

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 2006, the Company held 45.1% share of the non-life insurance market in the PRC.

The following table sets forth the net premiums earned, underwriting profit, net profit attributable to equity holders of the parent and total assets of the Company and its subsidiaries for the relevant periods.

	Year ended 31 December	
	2006 (RMB million)	2005 (RMB million)
Net premiums earned	55,616	53,384
Underwriting profit	604	1,508
Net profit attributable to equity holders of the parent	2,082	940
Total assets	106,124	95,112

RESULTS OF OPERATIONS

In 2006, the turnover of the Company and its subsidiaries increased slightly, 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 relevant periods.

	Year ended 31 December	
	2006 (%)	2005 (%)
Net premiums earned	100.0	100.0
Net claims incurred	(69.4)	(68.1)
Amortisation of deferred acquisition costs, net	(16.0)	(15.0)
Insurance protection expenses	(1.1)	(1.0)
General and administrative expenses	(12.4)	(13.1)
Underwriting profit	1.1	2.8
Net investment income	3.0	2.8
Net realised and unrealised gains/(losses) on investments	4.2	(0.6)
Finance costs	(0.4)	(0.3)
Interest expenses credited to policyholders' deposits	(0.2)	(0.3)
Profit before tax	6.8	3.7
Tax	(3.1)	(1.9)
Net profit attributable to equity holders of the parent	3.7	1.8
Loss ratio	69.4	68.1
Expense ratio	29.5	29.1
Combined ratio	98.9	97.2

¹ The relevant financial data for 2005 are restated according to the accounting policies adopted in 2006.

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 of the Company and its subsidiaries by segment, analysed as a percentage of the respective aggregate amount, for the relevant periods.

	Year ended 31 December	
	2006 (%)	2005 (%)
Net premiums earned		
Motor vehicle	74.6	72.9
Commercial property	10.3	11.4
Cargo	3.7	4.3
Liability	3.9	3.6
Accidental injury	3.3	3.3
Other	4.2	4.5
Total	100	100
Net claims incurred		
Motor vehicle	78.5	75.9
Commercial property	10.6	12.4
Cargo	1.9	2.7
Liability	2.9	3.6
Accidental injury	2.6	1.9
Other	3.5	3.5
Total	100	100
Amortisation of deferred acquisition costs, net		
Motor vehicle	78.1	78.4
Commercial property	9.1	10.3
Cargo	3.5	4.7
Liability	3.5	3.7
Accidental injury	2.9	3.3
Other	2.9	(0.4)
Total	100	100

TURNOVER

Turnover of the Company and its subsidiaries was RMB71,348 million in 2006, representing an increase of RMB5,434 million, or 8.2%, over RMB65,914 million in 2005. The increase was primarily due to an increase of RMB5,336 million in the turnover of the Company and its subsidiaries' motor vehicle insurance business, and such considerable growth was driven by the compulsory motor vehicle third party liability insurance. Turnover of the liability insurance and the accidental injury insurance segments of the non-motor vehicle insurance business also increased. However, the effect of such increases was partially offset by a RMB476 million decrease in the turnover of the commercial property insurance segment.



The Company has committed to building up its e-commerce brand "Through Train to PICC P&C" of its service line 95518 and its www.e-picc.com.cn platform.

NET PREMIUMS EARNED

Net premiums earned of the Company and its subsidiaries was RMB55,616 million in 2006, representing an increase of RMB2,232 million, or 4.2%, over RMB53,384 million in 2005. This increase in net premiums earned was primarily due to a rapid increase in net premiums earned from the motor vehicle insurance segment in 2006. Net premiums earned from the motor vehicle insurance segment increased by RMB2,604 million over 2005. However, the effect of such increase was partially offset by the decreases of net premiums earned in the commercial property insurance and the cargo insurance segments of the non-motor vehicle insurance business.

NET INVESTMENT INCOME

Net investment income of the Company and its subsidiaries was RMB1,689 million in 2006, representing an increase of RMB211 million over RMB1,478 million in 2005. This increase was primarily due to increases in interest income from debt securities and dividend income from equity securities of RMB106 million and RMB62 million, respectively. The increases were primarily due to a substantial increase in the balance of investments in debt securities and equity securities.

NET REALISED AND UNREALISED GAINS/(LOSSES) ON INVESTMENTS

Net realised and unrealised gains/(losses) on investments of the Company and its subsidiaries was the net gains of RMB2,326 million in 2006, representing an increase of RMB2,662 million over the net losses of RMB336 million in 2005. This increase was primarily due to the better performance of the stock markets, which led to a RMB2,646 million increase in unrealised gains on investments in equity securities compared to 2005.

NET CLAIMS INCURRED

Net claims incurred of the Company and its subsidiaries was RMB38,616 million in 2006, representing an increase of RMB2,281 million, or 6.3%, over RMB36,335 million in 2005. Loss ratio of the Company and its subsidiaries increased to 69.4% in 2006 from 68.1% in 2005. The increase in net claims incurred was primarily due to an increase of RMB2,702 million in net claims incurred of the motor vehicle insurance segment from RMB27,593 million in 2005 to RMB30,295 million in 2006, and partially due to an increase of RMB309 million in net claims

incurred of the accidental injury insurance segment of the non-motor vehicle insurance business compared to 2005. However, the effect of such increases was partially offset by the decreases of RMB445 million and RMB242 million in net claims incurred of the commercial property insurance and the cargo insurance segments in 2006 compared to 2005, respectively. Net loss and loss adjustment expense reserves as of 31 December 2006 increased by RMB1,175 million as compared to 31 December 2005.

AMORTISATION OF DEFERRED ACQUISITION COSTS, NET

Net amortisation of deferred acquisition costs of the Company and its subsidiaries was RMB8,882 million in 2006, representing an increase of 11.0% over RMB8,001 million in 2005. This increase was primarily due to a substantial increase in commission expenses paid to insurance intermediaries and agents in 2006 compared to 2005, and a remarkable decrease in reinsurance commission receivable as a result of a decrease in the proportion of reinsurance.

INSURANCE PROTECTION EXPENSES

According to the relevant PRC insurance laws and regulations, the Company and its subsidiaries are required to accrue an insurance protection fund based on 1% of their retained premiums. Insurance protection expenses of the Company and its subsidiaries was RMB610 million in 2006, representing an increase of 13.6% over RMB537 million in 2005. The increase was due to an increase in retained premiums.

INTEREST EXPENSES CREDITED TO POLICYHOLDERS' DEPOSITS

Interest expenses of the Company and its subsidiaries credited to policyholders' deposits was RMB138 million in 2006, representing a slight decline from RMB143 million in 2005. This was primarily due to a decrease in the average balance of policyholders' deposits from the Company and its subsidiaries' Golden Bull homeowners insurance products.

FINANCE COSTS

Finance costs of the Company and its subsidiaries was RMB209 million in 2006, representing an increase of RMB28 million over RMB181 million in 2005. Such increase was primarily due to an increase of RMB26 million in the interest expenses on securities sold under agreements to repurchase as compared to 2005.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses of the Company and its subsidiaries was RMB6,904 million in 2006, representing a decrease of 1.4% from RMB7,003 million in 2005. This decrease was primarily due to a RMB163 million decrease in depreciation expenses for property, plant and equipment.

PROFIT BEFORE TAX

As a result of the foregoing, profit before tax of the Company and its subsidiaries was RMB3,800 million in 2006, representing an increase of RMB1,855 million over RMB1,945 million in 2005.

TAX

Income tax expense of the Company and its subsidiaries was RMB1,718 million in 2006, representing an increase of RMB713 million over RMB1,005 million in 2005. The Company and its subsidiaries' effective tax rate decreased to 45.2% in 2006 from 51.7% in 2005.

NET PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

As a result of the foregoing, net profit of the Company and its subsidiaries was RMB2,082 million in 2006, representing an increase of RMB1,142 million over RMB940 million in 2005. Basic earnings per share attributable to ordinary equity holders of the parent in 2006 was RMB0.187.

COMBINED RATIO

Combined ratio of the Company and its subsidiaries increased from 97.2% in 2005 to 98.9% in 2006, primarily due to an increase in the Company and its subsidiaries' loss ratio from 68.1% in 2005 to 69.4% in 2006 and an increase in the expense ratio from 29.1% in 2005 to 29.5% in 2006.

RESULTS OF SEGMENT OPERATIONS

Motor Vehicle Insurance

	Year ended 31 December	
	2006 (RMB million)	2005 (RMB million)
Turnover	49,837	44,501
Net premiums earned	41,502	38,898
Net claims incurred	(30,295)	(27,593)
Amortisation of deferred acquisition costs, net	(6,935)	(6,270)
Insurance protection expenses	(467)	(390)
Segment profit before unallocated income and expenses	3,805	4,645
Loss ratio	73.0%	70.9%
Expense ratio	17.8%	17.1%
Combined ratio	90.8%	88.0%

Turnover of the motor vehicle insurance segment of the Company and its subsidiaries was RMB49,837 million in 2006, representing an increase of RMB5,336 million, or 12.0%, over RMB44,501 million in 2005. This increase was primarily due to the remarkable turnover of the compulsory motor vehicle third party liability insurance of the Company and its subsidiaries in the second half of 2006.

Net premiums earned from the motor vehicle insurance segment was RMB41,502 million in 2006, representing an increase of RMB2,604 million, or 6.7%, over RMB38,898 million in 2005. This increase was primarily due to a relatively rapid growth in the turnover in 2006 and a decrease of RMB2,490 million in reinsurance premiums ceded compared to 2005. However, the effect of the foregoing was partially offset by an increase of RMB5,222 million in the change in the balance of net unearned premium reserves of the motor vehicle insurance segment in 2006.

Net claims incurred of the Company and its subsidiaries' motor vehicle insurance segment was RMB30,295 million in 2006, representing an increase of RMB2,702 million, or 9.8%, over RMB27,593 million in 2005. The loss ratio increased to 73.0% in 2006 from 70.9% in 2005. The increase in net claims incurred was primarily due to an increase of RMB2,322 million in claim expenses in the Company and its subsidiaries' motor vehicle insurance segment, and an increase of RMB438 million in the change in net loss and loss adjustment expense reserves in 2006 compared to 2005. However, the effect of such increases was partially offset by an increase of RMB58 million in the loss recovered from reinsurance over 2005.



The service line 95518 of the Company was awarded the "2006 China Best Contact Center" prize.

Net amortisation of deferred acquisition costs of the motor vehicle insurance segment of the Company and its subsidiaries was RMB6,935 million in 2006, representing an increase of 10.6% over RMB6,270 million in 2005. This increase was primarily due to an increase in commission expenses paid to insurance intermediaries and agents compared to 2005 and a substantial decrease in reinsurance commission receivable.

Insurance protection expenses charged to the motor vehicle insurance segment increased by 19.7% from RMB390 million in 2005 to RMB467 million in 2006 due to an increase in retained premiums.

The expense ratio of the motor vehicle insurance segment increased from 17.1% in 2005 to 17.8% in 2006, primarily due to an increase in net amortisation of deferred acquisition costs.

As a result of the foregoing, the segment profit before unallocated income and expenses of the motor vehicle insurance segment was RMB3,805 million in 2006, representing a decrease of 18.1% compared to RMB4,645 million in 2005.

Commercial Property Insurance

	Year ended 31 December	
	2006 RMB million	2005 RMB million
Turnover	8,193	8,669
Net premiums earned	5,747	6,100
Net claims incurred	(4,074)	(4,519)
Amortisation of deferred acquisition costs, net	(805)	(828)
Insurance protection expenses	(55)	(60)
Segment profit before unallocated income and expenses	813	693
Loss ratio	70.9%	74.1%
Expense ratio	15.0%	14.6%
Combined ratio	85.9%	88.7%

Turnover of the commercial property insurance segment decreased by RMB476 million, or 5.5%, from RMB8,669 million in 2005 to RMB8,193 million in 2006, primarily due to the continued decline in premium rates resulting from the intensified market competition in 2006.

Net premiums earned from the commercial property insurance segment decreased by RMB353 million, or 5.8%, from RMB6,100 million in 2005 to RMB5,747 million in 2006, primarily due to a RMB476 million decline in turnover compared to 2005. However, this effect was partially offset by a RMB41 million decrease in reinsurance premiums ceded and a RMB82 million decrease in the change in net unearned premium reserves compared to 2005.

Net claims incurred of the commercial property insurance segment decreased by 9.8% from RMB4,519 million in 2005 to RMB4,074 million in 2006. The decrease was primarily due to a RMB564 million decrease in the claim expenses compared to 2005, and a RMB246 million decrease in the change in net loss and loss adjustment expense reserves compared to 2005. However, this effect was partially offset by a RMB365 million decrease in losses recovered from reinsurance compared to 2005.

Net amortisation of deferred acquisition costs of the commercial property insurance segment decreased slightly from RMB828 million in 2005 to RMB805 million in 2006, primarily due to the decreases in the government levies and surcharge and the underwriting personnel salary expenses.

Insurance protection expenses charged to the commercial property insurance segment decreased by 8.3% from RMB60 million in 2005 to RMB55 million in 2006, due to a decrease in retained premiums.

Mainly due to the decrease in the net premiums earned, the expense ratio of the commercial property insurance segment increased from 14.6% in 2005 to 15.0% in 2006.

As a result of the foregoing, the segment profit before unallocated income and expenses of the commercial property insurance segment was RMB813 million in 2006, representing an increase of 17.3% compared to RMB693 million in 2005.

Cargo Insurance

	Year ended 31 December	
	2006	2005
	RMB million	RMB million
Turnover	2,763	2,793
Net premiums earned	2,073	2,269
Net claims incurred	(744)	(986)
Amortisation of deferred acquisition costs, net	(315)	(377)
Insurance protection expenses	(21)	(21)
Segment profit before unallocated income and expenses	993	885
Loss ratio	35.9%	43.5%
Expense ratio	16.2%	17.5%
Combined ratio	52.1%	61.0%

Turnover of the cargo insurance segment decreased by RMB30 million, or 1.1%, from RMB2,793 million in 2005 to RMB2,763 million in 2006, primarily due to the declined average premium rates of cargo insurance and the significant decrease in the number of domestic cargo insurance policies underwritten compared to 2005 as a result of intensified market competition.

Net premiums earned from the cargo insurance segment decreased by RMB196 million, or 8.6%, from RMB2,269 million in 2005 to RMB2,073 million in 2006, primarily due to a RMB129 million increase in the change in net unearned premium reserves and a RMB37 million increase in reinsurance premiums ceded.

Net claims incurred of the cargo insurance segment decreased by 24.5% from RMB986 million in 2005 to RMB744 million in 2006. The decrease was primarily due to a RMB101 million decrease in the claim expenses compared to 2005 resulting from the decreased number of settled claims. The loss ratio of the cargo insurance segment decreased from 43.5% in 2005 to 35.9% in 2006.

Net amortisation of deferred acquisition costs of the cargo insurance segment decreased by RMB62 million from RMB377 million in 2005 to RMB315 million in 2006, primarily due to the decrease in commission expenses paid to insurance intermediaries and agents compared to 2005.

Insurance protection expenses charged to the cargo insurance segment was RMB21 million in 2006, close to that in 2005, primarily due to the slight changes in the retained premiums of the cargo insurance segment in 2006 compared to 2005.

The expense ratio of the cargo insurance segment decreased from 17.5% in 2005 to 16.2% in 2006.

As a result of the foregoing, the segment profit before unallocated income and expenses of the cargo insurance segment was RMB993 million in 2006, representing an increase of 12.2% compared to RMB885 million in 2005.

Liability Insurance

	Year ended 31 December	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Turnover	3,013	2,561
Net premiums earned	2,160	1,923
Net claims incurred	(1,123)	(1,300)
Amortisation of deferred acquisition costs, net	(309)	(298)
Insurance protection expenses	(23)	(19)
Segment profit before unallocated income and expenses	705	306
Loss ratio	52.0%	67.6%
Expense ratio	15.4%	16.5%
Combined ratio	67.4%	84.1%

Turnover of the liability insurance segment was RMB3,013 million in 2006, representing an increase of RMB452 million, or 17.6%, over RMB2,561 million in 2005. This increase was primarily due to the rapid growth in the turnover of carrier's liability insurance and public liability insurance.

Net premiums earned from the liability insurance segment was RMB2,160 million in 2006, representing an increase of RMB237 million, or 12.3%, over RMB1,923 million in 2005. This increase was primarily due to the increased turnover of the liability insurance. However, the effect of such increase was partially offset by a RMB132 million increase in the change in net unearned premium reserves and a RMB83 million increase in reinsurance premiums ceded.

Net claims incurred of the liability insurance segment was RMB1,123 million in 2006, representing a decrease of 13.6% from RMB1,300 million in 2005. This was primarily due to a RMB152 million increase in losses recovered from reinsurance compared to 2005. The loss ratio of the liability insurance segment decreased from 67.6% in 2005 to 52.0% in 2006.

Net amortisation of deferred acquisition costs of the liability insurance segment was RMB309 million in 2006, representing an increase of RMB11 million over RMB298 million in 2005. This was primarily due to the increase in commission expenses paid to insurance intermediaries and agents compared to 2005 as a result of the Company and its subsidiaries' business growth, and the increase in the government levies and surcharge and the underwriting personnel salary expenses.

Insurance protection expenses charged to the liability insurance segment was RMB23 million in 2006, representing an increase of RMB4 million, or 21.1%, over RMB19 million in 2005. This was primarily due to an increase in the retained premiums of the liability insurance segment in 2006.

The expense ratio of the liability insurance segment decreased from 16.5% in 2005 to 15.4% in 2006.

As a result of the foregoing, the segment profit before unallocated income and expenses of the liability insurance segment was RMB705 million in 2006, representing an increase of 130.4% compared to RMB306 million in 2005.

Accidental Injury Insurance

	Year ended 31 December	
	2006 RMB million	2005 RMB million
Turnover	2,561	2,371
Net premiums earned	1,827	1,777
Net claims incurred	(1,004)	(695)
Amortisation of deferred acquisition costs, net	(262)	(261)
Insurance protection expenses	(18)	(18)
Segment profit before unallocated income and expenses	543	803
Loss ratio	55.0%	39.1%
Expense ratio	15.3%	15.7%
Combined ratio	70.3%	54.8%

Turnover of the accidental injury insurance segment was RMB2,561 million in 2006, representing an increase of RMB190 million, or 8.0%, over RMB2,371 million in 2005. This increase was primarily due to the rapid increase in the number of insurance policies underwritten.

Net premiums earned from the accidental injury insurance segment was RMB1,827 million in 2006, representing an increase of RMB50 million, or 2.8%, over RMB1,777 million in 2005. This was primarily due to the increased turnover of the accidental injury insurance segment and a RMB42 million decrease in the change in net unearned premium reserves. However, this effect was offset by a RMB182 million increase in reinsurance premiums ceded.

Net claims incurred of the accidental injury insurance segment was RMB1,004 million in 2006, representing an increase of 44.5% over RMB695 million in 2005. This was primarily due to a RMB252 million increase in the claim expenses compared to 2005 and a RMB171 million increase in the change in net loss and loss adjustment expense reserves. However, this effect was partially offset by a RMB114 million increase in losses recovered from reinsurance. The loss ratio of the accidental injury insurance segment increased from 39.1% in 2005 to 55.0% in 2006.

Net amortisation of deferred acquisition costs of the accidental injury insurance segment was RMB262 million in 2006, close to RMB261 million in 2005. This was primarily due to the increase in commission expenses paid to insurance intermediaries and agents and the increase in the government levies and surcharge were offset by an increase in reinsurance commission recovered.

Insurance protection expenses charged to the accidental injury insurance segment was RMB18 million in 2006, close to that in 2005, as there were no substantial changes in the retained premiums of the accidental injury insurance segment in 2006.

The expense ratio of the accidental injury insurance segment decreased from 15.7% in 2005 to 15.3% in 2006.

As a result of the foregoing, the segment profit before unallocated income and expenses of the accidental injury insurance segment was RMB543 million in 2006, representing a decrease of 32.4% compared to RMB803 million in 2005.

DEVELOPMENT OF NEW PRODUCTS

In 2006, the Company developed a total of 202 new insurance products, including 42 national products and 160 regional products. The Company modified 34 motor vehicle insurance products in response to the launch of the compulsory motor vehicle third party liability insurance, and modified 225 commercial property insurance products and 128 construction insurance products in response to the Pure Risk Loss Ratio Program of the China Insurance Regulatory Commission (the "CIRC").



Being the top winner among the property and casualty insurance companies in terms of the number of prizes, 5 products of the Company were awarded 6 grand prizes at the China First Innovative Insurance Products Awards 2006.

CASH FLOW

	Year ended 31 December	
	2006 <i>(RMB million)</i>	2005 <i>(RMB million)</i>
Net cash inflow from operating activities	5,324	2,651
Net cash outflow from investing activities	(912)	(956)
Net cash inflow/(outflow) from financing activities	1,299	(2,075)
Net increase/(decrease) in cash and cash equivalents	5,711	(380)

Net cash generated from operating activities of the Company and its subsidiaries was RMB5,324 million in 2006, representing an increase of 100.8% over 2005. This was primarily due to an increase of RMB7,487 million in cash premiums received over 2005. However, this effect was partially offset by an increase of RMB1,847 million in claim expenses paid in cash.

Net cash outflow from the Company and its subsidiaries' investing activities was RMB912 million in 2006, representing a decrease of RMB44 million compared to 2005. Such a decrease was primarily due to a decrease of RMB723 million in capital expenditure compared to 2005. However, the effect of such a decrease was partially offset by an increase of RMB582 million in net expenses on securities investment and deposits with banks or other financial institutions with a maturity of more than three months.

Net cash inflow from the Company and its subsidiaries' financing activities was RMB1,299 million in 2006, while the net outflow from such activities in 2005 was RMB2,075 million. This was primarily due to the substitution of the RMB2,000 million subordinated loan obtained from China Development Bank in 2003 by the RMB3,000 million subordinated debts issued by the Company in 2006, the payment of interim dividend of RMB802 million in 2005 and the payment of RMB611 million for the securities sold under agreements to repurchase in 2005.

Net increase in cash and cash equivalents (mainly in RMB) of the Company and its subsidiaries in 2006 was RMB5,711 million.

LIQUIDITY

The cash flow of the Company and its subsidiaries 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 needs for the liquidity of the Company and its subsidiaries are principally for payment of claims and the fulfilment of other obligations under outstanding insurance policies, capital expenditures, operating expenses, tax payments, dividend payments and investment requirements.

The Company issued fixed-rate subordinated debts of RMB3,000 million with a term of 10 years to institutional investors in the PRC in December 2006 for the primary purpose of repaying the RMB2,000 million subordinated loan obtained from China Development Bank on 10 October 2003. This subordinated loan was fully settled by the Company on 21 December 2006 and the remaining balance of subordinated debts was reserved for improving the Company's solvency.

The Company obtained a 10-year revolving credit facility from China Development Bank for up to RMB10 billion on 26 August 2003. Each drawdown made under this facility is repayable within one year. As of the date of this report, no amount has been drawn down under that facility.

Save for the subordinated debts and the credit facility mentioned above, the Company and its subsidiaries do not obtain working capital by borrowing.

The Company and its subsidiaries expect that they can fund their working capital needs in the future from cash generated from operating activities. The Board is of the opinion that the Company and its subsidiaries have sufficient working capital.

CAPITAL EXPENDITURE

The capital expenditure of the Company and its subsidiaries was primarily for property construction, acquisition of motor vehicles for operations and development of information systems. Capital expenditure was RMB954 million in 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 RMB9,143 million on 31 December 2006. The Company's actual solvency margin calculated pursuant to the regulations of the CIRC was RMB12,344 million and the solvency margin adequacy ratio was 135% (Note).

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

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

PREMIUM TO CAPITAL RATIO

The premium to capital ratio is the ratio of retained premiums in any financial year to the sum of paid-in capital, capital reserves 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 2006 was 3.81 times (Note).

Note: Calculated in accordance with the PRC Accounting Regulations for Financial Institutions, where retained premiums was represented by the figure for the full year ended 31 December 2006.

GEARING RATIO

As of 31 December 2006, the gearing ratio of the Company and its subsidiaries (Note) was 77.6%, representing a decrease of 1.6 percentage points from 79.2% as of 31 December 2005.

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

CONTINGENT LIABILITIES

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

INTEREST RATE RISK

The Company and its subsidiaries' holdings in fixed income investments or fixed interest rate liabilities are subject to interest rate risk. The Company and its subsidiaries also invest in floating rate instruments, interest proceeds from which can increase or decrease due to changes in interest rates. The Company and its subsidiaries' holdings in mutual funds are also exposed to price fluctuations caused by changes in interest rates.

The Company and its subsidiaries manage exposure to risks associated with interest rate fluctuations through active review of the investment portfolio and consultation with financial investment experts. The goal is to maintain liquidity and generate stable returns.

CREDIT RISK

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

The investment assets, reinsurance assets and deposits with commercial banks of the Company and its subsidiaries are subject to credit risk.

The Company and its subsidiaries are subject to credit risk on investments such as corporate bonds and mutual funds. The Company and its subsidiaries diligently manage 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 and its subsidiaries are also subject to credit risk with respect to amounts owed to them by their reinsurers. As a result, except when dealing with national reinsurers such as China Property and Casualty Reinsurance Company Ltd., the Company and its subsidiaries primarily purchase reinsurance from reinsurers with A.M. Best ratings of A- or above, and pay particular attention to their creditworthiness and financial condition.

The Company and its subsidiaries manage and lower credit risk affecting their bank deposits mainly by depositing most of their deposits with state-owned or state-controlled banks.

EXCHANGE RATE RISK

The Company and its subsidiaries conduct their business primarily in Renminbi, which is also their functional and financial reporting currency. However, a portion of their 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 their claims, account receivables and liabilities is also denominated in foreign currencies, typically US dollars. In addition, a portion of their investment assets and cash which is denominated in foreign currencies, typically in US dollars, is also subject to exchange rate risk.

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

INTEREST RATE SWAP

The Company is exposed to the variability of cash flows on financial assets which bear interest at a variable rate and therefore, uses interest rate swaps by receiving interest at a fixed rate from the counterparties and paying a variable rate interest payment to hedge its risks. As of 31 December 2006, the Company held interest rate swap contracts with aggregate notional amount of RMB550 million.

INVESTMENT IN ASSOCIATE

On 25 July 2006, the Company entered into an agreement with PICC Holding, fellow subsidiaries of the Company and an independent third party in respect of the contribution of RMB160 million by the Company to the registered capital of PICC Asset Management Company Limited and the holding of 20% of its equity interests. The Company believes that such transaction is in the interest of the Company as a whole and benefits 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 risks and to earn stable returns.

EMPLOYEES

As of 31 December 2006, the Company had 60,993 employees. Staff salaries paid by the Company and its subsidiaries in 2006 was RMB4,665 million, which included basic salaries and performance related bonuses. In addition, the Company and its subsidiaries make contributions to pension schemes and social medical insurance plans for their employees in accordance with the relevant PRC regulations. Senior management of the Company are entitled to share appreciation rights. No shares will be issued under the scheme and, therefore, the shareholdings of shareholders will not be diluted. The Company and its subsidiaries enhance 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 the Company and its subsidiaries maintain a good relationship with their employees.



The Company is the strategic partner in the Olympic Games' Steersmen Selection programme jointly hosted by General Administration of Sport of China and China Central Television.