

Embedded Value

Introduction

In order to provide investors with an additional tool to understand our economic value and business performance results, the Group has disclosed information regarding embedded value in this section. The embedded value represents the shareholders' adjusted net asset value plus the value of the Group's in-force life insurance business adjusted for the cost of regulatory solvency margin deployed to support this business. The embedded value excludes the value of future new business sales.

The Group has received advice from and consulted with Watson Wyatt Consultancy (Shanghai) Ltd in the selection of basis and the calculation of the value of in-force life insurance business and the value of one year's new business. The Group remains wholly responsible for the results and presentation of the embedded value which comprises the adjusted net asset and the value of in-force life insurance business.

The calculation of embedded value necessarily makes a number of assumptions with respect to future experience. As a result, future experience may vary from that assumed in the calculation, and these variations may be material. The market value of the Group is measured by the value of the Group's shares on any particular day. In valuing the Group's shares, investors take into account a variety of information available to them and their own investment criteria, therefore these calculated values should not be constructed as a direct reflection of the actual market value.

Components of Economic Value

As at December 31, (in RMB million)	2006	2005
Adjusted net asset value	46,282	33,072
Value of in-force insurance business written prior to June 1999	(20,932)	(18,089)
Value of in-force insurance business written since June 1999	48,011	38,537
Cost of holding the required solvency margin	(7,788)	(5,157)
Embedded Value	65,573	48,363
Value of one year's new business	6,007	5,148
Cost of holding the required solvency margin	(875)	(609)
Value of one year's new business after cost of solvency	5,132	4,539

The adjusted net asset value is based on the audited shareholders net assets of the Group as measured on the PRC statutory basis. The values placed on certain assets have been adjusted to the market values. It should be noted that the adjusted net asset is for the whole Group, including Ping An Life and other business units, whilst the value of in-force insurance business and the value of one year's new business presented are only in respect of Ping An Life and not other business units.

Key Assumptions

The assumptions used in the embedded value calculation in 2006 have been made on a "going concern" basis, assuming continuation of the economic and legal environment currently prevailing in the PRC. The statutory reserving basis and solvency margin requirement were assumed in the calculation. Certain portfolio assumptions were based on the Group's own recent experience as well as considering the more general PRC market and other life insurance markets' experience. The principal bases and assumptions used in the calculation are described below:

Risk Discount Rate

The non investment-linked fund's earned rate of 12% has been assumed in each future year as the risk discount rate for the in-force life insurance business. The earned rate is the investment return adjusted for tax paid. This specific discount rate approach for the in-force business is to avoid understating the effect of losses arising from those high interest rate guaranteed products we sold prior to June 1999. A level 12% has been assumed in each future year for the calculation of one-year's new business value.

Embedded Value

Investment Returns

Future investment returns have been assumed to be 4.30% in 2007 and to increase 0.1% every year to 4.70% in 2011 and thereafter for the non investment-linked fund. For the investment-linked fund, future investment returns have been assumed to be 4.80% in 2007 and to increase 0.1% every year to 5.20% in 2011 and thereafter. These returns have been derived by consideration of the current capital market condition, the Group's current and expected future asset allocations and associated investment returns for a range of major asset classes.

Taxation

A 15% average income tax rate has been assumed. In addition, a 5.5% business tax rate has been applied to the gross written premiums of the short-term accident insurance business.

Mortality

The experience mortality rates have been based on 65% and 60% of China Life (1990-1993) table for male and female respectively for non annuitants. For annuitants, 75% of the China Life Annuity (1990-1993) table has been assumed. The newly published China Life and annuity (2000-2003) table has been used in calculating statutory reserves.

Morbidity

Morbidity assumptions have been based on the Group's own pricing table. The loss ratios have been assumed to be in the range of 15% and 75% for short term accident and health insurance business.

Discontinuances

Policy discontinuance rates have been based on the Group's recent experience studies. The discontinuance rates are dependent on the pricing interest rate and the product type.

Expenses

Expenses assumptions have been based on the Group's most recent expenses investigation. For calendar year 2006, the assumed expenses and commissions equated to around 77% of the expenses allowance priced into the products. The unit maintenance expenses were assumed to increase at 2% per annum.

Policyholder Dividends

Policyholder dividends have been based on 80% of the interest and mortality surplus for individual life and bancassurance participating business. For group life participating business, dividends have been based on 90% of interest surplus only.

New Business Volumes and Business Mix

The volume of new business sold and modeled during 2006 to calculate the value of one year's new business was RMB23,698 million in terms of first year premium. The mix of the new business measured by first year premium was:

	Percentage
Individual life	46.1%
Long-term business	44.2%
Short-term business	1.9%
Group life	28.9%
Long-term business	19.9%
Short-term business	9.0%
Bancassurance	25.1%
Long-term business	25.1%
Total	100.0%

* Figures may not be additive due to rounding.

Embedded Value Movement

The table below shows how the embedded value grew to more than RMB65,573 million as at December 31, 2006.

(in RMB million)	2006	
Embedded value as at December 31, 2005	48,363	
Expected return on year-start embedded value	2,967	Expected growth of embedded value occurred in 2006.
Value of one-year new business	6,222	The contribution came from new business sold during 2006 and discounted at earned rate/12%.
Assumption and modeling changes	(3,049)	Statutory reserve valuation interest rates change, lapse rates change and tax rate change etc. decreased embedded value on an aggregate basis.
Market value adjustment impact	9,206	The market value adjustment of equity investments increased due to large unrealised capital gains.
Investment return variance	3,399	Actual investment return in 2006 was higher than the assumed return.
Other experience variances	447	Other variances between actual experience and assumptions.
Embedded value before capital changes	67,556	Embedded value before impact of capital change increased 39.7%.
Shareholder dividends	(1,982)	Dividends paid to shareholders during 2006.
Embedded value as at December 31, 2006	65,573	
Embedded value per share as at December 31, 2006 (in RMB)	10.58	

* Figures may not be additive due to rounding.

Sensitivity Analysis

The Group has investigated the effect, on the value of in-force business and the value of one year's new business, of varying independently certain assumptions regarding future experience. Specifically, the following changes in assumptions have been considered:

- Risk discount rate
- Investment return increased by 25 basis points every year
- Investment return decreased by 25 basis points every year
- A 10% reduction in mortality and morbidity for assured lives
- A 10% reduction in policy discontinuance rates
- A 10% reduction in maintenance expense
- A 5% increase in the policyholders' dividend payout ratio

Embedded Value

(in RMB million)	Risk Discount Rate			
	Earned Rate/11.0%	Earned Rate/12.0%	Earned Rate/13.0%	12.0%
Value of in-force business	20,797	19,291	17,895	21,039
	11.0%	12.0%	13.0%	Earned Rate/12.0%
Value of one year's new business	5,637	5,132	4,691	6,222
Assumptions (in RMB million)	Value of in-force business		Value of one year's new business	
Central case	19,291		5,132	
Investment return increased by 25bp every year	23,699		5,252	
Investment return decreased by 25bp every year	14,437		5,012	
10% reduction in mortality and morbidity rates	19,531		5,223	
10% reduction in policy discontinuance rates	19,915		5,329	
10% reduction in maintenance expense	20,252		5,251	
5% increase in the policyholders' dividend payout ratio	18,209		5,006	

Risk discount rate were earned rate/12.0% and 12.0% for in force business and new business respectively.