

## OVERVIEW

The Company is a leading non-life insurance company in the PRC providing a broad range of property and casualty insurance products together with accidental injury insurance and short-term health insurance products for customers. In the first half of 2006, the Company held 47.3% share of the non-life insurance market in the PRC.

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

	Six months ended 30 June	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Net premiums earned	24,792	24,939
Underwriting profit <sup>1</sup>	535	1,565
Net profit	1,109	889
Total assets <sup>2</sup>	109,129	96,268

<sup>1</sup> Underwriting profit represents net premiums earned less net claims incurred, and after amortisation of deferred acquisition costs, insurance protection expense and general and administrative expenses. Underwriting profit for the first half of 2005 is restated according to the presentation of reporting for 2006.

<sup>2</sup> The figure of total assets as at 30 June 2005 is extracted from the data in the 2005 interim report.

## RESULTS OF OPERATIONS

In the first half of 2006, the Company's turnover increased mildly, underwriting profit decreased and investment income improved remarkably. The following table sets forth selected financial ratios shown as percentages of net premiums earned for the periods indicated.

	Six months ended 30 June	
	2006	2005
	(%)	
Net premiums earned	100	100
Net claims incurred	(74.3)	(72.4)
Amortisation of deferred acquisition costs, net	(10.2)	(8.7)
Insurance protection expense	(1.3)	(1.2)
General and administrative expenses	(12.0)	(11.4)
Underwriting profit	2.2	6.3
Net investment income	3.2	2.8
Net realised and unrealised gains/(losses) on investments	3.6	(2.9)
Finance costs	(0.3)	(0.3)
Interest expense credited to policyholders' deposits	(0.3)	(0.3)
Profit before tax	7.5	5.5
Tax	(3.0)	(1.9)
Net profit	4.5	3.6
Loss ratio	74.3	72.4
Expense ratio	23.5	21.3
Combined ratio	97.8	93.7

## MANAGEMENT DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITIONS

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

	Six months ended 30 June	
	2006	2005
	(%)	
<b>Net premiums earned</b>		
Motor vehicle insurance	74.6	73.7
Commercial property insurance	10.6	10.9
Homeowners insurance	1.0	1.6
Other insurance	13.8	13.8
<b>Total</b>	<b>100.0</b>	100.0
<b>Net claims incurred</b>		
Motor vehicle insurance	81.6	79.9
Commercial property insurance	9.2	8.9
Homeowners insurance	0.6	0.4
Other insurance	8.6	10.8
<b>Total</b>	<b>100.0</b>	100.0
<b>Amortisation of deferred acquisition costs, net</b>		
Motor vehicle insurance	78.4	92.2
Commercial property insurance	8.5	7.8
Homeowners insurance	3.4	6.4
Other insurance	9.7	(6.4)
<b>Total</b>	<b>100.0</b>	100.0

### TURNOVER

Turnover of the Company was RMB36,983 million in the first half of 2006, representing an increase of RMB2,101 million or 6.0% over RMB34,882 million in the first half of 2005. The increase was primarily due to an increase of RMB1,867 million in turnover of the motor vehicle insurance segment which showed substantial growth in the first half of 2006 and also increases in turnover of the Company's liability insurance and accidental injury insurance segments in the non-motor vehicle insurance business. However, the effect of such increase was partially offset by a RMB166 million decrease in turnover of the commercial property insurance segment, a RMB93 million decrease in turnover of the homeowners insurance segment and a RMB90 million decrease in turnover of the cargo insurance segment.

### NET PREMIUMS EARNED

Net premiums earned of the Company was RMB24,792 million in the first half of 2006, representing a decrease of RMB147 million, or 0.6%, compared to RMB24,939 million in the first half of 2005. This decrease was primarily due to an increase of RMB2,995 million in the changes in net unearned premium reserves in the first half of 2006 compared to the first half of 2005, but the effect of the increase in net unearned premium reserves was partially offset by the increase in the gross premiums income.

### NET INVESTMENT INCOME

Net investment income of the Company was RMB781 million in the first half of 2006, representing an increase of RMB90 million over RMB691 million in the first half of 2005. This increase was primarily due to increases in interest income of RMB36 million from cash and cash equivalents and term deposits and interest income of RMB44 million from debt securities. The increase in such interest income was primarily driven by the increase in the balance of cash and cash equivalents and investments in debt securities.

### NET REALISED AND UNREALISED GAINS/(LOSSES) ON INVESTMENTS

In the first half of 2006, the Company's net realised and unrealised gains on investments was RMB885 million, representing an increase of RMB1,612 million compared to net losses of RMB727 million in the first half of 2005. This increase was primarily due to the recovery of the equity markets, which led to a RMB1,962 million increase in unrealised gains on investments in equity securities to RMB1,373 million compared to the corresponding period of 2005. Such increase was partially offset by an increase of RMB422 million in realised losses on investments in equity securities compared to the same period of last year.

### NET CLAIMS INCURRED

The Company's net claims incurred was RMB18,426 million in the first half of 2006, representing an increase of RMB376 million or 2.1% from RMB18,050 million in the first half of 2005. Loss ratio of the Company increased to 74.3% in the first half of 2006 from 72.4% in the same period of 2005. The increase in net claims incurred was primarily due to an increase of RMB613 million in net claims incurred of the motor vehicle insurance segment from RMB14,423 million in the corresponding period of 2005 to RMB15,036 million in the first half of 2006, and increases in net claims incurred of the accidental injury insurance and homeowners insurance in the non-motor vehicle insurance business of RMB160 million and RMB29 million, respectively, compared to the same period of 2005. However, the effect of such increases was partially offset by a decrease of RMB373 million in net claims incurred in cargo insurance segment in the first half of 2006 compared to the same period of last year. Net loss and loss adjustment expense reserves as of 30 June 2006 increased by RMB1,196 million compared to 31 December 2005.

### AMORTISATION OF DEFERRED ACQUISITION COSTS, NET

Net amortisation of deferred acquisition costs of the Company was RMB2,523 million in the first half of 2006, representing an increase of 15.8% over RMB2,178 million in the first half of 2005. This increase was primarily due to a substantial increase in commission expenses paid to insurance intermediaries and agents in the first half of 2006 compared to the corresponding period of last year and a decrease in reinsurance commission receivable.

### INSURANCE PROTECTION EXPENSE

According to the relevant PRC insurance laws and regulations, the Company is required to accrue an insurance protection fund based on 1% of its retained premiums. Insurance protection expense of the Company was RMB338 million in the first half of 2006, representing an increase of 11.9% from RMB302 million in the corresponding period of last year. This increase was due to an increase in retained premiums.

### INTEREST EXPENSE CREDITED TO POLICYHOLDERS' DEPOSITS

Interest expense of the Company credited to policyholders' deposits was RMB63 million in the first half of 2006, representing a slight decrease from RMB67 million in the first half of 2005. This was primarily due to a decrease in policyholders' deposits from the Company's Golden Bull homeowners insurance products.

### FINANCE COSTS

Finance costs of the Company were RMB75 million in the first half of 2006, representing an increase of RMB7 million over RMB68 million in the first half of 2005. This increase was primarily due to an increase of RMB8 million in interest expenses on securities sold under sale and repurchase agreements compared to the corresponding period of last year.

### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses of the Company were RMB2,970 million in the first half of 2006, representing an increase of 4.4% from RMB2,844 million in the first half of 2005. This increase was primarily due to a RMB113 million increase in bad debt losses compared to the same period of last year resulting from a RMB414 million bad debt provision on premiums receivable in the first half of 2006.

### PROFIT BEFORE TAX

As a result of the foregoing, profit before tax of the Company was RMB1,853 million in the first half of 2006, representing an increase of RMB479 million from RMB1,374 million in the first half of 2005.

### TAX

Income tax expense of the Company was RMB744 million in the first half of 2006, representing an increase of RMB259 million over RMB485 million in the first half of 2005. The Company's effective tax rate increased to 40.15% in the first half of 2006 from 35.3% in the first half of 2005.

### NET PROFIT

As a result of the foregoing, the Company's net profit was RMB1,109 million in the first half of 2006, representing an increase of RMB220 million from RMB889 million in the first half of 2005. Basic earnings per share in the first half of 2006 was RMB0.100.

## COMBINED RATIO

The Company's combined ratio increased from 93.7% in the first half of 2005 to 97.8% in the first half of 2006, primarily due to an increase in the Company's loss ratio from 72.4% in the first half of 2005 to 74.3% in the first half of 2006 and an increase in the expense ratio from 21.3% in the first half of 2005 to 23.5% in the first half of 2006.<sup>3</sup>

<sup>3</sup> The figures for the first half of 2005 are restated according to the presentation of reporting for 2006.

## RESULTS OF SEGMENT OPERATIONS

### Motor Vehicle Insurance

	Six months ended 30 June	
	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Turnover	24,739	22,872
Net premiums earned	18,494	18,384
Net claims incurred	(15,036)	(14,423)
Amortisation of deferred acquisition costs, net	(1,979)	(2,007)
Insurance protection expense	(243)	(211)
Segment profit before unallocated income and expenses	1,236	1,743
Loss ratio	81.3%	78.5%
Segment expense ratio	12.0%	12.1%
Segment combined ratio	93.3%	90.6%

Turnover of the motor vehicle insurance segment in the first half of 2006 was RMB24,739 million, representing an increase of RMB1,867 million or 8.2% from RMB22,872 million in the first half of 2005. This increase was primarily due to a 10.2% increase in the number of motor vehicles insured by the Company in the first half of 2006 compared to the same period of last year.

Net premiums earned from the motor vehicle insurance segment was RMB18,494 million in the first half of 2006, close to RMB18,384 million in the first half of 2005. This was primarily due to an increase of RMB1,955 million in gross premiums income of the motor vehicle insurance segment in the first half of 2006 compared to the first half of 2005 and a decrease of RMB1,075 million in reinsurance premiums ceded of the motor vehicle insurance segment over the same period of last year, but such effects were offset by an increase of RMB2,832 million in the changes in net unearned premium reserves of the motor vehicle insurance segment.

Net claims incurred of the motor vehicle insurance segment increased by RMB613 million or 4.3% from RMB14,423 million in the first half of 2005 to RMB15,036 million in the first half of 2006, and loss ratio increased to 81.3% in the first half of 2006 from 78.5% in the first half of 2005. The increase in net claims incurred was primarily due to an increase of RMB968 million in claim paid of the motor vehicle insurance segment in the first half of 2006 compared to the same period of last year, but the effect of the increase in claim paid was partially offset by a decrease of RMB181 million in the change in net loss and loss adjustment expense reserve and an increase of RMB174 million in paid losses recoverable from reinsurers compared to the same period of last year.

Net amortisation of deferred acquisition costs of the motor vehicle insurance segment was RMB1,979 million in the first half of 2006, close to RMB2,007 million in the first half of 2005.

Insurance protection expense charged to the motor vehicle insurance segment increased by 15.2% from RMB211 million in the first half of 2005 to RMB243 million in the first half of 2006 due to an increase in retained premiums.

The expense ratio for the motor vehicle insurance segment decreased from 12.1% in the first half of 2005 to 12.0% in the first half of 2006, primarily due to a slight decrease in net amortisation of deferred acquisition costs.

Overall, profit before unallocated income and expenses of the motor vehicle insurance segment was RMB1,236 million in the first half of 2006, representing a decrease of 29.1% compared to RMB1,743 million in the first half of 2005.

### Commercial Property Insurance

	Six months ended 30 June	
	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Turnover	5,164	5,330
Net premiums earned	2,642	2,712
Net claims incurred	(1,702)	(1,604)
Amortisation of deferred acquisition costs, net	(214)	(170)
Insurance protection expense	(38)	(41)
Segment profit before unallocated income and expenses	688	897
Loss ratio	64.4%	59.1%
Segment expense ratio	9.5%	7.8%
Segment combined ratio	73.9%	66.9%

Turnover of the commercial property insurance segment decreased by RMB166 million or 3.1% from RMB5,330 million in the first half of 2005 to RMB5,164 million in the first half of 2006. Such decrease in turnover was primarily due to a continued decrease in premium rates resulting from the intensified market competition in the first half of 2006.

Net premiums earned from the commercial property insurance segment decreased by RMB70 million or 2.6% from RMB2,712 million in the first half of 2005 to RMB2,642 million in the first half of 2006. This was primarily due to a decrease of RMB171 million in gross premiums income and an increase of RMB73 million in reinsurance premiums ceded compared to the same period of last year. However, such effect was partially offset by a decrease of RMB169 million in the changes in net unearned premium reserves compared to the first half of 2005.

Net claims incurred of the Company's commercial property insurance segment increased by 6.1% from RMB1,604 million in the first half of 2005 to RMB1,702 million in the first half of 2006. The increase in net claims incurred was primarily due to a decrease of RMB481 million in paid losses recoverable from reinsurers compared to the same period of last year. The impact of such decrease in paid losses recoverable from reinsurers was partially offset by a decrease of RMB382 million in claim paid compared to the same period of last year.

Net amortisation of deferred acquisition costs of the Company's commercial property insurance segment increased by 25.9% from RMB170 million in the first half of 2005 to RMB214 million in the first half of 2006, primarily due to an increase in commission expenses which was caused by the intensified market competition for commercial property insurance business in the first half of 2006.

Insurance protection expense charged to the commercial property insurance segment decreased by 7.3% from RMB41 million in the first half of 2005 to RMB38 million in the first half of 2006, due to a decrease in retained premiums.

Due to the above increase in net amortisation of deferred acquisition costs, the expense ratio of the commercial property insurance segment increased from 7.8% in the first half of 2005 to 9.5% in the first half of 2006.

As a result of the foregoing, profit before unallocated income and expenses of the commercial property insurance segment was RMB688 million in the first half of 2006, representing a decrease of 23.3% compared to RMB897 million in the first half of 2005.

### Homeowners Insurance

	Six months ended 30 June	
	2006 RMB million	2005 RMB million
Turnover	492	585
Net premiums earned	237	397
Net claims incurred	(101)	(72)
Amortisation of deferred acquisition costs, net	(85)	(140)
Net investment income	130	126
Net realised and unrealised gains/(losses) on investments	66	(132)
Interest expense credited to policyholders' deposits	(63)	(67)
Insurance protection expense	(5)	(5)
Segment profit before unallocated income and expenses	179	107
Loss ratio	42.6%	18.1%
Segment expense ratio	38.0%	36.5%
Segment combined ratio	80.6%	54.6%

Turnover of the homeowners insurance segment decreased by RMB93 million or 15.9% to RMB492 million in the first half of 2006 compared to RMB585 million in the first half of 2005. The decrease was primarily due to terminations of residential mortgage loan insurance policies caused by an increase in interest rates.

Net premiums earned from the homeowners insurance segment decreased by RMB160 million or 40.3% to RMB237 million in the first half of 2006 compared to RMB397 million in the first half of 2005. This decrease was primarily due to a decrease of RMB91 million in gross premiums income and an increase of RMB134 million in the changes in unearned premium reserves, however, the impact of these two factors on the decrease in net premiums earned was partially offset by a decrease of RMB68 million in reinsurance premiums ceded.

Net claims incurred for the homeowners insurance segment increased by 40.3% to RMB101 million in the first half of 2006 compared to RMB72 million in the first half of 2005. Loss ratio of the homeowners insurance segment increased from 18.1% in the first half of 2005 to 42.6% in the first half of 2006 primarily due to a substantial decrease in net premiums earned.

Net amortisation of deferred acquisition costs of the homeowners insurance segment decreased by RMB55 million to RMB85 million in the first half of 2006 compared to RMB140 million in the first half of 2005. This decrease was primarily due to the decrease in net premiums earned.

Insurance protection expense charged to the homeowners insurance segment was RMB5 million in the first half of 2006, close to the level in the first half of 2005. This was primarily because retained premiums of homeowners insurance segment in the first half of 2006 did not change much from that in the same period of 2005.

The expense ratio for the homeowners insurance segment increased from 36.5% in the first half of 2005 to 38.0% in the first half of 2006.

## MANAGEMENT DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITIONS

The net investment income derived from policyholders' deposits of the homeowners insurance segment increased by RMB4 million from RMB126 million in the first half of 2005 to RMB130 million in the first half of 2006. This increase was primarily due to an increase in interest received in respect of the investment fund portfolio using deposits from the Golden Bull homeowners insurance product.

Interest expense credited to policyholders' deposits of the homeowners insurance segment was RMB63 million in the first half of 2006, representing a slight decrease compared to RMB67 million in the first half of 2005, primarily due to a decrease in the amount of the policyholders' investment fund compared to that in the same period of 2005.

As a result of the foregoing, profit before unallocated income and expenses of the homeowners insurance segment was RMB179 million in the first half of 2006, representing an increase of 67.3% compared to RMB107 million in the first half of 2005.

### Other Insurance

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

	Six months ended 30 June	
	2006 <i>RMB million</i>	2005 <i>RMB million</i>
<b>Turnover</b>		
Cargo insurance	1,488	1,578
Liability insurance	1,645	1,377
Accidental injury insurance	1,193	1,070
Other insurance	2,262	2,070
<b>Total</b>	<b>6,588</b>	6,095
<b>Net premiums earned</b>		
Cargo insurance	986	1,147
Liability insurance	942	848
Accidental injury insurance	805	789
Other insurance	686	662
<b>Total</b>	<b>3,419</b>	3,446
Net claims incurred	(1,587)	(1,951)
Amortisation of deferred acquisition costs, net	(245)	139
Insurance protection expense	(52)	(45)
Segment profit before unallocated income and expenses	1,535	1,589
Loss ratio	46.4%	56.6%
Segment expense ratio	8.7%	-2.7%
Segment combined ratio	55.1%	53.9%

Turnover of the other insurance segment increased by 8.1% from RMB6,095 million in the first half of 2005 to RMB6,588 million in the first half of 2006. This increase was primarily due to the increase of 11.5% and 19.5% in turnover of accidental injury insurance and liability insurance, respectively, in the first half of 2006 as compared to those in the first half of 2005. Turnover of liability insurance increased primarily because turnover of carriers' liability insurance and employers' liability insurance increased substantially.



Net premiums earned from the other insurance segment decreased by 0.8% from RMB3,446 million in the first half of 2005 to RMB3,419 million in the first half of 2006. This decrease was primarily due to a decrease of RMB161 million in net premiums earned from cargo insurance.

Net claims incurred for the other insurance segment decreased by 18.7% from RMB1,951 million in the first half of 2005 to RMB1,587 million in the first half of 2006. Such decrease was primarily due to a decrease of RMB373 million in the net claims incurred for cargo insurance, the impact of the decrease in the net claims incurred for cargo insurance was, however, partially offset by an increase of RMB160 million in net claims incurred for accidental injury insurance.

Mainly due to the decrease of net claims incurred, the loss ratio of the other insurance segment decreased to 46.4% in the first half of 2006 from 56.6% in the first half of 2005.

Net amortisation of deferred acquisition costs of the other insurance segment was RMB245 million in the first half of 2006.

Insurance protection expense charged to the other insurance segment increased by 15.6% to RMB52 million in the first half of 2006 as compared to RMB45 million in the first half of 2005. This increase was due to an increase in retained premiums.

As a result of the foregoing, the other insurance segment recorded an RMB1,535 million profit before unallocated income and expenses in the first half of 2006, representing a decrease of 3.4% compared to RMB1,589 million in the first half of 2005.

#### DEVELOPMENT OF NEW PRODUCTS

In the first half of 2006, the Company developed 81 new insurance products mainly in the areas of the motor vehicle insurance, liability insurance, agriculture insurance and credit and guarantee insurance, of which 57 are national products (including 18 stand-alone coverages and 39 supplementary coverages) and 24 are regional products (including 15 stand-alone coverages and 9 supplementary coverages).

In the first half of 2006, in an effort to respond to the newly adopted requirement of compulsory traffic accident liability insurance in respect of motor vehicles, the Company revised its existing commercial third party liability insurance products and successfully procured a smooth transition of the motor vehicle insurance business. Based on the research of new demand of the market, the Company developed and re-designed a series of specifically targeted and highly adaptable products to meet the needs of diversified insurance coverages.

#### CASH FLOW

	Six months ended 30 June	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Net cash inflow from operating activities	3,174	6,839
Net cash outflow from investing activities	(3,015)	(1,297)
Net cash inflow/(outflow) from financing activities	3,939	(2,413)
Net increase in cash and cash equivalents	4,098	3,129

Net cash generated from operating activities of the Company was RMB3,174 million in the first half of 2006, representing a decrease of 53.6% compared to the first half of 2005. The decrease was primarily due to a rapid growth in cash payment of premiums ceded to reinsurers in the first half of 2006.

Net cash outflow from the Company's investing activities in the first half of 2006 was RMB3,015 million, representing an increase of RMB1,718 million compared to the first half of 2005. Such increase in cash outflow was primarily due to an increase of RMB3,544 million in cash inflow resulted from decreased proceeds from selling investments in securities, an increase of RMB7,654 million in cash outflow resulted from decreased cash expenses for investments in securities, and an increase of RMB2,142 million in cash inflow caused by increased deposits in banks and other financial institutions with original maturities of over three months.

Net cash inflow from the Company's financing activities in the first half of 2006 was RMB3,939 million, representing an increase of RMB6,352 million compared to the first half of 2005. The increase was primarily due to an increase of RMB4,961 million in cash inflow resulted from the change in the securities sold under the sale and repurchase agreements and an increase of RMB1,542 million in cash inflow resulted from the change in the securities purchased under purchase and resale agreements.

Net increase in cash and cash equivalents of the Company in the first half of 2006 was RMB4,098 million.

### LIQUIDITY

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

The Company entered into a subordinated loan agreement with China Development Bank on 10 October 2003, whereby the Company obtained a subordinated loan of RMB2,000 million from China Development Bank. This loan is unsecured and bears interest at a rate which is equal to 90% of the five-year term lending rate fixed by the People's Bank of China. The loan will be due in November 2023. The Company obtained a 10-year revolving credit facility from China Development Bank for up to RMB10 billion on 26 August 2003. Each drawdown made under this facility is repayable within one year. As of the date of this interim report, no amount has been drawn down under that facility. Save for the subordinated loan and the credit facility mentioned above, the Company has not obtained working capital by other means of borrowing.

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

### CAPITAL EXPENDITURE

The capital expenditure of the Company has primarily been for property construction, acquisition of motor vehicles for business needs and development of information systems. Capital expenditure was RMB310 million in the first half of 2006.

### SOLVENCY MARGIN REQUIREMENT

The Company is subject to a number of regulations regarding financial operations, including maintaining a stipulated solvency margin, complying with 11 regulatory benchmarks and providing for certain funds and reserves. In accordance with the insurance laws and regulations in the PRC, the Company is required to maintain a minimum solvency margin of RMB8,435 million as of 30 June 2006. The Company's actual solvency margin as of 30 June 2006 calculated pursuant to the regulations of the CIRC was RMB11,440 million and solvency margin adequacy ratio was 136%<sup>4</sup>.

Pursuant to the CIRC regulations, if an insurance company fails to meet 4 out of the 11 benchmarks regarding solvency, the CIRC has the right to demand an explanation and investigate into the reasons for non-compliance. In the first half of 2006, the Company failed to meet fewer than 4 of such benchmarks.

<sup>4</sup> Calculated in accordance with the PRC Accounting Regulations for Financial Institutions.

### PREMIUM TO CAPITAL RATIO

The premium to capital ratio is the ratio of retained premiums in any financial year to the sum of paid-in capital, capital reserves and surplus reserves. Pursuant to the Insurance Law, this premium to capital ratio may not exceed 4 times for any property and casualty insurance company in any financial year. The premium to capital ratio for the Company in the first half of 2006 was 3.52 times<sup>5</sup>.

<sup>5</sup> Calculated in accordance with the PRC Accounting Regulations for Financial Institutions, where the figure of retained premiums was calculated for the full year ended 30 June 2006.

### GEARING RATIO

As of 30 June 2006, the Company's gearing ratio<sup>6</sup> was 81.7%, representing an increase of 1.9 percentage points from 79.8% as of 31 December 2005.

<sup>6</sup> Gearing ratio is represented by total liabilities (excluding subordinated loan) divided by total assets under accounting principles generally accepted in Hong Kong.

### CONTINGENT LIABILITIES

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

### INTEREST RATE RISK

The Company's holdings in fixed income investments or fixed interest rate liabilities are subject to interest rate risk. The Company also invests in floating rate instruments, interest proceeds from which can rise and fall due to changes in interest rates. The interest payment for the subordinated loan of the Company will fluctuate due to changes in interest rates fixed by the central bank. The Company's holdings in mutual funds are also exposed to price fluctuations caused by changes in interest rates.

The Company manages exposure to risks associated with interest rate fluctuations through active review of the investment portfolio and consultation with investment advisers. The goal is to maintain liquidity and generate stable returns.

### CREDIT RISK

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

The Company is subject to credit risk on its premiums receivable, investment assets, reinsurance assets and deposits with commercial banks. The Company is subject to credit risk on investments such as corporate bonds and mutual funds. The Company diligently manages credit risk by analysing the creditworthiness of companies prior to making investments as well as strictly following the CIRC guidelines which only permit investments in corporate bonds with rating higher than AA. The Company is also subject to credit risk with respect to amounts owed to it by its reinsurers. As a result, except when dealing with national reinsurers such as China Property and Casualty Reinsurance Company Ltd., the Company primarily purchases reinsurance from reinsurers with A.M. Best ratings of A- or above, and pays particular attention to their creditworthiness and financial condition. The Company manages and lowers credit risk affecting its bank deposits mainly by depositing most of its deposits with state-owned or state-controlled banks.

### EXCHANGE RATE RISK

The Company conducts its business primarily in Renminbi, which is also its functional and financial reporting currency. However, a portion of its business (including a portion of commercial property insurance, international cargo insurance and aviation insurance) is conducted in foreign currencies, typically US dollars. A portion of its claims, account receivables and liabilities is also denominated in foreign currencies, typically US dollars. In addition, a portion of its investment assets and cash which is denominated in foreign currencies is also subject to exchange rate risk.

As such, the Company is exposed to exchange rate risk with respect to its foreign currency business, assets and liabilities. Foreign exchange transactions under the Company's capital account are subject to foreign exchange regulations and require the approval of the State Administration of Foreign Exchange. Foreign exchange policies adopted by the PRC government could cause exchange rates to vary.

### HEDGING INSTRUMENTS

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

### EMPLOYEES

As of 30 June 2006, the Company had 60,628 employees. Staff salaries paid by the Company in the first half of 2006 were RMB1,629 million which mainly includes basic salaries and performance related bonuses. In addition, the Company makes contributions to pension schemes and social medical insurance plans for its employees. Senior management of the Company are entitled to share appreciation rights. The share appreciation rights scheme does not require any issue of shares and hence the rights of the shareholders will not be diluted. The Company enhances the performance and efficiency of employees by providing various career development paths, strengthening personnel training and implementing performance review. The Company is of the view that it maintains a good relationship with its employees.

### LATEST DEVELOPMENT

On 25 July 2006, the Company entered into an agreement with PICC Holding Company, fellow subsidiaries of PICC Holding Company and an independent third party, pursuant to which the Company agreed to contribute RMB160 million to the registered capital of PICC Asset Management Company Limited, and will be holding 20% of its equity interests. The Company is of the view that the transaction will benefit the refinement of the Company's asset management model and the enhancement of the Company's investment structure, so as to enable the Company to better control investment risk and to stabilize investment returns, and that the transaction is in the interests of the Company as a whole.

### LOOKING FORWARD

With the sustained growth of China's economy, a comparatively rapid growth will be maintained in the domestic insurance market in the second half of 2006. The promulgation of the *Several Opinions of the State Council on the Reform and Development of the Insurance Industry* and the smooth implementation of the *Regulations on Mandatory Traffic Accident Liability Insurance for Motor Vehicles* will play an active role in promoting the development of the non-life insurance market. The PRC insurance regulatory authority is strengthening its efforts in regulating the insurance market and maintaining market order, which will promote a more rational competition in the non-life insurance market. The implementation of the administrative measures on investments of insurance funds, such as the *Interim Measures on the Administration of Stock Investments of Insurance Institutional Investors* and the *Administrative Measures on the Pilot Indirect Investments of Insurance Funds into Infrastructure Projects*, will play an active role in increasing investment returns of insurance companies.

In order to increase value for its shareholders, the Company will increase its efforts in the development of product lines and the promotion of business growth, strive to promote human resources reforms and employ experts on actuarial techniques. The Company will also comprehensively enhance costs management, strengthen marketing and broaden sales channels in order to promote its business development. The Company will enforce stringent claims management and control so as to enhance claims quality in a comprehensive manner, promote customer resources management and improve service quality. Furthermore, the Company will enhance risk control in using investment funds so as to improve investment returns.