

## OVERVIEW

The Company is a leading non-life insurance company in the PRC providing a broad range of property and casualty insurance products together with accidental injury insurance and short-term health insurance products for customers. In 2004, the Company held 58.1% share of the non-life insurance market in the PRC.

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

	Year ended 31 December	
	2004	Pro forma 2003
	<i>(RMB in millions)</i>	
Net premiums earned	50,628	40,409
Underwriting profit <i>(Note)</i>	465	1,496
Net profit	208	1,451
Total assets	88,262	84,572

*Note:* Underwriting profit represents net premiums earned less net claims incurred, and after amortisation of deferred acquisition costs, insurance protection expense and general and administrative expenses.

## RESULTS OF OPERATIONS

In 2004, the Company's turnover increased steadily, while underwriting profit and investment income decreased.

The following table sets forth selected financial information shown as percentages of net premiums earned and certain financial ratios for the periods indicated.

	Year ended 31 December	
	2004	Pro forma 2003
	<i>(%)</i>	
Net premiums earned	100.0	100.0
Net claims incurred	(76.8)	(71.9)
Amortisation of deferred acquisition costs	(7.0)	(6.1)
Insurance protection expense	(1.1)	(1.2)
General and administrative expenses	(14.1)	(17.1)
Underwriting profit	1.0	3.7
Interest and dividend income, net	2.5	1.7
Net gains/(losses) on trading and non-trading securities	(1.9)	0.6
Finance costs	(0.2)	(0.1)
Interest expenses credited to policyholders' deposits	(0.3)	(0.3)
Profit before taxation	1.0	5.7
Tax	(0.6)	(2.1)
Net profit	0.4	3.6
Loss ratio	76.8%	71.9%
Expense ratio	22.2%	24.4%
Combined ratio	99.0%	96.3%

The following table sets forth the net premiums earned, net claims incurred and amortisation of deferred acquisition costs for each of the Company's segments as a percentage of the respective combined amounts for the periods indicated.

	<b>Year ended 31 December</b>	
	<b>2004</b>	Pro forma <b>2003</b>
	(%)	
<b>Net premiums earned</b>		
Motor vehicle insurance	<b>70.7</b>	66.6
Commercial property insurance	<b>12.6</b>	15.9
Homeowners insurance	<b>0.9</b>	2.6
Other insurance	<b>15.8</b>	14.9
<b>Total</b>	<b>100.0</b>	100.0
<b>Net claims incurred</b>		
Motor vehicle insurance	<b>78.9</b>	74.4
Commercial property insurance	<b>10.2</b>	11.3
Homeowners insurance	<b>0.6</b>	1.2
Other insurance	<b>10.3</b>	13.1
<b>Total</b>	<b>100.0</b>	100.0
<b>Amortisation of deferred acquisition costs</b>		
Motor vehicle insurance	<b>75.6</b>	82.8
Commercial property insurance	<b>7.4</b>	5.0
Homeowners insurance	<b>0.8</b>	5.4
Other insurance	<b>16.2</b>	6.8
<b>Total</b>	<b>100.0</b>	100.0

## **TURNOVER**

Turnover of the Company was RMB62,003 million in 2004, representing an increase of RMB7,035 million, or 12.8%, over RMB54,968 million in 2003. The increase was primarily due to a RMB7,604 million increase in turnover of the motor vehicle insurance segment.

### NET PREMIUMS EARNED

Net premiums earned of the Company was RMB50,628 million in 2004, representing an increase of 25.3% over RMB40,409 million in 2003. This increase in net premiums earned was primarily due to an increase in turnover, a decrease in reinsurance premiums ceded and a decrease in the change in net unearned premium reserves. Reinsurance premiums ceded decreased from RMB11,116 million to RMB9,283 million, primarily due to a reduction in the statutory reinsurance rate from 15% in 2003 to 10% in 2004 in accordance with the requirements set out in the WTO Accession Protocol signed by the PRC. The decrease in the change in net unearned premium reserves in 2004 from that in 2003 was primarily due to a larger portion of turnover being recorded in the first half than in the second half of the year and a shortening of the average term of insurance policies underwritten in 2004.



### INTEREST AND DIVIDEND INCOME

Interest and dividend income of the Company was RMB1,252 million in 2004, representing an increase of 81.4% over RMB690 million in 2003. This increase was primarily due to an increase in interest income and dividend income from trading and non-trading securities of RMB272 million and RMB192 million, respectively. The increase in interest income from trading and non-trading securities was primarily due to an increase of investments in debt securities in 2004 compared to 2003 and an increase in average yield on investment in debt securities. The increase in dividend income from trading and non-trading securities was primarily due to an increase in dividends from the mutual funds in which the Company invested.

### NET GAINS/(LOSSES) ON TRADING AND NON-TRADING SECURITIES

The Company's net losses on trading and non-trading securities was RMB948 million in 2004, representing a decrease of RMB1,208 million as compared to a net gain of RMB260 million in 2003. This decrease was primarily due to the continued decline in the domestic equity markets, which led to decreases in unrealised gains in respect of trading mutual funds and trading debt securities by RMB937 million and RMB77 million respectively. Net losses on trading and non-trading securities for 2004 also include provisions for impairment losses of certain debt securities held by the Company as at 31 December 2004. The Company has assessed the expected net recoverable amount of those debt securities and their accrued interest and considered that necessary provisions have been made to cover any potential shortfall between the expected net recoverable amount and the carrying amount as at 31 December 2004.

### NET CLAIMS INCURRED

The Company's net claims incurred was RMB38,905 million in 2004, representing an increase of 33.9% over RMB29,063 million in 2003, and financial year loss ratio increased to 76.8% in 2004 from 71.9% in 2003. The increase in net claims incurred was primarily due to an increase in net claims incurred of the motor vehicle insurance segment from RMB21,618 million in 2003 to RMB30,713 million in 2004, representing an increase of 42.1%. The increase in net claims incurred was also partly due to the increases in net claims incurred of the commercial property insurance and the accidental injury insurance segments. However, the increases in net claims incurred of the motor vehicle insurance, the commercial property

insurance and the accidental injury insurance segments were partially offset by decreases in net claims incurred of the liability insurance, the cargo insurance and the homeowners insurance segments in 2004. Net loss and LAE reserves as of 31 December 2004 increased by RMB3,642 million as compared to 31 December 2003, partly due to an increase of RMB2,454 million in the loss and LAE reserves for claims that occurred prior to 31 December 2003, after comparing the latest actuarial results as of 31 December 2004 to the actuarial results as of 31 December 2003.

#### **AMORTISATION OF DEFERRED ACQUISITION COSTS**

Amortisation of deferred acquisition costs of the Company was RMB3,560 million in 2004, representing an increase of 43.6% over RMB2,479 million in 2003. This increase was primarily due to a RMB698 million increase in commission expenses paid to insurance intermediaries, a RMB660 million decrease in reinsurance commission receivable and a RMB485 million increase in salaries paid to underwriting personnel in 2004 compared to 2003. The increase in commission expenses was primarily due to an increase in turnover. The decrease in reinsurance commission receivable was primarily due to a decrease in reinsurance premiums ceded. The increase in salaries paid to underwriting personnel was primarily due to the adoption of a new compensation and incentive system by the Company in 2004, which increased overall compensation levels in response to market competition.

#### **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 was RMB563 million in 2004, representing an increase of 20.3% over RMB468 million in 2003. This increase was due to an increase in retained premiums.

#### **INTEREST EXPENSE CREDITED TO POLICYHOLDERS' DEPOSITS**

Interest expense of the Company credited to policyholders' deposits was RMB144 million in 2004, representing an increase of 17.1% over RMB123 million in 2003. This increase was primarily due to an increase in the average balance of policyholders' deposits from the Company's Golden Bull homeowners insurance products in 2004 compared to 2003.

#### **FINANCE COSTS**

Finance costs of the Company were RMB120 million in 2004, representing an increase of RMB85 million over RMB35 million in 2003. This increase was primarily due to a RMB2,000 million subordinated loan obtained by the Company in the second half of 2003, for which the Company incurred an interest expense of RMB105 million in 2004.

#### **GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses of the Company were RMB7,135 million in 2004, representing an increase of 3.4% over RMB 6,903 million in 2003. This increase was primarily due to a RMB501 million increase in personnel expenses and a RMB427 million increase in office expenses. These increases were partially offset by a RMB212 million decrease in depreciation expenses, and a RMB484 million decrease in other remaining expenses, and a RMB484 million decrease in other remaining expenses as a result of an increased control over capital expenditure and operating expenses in 2004.

## PROFIT BEFORE TAXATION

As a result of the foregoing, profit before taxation of the Company was RMB505 million in 2004, representing a decrease of RMB1,783 million from RMB2,288 million in 2003.

## TAX

Income tax expense of the Company was RMB297 million in 2004, representing a decrease of RMB540 million from RMB837 million in 2003. The Company's effective tax rate increased to 58.8% in 2004 from 36.6% in 2003. The increase in effective tax rate was primarily due to a larger portion of non-tax deductible expenses related to profit before taxation in 2004 compared to 2003.

## NET PROFIT

As a result of the foregoing, the Company's net profit was RMB208 million in 2004, representing a decrease of 85.7% from RMB1,451 million in 2003. Basic earning per share in 2004 was RMB0.019.

## COMBINED RATIO

The Company's combined ratio increased from 96.3% in 2003 to 99.0% in 2004, primarily due to an increase in loss ratio from 71.9% in 2003 to 76.8% in 2004, partially offset by a decrease in expense ratio from 24.4% in 2003 to 22.2% in 2004.

## RESULTS OF SEGMENT OPERATIONS

### Motor Vehicle Insurance

	Year ended 31 December	
	2004	Pro forma 2003
	<i>(RMB in millions)</i>	
Turnover	42,898	35,294
Net premiums earned	35,802	26,930
Net claims incurred	(30,713)	(21,618)
Amortisation of deferred acquisition costs	(2,691)	(2,053)
Insurance protection expense	(409)	(323)
Segment profit before unallocated income and expenses	1,989	2,936
Loss ratio	85.8%	80.3%
Segment expense ratio	8.6%	8.8%
Segment combined ratio	94.4%	89.1%

Turnover of the motor vehicle insurance segment increased by 21.5% from RMB35,294 million in 2003 to RMB42,898 million in 2004. This increase was primarily due to an increase in the number of motor vehicles insured and an increase in premium rates. The Company insured 22.28 million motor vehicles in 2004, representing an increase of 4.22 million motor vehicles over 2003.

Net premiums earned of the motor vehicle insurance segment increased by 32.9% from RMB26,930 million in 2003 to RMB35,802 million in 2004. This increase was primarily due to an increase in turnover and a decrease in reinsurance premiums ceded.

Net claims incurred of the motor vehicle insurance segment increased by 42.1% from RMB21,618 million in 2003 to RMB30,713 million in 2004, and loss ratio increased to 85.8% in 2004 compared to 80.3% in 2003. The substantial increase in net claims incurred of the motor vehicle insurance segment in 2004 was due to a number of factors including the continuing unfavorable effects of the deregulation of motor vehicle insurance terms and premium rates in 2003, changes in laws and regulations governing road traffic management and the compensation of personal injuries which resulted in an increase in the number of claims and a rise in claims payment standard, an increase in the number of private motor vehicles insured that exhibited higher accident rate, and a significant increase in the number of small claims leading to an increase in claims settlement expenses. Loss and LAE reserves of the motor vehicle insurance segment increased by RMB3,306 million as of 31 December 2004 compared to 31 December 2003. The Company increased the loss and LAE reserves for motor vehicle insurance claims that occurred prior to 31 December 2003 by RMB2,153 million, after comparing the latest actuarial results as of 31 December 2004 to the actuarial results as of 31 December 2003.



Amortisation of deferred acquisition costs of the motor vehicle insurance segment increased by 31.1% from RMB2,053 million in 2003 to RMB2,691 million in 2004. The increase was primarily due to an increase in turnover resulted in corresponding increases in commission expenses and underwriting personnel expenses, and a decrease in reinsurance commission caused by a decrease in reinsurance premiums ceded.

Insurance protection expense of the motor vehicle insurance segment increased by 26.6% from RMB323 million in 2003 to RMB409 million in 2004 due to an increase in retained premiums.

The segment expense ratio for the motor vehicle insurance segment decreased from 8.8% in 2003 to 8.6% in 2004 as net premiums earned increased at a faster rate than the sum of amortization of deferred acquisition costs and insurance protection expenses.

Overall, profit before unallocated income and expenses of the motor vehicle insurance segment was RMB1,989 million in 2004, representing a decrease of 32.3% compared to RMB2,936 million in 2003.

**Commercial Property Insurance**

	<b>Year ended 31 December</b>	
	<b>2004</b>	Pro forma <b>2003</b>
	<i>(RMB in millions)</i>	
Turnover	<b>7,987</b>	8,090
Net premiums earned	<b>6,402</b>	6,437
Net claims incurred	<b>(3,981)</b>	(3,285)
Amortisation of deferred acquisition costs	<b>(262)</b>	(125)
Insurance protection expense	<b>(66)</b>	(59)
Segment profit before unallocated income and expenses	<b>2,093</b>	2,968
Loss ratio	<b>62.2%</b>	51.0%
Segment expense ratio	<b>5.1%</b>	2.9%
Segment combined ratio	<b>67.3%</b>	53.9%

Turnover of the commercial property insurance segment decreased by 1.3% from RMB8,090 million in 2003 to RMB7,987 million in 2004, primarily due to a decrease in average premium rates resulting from more intense market competition, and also due to a reduction of exposure to certain higher risk business with the objective of improving the underwriting quality of the commercial property insurance segment.

Net premiums earned of the commercial property insurance segment decreased by 0.5% from RMB6,437 million in 2003 to RMB6,402 million in 2004. The decrease was primarily due to a decrease in turnover, partially offset by a decrease in reinsurance premiums ceded.

Net claims incurred of the commercial property insurance segment increased by 21.2% from RMB3,285 million in 2003 to RMB3,981 million in 2004. The increase in net claims incurred was primarily due to material losses to certain commercial properties insured caused by a number of natural disasters which occurred in 2004, resulting in a substantial increase in claims. The increase was also partially due to a decrease in loss recovered from reinsurance compared to 2003. Due to the substantial increase in net claims incurred, the loss ratio of the commercial property segment increased to 62.2% in 2004 from 51.0% in 2003.

Amortisation of deferred acquisition costs of the commercial property insurance segment increased by 109.6% from RMB125 million in 2003 to RMB262 million in 2004, primarily due to an increase in commission expenses, which was caused by increasing market competition for commercial property insurance, and a decrease in reinsurance commission, which was caused by a decrease in reinsurance premiums ceded.

Insurance protection expense of the commercial property insurance segment increased by 11.9% from RMB59 million in 2003 to RMB66 million in 2004, due to an increase in retained premiums.

Due to an increase in amortisation of deferred acquisition costs and an increase in insurance protection expense, the segment expense ratio of the commercial property insurance segment increased from 2.9% in 2003 to 5.1% in 2004.

As a result of the foregoing, profit before unallocated income and expenses of the commercial property insurance segment was RMB2,093 million in 2004, representing a decrease of 29.5% compared to RMB2,968 million in 2003.

## Homeowners Insurance

	Year ended 31 December	
	2004	Pro forma 2003
	<i>(RMB in millions)</i>	
Turnover	1,257	1,425
Net premiums earned	452	1,045
Net claims incurred	(236)	(340)
Amortisation of deferred acquisition costs	(29)	(134)
Interest and dividend income	179	26
Net gains/(losses) on trading and non-trading securities	(95)	64
Interest expense credited to policyholders' deposits	(144)	(123)
Insurance protection expense	(12)	(17)
Segment profit before unallocated income and expenses	115	521
Loss ratio	52.2%	32.5%
Segment expense ratio	9.1%	14.4%
Segment expense combined ratio	61.3%	46.9%

Turnover of the homeowners insurance segment decreased by 11.8% from RMB1,425 million in 2003 to RMB1,257 million in 2004. The decrease was primarily due to an increase in homeowners insurance policy terminations caused by an increase and the expectation of further increases in residential mortgage interest rates.

Net premiums earned of the homeowners insurance segment decreased by 56.7% from RMB1,045 million in 2003 to RMB452 million in 2004. This decrease was primarily due to the termination of homeowners insurance policies underwritten in previous years.

Net claims incurred of the homeowners insurance segment decreased by 30.6% from RMB340 million in 2003 to RMB236 million in 2004. Loss ratio of the homeowners insurance segment increased from 32.5% in 2003 to 52.2% in 2004, primarily because net premiums earned decreased at a faster rate than net claims incurred.

Amortisation of deferred acquisition costs of the homeowners insurance segment decreased by 78.4% from RMB134 million in 2003 to RMB29 million in 2004. This decrease was primarily due to a substantial increase in unearned premium reserves at the end of 2004, which led to a substantial increase in the deferral of acquisition costs.

Insurance protection expense charged to the homeowners insurance segment decreased from RMB17 million in 2003 to RMB12 million in 2004, due to a decrease in retained premiums.





The segment expense ratio for the homeowners insurance segment decreased from 14.4% in 2003 to 9.1% in 2004 as the sum of amortization of deferred acquisition costs and insurance protection expense decreased at a faster rate than net premiums earned.

The interest and dividend income derived from policyholders' deposits of the homeowners insurance segment increased by RMB153 million from RMB26 million in 2003 to RMB179 million in 2004. This increase was primarily due to an increase in interest rates in 2004 and an increase in dividends received in respect of mutual fund investment using deposits from the Golden Bull homeowners insurance product.

Interest expense credited to policyholders' deposits of the homeowners insurance segment increased by 17.1% from RMB123 million in 2003 to RMB144 million in 2004. This increase was primarily due to an increase in the average balance of policyholders' deposits from the Company's Golden Bull homeowners insurance product in 2004 compared to 2003.

As a result of the foregoing, profit before unallocated income and expenses of the homeowners insurance segment was RMB115 million in 2004, representing a decrease of 77.9% compared to RMB521 million in 2003.

### Other Insurance

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

	<b>Year ended 31 December</b>	
	<b>2004</b>	Pro forma 2003
	<i>(RMB in millions)</i>	
<b>Turnover</b>		
Cargo insurance	2,724	2,657
Liability insurance	2,051	2,406
Accidental injury insurance	1,890	1,745
Other insurance	3,196	3,351
<b>Total</b>	<b>9,861</b>	10,159
<b>Net premiums earned</b>		
Cargo insurance	2,940	2,314
Liability insurance	1,850	2,116
Accidental injury insurance	1,688	514
Other insurance	1,494	1,053
<b>Total</b>	<b>7,972</b>	5,997
Net claims incurred	(3,975)	(3,820)
Amortisation of deferred acquisition costs	(578)	(167)
Insurance protection expense	(76)	(69)
Segment profit before unallocated income and expenses	3,343	1,941
Loss ratio	49.9%	63.7%
Segment expense ratio	8.2%	3.9%
Segment combined ratio	58.1%	67.6%

Turnover of the other insurance segments decreased by 2.9% from RMB10,159 million in 2003 to RMB9,861 million in 2004. This decrease was primarily due to a substantial decrease in turnover of employers' commercial liabilities insurance. Turnover of employers' commercial liabilities insurance decreased as the promulgation and implementation of the "Regulations on Industrial Accident Insurance" in 2004 required certain employers to subscribe for employers' liability insurance through a public fund rather than through commercial insurers.

Net premiums earned of the other insurance segment increased by 32.9% from RMB5,997 million in 2003 to RMB7,972 million in 2004. This increase was primarily due to an increase of RMB1,174 million in net premiums earned of accidental injury insurance and an increase of RMB626 million in net premiums earned of cargo insurance.

Net claims incurred for the other insurance segments increased by 4.1% from RMB3,820 million in 2003 to RMB3,975 million in 2004. The increase in net claims incurred was primarily due to an increase of RMB585 million in net claims incurred for accidental injury insurance. By introducing stringent measures on underwriting criteria and improving claims management, the loss ratio of the other insurance segments decreased to 49.9% in 2004 from 63.7% in 2003.

Amortisation of deferred acquisition costs of the other insurance segments was RMB578 million in 2004, representing an increase of RMB411 million compared to 2003.

Insurance protection expense of the other insurance segments increased by 10.1% to RMB76 million in 2004 as compared to 2003. This increase was due to an increase in retained premiums.

As a result of the foregoing, the other insurance segments recorded a RMB3,343 million profit before unallocated income and expenses in 2004, representing an increase of 72.2% compared to RMB1,941 million in 2003.

## DEVELOPMENT OF NEW PRODUCTS

In 2004, the Company developed 222 new insurance coverages in liability insurance, accidental injury insurance, short-term health insurance, motor vehicle insurance, commercial property insurance and homeowners insurance product lines, of which 87 are stand-alone coverages and 135 are supplementary coverages.

In 2004, the Company strengthened its market research and marketing, and designed customised products for targeted customer groups and specific channels. The Company also actively strengthened its cooperation with its strategic partner, AIG, in improving its accidental injury insurance product offerings and in launching short-term health insurance products.



The experts from AIG visited the Company's Hebei branch.

**CASH FLOW**

	<b>Year ended 31 December</b>	
	<b>2004</b>	Pro forma 2003
	<i>(RMB in millions)</i>	
Net cash inflow/(outflow) from operating activities	<b>6,705</b>	7,559
Net cash inflow/(outflow) from investing activities	<b>(7,477)</b>	(9,222)
Net cash inflow/(outflow) from financing activities	<b>(957)</b>	8,038
Net increase/(decrease) in cash and cash equivalents	<b>(1,729)</b>	6,375

Net cash generated from operating activities was RMB6,705 million in 2004, representing a decrease of 11.3% from 2003. The decrease was primarily due to increases in personnel expenses and premiums receivables, and a substantial decrease in payables to reinsurers in 2004.

Net cash used by the Company in investing activities in 2004 was RMB7,477 million, representing a decrease of RMB1,745 million compared to 2003. The decrease was primarily due to an increase in cash outflow for investments in securities.

Net cash used by the Company in financing activities in 2004 was RMB957 million, while net cash generated from financing activities in 2003 was RMB8,038 million. The net cash outflow increased substantially in 2004 compared to 2003 primarily because the Company's net cash inflows in 2003 included proceeds of RMB5,610 million from its initial public offering in 2003 and RMB2,000 million from the subordinated-loan obtained in 2003. The increase was also partially due to the payment of RMB644 million special dividend to the Company's ultimate holding company, PICC Holding, in 2004 and a decrease of RMB504 million in policyholders' deposits.

Net decrease in cash and cash equivalents of the Company in 2004 was RMB1,729 million.

**LIQUIDITY**

The Company's cash flow is primarily derived from cash generated from operating activities, and, in particular, cash from insurance premiums received. Additional liquidity sources include interest and dividend income, proceeds from matured 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 expenditures, operating expenses, tax payments, dividend payments and investment.

The Company entered into a subordinated loan agreement with China Development Bank on 10 October 2003, whereby the Company obtained from China Development bank a subordinated loan of RMB2,000 million. This loan is unsecured and bears interest at a rate which is equal to 90% of the 5-year lending rate as set 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 this facility is repayable within one year. As of the date of this announcement, 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 of the Company (the “Board” or 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 for business needs and development of information systems. Capital expenditure was RMB1,212 million in 2004.

Save for a property purchase agreement approved by the Board on 19 January 2005 in relation to the purchase of a new headquarters building with floor space of approximately 78,000 square meters for RMB1,705 million, for which the Company has prepaid part of the amount, there is no other material capital expenditure. The Company believes that it has sufficient capital resources to fully satisfy its capital expenditure plan and its 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 RMB8,437 million in 2004. The Company’s solvency margin for calculated pursuant to the CIRC regulations was RMB9,740 million and solvency margin adequacy ratio was 115% (*Note*).

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 2004, the Company failed to meet fewer than four of such benchmarks.

*Note:* Calculated in accordance with the PRC Accounting Regulations for Financial Institutions.

### PREMIUM TO CAPITAL RATIO

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 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 in 2004 was 3.4 times (*Note*).

*Note:* Calculated in accordance with the PRC Accounting Regulations for Financial Institutions.

### GEARING RATIO

As of 31 December 2004, the Company’s gearing ratio (*Note*) was 79.0%, representing an increase of 1.2 percentage point from 77.8% in 2003.

*Note:* Gearing ratio is represented by total liabilities (excluding the subordinated loan) divided by total assets under accounting principles generally accepted in Hong Kong.

## CONTINGENT LIABILITIES

Owing to the nature of the insurance business, the Company is involved in legal proceedings in the ordinary course of business, including being the plaintiff or the defendant in litigation and arbitration. Such legal proceedings mostly involve claims on the Company's insurance policies. While the outcomes of such contingencies and lawsuits 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 holdings in fixed income investments are 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 holdings in mutual funds are 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 with a goal toward maintaining 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 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 underwriting certain international cargo insurance and aviation insurance) are conducted in foreign currencies, typically US dollars. A portion of its claims, account receivable and liabilities is also denominated in foreign currencies, typically US dollars.

As such, the Company is exposed to exchange rate risk with respect to its foreign currency business, assets and liabilities. 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 Company does not use any financial instruments for hedging purposes.

## EMPLOYEES

As of 31 December 2004, the Company had 62,862 employees. Personnel expenses in 2004 was RMB4,410 million. The Company makes contributions to retirement plans and social medical insurance plans for its employees. The Company enhances the performance and efficiency of employees by providing various career development channels, strengthening personnel training and implementing performance review. The Company is of the view that it maintains a good relationship with its employees.

