

OVERVIEW

As a leading insurance company in the PRC property and casualty insurance market, the Company provides various property and casualty insurance products as well as a broad range of accidental injury insurance and short-term health insurance products to its customers. The accidental injury insurance and short-term health insurance products jointly developed by the Company and American International Group, Inc. ("AIG") have been launched and gradually rolled out to the nationwide market. In the first half of 2005, the Company's market share in the property and casualty insurance market was 53.1%.

The following table sets forth the net premiums earned, underwriting profit, net profit and total assets of the Company for the periods indicated.

	Six months ended 30 June	
	2005 <i>RMB million</i>	2004 <i>RMB million</i>
Net premiums earned	24,939	24,206
Underwriting profit ¹	1,529	1,418
Net profit attributable to shareholders	889	963
Total assets	96,268	93,705

1 Underwriting profit represents net premiums earned minus net claims incurred, and after amortisation of deferred acquisition costs, insurance protection expense and general and administrative expenses.

RESULTS OF OPERATIONS

In the first half of 2005, the Company's turnover decreased slightly whilst its underwriting performance was relatively satisfactory. The Company's investment return still requires further improvement. The following table sets forth selected financial information shown as percentages of net premiums earned for the periods indicated.

	Six months ended 30 June	
	2005	2004 (%)
Net premiums earned	100.0	100.0
Net claims incurred	(72.4)	(72.7)
Amortisation of deferred acquisition costs	(8.7)	(6.7)
Insurance protection expense	(1.2)	(1.3)
General and administrative expenses	(11.5)	(13.4)
Underwriting profit	6.1	5.9
Net investment income	2.7	2.1
Net realised and unrealised losses on investments	(2.9)	(2.1)
Finance costs	(0.2)	(0.3)
Interest expenses credited to policyholders' deposits	(0.3)	(0.3)
Profit before tax	5.5	5.3
Tax	(1.9)	(1.3)
Net profit attributable to shareholders	3.6	4.0
Loss ratio	72.4	72.7
Expense ratio	21.5	21.4
Combined ratio	93.9	94.1

The following table sets forth the net premiums earned, net claims incurred and amortisation of deferred acquisition costs by segment, analysed as percentages, for the periods indicated.

	Six months ended 30 June	
	2005	2004 (%)
Net premiums earned		
Motor vehicle	73.7	67.7
Commercial property	10.9	13.4
Homeowners	1.6	1.6
Other	13.8	17.3
Total	100.0	100.0
Net claims incurred		
Motor vehicle	79.9	80.2
Commercial property	8.9	7.1
Homeowners	0.4	0.6
Other	10.8	12.1
Total	100.0	100.0
Amortisation of deferred acquisition costs		
Motor vehicle	92.2	81.7
Commercial property	7.8	8.2
Homeowners	6.4	2.9
Other	(6.4)	7.2
Total	100.0	100.0

TURNOVER

Turnover of the Company reached RMB34,882 million in the first half of 2005, representing a decrease of RMB507 million (or 1.4%) compared to RMB35,389 million in the first half of 2004. The decrease was primarily due to a decrease of RMB1,325 million in turnover of the motor vehicle segment.

NET PREMIUMS EARNED

Net premiums earned of the Company amounted to RMB24,939 million in the first half of 2005, representing an increase of RMB733 million compared to RMB24,206 million in the first half of 2004. The increase was primarily due to a decrease in the change in net unearned premium reserves, which was partially offset by an increase in reinsurance premiums ceded and a decrease in turnover. Reinsurance premiums ceded increased from RMB4,803 million, or 13.6% of turnover, in the first half of 2004 to RMB6,670 million, or 19.1% of turnover, in the first half of 2005. The increase was primarily due to an increase in the commercial reinsurance ratio. As a result, despite a 5 percentage points decrease in the statutory reinsurance ratio in 2005 compared to that in 2004, the Company's reinsurance premiums ceded as a percentage of total premiums increased significantly in the first half of 2005 compared to the first half of 2004.

NET INVESTMENT INCOME

Net investment income of the Company reached RMB679 million in the first half of 2005, representing an increase of 28.1% compared to RMB530 million in the first half of 2004. The increase was primarily due to increases in interest income from bank deposits, debt securities and loans of RMB103 million, RMB83 million and RMB67 million, respectively. However, such increases were partially offset by a decrease of RMB104 million in dividend income from equity securities. The increase in interest income was primarily due to increased bank interest rates and increased balances of time deposits and debt securities investments, whereas the decrease in dividend income from equity securities was primarily due to the decrease in dividends from mutual funds.

NET REALISED AND UNREALISED LOSSES ON INVESTMENTS

Net realised and unrealised losses on the Company's investments in debt and equity securities reached RMB711 million in the first half of 2005, representing an increase of RMB197 million compared to the net losses of RMB514 million in the first half of 2004. The increase was primarily due to an increase in the provisions for impairment losses of debt securities that the Company deposited in Hantang Securities and a decrease in the realised and unrealised gains on equity investments, but such increase was partially offset by an increase in the realised and unrealised gains from debt securities investments.

NET CLAIMS INCURRED

The Company's net claims incurred amounted to RMB18,050 million in the first half of 2005, representing an increase of 2.6% compared to RMB17,586 million in the first half of 2004. Loss ratio of the Company was 72.4% in the first half of 2005, slightly lower than 72.7% in the first half of 2004. The increase in net claims incurred was primarily due to an increase of RMB356 million in net claims incurred in the commercial property segment to RMB1,604 million in the first half of 2005 compared to RMB1,248 million in the first half of 2004, and an increase of RMB327 million in net claims incurred in the motor vehicle segment to RMB14,423 million in the first half of 2005 compared to RMB14,096 million in the first half of 2004. Net loss and loss adjustment expense reserves as of 30 June 2005 increased by RMB1,749 million compared to 31 December 2004. The increase was primarily due to an increase in the loss and loss adjustment expense reserves for claims that occurred in 2005. The increase was also partially due to the Company's increase of RMB477 million in its loss and loss adjustment expense reserves for claims that occurred prior to 31 December 2004, after comparing the latest actuarial results as of 30 June 2005 to the actuarial results as of 31 December 2004. Of such increase, RMB298 million and RMB163 million were attributable to claims of the motor vehicle segment and claims of the commercial property segment which occurred prior to 31 December 2004, respectively.

AMORTISATION OF DEFERRED ACQUISITION COSTS

Amortisation of deferred acquisition costs amounted to RMB2,178 million in the first half of 2005, representing an increase of 33.9% compared to RMB1,626 million in the first half of 2004. The increase was primarily due to a significant increase in the first half of 2005 in amortisation of acquisition costs incurred in previous years, which was partially offset by an increase in reinsurance commission receivable as a result of a higher ceding ratio in the first half of 2005.

INSURANCE PROTECTION EXPENSE

According to the relevant PRC insurance law and regulations, the Company is required to accrue an insurance protection fund based on 1% of its retained premiums. Insurance protection expense of the Company amounted to RMB302 million in the first half of 2005, representing a decrease of 7.1% compared to RMB325 million in the first half of 2004. The decrease was primarily due to a decrease in retained premiums.

INTEREST EXPENSE CREDITED TO POLICYHOLDERS' DEPOSITS

Interest expense of the Company credited to policyholders' deposits was RMB67 million in the first half of 2005, representing a decrease of 14.1% compared to RMB78 million in the first half of 2004. The decrease was primarily due to a lower average balance of policyholders' deposits from the Company's Golden Bull homeowners insurance products in the first half of 2005 compared to the first half of 2004.

FINANCE COSTS

Finance costs amounted to RMB56 million in the first half of 2005, representing a decrease of RMB10 million compared to RMB66 million in the first half of 2004. The decrease was primarily due to a decrease in interest expense on reinsurance funds withheld in the first half of 2005 compared to the first half of 2004.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses of the Company amounted to RMB2,880 million in the first half of 2005, representing a decrease of RMB371 million compared to RMB3,251 million in the first half of 2004. The decrease was primarily due to the Company's strengthened efforts in costs control and also due to the decrease in depreciation and amortisation.

PROFIT BEFORE TAX

Profit before tax amounted to RMB1,374 million in the first half of 2005, representing an increase of RMB84 million compared to RMB1,290 million in the first half of 2004. The increase was primarily due to an increase of RMB149 million in net investment income and an increase of RMB111 million in underwriting profit. However, these increases were partially offset by an increase of RMB197 million in net realised and unrealised losses on investments in debt and equity securities.

INCOME TAX

Income tax was RMB485 million in the first half of 2005, representing an increase of 48.3% compared to RMB327 million in the first half of 2004. The Company's effective tax rate increased to 35.3% in the first half of 2005 compared to 25.3% in the first half of 2004.

NET PROFIT

As a result of the foregoing, the Company's net profit decreased by 7.7% to RMB889 million in the first half of 2005 compared to RMB963 million in the first half of 2004. Basic earnings per share in the first half of 2005 was RMB0.080.

COMBINED RATIO

The Company's combined ratio decreased from 94.1% in the first half of 2004 to 93.9% in the first half of 2005, primarily due to the decrease in loss ratio from 72.7% in the first half of 2004 to 72.4% in the first half of 2005.

RESULTS OF SEGMENT OPERATIONS

Motor Vehicle Insurance

	Six months ended 30 June	
	2005 RMB million	2004 RMB million
Turnover	22,872	24,197
Net premiums earned	18,384	16,377
Net claims incurred	(14,423)	(14,096)
Amortisation of deferred acquisition costs	(2,007)	(1,328)
Insurance protection expense	(211)	(231)
Segment profit before unallocated income and expenses	1,743	722
Loss ratio	78.5%	86.1%
Segment expense ratio	12.1%	9.5%
Segment combined ratio	90.6%	95.6%

Turnover of the motor vehicle segment reached RMB22,872 million in the first half of 2005, representing a decrease of 5.5% compared to RMB24,197 million in the first half of 2004. This decrease was primarily due to an intense competition in the motor vehicle insurance market and the Company's adjustments of its motor vehicle insurance business portfolio with a view to enhance the profitability of the motor vehicle insurance business.

Net premiums earned of the motor vehicle segment amounted to RMB18,384 million in the first half of 2005, representing a 12.3% increase compared to RMB16,377 million in the first half of 2004. The increase was primarily due to a decrease in the change in unearned premium reserves, which was partially offset by a decrease in turnover and an increase in reinsurance premiums ceded.

Net claims incurred of the motor vehicle segment increased by 2.3% to RMB14,423 million in the first half of 2005 from RMB14,096 million in the first half of 2004, primarily due to the increase in net premiums earned and the increase in personal injury claims standard. Loss ratio of the motor vehicle segment of the Company decreased to 78.5% in the first half of 2005 compared to 86.1% in the first half of 2004, primarily due to the Company's adoption of various measures to enhance the profitability of the motor vehicle segment and its improved claims management, as well as a decrease in the number of traffic accidents.

Amortisation of deferred acquisition costs charged to the motor vehicle segment increased by 51.1% to RMB2,007 million in the first half of 2005 compared to RMB1,328 million in the first half of 2004. The increase was primarily due to an increase in this year's amortisation of deferred acquisition costs incurred in previous years, which was partially offset by an increase in reinsurance commission receivable as a result of a higher ceding ratio.

Insurance protection expense charged to the motor vehicle segment decreased by 8.7% to RMB211 million in the first half of 2005 compared to RMB231 million in the first half of 2004 due to a decrease in retained premiums.

Primarily due to a sharp increase in amortisation of deferred acquisition costs, the expense ratio of the motor vehicle segment increased to 12.1% in the first half of 2005 compared to 9.5% in the first half of 2004.

As a result of the foregoing, primarily due to a relatively rapid increase in net premiums earned, the motor vehicle segment recorded a profit of RMB1,743 million before unallocated income and expenses in the first half of 2005, representing an increase of 141.4% compared to RMB722 million in the first half of 2004.

Commercial Property Insurance

	Six months ended 30 June	
	2005 RMB million	2004 RMB million
Turnover	5,330	5,145
Net premiums earned	2,712	3,238
Net claims incurred	(1,604)	(1,248)
Amortisation of deferred acquisition costs	(170)	(133)
Insurance protection expense	(41)	(45)
Segment profit before unallocated income and expenses	897	1,812
Loss ratio	59.1%	38.5%
Segment expense ratio	7.8%	5.5%
Segment combined ratio	66.9%	44.0%

Turnover of the commercial property segment of the Company increased by 3.6% to RMB5,330 million in the first half of 2005 compared to RMB5,145 million in the first half of 2004, primarily due to the Company's efforts commencing from the second half of 2004 in adjusting its business structure and taking various measures to promote its business development in the commercial property segment.

Net premiums earned of the commercial property segment reached RMB2,712 million in the first half of 2005, representing a 16.2% decrease compared to RMB3,238 million in the first half of 2004. The decrease was primarily due to an increase in reinsurance ratio and partially due to an increase in the change in unearned premium reserves.

Net claims incurred of the commercial property segment increased by 28.5% to RMB1,604 million in the first half of 2005 compared to RMB1,248 million in the first half of 2004. The increase was primarily due to the unfavorable development of loss and loss adjustment expense reserves for previous years and the continued decrease in the premium rate.

Due to a substantial increase in net claims incurred and decrease in net premiums earned, loss ratio for the commercial property segment increased from 38.5% in the first half of 2004 to 59.1% in the first half of 2005.

Amortisation of deferred acquisition costs charged to the commercial property segment increased by 27.8% to RMB170 million in the first half of 2005 compared to RMB133 million in the first half of 2004. The increase was primarily due to an increase in this year's amortisation of deferred acquisition costs incurred in previous years, which was partially offset by an increase in reinsurance commission receivable as a result of a higher ceding ratio.

Insurance protection expense charged to the commercial property segment decreased by 8.9% to RMB41 million in the first half of 2005 compared to RMB45 million in the first half of 2004, primarily due to a decrease in retained premiums.

Due to the increase in amortisation of deferred acquisition costs and the decrease in net premiums earned mentioned above, the segment expense ratio of the commercial property segment increased to 7.8% in the first half of 2005 compared to 5.5% in the first half of 2004.

As a result of the foregoing, the commercial property segment recorded a profit of RMB897 million before unallocated income and expenses in the first half of 2005, representing a decrease of 50.5% compared to RMB1,812 million in the first half of 2004.

Homeowners Insurance

	Six months ended 30 June	
	2005 <i>RMB million</i>	2004 <i>RMB million</i>
Turnover	585	793
Net premiums earned	397	378
Net claims incurred	(72)	(103)
Amortisation of deferred acquisition costs	(140)	(47)
Net investment income	126	53
Net realised and unrealised losses on investments	(127)	(7)
Interest expense credited to policyholders' deposits	(67)	(78)
Insurance protection expense	(5)	(8)
Segment profit before unallocated income and expenses	112	188
Loss ratio	18.1%	27.2%
Segment expense ratio	36.5%	14.6%
Segment combined ratio	54.6%	41.8%

Turnover of the homeowners segment decreased by 26.2% to RMB585 million in the first half of 2005 compared to RMB793 million in the first half of 2004. The decrease was primarily due to an increase in mortgage loan guarantee policies terminations resulting from the increase in interest rates and the government's macro economics control over the real estate market, and partially due to an intense competition in homeowners insurance market.

Net premiums earned of the homeowners segment increased by 5.0% to RMB397 million in the first half of 2005 compared to RMB378 million in the first half of 2004. The increase was primarily due to a decrease in change in unearned premium reserves caused by a decrease in turnover of the homeowners insurance in the first half of 2005.

Net claims incurred of the homeowners segment decreased by 30.1% to RMB72 million in the first half of 2005 compared to RMB103 million in the first half of 2004. Loss ratio decreased to 18.1% in the first half of 2005 compared to 27.2% in the first half of 2004.

Amortisation of deferred acquisition costs charged to the homeowners segment increased by 197.9% to RMB140 million in the first half of 2005 compared to RMB47 million in the first half of 2004. The increase was primarily due to an increase in this year's amortisation of deferred acquisition costs incurred in previous years, which was partially offset by an increase in reinsurance ratio resulting in an increase in reinsurance commission receivable.

Insurance protection expense charged to the homeowners segment decreased to RMB5 million in the first half of 2005 compared to RMB8 million in the first half of 2004, primarily due to a decrease in retained premiums.

Due to the substantial increase in the amortisation of deferred acquisition costs, the segment expense ratio of the homeowners segment increased to 36.5% in the first half of 2005 compared to 14.6% in the first half of 2004.

The net investment income from policyholders' deposits of the homeowners segment increased by RMB73 million to RMB126 million in the first half of 2005 compared to RMB53 million in the first half of 2004, primarily due to an increase in interest and dividend income derived from the deposits and bonds invested through of the Golden Bull homeowners insurance products.

Interest expense credited to policyholders' deposits of the homeowners segment decreased by 14.1% to RMB67 million in the first half of 2005 from RMB78 million in the first half of 2004, primarily due to a decrease in average balance of deposits of the Golden Bull homeowners insurance products.

As a result of the foregoing, the homeowners segment recorded a profit of RMB112 million before unallocated income and expenses in the first half of 2005, representing a decrease of RMB76 million compared to RMB188 million in the first half of 2004.

Other Insurance Segments

The Company's other insurance segments include cargo, liability, accidental injury, aviation, construction, marine hull and oil and gas, etc.

	Six months ended 30 June	
	2005 <i>RMB million</i>	2004 <i>RMB million</i>
Turnover		
Cargo insurance	1,578	1,527
Liability insurance	1,377	1,094
Accidental injury insurance	1,070	836
Other insurance	2,070	1,797
Total	6,095	5,254
Net premiums earned		
Cargo insurance	1,147	1,710
Liability insurance	848	942
Accidental injury insurance	789	851
Other insurance	662	710
Total	3,446	4,213
Net claims incurred	(1,951)	(2,139)
Amortisation of deferred acquisition costs	139	(118)
Insurance protection expense	(45)	(41)
Segment profit before unallocated income and expenses	1,589	1,915
Loss ratio	56.6%	50.8%
Segment expense ratio	-2.7%	3.8%
Segment combined ratio	53.9%	54.6%

Turnover of the other insurance segments increased by 16.0% to RMB6,095 million in the first half of 2005 compared to RMB5,254 million in the first half of 2004. The increase was primarily due to the increase in the turnover of the liability and accidental injury segments of RMB283 million and RMB234 million, respectively, in the first half of 2005 compared to the first half of 2004. The increase in turnover of the liability segment was primarily due to the launch of a number of new products in the market, and the increase in the accidental injury segment was primarily due to the Company's strengthened marketing efforts on the new products developed in 2004.

Net premiums earned of the other insurance segments decreased by 18.2% to RMB3,446 million in the first half of 2005 compared to RMB4,213 million in the first half of 2004. This decrease was primarily due to an increase in change in net unearned premium reserves, causing a decrease of RMB563 million in net premiums earned of the cargo segment.

Net claims incurred of the other insurance segments decreased by 8.8% to RMB1,951 million in the first half of 2005 compared to RMB2,139 million in the first half of 2004.

Due to the decrease in net premiums earned, loss ratio of the other insurance segments increased to 56.6% in the first half of 2005 compared to 50.8% in the first half of 2004.

Amortisation of deferred acquisition costs charged to other insurance segments amounted to negative RMB139 million in the first half of 2005, representing a decrease of RMB257 million compared to RMB118 million in the first half of 2004. The decrease was primarily due to an increase in reinsurance commission receivable as a result of a higher ceding ratio in the first half of 2005.

Insurance protection expense charged to the other insurance segments was RMB45 million in the first half of 2005, representing an increase of 9.8% compared to the first half of 2004, primarily due to an increase in retained premiums.

As a result of the foregoing, the other insurance segments recorded a profit of RMB1,589 million before unallocated income and expenses, representing a decrease of 17.0% compared to RMB1,915 million in the first half of 2004.

DEVELOPMENT OF NEW PRODUCTS

In the first half of 2005, the Company developed 12 new national insurance products in, amongst others, homeowners insurance, liability insurance and motor vehicle insurance product lines, of which 4 are stand-alone products and 8 are supplementary products.

In the second half of 2005, the Company will further strengthen its market research and development, focus on targeted customer groups and specific channels, and design customised products. The Company will also actively strengthen its cooperation with AIG, improve the accidental injury insurance products and continue to promote the short-term health insurance products in key cities throughout the PRC.

CASH FLOW

	Six months ended 30 June	
	2005 <i>RMB million</i>	2004 <i>RMB million</i>
Net cash inflow from operating activities	6,839	8,102
Net cash outflow from investing activities	(1,297)	(3,132)
Net cash outflow from financing activities	(2,413)	(839)
Net increase in cash and cash equivalents	3,129	4,131

Net cash inflow from the Company's operating activities in the first half of 2005 was RMB6,839 million, representing a decrease of 15.6% compared to the first half of 2004. The decrease was primarily due to factors such as decrease in premiums received in cash and increase in surrenders in the first half of 2005.

Net cash outflow from the Company's investing activities in the first half of 2005 was RMB1,297 million, representing a decrease of 58.6% compared to the first half of 2004. Such decrease was primarily due to a decrease in net cash outflow for investments in securities.

Net cash outflow from the Company's financing activities in the first half of 2005 was RMB2,413 million, as compared to RMB839 million in the first half of 2004, primarily due to an increase in securities purchased under resale agreements.

Net increase in cash and cash equivalents of the Company in the first half of 2005 was RMB3,129 million.

LIQUIDITY

The Company's cash flow is primarily derived from the cash generated from operating activities, mainly cash from insurance premiums received. Additional liquidity sources include proceeds from investments, maturities of investments, disposal of assets and financing activities. The Company's liquidity needs consist principally of payment of claims and other obligations under outstanding insurance policies, capital expenditure, operating expenses, tax payments, dividend payments and investment needs.

The Company entered into a RMB2,000 million subordinated loan agreement with China Development Bank on 10 October 2003. This loan is unsecured and bears interest at a rate which is equal to 90% of the 5-year lending rate fixed by the People's Bank of China. The loan comes due in November 2023.

The Company obtained a 10-year revolving credit facility from China Development Bank for up to RMB10 billion on 26 August 2003. Each drawdown made under that facility is repayable within one year. As of the date of this interim report, no amount has been drawn down under that facility.

Save for the subordinated loan and the credit facility mentioned above, the Company does not obtain working capital by borrowing.

The Company expects that it can fund its working capital needs in the future from cash generated from operating activities. The Board of Directors is of the opinion that the Company has sufficient working capital.

CAPITAL EXPENDITURE

The capital expenditure of the Company has primarily been for property construction, acquisition of motor vehicles and development of information systems. Capital expenditures of the Company amounted to RMB648 million in the first half of 2005.

Save for the construction of the new headquarters building starting from the first half of 2005, there was no other material capital expenditure. The Company believes that it has sufficient capital resources to fully satisfy its capital expenditure plan and its daily working capital requirements.

SOLVENCY MARGIN REQUIREMENT

The Company is subject to a number of regulations regarding financial operations, including maintaining a stipulated solvency margin, complying with 11 regulatory benchmarks and providing for certain funds and reserves. In accordance with the insurance laws and regulations in the PRC, the Company is required to maintain a solvency margin that exceeds a minimum statutory level of RMB8,058 million in the first half of 2005. The Company's solvency margin calculated pursuant to the CIRC regulations was RMB11,793 million and solvency margin adequacy ratio was 146.4%.

Pursuant to the CIRC regulations, if an insurance company fails to meet 4 of the 11 benchmarks regarding solvency, the CIRC has the right to demand an explanation and investigate into the reasons for non-compliance. In the first half of 2005, the Company failed to meet fewer than four of such benchmarks.

GEARING RATIO AND OTHER RATIOS

As of 30 June 2005, the gearing ratio² of the Company was 81.6%, representing an increase of 0.3 percentage point from 81.3% as of 31 December 2004. The premium to capital ratio is the ratio of retained premiums in any financial year to the sum of paid-in capital, capital reserves, surplus reserves and public welfare funds. Pursuant to the PRC Insurance Law, this premium to capital ratio may not exceed 4 times for any property and casualty insurance company in any financial year. The premium to capital ratio for the Company as of 30 June 2005 reached 3.39 times³.

2 Gearing ratio is represented by total liabilities divided by total assets, in accordance with accounting principles generally accepted in Hong Kong.

3 Calculated in accordance with the PRC Accounting Regulations for Financial Institutions. The figures of retained premiums were for the full year ended 30 June 2005.

CONTINGENT LIABILITIES

Owing to the nature of the insurance business, the Company is involved in legal proceedings in the ordinary course of business, as plaintiff or defendant. Such legal proceedings mostly involve claims on the Company's insurance policies. While the outcomes of such contingencies or legal proceedings cannot be determined at present, the Company believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Company.

INTEREST RATE RISK

The Company's holding in fixed income investments is subject to interest rate risk. The Company also invests in floating rate instruments, interest proceeds from which can rise and fall due to changes in interest rates. The Company's holding in mutual funds is also exposed to price fluctuations caused by changes in interest rates. The Company manages exposure to risks associated with interest rate fluctuations through active review of the investment portfolio and consultation with financial investment experts. The goal is to maintain liquidity and to generate stable returns.

CREDIT RISK

The Company is subject to credit risk on investments such as corporate bonds and mutual funds. The Company diligently manages credit risk by analysing the creditworthiness of companies prior to making investments as well as strictly following the CIRC guidelines which only permit investments in corporate bonds with rating higher than AA. The Company is also subject to credit risk with respect to amounts owed to it by reinsurers. As a result, except when dealing with national reinsurers such as China Property and Casualty Reinsurance Company Ltd., the Company only purchases reinsurance from reinsurers with A.M. Best ratings of at least A-, and pays particular attention to their creditworthiness and financial condition.

EXCHANGE RATE RISK

The Company conducts its business primarily in Renminbi, which is also its functional and financial reporting currency. However, a portion of its business (including international cargo insurance and aviation insurance) is conducted in foreign currencies, typically US dollars. A portion of its claims and liabilities are also denominated in foreign currencies, typically US dollars. Starting from 21 July 2005, China has reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Renminbi is no longer solely pegged to the US dollar and the Renminbi exchange rate regime now has greater flexibility. On the same day, the People's Bank of China adjusted the exchange rate of the US dollar against the Renminbi at 19:00 hour of 21 July 2005 to RMB8.11 per US dollar, resulting in an approximately 2% decrease in the trading price of the US dollar. As the Company needs to convert foreign currencies denominated assets and liabilities into Renminbi in its financial statements as at the end of accounting periods, fluctuations in exchange rates will affect the Company's balance sheet position and its profit and loss account. The impact of exchange rate fluctuations will, however, ultimately depend on the extent of exchange rate fluctuations during the accounting period.

Most of the Company's sales are domestic and as such it has a limited amount of foreign currency denominated accounts receivable. Foreign exchange transactions under the Company's capital account are subject to foreign exchange regulations and require the approval of the State Administration of Foreign Exchange. Foreign exchange policies adopted by the PRC government could cause future exchange rates to vary.

HEDGING INSTRUMENTS

The use of funds in Renminbi and foreign currencies by insurance companies in the PRC is subject to the regulatory control by regulatory bodies of the PRC. Therefore, the Company does not use any financial instruments for hedging purposes.

LOOKING FORWARD

With the stable growth of China's economy and the increasing sales volume of motor vehicles, a comparatively rapid growth will be maintained in the domestic insurance market in the second half of 2005. With the promulgation of the Administrative Measures on Non-life Insurance Reserves, the PRC insurance regulatory authorities will strengthen their efforts in regulating the insurance market and maintaining market order, which will promote a more rational competition in the non-life insurance market. Furthermore, the deepening of reforms on share segregation of share capital will lead to the stable development of the PRC capital market.

In order to increase value for shareholders, the Company will strive to refine the "three centers" (the underwriting center, claims center, and finance center), and consistently strengthen underwriting management and further improve its claims management. The Company will integrate its information systems and improve the application of information resources. The Company will employ experts and promote trainings on actuarial techniques. The Company will adjust its business portfolio to focus more on profitable non-motor vehicle insurance business. The Company will also enhance its cooperation with AIG and the marketing of short-term health insurance products. The Company will further enhance its risk control in its use of investment funds while trying to improve its investment return.