

Business Review

GROSS WRITTEN PREMIUMS AND DEPOSITS

RMB million

2004

Individual life insurance

Risk-type products	50,113
First-year written premiums	19,900
Single written premiums	2,526
Regular written premiums	17,374
Renewal written premiums	30,213
Deposit products	66,981
First-year deposits	54,662
Single deposits	52,343
Regular deposits	2,319
Renewal deposits	12,319
Policy fees	4,796

Group life insurance

Risk-type products	344
First-year written premiums	295
Single written premiums	261
Regular written premiums	34
Renewal written premiums	49
Deposit products	21,756
First-year deposits	21,738
Single deposits	21,726
Regular deposits	12
Renewal deposits	18
Policy fees	398

Accident and health insurance

Gross	10,606
Accident insurance	
Written premiums	4,977
Short-term health insurance	
Written premiums	5,629

1. INDUSTRY OVERVIEW

Pursuant to the data released by the China Insurance Regulatory Commission (“CIRC”), “insurance penetration” (measured by total insurance premiums as a percentage of GDP) of the PRC was 3.4% in 2004, representing an increase of 2.1% from 2003; “insurance density” (means the per capita premiums based on the permanent population) was RMB332 in 2004, representing an increase of 15.5% from 2003. According to the statistics prepared under the PRC accounting standards issued by the CIRC, the gross written premiums of the life insurance sector in the PRC grew by 7.2% compared with 2003, representing the steady growth of this sector.

The PRC economy and its GDP have been growing at a high speed, fuelling the rise in the general living standards and the awareness of insurance in the country. Such a backdrop has spawned new development opportunities for the insurance industry. In 2004, the CIRC announced a series of proactive policies to further expand the investment channels for insurance assets. For example, insurance assets are permitted to invest in subordinate bonds and equity market. Besides, the foreign currency assets held by insurance institutions are also allowed to invest in overseas capital market. Investment returns on assets held by insurance institutions are expected to improve. At the same time, full-scale opening-up in insurance market led to an increase in the number of new entrants to the market and thus more intense competition among insurers occurred in the PRC. The Company believes that it will not face serious competition from these new entrants, including those specialised insurers in the near future. The Company emphasizes on the research and analysis of development trends and policy changes of macro economy and the formulation of corresponding strategies.

2. BUSINESS OVERVIEW

2004 was the first year after the Company’s restructuring and listing. Its business development strategy in 2004 was to achieve “sustained growth and prudent operation to improve profitability and to generate attractive returns for investors”. Aggressive efforts were made to pursue business restructuring in line with customer demand and profitability. The focus was on driving the sales of risk-type products, particularly regular premium products. In 2004, the Company’s business sustained its rapid growth and its asset scale continued to expand as it moved ahead to realize the objective of business restructuring. The Company’s gross written premiums and policy fees for the year ended December 31, 2004 were RMB66,257 million, representing an increase of 25.2% from 2003. Its total revenues calculated in accordance with the PRC accounting standards grew at a rate of 11.4%, higher than the industry average of 7.2%.

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The Company started its business restructuring in 2003 with the aim to enhance its profitability and sustaining its steady growth. In this connection, the Company formulated its business plans and budgets in a way to take full consideration of the business restructuring. In respect of product strategy, the primary focus was on risk-type participating products. Besides, performance standards were established, with the levels of risk-type premiums and regular premiums as the leading benchmarks for assessing the performance of branches. Such a measure proved effective in driving branches to undertake business restructuring, maintaining the high growth rate of risk-type products and regular premium products. For the year ended December 31, 2004, the total risk-type written premiums were RMB61,063 million, representing a 28.9% increase from 2003. In particular, the first year risk-type written premiums (including those attributable to long-term health insurance but excluding those involving accident and short-term health insurance) were RMB20,195 million, representing an increase of 49.5% from 2003. The first-year regular risk-type written premiums (including those attributable to long-term health insurance) were RMB17,408 million, representing an increase of 94.5% from 2003 and accounting for 86.2% of the first-year risk-type written premiums (including those attributable to long-term health insurance but excluding those involving accident and short-term health insurance). As a result of its solid business growth after the restructuring, the Company has maintained its leadership in the life insurance sector in the PRC.

3. PRINCIPAL INSURANCE BUSINESSES OF THE COMPANY

The Company offers individual and group life insurance, accident and health insurance. It had about 60 million individual and group life insurance policies, annuity contracts and long-term health insurance policies in force as at December 31, 2004.

(1) Individual Life Insurance

For the year ended December 31, 2004, the Company's gross written premiums and policy fees attributable to individual life insurance were RMB54,909 million, representing 82.9% of the gross written premiums and policy fees for the year and an increase of RMB12,621 million, or 29.8%, over RMB42,288 million in 2003.

The risk-type gross written premiums attributable to individual life insurance were RMB50,113 million, representing an increase of RMB13,205 million, or 35.8%, over RMB36,908 million in 2003. The first-year risk-type gross written premiums attributable to individual life insurance were RMB19,900 million, which accounted for 39.7% of the written premiums attributable to individual life insurance. The first-year risk-type regular written premiums attributable to individual life insurance were RMB17,374 million, which accounted for 87.3% of the first-year risk-type written premiums attributable to individual life insurance.

The Company markets both participating and non-participating life insurance products. On the basis of the HK generally accepted accounting principles, the gross written premiums attributable to individual life insurance participating products and non-participating products for the year ended December 31, 2004, were RMB22,363 million and RMB27,750 million respectively.

Participating endowment products form one of the most important product series of the Company.

(2) Group Life Insurance

For the year ended December 31, 2004, the Company's gross written premiums and policy fees attributable to group life insurance were RMB742 million, representing 1.1% of the gross written premiums and policy fees for the year and an increase of RMB310 million, or 71.8%, over RMB432 million in 2003.

The Company offers both participating and non-participating group life insurance products.

(3) Accident and Short-term Health Insurance

For the year ended December 31, 2004, the Company's gross written premiums attributable to accident and short-term health insurance were RMB10,606 million, representing an increase of RMB401 million, or 3.9%, over RMB10,205 million in 2003. In particular, the gross written premiums attributable to accident insurance amounted to RMB4,977 million, accounting for 7.51% of the gross written premiums and policy fees for the year, while the gross written premiums and policy fees attributable to short-term health insurance were RMB5,629 million, representing 8.50% of the gross written premiums and policy fees for the year.

4. DISTRIBUTION CHANNELS

The Company has the largest and most extensive distribution force and network in the life insurance sector in the PRC, covering almost every county level administrative regions in China, except the Tibet Autonomous Region.

Exclusive agents, direct sales force and intermediaries comprising mainly banks and post offices are the three major distribution channels of the Company.

(1) Exclusive agents

Exclusive agents (including those who are not yet qualified as agents) is the Company's primary distribution channel for individual life, individual accident and individual health insurance products. In 2004, the Company's exclusive agents expanded mildly. As at December 31, 2004, the Company retained nearly 668,000 agents at its over 9,300 field offices. These two figures represented an increase of about 13,000 and 1,100 from 2003 respectively.



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The Company has training programs, marketing tools and IT systems in place to support the operation of its exclusive agent sales force. Under its training system for new agents, the Company has standardized practices for the recruitment of new agents. At the same time, various measures are pursued to reduce the turnover of exclusive agents. To support the Company's overall development strategy in large and medium cities, the Chartered Insurance Agency Management ("CIAM") qualification certification program was introduced to improve the quality of senior agent management in those cities. Based on the market segmentation study, a special sales force will be established for the high-end market segment. The Company also engaged in cooperation with internationally renowned training institutions such as the Life Office Management Association ("LOMA") and Life Insurance Marketing and Research Association ("LIMRA"), as well as colleges and universities in China, to enhance the professional standard and overall service quality of its agents. As at December 31, 2004, the percentage of certificate holders for exclusive agents was 72%, representing an increase of 8.5 percentage points over the 63.5% in 2003.

The Company retains designated supervisors to manage exclusive agents and hires full-time trainers to offer training to them. Besides, the Company has set up product management and customer service standards, which all field offices and agents must meet.

Apart from commissions and performance-based bonuses, the Company also provides pensions, as well as group life and medical insurance protection for its exclusive agents based on individual service history and performance. In addition, the Company also organizes sales contests for field offices and sales units to motivate its sales agents. Sales summits and cultural marketing programs are also held for exclusive agents from time to time to serve as non-monetary incentives in order to enhance their sense of belonging and corporate unity.

The "Jin Ding Project", the objective of which is to improve overall sales performance, was implemented with the participation of the Company's exclusive agents across the nation during the year. The Company expects that this three to five-year project will help improve the innovation of exclusive agents in marketing and management practices, thus enhancing their professional standards and competitiveness.

Apart from the provision of a centralized business support and information management system for its exclusive agents, the Company has also developed the "Risk Warning System" and "Credit Rating System" to enhance the control of operation risks of exclusive agents. In particular, the focus of "Risk Warning System for Exclusive Agents" is on the prevention of any irregularities of exclusive agents. The system has been launched nationwide after completion of trial run and assessment. The purpose of the "Credit Rating System" is to strengthen the professional ethics of exclusive agents. The system is expected to be fully implemented in 2005.

(2) Direct sales force

The Company's direct sales force is the primary distribution channel for its group life insurance and annuities, group accident and health insurance products. As at December 31, 2004, the Company retained a total of approximately 12,000 full-time employees, representing an increase of 20% from 10,000 in 2003, in its direct sales force. These direct sales representatives were allocated to over 4,000 branch offices of the Company, covering almost all counties of China, except in the Tibet Autonomous Region. The training system for the direct sales force has been preliminarily established. A critical customer sales team was formed by the Company to enhance its professional standards and competitive edge to market large companies and key-account customers in large-scale industries.

(3) Intermediaries

The Company also provides a variety of individual and group life insurance products through intermediaries. This distribution channel is largely made up of commercial bank branches, post offices, credit cooperatives, as well as professional insurance agencies and insurance brokers. The Company has established bancassurance business relationships with branches of commercial banks and post offices. As at December 31, 2004, the Company had cooperated with more than 87,000 bank branches and post offices with 12,000-strong customer relationship team, which offers supporting services to the businesses.

5. BUSINESS MANAGEMENT

After eight months of efforts, the Company has completed a customer-oriented business reform program with the purpose of implementing an industry-leading and forward-looking life insurance business management system. To cope with changes in business trends and corporate development, the Company upgraded its core business processing system and developed a group annuity system. In addition, the Company amended its "Code of Practices for Underwriting", "Code of Practices for Claims Management" and "Code of Practices for Conservation", prepared the "Code of Practices for Group Annuity" and established a customer service management system.

(1) Underwriting and claims management

Supported by its computer system, the Company managed its underwriting and claims management operations and exercised risk control by setting down authorization limits on its branch offices and implementing a hierarchy-based system of underwriters and claims inspectors. Material cases with significant uncertainties beyond the authorization of provincial branches were handled directly by the head office. In a bid to enhancing its service quality, the Company also offered regular training sessions for its underwriters and claims inspectors. Periodic and ad hoc inspections were conducted on a company-wide basis. Under the recent reform of its human resource system, the Company has also established qualification standards as part of the entry requirements for professional underwriters.

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(2) Customer service

The Company mainly provides customer service through its customer service teams at different branches and field offices throughout China and with the support of an advanced call center. In 2004, the Company's customer service system was further optimized, as proven by the significant improvement in the quality of service. During the year, its centralized service platform "95519" Call Center successfully achieved the CCCS-OP-2003 National Call Center Operating Performance Standards and was granted the Award of the Best Performing Call Centre in China 2004. On the other hand, the 95519 SMS Customer Service System was also introduced to all branches of the Company.

6. PRODUCT DEVELOPMENT

A Product Development Committee has been established during the year. Comprising members from the management, heads of various core business departments and professionals of the Company, the Committee is responsible for formulating product development plans and strategies for the Company. It sets down the direction of product development and engages in the discussion, studies and resolution of serious issues in the product development process. In 2004, the Company optimized its product development process and implemented an incentive scheme to encourage product innovation. Coping with changes in market needs, the Company successfully developed several new products including joint life, unit-link and universal products.

7. ACTUARIAL MANAGEMENT

The Company undertakes periodic and thorough monitoring, analysis and research on the performance of its products, including profitability and risk assessments, to support the setting up of a scientific pricing system. In 2004, the company terminated or modified certain products based on their profitability performance. For example, the "SHENGMING LUYIN" long term health insurance plan was terminated. In 2004, the Company's actuarial work focused on the research on mortality, expenses and morbidity. MoSes, an international advanced actuarial software system, was introduced. In the long term, the focus is on liability valuation, product profitability assessment, cash flow analysis, actuarial risk control and experience analysis, preparation of various actuarial reports, assistance in formulating investment strategies, assistance in formulating reinsurance strategies. All the work mentioned above is to support the Company's sustainable solid growth in an effective manner.

8. IT INFRASTRUCTURE

The Company has been establishing its proprietary IT infrastructure on the bases of its Application System, Database System, Foundation System and Governance System. In 2004, the Company completed its IT strategic planning, laying down specific goals and objectives for its IT development in the future. The core business processing system has been upgraded. In addition, the Company completed the development of CBPS8 version system, which catered to for such products as life insurance, health insurance, joint life, group annuity, unit-link and universal products. The development of the Group Annuity Business Processing System and unit-link and universal Business Processing System has also been completed successfully. The Company has realized the centralization of provincial data. Furthermore, the Company achieved paper-less operation with continued improvements in office automation and increased utilization of the remote education and video conferencing system.

9. INTERNAL CONTROL

(1) Internal control structure

The Company's internal control is carried out by a multi-level management system, comprising the Supervisory Committee, the Audit Committee and Risk Management Committee under the Board of Directors, the Internal Control Committee under the management, and the audit department and risk management department of the Company. The audit department is the supervisory department in charge of the execution of internal control policies of the Company, and has already built a vertically integrated management structure and a centralized audit system.

(2) Internal control system

In 2004, the Company formulated and improved various internal documents, including the "Internal Control Manual", "Internal Control Manual for Prevention of Malpractices" and "Internal Management System for Financial Reporting". To facilitate the implementation of various internal control measures, the Company further classified the duties covered by the "Internal Control Manual" and prepared the "Internal Control Guidelines". The "Internal Control Audit Guidelines" and "Internal Control Rating Measures" were also developed for governing the supervision and assessment activities in relation to the internal control system to promote its enhancement and effective implementation.

The Company has been in compliance with all applicable laws and regulations of the PRC, as well as the rules of the jurisdictions in which it is listed. In 2004, the Company pursued optimization of the internal control systems at its branches and prepared itself towards compliance with Sarbanes-Oxley Act Section 404. As it continued to enhance and optimize its internal control system, the Company identified and actively addressed certain issues that need to be resolved in the process. The Company believes that the continued improvement and effective operation of its internal control system is beneficial for its risk control and management and in the best interests of its customers and shareholders.

10. INVESTMENTS

Under the approval of competent authorities, including China Securities Regulatory Commission and CIRC, the Company was permitted to directly invest in the equity markets in China. Besides, the Company has also submitted an application for the permission to invest overseas with its foreign currency denominated fund, which is pending for the approval of the relevant authorities. As at December 31, 2004, the Company held RMB374,890 million in investment assets.

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The Strategy Committee under the Board of Directors, together with the Investment Decision-Making Committee and the Investment Risk Management Committee, form the Investment Decision-Making and management organ of the Company. In August 2004, the Company established the investment department, which, as a special unit to carry out the investment management and operation functions of the Company, is responsible for strengthening the professional management of the Company's investment activities. Through the formulation of rules, such as the "Investment Guidelines", the Company guides and manages the activities of the primary trustee of its investment assets, China Life Insurance Asset Management Company Limited.

In line with the new trends of the expansion of investment channels and latest changes in capital markets, the Company amended the Investment Guidelines in a timely manner. New investment criteria were set up to further improve the Company's investment management system. In 2004, the Company formulated, standardized and fine-tuned various regulatory documents in relation to the systems for investment and the related risk management. Such documents as the Investment Management System and Investment Risk Management System, which have already been reviewed and approved by the board of Directors, are being implemented.

The Company undertook extensive research and analysis of the impact of major changes in macro economy, including rising interest rate, on its business development. Its investment portfolio and structure were timely adjusted and enhanced under the principle of prudence to ensure proper matching between its assets and liabilities. As at December 31, 2004, the investment portfolio of the Company was as follows:

RMB million

Fixed maturity securities	150,234
Non-trading securities, at estimated fair value	69,791
Held-to-maturity securities	79,603
Trading securities, at estimated fair value	840
Equity securities	17,271
Non-trading securities, at estimated fair value	12,597
Trading securities, at estimated fair value	4,674
Term deposits	175,498
Policy loans	391
Securities purchased under agreements to resell	279
Cash and cash equivalents	27,217

Term deposits

Term deposits, primarily held by commercial banks in China, represented 46.8% of the Company's total investment assets as at December 31, 2004.

Fixed maturity securities

Fixed maturity securities, such as Chinese treasury bonds, Chinese financial institutional bonds and Chinese corporate bonds above specified ratings, represented 40.1% of the Company's total investment assets as at December 31, 2004.

Equity investment

Securities investment funds consist of Chinese domestic investment funds that are primarily invested in securities which are issued by Chinese companies and traded on China's securities exchanges. Such investments represented 4.6% of the Company's total investment assets as at December 31, 2004.

11. FINANCIAL MANAGEMENT

During the year, the Company took further steps to improve its performance appraisal system and strengthen its efforts on budget control to ensure all branches actively pursued the strategy of business restructuring and realized various business development objectives. Apart from striving for business development, the Company sought to categorize its expenses in a systematic manner and offer incentive scheme for expense management to achieve more stringent control of expenses for cost reduction. During the year, the Company continued to pursue centralized procurement and effectively reduced the expenditure on bulk items. Besides, financial expenses management policies were set up to support the continued healthy growth and business restructuring of the Company.

The Company has upgraded its financial information management system and stepped up efforts in integrating its information management. Besides, efforts are also made to further improve its financial management systems, including the "Financial Reporting and Internal Control Manual", "Comprehensive Budget Management Measures", "Funds Management Measures", "Accounting Personnel Management Measures" and "Fixed Assets Investment Measures". The Company believes that the implementation of these measures will be effective in the control and management of financial risks.