



## Management Discussion & Analysis

### Operating Results of 2003 and 2002 – Pro Forma Basis

We set forth below information and discussion regarding the pro forma effect of our restructuring for the years ended December 31, 2003 and 2002, as if it had occurred at the start of the years ended December 31, 2003 or 2002, respectively. The pro-forma financial data is on page 125.

**The unaudited pro forma consolidated financial information is not necessarily indicative of the results that could have been achieved had the restructuring in fact occurred on those dates and is not necessarily indicative of the financial results for any future periods.**

### Year Ended December 31, 2003 Compared with Year Ended December 31, 2002

#### *Pro Forma Net Premiums Earned and Policy Fees*

Pro forma net premiums earned and policy fees increased by RMB6,059 million, or 13.5%, to RMB50,807 million in 2003 from RMB44,748 million in 2002. This increase was primarily due to increases in net premiums earned and policy fees in the individual life insurance business and health insurance business offset in part by a decrease in net premiums earned and policy fees from group life insurance business.

Of total pro forma net premiums earned in 2003, RMB4,553 million was attributable to single premium products and RMB32,610 million was attributable to regular premium products (including both first-year and renewal premiums).

#### *Individual Life Insurance Business*

Pro forma net premiums earned and policy fees from the individual life insurance business increased by RMB4,626 million, or 12.3%, to RMB42,288 million in 2003 from RMB37,662 million in 2002. This increase was primarily due to an increase in sales of whole life products and growth in policy fees. These were offset in part by a decrease in sales of non-participating endowment products due to a shift toward participating endowment products, which are classified as investment products.

#### *Group Life Insurance Business*

Pro forma net premiums earned and policy fees from the group life insurance business decreased by RMB45 million, or 9.4%, to RMB432 million in 2003 from RMB477 million in 2002. This decrease was primarily due to a shift away from whole life products in favor of products which are classified as investment products, which led to a decrease in premiums from risk-type products, as well as a reduction in the level of our policy fees on some of our products due to increased competition.



### ***Accident and Health Insurance Business***

Pro forma net premiums earned from the accident and health insurance business increased by RMB1,478 million, or 22.4%, to RMB8,087 million in 2003 from RMB6,609 million in 2002. Pro forma gross written premiums from the accident insurance business decreased by RMB294 million, or 5.7%, to RMB4,880 million in 2003 from RMB5,174 million in 2002 and pro forma gross written premiums from the health insurance business increased by RMB1,561 million, or 41.5%, to RMB5,325 million in 2003 from RMB3,764 million in 2002. These changes were primarily due to strong growth in premiums from sales of supplemental medical insurance and other short-term health products. Sales of accident insurance decreased due to increased competition.

### ***Net Investment Income***

Pro forma net investment income increased by RMB2,444 million, or 56.2%, to RMB6,790 million in 2003 from RMB4,346 million in 2002. This increase was primarily due to an overall increase in investment assets, also impacted by a relatively higher level of investments in lower-yielding resale agreements and bank deposits due to limited market capacity.

### ***Net Realized Gains/Losses on Investments***

Pro forma net realized gains on investments were RMB599 million in 2003, compared to RMB140 million in 2002. This change was primarily due to increased net realized gains on equity securities.

### ***Net Unrealized Gains/Losses on Investments***

We reflect unrealized gains or losses on investments designated as trading in current period income. Pro forma net unrealized gains on investments were RMB254 million in 2003, compared to net unrealized losses on investments of RMB560 million in 2002. This change reflected unrealized capital gains on securities investment funds due to favorable conditions in the equity markets.

### ***Insurance Benefits and Claims***

Pro forma insurance benefits and claims, net of amounts ceded through reinsurance, increased by RMB3,933 million, or 12.6%, to RMB35,213 million in 2003 from RMB31,280 million in 2002. This increase was primarily due to an increase in insurance benefits and claims in the individual life insurance business as a result of an increase in business volume. Of this amount, pro forma life insurance death and other benefits increased by RMB1,510 million, or 65.4%, to RMB3,818 million in 2003 from RMB2,308 million in 2002, pro forma accident and health claims and claim adjustment expenses increased by RMB829 million, or 20.5%, to RMB4,882 million in 2003 from RMB4,053 million in 2002 and the pro forma increase in future life policyholder benefits decreased by RMB1,594 million, or 6.4%, to RMB26,513 million in 2003 from RMB24,919 million in 2002. The increase in pro forma life insurance death and other benefits was primarily due to an increase in the number of policies in force. Pro forma life insurance death and other benefits, as a percentage of pro forma gross written premiums and policy fees, were 7.2% in 2003, an increase from 4.9% in 2002.



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### ***Individual Life Insurance Business***

Pro forma insurance benefits and claims for the individual life insurance business increased by RMB3,149 million, or 11.8%, to RMB29,946 million in 2003 from RMB26,797 million in 2002. This increase was primarily due to increase in business volume during the period. Of these pro forma insurance benefits and claims, pro forma life insurance death and other benefits increased by RMB1,456 million, or 77.0%, to RMB3,348 million in 2003 from RMB1,892 million in 2002. This increase was primarily due to two types of policies, which we started to sell in 2000 and which pay benefits to policyholders every three years. The pro forma increase in future life policyholder benefits increased by RMB1,692 million, or 6.8%, to RMB26,598 million in 2003 from RMB24,906 million in 2002.

### ***Group Life Insurance Business***

Pro forma insurance benefits and claims for the group life insurance business decreased by RMB24 million, or 5.9%, to RMB385 million in 2003 from RMB409 million in 2002. This decrease was primarily due to a decrease in business volume. Of these pro forma insurance benefits and claims, pro forma life insurance death and other benefits increased by RMB74 million, or 18.7%, to RMB470 million in 2003 from RMB396 million in 2002 and pro forma increase in future life policyholder benefits decreased by RMB85 million in 2003, compared with an increase of RMB13 million in 2002.

### ***Accident and Health Insurance Business***

Pro forma insurance benefits and claims for the accident and health insurance business increased by RMB809 million, or 19.9%, to RMB4,882 million in 2003 from RMB4,073 million in 2002. This increase was primarily due to the increase in business volume in the health insurance business, offset in part by a decrease of average claim rate of health insurance business. Of these pro forma insurance benefits and claims, pro forma accident and health claims and claim adjustment expenses increased by RMB829 million, or 20.5%, to RMB4,882 million in 2003 from RMB4,053 million in 2002 and pro forma life insurance death and other benefits (comprised of long-term health benefits) were nil in 2003, compared to RMB20 million in 2002.

### ***Policyholder Dividends and Participation in Profits***

Pro forma policyholder dividends and participation in profits increased by RMB569 million, or 89.2%, to RMB1,207 million in 2003 from RMB638 million in 2002. This increase was primarily due to an increase in the overall amount of participating policies in force.

### ***Amortization of Deferred Policy Acquisition Costs***

The majority of acquisition costs are deferrable. Pro forma amortization of deferred policy acquisition costs increased by RMB1,191 million, or 31.1%, to RMB5,023 million 2003 from RMB3,832 million in 2002. This increase was primarily due to the increase in number and overall amount of policies in force.

***Underwriting and Policy Acquisition Costs***

Pro forma underwriting and policy acquisition costs primarily reflect the non-deferrable portion of acquisition costs attributable to insurance policies. Pro forma underwriting and policy acquisition costs increased by RMB267 million, or 48.1%, to RMB822 million in 2003 from RMB555 million in 2002. This increase was primarily due to the increase in business volume during the period.

***Administrative Expenses***

Pro forma administrative expenses include the non-deferrable portion of policy acquisition costs attributable to the insurance policies as well as compensation and other administrative expenses. Pro forma administrative expenses increased by RMB420 million, or 7.1%, to RMB6,326 million in 2003 from RMB5,906 million in 2002. This increase was primarily due to the increase in business volume.

***Other Operating Expenses***

Pro forma other operating expenses, which consist of employee housing benefits and legal and regulatory costs, decreased by RMB63 million, or 14.7%, to RMB367 million in 2003 from RMB430 million 2002. This decrease was primarily due to reduced losses on sales of employee housing, which has been phased out in accordance with PRC law.

***Interest Credited to Policyholder Contract Deposits***

Pro forma interest credited to policyholder contract deposits increased by RMB1,352 million, or 86.2%, to RMB2,920 million in 2003 from RMB1,568 million in 2002. This increase was primarily due to an increase in the total policyholder account balance.

***Income Tax***

Pro forma income tax expense was RMB2,582 million in 2003, compared to RMB1,904 million in 2002. This result was primarily attributable to a pro forma profit before tax and minority interests of RMB8,479 million. The 2003 pro forma effective tax rate of 30.5% reflects the income tax rate assuming the restructuring had occurred as of January 1, 2003 and assuming no tax losses were carried forward from prior years.

***Net Profit/Loss***

For the reasons set forth above, pro forma net profit increased by RMB1,333 million, or 29.5%, to RMB5,857 million in 2003 from RMB4,524 million in 2002.



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### Insurance Solvency Requirements

In March 2003, the CIRC introduced a new standard, the solvency ratio, to measure the financial soundness of insurance companies to provide better policyholder protection under the current regulatory system. The solvency ratio of an insurance company is a measure of capital adequacy, which is calculated by dividing the actual solvency level of the company (which is its admissible assets less admissible liabilities, determined in accordance with PRC GAAP and relevant rules) by the minimum solvency level it is required to meet. The following table shows our solvency ratio as of December 31, 2003:

	<b>As of December 31, 2003 (RMB in millions, except percentage data)</b>
Actual solvency	50,948
Minimum solvency	12,906
Solvency ratio	395%

Insurance companies are required to calculate and report annually to the CIRC their solvency level and twelve additional financial ratios to assist it in monitoring the financial condition of insurers. A “usual range” of results for each of the twelve ratios is used as a benchmark. The departure from the “usual range” of four or more of the ratios can lead to regulatory action being taken by the CIRC. Among these twelve financial ratios, the calculation of six ratios requires financial data of two previous years and we are accordingly not able to calculate such six ratios for the year of 2003 because we were just established in 2003.

We submitted our first report in 2004. Our solvency level as of December 31, 2003 was approximately 3.95 times the minimum regulatory requirement and the six applicable financial ratios were within their usual ranges.



## OPERATING RESULTS

Year Ended December 31, 2003 Compared with Year Ended December 31, 2002

### Overview

***As discussed elsewhere in this annual report, the restructuring of our predecessor CLIC was legally effective under PRC law and the restructuring on June 30, 2003; but for accounting purposes, the restructuring occurred as of September 30, 2003. Accordingly, our historical profit and loss accounts data for 2003 includes the data for our predecessor through September 30, 2003 and the data for the company from October 1, 2003 through December 31, 2003. As described more fully below, the year-on-year changes for many of the line items discussed below reflect the effect of the restructuring. For example, net premiums earned and policy fees for 2003 does not include any net premiums and policy fees attributable to the non-transferred policies which were retained by CLIC for the time period from October 1, 2003 through December 31, 2003. Likewise, the investment assets retained by CLIC are not included in our balance sheet as of December 31, 2003 and the income from such retained investment assets attributable to the period from October 1, 2003 through December 31, 2003, both realized and unrealized, is not included in our profit and loss accounts. The impact of the restructuring on accident and health business is less significant than that on individual and group businesses, since a greater portion of accident and health policies are comprised of transferred policies.***

### Net Premiums Earned and Policy Fees

Net premiums earned and policy fees increased by RMB792 million, or 1.2%, to RMB67,216 million in 2003 from RMB66,424 million in 2002. This increase was significantly less than the 2002 increase over 2001 as a result of the effect of the restructuring described above. The increase reflected increases in net premiums earned from the individual life insurance business and accident and health business offset in part by a decrease in net premiums earned and policy fees from the group life insurance business.

Net premiums earned and policy fees attributable to the transferred and new policies increased by RMB6,059 million, or 13.5%, to RMB50,807 million in 2003 from RMB44,748 million in 2002. This increase was primarily due to increases in net premiums earned from the individual life insurance and the accident and health businesses offset in part by decrease in net premiums earned and policy fees from the group life insurance business. Net premiums earned from risk-type participating products were RMB13,417 million in 2003, a decrease of RMB1,131 million or 7.8% from RMB14,548 million in 2002. This decrease was primarily due to a shift toward products which are classified as investment products. Of total net premiums earned in 2003 and attributable to the transferred and new policies, RMB4,553 million was attributable to single premium products and RMB32,610 million was attributable to regular premium products (including both first-year and renewal premiums). Of total net premiums earned in 2002 and attributable to the transferred policies, RMB8,896 million was attributable to single premium products and RMB25,035 million was attributable to regular premium products.



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### ***Individual Life Insurance Business***

Net premiums earned and policy fees from the individual life insurance business decreased by RMB361 million, or 0.6%, to RMB58,541 million in 2003 from RMB58,902 million in 2002. This decrease was due in part to the restructuring effect, as well as a decrease in sales of non-participating endowment products due to a shift toward participating endowment products, which are classified as investment products. This was offset in part by an increase in sales of whole life products and growth in policy fees.

Net premiums earned and policy fees from the individual life insurance business attributable to the transferred and new policies increased by RMB4,626 million, or 12.3%, to RMB42,288 million in 2003 from RMB37,662 million in 2002. This increase was primarily due to an increase in sales of whole life products and growth in policy fees. This was offset in part by a decrease in sales of non-participating endowment products due to a shift toward participating endowment products, which are classified as investment products.

### ***Group Life Insurance Business***

Net premiums earned and policy fees from the group life insurance business decreased by RMB161 million, or 21.5%, to RMB588 million in 2003 from RMB749 million in 2002. This decrease was due in part to the effect of the restructuring described above, as well as a shift away from whole life products in favor of products which are classified as investment products, which led to a decrease in premiums earned from risk-type products, as well as a reduction in the level of our policy fees on some of our products due to increased competition.

Net premiums earned and policy fees from the group life insurance business attributable to the transferred and new policies decreased by RMB45 million, or 9.4%, to RMB432 million in 2003 from RMB477 million in 2002. This decrease was primarily due to a shift away from whole life products in favor of products which are classified as investment products, which led to a decrease in premiums earned from risk-type products, as well as a reduction in the level of our policy fees on some of our products due to increased competition.

### ***Accident and Health Insurance Business***

Net premiums earned from the accident and health insurance business increased by RMB1,314 million, or 19.4%, to RMB8,087 million in 2003 from RMB6,773 million in 2002. Gross written premiums from the accident insurance business decreased by RMB393 million or 7.5%, to RMB4,880 million in 2003 from RMB5,273 million in 2002 and gross written premiums from the health insurance business increased by RMB1,480 million, or 38.5%, to RMB5,325 million in 2003 from RMB3,845 million in 2002. These changes were primarily due to strong growth in premiums from sales of supplemental medical insurance and other short-term health insurance products. Sales of accident insurance decreased due to increased competition.



Net premiums earned from the accident and health insurance business attributable to the transferred and new policies increased by RMB1,478 million, or 22.4%, to RMB8,087 million in 2003 from RMB6,609 million in 2002. Gross written premiums from the accident insurance business attributable to the transferred and new policies decreased by RMB294 million, or 5.7%, to RMB4,880 million in 2003 from RMB5,174 million in 2002 and gross written premiums from the health insurance business attributable to the transferred and new policies increased by RMB1,561 million, or 41.5%, to RMB5,325 million in 2003 from RMB3,764 million in 2002. These increases were primarily due to the same reasons as for the accident and health insurance business as a whole.

### **Net Investment Income**

Net investment income increased by RMB1,478 million, or 17.7%, to RMB9,825 million in 2003 from RMB8,347 million in 2002. This increase was primarily due to an overall growth in investment assets during 2003, notwithstanding a one-time drop in our total investment assets as of September 30, 2003 caused by the de-recognition of assets retained by CLIC in connection with the restructuring and a decrease in investment yield.

As of December 31, 2003, total investment assets were RMB279,248 million and the investment yield for the year ended December 31, 2003 was 3.4% (which includes the investment yield for investment assets held by CLIC through September 30, 2003). As of December 31, 2002, total investment assets were RMB266,463 million and the investment yield for the year ended December 31, 2002 was 3.8%. This decrease reflected a relatively higher level of investments in lower-yielding resale agreements and bank deposits due to limited market capacity.

### **Net Realized Gains/Losses on Investments**

Net realized gains on investments increased by RMB602 million, or 226.3% to RMB868 million from RMB266 million in 2002. This change was due to net realized gains of RMB550 million on debt securities and RMB318 million on securities investment funds in 2003. In 2002, the net realized gain of RMB446 million on debt securities was offset in part by net realized losses of RMB180 million on securities investment funds.

### **Net Unrealized Gains/Losses on Investments**

We reflect unrealized gains or losses on investments designated as trading in current period income. Our net unrealized gains on investments in 2003 were RMB247 million, compared to net realized loss of RMB1,067 million in 2002. The results in 2003 reflected unrealized gains on securities investment funds as of December 31, 2003 resulting from favorable conditions in the equity markets in 2003, compared to a steep fall in the equity markets in 2002.

### **Deposits and Policy Fees**

Deposits are gross additions to policyholder contract deposits. Total deposits increased by RMB26,627 million, or 41.2%, to RMB91,201 million in 2003 from RMB64,574 million in 2002. Policy fees increased by RMB1,086 million, or 21.7%, to RMB6,096 million in 2003 from RMB5,010 million in 2002. These increases were primarily due to increased sales of participating products in both the individual life insurance business and group life insurance business, offset in part by the effect of restructuring described above.





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Total deposits attributable to the transferred and new policies increased by RMB28,863 million, or 49.3%, to RMB87,435 million in 2003 from RMB58,572 million in 2002. Policy fees attributable to the transferred and new policies increased by RMB1,349 million, or 32.1%, to RMB5,557 million in 2003 from RMB4,208 million in 2002. These increases were primarily due to increased sales of participating products in both the individual life insurance business and group life insurance business. Total deposits from participating products increased by RMB27,986 million, or 53.4%, to RMB80,376 million in 2003 from RMB52,390 million in 2002. Total policy fees from participating products increased to RMB4,214 million in 2003 from RMB2,563 million in 2002.

### ***Individual Life Insurance Business***

Deposits in the individual life insurance business increased by RMB21,654 million, or 37.1%, to RMB79,962 million in 2003 from RMB58,308 million in 2002. Policy fees from the individual life insurance business increased by RMB1,135 million, or 24.5%, to RMB5,768 million in 2003 from RMB4,633 million in 2002. These increases reflected increased sales of participating endowment products, offset in part by the effect of restructuring described above.

Deposits in the individual life insurance business attributable to the transferred and new policies increased by RMB24,978 million, or 47.7%, to RMB77,318 million in 2003 from RMB52,340 million in 2002. Policy fees from the individual life insurance business attributable to the transferred and new policies increased by RMB1,305 million, or 32.0%, to RMB5,380 million in 2003 from RMB4,075 million in 2002. These increases were primarily due to increased sales of participating endowment products.

### ***Group Life Insurance Business***

Deposits in the group life insurance business increased by RMB4,973 million, or 79.4%, to RMB11,239 million in 2003 from RMB6,266 million in 2002. Policy fees from the group life insurance business decreased by RMB49 million, or 13.0%, to RMB328 million in 2003 from RMB377 million in 2002. These changes were primarily due to an increase of sales of participating annuity products, offset in part by a reduction in the level of our policy fees on some of our products due to increased competition, the fact that policy fees are no longer required to be paid on some of the non-transferred policies under the terms of the policies as well as the effect of the restructuring described above.

Deposits in the group life insurance business attributable to the transferred and new policies increased by RMB3,885 million, or 62.3%, to RMB10,117 million in 2003 from RMB6,232 million in 2002. Policy fees from the group life insurance business attributable to the transferred and new policies increased by RMB44 million, or 33.1%, to RMB177 million in 2003 from RMB133 million in 2002. These increases were due to increased sales of participating annuity products, offset in part by a reduction in the level of our policy fees on some of our products due to increase competition.

### ***Accident and Health Insurance Business***

There are no deposits in our accident and health insurance business.



### ***Insurance Benefits and Claims***

Insurance benefits and claims, net of amounts ceded through reinsurance, increased by RMB99 million, or 0.2%, to RMB56,536 million in 2003 from RMB56,437 million in 2002. This increase was due to the increase in business volume offset in part by the effect of restructuring described above. Life insurance death and other benefits increased by RMB1,560 million, or 22.3%, to RMB8,570 million in 2003 from RMB7,010 million in 2002. These increase was principally an increase in the number of policies in force. Life insurance death and other benefits as a percentage of gross written premiums and policy fees increased to 12.4% in 2003 from 10.2% in 2002.

Insurance benefits and claims, net of amounts ceded through reinsurance, attributable to the transferred and new policies increased by RMB3,934 million, or 12.6%, to RMB35,213 million in 2003 from RMB31,280 million in 2002. This increase was primarily due to an increase in insurance benefits and claims in the individual life insurance business as a result of an increase in business volume. Insurance benefits and claims, net of amounts ceded through reinsurance, attributable to participating products increased by RMB7 million, or 0.1%, to RMB13,982 million in 2003 from RMB13,975 million in 2002. Of these insurance benefits and claims attributable to participating products, life insurance death and other benefits increased to RMB536 million in 2003 from RMB132 million in 2002 and the increase in future life policyholder benefits decreased by RMB397 million, or 2.9%, to RMB13,446 million in 2003 from RMB13,843 million in 2002.

#### ***Individual Life Insurance Business***

Insurance benefits and claims for the individual life insurance business increased by RMB208 million, or 0.4%, to RMB50,947 million in 2003 from RMB50,739 million in 2002. This increase was due to the increase in business volume during the period offset in part by the effect of restructuring described above. Of these insurance benefits and claims, life insurance death and the benefits increased by RMB2,492 million, or 47.4%, to RMB7,744 million in 2003 from RMB5,252 million in 2002 and the increase in future life policyholder benefits decreased by RMB2,284 million, or 5.0%, to RMB43,203 million in 2003 from RMB45,487 million in 2002.

Insurance benefits and claims for the individual life insurance business attributable to the transferred and new policies increased by RMB3,149 million, or 11.8%, to RMB29,946 million in 2003 from RMB26,797 million in 2002. This increase was primarily due to the increase in business volume during the period. Of these insurance benefits and claims, life insurance death and other benefits increased by RMB1,457 million, or 77.0%, to RMB3,348 million in 2003 from RMB1,891 million in 2002. This increase was primarily due to two types of policies, which we started to sell in 2000, and which pay benefits to policyholders every three years. The increase in future life policyholder benefits increased by RMB1,692 million, or 6.8%, to RMB26,598 million in 2003 from RMB24,906 million in 2002.

#### ***Group Life Insurance Business***

Insurance benefits and claims for the group life insurance business decreased by RMB915 million, or 56.4%, to RMB707 million in 2003 from RMB1,622 million in 2002. This decrease was due to the effect of the restructuring described above and a decrease in business volume. Of these insurance benefits and claims, life insurance death and other benefits decreased by RMB909 million, or 52.4%, to RMB826 million in 2003 from RMB1,735 million in 2002 and the increase in future life policyholder benefits decreased by RMB119 million in 2003, compared with a decrease of RMB113 million in 2002.



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Insurance benefits and claims for the group life insurance business attributable to the transferred and new policies decreased by RMB24 million, or 5.9%, to RMB385 million in 2003 from RMB409 million in 2002. This decrease was primarily due to a decrease in business volume. Of these insurance benefits and claims, life insurance death and other benefits increased by RMB74 million, or 18.7%, to RMB470 million in 2003 from RMB396 million 2002 and the increase in future life policyholder benefits decreased by RMB85 million in 2003, compared with an increase of RMB13 million in 2002.

### ***Accident and Health Insurance Business***

Insurance benefits and claims for the accident and health insurance business increased by RMB806 million, or 19.8%, to RMB4,882 million in 2003 from RMB4,076 million in 2002. Of these amounts, accident and health claims and claim adjustment expenses increased by RMB829 million, or 20.5%, to RMB4,882 million in 2003 from RMB4,053 million in 2002 and life insurance death and other benefits (comprised of long-term health benefits) was less than RMB1 million in 2003 compared to RMB23 million in 2002. These changes were primarily due to the increase in business volume in the health insurance business offset in part by a decrease of average claim rate of health insurance business.

Insurance benefits and claims for the accident and health insurance business attributable to the transferred and new policies increased by RMB809 million, or 19.9%, to RMB4,882 million in 2003 from RMB4,073 million in 2002. This increase was primarily due to an increase of health insurance business, offset in part by a decrease of average claim rate of health insurance business. Of these insurance benefits and claims, accident and health claims and claims adjustment expenses increased by RMB829 million or 20.5%, to RMB4,882 million in 2003 from RMB4,053 million in 2002 and life insurance death and other benefits (comprised of long-term benefits) were nil in 2003, compared to RMB20 million in 2002.

### ***Policyholder Dividends and Participation in Profits***

Policyholder dividends and participation in profits increased by RMB566 million, or 88.3%, to RMB1,207 million in 2003 from RMB641 million in 2002. Virtually all of these amounts were attributable to the transferred and new policies because our predecessor only began to sell participating products in 2000. This increase was primarily due to an increase in the overall amount of participating policies in force.

### ***Amortization of Deferred Policy Acquisition Costs***

Amortization of deferred policy acquisition costs reflects the amortization of deferred policy acquisition costs attributable to the transferred and new policies. The majority of acquisition costs attributable to the transferred and new policies are deferrable. Amortization of deferred policy acquisition costs increased by RMB1,191 million, or 31.1%, to RMB5,023 million in 2003 from RMB3,832 million in 2002. This increase was primarily due to the increase in number and overall amount of policies in force.



### ***Underwriting and Policy Acquisition Costs***

Underwriting and policy acquisition costs primarily reflect acquisition costs attributable to non-transferred policies in the individual life insurance business and group life insurance business, as well as non-deferrable portions of the acquisition costs attributable to transferred and new policies. Underwriting and policy acquisition costs decreased by RMB367 million, or 22.1%, to RMB1,294 million in 2003 from RMB1,661 million in 2002. Underwriting and policy acquisition costs were 1.91% of net premiums earned and policy fees in 2003, compared with 2.5% in 2002.

Of this amount, underwriting and policy acquisition costs in the individual life insurance business and group life insurance business together decreased by RMB370 million, or 29.4%, to RMB890 million in 2003 from RMB1,260 million in 2002. This decrease was primarily due to the effect of restructuring described above. In addition, this decrease reflected declining commissions attributable to the non-transferred policies, since commissions generally decrease as policies are renewed in successive years. Underwriting and policy acquisition costs in the accidental and health insurance business increased by RMB3 million, or 0.7%, to RMB404 million in 2003 from RMB401 million in 2002. This increase was primarily due to the increase in business volume during the period.

### ***Administrative Expenses***

Administrative expenses include the non-deferrable portion of policy acquisition costs attributable to the transferred and new policies, as well as compensation and other administrative expenses. Administrative expenses increased by RMB700 million, or 11.4%, to RMB6,862 million in 2003 from RMB6,162 million in 2002. This increase primarily reflected the increase in business volume, offset in part by the effect of the restructuring described above.

### ***Other Operating Expenses***

Other operating expenses, which primarily consist of employee housing benefits and expenses of non-core businesses (which includes investments in property, hotels and other operations through subsidiaries), increased by RMB238 million, or 37.5%, to RMB872 million in 2003 from RMB634 million in 2002. This increase primarily reflected a revaluation of investment properties and the resulting impact on the profit and loss accounts offset in part by the effect of the restructuring described above. Investment properties are valued at intervals of not more than three years by independent valuers; in each of the intervening years valuations are undertaken by professionally qualified executives of within the company. The valuations are on an open market value basis related to individual properties and separate values are not attributed to land and buildings.



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### ***Interest Credited to Policyholder Contract Deposits***

Interest credited to policyholder contract deposits increased by RMB165 million, or 2.3%, to RMB7,260 million in 2003 from RMB7,095 million in 2002. This increase primarily reflected an increase in the total policyholder account balance offset in part by the effect of the restructuring described above.

Interest credited to policyholder contract deposits attributable to the transferred and new policies increased by RMB1,352 million, or 86.2%, to RMB2,920 million in 2003 from RMB1,568 million in 2002. This increase was primarily due to an increase in the total policyholder account balance. Interest credited to participating policyholder contract deposits increased to RMB2,235 million in 2003 from RMB922 million in 2002.

### ***Income Tax***

The Company pays income tax according to PRC enterprise income tax tentative regulations and related rules. Income tax expense, including current and deferred taxations, was RMB1,180 million in 2003, compared to RMB14 million in 2002. In accordance with PRC law, China Life and China Life Insurance Asset Management Company Limited, which is controlled by the Company, are subject to tax on their income from the dates of their incorporation, June 30, 2003 and November 23, 2003. Substantially all of the income expense for 2003 was attributable to the profit-making insurance businesses (attributable to the transferred and new policies) and asset management businesses of China Life. Our predecessor CLIC had operational losses in their core insurance businesses and accordingly had no income tax liability. All of its income tax expense for 2003 and 2002 related to its non-core operations and were immaterial compared to the income tax expense of China Life for 2003.

### ***Net Profit/Loss***

For the reasons set forth above, net loss was RMB1,428 million in 2003, an improvement from a net loss of RMB2,250 million in 2002.

#### ***Individual Life Insurance Business***

Net loss in the individual life insurance business was RMB208 million in 2003, an improvement from a net loss of RMB1,070 million in 2002. This result was primarily due to the increased impact of the more profitable transferred and new policies in the individual life business following the restructuring.

#### ***Group Life Insurance Business***

Net loss in the group life insurance business was RMB1,263 million in 2003, an improvement from a net loss of RMB2,475 million in 2002. This result was primarily due to the increased impact of the more profitable transferred and new policies in the group life business following the restructuring.

#### ***Accident and Health Insurance Business***

Net profit in the accident and health insurance business increased by RMB190 million, or 16.0%, to RMB1,380 million in 2003 from RMB1,190 million in 2002. Profitability increased due primarily to the rapid increase in health premiums, which was not reflected in claim experience. The overall performance of the accident business, despite the decrease in premiums, remained strong, while the performance of the health business was relatively weaker.



## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity Sources

Our principal cash inflows come from insurance premiums, deposits, proceeds from sales of investment assets, investment income and financing. The primary liquidity concerns with respect to these cash inflows are the risk of early contract holder and policyholder withdrawal, as well as the risks of default by debtors, interest rate changes and other market volatilities. We closely monitor and manage these risks.

Additional sources of liquidity to meet unexpected cash outflows are available from our portfolio of cash and investment assets. As of December 31, 2003, the amount of cash and cash equivalents was RMB42,616 million. In addition, substantially all of our term deposits with banks allow us to withdraw funds on deposit, subject to a penalty interest charge. As of December 31, 2003, the amount of term deposits was RMB137,192 million.

Our portfolio of investment securities also may provide us with a source of liquidity to meet unexpected cash outflows. As of December 31, 2003, investments in fixed maturity securities had a fair value of RMB70,604 million. As of December 31, 2003, investments in equity securities, primarily through securities investment funds, had a fair value of RMB10,718 million. However, the PRC securities market is still at an early stage of development, and we are subject to market liquidity risk because the market capitalization and trading volumes of the public exchanges are much lower than in more developed financial markets. We also are subject to market liquidity risk due to the large size of our investments in some of the markets in which we invest. We believe that some of our positions in fixed maturity securities may be large enough to have an influence on the market value. These factors may limit our ability to sell these investments at an adequate price, or at all.

### Liquidity Uses

Our principal cash outflows primarily relate to the liabilities associated with our various life insurance, annuity and accident and health insurance products, dividend and interest payments on our insurance policies and annuity contracts, operating expenses, income taxes and dividends that may be declared and payable to our shareholders. Liabilities arising from our insurance activities primarily relate to benefit payments under these insurance products, as well as payments for policy surrenders, withdrawal and loans.

We believe that our sources of liquidity are sufficient to meet our current cash requirements.

### Consolidated Cash Flows

The following sets forth information regarding consolidated cash flows for the periods indicated.

Net cash provided by operating activities, net cash used in investing activities and net cash provided by financing activities for 2003 were all significantly affected by the divestiture of the operations and business (including the operations and businesses attributable to the transferred policies) retained by CLIC as of September 30, 2003.



## Management Discussion & Analysis

Net cash provided by operating activities was RMB38,510 million in the year ended December 31, 2003, a decrease from RMB44,059 million in the year ended December 31, 2002. This decrease was primarily due to a change in working capital which used cash in the year ended December 31, 2003, compared with providing cash in the year ended December 31, 2002. Net cash provided by operating activities was RMB44,059 million in 2002, an increase from RMB33,833 million in 2001. The increase in cash provided by operating activities over both of these periods was primarily due to the rapid growth in new policies, and the lag time between receipt of premium income and the payment of claims under those policies.

Net cash used in investing activities was RMB105,166 million in the year ended December 31, 2003, RMB95,898 million in the year ended December 31, 2002 and RMB51,964 million in the year ended December 31, 2001. The increase in cash used in investing activities over all of these periods was primarily due to the growth in premiums and deposits, particularly those relating to sales of participating products, which are classified as investment-type products.

Net cash provided by financing activities was RMB94,743 million in the year ended December 31, 2003, RMB48,513 million in the year ended December 31, 2002 and RMB12,711 million in the year ended December 31, 2001. The increase in cash provided by financing activities over all of these periods was primarily due to the growth in premiums and deposits, particularly those relating to sales of participating products, which are classified as investment-type products and are therefore attributed to financing activities. In addition, our global share offering in December 2003 provided cash proceeds of approximately RMB24,707 million. As of December 2003, the cash proceeds from the global share offering were held in bank deposit accounts. We expect to use such proceeds for general corporate purposes and to strengthen our capital base.

### Recent Developments

On January 30, 2004, the Audit General of the National Audit Office of China (the "CNAO") announced that it had carried out an audit review of the financial statements of CLIC, our predecessor. The CNAO audit decision, dated March 30, 2004, which covers the balance sheet and income statement of CLIC for 2002, found that (i) there had been irregular use of RMB2,368 million of insurance funds, and irregular operations involving RMB2,374 million in the use of agents that was not in compliance with regulations and overpayment of surrender value by some branches of CLIC, including the use of agents not legally qualified in the insurance business, changes in premium rates and the scope of coverage without proper approval, and overpayment of surrender value and annuity payments when due; (ii) certain branches of CLIC had overstated or understated expenses and income resulting in the underpayment of taxes in the amount of RMB1.3 million; (iii) certain branches of CLIC maintained "unauthorized reserves" which involved an accumulated amount of RMB32.3 million, among which RMB11.1 million had been accumulated after 2001; and (iv) CLIC had failed to pay taxes when due in an amount of RMB43.1 million.





CLIC was directed to pay a total of approximately RMB67.5 million, including RMB9.2 million of business taxes and surcharges, RMB10.0 million of income taxes, RMB37.3 million of other taxes and RMB11.1 million in fines. The decision requires CLIC to rectify the irregular use of reinsurance funds and irregular operations described in section (i) above, and to submit a report on such rectification by May 31, 2004. The audit decision also requires CLIC to make such changes to its books and accounts described in sections (ii) and (iii) above to correct accounting entries regarding overstatement and understatement of expenses and income addressed in the report, and to submit reports on such adjustments to the CNAO. An appeal to the CNAO may be taken within 60 days of the date of CLIC's receipt of the audit decision. We will review the changes and adjustments made by CLIC in response to the audit decision in order to evaluate their impact on our operations.

On or about March 16, 2004 a complaint was filed in the United States District Court for the Southern District of New York alleging violations of the U.S. Securities Exchange Act of 1934 by the Company and certain of its officers and directors in connection with failure to fully disclose the audit review by the CNAO of CLIC. Three additional similar complaints have subsequently been filed against these same defendants. The complaints seek to recover damages on behalf of a purported class of persons who purchased the Company's publicly traded securities between December 22, 2003 and February 3, 2004. Each complaint seeks an award of damages in an unspecified amount, plus expert and attorneys' fees. As of the date hereof, none of the four complaints has yet been served and, accordingly, the Company's time to respond thereto has not yet begun to run. In connection with these complaints, the Company has engaged U.S. counsel to contest the complaints vigorously on behalf of the Company.







# Nationwide

## customer service

