

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 2005, the Company held 51.5% share of the non-life insurance market in the PRC.

The Company achieved favourable operating results in 2005. The improvement in the results was primarily due to a decrease in loss ratio of the motor vehicle insurance segment. The underwriting profit of the Company increased to RMB1,766 million in 2005 by 305.0% from 2004. Meanwhile, the Company achieved an increase in net investment income to RMB1,478 million by 11.5%, and a decrease of 66.0% in net realised and unrealised losses on investments in 2005.

The following table sets forth the net premiums earned, underwriting profit, net investment income, net realised and unrealised losses on investments, net profit and total assets of the Company for the relevant periods.

	Year ended 31 December	
	2005 <i>RMB million</i>	2004 <i>RMB million</i>
Net premiums earned	49,802	50,628
Underwriting profit	1,766	436
Net investment income	1,478	1,326
Net realised and unrealised losses on investments	(336)	(988)
Net profit	1,113	134
Total assets	93,380	90,757

RESULTS OF OPERATIONS

In 2005, due to the intense market competition, the Company's turnover increased slightly, whereas underwriting profit and investment income improved remarkably. The following table sets forth selected financial ratios shown as percentages of net premiums earned for the relevant periods.

	Year ended 31 December	
	2005 (%)	2004 (%)
Net premiums earned	100.0	100.0
Net claims incurred	(73.0)	(77.1)
Amortisation of deferred acquisition costs, net	(9.6)	(7.0)
Insurance protection expense	(1.1)	(1.1)
General and administrative expenses	(12.8)	(13.9)
Underwriting profit	3.5	0.9
Net investment income	3.0	2.6
Net realised and unrealised losses on investments	(0.7)	(2.0)
Finance costs	(0.4)	(0.3)
Interest expenses credited to policyholders' deposits	(0.3)	(0.3)
Exchange losses, net	(0.6)	(0.03)
Sundry income	0.1	0.1
Sundry expenses	(0.2)	(0.2)
Profit before tax	4.4	0.8
Tax	(2.2)	(0.5)
Net profit	2.2	0.3
Loss ratio	73.0	77.1
Expense ratio	23.5	22.0
Combined ratio	96.5	99.1

RESULTS OF OPERATIONS (CONTINUED)

The following table sets forth the net premiums earned, net claims incurred and amortisation of deferred acquisition costs, net, by segment, analysed as a percentage of the respective aggregate amount, for the relevant periods.

	Year ended 31 December	
	2005 (%)	2004 (%)
Net premiums earned		
Motor vehicle insurance	73.2	70.7
Commercial property insurance	11.3	12.6
Homeowners insurance	1.4	0.9
Other insurance	14.1	15.8
Total	100.0	100.0
Net claims incurred		
Motor vehicle insurance	75.9	79.3
Commercial property insurance	12.4	10.3
Homeowners insurance	0.6	0.6
Other insurance	11.1	9.8
Total	100.0	100.0
Amortisation of deferred acquisition costs, net		
Motor vehicle insurance	83.5	75.6
Commercial property insurance	9.4	7.4
Homeowners insurance	2.6	0.8
Other insurance	4.5	16.2
Total	100.0	100.0

TURNOVER

Turnover of the Company was RMB62,332 million in 2005, representing an increase of RMB329 million, or 0.5%, over RMB62,003 million in 2004. The increase was primarily due to the increases in the turnover of the Company's liability insurance, accidental injury insurance and commercial property insurance segments. However, the effect of such increases was partially offset by a RMB852 million decrease in turnover of the motor vehicle insurance segment and a RMB206 million decrease in turnover of the homeowners insurance segment.

NET PREMIUMS EARNED

Net premiums earned of the Company was RMB49,802 million in 2005, representing a decrease of 1.6% from RMB50,628 million in 2004. This decrease in net premiums earned was primarily due to a substantial increase in reinsurance premiums ceded. Reinsurance premiums ceded increased by RMB3,191 million from RMB9,283 million in 2004 to RMB12,474 million in 2005, primarily due to the increase in the ceding proportion of commercial reinsurance for effective risk control.

NET INVESTMENT INCOME

Net investment income of the Company was RMB1,478 million in 2005, representing an increase of 11.5% over RMB1,326 million in 2004. This increase was primarily due to increases in interest income from cash and cash equivalents and term deposits and debt securities of RMB172 million and RMB105 million, respectively. The effect of such increases was, however, partially offset by a decrease in dividend income of RMB208 million from equity securities. The increase in interest income from debt securities was primarily due to a substantial increase in investments in debt securities in 2005 compared to 2004 and an increase in average yield on investment in debt securities. The decrease in dividend income from equity securities was primarily due to a decrease in dividends from the mutual funds.

NET REALISED AND UNREALISED LOSSES ON INVESTMENTS

As of 31 December 2005, the Company's net realised and unrealised losses on investments was RMB336 million, representing a decrease of RMB652 million from RMB988 million in 2004. This decrease was primarily due to the gradual recovery of the domestic equity markets, which led to a RMB766 million increase in net unrealised gains on investment in equity securities and a RMB199 million increase in net realised gains on investment in debt securities. However, the Company's provision for impairment loss on available-for-sale securities as of 31 December 2005 was RMB245 million, representing an increase of RMB78 million over RMB167 million in 2004.

NET CLAIMS INCURRED

The Company's net claims incurred was RMB36,335 million in 2005, representing a decrease of 6.9% from RMB39,015 million in 2004. Loss ratio of the Company decreased to 73.0% in 2005 from 77.1% in 2004. The decrease in net claims incurred was primarily due to a decrease in net claims incurred of the motor vehicle insurance segment of 10.8% from RMB30,927 million in 2004 to RMB27,593 million in 2005, and partly due to a decrease in net claims incurred in the accidental injury insurance segment by RMB241 million to RMB695 million in 2005. However, the decreases in net claims incurred in the motor vehicle insurance and the accidental injury insurance segments



were partially offset by the increases in net claims incurred in the commercial property insurance and liability insurance segments in 2005. Net loss and loss adjustment expense reserve as of 31 December 2005 increased by RMB981 million as compared to 31 December 2004. Such increase was partly due to an increase of RMB1,063 million in the loss and loss adjustment expense reserve for claims that occurred prior to 31 December 2004, after comparing the latest actuarial results as of 31 December 2005 to the actuarial results as of 31 December 2004.

AMORTISATION OF DEFERRED ACQUISITION COSTS, NET

Net amortisation of deferred acquisition costs of the Company was RMB4,792 million in 2005, representing an increase of 34.6% over RMB3,560 million in 2004. This increase was primarily due to a RMB614 million increase in commission expenses paid to insurance intermediaries and a RMB174 million increase in salaries paid to underwriting personnel in 2005 compared to 2004. However, such increases in commission expenses paid to insurance intermediaries and in salaries paid to underwriting personnel were partially offset by a RMB136 million increase in reinsurance commission receivable. The increase in commission expenses was primarily due to an increase in the Company's commission rate by 0.9 percentage point to 9.0% as a result of the intensified market competition. The increase in salaries paid to underwriting personnel was primarily due to an increase in the overall compensation level after the adoption of a new compensation and incentive system by the Company in response to the increasingly intensified market competition. The increase in reinsurance commission receivable was primarily due to an increase in reinsurance premiums ceded.

INSURANCE PROTECTION EXPENSE

According to the relevant PRC insurance laws 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 RMB537 million in 2005, representing a decrease of 4.6% from RMB563 million in 2004. The decrease was due to a decrease in retained premiums.

INTEREST EXPENSE CREDITED TO POLICYHOLDERS' DEPOSITS

Interest expense of the Company credited to policyholders' deposits was RMB143 million in 2005, close to RMB144 million in 2004. This was primarily due to a basically same level of the average balance of policyholders' deposits from the Company's Golden Bull homeowners insurance products in 2005 compared to 2004.

FINANCE COSTS

Finance costs of the Company was RMB181 million in 2005, representing an increase of RMB12 million over RMB169 million in 2004. The increase was primarily due to an increase in interest expenses of the Company credited to reinsurers' deposits.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses of the Company were RMB6,372 million in 2005, representing a decrease of 9.7% from RMB7,054 million in 2004. This decrease was primarily due to a RMB150 million decrease in depreciation expenses for property, plant and equipment and decreases in other remaining expenses as a result of enhanced control over the scale of fixed assets and operating expenses in 2005.

PROFIT BEFORE TAX

Profit before tax of the Company was RMB2,203 million in 2005, representing an increase of RMB1,808 million from RMB395 million in 2004. This increase was primarily due to a RMB1,330 million increase in underwriting profit and a RMB652 million decrease in net realised and unrealised losses in investments in 2005.

TAX

Income tax expense of the Company was RMB1,090 million in 2005, representing an increase of RMB829 million from RMB261 million in 2004. The Company's effective tax rate decreased to 49.5% in 2005 from 66.1% in 2004. The decrease in effective tax rate was primarily due to a decrease in the proportion of non-tax deductible expenses related to profit before tax in 2005 compared to 2004.

NET PROFIT

As a result of the foregoing, the Company's net profit was RMB1,113 million in 2005, representing an increase of RMB979 million from RMB134 million in 2004. Basic earning per share in 2005 was RMB0.100.

COMBINED RATIO

The Company's combined ratio decreased from 99.1% in 2004 to 96.5% in 2005, primarily due to a decrease in the Company's loss ratio from 77.1% in 2004 to 73.0% in 2005, but the increase in the expense ratio from 22.0% in 2004 to 23.5% in 2005 partially offset the effect of the lowered loss ratio.

RESULTS OF SEGMENT OPERATIONS

Motor Vehicle Insurance

	Year ended 31 December	
	2005 RMB million	2004 RMB million
Turnover	42,046	42,898
Net premiums earned	36,443	35,802
Net claims incurred	(27,593)	(30,927)
Amortisation of deferred acquisition costs, net	(3,999)	(2,691)
Insurance protection expense	(390)	(409)
Segment profit before unallocated income and expenses	4,461	1,775
Loss ratio	75.7%	86.4%
Segment expense ratio	12.0%	8.7%
Segment combined ratio	87.7%	95.1%

Turnover of the motor vehicle insurance segment in 2005 was RMB42,046 million, representing a decrease of 2.0% from RMB42,898 million in 2004. This decrease was primarily due to a decrease in premium rates of the motor vehicles insured by the Company, partially offset by an increase in the number of motor vehicles insured. Premium rates of the Company's motor vehicle insurance segment decreased by 4.1% in 2005 from 2004. The Company insured 22.89 million motor vehicles in 2005, representing an increase of 0.61 million motor vehicles (or 2.7%) over 2004.

Net premiums earned from the motor vehicle insurance segment was RMB36,443 million in 2005, representing an increase of 1.8% from RMB35,802 million in 2004. This increase was primarily due to an increase of RMB22 million in the balance of unearned premium reserves in 2005, representing a decrease of RMB2,532 million compared to the increase of RMB2,554 million in the balance of unearned premium reserves in 2004. However, the effect of the decrease in the change in unearned premium reserves was partially offset by a RMB1,040 million increase in reinsurance premiums ceded over 2004 and a RMB852 million decrease in turnover from 2004 in the motor vehicle insurance segment.



Net claims incurred of the motor vehicle insurance segment decreased by 10.8% from RMB30,927 million in 2004 to RMB27,593 million in 2005, and loss ratio decreased to 75.7% in 2005 from 86.4% in 2004. The decreases were primarily due to an increase of RMB519 million in the loss and loss adjustment expense reserve of the motor vehicle insurance segment as of 31 December 2005 from that as of 31 December 2004, in comparison of an increase of RMB3,520 million as of 31 December 2004 from that as of 31 December 2003. The effect of the decrease in the change in the loss and loss adjustment expense reserve was partially offset by a decrease in loss recovered from reinsurance and an increase in claim expenses of the motor vehicle insurance segment in 2005.

Net amortisation of deferred acquisition costs of the motor vehicle insurance segment increased by 48.6% from RMB2,691 million in 2004 to RMB3,999 million in 2005. The increase was primarily due to corresponding increases in commission expenses and underwriting personnel salary expenses as a result of the intensified market competition.

Insurance protection expense charged to the motor vehicle insurance segment decreased by 4.6% from RMB409 million in 2004 to RMB390 million in 2005 due to a decrease in retained premiums.

The segment expense ratio for the motor vehicle insurance segment increased from 8.7% in 2004 to 12.0% in 2005, primarily due to an increase in net amortisation of deferred acquisition costs.

Overall, profit before unallocated income and expenses of the motor vehicle insurance segment was RMB4,461 million in 2005, representing an increase of 151.3% compared to RMB1,775 million in 2004.

Commercial Property Insurance

	Year ended 31 December	
	2005	2004
	RMB million	RMB million
Turnover	8,199	7,987
Net premiums earned	5,629	6,402
Net claims incurred	(4,519)	(4,003)
Amortisation of deferred acquisition costs, net	(451)	(262)
Insurance protection expense	(60)	(66)
Segment profit before unallocated income and expenses	599	2,071
Loss ratio	80.3%	62.5%
Segment expense ratio	9.1%	5.1%
Segment combined ratio	89.4%	67.6%

Turnover of the commercial property insurance segment increased by 2.7% from RMB7,987 million in 2004 to RMB8,199 million in 2005, primarily due to a substantial increase in the number of commercial properties insured compared to 2004. The effect of the increase in the number insured was partially offset by a decrease in average premium rates resulting from the intensified market competition.

Net premiums earned from the commercial property insurance segment decreased by 12.1% from RMB6,402 million in 2004 to RMB5,629 million in 2005. The decrease was primarily due to an increase in reinsurance premiums ceded, but the effect of the increase in reinsurance premiums ceded was partially offset by an increase in turnover and a decrease in the change of unearned premium reserves.

Net claims incurred of the commercial property insurance segment increased by 12.9% from RMB4,003 million in 2004 to RMB4,519 million in 2005. The increase in net claims incurred was primarily due to material losses to the commercial properties insured caused by a number of natural disasters in 2005, such as typhoon and flood, resulting in a substantial increase in claims. Such negative impact was partially offset by an increase in loss recovered from reinsurance compared to 2004. Due to the substantial increase in net claims incurred, loss ratio of the commercial property insurance segment increased to 80.3% in 2005 from 62.5% in 2004.

Net amortisation of deferred acquisition costs of the commercial property insurance segment increased by 72.1% from RMB262 million in 2004 to RMB451 million in 2005, primarily due to an increase in commission expenses and underwriting personnel salary expenses caused by the intensified market competition for commercial property insurance business in 2005.

Insurance protection expense charged to the commercial property insurance segment decreased by 9.1% from RMB66 million in 2004 to RMB60 million in 2005, due to a decrease in retained premiums.

Due to the above increase in net amortisation of deferred acquisition costs, the segment expense ratio of the commercial property insurance segment increased from 5.1% in 2004 to 9.1% in 2005.

As a result of the foregoing, profit before unallocated income and expenses of the commercial property insurance segment was RMB599 million in 2005, representing a decrease of 71.1% compared to RMB2,071 million in 2004.

Homeowners Insurance

	Year ended 31 December	
	2005 RMB million	2004 RMB million
Turnover	1,051	1,257
Net premiums earned	714	452
Net claims incurred	(228)	(240)
Amortisation of deferred acquisition costs, net	(126)	(29)
Net investment income	255	179
Net realised and unrealised losses on investments	(123)	(104)
Interest expense credited to policyholders' deposits	(143)	(144)
Insurance protection expense	(10)	(12)
Segment profit before unallocated income and expenses	339	102
Loss ratio	31.9%	53.1%
Segment expense ratio	19.0%	9.1%
Segment combined ratio	50.9%	62.2%

Turnover of the homeowners insurance segment decreased by 16.4% from RMB1,257 million in 2004 to RMB1,051 million in 2005. The decrease was primarily due to an increase in homeowners residential mortgage loan insurance policy terminations caused by an increase in interest rates and the expectation of further increases.

Net premiums earned from the homeowners insurance segment increased by 58.0% from RMB452 million in 2004 to RMB714 million in 2005. This increase was primarily due to a decrease of RMB457 million in the change of unearned premium reserves in 2005 compared to 2004, however, the impact of such decrease was partially offset by the decrease in turnover.

Net claims incurred for the homeowners insurance segment decreased by 5.0% from RMB240 million in 2004 to RMB228 million in 2005. Loss ratio of the homeowners insurance segment decreased from 53.1% in 2004 to 31.9% in 2005 primarily due to a substantial increase in net premiums earned.

Net amortisation of deferred acquisition costs of the homeowners insurance segment increased by RMB97 million from RMB29 million in 2004 to RMB126 million in 2005. This increase was primarily due to a decrease in reinsurance recoveries caused by a decrease in reinsurance premiums ceded in the homeowners insurance segment in 2005.

Insurance protection expense charged to the homeowners insurance segment decreased from RMB12 million in 2004 to RMB10 million in 2005, due to a decrease in retained premiums.

The segment expense ratio for the homeowners insurance segment increased from 9.1% in 2004 to 19.0% in 2005 primarily due to an increase in net amortisation of deferred acquisition costs.

The net investment income derived from policyholders' deposits of the homeowners insurance segment increased by RMB76 million from RMB179 million in 2004 to RMB255 million in 2005. This increase was primarily due to an increase in interest received in respect of the investment fund portfolio using deposits from the Golden Bull homeowners insurance product.

MANAGEMENT DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITIONS

Interest expense credited to policyholders' deposits of the homeowners insurance segment was RMB143 million in 2005, close to the level of RMB144 million in 2004.

As a result of the foregoing, profit before unallocated income and expenses of the homeowners insurance segment was RMB339 million in 2005, representing an increase of 232.4% compared to RMB102 million in 2004.

Other Insurance

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

	Year ended 31 December	
	2005 RMB million	2004 RMB million
Turnover		
Cargo insurance	2,665	2,724
Liability insurance	2,420	2,051
Accidental injury insurance	2,247	1,890
Other insurance	3,704	3,196
Total	11,036	9,861
Net premiums earned		
Cargo insurance	2,141	2,940
Liability insurance	1,783	1,850
Accidental injury insurance	1,653	1,688
Other insurance	1,439	1,494
Total	7,016	7,972
Net claims incurred	(3,995)	(3,845)
Amortisation of deferred acquisition costs, net	(216)	(578)
Insurance protection expense	(77)	(76)
Segment profit before unallocated income and expense	2,728	3,473
Loss ratio	56.9%	48.2%
Segment expense ratio	4.2%	8.2%
Segment combined ratio	61.1%	56.4%

Turnover of the other insurance segment increased by 11.9% from RMB9,861 million in 2004 to RMB11,036 million in 2005. This increase was primarily due to the increase of 18.9% and 18.0% in turnover of accidental injury insurance and liability insurance, respectively, as compared to those in 2004. Turnover of accidental injury insurance increased mainly because the Company boosted its promotion and marketing through its cooperation with AIG. Turnover of liability insurance increased mainly because turnover of public liability insurance increased substantially, partly caused by an increase in turnover of product liability insurance and professional liability insurance.

Net premiums earned from the other insurance segment decreased by 12.0% from RMB7,972 million in 2004 to RMB7,016 million in 2005. This decrease was primarily due to a decrease of RMB799 million in net premiums earned from cargo insurance.

Net claims incurred for the other insurance segment increased by 3.9% from RMB3,845 million in 2004 to RMB3,995 million in 2005. In the other insurance segment of the Company, net claims incurred for accidental injury insurance decreased by RMB241 million, but such decrease was offset by the increase of RMB205 million in net claims incurred for liability insurance.

Mainly due to the decrease of net premiums earned, the loss ratio of the other insurance segment increased to 56.9% from 48.2% in 2004.

Net amortisation of deferred acquisition costs of the other insurance segment was RMB216 million in 2005, representing a decrease of RMB362 million compared to RMB578 million in 2004. This decrease was primarily due to an increase in unearned premium reserves deferred to future years as a result of the change in the term structure of the premiums.

Insurance protection expense charged to the other insurance segment increased by 1.3% to RMB77 million in 2005 as compared to RMB76 million in 2004. This increase was due to an increase in retained premiums.

As a result of the foregoing, the other insurance segment recorded an RMB2,728 million profit before unallocated income and expenses in 2005, representing a decrease of 21.5% compared to RMB3,473 million in 2004.

DEVELOPMENT OF NEW PRODUCTS

In 2005, the Company developed 221 new insurance products mainly in the areas of commercial property insurance, liability insurance and homeowners insurance, of which 140 are national products (including 27 stand-alone coverages and 113 supplementary coverages) and 81 are regional products (including 44 stand-alone coverages and 37 supplementary coverages).

In 2005, based on the research of new characteristics and demand of the market, the Company developed and improved a number of highly adaptable and fast growing products with improved saleability customised to better address specific needs of the market. These products involved all areas of non-life insurance other than health insurance, offering customers a wider range of choices with respect to the types and coverages of the products. The Company also actively strengthened its cooperation with its strategic partner, AIG, in improving its products in accidental injury insurance and short-term health insurance. The development of the new products will enhance the continuous development of new businesses and is anticipated to drive a continuous growth in turnover and other operating results of the Company.



CASH FLOW

	Year ended 31 December	
	2005	2004
	<i>RMB million</i>	<i>RMB million</i>
Net cash inflow from operating activities	2,651	6,786
Net cash outflow from investing activities	(956)	(7,509)
Net cash outflow from financing activities	(2,075)	(1,006)
Net decrease in cash and cash equivalents	(380)	(1,729)

Net cash generated from operating activities of the Company was RMB2,651 million in 2005, representing a decrease of 60.9% compared to 2004. The decrease was primarily due to a substantial increase in premiums receivables and a rapid growth in cash payment to reinsurers in 2005.

Net cash outflow from the Company's investing activities in 2005 was RMB956 million, representing a decrease of RMB6,553 million compared to 2004. Such decrease was primarily due to a substantial decrease in net cash outflow for investments in equity and debt securities.

Net cash outflow from the Company's financing activities in 2005 was RMB2,075 million, representing an increase of RMB1,069 million compared to 2004. The substantial increase in net cash outflow was primarily due to an increase of RMB1,222 million in cash expenses in relation to the securities sold under repurchase agreements. The increase was also partially due to an increase of RMB158 million in the dividend payment in 2005. However, the impact of such increases was partially offset by a decrease of RMB300 million in the cash outflow in relation to the securities purchased under resale agreements.

Net decrease in cash and cash equivalents of the Company in 2005 was RMB380 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 needs.

The Company entered into a subordinated loan agreement with China Development Bank on 10 October 2003, whereby the Company obtained a subordinated loan of RMB2,000 million from China Development Bank. This loan is unsecured and bears interest at a rate which is equal to 90% of the long term lending rate fixed by the People's Bank of China. The loan will 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 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 for business needs and development of information systems. Capital expenditure was RMB1,677 million in 2005.

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 76,000 square meters for RMB1,647 million, for which the Company prepaid RMB1,037 million at the end 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 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 minimum solvency margin of RMB7,998 million in 2005. The Company's actual solvency margin for 2005 calculated pursuant to the regulations of the China Insurance Regulatory Commission ("CIRC") was RMB10,920 million and solvency margin adequacy ratio was 137% (*Note*)

Pursuant to the CIRC regulations, if an insurance company fails to meet 4 out of the 11 benchmarks regarding solvency, the CIRC has the right to demand an explanation and investigate into the reasons for non-compliance. In 2005, 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 2005 was 3.33 times (*Note*).

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

GEARING RATIO

As of 31 December 2005, the Company's gearing ratio (*Note*) was 79.8%, representing a decrease of 0.2 percentage point from 80.0% in 2004.

Note: Gearing ratio is represented by total liabilities (excluding 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, 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 holdings in fixed income investments or fixed interest rate liabilities 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 interest payment for the subordinated loan of the Company will fluctuate due to changes in interest rates fixed by the central bank. 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. The goal is to maintain liquidity and generate stable returns.

CREDIT RISK

Credit risk is the risk of an economic loss incurred by the Company resulting from the inability of debtors of the Company to make any principal or interest payment when due.

The Company's investment assets, reinsurance assets and deposits with commercial banks are subject to 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 its 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 A- or above, and pays particular attention to their creditworthiness and financial condition.

The Company manages and lowers credit risk affecting its bank deposits mainly by depositing most of its deposits with state-owned or state-controlled banks.

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 a portion of commercial property insurance, international cargo insurance and aviation insurance) is conducted in foreign currencies, typically US dollars. A portion of its claims, account receivables and liabilities is also denominated in foreign currencies, typically US dollars. In addition, a portion of its investment assets and cash which is denominated in foreign currencies, typically in US dollars, is also subject to exchange rate risk.

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 exchange rates to vary.

HEDGING INSTRUMENTS

The Company does not use any financial instruments for hedging purposes.

EMPLOYEES

As of 31 December 2005, the Company had 61,448 employees. Staff salaries payment by the Company in 2005 was RMB3,422 million which includes basic salaries and performance related bonus. In addition, the Company makes contributions to pension schemes and social medical insurance plans for its employees. Details of the retirement benefits of the Company are set out in notes 2.5 and 11 to the financial statements. Senior management of the Company are entitled to share appreciation rights. Details of the share appreciation rights scheme of the Company are set out in note 41 to the financial statements. The Company enhances the performance and efficiency of employees by providing various career development paths, strengthening personnel training and implementing performance review. The Company is of the view that it maintains a good relationship with its employees.



In 2005, the Company became official insurance partner of the Beijing 2008 Olympic Games.