Management Discussion and Analysis of Operations

The Group reported net income of HK$155.9 million despite a difficult year, as compared to HK$154.3 million in 2000. Total turnover for the year amounted to HK$1,981.2 million.

The following sections provide a detailed review and analysis of 2001 results and segmental performance.

I. Capital adequacy and financing

During the year under review, net cash generated from the Group's operating activities amounted to HK$281.4 million. Other investment activities required HK$4,560.2 million for the purchase of investments, which was largely funded by a net receipt of HK$3,044.3 million from disposal of investments.

As at December 31, 2001, the Group's net assets were HK$1,993.7 million. On statutory reporting basis, the Group's net assets far exceeded the statutory net surplus required by the Insurance Regulation.

II. Risk management

(a) Insurance risks

The Group is in the business of insuring against the risk of mortality, morbidity, disability, critical illness and other such risks. It retains a maximum of US$100,000 for each risk it insures, with the excess being reinsured through surplus treaty, coinsurance treaty, facultative reinsurance, and catastrophe treaty with reputable international reinsurers. Consequently, total claims payable in any given year can be predicted with a high degree of precision. Over the last five years, the actual claims in any given year have been within a few percentage points of expected claims. As part of our quality control process, the Group has invited reinsurers to audit our underwriting and claim practices and procedures on a regular basis, to ensure that they meet the highest industry standards.

(b) Investment risks

While the Group's products allow us considerable latitude in asset allocation, we adopt a relatively conservative investment strategy. Invested assets required to support our insurance liabilities are entrusted to our own asset management company, PCIIM. Whilst their investment mandate allows PCIIM to invest up to 30.0% of its assets in equities, the actual proportion has been around 6.0%, with the balance mainly invested in fixed interest instruments.

For fixed interest investments, it is the Group's investment policy to match the currencies of assets and liabilities. The Group does not require currency matching for equity investments because it subscribes to the view that currency fluctuation is a part of the overall investment consideration.

The Group has actively refined its investment model through the use of the Value at Risk (VaR) technique to measure portfolio risks and performance. Where appropriate, the Group also uses the Sharpe ratio to measure the investment performance of its fund managers.

(c) Business risks

The Group uses the well-known third-party actuarial software 'Prophet' to perform, on a regular basis, long-term projections of our profit and loss positions using a variety of business scenarios. Such long-term projections have enabled the Group to better understand the impact of the changing business environment on our financial results and capital requirements and have, over the years, assisted us in our decision making in anticipation of such changes.

As PCI is engaged in distributing insurance products in Hong Kong only, the obliteration of the World Trade Centre Towers as a consequence of terrorist attacks in New York City, did not have a direct impact on our operation. We have not received any claims related to the incident.

III. Rating

The Group has once again been reaffirmed an 'A- (Excellent)' rating from The A.M. Best Company, the largest and oldest U.S. rating agency specializing in rating insurance companies, after an in-depth study was carried out on the Group's operations in May 2001.

A.M. Best cited that the Group's capital strength as benefited from a flexible, low risk liability structure and a high quality, liquid investment portfolio. This allowed the Group to minimize its asset exposure during the last Asian financial markets crisis without compromising overall operating performance.

IV. Embedded value

The Group has a regular programme to calculate, in consultation with internationally renowned consulting actuaries, its embedded value. Embedded value per share for the past five years were as follows:

	Embedded Value (per share)
12/1997	$2.626
12/1998	$2.965
12/1999	$3.341
12/2000	$3.295
9/2001	$3.690

V. Investment

The Group's investment committee, which includes certain directors, meets on a weekly basis to review the current investment climate and make policy decisions where necessary. The Group has engaged its wholly-owned asset management company, PCIIM, to manage its investment portfolio. Our investment results are satisfactory, with invested assets representing insurance liabilities, yielding 6.2% return per annum on a dollar-weighted basis in 2001.

2001 will no doubt be remembered as another difficult year for investment. In response to terrorist attacks, recession and plunging corporate profits, the Federal Reserve aggressively lowered the Federal Funds Rate eleven times to a 40-year low. While the short-end of the US treasury market benefited from a fall of 4.75% in short-term interest rates, the yield on 10-year US Treasury Bills virtually remained unchanged at the end of the year. On the equities side, most major stock markets experienced another year of decline with the Morgan Stanley Capital International Inc. (MSCI) world index falling 17.3% in dollar terms. Against this background, we have maintained a very small exposure in equities with the bulk of the portfolio invested in cash and bonds.

Looking forward, there appears to be better prospects for economic recovery in 2002. With inventories reduced significantly, it is generally expected that there will be some rebound in industrial production over the next few months. However, the recovery could be quite moderate unless it is accompanied by stronger final demand. Given the mounting labour redundancies and the over-indebtedness of the household sector in the US, consumer spending is unlikely to grow beyond the current level. Moreover, declining profit margins and excess manufacturing capacity do not bode well for capital spending this year.

In line with the current consensus, we believe we are close to the end of an interest rate easing cycle. Nevertheless, we do not expect the Federal Reserve to reverse its stance soon and low interest rates will likely be sustained for the better part of this year. We take the view that the yield cycle will flatten and that credit spreads will narrow. Equities will remain volatile and we will focus on those countries and sectors that will benefit most from a better US economy.

The following table shows the asset distribution of the General Fund of the Group (excluding segregated funds):

VI. Joint-venture with The Bank of East Asia, Limited

A joint venture between the Group and The Bank of East Asia, Limited was set up in January 2001 for the issuance of a co-branded credit card.

The credit card offers a variety of services exclusively for PCI policyholders, which include the payment of policy premium and special discounts for medical check-ups and corrective surgery. By December 2001, the number of cardholders already stood at 14,566. The Group will continue to promote the credit card business amongst our growing policyholder base.

VII. Dividend cut

With interest rates cut for the eleventh successive time during year 2001 and mortgage rates hitting their lowest in 40 years,

Investment Portfolio Mix (%) – General Fund December 2001

	Fixed Interest	Mortgage & Loans	Cash	Equities	Others	Total
By Currency						
US$	69.5%	0.0%	7.2%	4.8%	0.4%	81.9%
HK$	0.7%	8.8%	6.3%	1.0%	0.1%	16.9%
Others	0.0%	0.0%	1.0%	0.2%	0.0%	1.2%
Total	**70.2%**	**8.8%**	**14.5%**	**6.0%**	**0.5%**	**100.0%**
By Geographical Area						
US	17.6%	0.0%	0.0%	0.2%	0.0%	17.8%
Europe	5.5%	0.0%	0.0%	0.0%	0.0%	5.5%
HK/China	23.0%	8.8%	14.5%	3.4%	0.5%	50.2%
Other Asia	24.1%	0.0%	0.0%	1.5%	0.0%	25.6%
Others	0.0%	0.0%	0.0%	0.9%	0.0%	0.9%
Total	**70.2%**	**8.8%**	**14.5%**	**6.0%**	**0.5%**	**100.0%**

bank deposit rates have declined significantly. We have reduced the dividend rate to our policyholders during the year under review.

VIII. Operations

The Company is reporting a Net Profit Attributable to Shareholders of HK$155.9 million for the year ended December 31, 2001 which represents an increase of 1.1% from the HK$154.3 million achieved in 2000. Earnings per share is HK$19 cents which is same as last year.

Total Premiums show an increase of 16.7% as compared to 2000. Investment and other income decreased by 11.7%, despite the difficult investment environment in Hong Kong. Total revenue for the year is HK$2,230.7 million, compared with HK$1,978.8 million recorded in 2000 (an overall increase of 12.7%). Policyholders' Benefits increased by 48.7%. The large percentage of increase was mainly due to the surrender of Provident Fund business as a result of MPF implementation. Apart from that, the increase was in line with the Group's business growth. Agency expenses dropped by 20% as compared to the previous year, reflecting lower commission rates of the business. Management Expenses have increased by 6.8%. Total Operating Expenses for the year are HK$1,467.8 million, or 28.1% above the HK$1,145.5 million reported in 2000.

The following is the expense ratio of the Group for the past five years:

	Expense Ratio
1997	124%
1998	117%
1999	120%
2000	122%
2001	111%

Commissions, override and other variable expenses are assumed to be equal to 100% of first-year premiums and 10% of renewal premiums. Administrative expenses are assumed to be equal to 25% of first-year premiums and 5% of renewal premiums. Dividing actual expenses by the summation of the four components above gives the 'expense ratio'.

(a) Agency Operations

We will sustain our current level of productivity in the coming year by maintaining the quality of our agents and increasing productivity. Less experienced recruits will be provided with comprehensive training on service standards and product knowledge. We will also encourage agents to undertake professional examinations and engage in further education. The agency division will channel necessary assistance and resources to agents participating in the Continuing Professional Development (CPD) Programme administered under the Insurance Intermediaries Quality Assurance Scheme (IIQAS).

Major events : Apart from the successful launch of the 'PCI Credit Card' in January, we also hosted our Annual Award Presentation in March 2001. Agents with impressive sales and service records were recognized and their efforts acknowledged.

It is crucial that our agents are properly equipped to approach an expanding portion of potential clients who are well versed in the latest technologies. The 'PowerAgent', a new mobile sales tool, was unveiled in December 2001 to connect with this expanding market segment.

In view of increasing demand for investment-linked products, we have allocated additional resources to facilitate agent enrolment for the relevant examination paper of IIQAS beginning in January 2002.

(b) Life Operations

Sales : The division registered a growth of 10.5% for the whole year. Productivity of individual agents went down by 15.6% compared with figures from 2000 and the total number of agents decreased by 5.7% to 2,045. As at December 31, 2001, our total number of in-force policies was 313,493, compared to 298,490 in 2000.

i.Individual first year premium

The following chart shows the Group's new sales based on Individual first year premium over the last five years by way of a 12-month moving total.

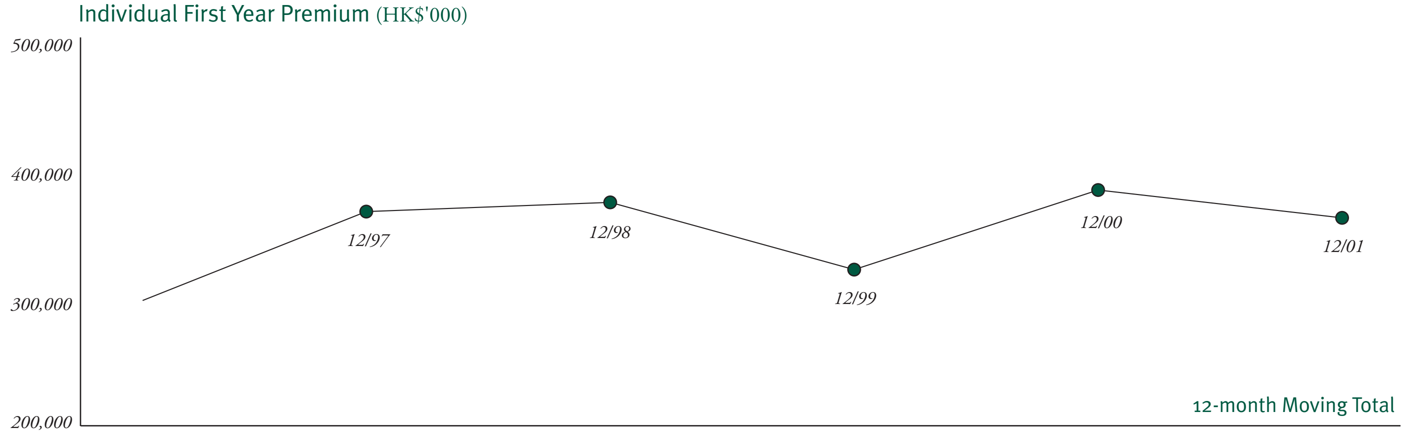
ii.Total premiums

The chart on the next page shows, on a 12-month moving total basis, the Group's total premium income over the last five years. (Despite a temporary slow down during the 1998-1999 period, the chart shows generally uninterrupted growth over the past five years.)

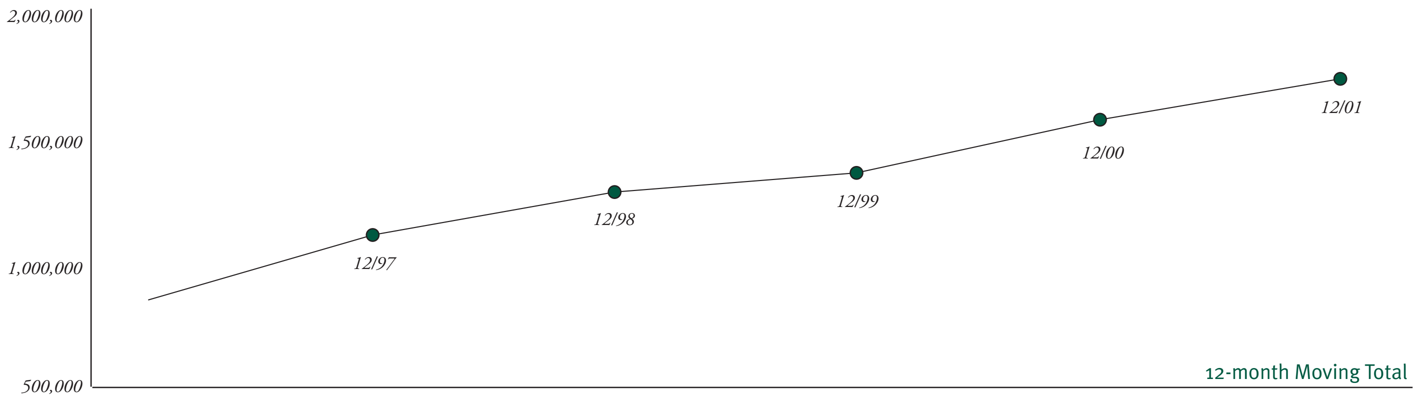
iii.Renewal ratio

The Group has constructed a model to produce what we call the 'renewal ratio'. Our model assumes that 80% of first-year premiums will stay on the books the following year and that 93% of the Group's renewal premiums will still be on the books the following year. Adding the two together owes the expected

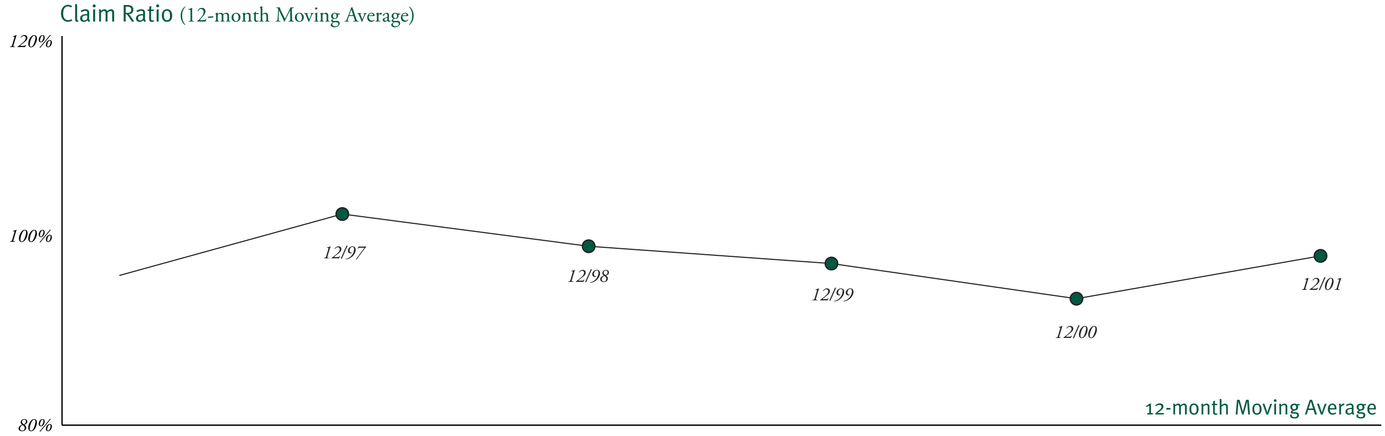
Individual First Year Premium (HK$'000)



Individual Total Premium (HK$'000)



Claim Ratio (12-month Moving Average)



modelled renewal premiums. The actual renewal premiums in the following year are then divided by the modelled renewal premiums to obtain the renewal ratio. A 100% renewal ratio means the Group's persistency follows the model exactly. A higher than 100 ratio means better persistency and vice versa.

The following is the renewal ratio of the Group for the last five years:

	Renewal Ratio
1997	105%
1998	90%
1999	92%
2000	98%
2001	98%

The renewal ratio of 2001 remained the same as that of 2000 and continued to be higher than the average of the past years shown in the table above.

iv.Claims experience

Claims (mortality and morbidity) experience fluctuates from year to year. The following chart gives the Group's overall claim ratio over the last 5 years:

	Claims Experience
1997	101.4%
1998	98.3%
1999	96.4%
2000	93.0%
2001	97.4%

Products : The 'Investment-linked Accumulation Rider' is an investment-linked supplementary benefit attached to life insurance policies. It is introduced in the form of a policy rider for the investment of dividends, cash bonuses and their accumulations.

Invested funds are managed with sufficient flexibility to meet the investment objectives of maximizing capital growth while preserving capital against inflation.

In November 2001, the 'Accident Death & Dismemberment Rider' was presented through a direct marketing campaign to around 103,000 selected current policyholders to provide additional accidental benefits. The launch has secured 3,600 contracts given difficult market sentiments.

The 'Wealth Builder' is PCI's first unit-linked product. It is an investment-linked product launched in December 2001 in response to current market demand - combining an investment element with insurance coverage. In addition to a fixed life insurance coverage, policyholders can adjust the level of investment according to their changing investment needs, as well as enjoying additional features for fund switching and premium holiday coverage.

Strategies : Our Call Centre Operation has enhanced our telephone enquiry service since June 2001, with supervisors monitoring real-time status of telephone calls, and call statistics gathered for planning purposes. A recording function was built into the system to facilitate training for complaint handling. These measures ensure that our staff are efficient and effective in attending to customers' inquiries.

New SOS membership cards were issued to existing life insurance policyholders in April 2001, enabling them to gain access to Worldwide Emergency Assistance Service more efficiently. Processes for identity verification with our Emergency Assistance Service provider was enhanced since November 2001. Our enhanced electronic administration system, 'Insure 21' ('I-21') was established in August 2001 catering for PCI's core business for individual life policies. The new system allows for better communication with clients and improves our overall service to policyholders who will now have better access to their policy status and other information.

(c) Life Personal Accident

Sales : During the period under review, Life Personal Accident ('LPA') division generated HK$75.1 million in premiums, of which HK$48.8 million was derived from 'Complementary Personal Accident', our top-selling product, and HK$26.3 million from other products in our range. These figures represent actual premiums earned, including new business production.

Products : In November 2001, the division introduced a new product, 'PalCare Special LPA', for comprehensive accident insurance with Hospital Income benefits.

Strategies : We have reviewed all contract provisions in February 2002. Training programmes will continue to take place throughout the year while leveraging upon resources and coordination with Agency Operations.

(d) Group Insurance

Sales : For the period under review, the Group Insurance division recorded an impressive 30.9% growth in premiums to HK$71.5 million, as compared to HK$54.6 million from the corresponding period in 2000. Our net income also showed 675.9% growth from HK$0.6 million to HK$4.5 million in 2001.

Products : As part of a periodic review, we revamped the product 'ADVANTAGEmployee Benefits Insurance Programme' which is especially made for smaller corporations in January 2002. We believe the updated product will better suit the changing needs of our customers.

Strategies : Our incentive programme, which began in June and ended in December 2001, accredited 57 contestants from 14 Regions for the 'Special Region Award'. As compared to figures reported in 2000, premium produced by our agents increased by 90.0% over the previous year.

In the coming year, we will continue to conduct training courses for our agents. In year 2001, overall participation in our Introductory classes was 70.0%, and for Intermediate classes, 86.0%, while the passing rate for examinations stood high at 97.0%. We will also continue to focus on business development.

(e) Retirement Scheme Business and Mandatory Provident Fund

Sales : Total contributions reported for 2001 were HK$171.7 million, while the total number of MPF members, as at

December 31, 2001, was 19,200, representing an increase of 23.1% from 15,600 registered members in 2000.

(f) General Insurance

Sales : Having gone through a number of changes in 2000, 2001 was a year in which the General Insurance division strengthened its operating structures. We continued to perform the role of an underwriting agent of Ming An Insurance since the first quarter of 2001.

For the period under review, total premium production was HK$66.7 million, reflecting a reduction of 14.7% as compared with HK$78.1 million as reported in 2000.

Underwriting stance for employee compensation business, particularly for those engaged in construction-related work, was tightened but with premium levels raised substantially. This has resulted in higher premium income from employees' compensation business although fewer contracts were actually written in 2001 as compared with 2000.

Strategies : During the year, we have successfully conducted a motivational programme, the 'Premium Growth Campaign', and essential training in preparation for IIQAS (Paper on General Insurance) will continue to take place. We have provided relevant courses and programmes to all agents undertaking the required examination since the scheme became effective in January 2002.

Premium levels for packaged policies (office, shop, clinic, home and domestic servants) has grown by 11.0% during the year, and is likely to persist as a trend. This inclination is in-line with our expectations and will complement our strategy to augment sales for profitable products (such as packaged or property damage policies), while gradually reducing the proportion of loss making products (such as motor vehicle coverage and employees compensation policies).

(g) PCI Investment Management Limited

Sales : Assets under management have grown substantially in 2001. As at December 31, 2001, total assets under PCIIM's management amounted to approximately HK$3.5 billion, an impressive growth of 80.0% year on year.

Products : November 2000 marked the successful launch of our flagship master unit trust, PCIIM Investment Funds, a Hong Kong Securities and Futures Commission authorized and a Cayman Islands domiciled umbrella fund. Seven months later, two more sub-funds, the Hong Kong Equity Fund and Global Fixed Income Fund were added to the master structure. Together with the existing Asia Pacific Fund and the Global Balanced Fund, the umbrella fund now consists of four sub-funds. While the addition of the new sub-funds provides a broader range of investment products to suit the needs of our investors, PCIIM will continue to look for further opportunities to introduce other specialized investment schemes in the coming years.

Strategies : Despite 2001 turned out to be a very tough year for the investment industry, PCIIM has achieved outstanding performance across all portfolios under management. According to Standard & Poor's Micropal investment fund data, PCIIM Asia Pacific Fund was ranked second amongst a total of 64 equity funds in 'the Far East and Pacific excluding Japan Equity Funds' category in 2001. This Fund has delivered a positive return of 10.7% against an average negative return of 3.7% in its category. In addition, the superior performance achieved by our PCIIM Global Balanced Fund caused PCIIM to be selected as the Winner of the 'SCMP Fund Manager of the Year Award 2001' in the one-year Asset Allocation Global Flexible Fund category. This annual award is organized by the South China Morning Post in association with Standard & Poor's Fund Services. Other discretionary portfolios managed by PCIIM also performed satisfactorily in 2001 with annualized investment returns well above the fund management industry averages.

PCIIM's investment performance in 2001 clearly demonstrated our investment management ability and established us firmly in the investment world. Our management believes it is now time for PCIIM to promote our investment services and further penetrate the marketplace. Particular effort will be exerted to extend our distribution network for our flagship PCIIM Investment Funds as well as to explore the huge institutional market for investment and provident fund management. As a member of the Group, PCIIM will also continue to work closely with our insurance parent to introduce and develop a wider range of investment linked products to meet the needs of the market.

(h) Information Technology

New and pending projects : A new system for our MPF division became fully functional in January 2001 and has been running smoothly ever since. An Interactive Voice Response System (IVRS), Internet enquiry service, and various payment methods were also made available to MPF customers in January 2001.

A new Individual Life administrative system, 'I-21', became operational in August 2001. The new system has significantly improved operating efficiency, system control, time-to-market new products/services, as well as enhanced information delivery to our customers, agents, and management. The 'I-21' system was further enhanced to handle new line of investment-linked products. The 'Investment-linked Accumulation Rider' and the 'Wealth Builder' were launched in August and December of 2001 respectively.

The LPA division has successfully implemented a new Claims and Policy Renewal system in May 2001, where it has complemented the launch of a new product in November 2001, enabling greater operating efficiency while facilitating better sales.

A Palm (handheld) computer system was introduced to facilitate our agents as their new point-of-sales selling tool in December 2001. The new device was readily received by our agents. Moreover, we are in the process of developing a new website exclusively for agents to allow for heightened level of information sharing when it goes live in the second quarter of 2002.

Our corporate website, on the other hand, is undergoing revamp and will be re-launched to exhibit a brand new look with enriched information and functions in the first half of 2002.

We have completed a feasibility study for our Life Operations unit on the implementation of an automated workflow and imaging system in August 2001, and an expert underwriting system will also become operational by the second quarter of 2002.

Our other priority is to reinforce security measures for all users and system functions. A security team has been designated in July 2001 with new security policies and standards to be introduced over time. Development and operational standards, as well as new service standards were introduced and have gone through pilot implementation in 2001. These new measures will complement the updated ISO 9002 standards in 2002.

Strategies : We will continue to enhance service/support for all agents, customers and users, and in particular, for our new line of investment-linked products. Efforts will be made to develop point-of-sales computer systems and internet service for agents. Other projects will include new infrastructures, such as document imaging and expert systems in order to enhance the Group's operational effectiveness and competitiveness.

(i) Human Resources

High quality employees are one of the most important assets in the financial services industry. Staff training and development will continue, therefore, to take precedence as a management objective.

Regular training programmes are provided to employees at all levels and, during the year, we have introduced an 8-module training series, 'Managing at PCI', especially for Assistant Managers and above. We have developed and implemented an updated collection of management materials with the assistance of reputable management consultants, to ensure that the quality of our programmes measure up to international standards. PCI also appoints education consultants to conduct workshops on business Mandarin and English-writing skill because language proficiency is of paramount importance in business communication. External speakers are invited to host regular workshops, talks and seminars. Topics usually focus on personal development issues such as mentoring, emotional intelligence, positive thinking and information on health care.

We value our best people and attempt to nurture potential leaders, providing them with the best training for their future roles. Every year, sponsorship is granted to management personnel to attend the Kellogg-HKUST Executive MBA programme, one of the most prestigious executive programmes in the World.

We regularly sponsor training programmes and encourage employees to sit for professional examinations. This enables the Group to benefit from knowledgeable employees, as each employee, in turn, is rewarded by enhanced competitiveness and personal satisfaction and achievement.

Facing the continued economic downturn, the Group will maintain its profitability through enhancing the efficiency and productivity of our employees and strengthening our operation. We are committed to providing a suitable environment to continuously develop, motivate and retain talented and devoted individuals.