishes to "dip into" one or another aspect of Spain.

In order to maintain greater precision we have adopted throughout the convention of using original Spanish terminology in italics after giving the best English equivalent translation on the first occasion that the term is encountered.

1.2 *Historical and Economic Background*

Appendix 1 sketches out Spain's turbulent course through the 19th and 20th centuries. The end of the Franco era in 1975, and the subsequent re-establishment of a constitutional monarchy underwriting a parliamentary democracy, will be familiar to the reader. However, it is important to highlight the several internal convulsions which Spain has experienced this century, and the oscillations between monarchy and republic, oligarchy and democracy, constitutional government and dictatorship.

Alongside these political developments, until very recently, Spain's economic development has been of lesser magnitude and has arrived later, relative to the experience of its northern European neighbours (Spain comparing itself especially with neighbouring France, and also with Germany as consequence of the increasing dominance of the D-Mark in the European Community since the mid-80s).

Modern historians of Spain identify throughout, as a common factor, successive attempts to overlay sophisticated forms of constitutional government on a relatively underdeveloped population (socially and economically). The authors, as actuaries, leave it to the historians to argue which is "cause" and which is "effect" between the tendency towards political instability, and retarded economic development. However the historical background is interesting – not least to explain why the evolution of current legislatory frameworks, and conventions of the life and pensions sectors, are compressed into as short a period as the last 20 years.

It is of course this accelerated development, a process of "catching-up" with its near neighbours, which has drawn in so many foreign ventures, a feature at least as evident in the financial services sector as in any other.

In Appendix 2 we give some basic economic statistics on present day Spain.

2. REGULATORY STRUCTURE

2.1 *Introduction*

We have placed at the beginning of the paper an outline of the regulatory framework within which Spain's life sector operates. This may look forbidding at first – there may exist the temptation to jump forward to Section 3. However, it is difficult to tackle each topic in a coherent manner, without some of this prior knowledge.

It is worth observing that Spanish law is of the Roman style which entails the full legal codification for any action or entity to be properly constituted in law. As an example of the difference with English or Scottish law, we may cite the concept of trust as it has evolved in common law, and around which much of the U.K. pensions framework has evolved. In some senses this is alien to Spain, and we see later how Spanish pensions legislation has emerged in a different manner. However one common strand between Spain and the U.K. is that tax legislation, as much as specific insurance law, has had and continues to have a major influence in both countries.

Unlike the U.K., Spain is accustomed to more detailed statutory control of such matters as life product-pricing, surrender values and reserving. The enforcer of this control is the *Dirección General de Seguros* (DGS commonly), the Spanish insurance inspectorate. We outline how the DGS functions – before discussing the individual statutes (as these statutes in almost every case – including pensions legislation and control of selling practices – make reference to how, when and where the DGS may intervene).

By virtue of tighter regulation, and the monitoring that accompanies it, in some cases the actuary (at least in legal terms) has less professional responsibility than his counterpart in the U.K. There is not an "appointed actuary" role in life offices. A life office actuary needs only to certify the exactitude of the calculation of the mathematical reserves – the certification of solvency falls to the board of directors when they approve and sign the audited accounts. On the other hand the statutory role which Spanish actuaries have in product pricing is greater than that of their U.K. counterparts.

2.2 *Insurance Inspectorate*

2.2.1 The *Dirección General de Seguros* (DGS) is the Spanish insurance inspectorate and is a department within the *Ministerio de Economía y Hacienda* (the Spanish government ministry combining the roles performed in the U.K. by the Treasury and the Department of Trade and Industry).

2.2.2 The *Director General de Seguros* is the head of the DGS. His role may be likened to the U.K. Government Actuary, but clearly there are differences. He does not have responsibilities such as costing national public social security schemes. However in other respects his profile is probably a more public one than in the U.K.; due in large part to the much greater interventionist role which the DGS performs. There is no tradition of the *Director General* being an actuary, and this is the case with the current *Director General*, Eduardo Aguilar.

2.2.3 The DGS's main means of control is its right to inspect: to inspect insurance companies, to inspect pension funds, to inspect brokers. In June 1993 the DGS announced its intention to increase its numbers of inspectors by 10 to 45. This increase reflects the greater demands being put upon the DGS by the various statutes entering into force. It also gives greater weight to the DGS's drive to eliminate many companies which, by virtue of their small size or financial weakness, the DGS does not consider to be viable in the medium to long-term.

2.2.4 The DGS is split into the following five main departments, each of which reports directly to the *Director General de Seguros*.

2.2.4.1 General Subdirectorate of Insurance and Legislative Policy

The role of this Subdirectorate is primarily one of co-ordination: it co-ordinates the activities of the five departments, the personnel requirements and relations with other departments of the *Ministerio de Economía y Hacienda*. In addition, it is responsible for elaborating new laws controlling the writing of insurance business.

2.2.4.2 General Subdirectorate of Inspection

As its name suggests this Subdirectorate has direct control of insurance activities, covering legal, technical and financial/economic areas of the business. There are two avenues of control, namely the teams of inspectors, who carry out their inspections in the offices of insurance companies, and the Department of Accounts Analysis. The latter has, in addition, its own dedicated team of inspectors whose role is to carry out investigations on specific aspects raised by the analysis of the accounts.

2.2.4.3 General Subdirectorate of Control of the Insurance Market

This Subdirectorate has responsibility for the granting of new insurance licences, approval (either active or passive) of technical notes (*notas técnicas*) and policy documents, and controls the activities of Insurance Intermediaries. Further details of each of these areas are set out in the remainder of this chapter.

2.2.4.4 General Subdirectorate of Pension Plans and Funds

The responsibility for controlling the authorisation of new Pension Plans and Funds and their day-to-day legal and technical activities falls to this Subdirectorate, although inspection *in situ* is the responsibility of the General Subdirectorate of Inspection. In Section 4 we cover the pensions market in depth.

2.2.4.5 Office of Studies and International Relations

This department liaises directly with the controlling authorities of other countries, particularly those of the European Union (EU), and is responsible for the drafting and elaboration of Brussels Directives as they relate to insurance.

2.3 *Legislation Regulating Life Assurance: Law 33/1984*

2.3.1 The private insurance law of 14 May 1908 was the first landmark in the regulation of the Spanish insurance market. Its central principle was to ensure that insurance companies did not operate in a reckless fashion, by requiring prior approval of companies' activities. These restrictions, whilst providing a certain degree of security for policyholders, also limited severely the innovations which companies were allowed to develop.

After almost half a century the 1908 law was replaced by the Law of 16 December 1954. This maintained the principle of control introduced by the 1908 law but failed to give the supervisory authorities the necessary muscle. The limitations of this law became ever more apparent as time passed, and the need for new solvency regulations and a means of rationalising and improving the transparency and competitiveness of the market became more pressing.

It was not until thirty years later that the *Ley 33/1984, Ordenación de Seguros Privados* (Law 33/1984 of 2 August, Regulation of Private Insurance) was passed to correct the weaknesses of previous laws. For the first time the law set out as its stated aim the protection of the policyholder through the regulation of the market in general, and control of companies in particular. A fuller interpretation of the framework introduced by the law was published a year later in the *Real Decreto* (Royal Decree 1348/1985, of 1 August), and apart from modifications passed in 1986 following Spain's entry into the EEC the law has remained relatively unchanged since then.

In the rest of this section we set out those aspects of *Ley 33/1984* as interpreted by *Real Decreto 1348* which we believe will be interesting to the U.K. reader. We have attempted to put these into context by drawing comparisons with U.K. legislation where appropriate.

2.3.2 *General Requirements of Technical Notes (Real Decreto 1348/85 Art. 53 as modified by Orden Ministerial 220 Art. 10 (Ministerial Order) dated 7 September 1987)*

A company wishing to introduce a new product (or to modify an existing product) is required to submit a technical note (*nota técnica*) to the DGS specifying the terms of the product in detail. In particular, a *nota técnica* for a life product must contain the following details:

(i) risk selection criteria, including admissible range of ages at inception, terms and requirements for medical examinations;
(ii) mortality and morbidity tables used;
(iii) technical interest rate;
(iv) conditions of participation in profits, including how it is calculated and how it is applied;
(v) formulae for calculating guaranteed surrender and paid-up benefits, as well as those for policy loans;
(vi) internal administration expenses (*gastos internos*) and commission loadings (*gastos externos*);
(vii) formulae for calculating the *prima pura* (pure or net premium), *prima de inventario* (premium with allowance for internal administration expenses) and the *prima de tarifa* (the office premium); and
(viii) formulae for calculating the mathematical reserves.

In the case of a company seeking initial authorisation (or to increase its scope of authorisation to another line of business) the company must wait for the DGS to approve the *nota técnica* before starting to write the business. In all other cases once the *nota técnica* has been submitted the company may start to write the business, although the DGS may intervene to prevent sales if it is not satisfied with any part of the *nota técnica*.

2.3.3 *Components of Notas Técnicas*

In this section we consider individually the components which make up the *nota técnica*:

2.3.3.1 **Mortality and disability tables** must be based on national or international experience, and must be within generally accepted confidence intervals for Spanish experience. The same tables must be used in the calculation of the mathematical reserves as were used in the calculation of the premiums.

In practice the mortality tables GKM80 and GRM80 (and the corresponding female tables GKF80 and GRF80) based on Central European assured lives (German and Swiss) are used. GKM80 is used for risk products and GRM80 for contracts with a savings element. Whilst no published experience exists for Spanish assured lives there is an equivalent of the ELT population mortality tables published by AGF Seguros S.A., the Spanish subsidiary of the French company AGF. These are called PEM80 and PEF80 for males and females respectively. Few companies use these tables in their product pricing or reserving, preferring to use the accepted standards set by the Central European tables.

2.3.3.2 The maximum **technical interest rate** allowable varies according to the term of each product and whether conventional or linked:

(i) For products with a term of less than five years the maximum technical interest rate is the average expected return on the assets of the same term covering the totality of the life technical provisions.

(ii) For products with a term of five years or more the maximum allowable technical interest rate is 6%. However, for a company which has net assets which exceed five times the life statutory minimum solvency margin the maximum in part (i) above applies.

(iii) For contracts linked to specific assets, either invested previously or simultaneously with the date of inception of the contract, the maximum technical rate of interest is the expected return on those assets.

A further restriction on the technical interest rate is that the rate of return on the assets backing the mathematical reserves must be at least as great as the technical interest rate. In the event that this condition is not met over two consecutive years the technical rate of interest must be revised (and a new *nota técnica* submitted) for all contracts sold in the future. The same interest rate must be used in the calculation of the mathematical reserves as was used in the calculation of the premiums.

The rate most commonly used is the 6% as referred to in part (ii) above, but short term single premium policies and annuities may take advantage of the less stringent restrictions set out in (i) and (iii).

2.3.3.3 There is considerable scope in the legislation for the use of different methods of **profit sharing**, although the precise method to be used in each case must be described in the *nota técnica*.

In practice, most companies calculate bonuses as a percentage (usually 90% or 95%) of the excess earned interest over the technical rate of interest. The resulting profit share is normally applied as a single premium to "buy" an increase in the sum assured. The requirement to specify the method of profit sharing is one of the fundamental differences between Spanish and U.K. with profits policies. In Spain the company is locked-in to a particular method of distributing surplus and has no scope to reflect external factors, other than the return on assets, at the moment of declaring the bonus.

2.3.3.4 Companies are required to specify the **surrender and paid up** terms in the *nota técnica*, for all contracts other than pure risk (term) or pure savings contracts. However, this does not exclude the possibility that an endowment, for example, has a zero surrender value, as long as this is made clear in the *nota técnica*.

Typically, all contracts with a savings element offer guaranteed surrender terms, which of course are set out in the *nota técnica*. These are normally defined as a percentage of the mathematical reserves applying at the time of alteration. The percentage will usually start at around 80% and increase to 100% over the full policy term. However, no surrender value tends to be paid until two annual premiums have been paid. The overall effect of this is that the company is locked-in to a policy with effectively fixed liabilities, and the investment policy must necessarily reflect this.

2.3.3.5 The **expenses** which are loaded into the premium basis must be set out in the *nota técnica*. These are split into "internal expenses" (*gastos internos*) and "external expenses" (*gastos externos*), being administration expenses and commission or sales related costs, respectively.

The administration expenses are normally loaded as a level percentage of the premium or the sum assured, with no allowance being made for higher initial expenses (although there are some exceptions). Whilst the external expenses should reflect the commission payable, it is not unusual for companies to load a maximum level of commission into the basis which is only paid to the best performing brokers or agents.

2.3.3.6 The Spanish equivalent of the **valuation premium** is the *prima de inventario* (inventory premium, with symbol P´). This is made up of the pure risk premium plus the internal expense allowance shown in the *nota técnica*. Whilst the definition of the valuation premium excludes the possibility of calculating Zillmerised mathematical reserves as such, some spreading of acquisition expenses may be brought into account as an offsetting item. The legislation governing this aspect is complicated, but it is worth taking a few lines to unravel it:

(i) Acquisition costs corresponding to commissions (net of reinsurance commission receivable) may be spread over a period no greater than the premium payment term, and may appear as a "fictitious" asset in the balance sheet (Article 45.8).

(ii) The full "un-Zillmerised" mathematical reserves must appear in the balance sheet.

(iii) For the purposes of the asset:liability solvency test the offset item may be deducted from the liabilities, and indeed this deduction may be applied even if it has not been included in the published balance sheet.

In Spain, unlike the U.K., the statutory minimum solvency margin must be based on the "un-Zillmerised" reserves, but it should be noted that the net shareholders' funds which must be sufficient to cover the statutory minimum solvency margin may include the offset previously referred to, but only up to a maximum of 3.5% of the capital at risk, and only to the extent that the offset does not appear as an asset in the Balance Sheet (Article 77.1 (i)).

2.3.3.7 The formulae used in calculating the **mathematical reserves (provisions)** are also set out in the *nota técnica*. The regulations regarding their calculation are considered further below.

2.3.4 *Products (Real Decreto 1348/85 Art. 50)*

Products may cover, as the main risk, death or survival or a combination of the two. For companies only authorised to write life business, disability (long term or short term) and accidental death may only be covered as a supplementary risk, and in this case the sum assured under the main risk (death and/or survival) must be at least as large as the supplementary cover.

2.3.5 *Calculation of the Mathematical Reserves (Real Decreto 1348/85 Art. 56)*

2.3.5.1 The legislation sets out the following rules concerning the calculation of the mathematical reserves:

(i) the mathematical reserves should be calculated as set out in the product's *nota técnica*, using the same interest rate and mortality or disability tables which were used to calculate the premium rates;

(ii) The premium to be used in the calculation of the mathematical reserves is the *prima de inventario* (pure premium plus loading for administration expenses) earned during the year;

(iii) The calculations should be carried out on a policy-by-policy basis;

(iv) Increases to the sum assured due to profit sharing, contractual revaluations or adjustments should be reflected in the calculation of the mathematical reserves. Profit sharing which has accrued but has not yet been converted into additional sum assured must also be allowed for.

2.3.5.2 The mathematical reserves are normally calculated by interpolating between the reserves at the curtate durations either side of the valuation date. To this is added the unearned part of the inventory premium less that part of the year's premium not yet received (if premiums are payable other than annually). This type of reserve is known as a *Provisión de Balance* or Balance Provision. Whilst some companies take into account the month of inception of each policy at the interpolation stage it is more usual to assume that the valuation date falls midway between policy anniversaries on average. More precise methods, in the U.K.-style, may be used but are not so wide spread.

2.3.6 *Investment of the Mathematical Reserves (Real Decreto 1348/85 Art. 62)*

The major point of difference between Spanish and U.K. regulations regarding the investment of the mathematical reserves is the requirement for Spanish companies to cover their gross mathematical reserves, without any reduction for reinsurance ceded. One of the implications of this is that surplus relief reinsurance is of little use to Spanish companies as a means of releasing capital. This requirement does not affect the calculation of the statutory minimum solvency margin which is calculated in line with EC legislation, and with only minor differences to the U.K. calculation. This is discussed further below.

2.3.7 *Capital Requirements (Real Decreto 1348/85 Art. 21 as modified by Real Decreto 1390/1988 dated 18 November 1988)*

Unlike the U.K. where the only capital requirement is the Guarantee Fund of 800,000 ECUs for proprietary companies and 600,000 ECUs for mutuals, Spanish life assurance companies are required to have subscribed capital of at least 1,500 million Ptas (approximately 9.5 million ECUs at 1 ECU = 159 Ptas), at least 50% of which should be paid-up.

It is the Government's intention to introduce legislation (see 2.5) which will, *inter alia*, increase the capital requirements for most lines of business. The expected change for the life assurance industry is that although the subscribed capital requirement will remain unchanged it will have to be fully paid-up.

Article 18 of the *Real Decreto 1348* restricts new companies to writing either life or non-life business. Prior to the introduction of Law 33 in 1984 there were very few companies authorised to write exclusively life business, although since then the number has increased considerably. According to information published by the DGS *(Balances y Cuentas 1992 – Seguros Privados)* some 50% of all proprietary companies (Spanish and foreign) authorised to write life business at the end of 1992 were composite companies, many of which write only small volumes of life business. The implications of an increase in paid-up capital may be that many composite companies will wish to sell their life portfolios.

2.3.8 *Net Shareholders' Funds (Real Decreto 1348/85 Art. 77)*

The *Real Decreto* sets out in detail the elements which may be considered for the purpose of demonstrating solvency. Amongst the admissible assets are 100% of the paid-up subscribed capital plus 50% of unpaid-up part (reflecting the fact that shareholders may be called upon at any time to make fully paid-up any part paid-up capital). As a result all companies may count at least 75% of their subscribed capital towards their net assets. If the proposed legislation (see 2.5) is passed this slightly anomalous "asset" will disappear.

The equivalent of U.K. Section 68 orders are also admissible, although Spanish legislation does not require companies to apply to the DGS in order to use these items.

Losses from the current year and accumulated losses from previous years should be deducted from the net shareholders' funds. It is, in fact, quite common for companies to write down their paid-up capital by the amount of accumulated losses, although this may give rise to the need for a capital injection at the same time. This is done to avoid the DGS intervening which they have the right to do once a company's losses reach 25% of its paid-up capital. In this case the DGS may require the company to take remedial action to reduce losses over an agreed term. Accumulated losses of 50% of paid-up capital may result in liquidation of the company.

2.3.9 *Returns to the Dirección General de Seguros*

Insurance companies are required to submit Returns to the DGS within six months of the year end, which for all insurance companies must coincide with the calendar year end (Art. 43.3). The Returns, entitled *Documentación Estadistico-Contable* (or Statistical-Accounting Documentation) are similar to Schedules 1 and 3 of the U.K. Returns, without reaching the level of detail included in Schedule 4.

The actuary is only required to sign as part of the Returns a statement as follows: "I have verified, in accordance with the requirements set out in Article 55 of the *Reglamento de Ordenación del Seguro Privado*, the methods used in the calculation of the technical provisions which appear in the accounts which have been approved by the *Asemblea General* and in the *notas técnicas* presented, and in their turn, approved by the *Dirección General de Seguros*".

The Board however certifies the overall financial situation of the company when the Returns to the DGS are made. It is the format of the Returns, therefore, that defines who carries which responsibilities, and leads to the different role of the Spanish actuary referred to at the beginning of this Section.

2.4 *Selling Practices*

2.4.1 *Law 9 of 1992*

Spain's *Ley 9/1992* set out a very different statutory framework for insurance intermediaries, in comparison to the legislation in this sphere which had preceded it, dating from 1969-1971 (there had been more recent amendments in 1985, 1986, 1990, but these did not alter the basic precepts established in 1969).

The motives for the new legislation passed in 1992 are in fact set out in a preamble to the legislation itself. This acknowledges that the 1969-1971 regulation was largely focused upon protecting insurance agents' professional interests. The preamble also cites the needs of a competitive market, looking more towards Europe, as impetus for reform – a reform necessary to remove a rigidity viewed as detrimental both to the consumer, and to the potential expansion of the insurance sector. However, amendments to Spanish legislation to take account of the Directive 77/92/EEC (of 12 December 1976) regarding distribution were, in fact, passed by Royal Decree in 1986 (*Real Decreto 1300/86*) and not in the law currently being discussed.

2.4.2 The main clauses of *Ley 9/1992* give effect to the following:

2.4.2.1 Having given a broad definition of what activities constitute acting as an insurance intermediary, it is required that an individual or a company engaging in that activity may only do so within the law having categorised himself either as an *agente de seguros* (an agent) or as a *corredor de seguros* (a broker). These terms are in effect "copyrighted" within the law – an intermediary must describe himself as one or the other – before he can sell. Having done so he must then of course subscribe to all the accompanying regulations. The law is very clear that neither an individual, nor a company, may act simultaneously in both categories.

2.4.2.2 An *agente de seguros* is legally an extension of the insurance company with which he is linked by virtue of a mandatory mercantile agency contract, entered into freely on mutually agreed terms between agent and insurance company.

Links with more than one company are prohibited, unless authorised in the contract or by subsequent written permission (such permission is understood to exist if different insurers have a written agreement to share a network). An agent is required to identify to a client (on his stationery, etc.) all of the companies with which he is linked.

2.4.2.3 The payment of a premium to an *agente de seguros*, or a communication with an *agente de seguros,* has the same legal effect as if it were made directly to the insurer. Also the law states that an insurer becomes liable for any previous debts of an agent, prior to his entering into the current agency contract. Clearly then the law, in several respects, sets out without any ambiguity the potentially onerous burden for the insurance company of the principle of the agent being an extension of the company itself.

2.4.2.4 The law requires each insurer to maintain an agents' register permanently in force including for each agent, past and present: name, dates of entry and lapse as agent, authorised sub-agents and authorisation of links by the said agent with other insurance companies. This register must be made available to the DGS for inspection on request and clearly will be the most straightforward means for the DGS to ensure that an insurance company is meeting the requisites of the law.

2.4.2.5 The law imposes on the insurance company the responsibility of training its *agentes de seguros.* A detailed training programme must be established, and the necessary resources made available for its effective execution. Again in this area the DGS may inspect the documentation, and indeed may verify the implementation of the programme. Furthermore the DGS has the right to modify and insist on the execution of an altered program.

2.4.2.6 The law requires that a *corredor de seguros* must offer impartial advice to a potential policyholder without being linked to any one insurer. The *corredor* must inform the client on all the conditions of the contract into which the client is entering and offer the cover best suited to the client's individual needs. Subsequently there is an ongoing obligation that the *corredor* furnishes to the client information regarding his covers and premiums, including during the final settlement of any claim.

For an individual to qualify as a *corredor de seguros* the requirements are:

(i) prior authorisation from the DGS;

(ii) must hold diploma of *Mediador de Seguros Titulado*;

(iii) depositing of a guarantee;

(iv) professional indemnity cover;

(v) delivery to DGS of a planned program of activities detailing the lines of insurance to be sold, the structure of the organisation, material and human resources, and training in cases where there are to be employees or agreements with third parties.

There are parallel requirements in the case of a corporate entity acting as a *Correduría* – again prior authorisation from the DGS is required, the technical director must hold a diploma as *Mediador de Seguros Titulado*, etc.

2.4.2.7 While the regulation of the activities of *agentes de seguros* is effected via the responsible insurance company, the DGS regulates *corredores* directly with powers of inspection on legal, technical or financial grounds. Also the DGS can require a *corredor* to put at its disposition details of the distribution of the business that it has placed with different insurers. The DGS has wide-ranging rights of access – and indeed has the power to inspect in cases where it believes activity as an insurance intermediary may be taking place.

2.4.2.8 The pivotal role of the DGS, especially in the case of *corredores*, is finally reinforced because the DGS also carries out the ultimate supervision over who receives a diploma as *Mediador de Seguros Titulado* (a pre-requisite for acting as *corredor* – see 2.4.2.6 above). The DGS maintains the register of holders of the diploma, the granting of which is subject to either an aptitude test or training course approved by the DGS, or is by virtue of being a university graduate from a business/economics faculty.

2.4.3 *Comparison with the United Kingdom.*

2.4.3.1 Given the role of the DGS it is very evident that Spain has not adopted, to any degree, industry self-regulation along similar lines to those applied in the last 6-7 years in the U.K. However some of the similarities are apparent – particulary the polarisation betwee independent financial advisers (*corredores* in Spain); and agents "tied" to companies. As in the U.K. this tied category in Spain includes tied agents (companies or individuals) alongside direct salesmen. Although the remuneration scales of different "ties" may vary extensively for commercial reasons, in all cases the legal constitution of the tie is the same – principally that of the agent being an extension of the insurance company itself.

2.4.3.2 For *agentes de seguros*, in some respects Spanish regulation seems less extensive than the equivalent LAUTRO supervision of tied agents in the U.K. For example the law does not insist on fact-finds of clients in any particular style. Another example is the possibility in Spain of multi-ties in specific situations. The DGS clearly can exert a significant influence upon specific companies, or upon the insurance industry in general, by exercising its right of inspection of amongst other things the insurance companies' training programme.

2.4.3.3 Comparing *corredores* with U.K. IFAs, the differences are more in terms of style (between statute and industry self-regulation) than in substance. It is interesting to note that the Spanish statute itself (without cross-reference to rulebooks of regulatory authorities, etc.) includes some very powerful clauses in relation to independence, absence of links with insurers, best advice and powers of inspection of where business is being placed.

2.4.3.4 The previous legislation, dating from 1969-1971, required that insurance agents hold a qualification from a *Colegio de Agentes y Corredores de Seguros*, the same law itself giving legal identity to these professional "colleges". However, in practice, in some sectors, there were already, even prior to the 1992 legislation, many agents selling without fulfilling this requirement. In abandoning this requirement, the 1992 law was therefore recognising what had in certain areas already become a day-to-day reality. Obviously the 1992 law effectively implies that the authorities are looking now to the insurers to control, indeed to underwrite, the selling activities of the intermediary market, with the single exception of *corredores*.

2.4.3.5 It is in the case of *corredores de seguros* that the professional colleges retain a role, re-denominated as *Colegios de Mediadores de Seguros Titulados*. The 1992 law again gives legal status to these colleges, and under direct control by the DGS they are active in training and testing candidates for the diploma of *Mediador de Seguros Titulado* (a pre-requisite for a *corredor*). Note however that they do not have exclusive rights over this diploma – indeed the law requires the DGS to maintain the register of *Mediadores de Seguros Titulados*, and admission to that register may be by routes other than the professional colleges. Reinforcing this new (diminished) role for the professional colleges, the 1992 law additionally states that in no case will membership be a pre-requisite for acting as *corredor*.

2.4.4 *Distribution since Law 9/1992*

2.4.4.1 In practice, the complete restructuring of the Spanish intermediary market has not taken place overnight, and agents continue to sell products of several companies, through a series of mercantile contracts with each respective insurer (possibly distinguished by line of business in a typical case). These agents do not fulfil the registration and authorisation requirements to be *corredores*: by default they are therefore *agentes de seguros* – with all that this implies in terms of the legal responsibility borne by the companies with whom the agent has entered into the said mercantile contracts. This is, in some ways, a weak part of the regulatory structure, as in practice it is clearly more difficult to assign precise responsibilities for the selling practices of, and moreover for the training of, agents with multiple ties of this nature. Moreover these agents seem to enjoy the liberties of *corredores de seguros* without being subjected to the more rigorous direct regulation by the DGS.

2.4.4.2 Celebrating the first anniversary of the 1992 legislation, in April 1993 the DGS passed a resolution "reflecting over, and interpreting certain of the precepts ...." contained within the new statute. One of the biggest issues which this addressed was the insufficient polarisation highlighted above in the preceding paragraph. The DGS's resolution recognised that the law admits multi-ties, but emphasised that this was contemplated as an "exception" and not to be the "general rule". Therefore granting of such an exception must take place within the strict control and strategic planning of the insurance company. The DGS went on to state that agency contracts must in no case give habitual authorisation for agents to operate with various different companies, and that it would run contrary to the 1992 law if insurers consciously were to encourage the proliferation of multi-tied agents, giving rise to doubts as to whether they may be categorised either as tied or independent.

This interpretation of multiple ties clarifies and amplifies significantly the original statute. The rest of the May 1993 resolution was more of a re-statement of the statute – the fact that the DGS felt the need to do this, suggested that in some other areas they were also unhappy about the degree of compliance up to that date. They emphasised for instance the following aspects:

(i) companies' responsibilities for selection and training of agents;

(ii) obligatory identification of company to which an agent is linked;

(iii) maintenance by companies of register of agents;

(iv) in relation to the total independence of *corredores* – the unwinding of exclusivity clauses, volume over-rides and indirect data processing assistance.

2.4.4.3 The May 1993 resolution coincided with the expiry of the transitional 12 months granted to *corredores* for them to subscribe to all the requisites of the new statute. The difficulties encountered by some potential *corredores* in securing professional indemnity cover was recognised, but at the same time the DGS reiterated very forcefully, to intermediaries and to companies alike, that without full registration as such, a *corredor* was no longer acting within the law. In general terms, difficulties with financing a deposit, paying for indemnity cover, etc. these have put pressure on smaller intermediaries, to seek ties, rather than support the additional costs of being designated as a *corredor*. Clearly again there are parallels with the recent evolution of the U.K. IFA market.

2.5 *Modification of Insurance Law*

The first draft of a proposed new insurance law was circulated during January 1994. This law will replace in its entirety Law 33/1984 (and its accompanying Royal Decree – see 2.3.1 above) and will amend Spanish legislation to reflect the requirements of the Third Life Directive. These are the subject of the next section. By the time this paper is presented the bill should have begun its passage through Parliament.

2.6 *The Third Life Directive*

2.6.1 *General*

The Third Life Directive ("Council Directive 92/96/EEC of 10 November 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC") sets out to change fundamentally the way life assurance is sold throughout the European Union (since the Directives use the older terminology of EEC we will use the abbreviations "EEC" and "EU" interchangeably).

Many of the details of the Directive are well known and well publicised, and it is not our objective to repeat these in full in this paper. What has been less fully covered are the potential implications of the Directive on life assurance in Spain. Below we set out the main points which we believe to be important from a Spanish perspective, with a brief discussion of how these may impact on the market. It is worth noting at this point that Spain and Portugal until December 1995 (and Greece until December 1998) have a minor transitional derogation from the articles concerning prior notification of general and special policy conditions and the calculations and coverage of technical reserves. In both cases, existing Spanish law will continue to apply up to the end of 1995.

We would commend any reader interested in a wider European interpretation of the Directive to the paper by Kamieniecki & O'Keeffe entitled "Life Assurance Marketing: A European Perspective" (Staple Inn Actuarial Society, 9 March 1993).

2.6.2 *Right of Establishment and Freedom to Provide Services Within the EU*

One of the basic tenets of the Third Life Directive is the principle of single authorisation from a company's home Member State being valid throughout the EU. With the authorisation received in its home Member State a company may carry on business in another Member State either through the right of establishment or freedom to provide services (Art. 4). This will give rise to the following distinctions between companies selling insurance in Spain:

(i) a *Sociedad Anonima* (S.A.), *Sociedad Mutua* (S.M.) or a *Sociedad Cooperativa* (S.C.) established in Spain and controlled directly by the Spanish authorities. This will include those foreign companies operating in Spain and established as one of the *Sociedades* mentioned above;

(ii) a branch (*delegación extranjera*) established in Spain but controlled by the authorities in its parent's home Member State; and

(iii) a company without physical presence in Spain selling business into Spain. Such companies will be controlled by the authorities in their home Member States.

On the face of it the process for establishing a branch in another Member State should become a formality, although the receiving Member State will have the opportunity to place conditions on the right of establishment where these protect the "interest of the general good". It remains to be seen how this clause will be interpreted and implemented in Europe generally, and in particular in Spain.

The possible impact of the right of establishment may be judged from recent trends in the granting of new licences to companies wishing to establish either a company or a branch in Spain. In recent years there has been a sharp decline in the number of new authorisations of companies and branches. In 1992 there were only three new companies authorised (including one branch) and in 1993 no new companies were authorised. This indicated that gaining authorisation has become more difficult as clearly there are still companies wishing to enter the Spanish market. Once the Directive becomes a reality clearly there will be more activity on this front.

The freedom to provide services may well prove to be the preferred solution to the bottleneck which is building up in the authorisation process. It avoids many of the problems associated with the establishment of a company or a branch, but will not be entirely without its own problems. Companies will need to take account of the different fiscal and contractual regimes applying in Spain and equally importantly, the cultural differences will need to be considered in designing and marketing suitable products for the Spanish market.

2.6.3 *Financial Supervision*

The Directive states "the financial supervision of an insurance undertaking, including that of the business it carries on either through branches or under the freedom to provide services, shall be the sole responsibility of the home Member State". To help them in that task, the competent authorities of the home Member State will have the power to carry out on-the-spot verifications, consistent with their roles as financial supervisors, of branches established in other Member States after first notifying the local competent authority. Member States must enact appropriate legislation to allow competent authorities to carry out their supervisory duties.

The competent authority of the Member State in which a branch operates or into which an insurer sells insurance under the freedom to provide services, is not entirely cut out of the supervisory picture. Article 40, which applies equally to branches established before the Directive entered into force and to those established thereafter, requires branches operating in a Member State to provide to the local competent authority "all documents requested of it for the purposes of this Article ...", although such documents may not extend beyond those required of companies with their head offices in the Member State. The purpose of Article 40 becomes clearer in later sub-paragraphs, namely to ensure compliance with applicable legislation in that Member State.

The DGS's responsibility for the control of branches established in Spanish territory (amongst them some of the most important foreign owned companies) will therefore be limited to ensuring compliance with applicable Spanish legislation and to the exchange of relevant documentation and information with other competent authorities to allow them to carry out their supervisory roles. The Directive allows a competent authority of one country to appoint intermediaries for the purpose of carrying out on-the-spot verifications, and it seems likely, at least in the early days, that the DGS will be the appointed Spanish intermediary of some other Member States.

2.6.4 *Approval of Notas Técnicas*

Prior approval or systematic notification of general and special policy conditions, premiums scales, technical bases, etc., is a recurring theme of the Directive, and is also the subject of the derogation mentioned in the section 2.6.1. The Directive acknowledges a Member State's right to require systematic notification of these documents, but "for the sole purpose of verifying compliance with national provisions ...", and "... without that requirement constituting a prior condition for an undertaking to carry on its business".

Spanish law currently makes a distinction between those companies which present *notas técnicas* as part of an application for initial authorisation (or for authorisation in additional lines of business), and those companies which simply wish to introduce a new or amended product. In the latter case the presentation of the *nota técnica* <u>does not</u> amount to a requirement for prior approval. As a result, and perhaps contrary to popular belief, little needs to change in this respect for the precise requirements of the Directive to be satisfied.

2.6.5 *Calculation and Coverage of the Mathematical Reserves*

The other derogation which applies until the end of 1995 is that Spain may require that the technical provisions be calculated and the "cover of those technical provisions by equivalent and matching assets and the localisation of those assets ..." be determined in accordance with its own law.

The need for this derogation stems from the differences between the limits which Spanish law currently places on assets used to back mathematical reserves and those in the Directive. As it stands now, Spanish law only restricts to 10% of the mathematical reserves shares or securities held in any one company (or 20% in shares of a group, unit trust, etc.). Article 22 of the Directive restricts this percentage to 5%, or 10% in certain circumstances. In addition, the Directive restricts to 10% of the total gross mathematical reserves investment in any one building or piece of land, while Spanish law places no limit at all. As many insurance companies in Spain own their head office building or have an insufficiently diversified investment portfolio the transitional period until 1995 gives them more time to adapt.

2.6.6 *Maximum Technical Interest Rate for Valuations*

Article 18B of the Directive sets out the requirements for the rate of interest used in the calculation of the mathematical reserves. In summary, when contracts contain an interest rate guarantee the competent authority of each Member State should set a maximum rate of interest, which should not exceed 60% of "the rate on bond issues by the State in whose currency the contract is denominated". However, when assets are not valued at book value the maximum rate may depend on the yield on assets currently held, less a prudential margin.

In both the U.K. and Spain assets are valued for solvency purposes at their market value, but in both countries there is some concern over the maximum rate currently applying (a 7.2% maximum future investment rate in the U.K. and 6% in Spain). Whilst it is not clear what the DGS will finally decide to do various suggestions have been mooted, including a reduction to 4% for the valuation technical rate of interest. Whatever limit is introduced, it looks almost certain that it will be lower than the current level. Since almost all insurance companies calculate their premiums and value their liabilities at 6% the effect of a reduction in the maximum could be enormous. This change would also signal a move away from the traditional correspondence between premium and valuation bases, to one where the valuation basis reflects current economic conditions.

2.6.7 *Publication of Bases and Methods used in the Calculation of Technical Provisions*

Article 18 of the Directive requires that companies "shall make available to the public the bases and methods used in the calculation of the technical provisions, including provisions for bonuses".

To the U.K. reader this may not seem worthy of comment since this information is readily available in the DTI returns. However, in Spain this information is strictly confidential. This is partly justified by the fact that in certain elements the reserving basis must coincide with the premium basis, and therefore public availability of one gives rise to common knowledge of the other. In the new environment created by the

Directive whilst the real importance of this will probably be limited, due to the likely divergence between the bases, force of habit may lead to some initial resistance to complying with this Article.

2.6.8 *Spanish Legislation and the Third Life Directive*

Like the U.K. and many other Member States, Spain did not meet the requirement of Article 51 of the Directive to amend national law to comply with its requirements by 31 December 1993. However, as mentioned in paragraph 2.5 above the first draft of a new law, which will introduce the changes required by the Directive as well as amending other aspects of insurance regulation, was circulated in January of this year. It is still possible that this will become law by 1 July 1994 which is the date specified by the Directive for its full implementation.

3. LIFE ASSURANCE MARKET

3.1 *Development of the Insurance Sector*

A quick analysis of the *Balances y Cuentas 1992 – Seguros Privados* published by the DGS gives an indication of the history of the Spanish insurance sector; amongst those companies which can trace their origins back to the years immediately following the first insurance law of 1908 (see 2.3.1) are Assicurazioni Generali, S.p.A. (life licence 1909) and Winterthur, Sociedad Suiza de Seguros (accidents licence 1910), perhaps two of the most important foreign companies in Spain. Other early foreign entrants to establish branch companies were Guardian Assurance Plc. (fire and natural catastrophes – 1909) and Zurich Companía de Seguros (accidents 1909). Amongst Spanish companies licensed around this time were Banco de Vitalicio de España (life 1909), and El Fénix Español, S.A. which in fact shows, as the year of authorisation to write life business, 1907. The company which dates back furthest according to this source is La Union y El Fénix Español which was authorised to write life and fire and natural disasters in 1864.

In more recent times, the sector has grown rapidly, given impetus particularly from the introduction of the insurance law, Law 33/1984 (see 2.3.1). Between that year and 1992 over 150 new insurance companies (life and non life) were established, representing about 25% of the current number of insurance companies. A significant number of these new companies were authorised to write only life assurance business as a result of the prohibition in that law of the creation of new composite companies.

In 1988 the number of new insurance licences granted peaked at 53 but since then there has been a steady decline. In both 1989 and 1990 23 new licences were issued, ten in 1991 and three in 1992. This pattern is consistent with the DGS's intention that there should be a contraction in the number of companies operating in the insurance sector, leading to a smaller number of stronger companies being better placed to face the competition in the opening up of the European market.

Indeed there has been a rapid reduction in the number of companies in recent years. At the end of 1991 there were 554 companies actively operating in the insurance market with a further 87 in liquidation. By the end of 1992 the number of active companies had fallen by 66 to 488 (a staggering 12% of the market by numbers of companies) and the number of companies in liquidation had increased to 107. This contraction of the market is largely amongst companies writing wholly or mostly non life business and it should be noted that it includes many companies which had insignificant volumes of business. In the last decade the number of life companies has remained fairly stable at around 140.

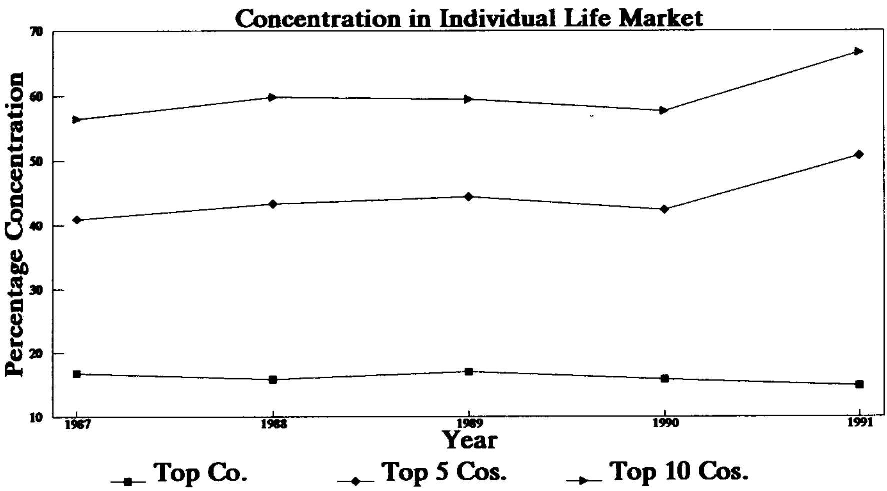
3.2 *Market Concentration*

Turning now to the life sector, Figure 1 shows the concentration in the individual regular premium market. The percentages are based on total premium income and not on new business premiums, since data on new business production is not readily available.

Figure 1 shows a reasonably stable development in the concentration of the market amongst the top company, top five and top ten companies. This stability, which perhaps may be considered to be the underlying pattern of concentration in the market, has been achieved by making a number of adjustments to the data. The most important of these adjustments was the removal of single premium business sold in the mid to late 1980s.

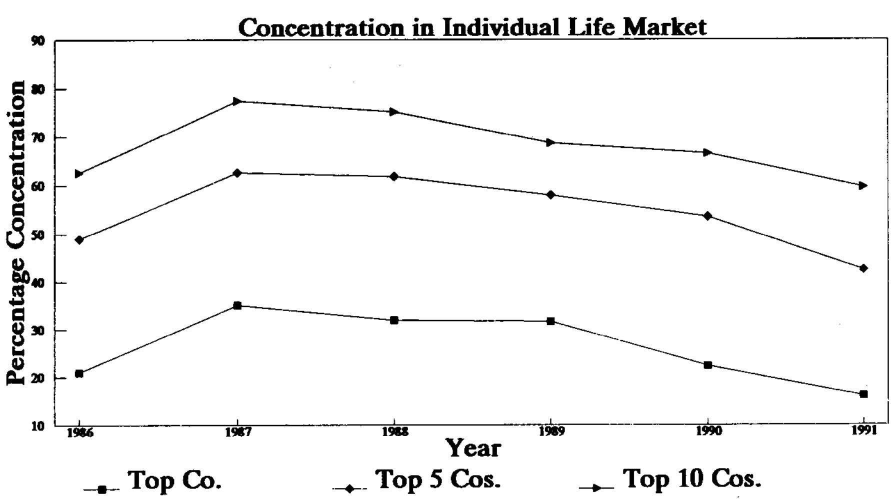
A short lived market was created around 1986 in the sale of short term single premium policies which were used as a means of sheltering from tax. These policies became very popular as an alternative to bank deposits for their attractive tax treatment and since there was apparent anonymity of the investor. The government, however, introduced retrospective legislation which removed the favourable tax treatment and obliged insurance companies to reveal the names of policyholders. The appearance and subsequent disappearance of these products is well demonstrated by Figure 2, which shows the unadjusted concentration graphs. In order to get a feeling of the impact of these single premium policies, one needs only to look as far as Euroseguros (owned by the powerful banking group Banco Bilbao Vizcaya) whose market share went from a little over 1% in 1986 to over 35% (and top ranking) in 1987. Euroseguros remains one of the leading companies in the market for more traditional short term (1-3 years) single premium policies.

Figure 1



Source: UNESPA with adjustments by the authors

Figure 2



Source: UNESPA

3.3 *Penetration of Life Assurance*

One obvious feature of the Spanish market is the low penetration of insurance within the population. Table 1 shows per capita life premium levels for the EU countries for 1990 and 1991, and the 1991 premiums as a percentage of GDP:

Table 1

Country	**Per Capita Life Premium Levels (in US $)**		**Premiums as % of GDP**
	1990	**1991**	**1991**
Great Britain	1,146	1,318	7.0%
Netherlands	835	936	4.5%
France	692	733	3.4%
Ireland	733	726	5.4%
Denmark	506	571	2.1%
Luxembourg	390	510	2.0%
Germany	563	505	2.2%
Belgium	251	270	1.2%
Italy	133	161	0.7%
Spain	**120**	**160**	**1.1%**
Portugal	49	66	1.0%
Greece	43	60	0.8%

Source: Sigma/Swiss Re.

The per capita premium income in Spain is well below that of its northern European counterparts, as is the case for life premium income as a percentage of GDP. There are several possible reasons for this phenomenon, not least the generous Social Security System. We return to discuss this later in Section 4.

3.4 *Distribution*

In 2.4.2 we discussed the new law (*Ley 9/1992*) governing the sale of insurance through *agentes de seguros* (agents) and *corredores de seguros* (brokers), and the effective polarisation between these two groups. In this section we look at how insurance is being sold now and at the effects to date of the new law.

Prior to the new law, distribution was a slightly grey area – and in many ways the law was introduced to legalise what had already become general practice. For example, although insurance products could only be sold by *agentes* or *corredores*, as they were previously defined, it was not unusual for banks to contract group policies in which the banks were the beneficiaries (*tomadores*) and the banks' customers the assured lives (*asegurados*), on what effectively amounted to an individual basis.

Further, while department store employees, for example, could not sell insurance products there was nothing stopping department stores from setting up their own *correduría* (broking house), and this was in fact what El Corte Inglés, Spain's leading department store, did a number of years ago. Since its establishment El Corte Inglés' *correduría*, El Centro de Seguros, had representation in the branches of its parent company, although it was not totally clear how the law legislated such an operation.

The major change then, introduced by the law, was that any person could act as an *agente de seguros*, without the need for external qualifications. This brought into the ambit of distribution bank employees, department store employees, etc. Likewise, *corredurías de seguros* are also now able to sell insurance other than through their own networks, although this does not in any way diminish the responsibility borne by the *correduría*.

It is impossible to separate the insurance and the banking sectors when considering the Spanish insurance market. There are few major insurance companies which are not owned by banks, with the obvious exception being Mapfre which, quite the opposite to the rest of the sector, owns a small bank, Banco Mapfre. Companies not themselves owned by banks have in many cases struck agreements of various sorts with banks, to allow them to compete with bank-owned companies in the potentially lucrative area of bancassurance. The types of agreements which have been reached are as follows:

(i) agreement between a bank and an insurance company to market insurance products through bank branches. Examples of this are the agreements between Plus Ultra (subsidiary of Norwich Union) and Banca Catalana and between Winterthur and the banks Abbey National España and recently Banca Jover;

(ii) joint venture agreements combining banking and insurance interests of major groups. Examples of this are the joint ventures between Generali and Banco Central Hispanoamericano (forming a holding company Central-Hispano Generali), Axa and Banco Bilbao Vizcaya (BBV), and between Fortis and the Caixa banking group.

Whilst banks currently sell a wide variety of simple life products (pure endowments for retirement purposes, term assurances, etc.) the sales rely largely on the bank customer taking the initiative. It may be assumed that as banks and insurance companies become more aware of the potential of bancassurance they will start to take a more pro-active role in exploiting the valuable bank customer databases to provide greater insurance sales.

Because of the recent re-drawings of distribution categories it is impossible to present a reliable picture of sales through each channel. However, from available historical data the authors would estimate a percentage breakdown in the region of: *agentes de seguros* 60%, *corredores de seguros* 20%, banks 10% and direct sales 10%.

3.5 *Products*

3.5.1 The majority of life companies write traditional products similar to those sold in the U.K. The main differences between Spanish and U.K. products stem principally from legislative requirements, which have been discussed in Section 2. We review these briefly below:

(i) Participation in profits calculated as a specified percentage (normally around 90%) of excess investment income over technical rate;

(ii) Participation in profits is re-applied as a single premium to buy an increase in the sum assured;

(iii) The concept of terminal or other discretionary bonuses does not exist;

(iv) Companies are taxed on profits, i.e. there is gross interest roll-up on companies' investments;

(v) Surrender and paid up terms must be specified at the outset of a contract. These are normally calculated as a percentage of the mathematical reserves;

(vi) Premium and reserving bases are the same;

(vii) The policyholder may deduct from his or her tax 10% of premiums paid on protection policies only.

3.5.2 There has been no parallel development to that in the U.K. of self employed and executive pension plans. The development in this area has been almost wholly in the area of *Planes de Pensiones* which are discussed in Section 4. Endowments are rarely sold in connection with house purchase, more commonly being savings vehicles. Two types of endowments are popular in Spain, the standard endowment product (*Mixto*), which has a guaranteed death and maturity benefit – although the two need not coincide, and pure endowments (*Diferido con reembolso*), which return premiums on death with or without interest.

3.5.3 Conventional and annually renewable term assurance are also common. The latter is particularly important in group business, as most medium and large companies provide group life cover for their employees.

3.5.4 Whole life products are less popular, although they had a brief surge when several insurance companies tried to sell endowment products dressed up as whole life products so as to take advantage of the 10% tax relief on protection policies. The government firmly closed this door at the beginning of 1993.

3.5.5 Unit linked products have not yet reached significant volumes. Currently only U.K. owned companies (Eagle Star and British Life) sell unit linked products, and even in these cases the funds are invested heavily in government fixed interest securities.

3.5.6 Other products which are successful in the U.K. such as dread disease have as yet not taken off in Spain. A few companies sell these products although volumes are not large. A number of companies offer rider benefits to risk policies where payment is related to the cause of death. One such common cover is known as the "Triple C" which pays out multiples of the basic sum assured on death due to heart attack (*corazón*), cancer (*cancer*) or traffic accidents (*carretera*).

3.5.7 Non-smoker discounts are not very common, although a couple of companies do offer differential rates.

3.6 *Profit Testing*

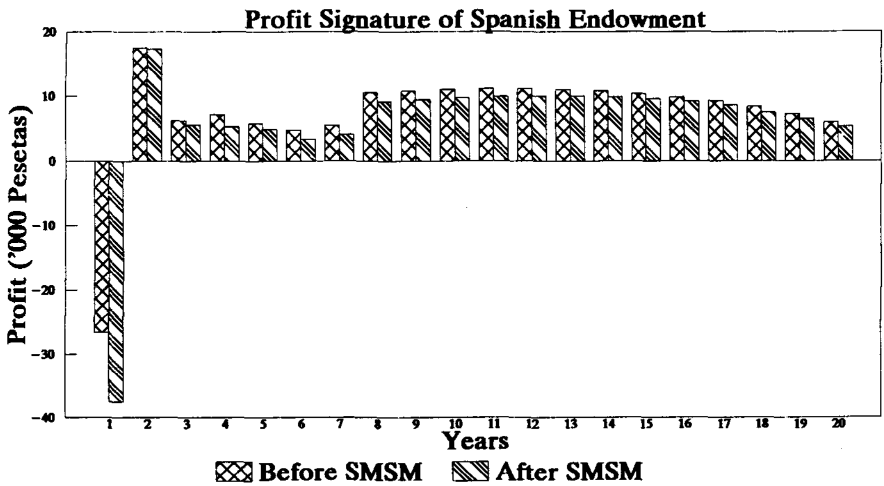
3.6.1 In the previous section we described in broad terms the main types of conventional life products written in Spain, together with the main legislative restrictions which give rise to some of their characteristics. In this section we consider the profitability of one typical product, an endowment or *mixto*. It is clearly not possible to draw conclusions about the profitability of all Spanish products based on the profit testing of one product at one age, premium, sum assured, etc. However, we hope that this section will provide sufficient information in order to highlight some of the differences between the profitability of Spanish and U.K. products.

3.6.1.1 The product considered in this section is an endowment product which pays out the sum assured on maturity and total premiums, both past and future, without interest on death. Both the annual premium and the sum assured increase by 10% p.a. simple. Profit sharing is at a rate of 90% of the excess earned interest over the technical rate, and the guaranteed surrender value is 82% of the mathematical reserves after two years, increasing by 1% every year thereafter. The profit share is applied as a single premium to purchase an additional slice of sum assured, which is paid out on both death and maturity. The term of these additional "policies" is the outstanding term on the original policy at the time of "purchase" and the basis used to calculate the new sum assured is the same as the original premium basis. No commission is payable on the single premium, although an expense charge is made as a percentage of the new sum assured. The profits emerging on these additional "policies" have been taken into account in the profit test.

3.6.1.2 In the past there have been very few insurance companies who have priced their products using profit testing techniques. Instead companies have relied on traditional methods in the knowledge that the pricing bases contain reasonable margins, and that the market is not very price sensitive. As a result reliable experience data is not collected by many insurance companies in a format which is readily usable for profit testing purposes. In Appendix 3 we set out the basis which we consider, in our opinion, to be reasonable for the current exercise. In the remainder of this section we look at the results of the profit testing and consider a number of important sensitivities. We also draw some broad comparisons with the way we would expect a similar U.K. product to react to each of the changes.

3.6.1.3 Figure 3 shows the profit signature of the endowment, both with and without allowance for the cost of the Statutory Minimum Solvency Margin (SMSM).

Figure 3



3.6.1.4 The basic shape of the profit signature takes a familiar form, although because commission is only payable during the first seven policy years there is a considerable increase in the emerging profits in the eighth year. As a result, perhaps a larger part of the profits are allowed to emerge in the later years of the product than would be the case with modern front end loaded unit linked U.K. products. Comparisons with traditional with profits contracts are difficult to draw, since the U.K. long term business fund and the 90/10 surplus distribution structure make profit testing these products complicated. However, from a shareholder's perspective, taking into account shareholder interest in the estate/investment reserves, it is common for most of the profit to emerge later in the contract's life.

The present value of future profits (PVFP) as a percentage of the first year's premium is 35% before the SMSM and 22% taking account of the SMSM. By any standards this product would be considered to be very profitable.

An analysis of the results shows that the most important source of profit is the company's retention of 10% of the excess investment return over the technical rate earned on the mathematical reserves. In addition there is an important mortality surplus generated.

3.6.2 The following paragraphs discuss the results of various sensitivity tests performed.

3.6.2.1 *Sensitivity to the Earned Interest Rate*

A 1% reduction in the earned interest rate reduces the PVFP as a percentage of the first year's premium (before SMSM) to around 28%. In other words a 1% fall in the earned rate leads to a reduction in the PVFP of almost 20%. In times of high interest rates this heavy reliance on the margin in the interest rate has been to the benefit of the company. However, with interest rates currently falling towards the 5% or 6% level commonly guaranteed in most savings products this must give some considerable cause for concern.

U.K. unit linked contracts (written in a 0/100 fund) would be expected to be significantly less sensitive to changes in the earned interest rate than is the case here. With profits contracts written by a proprietary office in a 90/10 fund may experience similar changes to those of the Spanish product, although this largely depends on the levels of guarantees given and the extent of other sources of profit (as well as the absolute level of investment return assumed in the central basis).

3.6.2.2 *Sensitivity to Lapse Rates*

Assuming that year 3 and future lapse rates were 50% higher than used under the central assumptions the PVFP as a percentage of the first year's premium reduces to 32%, ie. a reduction of 8% in the PVFP over the central basis. Given the combination of a guaranteed surrender value and the absence of any consideration of lapses in traditional pricing techniques it is clearly very important for companies to control their persistency rates.

The sensitivity of a U.K. unit linked product to a similar fall in lapse rates would depend largely on the product design: the more profit is taken up front the less sensitive the product is likely to be to such a change. The effect on a with profits contract of a 50% increase in the lapse rate would be a proportionately greater reduction in profitability than is the case in the Spanish contract, due to greater back-end loading.

3.6.2.3 *Sensitivity to Mortality*

If an experience mortality rate of 80% were used instead of the expected rate of 70% this would give rise to a fall in the PVFP as a percentage of one year's premium to 32%, or a fall of 8% in the PVFP over the central assumptions.

The sensitivity of a U.K. unit linked product (written in a 0/100 fund) should not be too dissimilar to that shown here, although the impact of changes may well be lower in the U.K. due to better mortality experience than in Spain. For with profits products written in a 90/10 fund the mortality experience is shared with policyholders and so sensitivity to a change in the mortality rate is low.

4. PENSIONS

4.1 *Overview*

In 1.2 we made reference to Spain's relative under-development economically compared to richer European states. Of course this is demonstrated by statistical comparisons of GDP, income per capita, etc. – but there are dangers in allowing excessive attention to Anglo-Saxon prejudice. Only the briefest of visits to the urban business districts of Bilbao, Barcelona or Madrid, will demonstrate the sophisticated business infrastructure and financial services which exist. It is perhaps the greater disparity between this urban wealth and poorer rural districts, which accounts for the depressed national statistics.

4.1.1 It does seem fair to state however, that the development of private pensions provision in Spain has, as yet, not reached an advanced stage in its development. This relative immaturity, especially in the setting of modern urban Spain, is notable: and it has been perceived throughout the last ten years by foreign entrants (actuaries, consultants, insurers) as one of the areas with great growth potential.

Nonetheless this potential success has proved to be hard to achieve for "players" in the market – domestic and foreign alike. For foreigners in particular, possibly starting-out with less complete understanding, and more intense ambitions, success has proved somewhat elusive.

4.1.2 In 1987 a new pensions regime was constituted by the promulgation of Law No. 8 of 1987. This law seemed set to form a watershed in the development of private provision by employees and employers. Very ambitiously it delineated in one law the full range of pensions for employed individuals, self-employed individuals, and also company schemes. Also it covered both defined-contribution and defined-benefit styles.

We return later to look at the detail of the framework created by the 1987 Law. But for now we restrict ourselves to observing the failure of the law to embrace comprehensively the existing and emerging areas of provision. For individual provision, plans subscribing to the 1987 Law have certainly made an impact and have absorbed market share, but a considerable volume of private provision has remained in other modes of savings for retirement.

The extent of the failure of the 1987 Law is more apparent for collective schemes. Other than a small minority who subscribed in the earliest days, most employers either administer their schemes by other modes, or simply do not make retirement provision for their employees.

The 1987 Law dominates the scene therefore even seven years on but it has several serious drawbacks. We return later to discuss these drawbacks and to consider how they have discouraged its widest application.

4.1.3 However first some space is devoted to a broader summary of how public and private sector provision has developed in Spain, prior to the most recent developments. Not least because the broader background, and in particular the expectation of retirement provision from the State, helps to explain the degree of uncertainty which any observer of this field will witness. Current high levels of State provision post-retirement, particularly for lower and medium salary-earners, obviously discourage private provision. On the other hand, these same high levels exacerbate the future demographic tensions between active and inactive populations (familiar in nearly all developed economies). Even if Spain feels able to ignore addressing these tensions for a few more years, it seems almost inevitable that soundly-funded, well-regulated private provision will have to be promoted in parallel with other initiatives.

All in all it is an area of considerable actuarial interest – not least in comparing Spain's solutions with those which the U.K. applies to similar problems.

4.2 *Development of State Provision*

4.2.1 *Early Development*

The earliest steps towards provision of "social security" in Spain can be traced from the beginning of this century, given impetus not only by philanthropic and charitable intentions, but also by a desire to regulate terms and conditions of labour. The reader should bear in mind that the social changes, generated by the Industrial Revolution in the late 18th and 19th centuries in northern and central Europe, arrived belatedly in Spain at the turn of 20th century. Even at that time the effects were restricted to specific industrial areas of Catalonia, the Basque country and Asturias – the exodus from rural communities into the cities came still later.

The first milestone was the *Ley de Accidentes de Trabajo* (workplace accidents) of 1900 and this gave rise to the first mutuals between interested employers. However it took until 1919/1921 for some form of State obligation for old-age pension to be manifested in the form of the pre-funded *Retiro Obligatorio Obrero.* This by no means gave universal coverage and was restricted to workers earning less than 4,000 Ptas annually.

The dictatorship of General Prima de Rivera, 1923-1931, witnessed some advance with the establishment of the *Organización Corporativa Nacional* and the first comprehensive Labour Code.

However, the Second Republic, 1931-1936, marked the slide towards Civil War, and even in its first years the Republic had to battle against severe economic debility which ruled out any significant progress in the area of social provision. Nonetheless the Second Republic did signal the first formal recognition of the State's obligations: when, for example, in Article 46 of the Constitution it stated "the Republic will ensure that every worker receives the necessary conditions for a decent existence", and furthermore that "... social legislation will regulate social insurance in relation to illness, accident, unemployment, old-age, invalidity and death".

Final cessation of hostilities in the Civil War came in 1939 and in that same year the new administration converted the *Retiro Obrero* of 1921 to become *Subsidio de Vejez*. The significance of this change being the adoption of financing on a pay-as-you-go basis, abandoning the previous pre-funded principles. Subsequent developments during the Franco era were:

1947 Recognition of invalidity, alongside age retirement, as giving entitlement to pension.

1957 The task of formulating the *Plan Nacional de Seguridad Social* was allocated by decree to the *Instituto Nacional de Previsión.*

1963 It took until 1963 however for this national "Plan" to be realised in a revision of the bases for Social Security.

1972 Law 24 of 1972 established a new Social Security regime with contributions and benefits related to salaries. Annual revisions of benefits were also established.

4.2.2 *Current Situation*

Post-Franco, the two significant legislative changes have been Law 26 of 1985, and Law 26 of 1990. These created the structure we find at the time of writing. Obviously, the Social Security structure in Spain, as much as in any advanced "western" nation is a complex one, and for a detailed analysis there are dangers in restricting attention to specific parts. However, for the purpose of setting the scene for Spanish pensions, we set out in Appendix 4 how contributions are calculated for employed persons, and how consequently retirement pensions are calculated and revalued.

For low- and medium-wage earners, the State offers the prospect of a post-retirement pension of the order of 70%-90% of pre-retirement income. This, as discussed in Appendix 4, goes significantly beyond U.K. State provision. In fact, a typical U.K. pensioner, aggregating State pension, with benefits from a company final salary scheme of reasonable quality, may well be broadly in line with his or her Spanish counterpart. The origins of the higher level of State provision in Spain appear to lie in the patriarchal relationship between the State and the populace during the Franco era.

The pressures, actual and impending, upon the Spanish State system started to be recognised in the early 80s, but a combination of successive left-centrist administrations, and exceptional economic growth have meant that only since the June 1993 elections, has the longer-term future of the State system been seriously addressed.

Appendix 4 makes specific reference to the recent political debate regarding revaluation of pensions in payment. In fact wider issues have also been discussed: especially altering the formulae for calculating pensions accrual, although implementation of such reform seems to remain a distant prospect. As yet the debate has not shifted its focus to promotion of private provision as an alternative to the State. A "virtuous" circle would need to be broken: extensive private provision will not occur, while contributions to the State, and benefits from the State, remain at high levels. Nor, as yet, does popular sentiment regard the longer-term security of State benefits as seriously under threat. Obviously such a threat is not a very saleable commodity, for a politician of any colour, given the high current level of dependence upon the State.

4.3 *Early Development of Private Provision (pre-1987)*

4.3.1 Appendix 4, and the closing comments of the preceding section, relate to the *Regimen General de Seguridad Social* – i.e. the normal regime for employees in non-public sector employment. There are however other regimes of social security (social security in its widest sense – healthcare, pensions, unemployment, etc.) which run in parallel for various categories of public-sector employeees such as civil servants nationally, regional and municipal administrators, employees of the judiciary.

4.3.2 Civil servants are automatically contracted-out of the social security system. Their contributions are paid to and their benefits paid by *Mutualidad de Funcionarios de la Administración Civil del Estado* (MUFACE) which is a mutual body established for this purpose. Health-care related benefits are provided by a panel of private medical insurers selected by MUFACE, and each civil servant may select an insurer from amongst this panel. Retirement and death benefits are also provided through MUFACE.

The situation for pension provision is similar in State-owned industries (it should be borne in mind how extensive these remain in Spain, albeit that there have been moves towards private capital injections, if not full-blown privatisations) – essentially again expectations are based upon the global State scheme plus a few top-ups of minor significance.

4.3.3 The dominance of State provision becomes very clear therefore: with coverage of a very wide span of the working population across the full spectrum of public and private sector basing their expectations on the *Seguridad Social* scheme. For example the national trade unions have in some years, 1993 included, negotiated directly with government regarding State pensions – they are regarded in some senses as part of employment terms and conditions, and rather less as a more detached social contract, entered into by government, on behalf of successive generations.

4.3.4 As already observed, the extent of coverage, and the obligatory cost of State retirement provision has impeded the growth of a corporate pensions sector. Such as does exist is limited in size and extent to the following areas:

(i) The banking and insurance sector (generally internally book-funded);

(ii) Utility companies – the electrity sector especially (again book-funded, by and large);

(iii) Individual provision by companies for high-earners – typically these may exist simply as a general promise, although recent audit regulations require that the cost of these be properly accounted for.

4.3.5 Appendix 5 gives an idea of the structure of a typical company scheme – it can be seen that the scheme is designed to sit on top of State provision and that its most extensive provision applies for higher-earners.

4.3.6 Prior to the 1987 law, there was no specific legislation regulating the funding of such schemes as then existed over and above State retirement provision. Effectively therefore, pre-funding was optional, as indeed was an actuarial assessment of the latent liability accruing on an employer's balance sheet. In practice however, actuaries played a role: but this was as consultants serving (in most cases) the employer and not, for example, performing statutory duties (such as the U.K.'s mandatory three-yearly valuation).

This lack of regulation gave rise to predictable difficulties: both the insufficiency of funding, and the danger that such funds as did exist were not properly isolated from the finances of the employer.

One such case, which received considerable publicity (only coming fully "to light" some five years after the introduction of the 1987 regulation), was that of *Telefónica*, the national telephone corporation. In the course of its incorporation into the 1987 *Planes de Pensiones* regime (see next section), a hefty deficit emerged as a result of the DGS insisting on realistic updated mortality tables and a more conservative valuation rate of interest. That the final remedial strategy imposes additional funding on *Telefónica* for a period in excess of 20 years, gives an indication of the shortfall which was found to exist, once conventional funding criteria were adopted.

4.4 *New Framework: Law 8/1987*

4.4.1 *Alternative Plan Structures*

The all-embracing intention of the 1987 reform (the details of which were actually promulgated in the subsequent Royal Decree 1307 of September 1988) can be seen from the three varieties of "Plan" which it created:

(i) *Sistema de Empleo* – this is recogniseable in the form of a conventional employer / employee scheme. The *promotor* of the plan is the employing company, while the *participes* (participants) are the employees (or subsequent beneficiaries, pensioners, etc.);

(ii) *Sistema Asociado* – this least utilised of the three varieties is aimed at groups of members not unified by a single employer, constituted under the auspices of a trade union or professional association, for example;

(iii) *Sistema Individual* – in this case the *promotor* will be a financial institution whose individual clients will enter as participants into the plan. The plan under *Sistema Individual* is constituted within the same common framework that applies to *Sistemas de Empleo* and *Asociados*. However the vast majority of the participants will regard their relationship with the financial institution as a straightforward one of account holder or policyholder, in the cases of banks or life companies, respectively.

Making the comparison with the U.K., it can be seen that this framework extends across the terrain covered by the separate threads of legislation which take in exempt-approved schemes (self-administered or insured), self-employed schemes and personal pensions. However it is also important to note that, at least as was legislated at the time (1987-1988), none of the *Planes de Pensiones* framework was imposed in a mandatory fashion. Not only could existing alternative individual insurance and bank products compete alongside *Planes de Pensiones Individuales*, but also in the area of employer-sponsored schemes the legislation offered a new regime to which schemes could subscribe, but the law did not require such schemes to do so.

Subsequent sections 4.5 and 4.6 discuss more of the detailed arrangements which have emerged in practice under *Planes* according to the *Sistemas de Empleo,* and to the *Sistemas Individuales*. However, firstly, we set out the important elements which are common across the distinct *sistemas* (including the *Asociado* variety which, on account of its rarity, we have elected not to discuss further).

4.4.2 *Tax Regime*

The tax regime offered within the *Planes de Pensiones* framework follows the following basic lines:

(i) contributions by participants (in individual plans, or as employees in an employee-sponsored scheme), subject to a maximum level, are allowed as deductions from income before income tax at the marginal rate;

(ii) employer contributions are not treated, for tax purposes, as income received in the hands of the employee, provided total employee and employer contributions are within the specified maximum;

(iii) funds enjoy gross roll-up while invested in the Plan;

(iv) pension and other benefits are taxed as regular income when they are received.

It was envisaged that this tax regime would be sufficient incentive for existing retirement savings "arrangements" to be drawn into the framework of the new law. The extent to which this did actually transpire is best left, once again, to sections 4.5 and 4.6.

4.4.3 *Statutory Requirements*

Other common principles which apply across the different *sistemas* of *Planes de*

Pensiones are:

(i) non-discrimination – equal access to a plan must be permitted;

(ii) accrued rights are rigorously defined and defended in all types of plan;

(iii) benefits may not be taken in any form prior to retirement, death, or disability;

(iv) benefits must be portable.

4.4.4 *Legal Framework*

The law clearly defines who carries out which different functions within a plan. Regarding these distinct functions, and before discussing specifically one or other type of plan, it is useful to set out the way a plan and the corresponding *fondo de pensiones* have to be constituted:

(i) *Plan de Pensiones* this forms the centre-piece and is built around its "rules" which define contributions and benefits, etc;

(ii) *Comisión de Control* a committee formed with representatives of the promoter, participants and beneficiaries which carries the primary responsibility for the operation of the plan;

majority control of the *Comisión de Control* must reside with the participants and beneficiaries;

(iii) *Fondo de Pensiones* the *Plan de Pensiones* is obliged to invest its funds in one or other *Fondo* constituted within the 1987 framework;

one *Fondo* may be dedicated to one particular *Plan*, or it could be the case that several different plans, e.g. small company schemes of limited resources, subscribe to the same *Fondo* (this creates no particular difficulty bearing in mind that the *fondo* is the investment vehicle, whereas it is the plan's rules which define individual entitlements, etc.)

technically a distinct *comisión de control* also exercises control of the *fondo* and there exist complex formulae to adjudicate this control function in the instances where more than one *plan* subscribes to the *fondo* – obviously this complexity doesn't exist in straightforward cases where one fondo is dedicated to one plan;

(iv) *Gestora* the fund manager role which will be occupied by a bank or life company in most instances;

in fact existing legislation requires banks to constitute the *gestora* as a legal entity separate from the bank, typically this is a wholly or partly-owned subsidiary – the same requirement for separation will be extended to those life companies which act as *gestoras*, if current draft laws are enacted;

(v) *Depositaria;* as the *gestora* may not retain legal title to the funds of the *fondo*, the *depositaria* fulfils the function of trustee/custodian of the assets of the fund – typically this function is carried out by a bank.

4.5 *Planes de Pensiones – Sistema Individual*

4.5.1 As was mentioned earlier an individual plan, from the plan-holder's perspective, will not be distinguishable from that of the conventional contractual arrangement between, say, life company and policyholder. However the *Plan de Pensiones* framework still applies. In fact the individual "policyholder" is a member of a plan, properly constituted with its own rules, and "promoted" by the life company (or other financial institution). There also exists the *Comisión de Control* which gives individual plan members legal representation in the running of the *Plan* (although in a typical case the *Comisión* will very rarely oppose the promoter's day-to-day management). The plan subscribes to a *Fondo*, whose *Gestora* will typically be the promoting financial institution or perhaps another associated company within the same financial group.

4.5.2 The legislation is extremely rigorous in terms of how the performance of the funds invested in the *Fondo* must be reflected in the accrued rights as defined under the *Plan*, this rigour applying equally to individual and to employer-sponsored plans. The practical result of this for individual plans is that the benefits must emerge dependent on a unit price which reflects the market value of the underlying funds at the particular moment in time. The consequence is a product perhaps most akin to a unit trust type vehicle. There is no scope for the promoting financial institution to make interest or benefit guarantees or to exercise its discretion in a way that would give more of the "flavour" of a traditional savings product (with an initial capital guarantee, or a profit-sharing mechanism, to give two possible examples).

4.5.3 The expense charges which the *gestora* and *depositaria* may levy on the *fondo* are also strictly limited with maxima of 2% and 0.6% respectively; these percentages essentially apply to the amount of funds under management.

In this aspect it is clearly the intention of the legislation to guarantee that the fiscal concessions of the *Plan de Pensiones* are passed on to the plan-holder rather than absorbed by the financial services "provider".

4.5.4 Obviously the expense structure which is permitted under *Planes de Pensiones* severely restricts the selling activities of life companies accustomed to paying for distribution via heavy front-end loadings on traditional retirement and savings products. This difficulty is compounded by the mandatory portability between plan providers – which renders uncertain the persistency rate which needs to be built into calculations if it is intended to offset higher front-end commissions against future fund charges. As a consequence of the restricted fund charges, and allied to the strength of bank-customer relationships, it has been the banks who have dominated the market for individual plans. The product is typically promoted year by year as a recurrent single-premium contribution. Sales promotions tend to emphasise the tax-saving on contributing to a *Plan de Pensiones*, almost to the detriment of the retirement-planning aspect.

4.5.5 In fact *Planes de Pensiones Individuales*, as sold through banks, will most likely be compared with a *Fondos de Inversión Mobiliaria* (FIM) the Spanish counterpart of the unit trust concept. For example the tax deductibility of the *Plan* would be set off against the greater liquidity offered under a FIM arrangement. Frequently the FIM will fare better in this comparison and *Planes de Pensiones* tend to find more favour with high-earners who may have already exhausted other avenues to minimise their taxable income, and who are also more attracted by the deferment of income to the post-retirement phase when lower marginal rates of tax can be expected to apply.

4.5.6 A saver in a lower-income bracket is more likely to be deterred from taking up a *Plan de Pensiones* by the lack of liquidity of his funds (recalling the general requirement that plan benefits cannot be taken prior to retirement). Also such a saver is likely to place less importance upon deferment of income for tax purposes. Indeed in certain cases it can be demonstrated that a traditional retirement endowment has the edge over a *Plan de Pensiones*: although contributions are not tax deductible, the tax-free receipt of the endowment's capital sum can outweigh the initial disadvantage.

4.6 *Planes de Pensiones – Sistema de Empleo*

4.6.1 The *Planes de Pensiones* framework also embraces both the concepts of *prestación definida* (defined benefit) and *aportación definida* (money-purchase) and it is only once the discussion turns to employer-sponsored plans that the former starts to assume some importance (obviously in individual plans there is no promoter who will assume the longer-term guarantees which defined-benefits imply).

4.6.2 In a typical *empleo* plan the scheme of benefits will be set out in the "rules" which apply to the particular *Plan de Pensiones* of the group of employees in the company / group of companies. It will be these rules which define the plan as defined benefit or money-purchase, or in the third category provided for in the legislation – *Planes Mixtos* where the benefits may combine elements of defined benefits and money-purchase.

4.6.3 Again the plan is governed by its *Comisión de Control*, and the requirement for majority control by the participants implies, in practical terms, majority control by employees (possibly co-ordinated through trade union representatives), leaving minority representation for the employer. Therefore there is majority employee control over the choice of *Fondo* to which the *Plan* will subscribe; similarly the employee-body can appoint or dismiss the actuary to the *Plan* and hence may influence the pace of funding (relevant in the case of defined benefits).

4.6.4 The *Fondo* to which a *Sistema de Empleo* plan subscribes is constituted in the same fashion as for *Planes Individuales* – again there will be a financial institution performing the function of *Gestora* of the *Fondo*, while another institution serves as *Depositaria*. Several plans may subscribe to one *Fondo*. But in the case of the plan of a large number of employees it is more likely that there will be a *Fondo* dedicated to he investment of that one plan alone.

4.6.5 In the case of individual plans the non-discrimination clauses of the *Plan de Pensiones* legislation have little practical significance – they simply state that any individual client who shows willingness to join must be permitted to do so. Non-discrimination assumes much greater importance for employers' plans however. The legislation requires eligibility for all employees with two years' service, and details how and when employees may exercise their right of entry in the different instances of defined benefit or money-purchase schemes. The legislation specifies that a plan may vary the emerging benefit using factors such as age, salary, service, contributions, etc. – and by its absence from this list, it is not permissible for a plan to vary eligibility or benefits between particular individuals or on the basis of status, e.g. between manual workers, staff, management, etc.

4.6.6 There is a general requirement under the 1987 legislation for any *Plan* (group or individual, money-purchase or defined benefits) to have in place an adequate system of "actuarial funding". This is relatively easy to satisfy in individual plans, or group plans of the money-purchase style, where benefits equate directly to the plan contributions rolled-up according to the investment returns of the *Fondo*. (The calculation of these investment returns is also strictly regulated in the law.)

It is in the case of group defined benefit schemes that the requirement for proper actuarial funding has had greater significance. The 1987 law was the first in Spain to put weight behind the role of the actuary in a pension scheme. Prior to 1987 the actuary's role would more typically be as advisor to the employer / company although the actuary may be involved to a limited extent in the application of external audit principles relating to "true and fair" costs of accumulating pension commitments.

4.6.7 In fact, having required an actuary to make valuations, the 1987 legislation does not itself proceed to dictate the bases which he should use. It does however insist on a proper evaluation of the demographic and financial variables. This has subsequently been given greater precision by Ministerial Order – requiring, for instance, a maximum interest rate of 6% and mortality tables based on data since 1970. What this means in practice, allowing for the rights invested in the DGS to inspect and intervene in the affairs of a *Plan de Pensiones*, can be seen from the case of *Telefónica*, to which reference has already been made in 4.3.6, in which the "reflotation" plan involved significant revisions to the actuarial bases used hitherto.

4.7 *The reasons why fewer Plans under the Sistema de Empleo have been set up than expected*

4.7.1 The statistics show some fairly large funds under management under the 1987 *Planes de Pensiones* regime for employers' schemes. Most of these however are funds of public or semi-public companies whose pension schemes and funds might already have been said to have been controlled in the "public domain". In contrast, few private employers have elected to subscribe existing pension commitments (be they well defined, or existing on relatively informal bases) to the 1987 framework of *Planes de Pensiones*. Likewise the new framework has by and large failed to persuade employers to promote new pension schemes for their workforces.

4.7.2 The reasons for this marked reluctance, setting apart cultural considerations, high provision and costs under State social security, etc., may be surmised to emanate from particular aspects of the 1987 law, as seen particularly from the employer's standpoint:

(i) Although subscribing under *Planes de Pensiones* carries with it tax breaks for employer as well as employee (the latter can enjoy the employer's contribution without it being taxed as a benefit in kind) the appeal of this is limited if hitherto pension commitments have been made without excessive rigour in relation to advance funding, etc.

(ii) It needs to be stressed that if the *Plan de Pensiones* route is not chosen, an employer can continue to opt for some method of internal funding. This carries with it its own obligations. In particular the new accountancy regulations introduced in the *1990 Plan General de Contabilidad* put much greater stress on the external audit requirement that the cost of accruing pension commitments be adequately represented in a company's accounts; this is a general principle and the external auditor will not concern himself greatly with the distinction between a scheme which is, or is not, constituted as a *Plan de Pensiones*.

(iii) Most private companies appear to have baulked at conceding investment and actuarial control to the *Comisión de Control* of a *Plan de Pensiones*. On the investment front, the fear being that the employer might subsequently be "obliged" to compensate employees for the failure of an investment strategy which he, the employer, had not had the means of preventing or correcting. In the case of a money-purchase scheme such "obligation" would be basically a "moral" one although he could take the view that the employees should bear the consequences of "their own" investment management. However in the case of a defined benefits scheme, the employer would necessarily have to make good a shortfall in funds, if the promised scheme benefits were to be sustained.

(iv) Employee control of the designation of a plan's actuary also carries with it difficulties for the employer who will see dangers if the actuary accelerates, to an unnecessary extent, the pace of funding of benefits, without taking account of the interests of the employer, who may be prime "pay-master" of the prospective plan.

(v) The non-discrimination aspects of the 1987 framework also restrict the employer's flexibility to maintain the pension scheme best suited to the company's broader objectives in the areas of personnel, remuneration, incentives, etc.

4.8 *Recent and Current Developments*

4.8.1 The consequence of the widespread abstention from subscribing their companies' pension arrangements to the 1987 framework on the part of private employers, has been that most continue with schemes without "externalised" funds: i.e. funds legally set apart from the company's normal commercial activities and its own financial resources. Similarly these pension schemes continue to be beyond the reach of the stricter demands for proper actuarial assessment of the funds necessary, and beyond the regulatory / inspection regime of the DGS.

4.8.2 It is clear that in this sense the coverage of the 1987 legislation has disappointed the regulators. Many signals in the interim have indicated the intentions of the authorities to act in this area: none has been clearer than the revisions which had almost completed their parliamentary passage when interrupted by the June 1993 parliamentary elections. Basically the revision, had it reached the statute book, would have insisted that pensions commitments be backed by external funds. The two routes permitted for such external funds would have been either the familiar one of 1987-style *Plan de Pensiones* or an insurance contract alternative.

4.8.3 The details of the insurance contract alternative would have been set out in regulations subsequent to the approval of the text of the 1993 law revision, but these never emerged due to the intervention of the elections. However, it seems reasonable to speculate that either the insurance option would only have been made available in very limited circumstances, or that it would have been accompanied by requirements for actuarial adequacy, and external funding, on a par with such requirements as already apply for *Planes de Pensiones.*

4.8.4 It remains contentious at the time of writing, whether the aspects of employee control and non-discrimination ought to be relaxed – either by revising the *Plan de Pensiones* legislation per se, or by making available a more flexible insurance alternative. Perhaps the latter is more likely, if only because of the vested interests already established within the *Planes de Pensiones* already constituted. In fact, at the time of the 1993 elections, some commentators suggested that a coalition or minority government might resuscitate the pension law revision for it rapidly to complete its passage onto the statute book, in order to permit a more flexible "insurance" option.

4.8.5 However this risks overstating how near to a "new dawn" the pensions sector was, or now is. Indeed there are many commentators who remain very pessimistic and see the very reasonable pursuit of external funding, and the like, inextricably tied into the *Plan de Pensiones* framework. The employee-control element may amount to an insurmountable hurdle for many employers – as a consequence of this some gloomily predict that moves to externalise funds may only serve to increase employers' reluctance to promote pension arrangements for their staff, and lead to the closure of a sizeable proportion of the few schemes which do exist

As this paper goes to print, the first draft of another round of legislation emerges, and the consultation process has commenced. If there is one certainty amidst all the conflicting interest groups, and amidst the sector's own lobbying, it is that there remain several chapters before the last word is written on Spanish retirement provision. This is a task the authors leave to others to complete.

5. THE ACTUARY IN SPAIN

5.1 *Origins of the Profession*

5.1.1 The *Instituto de Actuarios Españoles* was founded in 1943 in Madrid. However the origins of the profession in Spain can be traced at least as far back as 1866 when a Spanish mortality table was presented at the *Academia de Ciencias Exactas de Madrid*. (To set the background – the Faculty in Scotland was founded in 1856 and incorporated by Royal Charter in 1868; the corresponding dates for the Institute of Actuaries (London) are 1848 and 1884).

5.1.2 The nature of actuarial activity towards the end of the 19th Century can be deduced from the publications of the period. It can be seen that this first generation of "untitled" actuaries were occupied primarily with life insurance, but also participated in the development of demographic statistics, and contributed to the debate then unfolding in relation to labour law, social provision, etc. (which was discussed in Section 4). Also in this early phase can be seen the parallel development of the financial nuclei in Madrid, Barcelona and Bilbao.

5.1.3 1908 represents a landmark year for the development of the profession, as the State started to install regulatory mechanisms (see 2.3) for the emergent insurance private sector (whose growth was being accelerated by the arrival of foreign companies, principally Italian, French and German). However, in reference to the profession, this first round of legislation only went so far as to propose that the regulator assume responsibility for the organisation of *la enseñanza técnica de Seguro en España* (technical teaching/instruction of insurance in Spain).

More specific reference was made to "the actuary" in the statutes which founded, again in that same year 1908, the *Instituto Nacional de Previsión*, a public body dedicated to providing whole life, endowments and term assurances to "the working classes" (translating literally). This required that tariffs be calculated by an *Actuario de Seguros* ".... with a domestic or foreign professional qualification". With no domestic professional qualification in existence at that time, the first actuary to perform the designated role in the *Instituto Nacional de Previsión* was, in fact, a Belgian actuary, Dr. Lefranq.

By 1912 the regulations to facilitate the task of the regulator of the private sector had also become more specific. An actuary, or equivalent, was required to certify that reserves had been calculated in accordance with the legal prescriptions. Furthermore it was intended that the Inspectorate should avail itself, as soon as possible, of the services of a qualified actuary.

5.1.4 Given these advances subsequent progress appears slow, through until the foundation of the *Instituto* in 1943. However the civil and military turmoil of the period needs to be borne in mind. In fact some progress was made prior to the Civil War – with the foundation of actuarial studies in the curriculum of the Madrid "College of Commerce"; and with attempts to give greater actuarial emphasis in the entry qualifications for those discharging duties within the Insurance Inspectorate. Also the *Asociación Actuarial Matemática de España* had been founded in 1927, and was subsequently integrated into the *Instituto* on its foundation in 1943.

5.2 *The Profession Today*

5.2.1 It is unnecessary to catalogue the details subsequent to the *Instituto's* foundation in 1943. However it is important to understand the closer statutory links which can be seen to exist between State and profession. These need to be contrasted against the constitutions of the Faculty and Institute which are essentially private bodies, albeit incorporated by Royal Charters. For example, in Spain, State decrees during the 1950s gave legal title to actuaries, while the structure of the *Instituto* was given definition by Ministerial Order of the Finance ministry.

5.2.2 Admission to full membership of the *Instituto* is dependant on having gained a university degree in the actuarial discipline. Any such graduate may become a member, but not all do so – typically if a graduate subsequently pursues his career in some other sector, he will not need to incur the professional fees, etc. Therefore, although professional training in Spain is exclusively the domain of the universities, there is still a difference between actuarial graduates, and titled actuaries; the latter forming a sub-set of the former group.

Three universities offer the actuarial discipline – Complutense of Madrid, Autonoma of Barcelona, and the University of Bilbao, echoing the theme of the three dominant financial centres. The actuarial course is offered by the Economics Faculties. The curriculum in the first three years of study is that of Economics, with the emphasis varying between more "general" Economics studies, or more corporate material: company accounting, business economics, etc. It is in the fourth and fifth year that the student elects to take the actuarial speciality. The student has then emerged, up until very recently, with the degree in Economics (General or Corporate) with the secondary "title" of "actuary". However this process has now been rationalised and the intention is that any future graduate will assume one of three alternative degrees: General Economics, Corporate Economics, or Financial and Actuarial Sciences.

5.2.3 There is consistency in the curriculi of the three different universities as a consequence of statute – the relevant "study plans" being set out in directives which have the force of Royal Decrees. Subjects included in the fourth and fifth years are:

(i) Business Economics – investment and finance, sales, personnel and planning and management;

(ii) Actuarial – actuarial mathematics, actuarial statistics, mathematics of finance, principles of insurance, insurance contracts, insurance law, bases of Social Security, organisation of Social Security, and banking and stock exchange law.

5.2.4 It can be seen that in some respects the syllabus is more broadly based than the U.K. equivalent. In a comparison with the U.K.: – absent is pensions material, but this corresponds to the state of development of the pensions sector (although a qualified actuary could be called upon to undertake statutory duties under *Planes de Pensiones* legislation). Also, as may well be inevitable in the university context (of a first degree), the practical issues of insurance and pensions management are not explored in such great depth.

5.3 *Activities*

5.3.1 Currently the total output from the three universities amounts to some 225 graduates under the actuarial discipline, although this number is almost double that of four years ago. Of these an average of 70-80% have proceeded to full practising membership of the *Instituto,* whose total membership at the end of 1993 was around 1,500.

Very approximately this membership can be broken down into the different sectors:

insurance, and other finance, banking, etc.	40%
consulting practice	10%
government service	3%
other	47%

where "other" is made up largely of members not actively engaged in actuarial work.

5.3.2 As in the U.K., the insurance sector dominates numerically, wherein actuaries perform a range of roles, although it is probably true to say that they are, on the whole, more focused towards strictly actuarial tasks than may be the case with their U.K. counterparts. As was seen in Section 2, in an insurance company the statutory duties extend to an actuary certifying the correct calculation of reserves, and to "sealing" *notas técnicas*, prior to their submission to the DGS in cases of new products or product revisions.

5.3.3 Also in the same Section it was seen that the equivalent of the *Appointed Actuary* role does not exist in Spain – it is the Board of Directors of an insurer which bears the responsibility for adequacy, matching, etc., of assets against liabilities. However, the Spanish actuary bears a more explicit legal/statutory responsibility in the pricing process. It would be an error to suppose that in practice the role of the company actuary is any less important than in the U.K.

Consulting practice is mainly active in employee benefits and insurance brokerage areas, with practices varying from single actuaries with their own practice, to the familiar multinational names (probably there is a presence of all the large accountants, actuarial consultancies, and broker houses, whose name would be readily recognisable in the U.K.).

5.3.4 Some actuaries are involved in life and general insurance consultancy, but this type of consulting is in the early stages of its development.

Government service includes actuaries working in the service of the DGS, as well as wider areas of the finance ministry, social security, etc.

5.3.5 The *Instituto de Actuarios Españoles'* own professional activities are not dissimilar to those of either the Faculty or the Institute, concerning not only the fostering of actuaries' own professional interests, but also consideration of the wider implications for the insurance or pensions sector, for example, of legislation being proposed and drafted, or of specific initiatives from the various authorities.

Spain's very pro-European stance at a national level is also reflected in the *Instituto* which maintains full links with the Groupe Consultatif, and the International Actuarial Association (the latter is a relation of long-standing with a Spanish deputation participating in the 1927 London Congress under the auspices of the precursor of the *Instituto*, the *Asociación Actuarial Matemática de España*).

5.3.6 With the junior ranks of actuaries swollen by the impressive number of graduates emerging from the universities in recent years, the Spanish actuarial profession presents a young age profile, well-equipped to face the challenges which await it.

6. ENTRY OF U.K. COMPANIES

Discussing specific commercial operations is not the norm in a Faculty paper. However it seems inappropriate to cover in depth theoretical topics, without making some commentary on the very operations which have generated, over the last five to ten years, the U.K.'s interest in Spain. We have received very generous external help in compiling this part of the paper and have consulted widely whilst writing the paper. We hope to give a reasonable sketch of current British participation in the Spanish life sector.

6.1 *Diversity of Operations*

Table 2 sets out the various life insurance operations in Spain which have partial or total links with U.K.-based companies. The table includes total life premium income in 1992 (extracted from the official DGS publication of *cuentas y balances*). To put the U.K. operations in their proper context, the equivalent statistic for the biggest Spanish life operation in 1992 was 105,855 million Ptas and for the life company ranked 10th its was 22,049 million Ptas. It can be seen that none of the U.K. operations approach these magnitudes – the largest is Plus Ultra – which is ranked around 20th in

Table 2

Spanish Operation	U.K. linkage	Life Premium income (1992) M Ptas	Year of Start of U.K. involvement
British Life	Scottish Provident	443	1990
CU Vida	Commercial Union	4,318	1985
Dunbar Vida y Pensiones	Allied Dunbar	350	1989
Eagle Star Vida	Eagle Star	3,329	1987
Kairos Vida	Friends Provident	62	1990
Plus Ultra	Norwich Union Group	8,918	1990
Previasa Vida	Scottish Widows	1,197	1990
Prosperity	Standard Life	936	1993
Royal Life	Royal Insurance	1,651	—
Sun Alliance	Sun Alliance	1,024	—

terms of life premium income. Most of the U.K. operations are in the long "tail" of small Spanish insurers who, in aggregate, constitute a small percentage of a market-place dominated by big-players. However this is hardly surprising given most of the U.K. entrants are very recent start-ups.

It is harder to designate a precise "year of entry" in the case of some of the Composites and we have not done so in the cases of Royal and Sun Alliance. Brief resumés of each operation are reproduced in Appendix 6. Towards the end of 1993 the merger of the operations of Eagle Star Vida and Dunbar Vida & Pensiones was announced, with the combined operation continuing under the Eagle Star flag. Kairos Vida has also undergone a restructuring process as detailed in Appendix 6.

From an examination of the above table and of Appendix 6, it is clear that in size, and above all in style, there is a great diversity between the U.K. participants. However one possible categorisation, between the Composites and the Mutuals seems worthy of comment, without wanting to propose this as a unique means of polarising two "camps".

6.2 *U.K. Composite Insurers*

These deserve first mention, having been active for longest, typically starting with a small Spanish branch operation underwriting and administering general rather than life business. Several have, in recent years, then followed the trend towards constituting a distinct life business, which is then incorporated as a distinct cost centre and profit-generator, in many cases within a very diversified global business (within and outwith Europe).

Pursuit of profits is the obvious motivator behind these new life businesses, and in several instances they are able to build on the multi-national name-awareness which their U.K. parent group already has in Spain.

6.3 *U.K. Mutuals*

The U.K. mutuals have a remarkable presence in Spain, and profits remain paramount as the motive: there has been no attempt to trade in Spain within the mutual principle. However their operations have some different characteristics to those of the Composites. In general there can be identified amongst the mutuals (the authors believe) a desire to gain one or several footholds within the 12 countries of the European Union. To a degree this is a defensive measure – against the prospect of being marginalised in a Single Market dominated by fewer pan-European insurance groups. The mutuals therefore seem to have a more European focus than the Composites – they already have, and will consider more readily, ventures outside the European Union.

A common theme in the late 1980s, was the identification of the Mediterranean countries as having greatest growth potential, as well as being more open to setting-up new operations. Certainly some of the mutuals targeted Portugal, Spain, Italy and Greece, ahead of more problematical entries to, for example, French or German markets. That said however the realisation of these strategies in Spain have taken different forms including joint ventures, outright acquisitions, and as part of more complex restructurings. Extending the discussion beyond U.K. mutuals, it can be noted that three of the operations in the Table 2 would have been regarded as straightforward "green-field" start-ups in their day; however none of these three enter into 1994 maintaining precisely their original course, under their original ownership.

6.4 *Extent of U.K. Influence and Involvement*

We examine below U.K. influence and involvement in areas such as personnel, contract design, I.T. and cross-border selling.

6.4.1 *Personnel*

While not quite a golden rule that there must be a representative on site, the examples are few of U.K. operations which are being managed over long stretches with the only U.K. personnel input coming at Board level. In most instances there are some expatriates working alongside a predominantly Spanish domestic management. The position taken by the expatriate varies considerably – from technicians and middle managers – right through to executive chairmen.

In general the expatriate role seems to be the importation of know-how: moulding the actuarial function to the liking of the parent – this is a particularly interesting example for the purposes of this paper. There seems to be a tendency for the expatriate role to concentrate on financial, technical, administrative and control aspects. The expatriate role in sales and marketing is less common, but there has been at least one operation which has made a very conscious decision to import sales "know-how".

In fact the extent of the expatriate role in insurance is not unlike that found in other industry sectors. There can be identified what might be called a natural equilibrium – resultant from companies' balancing the additional costs of expatriates, against the benefits that it is hoped their input will bring.

Where the balance is struck varies over time, with different priorities during launch, or subsequent strategic switches. Besides resident expatriate input, short-term assistance, contracted-out from the U.K. parent to its Spanish off-shoot, also takes place. This is a useful way for the Spanish operation to benefit from the weight of its parent. "Consultancy" support such as this is limited however, by the language barrier, which tends to restrict this type of input more to technical areas.

6.4.2 *Innovations – Contract Designs, Style and Presentation*

6.4.2.1 Earlier in the paper the perceived lack of sophistication of the Spanish market was discussed. Against that setting it is reasonable that U.K. entrants have tended to see opportunities for promoting themselves with imported innovations. The list might feature unitising, investment-linking and investment fund choice, and greater transparency. However this is by no means the norm, and indeed much of the current sales of the U.K. operations, if they are viewed in aggregate, are of contracts very little distinguishable from the contracts of domestic Spanish companies. This may be viewed with some dismay by the U.K. patriot; on the other hand the typical Spanish with-profit endowment remains a very profitable animal (as seen in 3.6), and therefore seems not to be a species threatened with extinction, just yet.

6.4.2.2 Perhaps the important question to ask of the U.K. operations is whether they will be better-equipped to meet the new challenges if and when the pre-eminence of traditional contracts is threatened. Threatened, possibly by an increasing consumer "lobby" awareness, possibly by availability of products of foreign origin – perhaps indeed from the U.K. operations themselves.

6.4.2.3 One impressive "pioneering" activity which can be identified is unit-linking; here two or three U.K. operations are offering a concept still little known, perhaps frightening even, to the Spanish market. As yet it is probably too early to say whether this will take root the way that it did in the U.K. in the 70s. Spanish companies are presumably watching carefully to see whether these innovations start to gain significant market share. Meanwhile the "pioneers" proceed cautiously, particularly conscious that earlier unit-linked products failed to gain a foothold in Spain in the 70s, due in large part to poor investment performance.

The general detractions of unit-linking are very familiar – with the transfer of investment risk from insurer to policyholder. It is probably true to say that, in light of the past behaviour of the Peseta and of the Spanish Stock Exchange, Spanish private investors are more risk averse, and have a greater fear of non-guaranteed investments, than their U.K. counterparts.

However the unit-linked offices believe they can sell the product, and their favouring the unit-linked approach may set them ahead of the competition, if, as seems increasingly possible, the traditional offices have to take a hard look at the interest rate guarantees within their contracts.

6.4.2.4 Foreign investment expertise looks like another commodity with which the U.K. operations could gain a competitive advantage – and this may of course be applied to more than specific unit-linking innovations. Funds need to be invested in all varieties of contracts, from traditional with profits contracts, across the full spectrum to the most modern *Plan de Pensiones*. Nearly all this money currently goes into the bond market. There is clearly an opening for the operator (U.K. or otherwise) who wants to make a commitment to equities. However the consequences, and the costs, of making this commitment at the wrong time are clear. Even the unit-linked funds which do exist, have tended to keep investments at the short end of the bond market to avoid the falls in fund value that the Spanish market would find hard to accept.

6.4.2.5 In the pensions sphere, more so than in any other, there might have been expected to be the greatest importation of concepts and techniques from the highly developed U.K. sector. Indeed more than one operation can be seen to have entered Spain expressing grand ambitions for pensions – ambitions which have proved harder to realise within the rigid regulations which frustrate the re-use of U.K. designs.

6.4.2.6 It is too early to say who will be successful with what innovation – but clearly U.K. operations may be offered significant openings. A few years of bull market would clearly boost the arguments for unit-linking and more sophisticated fund management. Another opportunity may be the evolution of a less rigid pensions sector, enhanced by the seemingly inevitable reforms of State provision.

Overriding everything seems to be the need for the U.K. operation to have patience and not demand short-term dividends from its innovative investments; there have already been some false dawns, particularly in the pensions sphere – no doubt there will be more.

6.4.3 *Information Technology*

There seems to have been little "technology" transfer, from the U.K. to Spain, in the specific sphere of I.T. and it is worth analysing why. It would seem obvious on a first analysis that the U.K. parent would be looking to maximise the use of its existing "plant" – viz. its existing central processing hardware, its data networks and its accumulated investment in programming-software. Moreover modern telecommunication facilities seem to eliminate any geographical constraint: a terminal in Valencia plugged into a mainframe in Edinburgh is not very different to a terminal in Cardiff plugged into that same Edinburgh mainframe (although the screen in Valencia will have to be in Spanish).

However, despite this apparent logic, the authors do not think that any of the U.K. direct-insurer operations act, for I.T. purposes, as out-stations on-line to the U.K. (although this is the case in at least one reinsurance office). The greatest extent of "plant"-sharing is re-use of policy administration software – but this, inevitably, is limited to the situation where the U.K. operation has a strategy heavily slanted towards use of their U.K. contract styles. Where Spanish contract design is pre-dominant it becomes clear that a large proportion of the U.K. parent's administration software cannot be used without significant modification. This modification may be more expensive than starting afresh, especially bearing in mind that in the typical case it will be modification of the parent's complex major system, or suite of systems, designed for very high volumes. The Spanish off-shoot will be looking for something more straightforward, and designed with lower volumes in mind. In any event, several of the U.K. operations inherited existing administration systems in the course of acquiring a Spanish outfit, and in these cases the economic argument for absorption into a U.K. mainframe is probably even less convincing.

6.4.4 *Cross-border Selling*

There is, to date, only limited evidence of U.K.-Spanish link-ups where the Spanish operation is being used as a conduit to sell products originating outside Spain – but which instead have been written from the U.K. itself, or from an offshore centre. However it may be as yet too early to judge how much activity of this sort will evolve – bearing in mind that the Third Life Directive has not yet entered into force.

Undertakings for collective investment in transferable securities (UCITS) is the product which has been sold cross-borders for the longest time and there is at least one instance where this route has been used by a U.K.-Spanish pairing to sell into Spain (there are also several Luxembourg-based *société d'investissement* *à capital variable* (SICAVS) which are being promoted into Spain). Clearly the opportunities will start to open up for U.K. players seeking to operate European Union wide, but without such encumbrances as domestic bases in Spain or any other Member State.

Paradoxically, cross-border selling may be less attractive for the U.K. player who has a Spanish operation already in place. Indeed it seems logical to use a domestic Spanish operation to sell routine domestic Spanish products in the straightforward local fiscal regime. Cross-border selling need not be ruled out entirely, but in the next few years seems likely only to add some elite products to the mainstream product range.

6.5 *Integrated Operations*

6.5.1 Discussion of I.T. integration and cross-border operations, leads conveniently into consideration of the extent to which Spanish operations are integrated in a more general sense. At one extreme a U.K. parent can regard its operation as simply a tradeable investment holding – there has been the case of a Spanish operation changing hands in this way; clearly the seller had adopted this approach. At the other extreme, the parent may manage its Spanish operation alongside several other U.K. initiatives and several other domestic divisions as an integral part of its global business (and consequently may regard as almost immaterial the separate legal constitution of the Spanish company).

6.5.2 In reality, the level of support and control from most U.K. parents far exceeds that of a passive investor. Including even the two instances of joint ventures, it is clear that such holdings are not retained according to pure investment criteria – indeed they would probably be regarded as representing insufficient spread in fairly risky start-up situations. As investments, it seems likely that initiatives in Spain are considered as strategic investments: in the same way that the U.K. management will consider such things as investing in the launch of a significant new product range, or expanding its activity in a specific U.K. sales-channel.

6.5.3 However total integration of Spanish into U.K. business seems to remain a long way off – without exception every U.K. operation has a full executive management team "on site" in Spain, formulating the direction which the Spanish operation is taking. The extent of the national differences in all aspects: regulation, fiscal regime, contracts, distribution channels, etc., in their totality make it difficult to imagine that a centralised "Euro-"management could be effective. It is easy to comprehend the need to delegate significant powers to the local management. The typical model is probably that the parent sets criteria regarding availability of capital and the return required on that capital. The means of achieving these objectives are left in the hands of the local executive (typically some combination of Spanish and expatriate managers).

6.5.4 Longer-term, at least for U.K. parents whose goal is to integrate their components towards a pan-European business, the metamorphosis will be a difficult process. However as European convergence eliminates, step by step, national differences (in our context between Spain and the U.K.), so it should be possible to bring the businesses – contracts, systems, managements – closer together. The planning of such convergence is very fraught. While reasonably clear timetables exist for some aspects of the Single Market for financial services, the same cannot be said in the realms of eliminating fiscal variations, or of the uncertain progress towards the proposed single currency. In these more problematical areas, the "if" as well as the "when" has to be considered.

6.6 *Outlook for U.K. Companies in Spain*

The appropriate question is probably to ask whether U.K. entrants have started to realise the ambitions with which they entered Spain? In general they probably have, but they have clearly embarked on a long, hard road – which has been made no easier by Spain's sharp economic down-turn, compounded, for example, by such things as the deferment of effective enabling legislation for the pensions market. These variables perhaps have a greater destabilising effect for what are operations still in their infancy.

That the going has got tough is witnessed by the fall off in entries from the U.K. – we may count six between 1987 and 1990, but this compares with only one – Standard Life's entry with the purchase of Prosperity – in the three years up to the present.

Not unlike the U.K., the Spanish market has no shortage of small and medium sized companies who recognise the need for significant increases in volume to reach the critical mass needed to support fixed costs and secure the profitability necessary for survival. The Spanish market itself is unlikely to generate the necessary growth (even on the optimistic assumptions of the late 1980s). Inevitably there will be a battle for market share – numerically there seems set to be more entities losing, rather than winning, with a few large groups emerging plus some niche-players.

The majority of the U.K. players will be in the midst of this market-share battle: for them to triumph will require a combination of very able management, exploitation of their special U.K. attributes, strong and patient support from their parent ... and not a little luck, perhaps.

7. CONCLUSION

7.1 It would be absurd to make generalisations across the different spheres we have touched upon for the sake of arriving at a "conclusion on Spain". In any event we have tended to set out our expectations in each particular section. It is not easy to find the common thread that weaves this paper into a whole, but perhaps such a pursuit is doomed to fail from the start anyway. Indeed a U.K. practitioner would probably baulk at the idea of covering the entire U.K. actuarial field in a single essay.

7.2 However the relatively short timescales are a common feature – the "younger" profile of the *Instituto de Actuarios* gives a first example. Similarly we have seen that the structures within which insurers and pension schemes operate are of recent vintage. This is particularly so with pensions where the legislators have had an opportunity (an enviable one from the U.K. stand-point) to introduce a broad and ambitious regime, without being burdened by the historical "baggage" of older structures.

7.3 Our preceding sections have been predominantly factual. But it would not do justice to the title "An Outsider's View From Within" if we were not to make at least passing comment on the cultural gap which also has to be bridged. This is an area of great subtlety and perhaps so long as one remains an outsider it is an area which can never be fully understood. Nor is it something that can be set down in a concise manner in a written paper.

We limit ourselves to the observation that an incomer needs to realise that even the fullest grasp of the factual data will be inadequate if not backed-up by an understanding and acceptance of the way in which political, private or commercial elements inter-play with day-to-day business activities. New entrants need to merge the better parts of their experience gained before coming to Spain with more flexible Spanish methods so as to arrive at their "best business practice" for Spain. This then needs to be set in the context of a sector in a very dynamic phase where more extensive financial controls and the demand for greater transparency are coinciding with the pressures of adapting to a more open market. The implication of this for all practitioners alike, "outsiders" or not, is that what constitutes "best business practice" is inevitably undergoing significant and rapid change.

For the entrant who can adapt to the different climate, Spain still represents an exciting prospect. However there should be no illusions that the undeniable potential will be easy to unlock in any one or other venture.

7.4 On a personal note, the authors find Spain an exciting place to live and to work; after two years there remains much for us both still to learn. Spain certainly merits serious consideration for companies looking for a new market opportunity, and we would commend it to anybody who has the chance to become involved.

ACKNOWLEDGEMENTS

The opinions expressed in the paper are those of the authors who accept responsibility for any errors in the text.

We firstly thank all those who helped in the compilation of Appendix 6. It is not possible to list in full all those many people who have helped us, both directly and indirectly, in writing all the other sections. However we would like to mention: George Andrew, Ignacio del Barco, Rosa Ana Corella, Howard Froggatt, Pablo García García, Henry Karsten, Laurence Kleerekoper, José Luis Maestro Martínez, Alan Maxwell, John O'Neill, Irene Paterson, Ignacio Perea, Carlos de la Peña, Manuel Peraita, Vicente Pérez Jaime, Isabel Saiz Caballo, Marta Sarabia Montes, Félix Soroa Herrero.

We close with thanks to Margarita Llorente without whose efforts neither of the authors would have been able to read the source material.

APPENDIX 1

CHRONOLOGY 1868 - 1993

1868	The September Revolution - overthrow of monarchy of Queen Isabel II.
1873	First (Federal) Republic.
1874	Restoration of Borbón monarchy in King Alfonso XII.
1875 - 1898	Era of the *Turno Pacífico*: alternation of Liberal Conservative and Liberal parties by electoral management.
1898	Loss of last colonies (Cuba, Philippines and Puerto Rico).
1898 - 1923	Decay of Two-Party System.
1923	Overthrow of parliamentary system. Dictatorship of General Primo De Rivera.
1931	King Alfonso XIII leaves Spain. Second Republic.
1936 - 1939	Civil War.
1936	Army rising initially in Morocco, then spreading to mainland. Arrival of International Brigades.
1937	Guernica bombed. Fall of Bilbao.
1938	Nationalists succeed in dividing Republican zone.
1939	April surrender of Republican armies.
1939 - 1975	Era of Franco.
1953	Concordat signed with Vatican. Agreement on U.S. bases.
1969	Franco nominates Juan Carlos (grandson of Alfonso XIII), as his successor.
1974	Democratic coalition formed as Franco is taken seriously ill.
1975	Death of Franco. Coronation of Juan Carlos I.
1976	Democracy re-established.
1978	New Constitution including degrees of autonomy for regions (especially Catalonia and Basque Country).
1981	Failed coup attempt by Colonel Tejero.
1982	First of three successive outright election victories for Socialist Party of Felipe González (1982, 1986, 1989).
1984	Membership of NATO.
1986	Membership of European Community.
1993	Fourth election victory for Socialist Party but without overall majority.

APPENDIX 2

ECONOMIC STATISTICS

Table 3 shows the relative dimensions of Spain in the World Community. Economically Spain enjoyed rapid growth during the 1980s placing it just outside the "G7" group of the largest economic units.

Table 3

	Population (millions) 1990	**1990 G.D.P. U.S. Dollars 000,000,000**
Spain	39	429
U.K.	57	924
Germany	77	1,411
France	56	1,100
USA	251	5,446
Japan	124	3,140

Table 4 shows the high rates of inflation in Spain during the transitional period after Franco's death, and also more recently the degree of success which there has been in tackling at least some of the economic fundamentals which have lead to Spain experiencing on average higher inflation than its important European neighbours. Table 5 shows how Spain compares to the other Member States of the European Union.

Table 4

Year	**Retail Price Index**	**Year**	**Retail Price Index**
1974	18.1%	1984	9.0%
1975	14.2%	1985	8.2%
1976	19.7%	1986	8.3%
1977	26.3%	1987	4.6%
1978	16.5%	1988	5.9%
1979	15.6%	1989	6.9%
1980	15.3%	1990	6.5%
1981	14.4%	1991	5.5%
1982	14.0%	1992	5.4%
1983	12.2%	1993	4.9%

Source: Instituto Nacional Estadistica

Table 5

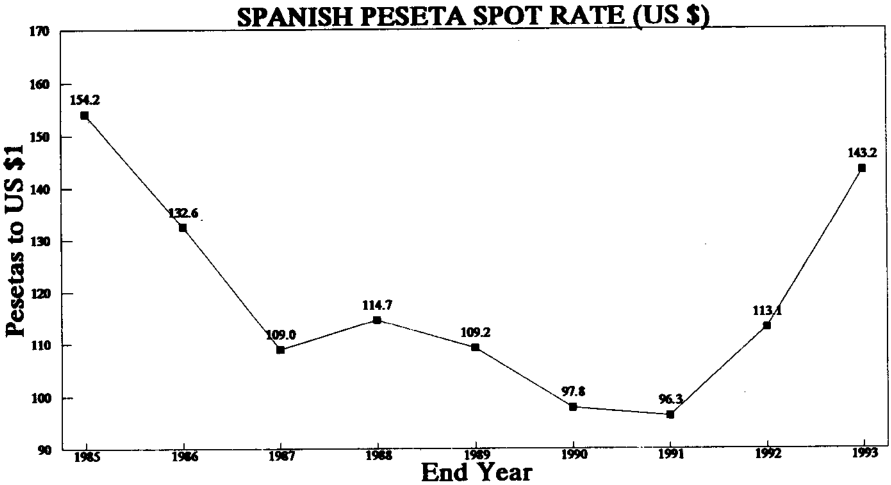
Country	Inflation Rate 1991	Inflation Rate 1992	Country	Inflation Rate 1991	Inflation Rate 1992
Belgium	2.8%	2.4%	Ireland	3.6%	2.4%
Denmark	2.3%	1.5%	Italy	6.1%	4.6%
France	3.1%	2.0%	Luxembourg	2.6%	2.9%
Germany	4.2%	3.7%	Portugal	8.9%	8.5%
Greece	18.0%	14.4%	**Spain**	**5.5%**	**5.4%**
Holland	4.9%	2.6%	U.K.	4.4%	2.6%
Total EC	4.8%	3.7%			
USA	3.1%	2.9%			
Japan	2.6%	1.2%			

Source: UNESPA

Figure 4 shows the Spanish Peseta against the US Dollar since 1985. The most important feature to bring out here is the dramatic weakening of the Peseta in 1993 caused by the partial collapse of the ERM and the loss of confidence that this implied in the realisation of Spain's economic policies of convergence.

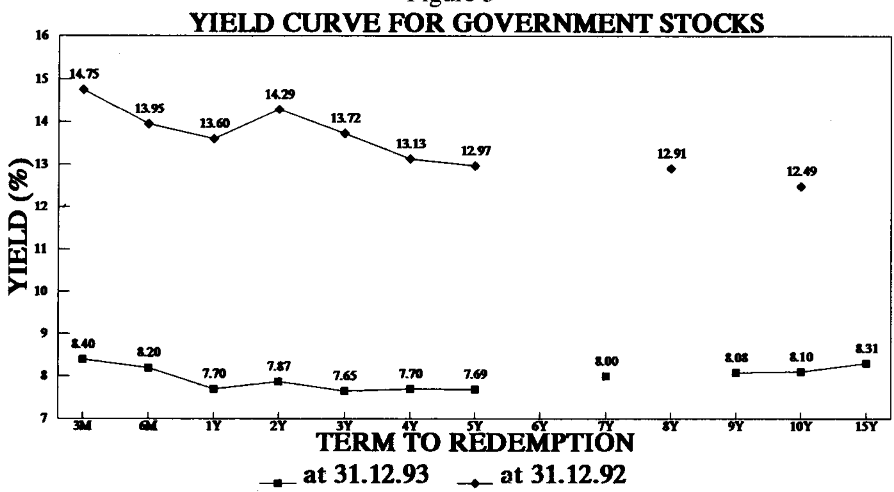
Figure 4

SPANISH PESETA SPOT RATE (US $)



1993 also witnessed a sharp fall in prevailing levels of interest rates, as shown in Figure 5. The inverted curve at the begining of 1993 showed that the market was anticipating some fall and by the end of 1993 this had been more than realised.

Figure 5



APPENDIX 3

PROFIT TESTING TECHNICAL DETAILS

1. *Policy Details*

The profit testing is based on a male aged 40 at inception, paying an annual premium of 100,000 Ptas (£500) for an initial sum assured (but not death benefit) of 1,975,000 Ptas (£9,875). The premiums and the sum assured increase by 10% p.a. simple.

2. *Mortality*

As discussed in Section 2.3.3.1 mortality is usually based on the Central European tables, GRM or GKM, for savings and risk products respectively. These are used in Spain due to the lack of assured lives tables. They are widely considered to be heavy for Spanish assured lives mortality, but are nonetheless used at their full value in product pricing.

Figure 6 compares the tables GRM80 (male assured lives for contracts with a saving element) at both 70% and 100% of q(x) with A67/70 ultimate, for ages up to 45.

Figure 6

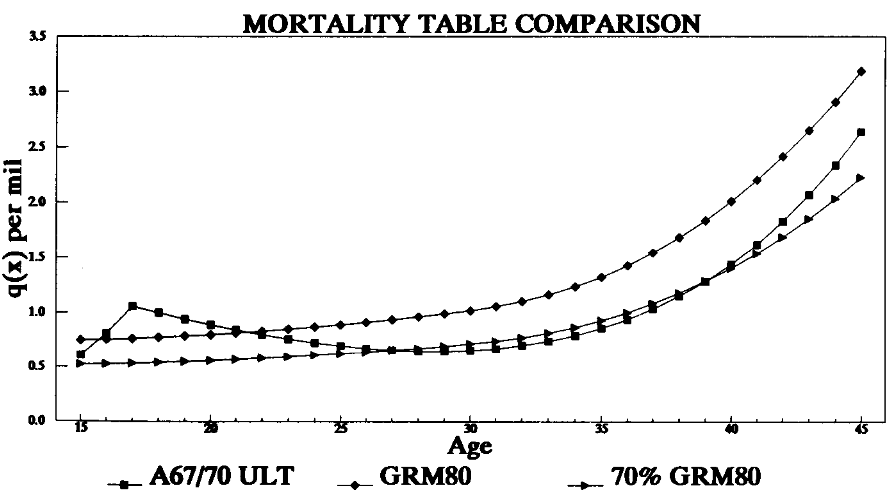


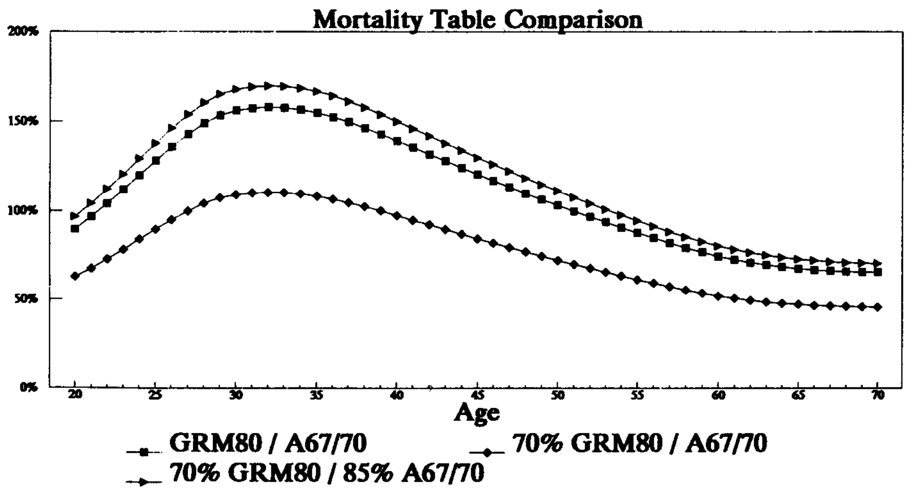
Figure 6 shows a number of interesting features:

(i) Whilst the rate of accident related deaths in Spain (and particularly at younger ages) is considerably above that in the U.K. this is not reflected in the mortality tables used, unlike in A67/70.

(ii) In the age range 27 to 40, A67/70 and 70% GRM80 are reasonably consistent. There is an increasing deviation between the tables from then on, and in fact, whilst the graph does not show this, A67/70 crosses 100% GRM80 at age 51.

We also show a graph (Figure 7) which compares, in percentage terms, the ratios of GRM80 to A67/70 Ult, 70% GRM 80 to A67/70 Ult and finally 70% GRM80 to 85% A67/70 Ult, the latter comparison being between a common profit testing assumption in both countries:

Figure 7



In the profit testing we have assumed 70% of GRM80, which we consider to be a reasonable overall representation of Spanish assured lives mortality.

3. *Interest Rate*

Over the last year the official bank rate has fallen from 13.75% (24 November 1992) to the current levels of 8.75% at the time of writing. Over the same period the yields on Government bonds have also fallen dramatically, as is shown in Appendix 2. On the last trading day of 1993 the gross redemption yield on the newly issued 15 year Government stock (the first 15 year stock ever to have been issued) was 8.31%.

For the profit testing we have used a gross rate of interest of 8%.

4. *Inflation*

   We have assumed a long term inflation rate of 3% below the interest rate, i.e. 5% p.a.

5. *Tax*

   Insurance companies are taxed on profits at 35%. The profit test has been performed on a stand alone tax basis.

6. *Expenses*

   Reliable information on per policy initial and renewal expenses is not readily available. We have assumed the following expenses, which we consider to be reasonable for a medium sized insurance company:

Initial:	40,000 Ptas (£200)
Renewal:	4,500 Ptas (£22.50)

7. *Commission*

   The following scale has been used:

Year 1:	30%
Year 2:	10%
Years 3-7:	8%

8. *Lapse*

   We have assumed the following rates:

Year 1:	15%
Year 2:	12%
Years 3-5:	8%
Thereafter:	5% p.a.

9. *Risk Discount Rate*

   We have assumed a risk discount rate of 12.5% p.a.

APPENDIX 4

SEGURIDAD SOCIAL - CONTRIBUTIONS AND RETIREMENT PENSIONS IN SPAIN

Contributions (*cotizaciones*) for employed persons of a private company are deducted directly from salary, plus levied directly on the employer - i.e. the same pattern as U.K. employee and employer National Insurance contributions.

These *cotizaciones* are calculated by applying percentages to salary up to a monthly maximum of 338,130 Ptas (1993 figure, an annual salary of around £20,000). Beyond this maximum salary there are no contributions made by employer or employee; nor are there corresponding benefits – e.g. the unemployment benefit is the same fixed quantity, irrespective of how much a salary may have exceeded the monthly maximum. It will be seen below that the same logic applies to retirement pensions.

There is also a monthly minimum of 68,310 Ptas (1993 figure, approximately £4,000) to which the standard employer and employee percentages will be applied, even if the actual salary received is lower. However this situation is an unlikely one as the minimum corresponds, more or less, to the Spanish minimum wage.

The 1993 percentages for employees are:

Contingencias comunes	4.90
Desempleo (unemployment)	1.20
Total %	6.10

... and for employers are:

Contingencias comunes	24.00
Accidentes de trabajo	0.99
Desempleo (unemployment) and other benefits	7.20
Total %	32.19

The percentages levied have been more or less constant since 1985, with the exception of that relating to unemployment which has witnessed successive increases in 1992 and 1993 (from 6.3% to 7.3% to 8.4%, summing employer and employee percentages).

The category *Contingencias comunes* encompasses health-care, invalidity benefits and retirement pensions: for the purposes of our paper, we detail only the last:- how entitlement to a retirement pension is secured, and how that benefit is calculated:

(i) State pension age is 65, for men and women.

(ii) For entitlement to benefit, it is necessary to have paid *cotizaciones* during a minimum of 15 years of which two must fall in the last eight years.

(iii) 35 years of *cotización* are required to receive 100% of the benefit, with 2% deducted for each year less than the necessary 35.

(iv) Pension is calculated based on the final 96 months *cotizaciones*, divided by 112, i.e. effectively 96/112ths of final salary below the maximum figure (approximately £20,000 per annum in 1993 as was seen above). The final 24 months are included at their nominal value. The previous 72 months are revalued, according to the Spanish retail price index, up to the start of the final 24 month period.

(v) The maximum gross pension instalment (of which 14 are paid annually) is 245,546 Ptas (1993 figure, around £17,000 per annum).

The maximum pension corresponds to around 96/112ths of the maximum salary considered for *cotizaciones* – but the link is less direct than it appears, and the position is further complicated by transitional provisions stemming from preceding regimes of *Seguridad Social.*

Pensions in payment are revalued annually under Government order. Updates at January 1992 and January 1993 were broadly in line with price inflation. However the increase as at January 1994 has been pegged at 3.5% as part of a national austerity package. This figure is based on the projected inflation for 1994, which is widely recognised as unrealistic, and therefore will represent a reduction in purchasing power. There is a promise that this loss will be recovered in 1995, although whether this recovery is made with or without payment of arrears, has been an important point in the political debate.

Brief Comparison with the U.K.

It is useful in the first place to draw a parallel between the U.K. "Upper Earnings Limit" and the Spanish maximum figure of 338,130 Ptas referred to earlier. At the rate of exchange in force at the time of writing, the two amount to a broadly equivalent annual figure (the U.K. figure being slightly higher). Therefore we can consider the concept of "UEL" as if it were common currency between U.K. and Spain: at least for the purposes of this comparison.

The Spanish formula of 96/112ths could give, in the absence of earnings inflation, a retirement pension in excess of 85% of final salary, where this salary lies on or below the "UEL". In practice however the two-year time-lag in the final years' revaluation will give perhaps 70-75%. Nonetheless this is a very significant level of State-derived post-retirement income. It may be compared, for example, with the U.K. concepts of basic State pension and earnings related pension which, when related in common parlance with a salary around national average earnings, produce of the order of 45% of final salary (25% and 20% respectively, taking account of the 1988 revision to SERPS). (In fact the quoted 20% for SERPS is an overstatement, bearing in mind working-life-time revaluation.)

The Spanish system does not include, as such, a basic State pension. However, the minimum *cotización* figure (and bearing in mind the national minimum wage as mentioned earlier) effectively produces a minimum pension and its value in broad terms is not unlike the U.K. basic figure. Therefore the more generous overall provision inherent in the Spanish scheme can be regarded as stemming from a more generous earnings related portion.

The Spanish system does not guarantee post-retirement revaluations to the same degree that the U.K. system does. However in this context it is worth observing that, in the final analysis, any State provision can be altered by subsequent legislation. Whether equitable or not, public expectations, on the basis of which contributions may have been made over a number of years, may not be fulfilled. A case in point is the 1988 revision to U.K. State pensions, which replaced earnings-related revaluations with price-related revaluations. In Spain over the period 1993 to 1995 this link with price inflation has been further weakened. This begs the question how far such dismantling can be carried out, until presumably a point can be reached where the uncertainty surrounding emerging benefits undermines the willingness of the active population to continue contributing.

The contribution rates in Spain, as seen above, are already at very high levels as at 1993, even before economic/demographic pressures unfold over the next two or three decades. This cost is currently being borne by employers (in fact employees pay slightly less in Spain than in the U.K.). Spanish employers are presently paying 32% of pay-roll, compared to a U.K. sliding scale with a maximum of 10.4% at UEL (although there is the compensating factor that Spanish employers do not contribute at all on salary in excess of the UEL).

APPENDIX 5

TYPICAL PRIVATE PENSION ARRANGEMENTS

A typical Spanish company pension arrangement (not adapted to the 1987 legislation) does not have service-related formulae for calculating benefits. Instead the definition of pension benefits is aimed at providing a target percentage of final salary and this percentage varies according to status.

The provision of pensions is at the discretion of the employer and therefore for late entrants the benefit package would be a matter for individual negotiation.

It is infrequent for the employee to be required to contribute under such arrangements.

Widows' pensions and lump sum death benefits are similar to those provided in the U.K.

Taking into account the integrated nature of these arrangements Table 6 shows typical benefits for three different levels.

Table 6

Target Pension as Percentage of Final Salary			
Category	**Social Security Benefit**	**Scheme Benefit under private arrangement**	**Total Benefit**
Blue collar	90%	—	90%
White collar	40%	40%	80%
Executive	15 – 30%	50%	65 – 80%

APPENDIX 6

U.K. INVOLVEMENT IN SPANISH LIFE SECTOR

As authors, we wrote to the following companies where there is British participation in the Spanish life operation. We asked for a short account of the general nature of their business and, where it was appropriate, brief comments on such matters as the extent of direct collaboration between U.K. and Spain (exchange of staff in particular), the use of profit-testing and model office techniques, distribution channels, product design and development (in particular the extent of U.K. influence).

In this appendix we reproduce the responses, and we would thank all the companies for their contributions.

1. British Life

British Life was founded in 1990 when Scottish Provident bought the Spanish branch of Equity and Law which had only just been launched.

British Life sells a limited range of modern products through its salaried direct salesforce, its best selling product is a type of universal life contract in which the benefits are linked to the value of the underlying investments, although the contract is not truly unit-linked. The products tend to have modern riders such as dread disease and non-smoker discounts are offered.

Currently the salesforce is spread over 13 branches in approximately half the regions of Spain, which will be extended over the medium term to approximately 25, covering all major cities in Spain.

An important theme of the Company's strategy is to differentiate itself by offering a higher standard of quality (in products and services) than that perceived in the market. It was considered that the only way to ensure this differentiation was to have its sales operation under its own control and hence the Company only distributes through its own salaried (partly fixed, partly variable) salesforce.

At the end of 1993 the Company will have a market-share of approximately 0.75% having almost doubled its new business in each of its first three years. In the medium term it is aiming for a 2.5% market-share.

Profit-testing and embedded value methods are used to manage and control the operation.

The Company has a current salesforce of almost 400 persons and 60 persons are working in head office. Of those 60 only two are from the U.K., the M.D. and an actuary in the planning department, a further senior Manager also has international experience.

2. Commercial Union Vida

CU Vida was formed late in 1985 and remained as a Life subsidiary of the Commercial Union Assurance Company plc up until 1991, when it became a subsidiary of the holding company Commercial Union España S.A. (domestic branch focused on General Insurance).

Although initially benefitting from the distribution network originated by the General business (and dominated by independent and tied agents), CU Vida has developed its own distribution strategy which places an increasing importance in the Direct Sales approach and the agreements with financial institutions.

Product development, initially supported by U.K. expertise, has been tailored to the specific demands of the Spanish market and allowing for the Spanish fiscal regulations. A wide range of products are provided, typically with profit endowments, Universal Life, Retirement and Protection covers, offering both individual and group policies. Likewise CU Vida manages individual and group pension funds.

Spanish actuaries are in charge of the whole process whilst the head office in London only participates at the supervisory level. From 1989, the product development has been based upon profit testing spreadsheet models, always allowing for the different distribution channel through which the product will be predominantly marketed. Once a year, the embedded value of the company is assessed.

Information Technology is another of the critical aspects in CU Vida strategy. Entirely in-house developed systems cover all the areas involved in the business, i.e. quotation, underwriting, claims procedures, policy issue, reinsurance, technical reserves calculation and management control. Hardware facilities are sub-contracted from CU España.

The cost of administration, financial, personnel and other departments located centrally is shared with CU España.

3. Eagle Star Vida

By 1987, Eagle Star had purchased the whole of the shares of a small established Spanish life company, and subsequently those of its former parent, a non-life company. The companies were based in Barcelona and the non-life company was the major producer of business. The non-life company continues to function in Barcelona under the Company's original name. The life company was reincorporated in 1989 as Eagle Star Vida and relocated to Madrid.

Early in 1990, Eagle Star Vida launched a range of unit-linked products including a savings plan, endowment assurance plan and a term assurance. Apart from these products (which form the major part of new business production) the company also sells group life business, group pension annuities and individual annuities. Eagle Star

Vida also administers a portfolio of traditional Spanish life policies which were acquired at the time of purchasing the life company. No new business of this type is now being sold.

New business is sold through a branch network which has been established throughout Spain.

Product design and systems for the unit-linked business were based on those used worldwide within the Eagle Star Group, adapted for the Spanish market. From the beginning of the operations of Eagle Star Vida, actuarial techniques such as profit testing, embedded values and business plan projections have been used.

Currently there is no U.K. representation in Spain but Eagle Star has access to a full range of resources based in the U.K., including actuarial resources.

4. Kairos Vida

Kairos is a composite Insurance Company incorporated in 1989, and in 1990 Friends Provident Life Office acquired a 30% stake in it. Although other shareholders in Kairos include Spanish Regional Savings Banks, a true bancassurance venture was not developed due to the reorganisations taking place within the Spanish Savings Banks sector.

Kairos Vida was formed in 1991 as a separate company with shareholdings 51% Kairos, 49% Friends Provident Life Office.

A range of traditional Spanish life assurance products was quickly developed and priced with the use of profit-testing techniques. A business plan was formed to sell through the agent distribution channels and to pilot direct sales. A model office was built to ensure long-term profitability. The company wrote its first policies in December 1991.

In 1992 a strategic decision was made to abandon development of the direct sales distribution channel, due to lower than forecast productivity. The existence of a model office was critical in being able to make this decision at a very early stage in the development of the distribution channel.

In December 1992 all of Friends Provident's interests in the Kairos group were transferred to Eureko, the European Insurance Group which is the centre for international co-operation and integration between the five partners, Friends Provident, A.V.C.B. (Holland), Ocidental (Portugal), TopDanmark (Denmark), Wasa (Sweden).

Over the summer of 1993 a formal transfer of all the life business of Kairos Vida was made back into the Kairos parent company, which had always maintained its licence to operate in the life branch, and Kairos began to write all the new life business.

During the autumn of 1993 the sale of the Kairos Vida company (with no in-force business) was completed to a third party, and Eureko made a capital injection to Kairos in order to fund future expansion. This capital injection represented a further investment in Spain, and it has recently been announced that Eureko has now taken a stake in excess of 50% in Kairos.

Eureko management stated that this investment demonstrates their confidence in the management of the company to build upon Kairos' position in the Spanish market.

Eureko's strategy will be to consolidate and develop the growth in the agent distribution channel, concentrating on motor and other individual business. They wish to maintain and improve on the current low unit costs, and the recent rapid increases in business volumes. They will study other possible developments, including other distribution options, for either life or non-life business.

5. Plus Ultra

Plus Ultra is a wholly owned subsidiary of the Norwich Union Group. Previously under the control of a Spanish bank, 90% of Plus Ultra was bought by Norwich Union in July 1990 with the remaining 10% purchased the following year.

Plus Ultra is a composite insurance company which was founded in 1887. It has been a consistent market leader in the Commercial risks market and in the last 10-15 years has expanded more into the Personal lines and the Individual Life market.

The Life products sold are predominantly traditional Spanish products and are sold through the company's agency network and via an agreement with a major Spanish bank.

Profit testing and model office techniques have been introduced and are now extensively used. The company's progress in life business is measured through a system of Embedded Value reporting.

On the Life side the U.K. representation is one actuary whose responsibilities are in financial control. In addition two further U.K. staff are based in Spain whose areas of expertise are Equity Investment and Motor Fleet Business.

6. Previasa Vida

Previasa is a Spanish general insurer, founded in 1932, with a large proportion of its business in private medical insurance. U.K. involvement commenced in 1990 with the founding of a joint venture life company, Previasa Vida, whose controlling shareholder is Previasa, with the U.K. mutual Scottish Widows being the other participating shareholder.

Previasa Vida sells traditional Spanish endowments and term assurances via the agency and branch network of its parent (this network includes the implantation of direct salesmen, devoted specifically to life products, within the parent's branches).

Profit-testing techniques have been introduced to test the viability of the contracts individually and of the office in terms of its global operation. Also embedded values are being used to give a better representation of the underlying evolution of the life operation's long-term profitability.

Previasa Vida's new business territory extends nationally throughout the parent's 42 branch network. However the central office comprises a tight-knit unit of 14 people in Madrid. I.T. development and maintenance of life systems is sub-contracted to the Spanish parent company. U.K. representation in Spain is one actuary from Scottish Widows (the post currently held by one of this paper's co-authors).

7. Prosperity

Prosperity S.A. de Seguros y Reaseguros was founded in June 1990 by the MMI insurance group. The company started selling life assurance in March of 1991. The company was purchased by Standard Life in June 1993. In the first full year of operation, 1992, the company achieved a premium income of 925 million Ptas which placed the company in the upper half of the ranking of life assurance companies in Spain.

The company sells a range of savings, pensions and protection products and also offers a range of other financial products, such as unit trusts, through Prosperity Financial Services which is also a wholly owned subsidiary of Standard Life. The company intends to commence selling Pension Funds in 1994.

The company has 120 employees with the head office situated in Barcelona. There are 21 branches located throughout the country and a network of approximately 1,000 brokers selling the company's products.

There is one U.K. actuary working in the Spanish subsidiary.

8. Royal Life España

Royal Life was founded in 1989, as a Spanish Company, to integrate the life business of the Royal Group in Spain. In the past, Royal has carried out its business through Regal and Royal Insurance, which had a small life portfolio.

Royal invested a large amount of money to create a good image and a significant brand awareness, as the bases for facilitating the work of a direct sales force. Royal sells individual and group business. As far as individual business is concerned, it sells traditional endowments and term assurances.

No British actuary has worked in Royal Life España since the second-half of 1989. As part of Royal Holdings, profit-testing techniques and embedded value calculations are carried out to evaluate the management of the company.

During 1993 Royal Life España focused its effort in developing a new Administration System with Oracle, which is called "ALEA". In the short term Royal will launch flexible products using this new Admin system.

9. Sun Alliance

Sun Alliance SA is a wholly owned subsidiary of Sun Alliance Group and trades as a composite insurer with a network of 35 offices around Spain and a Head Office in Barcelona. Life business accounts for around 12% of premium income and market share is currently around 0.25% with the objective in the short/medium term to increase to 1%.

Sun Alliance Vida sells traditional Endowment, Whole Life and Term Assurance policies with the recent successful addition of a dread disease contract. All policies are available with a range of options such as double and triple accident benefits. Following extensive systems changes it is planned to introduce the universal life concept and to target sections of the pensions market. Group business is a small but, with selective underwriting, profitable part of the portfolio.

Distribution is multi-pronged with direct sales growing in importance but with a base of business from the composite tied agency network. Some business, mainly term assurance, is received from brokers and direct marketing. Administration is centred in Barcelona. U.K. assistance is considerable but control is local and the organisation does not function as a Branch of the U.K. U.K. representation is limited to one Director with 20 years' experience of the U.K. Life Market.

DISCUSSION

The President, Professor J. J. McCutcheon I am delighted, in particular, to welcome three official guests of the Faculty. We are honoured that Senõr Manuel Peraita, President of the Spanish Institute of Actuaries, has managed to make the journey from Madrid. Even with aeroplanes, it is a long way to come and we are very honoured that he has chosen to join us tonight. Senõr Alberto Santandréu, *Canciller* in the Spanish Consulate here in Edinburgh, is also with us and our third official guest is Mr Duncan Ferguson, Chairman of the European Joint Committee of the Faculty and the Institute.

We are meeting today to discuss the paper "Spain: An Outsider's View from Within" by Mr Paul and Mr Simler. The increasingly international nature of actuarial work is very obvious to us all, and I think the President probably sees more of this than many others. I suspect that the Presidents in recent years have had to do rather more travelling than was the case 15 or 20 years ago and many of us in our day-to-day work are having to travel internationally. Within Europe, there is much activity and it is particularly appropriate therefore that we should have this opportunity to discuss affairs in Spain.

Mr R. B. Simler B.Sc., F.I.A. *(introducing the paper)* Much Faculty and Institute time and energy is given over to producing and discussing papers regarding advancements in actuarial thinking. This is, of course, important because the long term future of companies depends on the innovations of today. Similarly, with a view to their long term futures, many companies are diversifying into markets other than their own. As a profession, we should be playing our part in discussing and learning about these markets since, in our professional capacity, we are well placed to help companies wishing to take the step into new markets. Indeed, it is true to say that, as a profession, we already play a part. Almost all U.K. companies represented in Spain have, or have had at some time, some on-site U.K. actuarial involvement. In addition, the Spanish actuarial profession is second in size in Europe only to that of the U.K. and, as such, is well placed to provide us with the necessary support.

The purpose of this paper then was to generate discussion on a subject which is increasingly important for many of our companies, be they life offices or consultancy practices. Although the paper is specifically about the Spanish market, there must be many parallels with other European markets, particularly those in Southern Europe and we hope that discussion is generated in this area too.

Our motives were not entirely altruistic. Nothing quite focuses the mind towards learning about a particular market than having to stand up in front of one's own colleagues and talk knowledgeably about that market.

We have chosen to quote Karl Marx at the start of the paper. Marx does not provide obvious source material for Faculty papers, nor are his ideas currently flavour of the month. However, the quote we have selected, that is "there is hardly another country except Turkey which is so little known, and so misjudged by the rest of Europe, as is Spain" indicates a potential problem that may have been experienced, and may in future be experienced, by U.K. companies entering the Spanish market: that of misjudging Spain based on insufficient information and whilst this is by no means true in all cases we feel that the quote still rings true today. The lesson to be learned is that the new entrant should adapt to and contribute to the existing structures of the new market without attempting to impose U.K. ideas on that market as such a strategy would surely be doomed to failure.

Turning now to some recent developments since the paper went to print. The proposed new legislation highlighted in Paragraph 2.6.8 has still not begun its passage through Parliament. A number of parts of the Law, specifically those relating to fiscal matters, have not been fully drafted and, consequently, *el Consejo Económico y Social*, a body which is made up of business and union representatives, and which by constitution must be given the opportunity to comment on certain legislative changes before they may proceed to Parliament, has refused to do so, preferring to await a definitive draft. It appears increasingly unlikely that this Law will be on the Statute book before 1 July as required by the 3rd Life Directive. Even once the Law is finally approved by Parliament, there will still be a number of unresolved questions. It is not uncommon in Spanish Law for certain items to be left to a later *Reglamento* which in all cases must only amplify existing Law and not amend it. In this particular case, changes to the mathematical reserving basis and coverage of those reserves have been left to *Reglamento*. The Law also makes reference to a future ministerial order, or *Orden Ministerial*, which will incorporate into Spanish legislation the requirements of the EC Insurance Accounts Directive. Spanish Law as it currently stands will continue to apply in the meantime. It should be noted that no time limit is given for the introduction of these subsequent changes.

The new Law, as well as modifying insurance legislation, will also have a significant impact on the pensions market. It has been the intention of the Government for some time to force companies other than banks, which provide pension benefits to their employees, to fund these externally as was discussed in Section 4.8. The recent intervention by the Bank of Spain into the affairs of one of Spain's top six banks and the discovery of a large hole in its solvency position has now brought into some doubt the wisdom of the exemption for banks. Current rumours suggest that the exemption will be omitted from the final draft.

The pensions area remains a very topical one, not only because of the proposed legislative changes. Towards the end of February, the Economics Minister, Pedro Solbes, stated what many believed, but few have dared to say, that the State pension system is in danger of overload and that those who are now between 40 and 50 may not receive the State pension which they now expect when they come to retire in the next 20 or so years. The political fallout was to some extent mitigated by Felipe González's almost immediate response that the Social Security system will always guarantee a 'dignified' pension, although he did not go on to define exactly what this meant.

The marketing opportunities were not lost on a number of insurance companies who placed advertisements in the national press singing the praises of their retirement savings plans in these times of increasing uncertainty. Such companies are demonstrating now what has been clear for some time, namely that the private pensions market will present rich pickings at some point in the near future for the insurance and banking sectors.

Another form of savings vehicle, the *Plan de Ahorro Popular*, or Popular Savings Plan, is soon to be launched. This was first mooted by the Government at the start of the 1990s, but has taken longer than expected to get off the ground. The Government hopes that legislation will be in place by May of this year. The aim of PAPs is to encourage families to save through favourable tax treatment, PAPs allow the investment of some £5,000 per annum (including reinvestment of income) up to a maximum total investment of £50,000 with no tax on the money left in PAPs for 5 or more years. While some of the attractiveness of these plans has been diminished by restrictions on the underlying investments and the imposition of both a minimum and a maximum rate of return, the right to transfer funds from unit trusts or *Fondos de Inversión Mobiliaria*, without tax penalties, should generate quite a lot of activity.

Returning now to the insurance sector, it is worth making reference to UNESPA, the insurance industry representative body which is currently undergoing some changes. Following the exodus of a number of important insurance companies from within its ambit, UNESPA is studying the structure of the ABI in the hope of reproducing the ABI's more active role in representing the industry in negotiations with Government and European agencies over future legislative changes. Clearly such a reform is in the interests of the industry as a whole if it succeeds in re-establishing UNESPA as a body with universal industry backing.

Mr M. R. Kerr *(opening the discussion)* Like both authors I have only two years of working experience in the Spanish market. Given the largely factual nature of many aspects of tonight's paper, I intend to make few detailed technical comments and concentrate on what I see to be either the more contentious aspects or those of more general application.

Without doubt the paper can be contemplated on several levels.

* On a technical level, it describes very succinctly the structure, workings and regulations of the Spanish market. The technical aspects of the paper will not have been of the same interest to some people here as to practitioners in the Spanish market, but I found it very informative providing a technical outline which, to date, has been very difficult and time consuming to compile.
* On a European level it raises points, problems and possibilities arising from entry to European markets in general and some of the likely impacts of the 3rd Life Directive in particular. This will be of interest to any company involved in, or considering entry into, any European market.

* From a U.K. perspective, it allows us to compare and contrast current U.K. actuarial practices with those of another country. This should be of interest to all Fellows.

In Section 2.3.3 the authors discuss the different elements of a *nota tecnica*. When discussing the mortality tables used, they quite rightly state that these must be based on national or international experience – in reality, as noted, Swiss and German mortality tables are used even although the suitability of these to the Spanish assured population is questionable. However, I am aware of at least one British company which is adapting the Spanish population mortality table available (PEM80), multiplying it by A67-70 then dividing by ELT14. This also has its drawbacks given the different characteristics of the assured populations in the two countries, but reflects the current paucity of data. This paucity can be further illustrated by the fact that one large international consultancy last year wrote to several companies in the Spanish market inviting participation in a study of their own mortality experience and that of the group of companies as a whole. Needless to say participation came at a cost. As far as I know, the scheme never got off the ground. This could reflect several things:

* the cost;
* lack of interest due to the relative insensitivity of traditional products to changes in mortality;
* acceptance of the currently used tables; or
* unwillingness of companies to share data.

One must wonder when the Spanish Institute will produce appropriate tables.

As stated in Section 2.3.3.3 the method of distributing surplus must be included in the *nota tecnica*. This contrasts quite radically with U.K. practices where bonuses are declared normally without any explicitly stated criterion or formula. One might wonder which method is better. From the policyholders' viewpoint having a formula leads to no questions of 'realistic expectations' not being fulfilled unless quotations are based on unrealistic returns. All policies are treated equally so there appears to be little argument as to the equity of the system. From a company's viewpoint, however, the ability to reflect external circumstances is lost and there is no smoothing of returns. This inability to reflect external matters obviously commits the company much more and does not allow, for example, for reflection of a fall in asset values. The question of restricting investment freedom does not currently arise due to the restricted nature of investments.

In Section 2.3.6 the authors discuss investment of mathematical reserves. While Spanish companies must cover their gross mathematical reserve without any reduction for reassurance ceded, it is common practice for companies to withhold half of their reassurance premiums for one year, effectively covering the reserve of the ceded amount.

Selling practices are discussed in Section 2.4. This section is interesting due to the parallels in the polarisation existing in Spanish and U.K. markets between, effectively, tied agents and independent financial advisers. I think several points are worthy of comment.

* While in the U.K. training of agents is well regulated and defined in detail, Spanish Law states only that agents MUST receive training, without specifying what or when. A detailed note must be taken of this training and the DGS has the right to inspect this record and to decide on its sufficiency or otherwise.
* The concept of 'know your client' is not covered by legislation.
* Spanish IFAs have to give impartial, as opposed to best, advice. The dictionary definitions of the two words are as follows:

  BEST – most suitable, advantageous, advisable or appropriate;

  IMPARTIAL – without prejudice; not taking sides.

I leave each person to consider the differences and their implications.

While in Section 3.4 the authors give a historical estimate of the distribution by the different sales channels, one must wonder at its current accuracy after the recent changes and problems caused by the 1992 Law, especially as regards approval of *corredores de seguros*. I would be interested to hear the authors' opinions on the likely current distribution of sales.

Quotations and the information that must be given to a client are areas that it would have been interesting for the authors to have covered given the vast differences between practices in Spain and in the U.K. In contrast to the strict definition of the content and calculation of illustrations in Britain, in Spain no restriction is put on interest rates used in quotations for unit-linked policies and expenses need not be revealed. Reductions in yield are neither calculated nor illustrated. Testing questions could be raised as to reasonable expectations if such a concept existed in Spain.

In Section 3.6 the authors consider a profit test of a traditional Spanish endowment policy. The main source of profit is the undistributed margin in the interest rate and profitability is hugely sensitive to changes in this, providing very variable returns in an unstable economy. With interest rates in Spain currently dropping, the traditional endowment will soon not be very profitable given that a 1% drop in interest rates reduces profitability by 20%. The stability of profits arising from unit-linked or unitised with-profit style policies certainly proves beneficial under such circumstances. For example, a one point reduction in interest rate reduces profit by only 2% under a unitised with-profit policy currently sold by one U.K. company in Spain. In the current economic climate, this is good news for those British companies selling these types of policies.

The pensions market is then discussed. As stated, *Planes de Expleos* have had limited success (and where there has been success it has typically been for the banks). As Mr Simler said, much uncertainty exists as to their future. Individual plans have had more success. It is not clear in the paper whether the maximum expense charges applying to individual pension plans apply to the two other types of plans. I believe that they do. These maximum expenses are restricted to 2% of the fund for the *gestora* (typically the life assurance company or bank selling the product) and many companies are marketing the product with expenses lower than this to try and achieve a marketing edge in an almost uniform market. The major factor which could obviously differentiate companies would be the structure and performance of investments, but given that basically all investments are in government bonds this is not currently happening.

The restriction of expenses is obviously in the client's interest but it results in the business having a very low profitability – especially given the fact that clients are not obliged to continue premium payment and that accrued rights can be transferred to a different company without penalty. Entry to the market is made difficult for new operations due to the high capital strains required to sell the product and the slow recovery of costs. The fact that the client is not obliged to continue paying premiums has raised problems with the method of commission payment as some agents were abusing the system by encouraging clients to pay high initial premiums and then discontinue payment. Clawback of regular premium commission or treatment of all premiums as single premiums are among the solutions to this problem. An additional point is that given the restriction on expenses many companies offer lower commission than on the other alternative retirement plan (*Planes de Jubilacion*). This could raise interesting issues for *corredores* under impartiality of advice.

In Section 5 the authors talk about the actuarial profession in Spain. It is interesting to reflect that in 1908 the *Instituto Nacional de Provision* required that premiums be calculated by an actuary with a domestic or foreign qualification. Given that at that time there was no such qualification in Spain it was not quite mutual recognition but was certainly ahead of its time. As a footnote ironically it seems to be more difficult now to be recognised by the Spanish Institute of Actuaries. I am not aware of any British actuary being allowed to enter in the two years I have been there. However, I do believe that this position looks like changing for the better due to recent changes in the Spanish Institute.

In Section 6 the authors consider entry of U.K. companies to the market. There are currently 11 U.K. life companies with an active interest in Spain – the 10 shown by the authors in table 2 and the life arm of Barclays Bank in Spain. Table 2 displays the life premium income for the 10 companies mentioned in 1992. I felt it would have been more informative and relevant to have shown new business premium income due to the youth of the British interest. Unfortunately, as I am sure the authors found out, detailed information on this is hard to come by. However, I have managed to get figures for some of the companies mentioned for 1992. The market share of Plus Ultra, Commercial Union, Sun Alliance, Previasa, British Life and Prosperity varied between 0.5% and 2% as measured by new premium income, with each of these companies lying in the upper 60% of companies at that time in the Spanish market. This suggests that by now they will certainly have crept up the long tail of the market, where the authors suggested they were, to the body of the insurance industry.

Another interesting statistic is attendance at the quarterly British actuarial lunches in Madrid. I believe this quite accurately reflects the level of activity (or should I say inactivity?) of U.K. actuaries in Spain. During the two years I have been there, numbers have fallen from an all time high of 11 in 1993 to the current number of 6. Only three of the U.K. operations mentioned currently have a U.K. actuarial presence. This reflects not only the low level of new activity in the last two years, but the general short nature and high costs of overseas assignments and the traditional nature of the products sold by many U.K. operations. It also suggests that the opening up of the European market will not provide the level of employment opportunities envisaged several years ago. I would be interested to hear other people's opinions on this.

The authors talk briefly about banks in various parts of the paper. It is worth expanding on the rôles of banks in the Spanish life assurance market. Not only are many of the Spanish assurance operations owned by banks, but currently banks are selling simple life products – typically pure endowments and term assurances. Banks obviously start with several advantages such as their client base and lower costs which allow them to sell these traditional products either cheaper or more profitably than their life office competitors. Banks currently also have the only possible home purchase loans and very often oblige the client to buy a term assurance to cover the loan from the bank. Endowment mortgages basically do not exist. More and more banks are entering the field of pensions and are attracting a large proportion of the market and with their lower cost base they can sell these plans more profitably than life assurance companies.

A first draft of legislation detailing a new savings product has just been issued by the authorities. This product, mentioned by Mr Simler in his introduction, is the *Plan de Ahorro Popular (PAP).* It is a savings plan very similar in many ways to a TESSA, and it is expected to attract significant volumes of savings. The first draft would not allow assurance companies to sell these policies. Banks currently control nearly all investment money through their *Fondos de Inversión* and so it is not clear if money will be transferred from these to the PAPs or whether significant volumes of new money will be invested.

Turning now to the interest rate used in reserving bases. As stated in Section 2.6.6, under the 3rd Life Directive the maximum rate should not exceed 60% of the return on government bond issues. This would currently suggest a valuation interest rate of just under 5% for Spain which is significantly below the currently used rate of 6%, especially given the prospect of further interest cuts. It might not be unrealistic to assume, and it is currently rumoured, that 4% could well be chosen as the maximum rate. Using the example used by the authors in their profit test, at duration 10 years of a typical policy this would lead to an increase of roughly 30% in reserves. This would significantly affect all companies selling traditional business, although it is not clear whether this interest rate would apply to all, or only new, business.

In their conclusion, it would have been interesting for the authors to have conjectured more on the future prospects for the Spanish market and for the U.K. entrants in particular. Perhaps that would not have been appropriate in a largely factual paper. I hope it is allowable in this discussion.

Due to factors mentioned, the Spanish market is in a very critical phase of development.

* Large increases in reserves will result from changes in the maximum valuation rate of interest. Given that many companies are now struggling financially and offering to sell their portfolios this will exaggerate the situation even more.

* Entry to the Spanish market will be made much easier by the 3rd Life Directive, which along with the availability of many companies for sale should allow entry either by establishment of a subsidiary, a branch or through cross-border selling.

Combine these two changes with the strength and possibilities for banks: while Bancassurance is still in its infancy and banks are currently neither aggressively seeking business nor extending their product ranges, undoubtedly this will happen soon, providing even more, and potentially the most dangerous, competition in the life market. Add to this the relative lack of success to date of pensions and the uncertainty over the future of *Planes de Empleo* and we have a picture which perhaps might look gloomy for U.K. entrants but is certainly not unrealistic.

The Spanish market is one in which success will not be achieved overnight and it will only conceivably be achieved by an efficient, well directed, targeted and ambitious company able to identify and capitalise on gaps in the market. Unit-linking could be one of these gaps, avoiding problems with reserving bases and allowing British companies the opportunity to demonstrate their investment expertise and capitalise on experience from the U.K. market. Stiff competition will certainly come from the banks and the typically risk averse Spanish will need to be convinced of the advantages and possible benefits of unit-linking. The current low interest rate environment should help with this. Investment expertise to date has played little part even in the investment strategies of those companies selling unit-linked funds as most funds are invested in fixed interest securities. This, surely, must change.

The sophisticated options and futures available in today's markets would allow guarantees to be built into these products, limiting the risk to the investors and reducing their concern about the risks involved. I believe that options are currently available based on at least one index of the Spanish *Bolsa* so this is a realistic possibility. However, given the relative lack of sophistication of the Spanish market, I feel that any investment guarantee would need to be kept simple.

Other areas in which U.K. companies may have an advantage is in the client servicing area, which to date has received little attention but will increasingly become more important. Also, actuarial techniques such as profit testing and analysis of embedded value are still relatively new in Spain and so British companies should be better equipped to design, understand and monitor their business in such a way as to maximise returns. Many small banks also have no agreement or link with a life assurance company and possibilities must exist for companies to create links with these banks and distribute their policies through them. As I hope I have indicated the market is not an easy one but neither is it a market devoid of opportunities. One thing is certain and that is that any investment must be seen as long term as few gains will be realised in the short term.

As noted by the authors, Scottish mutuals are particularly active in the market. Given the significant amounts of capital required, the uncertainty over future developments and the returns currently available from other investments, the appropriateness of such investments is perhaps worthy of further consideration. This would be a lengthy topic and it is not one I can pursue now. I would, however, be interested to hear opinions on this.

Mr R. B. Akhurst, F.I.A. Spain has been one of the markets which has excited most interest over the last decade. Probably for every company that has gone in there, there has been at least one or two more that have undertaken feasibility studies.

I am a little disappointed that the authors did not bring in the non-life aspects. In Spain there is a strong inter-action between what happens on the non-life and the life sides, particularly in distribution. I will come back to that in a second.

I have been working in Spain on and off since 1979 and it has been quite interesting to see how that market has evolved in comparison to the others in Europe. Spain is rapidly coming to terms with Europe. It has been noticeable that it is not only the insurance industry that has been a field for foreign participation, but nearly all of the car manufacturers have set up plants there. There has been tremendous infrastructure development going on. Spain has a population of 40 million, the same as Poland, and comes fifth after the big 4 of the U.K., Italy, Germany and France, but in terms of entry and excitement, it is ahead of those in terms of getting international participation.

So when the DGS, the control authorities, are trying to restructure the industry locally to prepare for the weight of the Directives they have had a very difficult decision as to how to go about it. Although this is not in the spirit of the Directives, they seem to have, in effect, put a prohibition on new companies in the last couple of years. It has been very difficult to get a new licence for quite a while and the DGS has been trying to pursuade foreign companies coming in to take over some of the ailing companies that are around. There is a very high capital squeeze on but it is questionable whether they can maintain that into the future. A very high capital level is required and on the non-life side nearly one hundred companies are under care and management. The DGS do not want to see any more needing help. They are worried about the implications if life companies followed the same route. So they are putting pressure on to try and sort out the capital structure of the industry.

At the same time, they have got legislation problems. The opener referred to the rôle of the banks. It was the banks who were exempted from the requirement to fund externally their pension assets and this is indicative of the power they have within the decision-making process. A lot of the legislation has been favourable to the banking distribution mechanism. The pension plans on the individual side had a 2% margin taken out annually, which is very much a banking margin rather than an insurance margin. You cannot get adequate commissions out of 2% and, therefore, nearly all of the sales of individual pension products have been by banks. The main route for people saving is through banks. The insurance companies have not yet got into that market. They are going to find it very difficult to get critical mass. Why has that been?

Coming back to the non-life side, a lot of the trade-off has been for non-life companies saying "I will give you motor business, if you put in the life business as well." I think there has been a squeeze on the new life companies. Distribution channels have not been skilled in life business. The companies trying to build their own sales forces have found it quite hard going. Distribution has not been fully developed in European terms. There has been slow acceptance of new products. I felt that non-smoker products would develop but it is an occupational hazard going into a meeting in Spain where the majority of participants still do tend to smoke profusely!

As well as the heavy competition from banking, there is also lack of development of a large scale stockmarket which, in my book, goes hand in hand with the development of an insurance industry.

The rôle of the actuary is evolving. He has been very much a 'technician' in the past. The development of profit testing and asset/liability matching are bringing the actuary forward into the rôle that he can play in other countries. From 1983 onwards, I spent many hours in the evening encouraging my colleagues in my old company to develop profit testing so that they could launch products in 1985 – a few years earlier than suggested in the paper. We also had intense discussions with the authorities about the rôle of market value adjustment in surrender values because one of the big problems in Spain, as elsewhere, is running the investment risks of having guaranteed surrender values which tend to force a very conservative investment policy that few companies are minded to follow. If asset matching and profit testing do continue to develop, we won't see the sort of problem that I saw recently, where one major company was offering, effectively, a 10½% open-ended long-term guarantee to anybody who wanted to put money in in the next 30 years.

The new board of the actuarial profession is doing all it can to strengthen the rôle of the actuary. There have been hours of appointed actuary discussions on the implications of the 3rd Directive which is heavy in reserving implications. I think something that has not been mentioned is the mortality problem which may come through on annuities. These are being sold on mortality tables which probably take far too rosy a view of the life expectancy of annuitants in the future.

One requirement for success in Spain is to put good local management in place. The parent company has to be prepared to delegate to that local management. If it does not do that, it will not get good entrepreneurial local managers. Now if you do delegate, you have got to have great confidence in the local managers and you have got to have great confidence in the information systems that you set up and the decision processes that the local managers follow.

I am very much a pro-European. I am a great believer in free markets. I do have great concerns that the 3rd Directive is going too fast and too far, for not only Spain, but for quite a few markets in Europe. I think the U.K. style of freedom which is encapsulated in the 3rd Directive does put enormous requirements on individual companies to act responsibly and that can only happen when there is sufficient authority and responsibility in place for that process to be safe and I do hope for the development of the rôle of actuaries and I encourage appointed actuaries to take up that challenge. With that in place, Spain will be a tremendous market for the future for those who are prepared to sit there, work hard and take the rewards that will come in the longer term.

Mr R. B. Simler I respond to the point about the absence of non-life business in the paper. We agree that this is an area which merits consideration. It is a very important part of the insurance sector in Spain. It is a sector which has very big problems at the moment. We felt that, due to this and due to the large volume of information which we would have had to cover, that this area was probably best left to someone else. We felt that we already had a paper which was growing too quickly and to do justice to non-life business in the paper would have given everyone too much to read and too much to discuss tonight.

Mr M. C. Ledlie There are a number of features of the Spanish market which have been particularly notable in my short time working there and which the authors have not specifically picked up on.

One of these is the lack of hard factual information within the market which the opener hinted at. We are very familiar with a wealth of reviews and articles on products within the U.K. market, analysing in great detail past performance, premium rates, even looking at financial strengths of companies, but, in the Spanish market, I find a total lack of information of this sort. In the trade press, almost all the articles tend to be of a more general nature without looking at any specific product and without comparing one company with another. It is very difficult to get hard factual information. It suggests to me that, whilst the Spanish market is highly competitive, much of this competition is not on the price/performance issues which may be more important in the U.K.

I was surprised in the paper that there was not more specific analysis of the tax position of the life products which is undoubtedly a very important factor for the sales of financial products and I think perhaps more so in the Spanish market than in other markets. I will summarise the tax position. For protection policies, the authors have pointed out that 10% of the premium is tax deductible but the proceeds will be subject to inheritance tax. Savings products enjoy gross roll-up but the proceeds are taxed on the difference between the surrender or maturity value and the premiums paid although there is a sliding scale of reduction in the amount subject to tax which reduces to zero after 21 years for an annual premium contract and after 15 years for a single premium contract. It is also of note that in Spain there is a wealth tax and life assurance contracts fall within this taxation, so that individuals with a total value of wealth of above about £75,000 will be subject to the tax and the tax can be up to 2.5%. The life product will be included at its surrender value in this calculation.

The authors have mentioned the very low penetration of life assurance in the Spanish market. Based on the figures they have used, we can see that expenditure per capita is about 12% of that in the U.K. I think part of this is clearly explained by the lower GDP per capita in the Spanish market, which is about 60% of the U.K. level. The authors have stated that the higher levels of Social Security provision are also an important feature and I agree with this. Another reason for the difference will be competition from other products. Unit trusts in the Spanish market have seen a remarkable growth in recent years. In 1988, the funds under management for this product were about £400m. By 1993, the amount had grown more than 100-fold to £50,000m, so starting from virtually nothing the amount has risen to a very high level. The funds under management in unit trusts in the market are about 9 times that of pension funds. Annual premium for the product in recent years is about 4 times the amount for life assurance. It is a product very similar to a single premium life assurance contract and enjoys similar taxation. It is a product dominated by fixed interest unlike the U.K. where we find unit trusts invested in equities and it is again dominated by the banks. The success of this product goes a long way to explain why, in recent years, the life assurance market has only seen very steady, but unspectacular growth.

Mr C. Berman Much of the attention so far has been focused on doing business in Spain and that is not surprising given the paper itself. I would just make some observations on professional aspects.

I am not very good at Spanish but my translation of the title of the *Instituto* is not the Spanish Institute of Actuaries but the Institute of Spanish Actuaries. If that is so, it is not surprising that no U.K. members have been admitted to it!

There is a major difference between the *Instituto* on the one hand and the Faculty and the Institute on the other hand and that major difference is that the Faculty and Institute are education bodies. One of the main activities, if not the primary activity, of the U.K. bodies is the churning out of actuaries. They set examinations, they mark them, they set a syllabus, they train actuaries. So in the U.K. the actuarial profession, its quality, whatever it knows, is moulded by the Faculty and the Institute. Now it seems to me that in Spain the moulding of actuaries, certainly of new actuaries, is by the three universities, albeit that their curriculum is set by Statute and so there is some consistency between them.

What this leads me to wonder is what part the *Instituto* plays in this educational process. The *Instituto*, it seems to me from reading the paper, is just an association of graduates of these three universities. Is there any feedback? Does the *Instituto* itself play a part in setting the curriculum, in bringing to the attention of the universities any new developments and any changes that might be required? Indeed, are any of the teachers at these three universities members of the *Instituto?*

The President Could I pose a question for either the authors or for Senõr Peraita.

The authors refer to the three universities which they say offer an actuarial degree, Complutense of Madrid, Autonoma in Barcelona and the University of Bilbao. Are the authors aware of plans by any other universities to include actuarial science in their curriculum? I ask this question since only a few years ago I and my colleagues had the pleasure of teaching actuarial mathematics to a young economist who was on the staff of the University of Valencia and I understand that, at that time, it was part of the University of Valencia's planning to introduce actuarial science in order to play a rôle in the training of actuaries in Spain. Has that development happened and are any other Spanish universities offering what is often somewhat mysteriously called 'the actuarial discipline'?

Senõr M. Peraita *(President of the Spanish Institute)* First of all, I would like to thank the Faculty and the authors for this session and I would like to offer a couple of clarifications on two questions.

First I would like to mention that to become a member of the *Instituto* one has to first obtain the university actuarial degree. There is some confusion over mutual recognition. For a couple of years we had thought that the *Instituto* would be the one to recognise members of the profession from other countries. Now it is revealed that the Ministry of Education will first validate the studies and give a university title and then the actuary can become a member in Spain. I became President of the *Instituto* a year ago and I am the first President since the 1950s that has not been a university professor. During those years there have probably been too many professors at the *Instituto*, but relations are very good and on the board of the *Instituto* there are many people involved with education.

Since 1959 the *Instituto* officially represents the profession in some functions. In all insurance legislation, all legislation affecting insurance or pensions, the *Instituto* is asked for its opinion; just opinion, not binding opinion, but in any matter involving the profession or regulation of insurance and pensions the *Instituto* participates and can convey its advice.

Answering the question on how many universities offer actuarial studies today, we must notice first that there has been a sudden evolution of these studies in Spain. Still, an actuary is not well known in the general population (as in many countries) so actuarial students at universities are taught in the economics school or business school. There used to be a specified number of students taking actuarial studies. I finished my studies in the early 1970s and eight of us finished in the same year. Now, at that same university, which is the University of Madrid, there are about 100 new students finishing their studies every year. There has not been, during the past couple of years, any shift towards this title which is no longer called just 'actuary' but 'graduate'. While I do not know exactly the name of the level of studies, it is 5 years of university studies graduating in financial and actuarial sciences giving some importance also to other applications of the profession, not just insurance but all the financial world. I know of at least two more universities which possibly would like to offer this speciality in the future. One is Valencia and I think your President knows the person who is trying to promote that; he mentioned his one-year study here. The other one is a second university in Madrid. We have four universities in Madrid and one of them is also trying to gain this title.

If I may just make some short comments on what I have been hearing. I think the most important, and this is one of the tasks that our present board of the *Instituto* will give priority, is to try to obtain a mortality table for the country. We already have had contacts with the insurance association and reached agreement on the importance of this matter. We still have not agreed the details of how we could share this project. I think that within the next couple of years we might come up with a first mortality table based on experience of insurance companies.

With regard to the general population, for use more by pension funds, we might have a mortality table before that. There is already a team working on that. The head of the team is one of the members of the board of the *Instituto* and he is head of the department of actuarial science in Bilbao. Every 10 years there is a general census in Spain. The last one was, I think, in 1991/92. The process of carrying forward the information when compared to the previous census showed too large a difference to be confident of that information. However, things have been sorted out and we might have a general population mortality table on which we can rely for pension funds between one and two years from now.

With regard to the recent draft legislation, that legislation on insurance which complies with 3rd Directives (Life and Non-Life) was stopped last year because of the elections. At that time, the draft legislation would not have implemented all of the provisions of the 3rd Directives. In September we had a new draft which seemed to go very quickly and would have implemented both Directives and also changed some aspects of the pensions law but it was stopped politically because of the third part of the law which proposed changes in the pension plan legislation. There is a big battle on this aspect and deadlines have been passed and still we do not have the legislation even discussed at the Parliamentary level. It may be possible for the pension part of it to be taken away so that the adaptation to the 3rd Directives can go through more quickly.

I would like to stress one point which I found very strange, reflecting a lack of experience on the part of our authorities which I have not seen mentioned in this paper. It is regarding selling of insurance. If the present draft of the law is approved, full disclosure of the commission, regardless of whether it is a tied agent or broker, should be stated to the client. I think that could do serious damage to traditional insurance companies and, of course, it is very much in favour of bancassurance and insurance products sold by banks. Most of the commercial expense is not in the form of commission to any agent but policies have many types of loadings. This is not a very technical point but could have a big effect on how insurance is sold in Spain. I do not believe that these regulations could go through the Parliamentary discussion. The draft legislation has been halted since last December because today the Socialist Party does not have a clear majority. They do not have the majority in Parliament and they need to negotiate with all the minority parties, mainly the Catalans and the Basques, the Catalans being more in the right centre than the Socialist Party.

There is a big discussion in our country, as in every country, on the extent of the welfare state. Just this last weekend there was a congress of the Socialist Party where a whole new board had to be elected. I think that now that those things have finished, the law will come much more quickly. We hope that by June it will be moving ahead in the Parliamentary discussions.

Mr D. G. R. Ferguson, F.I.A. As Chairman of the European Joint Committee of the Institute and the Faculty, I have, for some years, been very concerned to see that the legislation which comes out of the European Union and, in particular, the 3rd Life and Non-Life Directives is such as firstly to encourage the development of insurance for the benefit of European consumers, taking advantage of the track record that we have got in this country and secondly to ensure that the actuarial profession can develop throughout Europe both for U.K. actuaries and for other E.U. actuaries in a way which will develop the profession in a stimulating way. That is, indeed, happening.

In Spain there is derogation until December 1995 for the full opening of the European market to freedom of sales. I do not know whether the opener's index of activity in Spain, the number of members attending the Madrid luncheon club, will increase exponentially after December 1995, but I do not think that matters so much. What is important is that from 1995 Spanish consumers will have open to them a much wider range of contracts.

Although there are delays in the introduction of the legislation. I do not think that that need be such a handicap. When I was first working in Spain in the 1970s, the legislation which was in force was the 1908 legislation, but this was not the legislation which was being applied in practice. In practice, people were applying a 1938 law which was never passed through Parliament due to the Spanish Civil War, but being a practical nation the legislation was applied as if it was in force. So we have the draft legislation to bring in the 3rd Directive and I am sure in practice that will be applied also.

Of course, the market will open up and the one factor which will make the market expand very rapidly will be the introduction of legislation to help develop a private pension market with the recognition of the burden on the State of an ageing population which applies throughout Europe. That is a particularly difficult topic for any Government to tackle and it is not surprising that it is taking some time. I only hope that the recent adverse publicity which is associated with the development of personal pensions in the U.K. will not be taken as an excuse for not tackling the problem in a number of the European markets including Spain.

The last remark that I would like to make is on the subject of the development of reciprocal membership of the different actuarial bodies under the *Groupe Consultatif* agreement and the Directive on higher education diplomas. It is extremely important that we should develop and continue to develop collegiate links between actuaries throughout Europe and I am pleased to see that the relations that already exist between the *Instituto* and the Faculty and the Institute are very good. We were very pleased a few years ago to be invited to a meeting in Madrid to explain in greater detail the importance of the rôle of the appointed actuary when all this legislation was under discussion and I hope that our contribution was then found valuable. We were certainly extremely well received.

It was interesting that an earlier speaker said that, so far, the reciprocal membership arrangements have not worked in relation to admission to the *Instituto*. I am sure that that does not reflect any ill-will between the different bodies. It is an administrative matter. I am sure that, in the same way that Spanish actuaries are very welcome to participate in our professional activities over here to the full, the British actuaries working in Spain are also very welcome to participate in Spain. I do believe that is a very different matter to automatically granting full recognition and, in particular, granting full Fellowship status of the Institute and the Faculty after only 12 months working in this country which is what the current rules say. If that relates to younger members of the profession who are continuing their professional education and perhaps coming straight from university to this country, the granting of full Fellowship after one year does seem to me to be somewhat unnecessary and unexpected and I hope we will work out a better system of dealing with that.

Mr P. J. L. O'Keeffe, F.I.A. I have a question to the authors on the status of mutuals in the Spanish market. Section 2.3.7 says that Spanish life assurance companies are required to have subscribed capital of at least 1500m Pesetas. The implication is that every insurance company must be proprietary rather than mutual. Later on, it goes on to say that those U.K. mutuals which have gone into the Spanish market have not done so on mutual lines. So my question is "Do mutuals exist and do they operate as such?"

Mr R. B. Simler I will attempt to answer the question. Mutuals do exist in Spain. I believe that the mutual funds need 50% of the capital requirements of proprietary companies. There are not many mutuals. The method which mutuals use to distribute surplus is based on a formula which allows them to distribute their excess surplus every year. The formula may, and indeed usually does, depend on policy term and on how long each person has been a *'mutualista'*. Basically, therefore, mutuals declare bonuses or participation in profits in the same way that proprietary companies do, that is with a formula over which they have little control.

Senõr M. Peraita If I may answer, "Yes, there are mutuals and have been for a long time." In the past the financial requirements were much weaker than for proprietary companies. Many of them have not grown in size and many have gone bankrupt. So there is not a high percentage of mutual companies, but a few exceptions. In the motor market, some of the largest insurance companies are mutual companies and operating very well.

Also in life assurance there was initially the largest Spanish group which is called, Mapfre. It is of mutual original and still some of the companies of the group are mutual companies. The authorities do not favour this type of legal entity. They favour proprietary companies, but of course mutuals are regulated and they exist. The law distinguishes two main types of mutual companies. Those which are called *prima fija,* which means fixed premiums, which have quite similar requirements to proprietary companies because the company cannot ask for payment of additional premiums on bad experience and then you have pure mutual companies in which the insured participate in profits, and in losses of course.

Mr D. R. L. Paul *(one of the authors)* Somebody who read the paper before tonight suggested to me that we put too much emphasis on the mutual status of several of the U.K. parents and that what we really had was the largest players in the U.K. life market tending to be the ones who had the interest in Spain. It was a cause rather than a symptom that these happened to include amongst them a string of mutual offices. If I were writing that part of the paper again I would tone down the importance of the mutuals. What we have is simply the biggest life offices in the U.K., although there are obviously exceptions to that categorisation.

Mr I. J. Thomson I was involved several years ago in looking at the business potential of developing in European countries and papers such as that in front of us tonight on each of the major target countries would certainly have been invaluable, particularly since it covers precisely the topics which the enquiring actuarial mind wants to find out about.

Overall, the paper has confirmed my general view on European operations. Firstly that sales across borders will take a considerable time to build to any meaningful volumes since local markets will continue to stick to locally designed and locally understood products. Secondly, I believe opportunities to establish local operations by foreign-owned companies will exist but few, if any, will lead to quick success. Thirdly, while the demographics of Europe suggest that private provision for old age must grow rapidly, it is obviously difficult to get the right balance between fiscal stimulation, product features and employer control.

However, since having skirted the European interest all those years ago, I have not been directly involved and, therefore, my remaining comments are more of a general nature and interest in comparing how some of the aspects brought out about Spain either closely correlate with, or are very different from, the U.K. experience. I have picked out four of these to comment on.

The first is distribution. The fact that distribution has tended to polarise in Spain between *corredores* and *agentes* with multi-ties apparently being phased out because of consumer confusion rings all too familiar bells with what has happened in the U.K.

Next, I would like to make one comment about the implementation of the 3rd Life Directive. Referring to Section 2.6.4 and the observation that the *notas technicas*, which would not amount to prior approval under the 3rd Life Directive, will continue after implementation. I wonder whether that will prove to mirror the final U.K. situation with regard to qualifying policies once the Inland Revenue make up their mind as to whether that concept will continue in the U.K.

My third point is about information on the market. The authors refer in Section 3.2 to the obvious difference that total premium income is the recorded statistic in Spain rather than the more normal U.K. practice of reporting new business volumes. This led me to consider whether the non-availability of new business figures might actually have proved advantageous in the U.K. situation. Would so much emphasis have been placed on new business if those figures had not been available? Would the emphasis on producing new business rather than quality of sales and business retention not have been more highly thought of earlier if those new business figures had not been so closely followed by the press and the life office management?

My final point is on pensions which I find particularly interesting. The approach taken in Spain would obviously have pleased the consumer groups in the U.K.; limitations on sales and marketing loadings, majority employee control and full preservation requirements. It is interesting to note that the ultimate poor sales success that has been enjoyed in Spain on the basis put forward just shows how wrong predictions can be and that the real commercial world only works when salesmen and employers have incentives to play their part. Perhaps the U.K. would have avoided the current transfer value problems if we had gone the Spanish route but doubtless millions of workers would have had much lower pension provision as a result.

Mr D. O. Forfar As a number of commentators have pointed out, one reason for the lower per capita life premium level in Spain is the high coverage of the Social Security system, particularly the generous level of State pensions. This, of course, is combined with the high cost to employers of the Social Security contributions. The authors have mentioned a contributions figure of some 32% of salary up to £20,000 which seems to leave little room, or possible incentive, to establish pension schemes additional to the State scheme. However, the authors and others have referred to the demographic time bomb which is facing Spain as well as other countries in Europe and I believe that certain countries in Europe, perhaps indeed Spain, are facing the prospect of very substantial increases, possibly as much as a 50% increase, in Social Security contributions if nothing is done about the revision of the State system. Curiously enough, the fact that the current system cannot be sustained is not generally recognised, either by the general public, the press or by the politicians, possibly because this fact is rather unpalatable.

I would be interested to know the level that the debate on this issue has reached in Spain. I wonder whether the Government has published the equivalent of a White Paper on the subject or has it been widely discussed in the press? Mr Simler made a brief reference to some comments by the Economics Minister.

Clearly in law, that is Law 8 of 1987, the authorities have recognised the need for greater emphasis on private pensions but the authors have highlighted certain failures of the 1987 regime and it does not seem to address the problem of the rapidly rising Social Security contributions. I wonder whether this matter has still to come out into the open in debate in Spain.

On a different topic, I would like to ask the authors whether there is the equivalent of an Insurance Ombudsman in Spain. I think I have heard mention of this but I wonder if the authors would comment on that and how that system works.

The President Mr Akhurst picked up one point that the authors have made about the rapid reduction in recent years in the number of insurance companies in Spain. The authors point out that last year there were no new licences granted and that in 1992 the number of active companies fell by 12%. It is interesting to note that the contraction in the market has been almost entirely in the non-life area. I have the impression that in Spain a great number of companies transact insignificant volumes of business. Is that, in fact, an accurate impression and, if so, is there any evidence that the regulatory authorities would actually wish many of these small companies to disappear or are they happy to allow them to carry on and face the commercial pressures?

Mr R. B. Simler The DGS has expressed strong views that it would like to see a contraction in the number of companies operating in the market. It has consistently dragged its feet when faced with new applications from companies from outside Spain. The fact that there have not been any new authorisations recently does not reflect lack of demand. The DGS has been unable to state that it will not authorise new companies because that would be contrary to the principles of the European market.

However, the *Director General de Seguros*, the equivalent of the Government Actuary, was quoted towards the end of last year as saying "our hands will not tremble in the pursuit of a reduction in the insurance market."

The Government intends to increase the existing capital requirements for insurance companies. At the moment, as mentioned in the paper, the capital requirement for a life company is 1,500m Pesetas, 50% of which must be paid up. The intention is to require the capital to be fully paid up. Many companies which only write small volumes of life business may be unable to meet this requirement. There will be a corresponding increase in non-life areas as well, again leading to some contraction in that market. The DGS has however been encouraging outside companies wishing to enter the market to purchase existing operations. It is concerned that a market with around 500 insurance companies will not be viable once the European markets open up.

Senõr M. Peraita It is true that the DGS has frozen the authorisation of new companies. I would like to stress that this affects everyone. I know of several large Spanish financial groups who wanted to have insurance companies approved. They are going through the same process. I would just like to make the point that, while this affects some foreign insurance companies who want to come into our market they are not the only victims. In the late 1980s, the situation was somewhat different. At that time in my experience from the day the first papers were filed until the authorisation was granted used to be around three or four months, but during the last two years the situation has been frozen and no new authorisations have been granted during that period.

There are many small companies who are solvent enough – they have good risk selection, good reinsurance programmes (they do not retain much risk – possibly they are not true insurers), but they are not distorting the solvency of the market, while there are some large insurance companies which are not in very good financial shape. I would not say that size is the only symptom of good health for an insurance company but our present authorities seem to have that rule.

Mr P. H. Grace One of the notices that accompanied tonight's paper invited members to broaden the discussion if they wished beyond the boundaries of the Iberian Peninsula and I would like to take up that invitation and speak briefly on one aspect from a slightly different perspective.

In Section 5.3 the authors draw attention to the Spanish *Instituto's* active involvement with the *Groupe Consultatif*. I am the Faculty's representative on the *Groupe's* Insurance Committee and, against the background of comments in the paper concerning the implementation of the 3rd Life Directive, will make some observations on the work of that committee.

At its outset, the *Groupe* formed a sub-committee on Insurance Accounts, which due to other developments, not least the move to the single market, had its objectives widened and in 1988 it became the Insurance Committee. All but two of the European actuarial associations are members of the *Groupe*, and each association which is a member is entitled to have one member on the Insurance Committee. Under its terms of reference, the committee considers from an actuarial perspective matters relating to both life and non-life insurance in Europe. The intention is to enable the *Groupe* to put forward, when appropriate, the actuarial profession's views to other organisations, particularly the European Commission.

The Insurance Committee have prepared several submissions to the European Commission, the most significant being prepared at the request of the Commission and presented to DGXV in October 1990. The report attempted to reconcile the different practices and traditions in use in the European Union by recommending a set of actuarial principles rather than rules. It was considered by the *Groupe* that each Member State would have no difficulty in adhering to the principles, regardless of the method used in the State for determining actuarial liabilities. These principles, with some amendments, were reflected in Article 18 of the 3rd Life Directive.

In common with an earlier speaker, the committee shares some concerns about the implementation of the Directive. In particular, the committee is concerned at the prospect of regulatory arbitrage across borders. The Insurance Committee, as a result, undertook a review of the 3rd Life Directive's impact on actuarial matters. This review raised a number of questions as to how certain parts of the Directive will be implemented, in particular where the principles in the Directive depart from the *Groupe's* original proposals. Problem areas identified include the valuation interest rate. The authors have summarised this part of the Directive in Section 2.6.6 and have drawn attention to some of the possible consequences for the Spanish companies.

The committee also identified difficulties in the treatment of future bonuses where it was apparent within the committee that there is a divergence of interpretations – one committee member was not even able to accept that such a thing as future bonuses could exist, let alone the need to make any provision for them. We also identified difficulties in determining the liabilities for unit-linked contracts given that this is an area in which many countries have not already developed products but where developments are likely in the foreseeable future.

I would like to comment briefly on the relationship between the actuarial profession and the supervisory authorities. In the U.K. we take for granted such a relationship. Members of the Government Actuary's Department are frequent participants in discussions on professional subjects and some play major parts in the work of the profession. As supervisor, the Department of Trade and Industry sends representatives to appropriate conferences and through the Joint Actuarial Working Party the profession communicates its views to both the Government Actuary's Department and the Department of Trade and Industry. The same cannot be said for all Member States. Few States recognise actuaries to the same extent as we are recognised in the U.K. The *Groupe Consultatif* sees a need to encourage the supervisors to involve the actuarial profession in their work. To this end, the Insurance Committee organises a joint meeting each year between its members and representatives of the supervisors. These meetings address issues that the committee considers to be a potential threat to the profession and to the life assurance industry. Last year, they considered some of the possible consequences on competition and solvency in the light of the need for the supervisors to terminate prior approval of premium rates. The next such meeting of supervisors takes place later this week and will address the problems to which I have already referred.

The President Mr Grace referred to the *Groupe Consultatif*. Many of you will know that in 1992 the *Groupe Consultatif* set up an Education Committee, the main aim of which was to try to distil and blend together the best features of the variety of systems of education and training of actuaries in the Member States. What features, if any, of the professional training of actuaries in Spain would the authors like to see incorporated into the training of actuaries in the U.K.?

Mr D. R. L. Paul What I admire about the training that actuaries get in Spain is that they are coming from, what is in the first year of their study, an economics degree. They have a grounding in business corporate economics and methods of accounting. Some actuaries in the U.K. will have that if they have done that kind of first degree, but it was certainly not included in my first degree and it is something that I have had to learn as I have gone along. I can see advantages in getting that training early on.

Mr D. C. Mason *(closing the discussion)* We have had a very full discussion here this evening and as few of the members of the Faculty have actually had experience of working outside the U.K., I think that that reflects great credit both on our authors and on those willing to contribute to the discussion.

The authors were defensive about starting to talk about regulation and Mr Kerr, in his opening remarks, suggested that technical aspect of the paper was likely to be uninteresting to many of the readers. I would disagree with that because I felt that section did much more than set the scene. In highlighting the different approaches in Spain and the U.K., the authors brought out issues which we should be considering in the U.K.; for example, because we have the question of the PIA getting authorisation later this year. These issues affect us commercially and they can go on to be professional issues as well.

In reading the paper, I had been interested in the public profile that the DGS had taken on its wish to reduce the number of companies operating in the Spanish market. I was made quite openly aware of that when I was researching in Spain and it has been referred to by several speakers this evening. Mr Akhurst said that there were 100 non-life companies currently under a 'care and maintenance' control by the DGS. That is a frightening proportion of the market.

Several of the speakers have commented that the market is closed to new licences and that the DGS is actively encouraging companies that wish to go into this market to do so by taking over one of the existing players. I think we should be particularly grateful for Senõr Peraita's comment that the absence of licences is also inhibiting the large local players.

In the U.K. aspects of jurisdiction of our industry are spread between the Treasury, the DTI and the DSS, quite apart from bodies such as the Office of Fair Trading, the Government Actuary's Department, the Securities and Investments Board and all its cohorts. I am quite surprised that no-one has commented on whether we would have been better off in the U.K. under single control such as the DGS exercises in Spain.

I would like to tell a story from my own personal experience of dealing with the DGS and it shows my respect for that body. I attended a commercial conference in Madrid shortly after the enactment of the original pensions fund legislation. Each of the speakers at the conference was given 45 minutes, apart from the Government spokesman who had 30 minutes at the beginning of the second day. We all assumed this to be the usual token Government spokesman brought in with a very tightly controlled brief. We could not have been more wrong.

After 1 hour 30 minutes, the Chairman reluctantly drew that session to a close out of respect for the other speakers who were still waiting in the wings. The speaker had been a very senior figure in the DGS at that time. He addressed every question put to him directly and that was from a hostile audience which included representatives of most of the multi-national companies which had private pension funds in operation in Spain. He explained the DGS's thinking and its rationale. He did not look for agreement, just for understanding. If a particular point had been decided politically, he said so. It was a masterly performance in open Government and he fully deserved the standing ovation he got as he left us that morning.

The discussion has widened with the contributions from Mr Akhurst, Mr Ferguson and Mr Grace, on to the question of the implementation in the European Union of the 3rd Life Directive. We had important and significantly different views being put to us today. Mr Akhurst's opinion was that the 3rd Directive in some countries was going too far, too fast and that the onus for acting responsibly being placed on the individual companies might not be sustained. I had a similar view expressed to me a year ago in the Italian market where the Italian equivalent of the ABI was worried about the opening up of its motor market in particular, which was a tariff market. They were not worried about intruders coming in, but the fact that there would be no control on prices and they felt that the sales organisations would dominate and the technical organisations would lose out. There might be a scandal and only then would the market be regulated. Mr Grace, when he was talking abut the rôle of the *Groupe Consultatif's* Insurance Committee, touched on similar, if slightly more technical, concerns. On the other hand, Mr Ferguson was perhaps the pure European at this stage.

One of the requirements in the technical notes is to state the method of participation in profits. Mr Kerr felt that if there was a formula then there was no doubt but that reasonable expectations were met and that all policyholders were treated fairly. All the problems were for the actuaries in insurance companies in being unable to smooth their returns. I had wondered about that section myself as to whether the U.K. freedom was automatically better. It has certainly given life companies the opportunity to invest widely. It has meant that the overall return to most of our with profit customers has been greater than might otherwise have been the case. But if you had somebody taking out a U.K. endowment in the late 1960s to mature now, did he really expect the possibility that half of his proceeds could come out of a maturity bonus and that total proceeds could change by more than 10% over a year? Both approaches in my view have advantages. The issue for us and for our employers is to make sure that our communication is clear and direct and that it is for the benefit of the policyholders, not to protect ourselves.

On the development of indigenous mortality tables for the Spanish market, I was delighted to hear from Senõr Peraita the steps that have been taken. I hope that Spain will be able to get an agreement between the profession and the industry so that work can go ahead, though they are being extremely optimistic in thinking that they will deliver the results in two years. There may still be a rôle for collaboration, using the expertise of the Continuous Mortality Investigation Bureau in the U.K. to assist in meeting that aggressive timescale. I am sure, we would appreciate being able to work with the *Instituto*.

Section 2.4 of the paper deals with the regulation of selling practices and my understanding could have been fuller if the authors had set out how the sub-agents were regulated. Mr Kerr emphasised that the market there has polarised again and drew the interesting distinction that the IFA in Spain has to give 'impartial' rather than 'best' advice. I am sorry that none of the other commentators this evening felt they could stand and say that the result would be an improvement in the U.K.

I am surprised that so few people have picked up the impact on the Spanish market of the likely reduction in the maximum technical rate of interest, particularly as the paper seems to emphasise that assets are already taken in at market value. Mr Kerr said that there could be a 30% increase in reserves. The resulting strain is likely to cause difficulties for a lot of companies. I found it difficult to believe that if the change was necessary that it would be prudent to introduce it only for new business and not acknowledge the fact that problems had been building up in the business already sold.

Several speakers commented on the availability, or lack of them, of market statistics on the operation of the Spanish market. Mr Kerr had been able, from his own sources, to get hold of some detailed information on new business statistics and it might be interesting to hear whether he feels the market will develop from that or whether he got his information purely because he was using it on a confidential basis. Mr Ledlie commented on the lack of hard data in the market and how difficult it was to understand what was happening in the absence of a reasonably sophisticated trade press as we have in the U.K. However, Mr Thomson felt the U.K. market would actually have been better off it it had not been able to concentrate on new business statistics and had been able to concentrate instead on the quality of its business in a less public profile. As long as the statistics in Spain are only available in terms of total premium income, then the financial management of the companies over the persistency of their business is likely to be less than it should be. It may be that they are keeping the statistics back purely on competition grounds. There may be a wider rôle for the actuary to play in looking at the quality of the business which is being written.

On the rôle of the banks in the insurance market, I have been surprised by the statement in Section 3.4 of the report that bancassurance sales currently rely primarily on the bank customer taking the initiative. Perhaps the authors could comment on this. Most of the sales are made across the bank counter at the telling positions as distinct from a direct sales force, but my understanding was that the banks were conducting aggressive advertising and marketing campaigns for insurance sales and that they were well aware of which of their bank customers were now also insurance customers even if they did not have a customer database actually driving the warm leads.

In preparing for tonight, I put down a heading 'profit testing'. I hope that readers got to Section 3.6 where we had the actuarial side of the paper rather than the excellent, but wider, commercial paper. Nobody has commented on that part at all this evening apart from the opener. There are a lot of aspects that I found interesting. The authors, for example, assume that, for the premium and the sum assured to increase each year is a normal policy feature that they do not need to comment on. To me it would be likely to be one of the fundamental reasons why the overall profitability of the contract would be greater than might be achieved in the U.K. You also have to remember that profit is expressed as a percentage of the initial premium even though there are these large ratcheted increases. I was also interested to note that the paper quoted a discount rate of 12½% as against the 15% that is more common in U.K. modelling. I wonder if, as the competition grows in the Spanish market, they also will find themselves wanting to move towards a higher figure than 12½% because that would have the effect of making sure that contracts are put together in such a way that the profits emerge more quickly and, therefore, are less susceptible to lapses.

The pensions market in Spain has led to comments from several people, but the overall message that has come out is that, apart from consulting opportunities, this market is not going to be a particularly lucrative one for the insurance industry and for actuaries associated with it. Mr Kerr even went as far as to challenge who would want to enter the market with the low margin products that can be offered and with the high capital costs of entry.

We have had quite a few comments on the actuarial profession in Spain, mostly brought together by Senõr Peraita answering questions and I would be interested to hear how our own President reacts to the suggestion that we could improve the economic and accounting content of the syllabus in the U.K. I expected comment on one other aspect from the paper in this area. The authors say "with the junior ranks of actuaries swollen by the impressive number of graduates emerging from the universities in recent years, and the figure is now 225 a year, the Spanish actuarial profession presents a young age profile, well-equipped to face the challenges which await it." Mr Akhurst was saying that the rôle of the actuary was evolving into areas such as profit testing and asset matching, but I still wondered whether the authors were right to be so optimistic. We have seen recently in the U.K., perhaps for the first time, an over-supply of actuaries. The view that I had heard about the development of the Spanish profession was that other sectors of the economy had shown a downturn ahead of the life industry and that the under-graduates had switched to actuarial studies as a last resort. Early in 1993, it was quoted to me that 80% of 1992 graduates were still unemployed. So I do not think the position for the profession is as rosy as it might be.

Mr Forfar asked whether there was an Insurance Ombudsman in Spain. My understanding is that there is not at a national level but that some companies have adopted an independent arbitration service. I am aware of one non-life company which has office and secretarial facilities made available to a retired lawyer to provide such a service for its customers.

Mr Kerr put down the challenge as to whether the use of capital in starting in Spain was, in fact, a good idea for Scottish mutuals. I am sorry that nobody tried to pick up that challenge and defend his company's view in the course of this evening. The overall position that has been illustrated by the remarks tonight is that the market is going to be extremely tough for insurance success in Spain. Mr Ledlie talked about the enormous growth of the Spanish unit trust industry over the last few years, so that its income is now four times that of the life premiums. We heard from Mr Simler that the Spanish TESSAs are going to get off the ground at last and that the current legislative draft says that that will not be a market in which insurance companies can participate.

Mr Kerr suggested that the overall picture for U.K. insurance companies going into Spain was gloomy. Mr Akhurst that it was no El Dorado. So, although the authors finish on optimistic comments that the right combinations of talent can get it right, I think any actuaries sent out from the U.K. to work in Spain are going to find it an excellent challenge which will put them in good stead for the whole of their career afterwards.

Mr D. R. L. Paul *(replying)* Can I start by thanking everybody who has spoken tonight for their generous comments about our paper. I think the best tribute that can be paid is the sort of discussion we have had tonight. I am sure I speak for Roger Simler as well when I say I am gratified that so many who are more or less involved in Spanish or European work have spoken.

We are appreciative of the guests whom the President has mentioned joined us tonight. Senõr Santandréu of the Consulate, Mr Duncan Ferguson and also Senõr Peraita of the *Instituto* who helped us considerably in our compilation of Section 5 of the paper and who has fielded some of the most difficult questions tonight! One other guest who has not been mentioned from the platform is Richard Caborn who is Labour MP for Sheffield Central and Chairman of the House of Commons Trade and Industry Committee. He was at one stage involved in the work of a report to look at trade in Europe and visited some of us out in Madrid and it was very nice to have his support in flying the flag for the U.K.

I am pleased to hear the *Instituto* is tackling mortality tables. Mr Kerr put some of the reasons why the private venture to get the mortality table off the ground did not work. I think it was the cost that was the block. It is interesting to hear that the *Instituto* is also having problems with its budget on this project. The mortality table may not seem a terribly important issue when you are pricing savings and endowment-type policies, but as Mr Akhurst mentioned it is much more critical for pricing annuities. That is a sub-set of activities for only some of the life offices in Spain.

Mr Kerr also mentioned the methods of distribution of surplus in Spain hinting at the restrictive nature of the *notas tecnicas* and the lesser degree to which actuaries can exercise their discretion in this area. One point I would bring out is that although by statute the *notas tecnicas* have to be very precise in their formulae as to how the investment rate of return which has been earned is applied, I have never seen any great degree of definition as to how to arrive at this investment rate of return, the figure at the very beginning. I have never seen that set out for either bond portfolios or equity portfolios and there does seem to me to be a degree of discretion in that area.

The other area where there is a degree of discretion possible in the *notas tecnicas* is in the expense basis. Although you have to set out your expense basis, this is traditionally set out as a level percentage throughout the term of a policy and, of course, the way that sales commissions in particular are paid is not in that fashion and, therefore, there has to be a capitalising of that to assess how much a policy can support in the way of sales commissions and there is a degree of discretion there.

Mr Kerr challenged us on our percentage figures for distribution by different categories of agent. We were not pretending that that was a very scientific measure, but we would still stand by those percentages as our best estimates with the qualification that many of those categorised as *corredores*, would be *corredores* under the previous legislation, and it remains doubtful whether some of them would be recognised under the current legislation although they seem to continue to operate as before.

We did not touch on the topic of illustrations in the paper. This is not an issue with most of the traditional contracts where the illustrations of benefits tend to fall out naturally along the lines of the pricing basis of the contract although you would still need to assess some investment rate of return to be projecting what your distribution of surplus would be at maturity. It is more of an issue for unit-linked contracts, but these are, to my knowledge, only sold by two or three companies so that is very much a pioneering area. It should not come as a surprise that Spanish regulation does not cope very well with that.

Mr Kerr suggested that, on a profit testing basis, traditional contracts are under serious threat from falling interest rates but that unit-linked contracts will fare better. I would agree with that.

I return to the restriction of expenses and how that is controlled. I had been thinking prior to this evening that one comes back to the U.K. and sees the impending trauma of hard disclosure. One can see some merits in having tighter restrictions and perhaps the U.K. might have avoided some of the excesses to which hard disclosure, pushed by the consumer lobby, is a reaction. Having said that, it was interesting that Senõr Peraita mentioned that disclosure is coming to Spain in just the same fashion. So for all that they have had a greater degree of pricing control on their contracts there is still perceived to be the need to disclose sales commissions in Spain, although it sounds like it will come two or three years later than in the U.K.

We would agree with the comments about the need to look at new business figures if they were available and I think it is probably true to say that the U.K. companies are not so far down the long tail as the figures we have used suggest. Professor McCutcheon mentioned the number of small companies that there are. One factor is the many companies that only work in one provincial city. This is a scale that we are not familiar with in the U.K.

We talked a little bit about the valuation interest rate and the need for that to come down in response to European Union legislation. I have to temper that with a little bit of caution because one has to realise where the Spanish market is. All is not well in some of the companies and the DGS is already nursing a lot of companies even on the basis of current valuation interest rates. This will not be an easy transition.

Mr Grace made the point that the relationships between the life industry and the supervisor and the professional bodies in each country are very different. It is too easy, from a U.K. perspective, to conclude that other countries tend to think, and tend to work, the same way we do. It is hard to imagine the current state of the Spanish market. It is hard to imagine that the U.K. Appointed Actuary system would be a powerful enough tool to cope with some of the changes which need to be forced through. These matters of regulation are really horses for courses. I would not think it appropriate to allege that our system would work well in Spain, nor do I think it would be appropriate to say that the Spanish degree of regulation would be appropriate in the U.K. market.

Mr Ledlie set out the tax position on traditional life contracts and I would agree that was something we should have put in the paper. Mr Ledlie has done it very nicely for us. The only thing I would add is that a large proportion of the sales of traditional life products are going to a relatively unsophisticated investor to the point where 'investor' is perhaps not the correct word to use. I think the sophisticated investor is tending to go for the unit trusts that we talked about and also into *planes de pensiones*. All these more modern instruments each have their own tax regime and it is the tax regime which is making these attractive.

Various speakers talked about the rôle of the *Instituto*. I think it is correct to recognise that the *Instituto* is not an educational body in the way that the Faculty and the Institute are. We do have to understand that difference and that is part of the reason why the cross-border recognition of professional qualifications is difficult. We have had questions and answers as to whether other universities are looking to work in this area and perhaps the logic is that it should be the universities that supervise the competence of foreign actuaries. I had an ambition to fight to get actuarial recognition in Spain and I had to temper it with the realisation that it is a long time before one has enough experience and enough knowledge of the marketplace to be competent to practice. I think that is the problem Duncan Ferguson has with the idea that people could come from Spain to this country and be practising very rapidly. We have to recognise the difficulties

There was the suggestion that it was helpful to the evolution of the market that new business premium income is not a published figure. It is a nice idea, but I have to say I doubt whether it is the case. In my experience there was no less pressure on what the year's new business figures were as a measure of the company's success.

Mr Forfar asked how far the debate on the future of the Social Security system has gone. This certainly has not reached a White Paper. It is a difficult topic for politicians to tackle. It is interesting to compare it with the U.K. where one can identify that in the 1980s there was a change from one style of funded system, I am talking on a macro-economic level, to another style of funded system, but when we start to see the figures for the people who did not make significant provision under the personal pension regime, it was, to a degree, changing from a funded to a non-funded system. It was changing from a funded to a pay-as-you-go system if you accept the idea that, in fact, in 20, 30 or 40 years time the State may have to pick up the inadequacies of people's own personal provision. What Spain has ahead of it is actually more difficult still because it has to go the other way. It is, on a macro-economic level, a pay-as-you-go system and if you start saying that you cannot afford a pay-as-you-go system, it is then very difficult to argue that you are going to have to pay even more than the pay-as-you-go system to start putting in place a funded system. It is a brave politician who tackles that.

Mr Forfar also asked whether there is an Ombudsman. We think there is a *Protector de Something*, but his rôle may be more general consumer protection which does not apply to the insurance sector. I am aware that the method which most policyholders use to solve complaints or disputes with their insurer is to contact DGS directly. The DGS seems to crop up in just about every field in Spain and the DGS certainly ran an office which dealt with individual enquiries. The DGS was a very objective judge in these situations. In my experience, the insurer would accept the DGS's judgement, be that in favour of the policyholder or in favour of the company and that was a reasonably fair and workable system.

Looking quickly at our section on what the curriculum is in the actuarial training in Spain, I think the other thing that Spanish actuaries are ready to practice in is matters of insurance law and contract law which, in the U.K., tend to be part of the Chartered Insurance Institute's syllabus rather than our own.

I would like to close by expressing my admiration for many of the professionals in Spain who over recent years have been weaving this new and intricate fabric in Spain's life and pensions arenas. There is clearly a great will for Spain to move its financial services sector forward. Repeating our own conclusions, Spain certainly merits serious consideration for a new market opportunity and we commend it to anyone who has the chance to become involved.

Subsequent to the meeting a number of written contributions were received:

Mr T. G. McKinlay As the authors note, working abroad is a rewarding and interesting experience which gives a new perspective on a number of actuarial areas. I have now worked for five years as the chief actuary for the French branch of a major U.K. mutual and it may be of interest, therefore, if I note some of the major differences I have met between practices in France and the U.K. In particular, it may be of interest to ask the question: "Where can France perhaps learn from the U.K. and vice versa?"

It is not possible in a short note to give a full description of the insurance environment in France, as the authors have done for Spain. In general, however, it would be true to say that much of what has been noted by the authors for Spain can broadly be applied to France but I will refer to any important differences between French and Spanish practices where relevant.

In France, as in Spain, insurance law is codified, specifying among other things, minimum premium and reserving bases. In practice, however, for premium bases, the company does have some discretion in setting mortality and expense levels and so profit testing techniques, although not widely used at present except by subsidiaries of U.K. companies, can usefully be applied and would help French companies better understand the nature of some of their financial risks. In contrast, however, although profit testing is little developed in France, there has been in recent years a move to develop asset liability management techniques as companies have become aware of the need to assess certain global risks in their portfolios, in particular, risks related to statutory surrender values.

Surrenders values in France are required by law to be at least 95% of statutory reserves. For a U.K. trained actuary, who is used to surrender values being determined depending on the financial conditions ruling at the time of surrender, this rule raises concern. How can an office invest to meet its long term guarantees and at the same time invest to avoid losses arising from paying statutory surrender values if asset market values fall? (It should be noted that French reserves, and thus surrender values, are calculated on a fixed valuation rate, as in the premium basis, and reserves, therefore, do not vary with fluctuations in market values, even for fixed interest investment). The imposition of statutory surrender values in France reflects the authorities' concern to protect policyholders, but also reflects the greater importance given in France than in the U.K. to the idea of mutualising risks and thus spreading risks over a wide category of insured lives. The French point of view on surrenders takes into account that a policyholder can find himself with an unforeseen need for funds or a change in his financial circumstances and as a result he may surrender his insurance savings policy. The office may make a profit or loss on the surrender depending on market values at the time of surrender. This profit or loss will be reflected in the office's accounting profit or loss and thus in the bonus declaration made to remaining policyholders. (French laws require companies to distribute a minimum of 85% of financial profits and 90% of technical profits). If the probabilities of profits or losses occurring are considered to be equal, over the long term policyholders can expect the effect of surrenders on their benefits to be neutral but are protected in case of early surrender occurring at a time when asset values are low.

Clearly, the French, and in particular the French authorities, do not believe in anti-selection by financially aware policyholders who could profit by surrendering and reinvesting elsewhere when asset values fall. Historically, it is probably true that the characteristics of French policyholders were such that selective surrendering did not represent a significant risk. A number of companies, however, are now questioning this hypothesis under the current more competitive and financially aware environment and are attempting to measure the potential impact on their financial position of this type of risk and more generally to assess the appropriateness of their assets in relation to their liabilities. The industry having now identified the statutory surrender value problem, it will be interesting to see what solutions emerge. In the case of significant anti-selection occurring the insurance authorities may be expected to modify the surrender value rules. However, companies may prefer to take their own preventive measures and are currently researching the use of financial options and of catastrophe risk reassurance as possible ways of protecting themselves. Whether French companies will find a solution to this problem or whether the research being undertaken will serve to convince the insurance authorities (as U.K. companies currently believe) that predetermined surrender values are unsound, time will tell. Should a solution emerge, however, U.K. companies may be interested to profit from French experience and introduce some level of protection for policyholders in the case of surrender. This would be a useful benefit to include in savings products if the associated risks could be adequately assessed and controlled. It is likely also to be a pre-requisite for U.K. companies entering other European markets where this type of protection on surrender is standard practice and expected by the market place.

Other areas where the French approach is likely to surprise a U.K. actuary are in the areas of bonus distribution, group life cover and annuities. French companies are required to distribute as bonus a minimum of 85% of their financial profits. French accounting rules tend to encourage companies to hold a high percentage of bond investments in their policyholder funds and under the accounting rules financial returns from bonds are smoothed so that they emerge uniformly over the term of the bond i.e. any capital gains or losses are amortised. A bonus rate is declared each year as a percentage of existing reserves (for the majority of French contracts). (French companies do not declare terminal bonuses.) As a result, the bonus rate declared reflects an average of historic returns on bonds. Thus policyholders who invested when interest rates were high will receive less than their contributions have earned and policyholders who invested when interest rates were low will earn more than their contributions have earned. The French approach to bonus again implies a mutualisation of risk, this time the investment risk associated with movements in interest rates. This can be contrasted with the U.K. situation, where the use of asset shares to determine maturity values by means of a terminal bonus means that each generation of policyholders carries its own investment risk (although of course some smoothing of risk may be introduced when using asset shares). While spreading risk, as in the French approach to bonus, can be considered a valid objective for an insurance company the French could be creating problems for the future. We have seen two decades of falling interest rates in France and so bonuses declared on insurance policies have lagged behind then current interest rates, with the result that insurance policies in France are seen as good investments by the market place. Should France enter a period of rising interest rates, the danger is that bonus rates would eventually lag behind bond returns and could then appear unattractive with a consequent impact on companies' abilities to write new business (and possibly even retain existing business). In this situation the U.K. asset share approach may offer some solutions to the French.

In the domain of group life, the mutualisation principle is again applied. For large group schemes, premium rates are set taking account of the constitution of the group with respect to age, sex, etc. Despite movements among employees, contribution rates for large group schemes can be expected to remain fairly stable. This would not necessarily be the case for small group schemes. The French approach is therefore to group small schemes together to form one large group and determine a common premium rate! While there may be administrative advantages and a simplification of client relations with this approach it is difficult to see how this approach can survive the increased competition associated with the opening up of European markets. The potential for anti-selection is clearly great.

In France, all contracts, except short term risk contracts, must participate in profits. As a result annuities in France are issued on a with-profits basis in contrast to the non-profit basis used in the U.K. There are no particular actuarial difficulties associated with with-profit annuities where distributing financial surplus in proportion to reserves results in a corresponding increase in the annuity payments made. From the policyholder's point of view, with-profits annuities have the attraction that increases in annuity payments can provide some protection against inflation with an appropriate investment policy. From the actuarial viewpoint the bonus loading provides a useful protection against improving mortality. It is surprising that with-profits annuities have not emerged in the U.K.

Perhaps the greatest difference a U.K. actuary notes in moving to continental Europe is the tendency for policyholders' funds to be invested in fixed interest investments. This can be explained perhaps in France, as in Spain, by the tendency for the market to be risk averse, preferring bonuses and surrender values to be guaranteed. It is not clear that this apparent risk aversion does not simply reflect the absence of choice in the product range and if U.K. style policies with terminal bonus had been available would they have sold?

As noted, surrender values are imposed by law in France and this tends to encourage a more conservative investment policy. Accounting rules in France also tend to encourage fixed interest investment by allowing such an asset to be accounted for at the minimum of acquisition or redemption value even if market value is less. Finally, the ordinary share market in France has historically been much less developed than in the U.K. so the attraction of shares has been less. For these reasons share investment by French insurance companies has been limited to date despite the fact the investment regulations for insurance companies are not restrictive with respect to ordinary shares.

At the present time, the Government is encouraging share investment and a more positive attitude can now be detected with regard to shares. While this may show up in the life insurance field as an increase in the sale of unit-linked products, there could also be a place for products with U.K. style terminal bonus. Terminal bonus products are, however, far removed from the traditional French product range and would most likely require a number of changes to French legislation (i.e. statutory surrender value and accounting rules) before French companies move in this direction. The marketing and communication effort required would also be significant if traditional risk averse attitudes are to be changed, having been created by many years of traditional, security orientated, insurance selling.

In the pension area the importance of pay-as-you-go schemes is even greater in France than in Spain. Not only does the state provide significant levels of pension, especially for the lower paid, but industry-wide pay-as-you-go schemes exist to provide a second layer of pension which means that, except for the very top earners, pension benefits have historically been very good. With the changing demographic features of the population, however, the shortfalls of a pay-as-you-go system are now being debated in public and moves by the Government to introduce an element of capitalisation are expected shortly. We wait to see what form this will take but the U.K.'s long experience in pension fund management should provide useful guidelines to French legislators, if the French can manage to put the recent U.K. pensions controversies into perspective.

With regard to the rôle of the Actuary in France, it is to be noted that until very recently the Actuary had no legal rôle to play with all official returns being signed by the Board, including certifying the accuracy of the reserves. Within the last year, however, companies have been given the right to use non-standard mortality tables in their premium and reserving basis provided the tables have been certified as appropriate by an actuary. This is the first legal recognition of the rôle of the actuary and can be expected to lead to further wider legal recognition.

Although, the rôle of the actuary in law has been limited in the past, the rôle of the actuary within a life office has been much wider but, as in Spain and unlike the U.K. very much limited to technical matters of premium rates and reserves. With the increasing awareness in France of the need to analyse the financial risks that an insurance company is subject to, we have seen the rôle and influence of the actuary increase in many companies over the last few years and the interest of the actuary in the global questions of asset liability management is very much on the increase. It is interesting to note that here again, by placing more importance on asset liability management than profit testing techniques, we see the French tendency to look at actuarial questions from a global, rather than a product, perspective, a tendency already noted with the French preference for a mutualisation approach to risks.

Mr S. H. Leckie I went to Hong Kong in August 1979. At that stage I was expecting to be overseas for two or three years and then return to the familiarity of the U.K. However, I am now in my 15th year in Hong Kong and am likely to stay there for the next few years. I was only the sixth actuary to work in Hong Kong. There were a few life insurance companies only and consulting activities were very embryonic. Also, in 1979 Hong Kong's population was just under 5 million, less than Scotland's population, whereas today Hong Kong's population exceeds 6 million. 1979 is also noteworthy in that this was a turning point in the People's Republic of China as in that year the P.R.C. decided to adopt an open door policy to the West. Over the last 15 years the number of actuaries in Hong Kong has grown more than ten-fold and we now have about 70 Fellows.

Economic growth in Hong Kong has been most remarkable with GDP per capita currently at US$17,000, which exceeds that of the U.K. As the Hong Kong economy changes from a manufacturing to a service bias, economic growth will remain strong but will probably average closer to 5% per annum in real terms rather than 10% per annum. Hong Kong is rapidly becoming the capital of the southern part of China with some 400 million population.

The profession has grown quite rapidly in most countries in the Asia and Pacific region and there is generally a feeling of optimism about the future potential for qualified actuaries. In Hong Kong most of the actuaries are Fellows of the U.S. Society of Actuaries. This is because Hong Kong people now look more towards Canada and the U.S. than they do towards the U.K. Also, the Society gives an associateship after completing half the examinations which the Faculty or Institute do not. Many of the actuarial students are extremely bright and hardworking and able to pass the computational part of the examinations readily but the later examinations which rely more on judgement and on English language ability prove very challenging.

In the P.R.C. the Institute of Actuaries is now sponsoring the first actuarial science course in one of Beijing's universities. In December 1993, Mr John Martin as President of the Institute and myself visited the university and were impressed with the enthusiasm of the students although the real challenge is to improve their English language abilities. The U.S. Society of Actuaries has also run courses at Nanking University for several years. In Japan, Korea, Taiwan, Philippines, Indonesia and Australia, the local actuarial body sets its own examinations whereas in other countries actuaries qualify as Fellows of the Faculty or Institute or U.S. Society or Australian Institute.

The actuarial work in Hong Kong tends to mirror that in the U.K. of perhaps 20 years ago in that most actuaries are employed by life insurance companies although consulting work is now growing rapidly. The actuaries were also involved in measuring investment performance and in other asset related work. Legislation will certainly have an effect on boosting the status of the profession. The actuarial profession is even less well-known in Hong Kong than it is in the U.K. However, the Insurance Companies Ordinance requires every life insurer to have an Appointed Actuary and under the Occupational Retirement Schemes Ordinance all defined benefit retirement plans require advice from a Fellow.

Hong Kong has been represented at the Congresses of the International Actuarial Association since about 1976 and a reading of the Hong Kong national reports at successive Congresses can prove illuminating. Equally, national reports on Hong Kong have been submitted to each of the bi-annual conferences of the International Association of Consulting Actuaries for the last 12 years. In October 1994, the IACA Conference will be held in Hong Kong for the first time and it is expected that about 300 consulting actuaries will participate.

Every two years the East Asian Actuarial Conference is held in a different city. The most recent one was in Singapore in December 1993 and the next one will be in Tokyo in October 1995. From very small beginnings, this conference is now attracting about 250 actuaries mostly from the region but with some from the U.K., U.S. and Australia.

One question which I believe the Faculty should address is – why is the Faculty not more active in the Far East? As a strong believer in the value of the Faculty's education and training, I feel that the Faculty has much to offer in this growing part of the world. Conversely, if the Faculty restricts its activities mainly to Scotland, then in time it will simply be regarded as outdated in the rapidly developing economies. To the best of my recollection no Faculty President has visited Hong Kong in the last 15 years. During this time, two Institute Presidents and about six Society Presidents have visited and given talks to the local Actuarial Society.

A question on the world's mind is what will happen to Hong Kong after 1997. Let me say that I am optimistic about Hong Kong's future as a separate region within the People's Republic of China. Undoubtedly there will be many changes and there seems certain to be continuing tension over the next 40 months between Britain and China. But overall I am convinced that the 21st century can be a golden era for Greater China.

Mr H. P. J. Karsten, F.I.A. If we look at the experience of non-Spanish insurers who have operations in Spain, there are some notable success stories. Perhaps the most well known such cases in Spain are Zurich and Winterthur, Swiss companies, which are the largest foreign insurers by size of Spanish premium income, and Generali, an Italian company, which obtained the largest published profits among foreign insurers in 1992, the last accounting year available at this time.

I think the key for success in Spanish insurance is the link between the actuary and the market. The market changes very rapidly as mentioned in the paper – many important developments have taken place over a span of twenty years. A lot of this change is tax driven. Recently, for example, savings type insurance products have been assisted by clarification and improvement of the capital gains tax situation.

The key point is for the actuary in Spain to be able to react quickly to changes in the tax and legal environment or to the market and implement new product designs and marketing approaches rapidly. The other key area is sensitivity by the actuary to the needs expressed by the distribution system used by the insurance company.

My own position is not dissimilar to that of the authors, as I work in a consulting company in Madrid and have the British actuarial qualification. However it is different in the sense that I have been in Spain for a longer time, for twelve years, and also have the Spanish actuarial qualification based on Spanish studies. The Spanish actuarial qualification is substantially different from the British one, and, in particular, it has a much greater amount of law, accounting and economics content. This gives Spanish actuaries good access to the legal and marketing issues that affect product design.

Mr C. A. Melvin F.I.A. The authors have produced an essential 'pocket-guide' to the Spanish life insurance market, which, together with a course in the language and the culture, should be essential reading for any actuary who has the good fortune to spend time working in that market. My views are those of the Managing Director responsible for launching two U.K. life operations in Spain, one of which acquired the other. My first observation is the sheer pace of change and development in Spain over recent years – "from the third world to the first in one generation" is a quotation which springs to mind. I therefore agree with the authors that Spain is a very exciting place in which to live and work and this presents a formidable management challenge, both to individuals and also to international insurers. Spain is one of the most difficult and frustrating countries in which to manage subsidiaries, particularly where the parent is of Northern European or North American origin. This is a function of the real differences which exist between the cultures which go beyond pure language barriers. Spaniards are fiercely independent, rejecting controls and preferring to pilot new ideas rather than get bogged down in detailed planning. They are entrepreneurs and risk takers – preferably with somebody else's money! It is not difficult to envisage some of the problems that can occur given the ways of working common in some Northern European insurers and attempts to impose sophistication on a relatively underdeveloped market. On the positive side, Spaniards are extremely creative and are marvellous improvisers. A successful management team of locals and ex-pats will need to achieve the right blend of the diverse cultural types.

International insurers contemplating establishing an operation in Spain will need to think carefully about the position of the CEO. Should he be a local or an ex-pat? There is no right or wrong answer to this question, but it is worth noting that where the top man is a Spaniard then it is normal practice to send out an ex-pat to occupy one of the other senior management positions – normally that of finance director. This is a very demanding position because of the dual reporting lines – hierarchically to the Chief Executive and functionally back to head office. This can create strong tensions between the two individuals, particularly where suspicions arise that the expatriate has the rôle of 'spy in the camp'. I came across a number of international insurance operations in Spain where such a situation was causing real difficulties – in some cases leading to a breakdown in communication between head office and subsidiary and consequently major problems in controlling the operation. It is perhaps worth adding a few words about the rôle of senior expatriates. In addition to responsibilities of their position in the local operation, they are also international managers of the parent company, and occasionally need to stand back from the day to day running of the operation and view it critically through the eyes of head office. This can present a real dilemma on occasions, especially where local market practices in either technical or business areas differ markedly from what would be acceptable back home.

Mr J. R. Mungall My experiences in Asia cover seven years and residence in three countries, Hong Kong, Korea and Indonesia, plus project work in three others, primarily in life insurance. I think the most challenging aspect of working in this part of the world is the language barrier. Asian languages are extraordinarily difficult for English speakers and one decides early on that surrounding oneself with a cocoon of English speakers is necessary if any kind of productive activity is to be possible. This makes one extremely dependent on a few people, and leads to frustration. Interviewing someone for a job through an interpreter is not a particularly happy experience. Signing actuarial statements written in a language that one cannot understand requires a lot of faith in one's staff. At least numbers are universal.

Of the three territories, Hong Kong's language, Cantonese, is by far the most difficult to learn, but by a happy coincidence is the least necessary, given the fact that the language of business and law is English. Indonesian is one of the easier languages to learn, but to get to the stage of using it in a business environment takes a lot more time than a normal working schedule allows. Often meetings will slip from English into the local language leaving one high and dry.

Another problem is the dearth of experienced staff – in most Asian countries the life insurance business is undergoing rapid growth, often from a very low base. This shortage is particularly acute in the technical areas, including actuarial work. In Korea for instance the vestiges of Confucian social rankings put technical people (engineers, architects, actuaries to name but a few) much further down the pecking order than they are in the West. Actuaries therefore are few and far between – 67 in the whole country, serving what is the sixth biggest life insurance market in the world – and in rôles that are restricted to technical matters. The actuarial ivory tower is more likely to be a broom cupboard in the basement. In hiring an actuarial assistant I had two overriding criteria: technical ability and fluency in English – but in the end had to compromise on the English. This meant that we communicated via a translator (my secretary) until we got down to the specific formulae that I wanted him to use when suddenly direct communication became possible.

My stint in Korea provided an insight into what is to Westerners one of the most 'foreign' societies around. Relationships are on the surface very formal and structured, with age being the key factor – two Koreans meeting for the first time will quickly establish who is the older, as this determines the honorific to be used in conversation, and also the depth of the blow to be given when parting. Company hierarchies are primarily based on age, because to do otherwise would run counter to this social structure. Typically, Koreans graduate from university at the age of 23 or 24, and then spend three years in the army doing national service, meaning that by the time they start work they are in their mid-twenties. They find it strange that a foreigner who is still a few months short of his thirtieth birthday would have almost ten years' working experience.

Respect for rank is one appealing feature of the Korean working environment. One of my staff used to come to the door of my office every morning, bid me "Good morning" and bow. This apparently was the respect I was entitled to because of rank, and he was treating me the way he would a Korean boss. I explained to him that I'd never had anyone in my U.K. office bow to me, so I didn't mind if he dropped the practice. The downside of this is that staff are reluctant to question or challenge their bosses, so a lot of potentially valuable input is lost.

The actuarial profession is in different stages of development in various Asian countries. Hong Kong probably has the highest concentration of Western qualified actuaries, a mix of expatriates who arrive qualified, and Hong Kongers who qualify locally. The preferred route to fellowship for the latter is a degree in actuarial science from an American, Canadian or Australian university, with a handful of exam credits therefrom, then a return to a job in Hong Kong to pursue the rest of the exams. Most students enroll in the American Society exams, with the Australian Institute becoming more popular recently. This in a territory that used to be the domain of the British bodies. In the other territories where I have worked there are Foreign Actuaries' Clubs, which involve no more than a fairly sociable lunch every couple of months and a chance to exchange information on the latest Ministry of Finance pronouncements, or Market gossip. In Indonesia our membership has doubled since 1992, and we now have six members. In Korea it was a rather lonely affair at first, but by the time I left in 1992 there were four of us. These are particularly useful since generally each actuary is alone in his company, and lacks colleagues with whom to discuss technical problems.

Incentives and support for actuarial students to pass the exams are common in Hong Kong and Singapore, but less so elsewhere, although nowhere is the study leave as generous as in U.K. That students still manage to complete the exams in reasonable time, in their second language, is testimony to the Asian work ethic.

Recognition of foreign actuarial qualifications is common but by no means universal – some territories accept the signature of a defined list of qualifications, for example former British colonies will tend to have the same list (FFA, FIA and FSA) as used in Britain, although the Australian FIAA is gaining acceptance. Another approach is for each actuary to have to seek approval based on his/her experience. Most insist on residence, and others take the view that they will only recognise overseas fellowships if reciprocity is offered.

Korea provided an opportunity to work in an environment of 'positive legislation', where an action is only allowed if the regulations specifically say so. In a society that reveres conformity, such a system is entirely natural. This puts tremendous power in the hands of Ministry of Finance officials, and gives a lot of scope for Westerners who are not used to this system to fall foul of the MOF.

Finally a word of advice for those in management positions in life offices. The Asian markets have huge potential, with rapidly growing economies, high savings ratios, and a relatively unsophisticated buying public. American, Canadian, Australian and Dutch companies are flocking in, but the British are conspicuous by their absence. Europe may be a tempting market, right on your doorstep, but Asia is not an opportunity to be missed.

Mr T. Lawrence F.I.A. I would like to follow the theme of looking to the future. I will base my remarks around one feature that is currently occupying the minds of Spanish actuaries and insurance companies. This feature is not unique to Spain, but allows a basis for 'compare and contrast with the U.K.' whilst allowing for a broader discussion, as this also has application to other territories in the E.U. My remarks are based on experience in Spain, where I have worked for the past four years.

The most immediate concern for insurance companies is the recent fall in interest rates and the implications of the 3rd Life Directive. In recent years, Spanish interest rates have been amongst the highest in Europe, having been used by the Government as a weapon in the fight against inflation. Now that inflation has largely been beaten, interest rates have been reduced substantially, as in other European countries, to try to help revitalise the economy. The Bank of Spain official interest rate has fallen from 13% at the start of 1993, to 8% in March 1994. I believe that this situation is not unique to Spain, although the fall in interest rates may not have been so great elsewhere. During these times of high interest rates, insurance companies were able to use technical interest rates, to calculate both premiums and reserves, of up to a maximum of 6% for long-term contracts, defined to be those of term greater than 5 years. Higher interest rates could be used for short-term contracts, where specific assets were bought to match the liabilities, or by companies with surplus five times greater than the minimum E.U. solvency margin. However, now both the regulatory authority and the provisions of the 3rd Directive are leading to the use of lower interest rates.

If lower technical interest rates apply only to future new business, the immediate effect will be a change in product design so as to soften the effect of the reduction in interest earnings, and hence profitability, of the insurance companies. This will lead to less attractive products for the public, who will see higher premiums and lower profit sharing. If companies have to use lower technical interest rates for the calculation of the mathematical reserves of the business already in force, there will be an increase in these reserves, which will reduce accounting profits in the year.

However, and if only because of this increase in reserves, there may be higher levels of investment income in future years. When one also takes into account the effect of the increase on the solvency margin, the effect on future reserve increases, and any changes in the terms for profit sharing and surrender values, one sees that a reduction in the technical interest rate will have a compounded effect on, not only the revenue account of the year in question, but also those of all future years.

It is worth remembering that, for most Spanish companies, the immediate concern is statutory reporting, i.e. the revenue account, rather than other long-term effects on the company, e.g. the embedded value.

It is not yet certain whether the reduction in the technical interest rate will apply to only the new business, or will also apply to the calculation of the reserves of the business in force. I have been in some meetings where the regulator has not been able, or willing, to state a definite position. This is understandable, when one considers the historical position, where, as stated in the paper, the reserving basis must legally follow the pricing basis, and thus is fixed for life.

There exists, for Spain a rare opportunity of the actuary being able to change the valuation basis. The worry of some actuaries, and the regulator, is that they have little experience of setting such a basis, only of calculating results. This is not to say that they cannot, or do not want to, set the basis; but they are very aware that today's decisions will affect the immediate statutory reporting (revenue account and balance sheet) position of the company.

Another concern is, what interest rate should they use? It is easy to say, as does the 3rd Directive, 60% of Government bond rates. But when these rates have fallen as in Spain, should one use the current rate of 8%, or expect some further fall in interest rates. Remember that 15 months ago the rate was 13%, and even at 31 December 1993 it was 8.5%. Which directors will be pleased that the actuary decides that he should base his valuation on bond rates of 7% or 6%, giving maximum valuation rates of 4.2% or 3.6% respectively? The use of these lower valuation rates, compared with the current level of 6%, will mean significantly higher reserves, with all the consequences, for companies.

All of this worry is about reducing interest rates, but what happens if interest rates rise? Will companies increase the valuation interest rate, thereby reducing reserves and releasing profits? Companies should take much, if not all, of the strain from increasing reserves now. However, this is not an opinion shared by all. For some companies which are short of capital, this could have very serious consequences, especially as regards solvency.

Actuaries are worried about whether their decisions will be understood and accepted. This worry is justified. Until now, they have not had the chance to influence their company's results to the extent that is currently before them. Who would relish the thought of, in one motion, significantly reducing the statutory profits for the year and reducing the solvency position of the company?

To many British actuaries, used to their environment and with their training, it may seem strange that such a position could have ever arisen. However, the situation has arisen, and is an example of the different thinking of actuaries and regulators in other countries. I believe that it is the different way of thinking that has brought about most of the differences between the U.K. and Spain, or for that matter, most E.U. countries.