MANAGEMENT OF RISKS

The Group have adopted prudent strategies and techniques which aim to effectively identify, evaluate and manage risks for both reinsurance underwriting and investments.

(i) Underwriting activities

The Group's reinsurance portfolio is made up of a mix of business spread across different geographic regions and classes, with emphasis towards Asian countries and non-marine property damage, marine cargo and hull and miscellaneous non-marine classes. In addition to diversifying its portfolio, the Group does not actively seek acceptance of any liability reinsurance business from customers operating outside of the Asia Pacific region, in particular, the United States of America. In the Asia Pacific region, where there are core-markets of the Group, liability reinsurance for motor, workers' compensation and general third party liability are written on a limited scale in order to provide customers with comprehensive reinsurance services.

(ii) Retrocession

The Group purchases retrocession facilities in order to increase its acceptance capacity, to diversify its risk exposure and to harmonize its net retention exposure to avoid any significant adverse impact to its financial performance which may be caused by single or multiple catastrophic losses. The retrocessionaires are chosen after careful consideration of their reputation and credit worthiness. In assessing the credit worthiness of retrocessionaires, the Group takes into account, among other factors, ratings and evaluation by recognized credit rating agencies and brokers, their claims-paying and underwriting track record, as well as the Group's past transaction experience with them. The Group also spreads out the credit risk by reinsuring with a number of retrocessionaires who are domiciled in many different countries.

MANAGEMENT OF RISKS *(Continued)*

(iii) Catastrophe exposure

The Group closely monitors its aggregate exposure to natural catastrophic perils around the world, and record down major catastrophic losses in a historical database. Aggregate exposure is reviewed and analyzed on a regular basis. The catastrophic exposure of the Group is protected by means of various excess of loss retrocession facilities which limits the Group's maximum net retained loss to a tolerable level.

(iv) Reserve adequacy

The Group is required under the Hong Kong Insurance Companies Ordinances to maintain reserves to cover its estimated claims liability and the related settlement expenses. The Group exercises great care and effort in setting up the reserves. The reserves are estimated by the Group, using actuarial methods such as loss development methods and/or Bornhuetter-Ferguson method. The adequacy of the reserves is regularly reviewed.

(v) Foreign currency

The Group underwrites business originating from many parts of the world. It is potentially subject to currency fluctuation when claims are to be paid. The Group hedged the currency risk by holding deposits in a number of currencies and by premium income generated from the underwriting in the relevant foreign currency. The transfer of foreign currency exposure through appropriate retrocession also provides the Group with additional hedging against such currency fluctuation risk. Members of the senior management are dedicated to monitor the book of foreign currencies held by the Group.

MANAGEMENT OF RISKS *(Continued)*

(vi) Investments

The Group's investment policy emphasizes asset quality and liquidity. However, its investments are subject to various exposures including market risks and credit risks, as well as interest rate risk. Prudent risk management procedures are in place with an aim to manage those risks. Market risks are the risks that changes in interest rates, foreign exchange rates or equity and commodity prices will affect the prices of monetary assets taken or held by the Group. The adoption of held to maturity approach of the fixed income securities has provided the Group with steady income and the composition of the investment portfolio is geared towards stable recurrent income.