1. Corporate Information

The Company was incorporated in Bermuda as an exempted company with limited liability under the Companies Act 1981 of Bermuda (as amended) on 17 May 1999. The shares of the Company are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

During the year, the Group offered a full range of whole life, endowment and term life insurance products to individuals in Hong Kong as well as other insurance products which included accident, medical and disability policies for individuals, group life and accident, medical and disability insurance, administration of retirement schemes and general insurance products through an agency arrangement. The Group also commenced to engage in asset management business during the year.

In the opinion of the directors, the ultimate holding company is Pacific Century Group (Cayman Islands) Limited, a company incorporated in the Cayman Islands.

2. Summary of Significant Accounting Policies

The Group's accounting policies, which are set out below, have remained unchanged from prior years, except as discussed in this note and in note 11.

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong for long term insurance companies and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the revaluation of investments and derivative financial instruments, as further explained below.

Basis of presentation and consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2000. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively.

The comparative consolidated financial statements had been prepared using the merger basis of accounting as a result of a group reorganisation completed on 16 June 1999. Under this basis, the Company has been treated as the holding company of its subsidiaries for the entire year ended 31 December 1999, rather than from the date of their acquisition by the Company on 16 June 1999. Accordingly, the consolidated results of the Group for the year ended 31 December 1999 included the results of the Company and its subsidiaries with effect from 1 January 1999 or since their respective dates of incorporation, where this is a shorter period, as if the current Group structure had been in existence throughout the year ended 31 December 1999. In the opinion of the directors, the consolidated financial statements prepared on the above basis presented more fairly the results and the state of affairs of the Group as a whole.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

2. Summary of Significant Accounting Policies (Continued)

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors. Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been permanent diminutions in values, when they are written down to values determined by the directors.

Associate

An associate is a company, not being a subsidiary, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of an associate is included in the consolidated revenue and profit and loss accounts and consolidated reserves, respectively. The Group's interest in an associate is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting less any provision for diminution in value, other than those considered to be temporary in nature, deemed necessary by the directors.

Goodwill

Goodwill arising on consolidation represents the excess purchase consideration paid over the fair values ascribed to the net underlying assets acquired and is eliminated against reserves in the year of acquisition.

Profit recognition

The operating profits on the long term insurance business of the Group are arrived at annually by means of an actuarial valuation of future insurance liabilities, determined by the appointed actuary of the Group using a Net Level Premium approach. The accounting principles and policies used in assessing the profits generated in the current year ended 31 December 2000 differ in certain significant respects from the solvency-based approach used in prior years. The main changes in the current year included:

(i) acquisition costs relating to the production of new business are deferred, to the extent that they can be recovered, and are shown explicitly as an asset in the balance sheet. Assumptions used in assessing the deferred acquisition costs reflect management's assessment of the most likely outcome of the future policy cash flows, subject to reasonable allowances for prudence purposes.

The previous approach allowed an implicit credit for acquisition costs in the actuarial valuation of liabilities, but only subject to certain maximum limits.

All other acquisition costs are expensed as and when incurred;

(ii) amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities in the balance sheet. On the previous basis, such amounts were recognised as reinsurance commissions; and

2. *Summary of Significant Accounting Policies (Continued)*

(iii) premiums relating to reinsurance contracts that do not transfer significant underwriting risk are treated as adjustments to the amounts carried on the balance sheet in respect of the contracts concerned. On the previous basis, such premiums were charged to the profit and loss account as incurred.

The major implication of the above changes is that profits are expected to emerge on a level basis over the average life of the insurance contracts under generally accepted accounting principles. The accounting practices previously adopted resulted in profits emerging generally towards the end of the life of the average insurance contract.

Premiums

Premiums in respect of traditional policies are recognised as income as they fall due, whereas those in respect of universal life, investment account and group policies are accounted for as they are received.

Premiums on reinsurance contracts that transfer underwriting risk are expensed as incurred. Premiums on reinsurance contracts that do not transfer significant underwriting risks are treated as adjustments to the amounts carried on the balance sheet in respect of the contracts concerned.

Investment income

Investment income is accounted for on a receivable basis. Dividend income from investments is recognised on the date on which the related investments are quoted as ex-dividend. Interest income from investments is accrued up to the balance sheet date.

Commissions

Commissions to agents and other related policy acquisition costs are expensed as incurred.

Commissions received on reinsurance policies that transfer underwriting risk are recognised as income at the same time as the reinsurance premiums are accounted for. Amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities on the balance sheet.

Deferred acquisition costs

The acquisition costs primarily related to the production of new business are deferred in so far as there are sufficient margins in the future premiums of the new business to fund the amortisation of the deferred acquisition costs (“DAC”). DAC include first year commissions and other costs related to the acquisition of new business.

DAC are carried at cost and amortised on a straight-line basis over ten years. In addition, DAC are adjusted for any impairment in value determined by reference to margins in the future premiums.

Insurance claims

Insurance claims are provided for as reported, whether admitted or not.