

Management Discussion and Analysis



CONSOLIDATED RESULTS

The following is a summary of the consolidated results of the Group.

For years ended December 31, (in RMB million)	2004	2003
Total revenue	63,251	66,623
Total claims, policyholders' benefits and expenses	(59,504)	(63,807)
Operating profit	3,747	2,816
Net profit attributable to shareholders	3,116	2,320

The following table sets forth the breakdown of our net profit by business segment:

For years ended December 31, (in RMB million)	2004	2003
Life insurance	2,704	1,950
Property and casualty insurance	217	96
Other businesses	195	274
Net profit attributable to shareholders	3,116	2,320

Ping An achieved record earnings in 2004. Net profit attributable to shareholders increased 34.3% to RMB3,116 million in 2004 from RMB2,320 million in 2003. This increase was primarily due to the better performance from our core life insurance and property and casualty insurance businesses, which accounted for approximately 86.8% and 7.0% respectively of our net profit. Net profit for our life insurance business increased 38.7% to RMB2,704 million in 2004 from RMB1,950 million in 2003. Results for our property and casualty insurance business improved significantly and its net profit increased 126.0% to RMB217 million in 2004 from RMB96 million in 2003.



Factors attributing to our improved performance include improved product mix of our life insurance business, significant growth for our property and casualty insurance business and our continued cost control initiatives. The improvement in our operating results was partially offset by lower total investment yield due to the poor performance of the PRC equity markets.

As a result of our record performance, earnings per share increased to RMB0.56 in 2004 from RMB0.47 in 2003. Dividend per share paid during the year increased to RMB0.12 in 2004 from RMB0.10 in 2003.

For years ended December 31, (in RMB)	2004	2003
Earnings per share - basic	0.56	0.47
Dividends per share	0.12	0.10

CONSOLIDATED INVESTMENT INCOME

For years ended December 31, (in RMB million, except percentages)	2004	2003
Interest income	6,738	5,780
Dividend income	393	69
Operating lease income	130	99
Net investment income	7,261	5,948
Realized and unrealized gains/(losses)	(773)	395
Total investment income	6,488	6,343
Net investment yield	4.1%	4.1%
Total investment yield	3.6%	4.5%

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Our net investment income increased 22.1% to RMB7,261 million in 2004 from RMB5,948 million in 2003. This increase was primarily due to an increase in our investment assets to RMB201,444 million as of December 31, 2004 from RMB155,920 million as of December 31, 2003. Net investment yield remained unchanged at 4.1% in 2004.

Our total investment income increased 2.3% to RMB6,488 million in 2004 from RMB6,343 million in 2003. Total investment income yield decreased to 3.6% in 2004 from 4.5% in 2003. This decrease was primarily due to the downturn in the PRC equity markets. As a result, the realized and unrealized losses in 2004 were RMB773 million compared to realized and unrealized gains of RMB395 million in 2003.

We continued to improve the asset allocation of our portfolio during the year in response to the rising interest rate and the volatile equity markets. As a result, our bond investments as a percentage of our total investment assets increased to 56.1% as of December 31, 2004 from 43.7% as of December 31, 2003. We were able to achieve 4.8% average rate of return from our new bond investments in 2004 as the bond yield increased significantly. In addition, our government bond investments, of which interest income enjoys tax exemptions, as a percentage of our total bond investment portfolio increased to 62.4% as of December 31, 2004 from 56.1% as of December 31, 2003. While the equity markets can be volatile, we believe our investment strategy will allow us to achieve stable returns and enhance our core net investment income. The following table presents our investment portfolio allocations among the major categories of our investments.

As at years ended December 31, (in RMB million, except percentages)	2004		2003	
	Carrying Value	% of Total	Carrying Value	% of Total
Fixed maturity investments				
Term deposits	80,320	39.9%	78,233	50.2%
Bond investments ⁽¹⁾	112,927	56.1%	68,177	43.7%
Other fixed maturity investments	675	0.3%	3,286	2.1%
Equity investments ⁽²⁾	6,018	3.0%	4,891	3.1%
Investment properties	1,504	0.7%	1,333	0.9%
Total investments	201,444	100.0%	155,920	100.0%

⁽¹⁾ Bond investments include the carrying value of derivatives embedded with the host contracts.

⁽²⁾ Equity investments include equity investment funds, equity securities and investment in an associate.

LIFE INSURANCE BUSINESS

Results of Operations

The following is a summary of the results of the life insurance business.

For years ended December 31, (in RMB million)	2004	2003
Gross written premiums and policy fees	49,899	55,043
Net earned premiums	48,972	53,806
Investment income	5,762	5,658
Other income	510	494
Total revenue	55,244	59,958
Change in deferred policy acquisition costs	2,071	2,848
Claims and policyholders' benefits	(12,033)	(10,826)
Increase in policyholders' reserves	(33,967)	(40,417)
Commission expenses	(4,577)	(5,074)
General and administrative expenses	(3,653)	(4,007)
Other expenses	(48)	(233)
Total expenses	(52,207)	(57,709)
Income taxes	(333)	(299)
Net profit	2,704	1,950

Management Discussion and Analysis

Gross Written Premiums, Policy Fees and Premium Deposits

For years ended December 31, (in RMB million)	2004	2003
Individual life		
First year premiums and policy fees	7,628	9,023
First year universal life premium deposits	1,333	–
First year investment-linked premium deposits	–	3
Total first year premiums, policy fees and premium deposits	8,961	9,026
Renewal premiums and policy fees	28,321	25,594
Renewal investment-linked premium deposits	2,882	2,948
Total renewal premiums, policy fees and premium deposits	31,203	28,542
Total gross written premiums, policy fees and premium deposits	40,164	37,568
Bancassurance		
First year premiums and policy fees	5,639	10,443
First year universal life premium deposits	81	–
Total first year premiums, policy fees and premium deposits	5,720	10,443
Renewal premiums and policy fees	197	119
Total gross written premiums, policy fees and premium deposits	5,917	10,562
Group insurance		
Gross written premiums and policy fees	8,114	9,864
Investment-linked premium deposits	534	860
Total gross written premiums, policy fees and premium deposits	8,648	10,724
Total life insurance		
Gross written premiums and policy fees	49,899	55,043
Premium deposits	4,830	3,811
Total gross written premiums, policy fees and premium deposits	54,729	58,854

Individual Life Business

Gross written premiums, policy fees and premium deposits for our individual life business increased 6.9% to RMB40,164 million in 2004 from RMB37,568 million in 2003. This increase was primarily due to a 9.3% increase in renewal premiums, policy fees and premium deposits to RMB31,203 million in 2004 from RMB28,542 million in 2003, which was primarily due to our continued focus on regular premium products and an increase of our customer persistency ratio.

Similar to the IFRS accounting treatment of our investment-linked products, a portion of the premiums received from our universal life policies, which were launched in May 2004, were recorded as premium deposits instead of gross written premiums. First year premium, policy fees and premium deposits for our individual life business decreased slightly to RMB8,961 million in 2004 from RMB9,026 million in 2003. This decrease was primarily due to our on-going agency rationalization program. However, we witnessed an encouraging trend as the first year premium, policy fees and premium deposits for our individual life business increased 28.8% to RMB5,045 million in the second half of 2004 from RMB3,916 million in the first half of 2004. This increase was primarily due to the successful launch of our universal life products.

Bancassurance Business

Gross written premiums, policy fees and premium deposits for our bancassurance business decreased 44.0% to RMB5,917 million in 2004 from RMB10,562 million in 2003. This decrease was primarily due to our decision to manage the growth of this business line to preserve profit margin. As a result, first year premiums, policy fees and premium deposits decreased 45.2% to RMB5,720 million in 2004 from RMB10,443 million in 2003.

Group Insurance Business

Gross written premiums, policy fees and premium deposits for our group insurance business decreased 19.4% to RMB8,648 million in 2004 from RMB10,724 million in 2003. This decrease was primarily due to our decision to manage the product mix to improve the profit margin of this business line. As a result of our product mix improvement, gross written premiums and policy fees for our short-term group insurance business increased 8.7% to RMB1,450 million in 2004 from RMB1,334 million in 2003.

Investment Income

Net investment income for our life insurance business increased 21.7% to RMB6,517 million in 2004 from RMB5,356 million in 2003. This increase was primarily due to the increase in investment assets to RMB180,993 million as of December 31, 2004 from RMB143,371 million as of December 31, 2003. Net investment yield for our life insurance business remained unchanged at 4.1% in 2004.

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Total investment income for our life insurance business increased 1.8% to RMB5,762 million in 2004 from RMB5,658 million in 2003. Total investment yield from our life insurance business decreased to 3.7% in 2004 from 4.4% in 2003. This decrease was primarily due to the volatile PRC equity markets in 2004. As a result, realized and unrealized losses were incurred for our equity investment funds.

For years ended December 31, (in RMB million, except percentages)	2004	2003
Net investment income	6,517	5,356
Net investment yield	4.1%	4.1%
Total investment income	5,762	5,658
Total investment yield	3.7%	4.4%

Change in Deferred Policy Acquisition Costs

The change in deferred policy acquisition costs was RMB2,071 million in 2004 as compared to RMB2,848 million in 2003. The smaller change in deferred policy acquisition costs was primarily due to a flat growth in first year premiums, policy fees and premium deposits from individual life products as well as an increase in amortization of deferred policy acquisition costs.

Increase in Policyholders' Reserves

This increase in policyholders' reserves was RMB33,967 million in 2004 as compared to RMB40,417 million in 2003. The smaller increase in policyholders' reserves was primarily due to (1) a decrease in gross written premiums attributable to our bancassurance and group insurance businesses, (2) the increase in payment for policyholders' benefits in 2004 and (3) the increase in sales of universal life products. A portion of the policyholders' liabilities was recorded as policyholders' contract deposits instead of policyholders' reserves.

Claims and Policyholders' Benefits

Claims and policyholders' benefits increased 11.1% to RMB12,033 million in 2004 from RMB10,826 million in 2003. Claims and policyholders' benefits as a percentage of gross written premiums and policy fees increased to 24.1% in 2004 from 19.7% in 2003. These increases were primarily due to an increase in payments on annuities and surrenders of insurance policies.

Policyholder dividends and provisions decreased 16.8% to RMB822 million in 2004 from RMB988 million in 2003. This decrease was primarily due to the decrease in our investment return for our participating life insurance products as a result of the poor performance of the PRC equity markets in 2004.

The following table summarizes total expenses pursuant to claims, surrenders, annuities, maturities, policyholders' dividends and provisions, and interest credited to policyholders' contract deposits.

For years ended December 31, (in RMB million)	2004	2003
Claims	2,545	2,714
Surrenders	3,866	3,010
Annuities	2,287	1,635
Maturities	2,506	2,479
Policyholders' dividends and provisions	822	988
Interest credited to policyholders' contract deposits	7	–
Total claims and policyholders' benefits	12,033	10,826

Commission Expenses

For years ended December 31,	2004	2003
Commission expenses as a percentage of gross written premiums, policy fees, and premium deposits	8.4%	8.6%

Commission expenses, which we paid primarily to our sales agents, decreased 9.8% to RMB4,577 million in 2004 from RMB5,074 million in 2003. This decrease was primarily due to the decrease in first year premiums from individual life insurance products in 2004 and the decrease in the overall gross written premiums and policy fees. Commission expenses as a percentage of gross written premiums, policy fees, and premium deposits decreased to 8.4% in 2004 from 8.6% in 2003.

General and Administrative Expenses

For years ended December 31,	2004	2003
General and administrative expenses as a percentage of gross written premiums, policy fees and premium deposits	6.7%	6.8%

General and administrative expenses decreased 8.8% to RMB3,653 million in 2004 from RMB4,007 million in 2003. This decrease was primarily due to the lower sales in group insurance and bancassurance products as well as our continued cost control initiatives. General and administrative expenses as a percentage of gross written premiums, policy fees and premium deposits decreased to 6.7% in 2004 from 6.8% in 2003.

Management Discussion and Analysis

Income Taxes

For years ended December 31,	2004	2003
Effective tax rate	11.0%	13.3%

Income taxes increased 11.4% to RMB333 million in 2004 from RMB299 million in 2003. This increase was primarily due to the increase in our operating profit. The effective tax rate decreased to 11.0% in 2004 from 13.3% in 2003. These decreases were primarily due to the increase in dividend income from equity investment funds and interest income from government bonds, which were both entitled to certain tax exemptions.

Net Profit

As a result of the foregoing, net profit for our life insurance business increased 38.7% to RMB2,704 million in 2004 from RMB1,950 million in 2003.

PROPERTY AND CASUALTY INSURANCE BUSINESS

Results of Operations

The following is a summary of the results of the property and casualty insurance business.

For years ended December 31, (in RMB million)	2004	2003
Gross written premiums	10,150	8,091
Net earned premiums	5,764	5,043
Investment income	244	303
Other income	1,172	878
Total revenue	7,180	6,224
Change in deferred policy acquisition costs	190	37
Claims expenses	(4,440)	(3,960)
Commission expenses	(678)	(602)
General and administrative expenses	(1,742)	(1,310)
Other expenses	(78)	(71)
Total expenses	(6,748)	(5,906)
Income taxes	(215)	(222)
Net profit	217	96

Combined Ratio

For years ended December 31,	2004	2003
Expense ratio	20.2%	21.2%
Loss ratio	77.0%	78.5%
Combined ratio	97.2%	99.7%

Gross Written Premiums

For years ended December 31, (in RMB million)	2004	2003
Automobile insurance	6,232	4,589
Non-automobile insurance	3,545	3,351
Accident and health insurance	373	151
Total gross written premiums	10,150	8,091

Gross written premiums increased 25.4% to RMB10,150 million in 2004 from RMB8,091 million in 2003. This increase in gross written premiums was primarily due to the significant growth in all three principal lines of our property and casualty insurance businesses.

Automobile Insurance Business

Gross written premiums attributable to our automobile insurance business increased 35.8% to RMB6,232 million in 2004 from RMB4,589 million in 2003. This increase was primarily due to the continued increase in demand for automobiles in the PRC and the stabilization of automobile insurance premium rates resulting from a decrease in price competition.

Non-automobile Insurance Business

Gross written premiums attributable to our non-automobile insurance business increased 5.8% to RMB3,545 million in 2004 from RMB3,351 million in 2003. This increase was primarily due to increase in sales of commercial property insurance and cargo insurance. Gross written premiums attributable to our commercial property insurance increased 9.9% to RMB1,461 million in 2004 from RMB1,329 million in 2003. Gross written premiums attributable to our cargo insurance increased 42.4% to RMB430 million in 2004 from RMB302 million in 2003.

Accident and Health Insurance Business

We started offering accident and health insurance to our customers in April 2003. Gross written premiums attributable to our accident and health insurance business increased 147.0% to RMB373 million in 2004 from RMB151 million in 2003. This increase was primarily due to a full year of sales reflected in 2004 as compared to only nine months sales reflected in 2003 and our continued focus on promoting sales of this line of business in 2004.

Management Discussion and Analysis

Investment Income

Net investment income for our property and casualty business increased 13.5% to RMB295 million in 2004 from RMB260 million in 2003. This increase was primarily due to the increase in investment assets to RMB7,579 million as of December 31, 2004 from RMB5,874 million as of December 31, 2003. Net investment yield for our property and casualty business increased to 4.3% in 2004 from 4.1% in 2003. This was primarily due to increase in the prevailing market interest rates.

Total investment income for our property and casualty insurance business decreased 19.5% to RMB244 million in 2004 from RMB303 million in 2003. Our total investment yield from our property and casualty insurance business decreased to 3.6% in 2004 from 5.1% in 2003. These decreases were primarily due to the more volatile PRC equity markets in 2004. As a result, realized and unrealized losses were incurred from our equity investment funds.

For years ended December 31, (in RMB million, except percentages)	2004	2003
Net investment income	295	260
Net investment yield	4.3%	4.1%
Total investment income	244	303
Total investment yield	3.6%	5.1%

Change in Deferred Policy Acquisition Costs

The change in deferred policy acquisition costs was RMB190 million in 2004 as compared to RMB37 million in 2003. The larger change in deferred policy acquisition costs was primarily due to the significant increase in gross written premiums for our property and casualty business.

Claims

For years ended December 31, (in RMB million, except percentages)	2004	2003
Automobile insurance	3,199	3,038
Non-automobile insurance	1,095	907
Accident & health insurance	146	15
Total claims	4,440	3,960
Loss ratio	77.0%	78.5%

Total claims increased 12.1% to RMB4,440 million in 2004 from RMB3,960 million in 2003. Our loss ratio decreased to 77.0% in 2004 from 78.5% in 2003.

Claims attributable to our automobile insurance business increased 5.3% to RMB3,199 million in 2004 from RMB3,038 million in 2003. This increase was primarily due to the additional claims reserves being provided for compulsory third party insurance coverage.

Claims attributable to our non-automobile insurance business increased 20.7% to RMB1,095 million in 2004 from RMB907 million in 2003. This increase was primarily due to an increase in claims paid resulting from typhoon damage.

Claims attributable to our accident and health insurance business increased to RMB146 million in 2004 from RMB15 million in 2003. This increase was primarily due to the significant growth in sales of accident and health insurance products in 2004.

Commission Expenses

For years ended December 31,	2004	2003
Commission expenses as a percentage of gross written premiums	6.7%	7.4%

Commission expenses increased 12.6% to RMB678 million in 2004 from RMB602 million in 2003. However, as a percentage of gross written premiums, commission expenses decreased to 6.7% in 2004 from 7.4% in 2003. This decrease was primarily due to the lower commission rates paid to our life insurance agents who cross-sells property and casualty products and our brokers.

General and Administrative Expenses

For years ended December 31,	2004	2003
General and administrative expenses as a percentage of gross written premiums	17.2%	16.2%

General and administrative expenses increased 33.0% to RMB1,742 million in 2004 from RMB1,310 million in 2003. As a percentage of gross written premiums, general and administrative expenses increased to 17.2% in 2004 from 16.2% in 2003. These increases were primarily due to the growth of our business.

Management Discussion and Analysis

Income Taxes

For years ended December 31,	2004	2003
Effective tax rate	49.8%	69.8%

Income taxes decreased 3.2% to RMB215 million in 2004 from RMB222 million in 2003. The effective tax rate decreased to 49.8% in 2004 from 69.8% in 2003. These decreases were primarily due to an increase in dividend income from equity investment funds and interest income from government bonds, which were both entitled to certain tax exemptions.

Net Profit

As a result of the foregoing, net profit from our property and casualty insurance business increased 126.0% to RMB217 million in 2004 from RMB96 million in 2003.

TRUST BUSINESS

Results of Operations

For years ended December 31, (in RMB million)	2004	2003
Total revenue	102	125
Net profit	3	65

Total revenue from our trust business decreased 18.4% to RMB102 million in 2004 from RMB125 million in 2003. Net profit from our trust business decreased to RMB3 million in 2004 from RMB65 million in 2003. This decrease was primarily due to an increase in goodwill amortization expenses.

SECURITIES BUSINESS

Results of Operations

For years ended December 31, (in RMB million)	2004	2003 ⁽¹⁾
Total revenue	288	291
Net profit	6	21

⁽¹⁾ Ping An Securities became a subsidiary of the Group with effect from October 22, 2003. Prior to this date, Ping An Securities was an associate of the Group. The results of Ping An Securities prior to October 22, 2003 were consolidated into our Group's consolidated results using the equity accounting basis.

Total revenue from our securities business decreased 1.0% to RMB288 million in 2004 from RMB291 million in 2003. Net profit from our securities business decreased to RMB6 million in 2004 from RMB21 million in 2003. These decreases were primarily due to the poor performance of the PRC equity markets in 2004.

BANK BUSINESS

Results of Operations

For years ended December 31, (in RMB million)	2004	2003 ⁽¹⁾
Total revenue	10	3
Net profit	3	2

⁽¹⁾ Ping An Bank became a subsidiary of the Group with effect from February 19, 2004. Ping An Bank's results for 2003 were not consolidated into our Group's consolidated results.

Total revenue from our bank business increased to RMB10 million in 2004 from RMB3 million in 2003. Net profit from our bank business increased to RMB3 million in 2004.

LIQUIDITY AND FINANCIAL RESOURCES

Liquidity and financial resources are managed at the Group level on a consolidated basis. We are a holding company and, with the exception of investment management activities, do not conduct any significant business operations on our own. As a result, we depend upon dividends and distributions from our operating subsidiaries for substantially all of our operating cash flows.

Liquidity for insurance companies generally refers to the ability of an insurance company to generate adequate amounts of cash from insurance underwriting and investment operations to meet payments for claims and policyholders' benefits and operating needs. The principal sources of funds generated by our insurance business are written premiums and policy fees, interest and dividend income and proceeds from the sale or maturity of our investments, while the major uses of these funds are to provide payments for claims and policyholders' benefits and other operating costs.

Net cash inflow from operating activities decreased to RMB34,370 million in 2004 from RMB35,178 million in 2003. This decrease was primarily due to a decrease in written premiums and policy fees.

Net cash outflow from investing activities was RMB40,253 million.

Net cash inflow from financing activities was RMB13,120 million as compared to the net cash outflow of RMB8,831 million in 2003. This was primarily due to proceeds received from our initial public offering.

Management Discussion and Analysis

In addition to cash and cash equivalents held by the Group, we have two additional sources of liquidity. First, the Group held liquid investments for trading purposes. These investments are listed or are traded in an active market and can be converted to cash easily without incurring significant charges. Furthermore, the Group had access to short-term borrowings.

The following table summarizes the carrying amount of liquid assets held by the Group:

For years ended December 31, (in RMB million)	2004	2003
Cash and cash equivalents	15,254	8,017
Held-for-trading investments	6,194	6,799
Total liquid assets	21,448	14,816

The management believes that the liquid assets currently held, together with net cash generated from future operations, will enable the Group to meet the foreseeable cash requirements.

CAPITAL STRUCTURE

Shareholders' Equity and Short-term Borrowings

Shareholders' equity increased to RMB28,253 million in 2004 from RMB12,952 million in 2003. This increase is primarily due to the net proceeds of RMB13,279 million received from our initial public offering and an increase in net profit in 2004.

Short-term borrowings, represented by securities sold under agreements to repurchase, increased to RMB601 million in 2004 from RMB200 million in 2003. Short-term borrowings were used as part of the liquidity management for our daily operations. The Group has no other significant loan arrangements besides these short-term borrowings.

Solvency Margin

The solvency margin ratio is a measure of capital adequacy for insurance companies. It is calculated by dividing the actual solvency margin by the statutory minimum solvency margin requirement. Under the applicable CIRC regulations, PRC insurance companies are required to maintain specified solvency margin ratios. As a general matter, the CIRC considers an insurance company with a solvency margin ratio of 100% or higher to be financially sound.

The following table sets forth the solvency margin ratios for our life insurance and property and casualty insurance businesses:

For years ended December 31, (in RMB million, except percentages)	Life Insurance		Property and Casualty Insurance	
	2004	2003 ⁽¹⁾	2004	2003 ⁽¹⁾
Actual solvency margin	11,335	8,752	1,754	1,440
Minimum solvency margin	9,206	7,661	1,105	835
Solvency margin ratio	123.1%	114.2%	158.7%	172.5%

⁽¹⁾ The above solvency margins as of December 31, 2003 have been restated in accordance with new regulations promulgated by the CIRC in late 2004.

Contractual obligations and Other Commercial Commitments

The following table sets forth our aggregate contractual obligations and other commercial commitments for the periods specified:

For years ended December 31, (in RMB million)	2004	2003
Contractual commitments	150	282
Operating lease commitments	799	676

RISK MANAGEMENT

Approach to Risk Management

Ping An regards risk management as a core discipline in our business practice. We are dedicated to develop and maintain a risk management framework that governs the overall infrastructure of the group's operations.

Members of the Risk Management Committee include the Chief Operating Officer, the Chief Actuarial Officer, the Chief Investment Officer, the Chief Internal Auditor and the Finance Director. Meetings of the risk management committee are attended by top management representatives from each core operation of the Group, including the Chief Legal Officer and the Head of Group Information Technology.

Management Discussion and Analysis

The committee meets on a quarterly basis to review the risk management progression. In these meetings, the risk management structure and major risk management issues are discussed on a macro level. Potential new corporate strategic objectives are evaluated for their risk exposures, major risk events for the past quarter are evaluated and development of new risk measurement techniques and risk control measures are presented and approved for implementation. Major operation risk weaknesses noted from our internal audit reviews and from external factors such as regulatory changes and accounting standards changes are also reviewed. Appropriate responses are formulated for the risk topics discussed. Lastly, the committee will review the appropriateness of measures implemented to address risk topics raised in prior meetings. On a monthly basis, the risk management committee meets to review the investment portfolio risk exposure report.

Insurance Product Risk

Insurance product risk is the risk of loss due to actual experience emerging differently than what was assumed when the product was designed and priced, as a result of investment returns, expenses, taxes, mortality and morbidity claims, and policyholder behavior.

The Group controls this risk closely through monitoring its product designing, pricing, and actual claims experience. Product risk is also mitigated through the use of aggregate retention limits through catastrophe reinsurance.

Asset and Liability Mismatching Risk

Asset and liability mismatching risk is the risk of loss due to the Group's inability to match its assets with its liabilities on the basis of both duration and investment return.

The Group's asset and liability management includes processes and models built to measure the sensitivity of net income and shareholders' equity under various deterministic interest rate scenarios. The scenarios and assumptions used are reviewed and updated periodically. Insights gained through the analysis are used to measure the risk exposures and capital position of the Group.

Under the current regulatory and market environment, the Group is unable to invest in assets with a duration of sufficient length to match the duration of its life insurance liabilities. When the regulatory and market environment permits, the Group intends to gradually lengthen the duration of its assets.

Market Risk

Market risk is the risk of potential loss that may result from changes in the value of a financial instrument as a result of changes in interest rates, market prices, foreign currency exchange rates and other market price-related factors. Under the current PRC regulatory and market environment, there is a lack of financial instruments available for the Group to hedge its market risk exposures efficiently. The Group controls its market risk exposures by setting a maximum risk exposure for each class of assets. When setting these limits, significant consideration is placed on the Group's risk appetite and impact on the Group's financial condition. These limits also take into account the Group's asset-liability management strategy.

The Group utilizes various techniques to quantify the market risk exposure, including sensitivity analysis and Value-at-Risk (“VaR”) computation. VaR is a summary statistical measure that uses historical market prices and estimates the maximum loss over a target horizon such that there is a low, pre-specified probability that the actual loss will be larger. However, the utilization of the VaR technique under the current PRC market and regulatory environment has its limitations due to the lack of reliable historical financial data.

Market Risk – Interest Rate Risk

Fixed maturity securities held by the Group are exposed to interest rate risks. These investments are substantially represented by bond investments that are recorded at fair value in the balance sheet.

The Group uses sensitivity analysis to estimate its risk exposure. Interest rate sensitivity is estimated by assuming a 50 basis points parallel shift in the bond yield curve.

As at December 31, 2004 (in RMB million)	Interest rate risk
Bond investments held-for-trading and available-for-sale	444

Market Risk – Market Price Risk

Listed equity investments held by the Group are exposed to market price risks. These investments are substantially represented by equity investment funds.

The Group uses the 10-day market price VaR technique to estimate its risk exposure. Market price VaR is computed as (equity investment funds valued at market price x 10-day worst market fluctuation at 99% level).

As at December 31, 2004 (in RMB million)	Market price risk
Equity investments funds held-for-trading and available-for-sale	341

Market Risk - Foreign Currency Risk

Foreign currency denominated investments and cash assets held by the Group are exposed to foreign currency risks. These assets include term deposits, cash and cash equivalents held in foreign currency. To reduce foreign currency risk, the Group controls the amount of foreign currency denominated assets held. The Group also chooses to hold assets in foreign currencies that the Renminbi is pegged to.

The Group uses sensitivity analysis to estimate its risk exposure. Foreign currency risk sensitivity is estimated by assuming a simultaneous and uniform 5% depreciation, against the Renminbi, of all foreign currency denominated term deposits, cash and cash equivalents.

As at December 31, 2004 (in RMB million)	Foreign currency risk
Foreign currency denominated term deposits, cash and cash equivalents	985

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Credit Risk

Credit risk is the risk of economic loss resulting from the failure of one of the Group's obligors to make any payment of principal or interest when due.

The Group is exposed to credit risks primarily associated with its term deposits arrangements with commercial banks and investments in bonds issued by PRC companies.

To evaluate credit risk property, the Group has established an internal credit rating system. The counterparties' ratings are reviewed at least annually through the system or whenever a credit event occurs.

The Group quantifies its credit risk exposure by assigning expected default rates and expected recovery rates of relevant credit grades for commercial banks and bond issuing companies. Credit risk is computed as (principal amount + outstanding interests) x default rate x (1 - recovery rate).

As at December 31, 2004 (in RMB million)	Credit risk
Term deposits placed with commercial banks and bonds issued by PRC companies	259

Operational Risk

Operational risk is the risk of loss resulting from internal operation failures or uncontrollable external events. Internal operation failures occur due to inadequate or failed internal processes (process risks), system failure (system risks), and human performance failure (people risks). Uncontrollable external events that contribute to operation risks are mainly due to legal matters or changes in the regulatory requirements, accounting standards and tax laws.

For internal operational risks, a proactive approach has been taken to implement appropriate and sufficient preventive controls, detective controls and damage limitation controls. These controls are embedded into the business processes, system operations and human performance. Rigorous checks on the reliability of the controls are performed by our internal and external audit functions. Our risk management committee and audit committee reviews the reports from our internal and external auditors to ensure that appropriate measures are taken to address control weaknesses detected. For the uncontrollable external events, our Legal Department, Finance Department and Planning and Actuarial Department monitor changes in regulatory requirements, accounting standards and tax laws closely.