1. CORPORATE INFORMATION

PICC Property and Casualty Company Limited (the "Company") is a limited liability joint stock company incorporated in the People's Republic of China (the "PRC").

The registered office of the Company is located at No. 69, Dongheyan Street, Xuanwumen, Beijing, the PRC.

The principal activities of the Company are providing property and casualty insurance. The details of the business lines are set out in note 4 of the financial statements.

In the opinion of the directors, the parent and the ultimate holding company of the Company is PICC Holding Company (the "Holding Company"), which is incorporated in the PRC.

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for certain debt securities, equity securities and structured deposits, which have been measured at fair value. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest million except when otherwise indicated.

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The following new and revised HKFRSs affect the Company and are adopted for the first time for the current year's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS 40	Investment Property
HKFRS 2	Share-based Payment
HKFRS 4	Insurance Contracts

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(CONTINUED)*

The adoption of HKASs 1, 7, 8, 10, 12, 14, 16, 18, 19, 21, 23, 24, 32, 33, 36 and 37 has had no material impact on the accounting policies of the Company and the methods of computation in the Company's financial statements. HKAS 24 has expanded the definition of related parties and affected the Company's related party disclosures. The impact of adopting the other HKFRSs is summarised as follows:

(a) HKAS 17 – Leases

In prior years, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and any impairment losses.

Upon the adoption of HKAS 17, the Company's leasehold interest in land and buildings is separated into leasehold land and buildings. The Company's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Company by the end of the lease term, and is reclassified from property, plant and equipment to prepaid land premiums, while buildings continue to be classified as part of property, plant and equipment. Prepaid land premiums for land lease payments under operating leases are initially stated at cost and subsequently amortised on a straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

This change in accounting policy has had no effect on the income statement and accumulated losses. The comparative amounts in the balance sheet for the year ended 31 December 2004 have been restated to reflect the reclassification of the leasehold land.

(b) HKAS 39 – Financial Instruments

Classification of financial instruments

In prior years, investments were classified into trading, non-trading and held-to-maturity securities.

Trading securities were stated at their fair values at the balance sheet date, on an individual basis, and their gains or losses arising from changes in the fair value of a security were credited or charged to the income statement.

Non-trading securities were stated at their fair values with their gains or losses arising from changes in fair value of a security dealt with in the non-trading securities revaluation reserve, until the security was sold, collected, or otherwise disposed of, or until the security was determined to be impaired, when the cumulative gains or losses derived from the security recognised in the non-trading securities revaluation reserve, together with the amount of any further impairment, was charged to the income statement in the period in which the impairment arises. Upon the adoption of HKAS 39, securities held by the Company as at 1 January 2005 in the amount of RMB5,265 million and RMB14,952 million were designated as financial assets at fair value through profit or loss and available-for-sale financial assets, respectively, under the transitional provisions of HKAS 39.

2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(CONTINUED)*

(b) HKAS 39 – Financial Instruments *(continued)*

Upon the adoption of HKAS 39, term deposits of RMB3,664 million (note 18), which were previously stated at amortised cost, were also designated as financial assets at fair value through profit or loss.

Held-to-maturity securities were stated at amortised costs less any impairment losses. Upon the adoption of HKAS 39, these securities held by the Company at 1 January 2005 in the amount of RMB2,910 million (note 21) were classified as loans and receivables. Comparative amounts have been reclassified for presentation purposes.

(c) HKAS 40 – Investment Property

In prior years, the Company made use of the exemption available to insurance companies under Hong Kong Statement of Standard Accounting Practice 13 "Accounting for investment properties" and did not separately present investment properties. Upon the adoption of HKAS 40, investment properties are reclassified and separately presented in the balance sheet. The comparative amounts in the balance sheet for the year ended 31 December 2004 have been restated to reflect the reclassification of these properties.

(d) HKFRS 2 – Share-based Payment

In prior years, no recognition and measurement of share-based payment transactions in which employees (including directors) were granted share appreciation rights were required until such rights were exercised or fully exercisable by employees.

The main impact of HKFRS 2 is the recognition of the cost of these transactions at fair value when these share appreciation rights are initially granted. This fair value is expensed over the period until vesting with the recognition of a corresponding liability. The revised accounting policy for share-based payment transaction is described in more details in note 2.5 "Summary of significant accounting policies".

As the adoption of HKFRS 2 did not have material impact on the prior year's financial statements, it was prospectively applied.

(e) HKFRS 4 – Insurance Contracts

In prior years, loss and loss adjustment expense reserves included loss adjustment expenses that can be directly attributable to individual claims but excluded indirect, unallocated loss adjustment expenses. Unallocated loss adjustment expenses include any part of the general administrative costs directly attributable to the claims function. Upon the adoption of HKFRS 4, in order to comply with the requirements for a liability adequacy test, unallocated loss adjustment expenses are included in the loss and loss adjustment expense reserves. The reinsurers' share of deferred acquisitions costs are also separately presented as liabilities in the financial statements.

The effects of the above changes are summarised in note 2.4 to the financial statements.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The Company has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements. Unless otherwise stated, these HKFRSs are effective for annual periods beginning on or after 1 January 2006:

HKAS 1 Amendment	Capital Disclosures
HKAS 19 Amendment	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC) – Int 4	Determining whether an Arrangement contains a Lease

The HKAS 1 Amendment shall be applied for annual periods beginning on or after 1 January 2007. The revised standard will affect the disclosures on qualitative information about the Company's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 incorporates the disclosure requirements of HKAS 32 relating to financial instruments. This HKFRS shall be applied for annual periods beginning on or after 1 January 2007.

HKAS 39 & HKFRS 4 Amendments – Financial Guarantee Contracts does not apply to the Company as the Company regards such contracts as insurance contracts and has used accounting policies applicable to insurance contracts.

HKAS 19 and HKAS 39 Amendments do not apply to the activities of the Company.

Except as stated above, the Company expects that the adoption of the pronouncements listed above will not have any significant impact on the Company's financial statements in the periods of initial application.

2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES

(a) Effect on the balance sheet

	Effect of adopting				
At 1 January 2005	HKAS 17	HKAS 40	HKFRS 4 Unallocated loss	HKFRS 4 Grossing-up of deferred	
Effect of new policies	Prepaid land premiums	Investment properties	adjustment expenses	acquisition costs	Total
	RMB million	*RMB million*	*RMB million*	*RMB million*	*RMB million*
Assets (Increase/(decrease))					
Deferred acquisition costs	–	–	–	2,153	2,153
Property, plant and equipment	(4,065)	(139)	–	–	(4,204)
Investment properties	–	139	–	–	139
Prepaid land premiums	4,065	–	–	–	4,065
Deferred tax assets	–	–	180	–	180
	–	–	180	2,153	2,333
Liabilities (Increase)					
Reinsurers' share of deferred acquisition costs	–	–	–	(2,153)	(2,153)
Loss and loss adjustment expense reserves	–	–	(545)	–	(545)
	–	–	(545)	(2,153)	(2,698)
					(365)

2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES *(CONTINUED)*

(a) Effect on the balance sheet *(continued)*

At 31 December 2005	Effect of adopting					
	HKAS 17	HKAS 40	HKFRS 2	HKFRS 4	HKFRS 4	
Effect of new policies	Prepaid land premiums	Investment properties	Share-based payment	Unallocated loss adjustment expenses	Grossing-up of deferred acquisition costs	Total
	RMB million	*RMB million*	*RMB million*	*RMB million*	*RMB million*	*RMB million*
Assets (Increase/(decrease))						
Deferred acquisition costs	–	–	–	–	1,345	1,345
Property, plant and equipment	(4,000)	(213)	–	–	–	(4,213)
Investment properties	–	213	–	–	–	213
Prepaid land premiums	4,000	–	–	–	–	4,000
Deferred tax assets	–	–	3	182	–	185
	–	–	3	182	1,345	1,530
Liabilities (Increase)						
Reinsurers' share of deferred acquisition costs	–	–	–	–	(1,345)	(1,345)
Loss and loss adjustment expense reserves	–	–	–	(553)	–	(553)
Other liabilities and accruals	–	–	(10)	–	–	(10)
	–	–	(10)	(553)	(1,345)	(1,908)
						(378)

2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES *(CONTINUED)*

(b) Effect on the income statement for the years ended 31 December 2005 and 2004

Effect of new policies	New presentation of income statement* RMB million	Effect of adopting: HKAS 39 Impairment loss of available-for-sale financial assets** RMB million	Effect of adopting: HKFRS 2 Share-based payment RMB million	Effect of adopting: HKFRS 4 Unallocated loss adjustment expenses RMB million	Total RMB million
Year ended 31 December 2005					
Increase in net claims incurred	–	–	–	(8)	(8)
Increase in net investment income	65	–	–	–	65
Increase in realised and unrealised losses on investments	(42)	(228)	–	–	(270)
Increase in exchange losses, net	(305)	–	–	–	(305)
Increase in sundry income	26	–	–	–	26
Increase in sundry expenses	(102)	–	–	–	(102)
Decrease/(increase) in general and administrative expenses	388	–	(10)	–	378
Increase in finance costs	(30)	–	–	–	(30)
Decrease in tax	–	75	3	2	80
Total decrease in profit	–	(153)	(7)	(6)	(166)
Decrease in basic earnings per share (in RMB)	–	(0.014)	(0.001)	(0.001)	(0.016)
Year ended 31 December 2004					
Increase in net claims incurred	–	–	–	(110)	(110)
Increase in net investment income	74	–	–	–	74
Increase in realised and unrealised losses on investments	(40)	–	–	–	(40)
Increase in exchange losses, net	(15)	–	–	–	(15)
Increase in sundry income	28	–	–	–	28
Increase in sundry expenses	(79)	–	–	–	(79)
Decrease in general and administrative expenses	81	–	–	–	81
Increase in finance costs	(49)	–	–	–	(49)
Decrease in tax	–	–	–	36	36
Total decrease in profit	–	–	–	(74)	(74)
Decrease in basic earnings per share (in RMB)	–	–	–	(0.007)	(0.007)

* During the year, the Company changed its presentation of the income statement. The directors are of the opinion the new presentation better reflects the operating results of the Company. In particular, underwriting results are separately presented in the income statement under this new presentation.

** The impairment has no impact on any asset or liability account as the amount is transferred from equity to income statement.

The effect of these new policies is presented in the statement of changes in equity.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Related parties

A party is considered to be related to the Company if:

(a) the party directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Company; (ii) has an interest in the Company that gives it significant influence over the Company; or (iii) has joint control over the Company;

(b) the party is a member of the key management personnel of the Company or its parent;

(c) the party is a close member of the family of any individual referred to in (a) or (b); or

(d) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (b) or (c).

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment and the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on the straight-line basis so as to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The principal annual rates used for this purpose are as follows:

Land and buildings	2.77% – 19.40%
Motor vehicles	16.17% – 24.25%
Office equipment, furniture and fixtures	8.82% – 32.30%

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date. Useful lives of certain property, plant and equipment have been revised during the year and the change in this accounting estimate was considered immaterial to the financial statements.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement of the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Construction in progress

Construction in progress represents buildings under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment or investment properties when completed and ready for use.

Investment properties

Investment properties are interests in land and buildings held to earn rental income and/or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes; or for sale in the ordinary course of business. Such properties are measured initially at cost, including transaction costs, less accumulated depreciation and any impairment losses at the balance sheet date.

Depreciation is computed on a straight-line basis, after taking into account the estimated residual value (3% of the original cost), over the estimated useful lives. The estimated useful lives of investment properties vary from 30 to 35 years.

The useful life and depreciation methods are reviewed periodically to ensure that the method and period of depreciation are consistent with the expected pattern of economic benefits from the individual investment properties.

Any gains or losses on retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

Transfers to, or from, investment properties are made when, and only when, there is evidence of a change in use.

Leases

Leases that transfer substantially all the rewards and risks of ownership of assets to the Company, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under capitalised finance leases are included in property, plant and equipment, and depreciated over the shorter of the lease terms and the estimated useful lives of the assets. The finance costs of such leases are charged to the income statement so as to provide a constant periodic rate of charge over the lease terms.

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Company is the lessor, assets leased by the Company under operating leases are included in property, plant and equipment, and rentals receivable under the operating leases are credited to the income statement on a straight-line basis over the lease terms. Where the Company is the lessee, rentals payable under the operating leases are charged to the income statement on a straight-line basis over the lease terms.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Leases *(continued)*

Prepaid land premiums under operating leases are initially stated at cost and subsequently recognised on a straight-line basis over the lease terms. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and the buildings as a finance lease in property, plant and equipment.

Investments and other financial assets

Applicable to the year ended 31 December 2004

The Company classified its investments as trading securities, non-trading securities and held-to-maturity securities.

Trading securities

Trading securities were investments in securities held for trading purposes and were stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security were credited or charged to the income statement in the period in which they arise.

Non-trading securities

Non-trading securities were investments in listed and unlisted securities intended to be held on a long term basis.

Listed securities were stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. Unlisted securities were stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments were determined by the directors having regard to, inter alia, the prices of the most recent reported sales or purchases of the securities, or comparison of price/earnings ratios and dividend and interest yields of the securities with those of similar listed securities, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in the fair value of a security were dealt with as movements in the non-trading securities revaluation reserve, until the security was sold, collected, or otherwise disposed of, or until the security was determined to be impaired, when the cumulative gains or losses derived from the security recognised in the non-trading securities revaluation reserve, together with the amount of any further impairment, were charged to the income statement in the period in which the impairment arises.

Securities purchased under purchase and resale agreements were recorded at cost. The difference between the purchase cost and the reselling price was credited as interest income over the period from the date of purchase to the date of resale using the effective interest method.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Investments and other financial assets *(continued)*

Applicable to the year ended 31 December 2004 *(continued)*

Non-trading securities (continued)

Securities sold under sale and repurchase agreements in which the Company maintains effective control of the securities were accounted for as secured borrowings. Such securities were maintained in the balance sheet with the proceeds of the sale included in other liabilities and accruals. The difference between the selling price and the repurchase price was amortised as interest expense over the period from the date of sale to the date of repurchase using the effective interest method.

Held-to-maturity securities

Held-to-maturity securities were investments in dated debt securities which the Company has the expressed intention and ability to hold to maturity, and were stated at amortised cost less any impairment losses which reflect their credit risk. Amortised cost was cost plus or minus the cumulative amortisation of the difference between the purchase price and the maturity amount. An impairment loss was charged to the investment and income statement in the period in which it arose, on an individual investment basis. In situations where the circumstances and events which led to an impairment of a held-to-maturity security ceased to exist and there was persuasive evidence that the new circumstances and events will persist for the foreseeable future, the reversal of the impairment was credited to the income statement, on an individual investment basis, to the extent of the amount previously charged.

Applicable to the year ended 31 December 2005

Financial assets in the scope of HKAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses are recognised in the income statement.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Investments and other financial assets *(continued)*

Applicable to the year ended 31 December 2005 *(continued)*

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost and amortised using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the two preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gains or losses previously reported in equity is included in the income statement.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis and option pricing models.

Impairment of financial assets

Applicable to the year ended 31 December 2005

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Financial assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Impairment of financial assets ***(continued)***

Applicable to the year ended 31 December 2005 ***(continued)***

Financial assets carried at amortised cost (continued)

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

Impairment losses on debt instruments are reversed through the income statement, if the increase in fair value of the instrument can be objectively related to an event, occurring after the impairment loss was recognised in the income statement.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Derecognition of financial assets and liabilities

Applicable to the year ended 31 December 2005

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Company retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset.

Where the Company has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in income statement.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Impairment of other assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than deferred tax assets and financial assets), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of an asset's or cash generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction cost.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits with maturity of generally within three months when acquired, and assets similar in nature to cash, which are not restricted as to use.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Product classification

Insurance contracts

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract, or those where at the inception of the contract there is a scenario with commercial substance where the level of insurance risk may be significant. The significance of insurance risk is dependent on both the probability of an insurance event and the magnitude of its potential effect.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remaining of its life time, even if the insurance risk reduces significantly during such period.

Investment contracts

Any contracts issued to policyholders but not considered insurance contracts under HKFRS 4 are classified as investment contracts.

Where contracts contain both a deposit component and an insurance component and the cash flows from the two components are distinct, the underlying amounts are unbundled. Any premiums relating to the insurance component are accounted for through the income statement and the remaining element is accounted for as a deposit through the balance sheet as described above.

Insurance contract liabilities

Unearned premium reserves

Unearned premium reserves are recognised to cover the unexpired portion of the risks written. Premiums are earned over the terms of the related insurance contracts on a 365-day basis.

Loss and loss adjustment expense reserves

The loss and loss adjustment expense reserves are recorded on an undiscounted basis and comprise estimated provisions for losses reported at the balance sheet date, losses incurred but not yet reported at the balance sheet date and direct and indirect, unallocated loss adjustment expenses.

The loss and loss adjustment expense reserves are calculated at a realistically estimated amount considered necessary to settle the loss in full, less a deduction for the estimated value of salvage and other recoveries, using recognised actuarial methods. Past experience is taken into account as well as current and future expected social and economic factors.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Insurance contract liabilities *(continued)*

Policyholders' deposits

Policyholders' deposits represent deposits received from policyholders which are refundable at maturities of the individual policyholder's insurance policy. These deposits are initially recognised at fair value and subsequently measured at amortised cost, using the effective interest rate method.

Liability adequacy test

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the contract liabilities net of related deferred acquisition cost assets. In performing these tests, current best estimates of future contractual cash flows, loss adjustment and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the income statement initially by writing off deferred acquisition cost assets and by subsequently establishing a provision for losses arising from the liability adequacy tests. The amount of provision is made for each class of business individually. Any deferred acquisition cost asset written off cannot subsequently be reinstated.

Deferred acquisition costs

Policy acquisition costs which vary with and are primarily related to the production of new and renewing business (consisting principally of commission expenses and underwriting personnel expenses) are deferred and amortised over the terms of the related insurance policies. Reinsurers' share of deferred acquisition costs are separately presented in the balance sheet as a liability item.

Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Income tax *(continued)*

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised, except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that they are probable that sufficient taxable profits will be available to allow all or part of the deferred tax assets to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Reinsurance

The Company assumes and/or cedes reinsurance in the normal course of business. Reinsurance assets primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Premiums on reinsurance assumed are recognised as revenue in the same manner as they would be if the reinsurance was considered direct business, taking into account the product classification of the reinsured business. Amounts due to reinsurers are estimated in a manner consistent with the associated reinsured policies and in accordance with the terms of the reinsurance contract. Premiums ceded and claims reimbursed are presented on a gross basis.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Employee benefits

Pension scheme

The employees of the Company are required to participate in a central pension scheme operated by the local municipal government. The Company is required to contribute 13.0% to 39.5% of its payroll costs to the central pension scheme. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

Share-based payment transactions

Senior executives working in the Company are granted share appreciation rights, which are settleable only in cash (cash-settled transactions). The cost of cash-settled transactions is measured initially at fair value using the Black-Scholes formula at the grant date taking into account the terms and conditions upon which the instruments were granted (see note 41). This fair value is expensed over the period until vesting with the recognition of a corresponding liability. The liability is remeasured at each balance sheet date up to and including the settlement date with changes in fair value recognised in the income statement.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Company and when the revenue can be measured reliably, on the following basis:

(a) premium income, on policy inception and earned on a pro rata basis over the term of the related policy coverage;

(b) rental income, on a time proportion basis over the lease terms;

(c) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset; and

(d) dividend income, when the shareholders' right to receive payment has been established.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Claims

Claims incurred include all claim losses occurring during the year, whether reported or not, including the related loss adjustment expenses and reduction for the value of salvage and other recoveries and any adjustments to claims outstanding from previous years.

Loss adjustment expenses include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all general administrative costs directly attributable to the claims function.

Borrowing costs

Borrowing costs are recognised as expenses in the income statement in the period in which they are incurred.

Profit appropriation

Under the PRC Company Law and the Company's articles of association, net profit after tax, as determined in accordance with PRC accounting standards and regulations ("PRC GAAP"), can only be distributed as dividends after making up prior years' cumulative losses, if any, and making allowance for the following statutory reserve funds, which cannot be used for purposes other than those for which they are created and are not distributable as cash dividends:

(a) *Statutory surplus reserve*

In accordance with the PRC Company Law and the Company's articles of association, the Company is required to appropriate 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC GAAP, to the statutory surplus reserve. When the balance of such reserve fund reaches 50% of the capital, any further appropriation is optional. The statutory surplus reserve can be utilised to offset prior years' losses or to increase capital. However, such balance of the statutory surplus reserve must be maintained at a minimum of 25% of the capital after any such usage.

(b) *Statutory public welfare fund*

In accordance with the PRC Company Law and the Company's articles of association, the Company is required to appropriate 5% to 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC GAAP, to the statutory public welfare fund, which will be utilised to build or acquire capital items, such as dormitories and other facilities for the employees of the Company, and cannot be used to settle staff welfare expenses.

In accordance with the PRC relevant regulations and the Company's articles of association, the retained profits of the Company for the purpose of profit distribution are deemed to be the lower of the amount determined in accordance with PRC GAAP, and the amount determined in accordance with generally accepted accounting principles in Hong Kong.

As a result of the amendment to the PRC Company Law, the Company was no longer required to appropriate net profit after tax (after offsetting any prior years' loss) with effect on 1 January 2006.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Foreign currencies

These financial statements are presented in Renminbi, which is the Company's functional and presentation currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Company's accounting policies, corporate management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Classification of financial assets

The Company classifies its financial assets in accordance with HKAS 39 as either financial assets at fair value through profit or loss, loans and receivables or available-for-sale financial assets, as appropriate. Certain of these classifications require judgements. In making these judgements, the Company considers the intention of holding these financial assets, compliance with the requirements of HKAS 39 and their implications to the presentation in the financial statements.

Impairment of available-for-sale equity financial assets

The Company determines that available-for-sale equity financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of what is significant or prolonged requires judgement. In making this judgement, the Company evaluates among other factors, the normal volatility in share price, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flows.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(CONTINUED)*

Judgements *(continued)*

Impairment of reinsurance assets

The Company performs an impairment review on its reinsurance assets when an indication of impairment occurs. In considering whether a reinsurance asset is impaired, the Company considers whether (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Company may not receive all amounts due to it under the terms of the contract; and (b) the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Claims liability arising from insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. There are several sources of uncertainty, including legislative changes and speed of settlement, that need to be considered in the estimation of the liability that the Company will ultimately pay for those claims. The Company uses a number of different actuarial techniques and assumptions to estimate the liability.

The directors believe that the loss and loss adjustment expense reserves at the balance sheet date are adequate to cover the ultimate costs of all incurred losses and direct loss adjustment expenses to that date, but the reserves are necessarily based on estimates and no representation is made that the ultimate liability may not exceed or be less than such estimates.

Financial assets registered under the exchange trading seats of securities companies

For debt securities subject to restriction on either disposal or transfer of the registration as explained in note 19 to the financial statements and an amount due from a securities company under liquidation as at 31 December 2005 as explained in note 26 to the financial statements, estimation is required when the Company determines the fair values of these financial assets or the extent of impairment, if they are classified as available-for-sale financial assets.

4. SEGMENT INFORMATION

Segment information is presented by way of the Company's primary reporting basis, by business segment. No further geographical segment information is presented as all of the Company's customers and operations are located in the PRC.

Summary details of the business segments are as follows:

(a) the motor vehicle segment provides insurance products covering motor vehicles;
(b) the commercial property segment provides insurance products covering commercial properties;
(c) the homeowners segment provides insurance products covering homes and their contents;
(d) the cargo segment provides insurance products covering vessels, crafts or conveyances;
(e) the liability segment provides insurance products covering policyholders' liabilities;
(f) the accidental injury segment provides insurance products covering accidental injuries; and
(g) the "other" segment mainly represents insurance products related to marine hull, aviation and oil and gas.

Information on the Company's reportable business segments is as follows:

	2005 *RMB million*	2004 *RMB million* (Restated)
Turnover		
Motor vehicle	42,046	42,898
Commercial property	8,199	7,987
Homeowners	1,051	1,257
Cargo	2,665	2,724
Liability	2,420	2,051
Accidental injury	2,247	1,890
Other	3,704	3,196
	62,332	62,003
Net premiums earned		
Motor vehicle	36,443	35,802
Commercial property	5,629	6,402
Homeowners	714	452
Cargo	2,141	2,940
Liability	1,783	1,850
Accidental injury	1,653	1,688
Other	1,439	1,494
	49,802	50,628
Net investment income		
Homeowners	255	179
Net realised and unrealised losses on investments		
Homeowners	(123)	(104)

4. SEGMENT INFORMATION *(CONTINUED)*

	2005 *RMB million*	2004 *RMB million* (Restated)
Net claims incurred		
Motor vehicle	**(27,593)**	(30,927)
Commercial property	**(4,519)**	(4,003)
Homeowners	**(228)**	(240)
Cargo	**(986)**	(963)
Liability	**(1,300)**	(1,095)
Accidental injury	**(695)**	(936)
Other	**(1,014)**	(851)
	(36,335)	(39,015)
Amortisation of deferred acquisition costs, net		
Motor vehicle	**(3,999)**	(2,691)
Commercial property	**(451)**	(262)
Homeowners	**(126)**	(29)
Cargo	**(274)**	(227)
Liability	**(183)**	(111)
Accidental injury	**(149)**	(65)
Other	**390**	(175)
	(4,792)	(3,560)
Insurance protection expense		
Motor vehicle	**(390)**	(409)
Commercial property	**(60)**	(66)
Homeowners	**(10)**	(12)
Cargo	**(21)**	(25)
Liability	**(19)**	(18)
Accidental injury	**(18)**	(16)
Other	**(19)**	(17)
	(537)	(563)
Interest expense credited to policyholders' deposits		
Homeowners	**(143)**	(144)
Segment profit before unallocated income and expenses		
Motor vehicle	**4,461**	1,775
Commercial property	**599**	2,071
Homeowners	**339**	102
Cargo	**860**	1,725
Liability	**281**	626
Accidental injury	**791**	671
Other	**796**	451
	8,127	7,421

4. SEGMENT INFORMATION *(CONTINUED)*

	2005 *RMB million*	2004 *RMB million* (Restated)
Unallocated operating income and expenses		
Net investment income	1,223	1,147
Net realised and unrealised losses on investments	(213)	(884)
General and administrative expenses	(6,372)	(7,054)
Exchange losses, net	(305)	(15)
Sundry income	26	28
Sundry expenses	(102)	(79)
Finance costs	(181)	(169)
	(5,924)	(7,026)
Profit before tax	2,203	395
Tax	(1,090)	(261)
Net profit attributable to shareholders	1,113	134

Net investment income and net realised and unrealised losses on investments attributable to homeowners' insurance products, which can be separately identified based on the results of its designated pool of investments, are separately disclosed. Depreciation and capital expenditure, which are not attributable to particular insurance products, are not allocated and are included under unallocated operating income and expenses.

	2005 *RMB million*	2004 *RMB million* (Restated)
Segment assets		
Motor vehicle	9,408	7,822
Commercial property	4,460	3,811
Homeowners	843	709
Cargo	530	456
Liability	761	508
Accidental injury	617	530
Other	4,787	4,307
	21,406	18,143
Unallocated assets	71,974	72,614
Total assets	93,380	90,757

4. SEGMENT INFORMATION *(CONTINUED)*

	2005 *RMB million*	2004 *RMB million* (Restated)
Segment liabilities		
Motor vehicle	38,296	37,135
Commercial property	6,766	6,723
Homeowners	11,861	11,934
Cargo	1,346	1,306
Liability	2,211	1,728
Accidental injury	1,747	1,784
Other	5,464	5,360
	67,691	65,970
Unallocated liabilities	8,853	8,634
Total liabilities	76,544	74,604

5. TURNOVER AND NET PREMIUMS EARNED

Turnover represents direct premiums written and reinsurance premiums assumed, net of government levies and surcharges.

	2005 *RMB million*	2004 *RMB million*
Turnover		
Direct premiums written	65,898	65,577
Reinsurance premiums assumed	16	6
	65,914	65,583
Less: Government levies and surcharges	(3,582)	(3,580)
	62,332	62,003
Net premiums earned		
Turnover	62,332	62,003
Less: Reinsurance premiums ceded	(12,474)	(9,283)
Net premiums written	49,858	52,720
Less: Changes in net unearned premium reserves	(56)	(2,092)
Net premiums earned	49,802	50,628

6. NET CLAIMS INCURRED

	2005 *RMB million*	2004 *RMB million* (Restated)
Gross claims paid	42,426	42,257
Less: Paid losses recoverable from reinsurers	(7,072)	(6,994)
Net claims paid	35,354	35,263
Add: Change in net loss and loss adjustment expense reserves *(note 36)*	981	3,752
Net claims incurred	36,335	39,015

7. NET INVESTMENT INCOME

	2005 *RMB million*	2004 *RMB million* (Restated)
Interest income from cash and cash equivalents and term deposits	725	553
Interest income from debt securities	541	436
Interest income from subordinated debts	141	68
Dividend income from equity securities	36	244
Rental income from investment properties	35	25
	1,478	1,326

8. NET REALISED AND UNREALISED LOSSES ON INVESTMENTS

	2005 *RMB million*	2004 *RMB million* (Restated)
Debt securities:		
Realised gains/(losses)	180	(19)
Unrealised losses	(40)	(5)
Equity securities:		
Realised losses	(210)	(12)
Unrealised gains/(losses)	21	(745)
Impairment loss on available-for-sale securities	(245)	(167)
	(294)	(948)
Add: investment management fee	(42)	(40)
	(336)	(988)

9. EXCHANGE LOSSES, NET

Exchange (losses)/gains can be attributable to the following functions:

	2005 RMB million	2004 RMB million (Restated)
Net realised and unrealised losses on investments	(310)	–
Net premiums earned	(15)	–
Net claims incurred	7	–
General and administrative expenses	13	(15)
	(305)	(15)

10. FINANCE COSTS

	2005 RMB million	2004 RMB million (Restated)
Interest on subordinated loan	110	105
Interest on securities sold under sale and repurchase agreements	30	49
Other finance costs	41	15
	181	169

11. PROFIT BEFORE TAX

The Company's profit before tax is arrived at after charging:

	Notes	2005 RMB million	2004 RMB million (Restated)
Auditors' remuneration, including interim review		15	13
Depreciation for property, plant and equipment	27	1,096	1,246
Depreciation for investment properties	28	6	4
Amortisation for prepaid land premiums	30	93	98
Employee expenses (including directors' remuneration):			
Wages salaries and staff welfare		4,634	4,267
Cash-settled share appreciation rights expense		10	–
Pension scheme contributions		432	440
Impairment loss on premiums receivable		136	81
Impairment loss on construction in progress		–	6
Minimum lease payments under operating leases – land and buildings		336	367
Net loss on disposals of items of property, plant and equipment and construction in progress		8	17

12. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2005 RMB'000	2004 RMB'000
Fees	2,436	2,494
Other emoluments:		
Salaries, allowances and benefits in kind	3,999	4,043
Performance related bonuses	2,272	2,467
Cash-settled share appreciation rights expense	1,833	–
Pension scheme contributions	754	588
	11,294	9,592

Certain directors and supervisors are entitled to bonuses which are determined by a number of factors including the operating results of the Company.

Certain directors and supervisors were granted share appreciation rights, in respect of their services to the Company, further details of which are set out in note 41 to the financial statements. The fair value of such rights, which has been amortised to the income statement, was determined as at the date of granted and remeasured at each balance sheet date and included in the above directors' and supervisors' remuneration disclosures.

12. DIRECTORS' AND SUPERVISORS' REMUNERATION *(CONTINUED)*

(a) Independent non-executive directors

The fees paid to independent non-executive directors during the year were as follows:

	2005 *RMB'000*	2004 *RMB'000*
Mr. Cheng Wai Chee, Christopher	303	274
Mr. Lu Zhengfei	302	302
Mr. Luk Kin Yu, Peter	303	–
Mr. Wang Tung Shun, Peter	21	274
	929	850

There were no other emoluments payable to the independent non-executive directors during the year (2004: Nil).

12. DIRECTORS' AND SUPERVISORS' REMUNERATION *(CONTINUED)*

(b) Chairman of Board, executive directors, non-executive directors and supervisors

	Fees *RMB'000*	Salaries, allowances and benefits in kind *RMB'000*	Performance related bonuses *RMB'000*	Cash-settled share appreciation rights expense *RMB'000*	Pension scheme contributions *RMB'000*	Total remuneration *RMB'000*
2005						
Chairman of Board						
Mr. Tang Yunxiang	137	737	505	220	132	1,731
Executive directors:						
Mr. Wang Yi (President)	137	700	480	220	127	1,664
Mr. Wang Yincheng	137	537	299	158	103	1,234
Mdm. Liu Zhenghuan	137	567	316	158	108	1,286
Mr. Fu Zhu	137	493	104	107	95	936
Non-executive directors:						
Mr. Ding Yunzhou	137	–	–	158	–	295
Mr. Zhou Shurui	137	–	–	158	–	295
Mr. Tse Sze-Wing, Edmund	137	–	–	118	–	255
Supervisors:						
Mr. Deng Zhaoyu (Chairman)	137	700	480	220	127	1,664
Mr. Tang Wei	137	–	–	158	–	295
Mr. Liu Qilong	137	265	88	158	62	710
	1,507	3,999	2,272	1,833	754	10,365
2004						
Chairman of Board						
Mr. Tang Yunxiang	137	737	505	–	101	1,480
Executive directors:						
Mr. Wang Yi (President)	137	700	480	–	97	1,414
Mr. Wang Yincheng	137	537	299	–	80	1,053
Mdm. Liu Zhenghuan	137	567	316	–	83	1,103
Mr. Fu Zhu	137	537	299	–	80	1,053
Non-executive directors:						
Mr. Ding Yunzhou	137	–	–	–	–	137
Mr. Zhou Shurui	137	–	–	–	–	137
Mr. Tse Sze-Wing, Edmund	137	–	–	–	–	137
Mr. Qiao Lin	137	–	–	–	–	137
Supervisors:						
Mr. Deng Zhaoyu (Chairman)	137	700	480	–	97	1,414
Mr. Tang Wei	137	–	–	–	–	137
Mr. Liu Qilong	137	265	88	–	50	540
	1,644	4,043	2,467	–	588	8,742

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration during the year.

13. FIVE HIGHEST PAID EMPLOYEES

All of the five highest paid employees during the year and the prior year were either directors or supervisors of the Company.

14. TAX

The provision for PRC income tax is calculated based on the statutory rate of 33% in accordance with the relevant PRC income tax rules and regulations.

	2005 *RMB million*	2004 *RMB million* (Restated)
Current – charge for the year	**1,042**	380
Deferred *(note 34)*	**48**	(119)
Total tax charge for the year	**1,090**	261

A reconciliation of the tax expense applicable to profit before tax using the statutory tax rate for the PRC, in which the Company is domiciled, to the tax expense at the effective tax rate and a reconciliation of the applicable rates i.e. statutory tax rates to the effective tax rates, are as follows:

	2005 *RMB million*	*%*	2004 *RMB million* (Restated)	*%*
Profit before tax	**2,203**		395	
Tax at the statutory tax rate of 33%	**727**	**33.0**	130	33.0
Income not subject to tax	**(98)**	**(4.4)**	(144)	(36.5)
Expenses not deductible for tax	**461**	**20.9**	275	69.6
Tax charge for the year	**1,090**	**49.5**	261	66.1

15. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders of RMB1,113 million (2004: RMB134 million) and the 11,142 million (2004: 11,142 million) ordinary shares in issue during the year.

Diluted earnings per share amounts for the years ended 31 December 2005 and 2004 have not been disclosed as no diluting events existed during these years.

16. DIVIDEND PER SHARE

During the year ended 31 December 2005, the Board of Directors declared an interim dividend of RMB802 million (2004: Nil). This declaration was approved by a Shareholders' meeting on 25 October 2005. The Board of Directors did not propose any final dividend for the year.

17. CASH AND CASH EQUIVALENTS

	2005 *RMB million*	2004 *RMB million*
Cash in hand	**25**	25
Demand deposits	**13,116**	14,942
Securities purchased under resale agreements with original maturity of less than three months	**–**	50
Deposits with banks and other financial institutions with original maturity of less than three months	**2,754**	1,258
	15,895	16,275

Demand deposits earn interest at floating rates based on daily bank deposit rates. Securities purchased under resale agreements and short term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Company, and earn interest at the respective short term time deposit/agreed rates. The carrying amount of the cash and cash equivalents approximate to its fair value.

At 31 December 2005, RMB195 million (2004: RMB1,099 million) was included in deposits with banks and other financial institutions as accrued insurance protection fund. The amount was maintained in accordance with relevant the PRC insurance law and regulations for insurance protection and restricted in use. Details of the restrictions are disclosed in note 32 to the financial statements.

At 31 December 2005, included in deposits with banks and other financial institutions was a clearing account deposit of RMB64 million (2004: RMB57 million) deposited with a PRC securities company.

18. TERM DEPOSITS

	2005 *RMB million*	2004 *RMB million*
Structured deposits with banks and other financial institutions:		
– at fair value	**3,107**	–
– at amortised cost	**838**	3,664
Deposits with banks and other financial institutions with original maturity of more than three months, at amortised cost	**7,696**	8,059
	11,641	11,723

18. TERM DEPOSITS *(CONTINUED)*

Certain structured deposits maintained with PRC banks and other financial institutions are designated as fair value through profit or loss financial instruments on initial adoption of HKAS 39. The returns of certain structured deposits are linked to certain US dollar-denominated debt instruments or the London inter-bank offered rate. Embedded in some of these structured deposits are options to enter into new and different structured deposit arrangements at their maturity dates. Their fair values are estimated by certain interest option pricing models.

The carrying amounts of term deposits stated at amortised cost approximate to their fair values.

19. DEBT SECURITIES

	2005 *RMB million*	2004 *RMB million* (Restated)
Listed debt securities, at fair value:		
Debt securities issued by the PRC central government	9,630	3,566
Debt securities issued by corporate entities	544	959
	10,174	4,525
Unlisted debt securities, at fair value:		
Debt securities issued by the PRC central government	4,053	4,360
Debt securities issued by banks and other financial institutions	1,889	2,397
Debt securities issued by corporate entities	2,408	3,367
	8,350	10,124
	18,524	14,649
Classification of debt securities:		
Fair value through profit or loss – held for trading	3,398	–
Available-for-sale	15,126	–
Trading	–	2,200
Non-trading	–	12,449
	18,524	14,649

The fair values are based on market prices or broker/dealer price quotations.

19. DEBT SECURITIES *(CONTINUED)*

As at 31 December 2005, certain debt securities of the Company were registered under the exchange trading seats of a PRC securities company. The total amounts of debt securities at fair value through profit or loss and available-for-sale securities at 31 December 2005 were RMB508 million and RMB55 million (31 December 2004: trading and non-trading securities of RMB546 million and non-trading securities of RMB53 million), respectively. Since 2004, the Company and the Company's investment manager, PICC Assets Management Company Limited ("PICC AMC"), a fellow subsidiary of the company, have instructed the securities company to either dispose of the debt securities, or to transfer the registration of the debt securities to the exchange trading seats of PICC AMC. The securities company has confirmed in writing to the Company that it would execute the said instruction and, as at the date of approving these financial statements, debt securities totalling RMB34 million (31 December 2004: RMB16 million) were disposed of by the securities company. In August 2005, a state-owned investment holding company injected capital in this securities company. In December 2005, an amount of RMB5 million was withdrawn from the securities company. The Company's management has been liaising with the securities company and the relevant regulatory authorities to ensure that the Company's assets are protected.

The Company's management has assessed the fair values and impairment of the above-mentioned debt securities, together with their accrued interests, by taking into account the restriction on disposals.

20. EQUITY SECURITIES

	2005 ***RMB million***	2004 *RMB million* (Restated)
Listed investments, at fair value:		
Mutual funds	**2,262**	2,781
Shares	**189**	–
	2,451	2,781
Unlisted investments, at fair value:		
Mutual funds	**389**	2,787
	2,840	5,568

	2005 ***RMB million***	2004 *RMB million*
Fair value through profit or loss – held for trading	**2,840**	–
Trading	**–**	2,781
Non-trading	**–**	2,787
	2,840	5,568

The fair values are based on market prices or bid prices quoted by mutual fund management companies.

21. SUBORDINATED DEBTS

	2005 RMB million	2004 RMB million (Restated)
Unlisted subordinated debts issued by banks and other financial institutions, at amortised cost	**2,910**	2,910

The fair value of these subordinated debts is RMB3,180 million (2004: RMB3,191 million). Fair values have been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

22. CAPITAL SECURITY FUND

In accordance with the PRC Insurance Law, the Company is required to maintain a deposit equivalent to 20% of its registered capital with banks designated by the China Insurance Regulatory Commission ("CIRC") as a security fund. The use of the security fund is subject to the approval of the CIRC.

23. PREMIUMS RECEIVABLE AND AGENTS' BALANCES, NET

	2005 RMB million	2004 RMB million
Premiums receivable and agents' balances	**4,064**	2,633
Less: Impairment loss on premiums receivable	**(297)**	(161)
	3,767	2,472

An aged analysis of the premiums receivable and agents' balances as at the balance sheet date, based on the payment due date and net of impairment, is as follows:

	2005 RMB million	2004 RMB million
Within 3 months	**3,163**	2,249
Over 3 months but less than 6 months	**457**	140
Over 6 months	**147**	83
	3,767	2,472

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

24. DEFERRED ACQUISITION COSTS

	Gross amount *RMB million*	Reinsurers' share *RMB million*	Net amount *RMB million*
At 1 January 2005	**4,406**	**(2,153)**	**2,253**
Costs deferred during the year	**8,126**	**(2,945)**	**5,181**
Amortisation	**(8,545)**	**3,753**	**(4,792)**
At 31 December 2005	**3,987**	**(1,345)**	**2,642**
At 1 January 2004	3,382	(2,098)	1,284
Costs deferred during the year	7,338	(2,809)	4,529
Amortisation	(6,314)	2,754	(3,560)
At 31 December 2004	4,406	(2,153)	2,253

	2005			2004		
	Gross amount ***RMB million***	**Reinsurers' share** ***RMB million***	**Net amount** ***RMB million***	Gross amount *RMB million*	Reinsurers' share *RMB million*	Net amount *RMB million*
Current	**3,470**	**(1,171)**	**2,299**	3,877	(1,895)	1,982
Non-current	**517**	**(174)**	**343**	529	(258)	271
	3,987	**(1,345)**	**2,642**	4,406	(2,153)	2,253

25. RECEIVABLES FROM REINSURERS

An aged analysis of the receivables from reinsurers as at the balance sheet date is as follows:

	2005 ***RMB million***	2004 *RMB million*
Within 3 months	**2,316**	755
Over 3 months but less than 6 months	**31**	80
Over 6 months	**153**	154
	2,500	989

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

26. PREPAYMENTS AND OTHER RECEIVABLES

	2005 *RMB million*	2004 *RMB million*
Amount due from provincial government	–	1,210
Interests receivable	434	444
Prepayments and deposits	163	115
Amount due from the Holding Company *(note 47(c))*	155	329
Other receivables	461	607
	1,213	2,705

During 1999, pursuant to the instruction from the State Council as part of the restructuring of the PRC insurance industry, the Company acquired the commercial insurance business of certain provincial and municipal governments. On the date of acquisition, the net liabilities assumed amounted to RMB1,210 million, which mainly consisted of unearned premium reserves and loss and loss adjustment expense reserves, net of cash and cash equivalents.

During the year, in accordance with notices issued by Ministry of Finance and the CIRC, the Company fully offset the balance of RMB1,210 million due from provincial and municipal governments against the accrued insurance protection fund.

In September 2004, a PRC securities company engaged by PICC AMC was placed under operational control by a special manager as instructed by the China Securities Regulatory Commission ("CSRC"). As at 31 December 2004, the Company had an outstanding amount of RMB415 million deposited at this securities company, including accrued interest amounting to RMB11 million and a clearing account deposit of RMB57 million. As the securities company went into liquidation in September 2005, the balance of RMB104 million, net of impairment, was reclassified to prepayment and other receivables.

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

27. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings *RMB million*	Motor vehicles *RMB million*	Office equipment, furniture and fixtures *RMB million*	Total *RMB million*
Cost:				
At 1 January 2005	**9,850**	**1,472**	**2,155**	**13,477**
Additions	**5**	**122**	**574**	**701**
Transfers *(note 29)*	**60**	**–**	**–**	**60**
Disposals	**(42)**	**(148)**	**(119)**	**(309)**
At 31 December 2005	**9,873**	**1,446**	**2,610**	**13,929**
Accumulated depreciation:				
At 1 January 2005	**(752)**	**(880)**	**(880)**	**(2,512)**
Depreciation	**(345)**	**(257)**	**(494)**	**(1,096)**
Disposals	**5**	**143**	**107**	**255**
As 31 December 2005	**(1,092)**	**(994)**	**(1,267)**	**(3,353)**
Net book value:				
As 31 December 2005	**8,781**	**452**	**1,343**	**10,576**
Cost:				
At 1 January 2004	9,675	1,477	1,909	13,061
Additions	22	118	546	686
Transfers *(note 29)*	165	–	–	165
Disposals	(12)	(123)	(300)	(435)
At 31 December 2004	9,850	1,472	2,155	13,477
Accumulated depreciation:				
At 1 January 2004	(408)	(631)	(635)	(1,674)
Depreciation	(348)	(364)	(534)	(1,246)
Disposals	4	115	289	408
At 31 December 2004	(752)	(880)	(880)	(2,512)
Net book value:				
As 31 December 2004	9,098	592	1,275	10,965

The Company's land and buildings are situated in Mainland China and held under medium term leases.

27. PROPERTY, PLANT AND EQUIPMENT *(CONTINUED)*

As at 31 December 2005, the title certificates of certain acquired buildings with a net book value of RMB385 million (2004: RMB367 million) were in the process of obtaining title registration.

The net book value of the Company's property, plant and equipment held under finance leases included in the total amount of property, plant and equipment at 31 December 2005, amounted to RMB1,938 million (2004: RMB1,975 million).

28. INVESTMENT PROPERTIES

	2005 *RMB million*	2004 *RMB million* (Restated)
Cost:		
At 1 January		
As previously reported	–	–
Effect of adopting HKAS 40 *(note 2.4(a))*	189	146
As restated	189	146
Additions	80	43
At 31 December	269	189
Accumulated depreciation:		
At 1 January		
As previously reported	–	–
Effect of adopting HKAS 40 *(note 2.4(a))*	(50)	(46)
As restated	(50)	(46)
Charge for the year	(6)	(4)
At 31 December	(56)	(50)
Net book value at 31 December	213	139

The fair value of the investment properties is RMB294 million (2004: RMB229 million). The fair value of the properties is determined by the directors with reference to recent market transactions.

The Company's investment properties are situated in Mainland China and held under medium term leases.

29. CONSTRUCTION IN PROGRESS

	2005 *RMB million*	2004 *RMB million*
At 1 January	949	642
Additions	887	478
Transfers to property, plant and equipment *(note 27)*	(60)	(165)
Disposals	(20)	–
Impairment	–	(6)
At 31 December	1,756	949

The Company's construction in progress is situated in Mainland China and held under medium term leases.

30. PREPAID LAND PREMIUMS

	2005 *RMB million*	2004 *RMB million* (Restated)
At 1 January		
As previously reported	–	–
Effect of adopting HKAS 17 *(note 2.4(a))*	4,065	4,158
As restated	4,065	4,158
Additions	28	5
Amortisation for the year	(93)	(98)
At 31 December	4,000	4,065

The leasehold land is situated in Mainland China and held under the following terms:

	2005 *RMB million*	2004 *RMB million* (Restated)
Long term leases	92	94
Medium term leases	3,908	3,971
	4,000	4,065

31. PAYABLES TO REINSURERS

Payables to reinsurers are analysed as follows:

	2005 *RMB million*	2004 *RMB million*
Reinsurance payables	3,169	641
Reinsurance funds withheld	362	670
	3,531	1,311

The reinsurance payables are non-interest-bearing and are due within three months from the balance sheet date or are repayable on demand. The reinsurance funds withheld as at 31 December 2005 and 2004 are repayable upon the expiration of the related reinsurance contracts.

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

32. ACCRUED INSURANCE PROTECTION FUND

	2005 *RMB million*	2004 *RMB million*
At 1 January	1,099	536
Accrued during the year	537	563
Offset against the amount due from provincial government *(note 26)*	(1,210)	–
Paid during the year	(231)	–
At 31 December	195	1,099

The Company is obligated to pay into an insurance protection fund based on 1% of its annual retained premiums in accordance with the relevant PRC insurance law and regulations. No further provision is required once the accumulated balance has reached 6% (2004: 6%) of the Company's total assets determined in accordance with the PRC GAAP.

All of the accrued insurance protection amounts are payable at request of the CIRC. Pursuant to a new regulation (CIRC[2004] No.16) issued by the CIRC, which became effective on 1 January 2005, all insurance companies in the PRC are required to deposit their accumulated insurance protection fund in a CIRC's designated bank account.

33. OTHER LIABILITIES AND ACCRUALS

	2005 RMB million	2004 RMB million
Premiums received in advance	1,827	2,222
Salaries and staff welfare payable	1,710	1,402
Amount due to the Holding Company *(note 47(c))*	116	190
Accrued capital expenditure	128	109
Amount due to a fellow subsidiary *(note 47(c))*	9	8
Securities sold under agreements to repurchase	–	611
Others	2,219	1,802
	6,009	6,344

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

34. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

	Revaluation of fair value through profit or loss (trading securities) *RMB million*	Revaluation of available-for-sale financial instruments (non-trading securities) *RMB million*	Depreciation of property, plant and equipment *RMB million*	Deferred income recognition of fair value through profit or loss (trading securities) *RMB million*	Deferred acquisition costs *RMB million*	Others *RMB million*	Total *RMB million*
At 1 January 2005							
As previously reported	281	251	209	–	–	9	750
Effect of adopting HKAS 39 and HKFRS 4	53	(88)	–	–	710	180	855
As restated at 1 January 2005	334	163	209	–	710	189	1,605
Deferred tax (charged)/credited to the income statement during the year *(note 14)*	(67)	55	16	–	(266)	79	(183)
Deferred tax debited to equity during the year	–	(181)	–	–	–	–	(181)
Gross deferred tax assets at 31 December 2005	267	37	225	–	444	268	1,241
At 1 January 2005							
As previously reported	–	–	–	(35)	(744)	–	(779)
Effect of adopting HKAS 39 and HKFRS 4	–	–	–	35	(710)	–	(675)
As restated at 1 January 2005	–	–	–	–	(1,454)	–	(1,454)
Deferred tax credited/(charged) to the income statement during the year *(note 14)*	–	–	–	(3)	138	–	135
Gross deferred tax liabilities at 31 December 2005	–	–	–	(3)	(1,316)	–	(1,319)
Net deferred tax liabilities at 31 December 2005							(78)

34. DEFERRED TAX *(CONTINUED)*

	Revaluation of trading securities *RMB million*	Revaluation of non-trading securities *RMB million*	Depreciation of property, plant and equipment *RMB million*	Deferred income recognition of trading securities *RMB million*	Deferred acquisition costs *RMB million*	Others *RMB million*	Total *RMB million*
At 1 January 2004							
As previously reported	(29)	3	149	–	–	(31)	92
Effect of adopting HKFRS 4	–	–	–	–	692	144	836
As restated at 1 January 2004	(29)	3	149	–	692	113	928
Deferred tax credited to the income statement during the year *(note 14)*	310	26	60	–	18	77	491
Deferred tax credited to equity during the year	–	222	–	–	–	–	222
Gross deferred tax assets at 31 December 2004	281	251	209	–	710	190	1,641
At 1 January 2004							
As previously reported	–	–	–	(1)	(424)	–	(425)
Effect of adopting HKFRS 4	–	–	–	–	(692)	–	(692)
As restated at 1 January 2004	–	–	–	(1)	(1,116)	–	(1,117)
Deferred tax charged to the income statement during the year *(note 14)*	–	–	–	(34)	(338)	–	(372)
Gross deferred tax liabilities at 31 December 2004	–	–	–	(35)	(1,454)	–	(1,489)
Net deferred tax assets at 31 December 2004							152

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

The change in respect of the deferred tax asset recognised arising from the revaluation of available-for-sale/non-trading securities is taken to the available-for-sale/non-trading securities revaluation reserve.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities as they relate to the same tax authority.

35. UNEARNED PREMIUM RESERVES

	2005			2004		
	Gross amount *RMB million*	Reinsurers' share *RMB million*	Net amount *RMB million*	Gross amount *RMB million*	Reinsurers' share *RMB million*	Net amount *RMB million*
At 1 January	30,803	(4,319)	26,484	30,422	(6,030)	24,392
Increase during the year	29,952	(5,498)	24,454	24,988	(3,504)	21,484
Release during the year	(28,248)	3,850	(24,398)	(24,607)	5,215	(19,392)
At 31 December	32,507	(5,967)	26,540	30,803	(4,319)	26,484
Current	28,305	(5,204)	23,101	27,269	(3,887)	23,382
Non-current	4,202	(763)	3,439	3,534	(432)	3,102
	32,507	(5,967)	26,540	30,803	(4,319)	26,484

36. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

	2005			2004		
	Gross amount *RMB million*	Reinsurers' share *RMB million*	Net amount *RMB million*	Gross amount *RMB million* (Restated)	Reinsurers' share *RMB million* (Restated)	Net amount *RMB million* (Restated)
At 1 January	21,817	(5,957)	15,860	18,391	(6,283)	12,108
Claims incurred during the year						
– Current year	41,290	(6,018)	35,272	43,219	(6,546)	36,673
– Prior year	1,345	(282)	1,063	2,464	(122)	2,342
Claims paid during the year						
– Current year	(24,852)	3,821	(21,031)	(25,342)	3,096	(22,246)
– Prior year	(17,574)	3,251	(14,323)	(16,915)	3,898	(13,017)
At 31 December	22,026	(5,185)	16,841	21,817	(5,957)	15,860
Current	16,033	(3,059)	12,974	16,148	(3,329)	12,819
Non-current	5,993	(2,126)	3,867	5,669	(2,628)	3,041
	22,026	(5,185)	16,841	21,817	(5,957)	15,860

Net claims incurred for the year ended 31 December 2005 increased by RMB1,063 million (2004: RMB2,342 million) as a result of adverse development of reserves from prior years, primarily on the motor insurance business, due to claim settlement patterns being slower than originally expected.

37. POLICYHOLDERS' DEPOSITS

An analysis of interest-bearing and non-interest-bearing deposits is set out below:

	2005 *RMB million*	2004 *RMB million*
Interest-bearing deposits	6,158	6,256
Non-interest-bearing deposits	2,291	2,530
	8,449	8,786

Policyholders' deposits consist of interest-bearing and non-interest-bearing deposits placed by policyholders.

Certain contracts offered by the Company require that the policyholders place a deposit with the Company which is refundable upon maturity, which varies from one year to perpetuity, and bears no interest. A contract holder can terminate the contract before the maturity date without penalties. The main feature of this product is that an insurance coverage is fixed at the inception of the policy and remains in effect during the policy period or until terminated by the contract holder.

From 2002, the Company has underwritten policies of another kind of homeowners insurance product containing both insurance and investment features. Policyholders deposit a fixed principal amount which is only refundable upon the maturity of the policy of three years or five years and the policyholders receive a fixed rate of interest. Penalties on early termination are charged according to the terms stated in the contract.

The carrying amounts disclosed above reasonably approximate to their fair values at year end.

38. SUBORDINATED LOAN

On 10 October 2003, the Company signed a loan agreement with China Development Bank which advanced a subordinated loan of RMB2,000 million to the Company. The loan is unsecured, bears interest at 90% of the People's Bank of China long term borrowing interest rate per annum and is repayable in November 2023.

The fair value of the subordinated loan is RMB2,674 million (2004: RMB2,702 million). Fair value has been estimated using quoted market prices for securities with similar credit, maturity and characteristics.

39. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS – TERMS, ASSUMPTIONS AND SENSITIVITIES

(a) Insurance contracts

Terms

Loss and loss adjustment expense reserves are refined on a half-yearly basis as part of a regular ongoing process as claims experience develops, certain claims are settled and further claims are reported. The reserve is not discounted for the time value of money.

The measurement process primarily includes projection of future claim costs through a combination of actuarial and statistical projection techniques.

Gross loss and loss adjustment expense reserves for aviation and oil and gas businesses are estimated by using incurred claim loss development and the incurred claim Bornheutter-Ferguson methodology. Gross loss and loss adjustment expense reserves for other lines of business are estimated by using incremental/cumulative claim loss developments, payment per claim incurred and cumulative loss Bornheutter-Ferguson methodologies for each major class of business. Larger claims are usually separately assessed.

Reinsurance recoveries on unpaid claims are separately estimated for statutory, non-statutory treaty and facultative reinsurance arrangements. Statutory reinsurance recoveries are estimated as a certain percentage of gross claim liabilities; non-statutory reinsurance recoveries are estimated by using the claim incurred Bornheutter-Ferguson methodology; facultative reinsurance recoveries are estimated by using large-claim recovery information provided by the claims department.

Assumptions and sensitivities

The principal assumption underlying the estimates is the Company's past claims development experience. Judgement is used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

As different statistical projection techniques may produce different estimates, the directors choose results that are considered appropriate for the observed claim development patterns. The range of reasonable estimates of loss and loss adjustment expense reserves, projected by different statistical techniques and varying key assumptions, represent different views of the impact of fluctuations in the speed of settlements, changes in premium rates and underwriting controls over ultimate losses.

The sensitivity of certain variables like legislative change, uncertainty in the estimation process, etc., is not possible to quantify with any degree of confidence. Furthermore, because of delays that arise between occurrence of a claim and its subsequent notification and eventual settlement, loss and loss adjustment reserves are not quantified with certainty at the balance sheet date.

39. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS – TERMS, ASSUMPTIONS AND SENSITIVITIES *(CONTINUED)*

(a) Insurance contracts *(continued)*

Assumptions and sensitivities *(continued)*

Reproduced below is an exhibit that shows the development of claims over a period of time on gross and net bases:

Accident year	2001 *RMB million*	2002 *RMB million*	2003 *RMB million*	2004 *RMB million*	2005 *RMB million*	Total *RMB million*
Gross basis						
Estimate of ultimate claims costs						
At the end of accident year			35,469	41,015	39,768	
One year later		33,297	37,724	40,758		
Two years later	28,078	34,081	38,706			
Three years later	28,198	34,192				
Four years later	28,229					
Current estimate of cumulative claims	28,229	34,192	38,706	40,758	39,768	181,653
Cumulative payments to date	(28,078)	(33,395)	(37,708)	(37,095)	(24,045)	(160,321)
Liability recognised in the balance sheet	151	797	998	3,663	15,723	21,332
Liability in respect of prior years and unallocated loss adjustment expenses						694
Total gross liability included in the balance sheet						22,026

39. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS – TERMS, ASSUMPTIONS AND SENSITIVITIES *(CONTINUED)*

(a) Insurance contracts *(continued)*

Assumptions and sensitivities *(continued)*

Accident year	2001 *RMB million*	2002 *RMB million*	2003 *RMB million*	2004 *RMB million*	2005 *RMB million*	Total *RMB million*
Net basis						
Estimate of ultimate claims costs						
At the end of accident year			27,215	33,316	32,788	
One year later		25,631	29,421	33,119		
Two years later	21,779	26,357	30,225			
Three years later	21,863	26,274				
Four years later	21,877					
Current estimate of cumulative claims	21,877	26,274	30,225	33,119	32,788	144,283
Cumulative payments to date	(21,846)	(25,897)	(29,605)	(30,621)	(20,124)	(128,093)
Liability recognised in the balance sheet	31	377	620	2,498	12,664	16,190
Liability in respect of prior years and unallocated loss adjustment expenses						651
Total net liability included in the balance sheet						16,841

39. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS – TERMS, ASSUMPTIONS AND SENSITIVITIES *(CONTINUED)*

(a) Insurance contracts *(continued)*

Assumptions and sensitivities *(continued)*

The liabilities as at 31 December 2001 and 2002, which are based on an actuarial valuation performed on 27 October 2003, are extracted from the Company's prospectus dated 27 October 2003 issued in respect of the listing of its shares on the HKSE.

Ultimate liabilities will vary as a result of subsequent developments. Differences resulting from re-assessment of the ultimate liabilities are recognised in subsequent years' financial statements.

(b) Reinsurance – Terms, assumptions and methods

The Company limits its exposure to loss within insurance operations through participation in reinsurance arrangements. The majority of the business ceded is placed on a quota share basis or surplus line basis with retention limits varying by product line. The Company is required to cede 5% (2004: 10%) of most its business to a state-owned reinsurance company in according with the PRC Insurance Law. Excess of loss catastrophic reinsurance is also arranged to limit the Company's exposure to certain catastrophic events.

Even though the Company may have reinsurance arrangements, it is not relieved of its direct obligations to its policyholders. The Company's premiums ceded to the top three reinsurance companies amounted to RMB9,610 million (2004: RMB7,613 million) and thus a credit exposure exists with respect to reinsurance ceded, to the extent that any of these reinsurers is unable to meet its obligations assumed under such reinsurance agreements.

40. ISSUED SHARE CAPITAL

	2005 *RMB million*	2004 *RMB million*
Shares		
Registered, issued and fully paid:		
7,685,820,000 domestic shares of RMB1.00 each	7,686	7,686
3,455,980,000 H shares of RMB1.00 each	3,456	3,456
	11,142	11,142

41. SHARE APPRECIATION RIGHTS

The shareholders of the Company approved the adoption of a scheme of share appreciation rights ("SAR") for senior management on 30 July 2003. The scheme is designed to link the interest of the Company's senior management with the Company's results of operations and the Company's share value (market price of its H Shares). The Board of Directors of the Company is responsible for making decisions under the scheme and administering the scheme. No shares will be issued under the scheme. Therefore, the shareholdings of shareholders will not be diluted as a result of the issuance of share appreciation rights.

Under the SAR scheme, the Board of Directors (excluding independent non-executive directors) and the Supervisory Committee (excluding independent supervisors), president, vice presidents, chief financial officer, division managers of the Company, presidents of provincial/municipal level branch offices, employees with special contribution to the Company as determined by the Company's Nomination, Remuneration and Review Committee, and other senior management at equivalent levels are eligible to receive share appreciation rights.

SAR will be granted in units with each unit representing one H Share. SAR granted in aggregate may not exceed 10% of the issued share capital at any time, and share appreciation rights granted to any individual may not exceed 1% of the issued share capital in any 12-month period. The number of SAR units granted to a person may also be adjusted in accordance with the result of his or her performance evaluation.

Under the SAR scheme, all SAR are valid for five years, but are not exercisable in the first year after the date of grant. As at each of the second, third, fourth and fifth anniversary of the date of grant, the total number of units of SAR exercised may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total number of units of SAR granted to such person. Thereafter, SAR which have not been exercised will lapse. If a grantee deceases or becomes severely disabled during the five-year period, his or her share appreciation rights will be fully vested immediately.

The exercise price of the SAR initially granted was equal to the offer price of the initial public offering of the Company. The exercise price of the SAR subsequently granted is equal to the higher of (i) the closing price of the H Shares on the date of grant and (ii) the average closing price of the H Shares on the five consecutive trading days before the date of grant. Upon exercise of the SAR, the person will receive cash payment, subject to any applicable withholding tax, equal to the product of the number of units of SAR exercised and the difference between the exercise price and market price of H Shares at the time of exercise.

41. SHARE APPRECIATION RIGHTS *(CONTINUED)*

The following table illustrates the number and weighted average exercise price of, and movements in, SAR during the year.

	2005		2004	
	Number of units *'000*	Weighted average exercise price *(HK$)*	Number of units *'000*	Weighted average exercise price *(HK$)*
As at 1 January	28,356	1.80	–	–
Granted during the year	109,698	1.93	29,278	1.80
Forfeited	(614)	1.80	(622)	1.80
Exercised	(925)	1.80	(300)	1.80
As at 31 December	136,515	1.90	28,356	1.80
Exercisable at 31 December	7,244		–	
Liabilities arising from SAR at 31 December (RMB million)	10		–	
Intrinsic value of vested SAR as at 31 December (RMB million)	3		–	
Weighted average remaining contractual life for outstanding SAR	4.30		4.50	
Range of exercise price for outstanding SAR		1.80-1.93		1.80
Weighted average share price at the date of exercise		2.58		2.75

41. SHARE APPRECIATION RIGHTS *(CONTINUED)*

The fair value of SAR granted during the year was RMB76 million.

The fair value of SAR is measured by using the Black-Scholes option pricing model taking into account the term and conditions at the balance sheet date. The following table lists the inputs to the model used for the computation as at 31 December 2005:

Dividend yield (%)	1.850
Expected volatility (%)	32.70
Historical volatility (%)	32.70
Risk-free interest rate (%)	3.240
Expected life of share appreciation rights (years)	3 – 4
Share price at the balance sheet date (HK$)	2.225

The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

No other features of the SAR granted were incorporated into the measurement of the fair value.

42. NOTE TO THE CASH FLOW STATEMENT

Major non-cash transaction

During the year, the Company offset a receivable of RMB1,210 million due from provincial and municipal governments against the accrued insurance protection fund.

43. RISK MANAGEMENT OBJECTIVES AND POLICIES

Similar to other insurance entities, the Company holds substantial financial assets including debt securities, equity securities and bank deposits as an integral part of its operations. The Company obtained a subordinated loan from China Development Bank which enhanced the solvency position of the Company. The Company has various other financial assets and liabilities such as premiums receivable and agents' balances, net, and reinsurance funds withheld, which arise directly from its operations. The main risks from the Company's financial instruments are credit risk, liquidity risk and market risk. The details of these risks, together with insurance risk, and the Company's management policies are set out below:

(a) Financial Risks

(1) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The Company is exposed to deposits placed with security firms, banks and similar institutions. As at 31 December 2005, the aggregate balance of cash and term deposits placed with the three most major banks amounted to RMB16,811 million (2004: RMB19,700 million).

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(a) Financial Risks *(continued)*

(1) Credit risk *(continued)*

The Company is also subject to credit risk of debt securities. The Company heavily invests in debt securities issued by the PRC government, banks and financial institutions. Details of these debt investments are set out in note 19 to the financial statements. The Company only invests in corporate debt securities with a PRC rating higher than AA.

The Company only issues insurance policies on credit to corporate customers or to individuals who purchase policies through insurance intermediaries. A policyholder usually has a maximum credit period of three months but a longer period can be granted on a discretionary basis. For large corporate customers and certain multi-year policies, payments by instalments are usually arranged. One of our major performance indicators is the ability to collect premiums receivable on a timely basis. The Company's premiums receivable relate to a large number of diversified customers and therefore there is no significant concentration of credit risk.

Except for a state-owned reinsurance company, reinsurance is mainly placed with reinsurers with A.M. Best rating of A– or above. Premiums ceded to the state-owned reinsurance company are withheld as reinsurance funds by the Company to mitigate the credit risk of the Company. Management performs regularly assessment of creditworthiness of reinsurers to update reinsurance purchase strategies and ascertaining suitable allowances for impairment of reinsurance assets. As at 31 December 2005, the top three insurance companies owed an aggregate amount of RMB2,111 million (2004: RMB501 million) to the Company.

(2) Liquidity or funding risk

Liquidity or funding risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or a counterparty failing on repayment of a contractual obligation; or an insurance liability falling due for payment earlier than expected; or the inability to generate cash inflows as anticipated.

The major liquidity risk confronting the Company is the daily calls on its available cash resources in respect of claims arising from insurance contracts.

It is unusual for a Company primarily transacting insurance business to predict the requirements of funding with absolute certainty as theory of probability is applied on insurance contracts to ascertain the likely provision and the time period when such liabilities will require settlement. The amounts and maturities in respect of insurance liabilities are thus based on management's best estimate based on statistical techniques and past experience.

The Company holds 17% (2004: 18%) of the total assets as demand deposits and term deposits with original maturity less than three months to ensure sufficient liquid assets are available. 55% (2004: 31%) of debt securities are listed on stock exchanges. Additions of illiquid assets, in particular properties, were closely monitored by management.

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(a) Financial Risks *(continued)*

(3) Market risk

Market risk is the risk of changes in fair value of financial instruments from fluctuations in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether any such change in price is caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

The Company mitigates its market risk through proper diversification of its investment portfolio. An investment mandate was also approved by an investment committee to direct investment decisions.

(i) Currency risk

The Company's principal transactions are carried out in Renminbi.

Certain policies issued by the Company, however, in particular cargo, commercial properties and aviation insurance, were denominated in US dollars. Therefore, premiums received, reinsurance premiums ceded, claims paid and paid losses recovered from reinsurers in respect of these policies are transacted in US dollars.

Moreover, the Company holds deposits of RMB12,089 million (2004: RMB9,660 million) of which their carrying values were mainly exposed to fluctuations of foreign exchange rates.

(ii) Interest rate risk

Interest rate risk is the risk that the value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company mainly invests in short to medium term, of which the maturities vary from one to seven years, financial assets in view of the short durations of insurance liabilities. The Company intends to maintain a duration of the investment portfolio below the market level of financial assets with similar characteristics. A high proportion of interest-sensitive financial assets are also held by the Company to reduce its interest rate risk.

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(a) Financial Risks *(continued)*

(3) Market risk *(continued)*

(ii) Interest rate risk (continued)

The following tables sets out the interest rates that the Company's financial instruments are exposed to during the reporting periods:

Items	2005	2004
Assets:		
Cash and cash equivalents	0.72% – 4.38%	0.72% – 2.52%
Term deposits	1.89% – 11.50%	1.09% – 12.08%
Debt securities	0.34% – 11.83%	1.00% – 11.83%
Subordinated debts	4.87% – 5.17%	4.87% – 5.17%
Capital security fund	2.25%	2.33% – 2.87%
Liabilities:		
Payables to reinsurers		
– reinsurance funds withheld	2.25%	1.98% – 2.25%
Policyholders' deposits		
– interest-bearing	2.20% – 2.63%	2.20% – 2.63%
Subordinated loan	5.51%	5.18%

The following tables sets out the carrying amount, by maturity, of the Company's financial instruments that are exposed to interest rate risk:

31 December 2005

Fixed rate	Within 1 year *RMB million*	1-2 years *RMB million*	2-3 years *RMB million*	3-4 years *RMB million*	4-5 years *RMB million*	More than 5 years *RMB million*	Total *RMB million*
Assets:							
Cash and cash equivalents	2,754	–	–	–	–	–	2,754
Term deposits	7,076	300	20	–	300	–	7,696
Debt securities	1,248	2,087	3,081	3,891	1,162	4,011	15,480
Capital security fund	2,228	–	–	–	–	–	2,228
Liabilities:							
Payables to reinsurers							
– reinsurance funds withheld	(362)	–	–	–	–	–	(362)
Policyholders' deposits							
– interest bearing	(2,275)	(3,883)	–	–	–	–	(6,158)

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(a) Financial Risks *(continued)*

(3) Market risk *(continued)*

(ii) Interest rate risk (continued)

Floating rate	Within 1 year *RMB million*	1-2 years *RMB million*	2-3 years *RMB million*	3-4 years *RMB million*	4-5 years *RMB million*	More than 5 years *RMB million*	Total *RMB million*
Assets:							
Cash and cash equivalents	13,141	–	–	–	–	–	13,141
Term deposits	923	241	40	320	173	2,248	3,945
Debt securities	–	1,204	–	24	1,127	689	3,044
Subordinated debts	–	–	–	1,220	1,690	–	2,910
Liabilities:							
Subordinated loan	–	–	–	–	–	(2,000)	(2,000)

31 December 2004

Fixed rate	Within 1 year *RMB million*	1-2 years *RMB million*	2-3 years *RMB million*	3-4 years *RMB million*	4-5 years *RMB million*	More than 5 years *RMB million*	Total *RMB million*
Assets:							
Cash and cash equivalents	1,258	–	–	–	–	–	1,258
Term deposits	4,908	2,851	300	–	–	–	8,059
Debt securities	1,659	654	646	2,454	1,428	6,316	13,157
Capital security fund	2,228	–	–	–	–	–	2,228
Liabilities:							
Payables to reinsurers							
– reinsurance funds withheld	(670)	–	–	–	–	–	(670)
Policyholders' deposits							
– interest-bearing	–	(2,331)	(3,925)	–	–	–	(6,256)

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(a) Financial Risks *(continued)*

(3) Market risk *(continued)*

(ii) Interest rate risk (continued)

Floating rate	Within 1 year *RMB million*	1-2 years *RMB million*	2-3 years *RMB million*	3-4 years *RMB million*	4-5 years *RMB million*	More than 5 years *RMB million*	Total *RMB million*
Assets:							
Cash and cash equivalents	15,017	–	–	–	–	–	15,017
Term deposits	1,186	87	247	41	328	1,775	3,664
Debt securities	–	–	771	–	51	670	1,492
Subordinated debts	–	–	–	–	1,220	1,690	2,910
Liabilities:							
Subordinated loan	–	–	–	–	–	(2,000)	(2,000)

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

The other financial instruments of the Company that are not included in the above tables are non-interest bearing and are not subject to interest rate risk.

(b) Insurance Risk

The risk under an insurance contract is the possibility of occurrence of an insured event and uncertainty of the amount and timing of any resulting claim. The principal risk the Company faces under such contracts is that the actual claims payments and the costs of claims settlement exceed the carrying amount of insurance liabilities. This could occur due to any of the following:

Occurrence risk – the possibility that the number of insured events will differ from those expected.

Severity risk – the possibility that the costs of the events will differ from those expected.

Development risk – the possibility that changes may occur in the amount of an insurer's obligation at the end of the contract period.

43. RISK MANAGEMENT OBJECTIVES AND POLICIES *(CONTINUED)*

(b) Insurance Risk *(continued)*

The Company has an objective to control and minimise insurance risk, to reduce volatility of operating profits. The Company manages insurance risk through the following mechanism:

- Launch of any new product has to be approved by appropriate authorities;
- Underwriting and claim handling authorities at different levels are properly established;
- Treaty reinsurance and most facultative reinsurance arrangements are centrally managed at the head office level; and
- Catastrophic reinsurance is used to limit the Company's exposure to flooding, earthquakes and typhoons.

Claims of certain provinces in the PRC are often affected by natural disasters including flooding, earthquakes and typhoons. Therefore, an undue concentration of risk units in these areas may have an impact on the severity of claim payments on a portfolio basis. The Company has achieved geographical diversification by accepting risks in different provinces of the PRC.

The Company's concentration of insurance risk before and after reinsurance, measured by geographical turnover and net premiums written is as follows:

	Gross	**Net**
	RMB million	*RMB million*
31 December 2005		
Coastal and developed provinces/cities	28,439	21,975
Western China	5,387	4,307
North China	9,298	7,730
Central China	7,363	6,089
Northeastern China	11,845	9,757
Total	62,332	49,858

Gross and net premiums written by type of business are disclosed in note 4 to the financial statements.

44. CONTINGENT LIABILITIES

(a) Pursuant to the reorganisation of the People's Insurance Company of China as at 30 September 2002, except for liabilities constituting or arising out of or relating to business undertaken by the Company after the reorganisation, no other liabilities were assumed by the Company and the Company is not liable, whether severally or jointly and severally, for debts and obligations incurred prior to the reorganisation. The Holding Company has also undertaken to indemnify the Company in respect of any loss or damage incurred in connection with or arising from the transfer of the assets and liabilities to the Company in the reorganisation, any loss or damage suffered or incurred by the Company in relation to the novation of insurance contracts and reinsurance contracts from the Holding Company to the Company, and as a result of any breach by the Holding Company of any provision of the reorganisation.

(b) Owing to the nature of 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 and any losses arising therefrom will probably be indemnified by reinsurers or other recoveries including salvages and subrogation. While the outcome of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Company.

45. OPERATING LEASE COMMITMENTS

The Company leases certain of its land and buildings and motor vehicles under operating lease arrangements. Leases for properties are negotiated for terms ranging from one to twenty years, and those for motor vehicles are negotiated for terms ranging from one to three years.

At 31 December 2005, the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	2005 ***RMB million***	2004 *RMB million*
Within one year	**310**	310
In the second to fifth years, inclusive	**292**	466
After five years	**46**	40
	648	816

46. CAPITAL COMMITMENTS

In addition to the operating lease commitments detailed in note 45 above, the Company had the following commitments at the balance sheet date:

	2005 RMB million	2004 RMB million
Contracted, but not provided for:		
– property, plant and equipment	835	1,473
Authorised, but not contracted for:		
– property, plant and equipment	44	85
– acquisition of an investment	160	–
	1,039	1,558

47. RELATED PARTY TRANSACTIONS

(a) Transactions with related parties

	Notes	2005 RMB million	2004 RMB million
Transactions with the Holding Company:			
Property rental expenses	(i)	211	211
Property rental income	(i)	11	11
Motor vehicle rental expenses	(ii)	22	22
Motor vehicle rental income	(ii)	4	4
Services fee income	(iii)	4	4
Management fee	(iv)	3	3
Transactions with a fellow subsidiary:			
Management fee	(v)	36	34
Transactions with a major shareholder:			
Reinsurance premiums ceded	(vi)	619	266
Claims recoverable	(vi)	139	21
Reinsurance commission received/receivables	(vi)	174	53

47. RELATED PARTY TRANSACTIONS *(CONTINUED)*

(a) Transactions with related parties *(continued)*

Notes:

(i) The Company entered into a Property Leasing Agreement with the Holding Company on 9 October 2003 under which the Company rented certain properties from the Holding Company and the Holding Company rented certain properties from the Company. The rental charges in respect of these properties are based on market rates. The term of the Property Leasing Agreement is four years effective from 7 July 2003.

(ii) The Company entered into a Motor Vehicle Rental Agreement with the Holding Company on 9 October 2003 under which the Company rented certain motor vehicles from the Holding Company and the Holding Company rented certain motor vehicles from the Company. The rental charges for the motor vehicles are based on market rates. The term of the Motor Vehicle Rental Agreement is four years effective from 7 July 2003.

(iii) The Company entered into an Information System Services Agreement with the Holding Company on 9 October 2003 pursuant to which the Company agreed to provide the Holding Company with certain information services, including (i) facilities leasing services and network services; (ii) software and application services; (iii) other computer-related facilities maintenance services; and (iv) other information system services agreed by both parties. The services fee payable to the Company by the Holding Company are to be no less than market rates, and are determined with reference to the costs associated with the labour and the equipment required to provide the services and support pursuant to the Information System Services Agreement between the Company and the Holding Company. The term of the Information System Services Agreement is four years.

(iv) The Company entered into an agreement with the Holding Company on 9 August 2004, under which the Company took the responsibility of managing the payments of retirement benefits to the retired employees of the Holding Company's provincial and municipal offices. Management fee is calculated based on RMB300 per annum for every retired employee of the Holding Company. The term of the agreement is three years effective from 1 January 2004.

(v) On 10 October 2003, the Company and PICC AMC entered into an asset management agreement which became effective on the same date. Pursuant to the asset management agreement, PICC AMC provides investment management services in respect of certain financial assets of the Company. The Company pays an annual management fee to PICC AMC, which is calculated based on the average daily net asset value of the assets under management of PICC AMC in a particular year and the applicable annual rate. The term of the asset management agreement is four years.

(vi) The Company entered into a Technical Assistance and Co-operation Agreement with AIG on 29 September 2003, pursuant to which the Company and one of AIG's wholly-owned subsidiaries will co-operate in the development of accident and health insurance products and the Company will cede quota share reinsurance at fixed cession percentages. This obligation was reflected in a separate reinsurance agreement, which was entered in the Company's ordinary and usual course of business. The intention of the parties is for the co-operation to continue indefinitely. Either party may request to review the key terms of the Co-operation Agreement every 15 years. Moreover, the Company entered into a quota share reinsurance arrangement with AIG in respect of its aviation and accidental injury business on a normal and commercial basis.

The transactions mentioned in (i) to (v) above constitute connected transactions under the HKSE Listing Rules. For items (i) to (iii) and (v) above, a waiver has been granted by the HKSE to the Company from strict compliance with requirements of connected transaction rules of the HKSE Listing Rules in respect of the connected transactions set out above.

47. RELATED PARTY TRANSACTIONS *(CONTINUED)*

(b) Transactions with other state-owned enterprises in the PRC

The Company operates in an economic environment predominated by enterprises directly or indirectly owned or controlled by the PRC government through its numerous authorities, affiliates or other organisations (collectively "State-owned Enterprises"). During the year, the Company had transactions with State-owned Enterprises including but not limited to sales of insurance policies. The directors consider that transactions with other State-owned Enterprises are activities in the ordinary course of the Company's business, and that the dealings of the Company have not been significantly or unduly affected by the fact that the Company and the other State-owned Enterprises are ultimately controlled or owned by the PRC government. The Company has also established pricing policies for insurance products, and such pricing policies do not depend on whether or not the customers are State-owned Enterprises. Having due regard to the substance of the relationships, the directors are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

(c) Outstanding balances with related parties

	Due from related parties		Due to related parties	
	2005	2004	**2005**	2004
	RMB Million	*RMB Million*	***RMB Million***	*RMB Million*
The Holding Company	**155**	329	**116**	190
A fellow subsidiary	**–**	–	**9**	8
A major shareholder	**12**	57	**46**	113
	167	386	**171**	311

The balances with the Holding Company, a fellow subsidiary and a major shareholder are unsecured, interest-free and settled on a quarterly basis.

(d) Compensation of key management personnel (including Chairman of Board and executive directors)

	2005	2004
	RMB'000	*RMB'000*
Short term employee benefits	**5,423**	5,662
Post-employment benefits	**565**	441
Cash-settled share appreciation rights expense	**863**	–
Total compensation paid to key management personnel	**6,851**	6,103

Further details of directors' emoluments are included in note 12 to the financial statements.

48. COMPARATIVE FIGURES

As further explained in notes 2.2 and 2.4 to these financial statements, due to the adoption of new and revised HKFRSs and the new presentation of the income statement during the current year, the accounting treatment and presentation of certain items and balances in these financial statements have been revised to comply with the new requirements. Accordingly, certain prior year and opening adjustments have been made and certain comparative amounts have been reclassified or restated to conform to the current year's presentation and accounting treatment.

49. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved and authorised for issue by the Board of Directors on 21 April 2006.