BBVA making the difference
Agustín Vidal
General Manager Pensions and Insurance in America

“At the head of a growing business”

Latin America: earnings and outlook to 2050

BBVA making the difference
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Current state of the pension business in Latin America
- Forecasts of basic parameters
- Second generation reforms of pension systems
- BBVA’s positioning and strategy
- Conclusions
Why do we need pension systems?

Historically, society has noticed the necessity of creating institutions that cater for the following needs of the population:

To replace the income that people cease to receive due to:

- Retirement
- Accidents
- Death
And the pension industry will play a more significant role in the future

Old-Age Dependency Ratio

BBVA is ready to tackle this challenge. It implies the creation of banking and pension units to service an increasingly important segment of the population.

Source: United Nations and BBVA.
Naturally, this applied to Latin America but something was lacking…

The region went through a deep economic crisis at the beginning of the 80s and this made it clear that regional governments were not able to meet their commitments to pensioners. It was necessary to make a change in the system and the two options were:

**MODIFICATION**

Handle the crisis by changing only some parameters of the Distribution System (increasing the retirement age, increasing contributions, discouraging early retirements, etc).

**STRUCTURAL CHANGE**

Complete reform of the pension system, replacing the Distribution Model with individual savings and capital via obligatory pension funds.

**Or**
In the last 25 years, Latin America has reformed its pension systems.

<table>
<thead>
<tr>
<th>25 years ago</th>
<th>Today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution system</td>
<td>Individual account system</td>
</tr>
<tr>
<td>Government-run / no competition</td>
<td>Privately managed / competition</td>
</tr>
<tr>
<td>Rigid</td>
<td>Individual freedom</td>
</tr>
<tr>
<td>Multiple special systems / discretionary</td>
<td>Uniform</td>
</tr>
<tr>
<td>No accumulation of funds or good management</td>
<td>Accumulation of funds / trustee obligation / intangible nature</td>
</tr>
<tr>
<td>The state’s role: manager / supervisor</td>
<td>The state’s role: supervisor / subsidiary</td>
</tr>
</tbody>
</table>

Each country implemented the reform in accordance with its possibilities and preferences (demographics, budget and degree of social concern).
Rapid growth of participants and assets under management

Penetration
Participants / Pop 14-64

Breakdown of participants by age

Pension Assets: % of GDP

Especially in the younger segments of the population

With a sustained increase in pension assets

Source: BBVA, FIAP, AIOS
Development of capital markets

Business opportunity for the private sector to generate value

Portfolio management moving towards multifunds

Real return in 2006 (%)

Source: AIOS

Diversification of the portfolio in 2006 (%)
The reforms significantly reduced the pension deficit in several countries. The amount depends on the models used and on other reforms implemented (Zviniene & Packard 2004).

Corbo & Schmidth estimated that pension reform in Chile added 0.5% to 2001 GDP.
Short-term achievements

- A significant proportion of employees in the standard job market are covered by the new pension systems
- The pension systems acquired greater long-term balance
- Pension funds have grown rapidly and play an important role in the local capital markets
- They generated important domestic savings which were invested locally, boosting economic growth and financing projects
- Political risk linked to pensions diminished

Economic development has been stimulated and the social security system is now financially viable
Can we do more?

Although short-term results are encouraging, there is still room to improve.

• Penetration
  Penetration is still low in most countries
  Reasons: Level of development, confidence in the system, job market, etc.

• Pensions
  Pensions will be good for employees if they make regular contributions. Those who make infrequent payments will be less lucky and those with low incomes are a cause for concern

Rather than a problem, BBVA sees this as an opportunity

Penetration - 2006
Participants / Pop 14-64

Pension levels - 2006
Pension / Salary

Source: BBVA
Current state of the pension business in Latin America

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Second generation reforms of pension systems

BBVA’s positioning and strategy

Conclusions
Scorecard of pension system performance

Measures and Conclusions

• The implementation of reforms has been adequate
• But these reforms can be improved
• They must be complemented from various angles
  • Improvements in the pension system: penetration and salary replacement level
  • Economic subsystems: capital markets and job markets. Fiscal management

A basis for successful future reform

• A public sector / private sector compromise is needed
• The public and private systems must complement each other
  • A single and comprehensive approach
  • The new industry needs the know-how and a broader range of skills
Penetration of the work force:
On average, coverage will extend to 64% of the work force

Penetration will continue
Participants / Pop 14-64

But the situation will vary by country. Whereas in Chile and Mexico up to 80% of the work force will participate, countries such as Peru and Colombia have a long way to go.

Source: BBVA
Old-age coverage: On average, 50% of retirees will have old-age coverage

There are different trends in each country. In Chile and Mexico more than 70% of retirees will have a pension, but in countries such as Colombia and Peru the figure will be less than 50%.

Source: BBVA
Long-term disability and surviving spouse pensions: the number of participants with this type of coverage will grow in Chile, Perú, and México.

Disability and surviving spouse coverage
(disab + ss) / participants

Source: BBVA
Retirement pensions: the level of salary replacement will depend on the rules implemented in each country, which we expect to be reasonable.

Replacement levels in LATAM*

Source: BBVA
*pension / avg. salary over last 10 years
Assets: growth will be more than double that of GDP, confirming the industry’s importance

Evolution of Assets

Source: BBVA
In summary

1. The system’s coverage will continue to increase.

2. Countries are seeking ways (mutual support between public and private sectors) to increase coverage faster in countries with low levels of enrollment. We see this as a great opportunity.

3. Pension expectations are also becoming more realistic.

4. Disability and surviving spouse coverage will become increasingly important, increasing from 2% to 12% of total participants.

5. Assets will continue to grow, increasing from about 20% of annual GDP to 47%.

6. In summary, the pension industry is already a promising one and we are working on reforms to increase its potential.
Current state of the pension business in Latin America

Forecasts of basic parameters

Second generation reforms of pension systems

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Second generation reforms so far in Latin America

### The main measures on pension reform are:

<table>
<thead>
<tr>
<th>Number</th>
<th>Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Schemes to foster participation in sectors where coverage is low, using attractive financial vehicles in conjunction with tightly focused government support.</td>
</tr>
<tr>
<td>2</td>
<td>Customising pension programmes and access for each segment of the labor market.</td>
</tr>
<tr>
<td>3</td>
<td>Incentives to encourage contributions throughout the employment life cycle.</td>
</tr>
<tr>
<td>4</td>
<td>Generate realistic pension schemes (realistic pension levels).</td>
</tr>
<tr>
<td>5</td>
<td>Development of financial instruments that allow higher returns for the system.</td>
</tr>
<tr>
<td>6</td>
<td>Ensuring that the measures help to maintain fiscal stability.</td>
</tr>
</tbody>
</table>
In view of the latest reforms, BBVA has assessed the impact of various scenarios.

**Chile**

**Penetration**
- Improve incentives for the self-employed, according to type. Tax incentives, health, credit, etc.

**Pensions**
- Extension of minimum pensions to the entire system with access according to years of contribution.
- Increase female retirement age to 65.

**Government costs**
- These costs start to fall in 2025. Therefore welfare benefits can commence at that point.

**Others**
- Frequency of contribution: the self-employed could pay in more than the obligatory 1%
- Investments: improve the possibility of investment in pension funds
- Increase the limits on investments in foreign markets.

**Mexico**

**Penetration**
- Government to match voluntary payments by self-employed
- Establish a national pension system.

**Pensions**
- Increase obligatory contributions from 6.5% to 11.3% gradually.
- Focus public resources: double the ‘social’ contribution for people on the lower scale and remove it for those with higher incomes.
- Relax requirements for the minimum pension (19 yrs to achieve 50% on a sliding scale)
- Transfer housing balance to retirement assets before retirement age.

**Government costs**
- Close benefit schemes that have a deficit.
- Use the welcome bonus to cut costs and reform the state welfare system.

**Others**
- Strengthen risk-return options for pension fund managers.
- Allow new asset types.
- Remove country bias in investment and allow new investment vehicles.

**Peru**

**Penetration**
- Two incentive programmes for fixed contributions of S/30 and S/50 per month for irregular workers and self-employed with low incomes.
- Obligatory membership for self-employed with high incomes.

**Pensions**
- Extend minimum pension, making requirements more flexible for those with low SPP incomes.
- Accelerate the decline in replacement levels and bring higher SNP pensions into line with contributions.

**Government costs**
- These costs start to fall in 2035.
- At that point steps can be taken to improve coverage and social benefits.
- Use complementary grants to finance these measures or social contributions to finance the minimum SPP pension.

**Others**
- Privatise management of the state pension fund (FCR).
- Gradually raise the benchmark used to calculate public-sector pensions from 60 to 240 months.
The Chilean system is mature and so the effect of extending coverage will be much less than in countries such as Peru and Mexico. Furthermore, the sharp impact in the Peruvian case is due to the low cost of the proposed contribution programmes (less than €10) and the subsidised pensions guaranteed under these programmes.

The reforms will enable Peru and Mexico to increase coverage about 16 points by 2050 whereas Chile will gain 5 points.

Forecast of participants (million)
Retirement coverage after reforms:
As the Chilean system is more mature, the effect of the proposed reforms will be greater in Peru and Mexico.

Forecast number of retirees

Chile

Mexico

Peru

Old-age coverage
Retirees / Pop > 64

Source: BBVA
In Chile coverage will decrease slightly due to the higher retirement age for women.
Assets under management following reforms

**Chile**

Assets under management (€m)

**Mexico**

Assets under management (€m)

**Peru**

Assets under management (€m)

% GDP with reforms and Ex reforms

Source: BBVA
The reforms will increase penetration, pension levels and assets managed in the region

1. Pension funds could grow an additional 25% compared to the base scenario.

2. Penetration could increase a further 20% over the base scenario.

3. Comparative pension levels could increase about 22%.

4. Government costs are contained at 0.2% to 0.5% of GDP
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### Regional Leader

<table>
<thead>
<tr>
<th></th>
<th>Customers (million)</th>
<th>Employees</th>
<th>Assets Under Management</th>
<th>Attributable Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pensions</strong></td>
<td>5,363^(1)</td>
<td>9,935</td>
<td>60,972</td>
<td>165.6</td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td>7,034</td>
<td>3,291</td>
<td>2,062</td>
<td>189.6</td>
</tr>
<tr>
<td><strong>Total Pen + Ins</strong></td>
<td>NA</td>
<td>13,246</td>
<td>57,083</td>
<td>355.2</td>
</tr>
<tr>
<td><strong>% s/ BBVA South America</strong></td>
<td>18.9%^(2)</td>
<td>20.0%</td>
<td>23.7%</td>
<td>41.4%</td>
</tr>
<tr>
<td><strong>% s/ BBVA Group</strong></td>
<td>15.2%^(2)</td>
<td>13.4%</td>
<td>10.7%</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

**As of Sep 2007**

- Figures correspond to the group's contribution (figure for all affiliates is 12.4 million)
- % calculated based on Pension Clients

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**Source:** BBVA proprietary management and finance reporting.

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1€ = 0.705268 USD
With a focus on a complimentary business

BBVA’s Pensions and Insurance Business

- Administration of Pension Funds
- Disability and Life Insurance
- Pension Income

Pensions

- Life:
  - Risk
    - Death
    - Disability
    - Accidents

Insurance

- Non-life
  - Autos
  - Damages
  - Health
  - Job related risks
The strategy for our Insurance business is also defined

- In Latin America the reforms in the Social Security System have created a strong specialty in the insurance business
- We still can develop a profitable business in insurance
- Most of BBVA’s insurance products sales are done through its network
- Insurance banking concept is developing in the financial sector, being integrated with pensions, banking businesses and asset management

Future success of big sales of financial services in Latin America will depend on efficient integration of banking business, pensions and insurance: the so called “financial triangle”
The level of evolution and the model selected can explain the disparity in the composition of each group’s income.
Moving toward a developed integrated model, considering the critical mass of the market and participation

**Fundamentals**

- advances in the integrated model are realized
- the structure of competition in distinct markets
- It’s possible to transfer synergies to other countries
- complementary to the pensions business
- our significant presence in the banking industry
- the classic model is insufficient and will not reach the objective market
- opportunity for market share growth and risk diversification

As a complementary, some businesses will adopt the distribution model
This strategy has allowed us to take advantage of our distribution channels and diversify risk.

Growth of revenue and income based on the accessability of channels to the customer and product capability.
In the Pension business, the level of growth is major:

Total business income (non-pension)

Includes the Bancomer Insurance business in Mexico
A proven track record

Evolution of net profit (non-pension)

CAGR 07/03 = 30.8%

Includes the Bancomer Insurance Business in Mexico

Includes Mexico’s pension business
* Aggregate: Argentina, Chile, Colombia, Mexico, Peru, Bolivia and Dominican Rep. (constant Euros)
Pension reform is leading to financial systems in which banking, insurance and pension businesses must strike a new balance, modifying their structure and relative importance.

Based on this premise, BBVA is building a new strategy to strengthen its leadership as the top global supplier of financial services in Latin America.
... this means we must adapt our internal systems to handle the impact of social security reforms on cash flow and investments.

Structure of the pension industry’s earnings.

Pension Coverage Chile

From a model of accumulation to a model of disbursement and coverage on contingencies.
### The five basic principles of this strategy:

<table>
<thead>
<tr>
<th>Category</th>
<th>Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EARNINGS</strong></td>
<td>Growing of profits and RAROC improvement</td>
</tr>
</tbody>
</table>
| **MULTI-PRODUCT BUSINESS STRUCTURE** | Development of management revenues  
Development of voluntary-pension business                                                                 |
| **DEVELOPMENT OF RISK-MGT CAPACITY** | Development of BBVA’s skills related to management of biometric, trustee and political risks               |
| **A NEW GROUP PROJECT**          | Develop synergy schemes based on changes in procedure and co-operation with other banks               |
| **MANAGEMENT OF PENSION SYSTEMS** | Co-operate with the competition to improve the industry. Co-operate with the authorities and multinational organisations to develop the systems |
This strategy means BBVA must modify the way it adds value in the pension market and widen its product range.

We can sum up both aspects via six growth and transformation projects.

### Vision and Strategy

**Main lines of action**

#### BBVA’s current situation by country and type of business

<table>
<thead>
<tr>
<th>Country</th>
<th>Capitalising contributions</th>
<th>Payment of pensions</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Obligatory P.</td>
<td>Voluntary P.</td>
<td>Demised</td>
</tr>
<tr>
<td>ARGENTINA</td>
<td>Single fund</td>
<td>Multi-fund</td>
<td>Individual</td>
</tr>
<tr>
<td>CHILE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>COLOMBIA</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MEXICO</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>PERU</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>BOLIVIA</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DOMINICAN</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Legislated/No legislation**

**Presence BBVA**

**BBVA’s level of activity**

- low
- average
- high
- total
**No. 1 in pensions**

<table>
<thead>
<tr>
<th>Figures for September 2007</th>
<th>Assets ($m)</th>
<th>Participants (m)</th>
<th>Contributors (m)</th>
<th>Contributions ($m)</th>
<th>Ranking</th>
<th>LatAm Presence</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBVA</td>
<td>61,021</td>
<td>12.4</td>
<td>5.3</td>
<td>3,107</td>
<td>1st</td>
<td>AR, BO, CL, CO, EC, MX, PE</td>
</tr>
<tr>
<td>CITI</td>
<td>46,024</td>
<td>10.0</td>
<td>4.4</td>
<td>2.520</td>
<td>2nd</td>
<td>CL, CO, MX, PA, PE, UR</td>
</tr>
<tr>
<td>ING (AETNA)</td>
<td>43,819</td>
<td>9.2</td>
<td>3.5</td>
<td>2.178</td>
<td>3rd</td>
<td>CL, PE, MX, CO</td>
</tr>
<tr>
<td>SCH</td>
<td>5,942</td>
<td>2.3</td>
<td>0.8</td>
<td>419</td>
<td>4th</td>
<td>AR, UR</td>
</tr>
</tbody>
</table>

**BBVA manages 23.7% of the $260.4 billion in the pension funds and it has 17.8% of the 69.9 million participants in Latin America**

Source: BBVA based on information from FIAP and local authority bulletins
In this business, asset management is the center of activity and as a result the portfolios are significant.

**ASSETS UNDER MANAGEMENT**

Our unit manages €46 billion of which €42 billion is pension funds. The assets we manage have a significant effect on domestic economies. In Chile they account for 20% of GDP.
A business with strong revenue growth, generated by the Multi-Product Strategy

TOTAL REVENUES AND STRUCTURE OF THE PENSION BUSINESS

![Bar chart showing the total revenues and structure of the pension business from 2003 to 2007. The chart indicates a CAGR of 17.7% from 2003 to 2007.]

- 2003
- 2004
- 2005
- 2006
- 2007

- Other income
- Premiums revenues
- Commissions

CAGR 07 / 03 = 17.7%
Taking us to higher earnings growth potential, which in the pension business is very relevant:

**Evolution of Net profit (pensions)**

- **Higher market share in profits than in collections and revenues**

*Includes Mexico's pension business*

*Aggregate: Argentina, Chile, Colombia, Mexico, Peru, Bolivia and Dominican Rep. (constant Euros)*
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Conclusions
1. Pensions are a strategic part of BBVA's activities. They play a fundamental role in linking the population to financial services.

2. The track record of the pension systems confirms our view that this is a growing industry with an important future.

3. Reform of the pension systems has been a success. It will have a significant effect on the future development of these countries.

4. The results so far are substandard. Naturally, there is room for improvement and further development.

5. Our models indicate we can define proposals which, if they are coordinated with other parties, will lead to important gains for the industry and the countries in question, without affecting their respective governments. BBVA is working closely with government agenda related to economic policies.