



**PICC 中国人保财险** (Stock Code: 2328)

北京 2008 年奥运会保险合作伙伴  
OFFICIAL INSURANCE PARTNER OF THE BEIJING 2008 OLYMPIC GAMES



Annual Report  
**2006**

## COMPANY PROFILE

PICC Property and Casualty Company Limited (the “Company”) was established in July 2003 with The People’s Insurance Company of China, later renamed as PICC Holding Company (“PICC Holding”) as its sole promoter. The Company became the first domestic financial enterprise to list overseas when the Company successfully listed on The Stock Exchange of Hong Kong Limited (“Stock Exchange”) on 6 November 2003 through the issuance of 3,455,980,000 H Shares. The Company currently has a total share capital of 11,141,800,000 shares, of which 69% are held by PICC Holding and 9.9% are held by American International Group, Inc. (“AIG”), a strategic investor of the Company. As of the end of 2006, the Company had 60,993 employees.

### Principal Activities

Motor vehicle insurance, commercial property insurance, homeowners insurance, cargo insurance, liability insurance, accidental injury insurance, short-term health insurance, hull insurance, agriculture insurance, surety insurance, which are denominated in RMB and foreign currencies, together with the reinsurance of the above insurance products, and investment and fund application business permitted under the relevant laws and regulations of the PRC.

### Competitive Advantages

- ◆ **Brand Recognition.** With 58 years of operating history, the “PICC” brand enjoys a prominent reputation in the PRC market and has influences in the international insurance market.
- ◆ **Leading Market Position.** The Company has a leading position in the non-life insurance market in mainland China, with a market share of 45.1% in 2006.
- ◆ **Personnel Advantages.** The Company has nurtured and trained a large number of insurance specialists and has an outstanding workforce with extensive expertise, proficient technical skills and distinctive commitment.
- ◆ **Extensive Network.** With more than 4,500 branches nationwide, the Company has the most extensive distribution network among all property and casualty insurance companies in the PRC. The service line 95518 and [www.e-picc.com.cn](http://www.e-picc.com.cn) electronic commerce platform of the Company provide various insurance services 7 days 24 hours to customers.
- ◆ **Solid Customer Base.** The Company has strong capabilities in product development and customer service to meet customer needs, and has the largest and the most stable customer base in the non-life insurance market in mainland China.
- ◆ **Technical Advantages.** The Company has comprehensive and mature technical expertise in and information platform for core capabilities such as underwriting, claims management and product development.
- ◆ **Data Advantages.** The extensive operational data accumulated by the Company over the years provide a solid foundation for analysis and decision-making, and further the Company to have a thorough understanding of the non-life insurance market in mainland China.

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## FINANCIAL HIGHLIGHTS

Summaries of the results and the assets and liabilities of the Company and its subsidiaries for each of the past five financial years are set out as follows:

### RESULTS

	Year ended 31 December				
	2002	2003	2004	2005	2006
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
				(Restated)	
Turnover	50,571	54,968	62,003	65,914	71,348
Underwriting profit	1,045	1,496	436	1,508	604
Net investment income	648	690	1,326	1,478	1,689
Net realised and unrealised gains/(losses) on investments	(645)	260	(988)	(336)	2,326
Profit before tax	994	2,288	395	1,945	3,800
Tax	(716)	(837)	(261)	(1,005)	(1,718)
Net profit attributable to equity holders of the parent	278	1,451	134	940	2,082

Only certain material items of the income statement are extracted and presented in the table above.

### ASSETS AND LIABILITIES

	31 December				
	2002	2003	2004	2005	2006
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
				(Restated)	
Total assets	71,626	84,572	90,757	95,112	106,124
Total liabilities	61,333	67,815	74,604	77,314	85,397
Thereinto: subordinated loan/debts	–	2,000	2,000	2,000	3,000
Net assets	10,293	16,757	16,153	17,798	20,727

The figures for 2002 were extracted from the Company's prospectus dated 27 October 2003. The results of the Company for 2003 were based on its pro forma income statement for the year then ended. The figures for 2002, 2003 and 2004 are not retrospectively adjusted to comply with accounting policies in 2006.



Mr Wu Yan, Chairman of the Company

Dear Shareholders,

In 2006, the insurance industry continued to maintain a rapid development, and the Company achieved a new breakthrough in its operating results and new success in its reform and development.

In 2006, the insurance industry of Mainland China continued to maintain a rapid growth. Premiums income of the entire insurance industry reached RMB564.14 billion, representing an increase of 14.4% over last year, of which premiums income generated from the property insurance segment reached RMB150.94 billion, representing an increase of 22.6% over last year. The competition in the insurance market has been further intensified, and group-based competition and cross-selling are becoming an important trend in the industry development.

In 2006, premiums income of the Company and its subsidiaries amounted to RMB71,348 million, representing an increase of 8.2% over 2005. Net premiums earned reached RMB55,616 million, representing an increase of 4.2% over 2005. Underwriting profit was RMB604 million, representing a decrease of 59.9% from 2005. Combined ratio was 98.9%. Investment income was RMB4,015 million, representing an increase of 251.6% over 2005. Net profit was RMB2,082 million, representing an increase of 121.5%. Return on net assets was 10.8%, representing an increase of 101.6% as compared to 2005. The Company and its subsidiaries' total assets at the end of 2006 were RMB106,124 million, representing an increase of 11.6% over 2005. The Company's market share was 45.1% and continued to maintain a leading position in the non-life insurance market in Mainland China.

In 2006, the Company continued to deepen its reformation and enhance its management and, as a result, the Company has further demonstrated its operating vigour and strengthened the impetus to its development.

- **Refinement of corporate governance structure:** The Company has completed the election of the new session of the Board of Directors and established the Company's second session of the Board of Directors, Supervisory Committee and management team. The Company has further optimised its corporate governance structure, strengthened the construction of the Board of Directors and improved the functions of various board committees, thereby further enhancing the corporate governance level.
- **Innovation of operating mechanisms:** The Company consolidated its business operations and management functions with reference to its product lines and improved the quality and efficiency of its operations. The Company also strengthened its performance management, improved its performance-based appraisals, refined its investment management mechanisms, regulated the investment behaviour and promoted the progressive application of funds overseas.
- **Motivation of field staff:** The Company optimised its allocation of resources, concentrated its resources for frontline businesses, strengthened the construction of basic branches, focused on the development and training of the marketing team, and improved the competitiveness and service capabilities of its field staff. The Company also strengthened its product innovation and extended the scopes of insurance coverages. Furthermore, the Company has extensively developed the commercial insurance market that complements policy-related insurance products.

## CHAIRMAN'S STATEMENT

- **Enhancement of risk control:** The Company strengthened its financial reporting and supervision, refined insurance segments cost management, strengthened its quality of claims management, promoted a nationwide uniform claims handling procedure for motor vehicle insurance. The Company also strengthened the management of premiums receivable, prevented operating risks, refined the reinsurance mechanism in order to improve its risk control level.
- **Emphasis on personnel training:** The Company promoted the development of the human resources information system and reformed its employment system. The Company preliminary established a multi-level and wide-ranging employee training framework and system, delivered programmed training to front-line management officers by rotation, strengthened horizontal and vertical staff communications within the system, and enhanced the personnel pool.
- **Fulfilment of social responsibilities:** The Company actively participated in the construction of a harmonious society and provided solid insurance protection for the economic and social development. The Company developed supplemental medical insurance and rural cooperation medical insurance businesses in earnest, proactively explored new models for agriculture insurance business and widened the scope of its insurance services. The Company also emphasised disaster prevention, assistance during disasters and reconstruction after disasters, took its initiatives to provide effective insurance services for people in the disaster-stricken areas. Moreover, the Company actively undertook the insurance for major projects such as the three-gorges project and satellite launching. The Company also strengthened its efforts in the development of Olympics-related insurance services and the promotion of "Olympic Steersmen" activity in order to enhance its brand awareness and promote its market image.

In 2007, the Company is presented with opportunities and challenges in its development and reform. China's economy will maintain a relatively rapid growth, and the quality and efficiency of the economic development will be further enhanced. The building of a harmonious society will result in extensive demands for a better and quicker development of a stronger insurance industry in China. The further promotion of the construction of new socialist rural areas will result in new opportunities for the exploitation of the enormous rural insurance market, which has become a new area of growth. Moreover, with the further refinement of PICC Group's strategies, the extensive reformation of PICC Group's systems and mechanisms will certainly be accelerated, the capabilities of resources integration will be strengthened and the overall advantages will be further leveraged. These factors will create favourable conditions for the Company to accelerate its development and enhance its efficiency.

In 2007, the Company will deeply participate in the construction of a harmonious society under the principles of scientific development and will pragmatically accomplish the following six tasks. Firstly, the Company will strengthen the foundation for management and control and enhance the field staff's capabilities of accelerated development. Secondly, the Company will refine its operating mechanisms and establish a solid execution system. Thirdly, the Company will innovate its marketing system and actively explore cross-selling models. Fourthly, the Company will strengthen its capital operations and will focus on the appropriate integration of capital operations and business expansion. Fifthly, the Company will guard itself against operational risks and increase its efforts on auditing, supervision and inspection. Sixthly, the Company will enhance its service standard and refine its centrally-managed service platform. Through the effective performance of the above tasks, the Company will strive to achieve a rapid expansion of its businesses and a stable improvement in its operating efficiency and continue to keep its efforts in consolidating its leading position in China's non-life insurance market so as to create greater value for the shareholders and make more contributions to the economic and social development.

Lastly, on behalf of the Board of Directors and personally, I would like to extend sincere gratitude to Mr Tang Yunxiang, former Chairman of the Board of Directors and Mr Deng Zhaoyu, former Chairman of the Supervisory Committee for their contributions to the Company during their period of service with the Company.

**Wu Yan**  
*Chairman*

Beijing, the PRC  
17 April 2007

### DIRECTORS

**Wu Yan**, age 46, Chairman of the Board of Directors, Executive Director of the Company, and General Manager of PICC Holding. From 1985 to 1998, Mr Wu was the Deputy Secretary of the Communist Youth League of Xinjiang Autonomous Region, a member of the Standing Committee of Beortalar Autonomous County Communist Party Committee, the Party Secretary of the Communist Party Committee of the city of Bole, the Party Secretary of the Communist Youth League of Xinjiang Autonomous Region, and the Vice Minister of the Central Communist Youth League Organization Department. Mr Wu was the Party Secretary of the Central Finance League and the President of the National Finance Youth Union from 1998 to 2003. Mr Wu was the Vice President of China Life Insurance (Group) Company from 2003 to January 2007, a Director and the President of China Life Insurance Asset Management Company Limited from 2003 to 2005. Mr Wu was a Non-executive Director of China Life Insurance Company Limited from 2003 to January 2006, and an Executive Director and the President of that company from January 2006 to January 2007. Mr Wu graduated from Xinjiang College of Finance and Economics majoring in finance in 1981, and graduated from the China Academy of Social Sciences with a doctorate degree in national economics in 2002.

**Wang Yi**, age 51, a senior economist, Vice Chairman of the Board of Directors, Executive Director, President and Chief Executive Officer of the Company, and a Deputy General Manager of PICC Holding. Mr Wang joined The People's Insurance Company of China ("PICC") in 1979 and was previously the Deputy General Manager of PICC Ningbo Branch, General Manager of PICC Hangzhou Branch, General Manager of PICC Zhejiang Branch and Deputy General Manager of PICC. Mr Wang graduated from Zhejiang Radio and Television University in 1986. He graduated from the Chinese Communist Party School with a bachelor's degree in economics and management in 2000 and a master's degree in political science in 2004. He has 28 years of operation and management experience in the PRC insurance industry.

**Tse Sze-Wing, Edmund**, GBS, age 69, Non-executive Director of the Company. Mr Tse is the Senior Vice Chairman of Life Insurance of American International Group, Inc. (AIG) as well as the Chairman and Chief Executive Officer of American International Assurance Company, Limited (AIA). He also holds various senior positions and directorships in other AIG companies around the world. In 2003, he was elected to the Insurance Hall of Fame, the most prestigious award in the global insurance industry. Mr Tse graduated with a bachelor's degree in Mathematics from The University of Hong Kong, which later conferred on him an Honorary Fellowship and an Honorary Doctorate Degree in Social Sciences. Mr Tse also holds diplomas from the College of Insurance and the Graduate School of Business of Stanford University. He has 46 years of extensive management experience in the insurance market, both in Asia and globally.

**Cheng Wai Chee, Christopher**, GBS, OBE, JP, age 59, Independent Non-executive Director of the Company. Mr Cheng is the Chairman of USI Holdings Limited, Winsor Properties Holdings Limited and Wing Tai Corporation Limited. He is also Independent Non-executive Director of several listed and unlisted companies in Hong Kong, including NWS Holdings Limited, New World China Land Limited and DBS Bank (Hong Kong) Limited. Mr Cheng plays an active role in public service. He currently serves as a Non-executive Director of the Board of the Securities and Futures Commission of the Government of the Hong Kong Special Administrative Region of the People's Republic of China ("HKSAR Government"), and a member of the Exchange Fund Advisory Committee of the HKSAR Government. He has served as the Chairman of the Hong Kong General Chamber of Commerce, the Chairman of the Competition Policy Review Committee and a Council member of the Hong Kong Trade Development Council. Mr Cheng also has a keen interest in the management of public affairs. He is the Chairman of the Standing Committee on Judicial Salaries and Conditions of Service of the HKSAR Government. As a long-serving former member of the Public Service Commission, he provided advice to the HKSAR Government on the formulation of human resources management policies and practices for the civil service. Mr Cheng is also a Steward of the Hong

## BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND OTHER SENIOR MANAGEMENT

Kong Jockey Club and a Council member of The University of Hong Kong. Mr Cheng holds a bachelor's degree in business administration from the University of Notre Dame, Indiana, USA, and a master's degree in business administration from Columbia University, New York. He was appointed as a Justice of the Peace in 1985, and was awarded an O.B.E. in 1992 and the Gold Bauhinia Star in 2004.

**Lu Zhengfei**, age 44, a professor and a supervisor of doctoral students, Independent Non-executive Director of the Company. Mr Lu is the Associate Dean of Guanghua School of Management and head of the Accounting Department, Peking University, a consultant to China Accounting Standards Committee of the Ministry of Finance, a committee member and an Academic Committee member of Chinese Accounting Association, a Standing Committee member of Chinese Audit Association, and a member of Chinese Tax Association and Chinese Costing Research Institute. He is also a Guest Editor of Accounting Research and a member of the Editorial Committee of Auditing Research. Mr Lu was elected into the "100 Outstanding Persons' Research Program" as a man of talent in social science theories in Beijing in 2001, and into the "New Century Excellent Scholarship Program" of the Ministry of Education of the PRC in 2005. Mr Lu graduated from Nanjing University with a doctorate degree in economics, and completed the post-doctoral research on economics (accounting) at Renmin University of China.

**Luk Kin Yu, Peter**, age 66, Independent Non-executive Director of the Company. Mr Luk is a fellow member of the Institute of Actuaries in England, Institute of Actuaries of Australia, and Society of Actuaries in the United States of America respectively. Mr Luk was the Chief Actuary of American International Assurance Co., Ltd., Chief Financial Officer of the Pacific-Asia Division of Manufacturers Life Insurance Co. Ltd., Appointed Actuary of Australian Casualty and Insurance Co. Ltd., a Principal Actuary of Mercer, Campbell, Cook & Knight, an Executive Director and Chief Financial Officer of Pacific Century Insurance Holdings Limited. Mr Luk is the founding president of the Actuarial Society of Hong Kong and was President of that society for several sessions, Chairman of the Advisory Committee of Insurance, Financial and Actuarial Analysis of The Chinese University of Hong Kong, Chairman of the Advisory Committee of the Department of Mathematics of City University of Hong Kong, and advisor to the Actuarial Committee of Shanghai Insurance Institute. He is the Chief Executive Officer of Plan-B Consulting Limited. Mr Luk has substantial experience in the insurance industry.

**Ding Ningning**, age 59, Independent Non-executive Director of the Company. Mr Ding is the Director of the Department of Social Development Research of the Development Research Centre ("DRC") of the State Council of the PRC and a member of the Academic Committee of the DRC, a member of China Energy Research Society and The China Association for Labor Studies. Mr Ding has been conducting research at the DRC for 25 years since 1982 and was the Director of the Department of Enterprise Economic Research of the DRC from 1993 to 1998. He was a member of the Listed Company Supervisory Committee of China Securities Regulatory Commission from 1993 to 2000. Mr Ding graduated from Tsinghua University with a bachelor's degree in electric engineering. Mr Ding enrolled in the Chinese Communist Party School and graduated from its first doctorate course in economics. Mr Ding studied and conducted research on British economic history at The Centre of Chinese Study of Oxford University in England and has substantial experience in the area of economic research.

**Wu Gaolian**, age 54, a senior economist, Non-executive Director of the Company, and a Deputy General Manager of PICC Holding. Mr Wu joined PICC in 1992 and was previously the General Manager of PICC Tonghua Branch in Jilin Province, General Manager of PICC Changchun Branch in Jilin Province, Deputy General Manager of PICC Jilin Branch, General Manager of PICC Guangxi Branch, and General Manager of PICC Liaoning Branch. Mr Wu is an economic management graduate of the Chinese Communist Party School and graduated from a postgraduate program in banking at the China Academy of Social Sciences. He has 15 years of operation and management experience in the PRC insurance industry.

## BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND OTHER SENIOR MANAGEMENT

**Zhou Shurui**, age 54, a senior administrative engineer, Non-executive Director of the Company, and a Deputy General Manager of PICC Holding. Mr Zhou previously worked in the Hebei Provincial People's Government. Mr Zhou joined PICC in 1992 and was previously the Manager, Assistant General Manager, Deputy General Manager and General Manager of the Human Resources Department of PICC. Mr Zhou graduated from Hebei Normal University with a college diploma and a bachelor's degree, and from a postgraduate program in banking at The Central University of Finance and Economics. He has 25 years of experience in management.

**Wang Yincheng**, age 46, a senior accountant, Executive Director, Executive Vice President and Chief Financial Officer of the Company. Mr Wang joined PICC in 1982 and was previously the Deputy General Manager of the Planning and Finance Department of PICC Property Insurance Company, General Manager of PICC Shenzhen Branch and Assistant General Manager of PICC. Mr Wang graduated from Zhongnan University of Economics and Law with a doctorate degree in economics. He has 25 years of experience in economic and financial management in the PRC insurance industry.

**Liu Zhenghuan**, age 56, a senior economist, Executive Director, Executive Vice President and Secretary of the Board of Directors of the Company. Ms Liu joined PICC in 1984 and was previously the Deputy Manager and Manager of the Operations Division of PICC Anhui Branch, Deputy General Manager and General Manager of PICC Anhui Branch and General Manager of PICC Jiangsu Branch. Ms Liu graduated from Fudan University with a master's degree in economics. She has 23 years of operation and management experience in the PRC insurance industry.

**Li Tao**, age 40, Ph.D, a senior economist, Non-executive Director of the Company, and the General Manager of the Development and Reformation Department and the Policy Research Department of PICC Holding. Mr Li lectured at Beijing University of Aeronautics and Astronautics. Mr Li joined PICC in 1998 and was previously the Manager of the Policy Research Division of the Research and Development Centre of PICC, Deputy General Manager of the Research and Development Centre and the Planning and Statistics Department of PICC, and Deputy General Manager and General Manager of the Secretariat of the Board of Directors of the Company. Mr Li graduated from Renmin University of China with a master's degree in philosophy in 1993, and from the Chinese Communist Party School with a doctorate degree in economics in 1998. He has 14 years of research and management experience.

### SUPERVISORS

**Ding Yunzhou**, age 53, a senior economist, became the Chairman of the Supervisory Committee of the Company in October 2006. Mr Ding is a Deputy General Manager of PICC Holding. Mr Ding served as a Non-executive Director of the Company from July 2003 to October 2006. Mr Ding joined PICC in 1977 and was previously the Deputy General Manager of the International Insurance Department of PICC, Chairman and General Manager of China Insurance (UK) Company Limited and Chief Representative of the London Representative Office of PICC, and Assistant General Manager and Deputy General Manager of PICC. Mr Ding graduated from Dalian University of Foreign Languages and has 31 years of operation and management experience in the domestic and international insurance industries.

**Li Dianjun**, age 64, a university graduate, a researcher, became an Independent Supervisor of the Company in May 2006. Mr Li was previously a deputy county mayor of the regional government of the PRC, the Director-general of the Personnel Department of the Head Office of the People's Bank of China and the Vice President of Agricultural Bank of China. Mr Li was appointed by the State Council of the PRC as the Chairman of the Supervisory Committees of China Life Insurance Company, PICC Holding and China Reinsurance (Group) Company. Mr Li graduated from Northeast Normal University with a bachelor's degree in arts. Mr Li has 24 years of operation and supervision experience in central bank, commercial banks and insurance companies.

## BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND OTHER SENIOR MANAGEMENT

**Sheng Hetai**, age 36, a senior economist, became a Supervisor of the Company in October 2006. Mr Sheng is the General Manager of the Equity Capital Management Department and the Risk Management Department of PICC Holding. Mr Sheng joined PICC in 1998 and was previously the Manager of the Research Division of the Marketing Department of PICC, Deputy General Manager of the Products Development Centre of PICC and Deputy General Manager of the Research and Development Department of PICC Holding. Mr Sheng graduated from Peking University with a doctorate degree in economics and has 9 years of management experience in the PRC insurance industry.

**He Bangshun**, age 56, a senior economist, became a Supervisor of the Company in October 2006. Mr He is the General Manager of the Audit Department of the Company. Mr He joined PICC in 1975 and was previously the Deputy Manager of the Fourth Division of the International Business Department of PICC, Manager of the Marketing Development Division of PICC, and Manager of the Import and Export Cargo Transportation Insurance Division of that department. Mr He was also the Deputy General Manager of The Ming An Insurance Company (Hong Kong) Limited, Deputy General Manager of China Reinsurance Company (Hong Kong) Limited, and Deputy General Manager and General Manager of the Reinsurance Department of PICC. Mr He graduated from Beijing International Studies University and has over 30 years of operation and management experience in the domestic and international insurance industries.

### OTHER SENIOR MANAGEMENT

**Guo Shengchen**, age 52, a university graduate and a senior economist, Executive Vice President of the Company. Mr Guo joined PICC in 1984 and was previously the Assistant General Manager, Deputy General Manager and General Manager of PICC Beijing Branch. He has 33 years of operation and management experience in the PRC financial and insurance industries.

**Zhao Shuxian**, age 55, a university graduate and a senior economist, Executive Vice President of the Company. Ms Zhao joined PICC in 1978 and was previously the Deputy General Manager of the Operations Department and General Manager of the Special Risk Insurance Department of PICC Property Insurance Company, and Chief Representative of the European Representative Office of PICC. She has 29 years of operation and management experience in the PRC insurance industry.

**Jia Haimao**, age 53, a senior economist, Executive Vice President of the Company, and the principal of the Jiangsu Branch of the Company. Mr Jia joined PICC in 1984 and was the Deputy General Manager and General Manager of the Motor Vehicle Insurance Department of PICC. He has 23 years of operation and management experience in the PRC insurance industry.

**Li Yuquan**, age 41, Ph.D, an associate professor, Executive Vice President and Compliance Officer of the Company. Mr Li joined PICC in 1994 and was the Deputy Manager and Manager of the International Insurance Department and the Administrative Department of PICC, Deputy General Manager of the Marketing Department of PICC, General Manager of the Legal Department of PICC and General Manager of PICC Shanghai Branch. He has 18 years of experience in research on PRC insurance laws and the operation and management of the PRC insurance industry.

**Wang He**, age 50, Ph.D, a senior economist, Executive Vice President of the Company. Mr Wang joined PICC in 1988 and was the Manager of the Operations Department of PICC Fujian Branch, Deputy General Manager of PICC Xiamen Branch and Deputy Executive General Manager of the Products Development Centre of PICC. He has 19 years of operation and management experience in the PRC insurance industry.

## 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

<sup>1</sup> 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 (%)
<b>Net premiums earned</b>		
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
<b>Total</b>	<b>100</b>	<b>100</b>
<b>Net claims incurred</b>		
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
<b>Total</b>	<b>100</b>	<b>100</b>
<b>Amortisation of deferred acquisition costs, net</b>		
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)
<b>Total</b>	<b>100</b>	<b>100</b>

### 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](http://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 <i>RMB million</i>	2005 <i>RMB million</i>
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**

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

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

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## REPORT OF THE DIRECTORS

The Board of Directors presents their report and the audited financial statements of the Company and its subsidiaries for the year ended 31 December 2006 (the “Year”).

### PRINCIPAL ACTIVITIES

The Company engages in motor vehicle insurance, commercial property insurance, homeowners insurance, cargo insurance, liability insurance, accidental injury insurance, short-term health insurance, hull insurance, agriculture insurance, surety insurance, which are denominated in RMB and foreign currencies, together with the reinsurance of the above insurance products, and investment and fund application business permitted under the relevant laws and regulations of the PRC. The Company’s subsidiaries mainly engage in providing insurance agency services and training services for the Company.

### FINANCIAL RESULTS AND DIVIDEND

The results of the Company and its subsidiaries for the Year and the state of financial affairs of the Company and its subsidiaries as at 31 December 2006 are set out on pages 47 to 117 of this annual report.

The Board of Directors did not propose any final dividend for the Year.

### FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Company and its subsidiaries for the last five financial years is set out on page 2 of this annual report.

### PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

Changes in the property, plant and equipment and investment properties of the Company and its subsidiaries during the Year are set out in notes 30 and 31 to the financial statements respectively.

### SHARE CAPITAL

There were no movements in the share capital of the Company during the Year.

### PRE-EMPTIVE RIGHTS

There are no provisions regarding pre-emptive rights in respect of the transfer of shares or issue of new shares of joint-stock limited companies under the Company Law of the People’s Republic of China (“Company Law”).

### PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

The Company and its subsidiaries did not purchase, sell or redeem any of its listed securities during the Year.

### RESERVES

Details of the reserves of the Company and its subsidiaries and their changes during the Year are set out in the Consolidated Statement of Changes in Equity on page 49 of this annual report.

### DISTRIBUTABLE RESERVES

As at 31 December 2006, the Company did not have any distributable reserves based on the PRC accounting standards.

### SUBORDINATED DEBTS

Details of the subordinated term debts issued by the Company during the Year are set out in the paragraph headed “Liquidity” under the section headed “Management Discussion and Analysis of Operating Results and Financial Conditions” on page 19 of this annual report.

### CHARITABLE AND OTHER DONATIONS

Charitable and other donations made by the Company and its subsidiaries in the Year amounted to RMB72.06 million.

### MAJOR CUSTOMERS

The aggregate turnover of the Company and its subsidiaries with their five largest customers did not exceed 10% of the total turnover of the Company and its subsidiaries for the Year.

### FIVE LARGEST REINSURERS

The reinsurance premiums ceded to the five largest reinsurers of the Company in the Year, and the ratings given by A.M. Best or Standard & Poor’s are as follows (*Note 1*):

Reinsurer	Reinsurance premiums ceded (RMB million)	A.M. Best Rating	Standard & Poor’s Rating
CHINA RE	3,371	Not applicable	Not applicable
MUNICH RE	2,917	A+	A+
SWISS RE	1,225	A+	AA
AIG ( <i>Note 2</i> )	739	A+	AA+
Lloyd’s Syndicates	270	A	A

*Notes:*

1. Credit ratings as of 31 December 2006.
2. The accumulated reinsurance premiums ceded to the subsidiaries of AIG.

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## REPORT OF THE DIRECTORS

### DIRECTORS AND SUPERVISORS

The directors and supervisors of the Company and their changes during the Year as well as the changes of the directors from 1 January 2007 until the date of this report are set out in the Corporate Governance Report of this annual report. There is no change in the members of the Supervisory Committee from 1 January 2007 to the date of this report.

### BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND OTHER SENIOR MANAGEMENT

Biographical details of the directors, supervisors and other senior management of the Company are set out on pages 5 to 8 of this annual report.

### DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS AND REMUNERATION

The Company did not enter into any service contracts, which are not determinable by the Company within one year without payment of compensation (other than statutory compensation), with its directors and supervisors.

Details of the remuneration of the directors and supervisors of the Company are set out in note 12 to the financial statements.

### HIGHEST PAID INDIVIDUALS

Details of the remuneration of the five highest paid individuals of the Company are set out in note 13 to the financial statements.

### DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

None of the directors and supervisors had a material interest, whether directly or indirectly, in any contracts which were significant to the business of the Company and subsisted at the end of the Year or at any time during the Year.

### MANAGEMENT CONTRACT

Pursuant to the asset management agreement entered into between the Company and PICC Asset Management Company Limited (an associate of the Company and a subsidiary of the Company's controlling shareholder), PICC Asset Management Company Limited provides investment management services in respect of certain assets of the Company. The Company pays an annual management fee to PICC Asset Management Company Limited. The particulars of this agreement are set forth in note 49(a) to the financial statements.

### **DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVE'S INTERESTS IN SHARES**

The directors, supervisors and chief executive of the Company had not held the interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as defined in the Securities and Futures Ordinance (“SFO”) as of 31 December 2006 that are required to be recorded in the register required to be kept under section 352 of the SFO and required to be notified to the Company and the Stock Exchange under the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“Listing Rules”).

### **DIRECTORS' INTEREST IN COMPETING BUSINESS**

PICC Life Insurance Company Limited (“PICC Life”) and PICC Health Insurance Company Limited (“PICC Health”), subsidiaries of PICC Holding, the controlling shareholder of the Company, also engage in accidental injury insurance and short-term health insurance business.

Mr Tang Yunxiang (resigned on 1 February 2007), the former Chairman of the Company, served as the Chairman and President of PICC Life and the Chairman of PICC Health. Mr Ding Yunzhou (retired on 18 October 2006), Mr Wu Gaolian and Mr Zhou Shurui, non-executive directors of the Company, have acted as the Chairman of the Supervisory Committee of PICC Health, a non-executive director of PICC Life and a non-executive director of PICC Health, respectively.

Pursuant to the reorganisation agreement entered into between the Company and PICC Holding, PICC Holding has undertaken not to carry on any insurance business in the PRC which is of the same or similar nature as, or competes with, the core business of the Company.

Save as disclosed above, none of the directors of the Company is or was interested in any business that competes or competed or is or was likely to compete, either directly or indirectly, with the Company's business from 1 January 2006 to the date of this report.

### **MATERIAL CONTRACTS**

The Company entered into various agreements with PICC Holding (the controlling shareholder of the Company), PICC Asset Management Company Limited (an associate of the Company and a subsidiary of the Company's controlling shareholder), and AIG (the strategic investor of the Company). Details of the transactions pursuant to these agreements during the Year are set out in note 49 to the financial statements.

## REPORT OF THE DIRECTORS

### DISCLOSEABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER SFO

As at 31 December 2006, the following shareholders had interests or short positions in the shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO:

Name of shareholder	Capacity	Number of domestic shares	Nature of interests	Percentage of total number of domestic shares in issue	Percentage of total number of shares in issue
PICC Holding	Beneficial owner	7,685,820,000	Long position	100%	69.0%

Name of shareholder	Capacity	Number of H shares	Nature of interests	Percentage of total number of H shares in issue	Percentage of total number of shares in issue
AIG (Note 1)	Interest of controlled corporations	1,103,038,000	Long position	31.92%	9.9%
Birmingham Fire Insurance Company of Pennsylvania (Note 1)	Beneficial owner	562,549,380	Long position	16.28%	5.05%
Commerce and Industry Insurance Company (Note 1)	Beneficial owner	330,911,400	Long position	9.58%	2.97%
Lexington Insurance Company (Note 1)	Beneficial owner	209,577,220	Long position	6.06%	1.88%
Morgan Stanley	Interest of controlled corporations	402,123,169 148,466,645	Long position Short position	11.64% 4.30%	3.61% 1.33%
JPMorgan Chase & Co.	Beneficial owner/ Investment manager/ Custodian-corporation/ Approved lending agent	175,856,024 (Note 2)	Long position	5.09%	1.58%

*Notes:*

1. Birmingham Fire Insurance Company of Pennsylvania, Commerce and Industry Insurance Company, Lexington Insurance Company were controlled corporations of AIG.
2. Included in the 175,856,024 shares were 64,476,000 shares held in the capacity as beneficial owner, 1,630 shares held in the capacity as investment manager and a lending pool of 111,378,394 shares.

Save as disclosed above, the Company is not aware of any other persons having any interests or short positions in the shares or underlying shares of the Company as at 31 December 2006 required to be recorded in the register kept under section 336 of the SFO.

### PUBLIC FLOAT

As at the date of this report, 31% of the issued share capital of the Company is held by the public.

### CONNECTED TRANSACTIONS

The connected transactions and the continuing connected transactions of the Company for the Year are set out in note 49 to the financial statements.

The independent non-executive directors of the Company have reviewed all the continuing connected transactions and confirmed that:

1. all transactions were entered into in the ordinary and usual course of business;
2. all transactions were on normal commercial terms, fair and reasonable and in the interests of the shareholders of the Company as a whole;
3. all transactions were carried out in accordance with the terms of the agreements governing the transactions; and
4. for items (i) to (v) and (vii) set out in note 49 to the financial statements, none of the transactions exceeded the relevant annual upper limits approved by the Stock Exchange or previously disclosed in the Company's announcement.

The auditors of the Company have reviewed all the continuing connected transactions and confirmed to the Board of Directors that:

1. all transactions have been approved by the Board of Directors;
2. all transactions (when involving the provision of goods or services by the Company) were carried out in accordance with the Company's pricing policy;
3. all transactions were carried out in accordance with the terms of the agreements governing the transactions; and
4. for items (i) to (v) and (vii) set out in note 49 to the financial statements, none of the transactions exceeded the relevant annual upper limits approved by the Stock Exchange or previously disclosed in the Company's announcement.

The Company has complied with the requirements of the waiver granted by the Stock Exchange or the disclosure requirements under Chapter 14A of the Listing Rules.

### CORPORATE GOVERNANCE

Details of the corporate governance of the Company are set out in the Corporate Governance Report of this annual report.

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## REPORT OF THE DIRECTORS

### AUDIT COMMITTEE

The Audit Committee has reviewed the audited financial statements for the Year. The composition and the role of the Audit Committee and a summary of its work performed during the Year are set out in the Corporate Governance Report of this annual report.

### AUDITORS

The tenure of Ernst & Young and Ernst & Young Hua Ming, which serve as the international auditors and domestic auditors of the Company respectively, shall end at the conclusion of the forthcoming annual general meeting.

By Order of the Board

**Wu Yan**

*Chairman*

Beijing, the PRC

17 April 2007

### Dear Shareholders:

All members of the Supervisory Committee of the Company duly carried out its supervisory duties in good faith and effectively protected the interests of the Company, its shareholders and its employees strictly in accordance with the relevant provisions of the Company Law and the Articles of Association of the Company (“Articles of Association”) in the Year.

During the Year, the Supervisory Committee convened four meetings, at which nine proposals, including the Auditors’ Report and Audited Financial Statements for 2005, and the Profit Distribution Plan for 2005, were considered and approved. The supervisors attended four meetings of the Audit Committee, at which the Chief Financial Officer, the Finance Department and the Audit Department of the Company reported the financial conditions and business operations of the Company for 2005 and the first half of 2006, and the Company’s auditors reported the audit work for the Company for 2005 and the first half of 2006. The supervisors attended four shareholders’ general meetings and four meetings of the Board of Directors to perform on-site supervision of the legality of the substance and procedures of the meetings. The supervisors supervised the implementation by the Board of Directors of the resolutions of the shareholders’ general meetings, and submitted the Report of the Supervisory Committee for 2005 to the shareholders’ general meeting, at which it was approved.

To further strengthen the role of the Supervisory Committee, the Supervisory Committee nominated a new independent supervisor and convened a special shareholders’ general meeting to approve the appointment. The Supervisory Committee was re-elected in October 2006 and the second Supervisory Committee of the Company was formed with Mr Ding Yunzhou acting as its chairman.

During the Year, the Supervisory Committee conducted inspection, investigation of as well as research on the Company’s Jilin Branch and Xiamen Branch and their sub-branches, and submitted reports on the results as well as proposals on improvement to the management of the Company.

The Supervisory Committee is of the view that:

In the Year, the directors and senior management of the Company have performed their duties set forth in the Articles of Association in diligence and good faith, implemented all resolutions of the shareholders’ general meetings and those of the Board of Directors in earnest, and made persistent efforts for the Company’s development. No director or member of the senior management was found to have committed any breach of any laws, regulations or the Articles of Association or to have infringed any rights or interests of the Company, its shareholders or its employees in performing their duties during the Year.

The reviewed financial statements of the Company for the interim period of 2006 and the audited financial statements of the Company and its subsidiaries for 2006 were prepared strictly in accordance with the relevant accounting standards and consistently applied the accounting treatments, and the information contained in the financial statements gave a true and fair view of the financial conditions and operating results of the Company and its subsidiaries.

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## REPORT OF THE SUPERVISORY COMMITTEE

The connected transactions of the Company were conducted on an arm's length basis and satisfied the relevant regulatory provisions of the Stock Exchange. There was no indication of any infringement of the interests of the Company or its independent shareholders.

In 2007, the Supervisory Committee will continue to perform its supervisory duties strictly in accordance with the relevant provisions of the Company Law and the Articles of Association, further increase its supervisory efforts, protect the interests of the Company, its shareholders and its employees in earnest and accomplish its work diligently.

By Order of the Supervisory Committee

**Ding Yunzhou**

*Chairman of the Supervisory Committee*

Beijing, the PRC

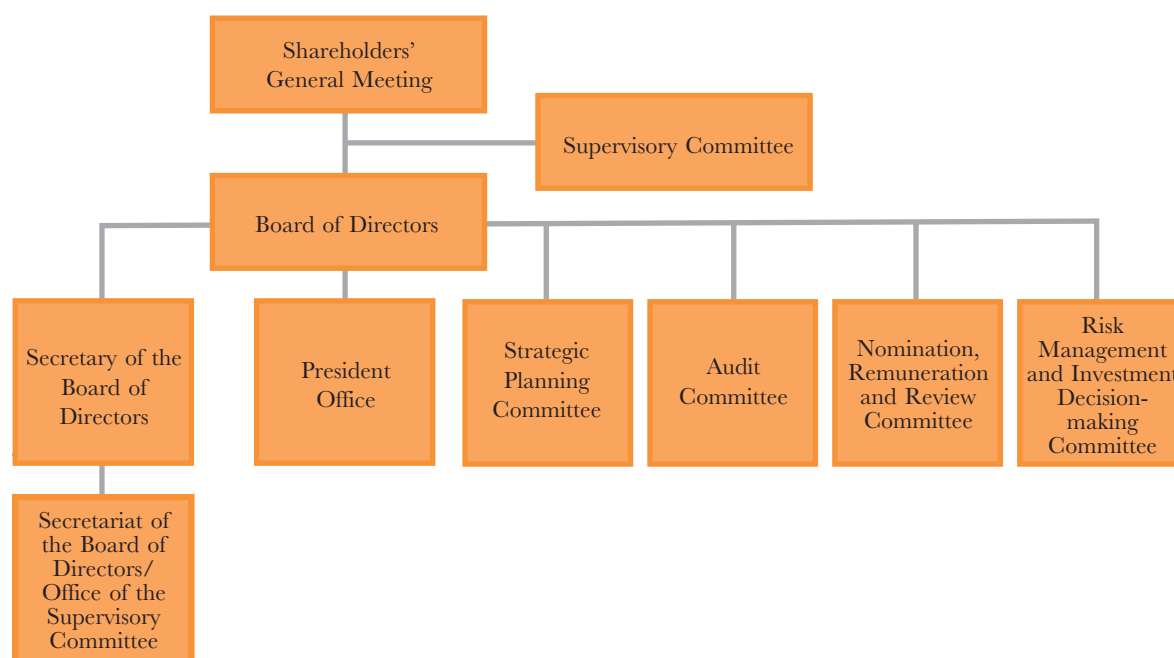
17 April 2007

## OVERVIEW

The Company believes that maintaining sound corporate governance is in the interests of the Company, its shareholders and stakeholders. In accordance with the Company Law, the Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies (“Special Regulations”), the Mandatory Provisions for the Articles of Association of Companies Listing Overseas (“Mandatory Provisions”), the Listing Rules, the Guidelines on Regulating Corporate Governance Structure of Insurance Companies (Trial) (“Guidelines”), the Articles of Association and other relevant laws and regulations, the Company has persisted in improving its corporate governance.

During the Year, by applying the Guidelines and the principles and code provisions of the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules (“Code on Corporate Governance Practices”), the Company continuously refined the operating mechanism of the Board of Directors and the board committees, clearly defined the duties and responsibilities of the Board of Directors, the Audit Committee, the management and the relevant functional departments with regard to the internal control of the Company, and reviewed and ceaselessly enhanced the effectiveness of the Company’s internal control system.

Save as during the period from 1 January 2006 to 17 January 2006, the composition of the Nomination, Remuneration and Review Committee of the Company did not meet the requirement under Code Provision B.1.1 of the Code on Corporate Governance Practices that the majority of the remuneration committee members should be independent non-executive directors, the Company complied with all the other code provisions of the Code on Corporate Governance Practices in 2006. Since Mr Ding Ningning was appointed an Independent Non-executive Director and a member of the Nomination, Remuneration and Review Committee of the Company on 18 January 2006, the composition of the Nomination, Remuneration and Review Committee of the Company has met the requirement under Code Provision B.1.1 of the Code on Corporate Governance Practices.



## BOARD OF DIRECTORS

### Overview

During the Year, the Board of Directors convened four shareholders’ general meetings and submitted twenty proposals to the shareholders’ general meetings for consideration and approval, and held five board meetings and considered and approved forty-four proposals. The Board of Directors formulated the business development plan, financial

budget, fixed assets investment plan, strategic allocations of and investment policies on custodian assets of the Company, etc. The Board of Directors also conducted annual performance appraisals of the Company's Directors and senior management, adjusted the remuneration structure of the senior management, and enhanced the effectiveness of the Company's internal control system.

The Board of Directors meets regularly at least four times a year, and holds special meetings when necessary. Notices and meeting materials for regular board meetings are given to the directors at least fourteen days and three days prior to the meetings, respectively. All the directors are entitled to submit proposals to be listed as part of the agenda of the board meetings. Detailed minutes of each board meeting are kept. Four board committees are formed under the Board of Directors, namely the Strategic Planning Committee, the Audit Committee, the Nomination, Remuneration and Review Committee, and the Risk Management and Investment Decision-making Committee, respectively. The duties and responsibilities of and operating procedures for each of the above board committees are clearly defined. The board committees submit opinions and proposals to the Board of Directors on matters within their respective scope of duties and responsibilities.

During the Year, in accordance with the principles and code provisions set out in A.1, A.3, A.4 and A.6 of the Code on Corporate Governance Practices and the relevant provisions of the Company Law, the Guidelines and the Articles of Association, the Board of Directors continued to regulate its operations and enhance the corporate governance. The Board of Directors has complied with all the code provisions under A.1, A.3, A.4 and A.6.

### Composition

During the Year, the Board of Directors of the Company comprised the following Directors:

Name	Position	Date of Commencement of Directorship	Term
Mr Tang Yunxiang (resigned)	Chairman	6 July 2003	Resigned on 1 February 2007
Mr Wang Yi	Vice Chairman, Executive Director	6 July 2003	From 18 October 2006 to 5 July 2009
Mr Tse Sze-Wing, Edmund	Non-executive Director	15 June 2004	From 6 July 2006 to 5 July 2009
Mr Cheng Wai Chee, Christopher	Independent Non-executive Director	30 July 2003	From 30 July 2006 to 5 July 2009
Mr Lu Zhengfei	Independent Non-executive Director	24 February 2004	From 24 February 2004 to 23 February 2007
Mr Luk Kin Yu, Peter	Independent Non-executive Director	29 April 2005	From 29 April 2005 to 28 April 2008
Mr Ding Ningning	Independent Non-executive Director	18 January 2006	From 18 January 2006 to 17 January 2009
Mr Ding Yunzhou (retired)	Non-executive Director	6 July 2003	Retired on 18 October 2006
Mr Wu Gaolian	Non-executive Director	18 October 2006	From 18 October 2006 to 5 July 2009
Mr Zhou Shurui	Non-executive Director	6 July 2003	From 18 October 2006 to 5 July 2009
Mr Wang Yincheng	Executive Director	6 July 2003	From 18 October 2006 to 5 July 2009
Ms Liu Zhenghuan	Executive Director, Secretary of the Board of Directors	6 July 2003	From 18 October 2006 to 5 July 2009
Mr Li Tao	Non-executive Director	18 October 2006	From 18 October 2006 to 5 July 2009

*Note:* Mr Lu Zhengfei was re-appointed the Company's Independent Non-executive Director on 24 February 2007 and his term of appointment will expire on 23 February 2010.

Change of directors for the period from 1 January 2007 to the date of this report is as follows:

Mr Wu Yan was appointed the Company's Chairman, Executive Director, Chairman of the Strategic Planning Committee, and Chairman of the Risk Management and Investment Decision-making Committee on 23 March 2007.

### Duties and Responsibilities

The Board of Directors is responsible for providing leadership and monitoring and controlling the operations of the Company, formulating the overall strategies, policies, financial budgets and final accounts of the Company, determining the annual operational plans and investment plans of the Company, determining the fundamental management system and internal management structure, assessing the performance of the Company and supervising the work of the management. The Board of Directors is also responsible for convening shareholders' general meetings, reporting its work to the shareholders' general meetings, implementing resolutions of the shareholders' general meetings; formulating plans for distribution of profits and recovery of losses, formulating proposals for the increase in or reduction of the registered capital of the Company, the issue of corporate bonds and any amendments to the Articles of Association, drawing up plans for the merger, division, dissolution or change of the form of the Company; appointing or removing the Company's President, Vice Presidents, Secretary of the Board of Directors and other senior management personnel and determining their remuneration, rewards and disciplinary matters; electing members of the board committees; and approving the Company's investment in other enterprises or provision of guarantees to persons other than the Company's shareholders or actual controllers. The Board of Directors is ultimately responsible for the internal control, risk management and compliance management of the Company.

The Board of Directors delegates the daily business operations and management of the Company to the management.

### Summary of Work Undertaken

During the Year, the Board of Directors held five meetings and considered forty-four proposals. The attendance of each director is recorded as follows:

Name	Number of meetings attended/ Number of meetings that require attendance	Attendance rate
Tang Yunxiang	5/5	100%
Wang Yi	5/5	100%
Tse Sze-Wing, Edmund	5/5	100%
Cheng Wai Chee, Christopher	2/5	40%
Lu Zhengfei	5/5	100%
Luk Kin Yu, Peter	5/5	100%
Ding Ningning	4/4	100%
Ding Yunzhou	3/3	100%
Wu Gaolian	2/2	100%
Zhou Shurui	5/5	100%
Wang Yincheng	5/5	100%
Liu Zhenghuan	5/5	100%
Li Tao	2/2	100%

*Notes:*

1. Mr Ding Ningning was appointed the Company's Independent Non-executive Director on 18 January 2006.
2. Mr Ding Yunzhou retired from the position of the Company's Non-executive Director on 18 October 2006.
3. Mr Wu Gaolian and Mr Li Tao were appointed the Company's Non-executive Directors on 18 October 2006.

The main tasks accomplished by the Board of Directors in the Year included the followings:

- convened four shareholders' general meetings and submitted twenty proposals to the shareholders' general meetings including the Directors' Report for 2005, the Auditors' Report and the audited financial statements for 2005, profit distribution plans for 2005, amendments to the Articles of Association, and proposals for authorising the Board of Directors to issue subordinated term debts and election of the second Board of Directors;
- approved the business development plan, financial budget, fixed asset investment plan, and strategic allocations of and investment policies on custodian assets of the Company for the Year;
- approved the total amount of remuneration of the Company for the Year, adjusted the remuneration structure of the senior management and increased the proportion of the fixed remuneration of the senior management in order to ensure the stability of and better motivate employees of high calibre, and conducted the annual performance appraisals of the Company's senior management including the Chairman, Directors and the President;
- clearly defined the duties and responsibilities of the Board of Directors, the Audit Committee, the management and the relevant functional departments with regard to the internal control in accordance with the provisions of the Code on Corporate Governance Practices on internal control and the provisions of the Guidelines on internal control, risk management and compliance management; approved the Company's internal control evaluation report, risk evaluation report and compliance evaluation report for the Year, considered the report on improvement on the basis of the Management Letter of last year, and reviewed and continuously enhanced the effectiveness of the Company's internal control system;
- submitted the proposal for the amendments to the Articles of Association in accordance with the Company Law (as amended and effective as of 1 January 2006), the Special Regulations, the Mandatory Provisions and the Guidelines, which amendments, having been approved at the shareholders' general meeting and by CIRC, have come into force;
- elected the Chairman and the Vice Chairman of the second Board of Directors of the Company, and appointed the President, the Vice Presidents and the Secretary of the Board of Directors;
- appointed Mr Ding Ningning as a member of the Nomination, Remuneration and Review Committee so that the requirement under Code Provision B.1.1 of the Code on Corporate Governance Practices that the majority of the remuneration committee members should be independent non-executive directors has been met, and re-adjusted the composition of some board committees in line with the expertise of the Directors of the Company's second Board of Directors.

### DIRECTORS

#### Responsibilities with respect to Financial Statements

Directors are responsible for the preparation of financial statements for every financial year and the interim period thereof which shall give a true and fair view of the business operations of the Company in accordance with the financial reporting standards issued by the Hong Kong Institute of Certified Public Accountants and the adoption of appropriate and consistent accounting policies.

### Securities Transactions

The Company has formulated guidelines on transactions of the Company's securities that apply to the directors and all the employees, and the terms of the guidelines are no less exacting than those set out in the Model Code. The Company has made enquiries of all the Directors and they all have confirmed that they have complied with the requirements under the Model Code and the guidelines during the Year.

### Independence of Independent Non-executive Directors

The Company has received the annual confirmation letters from all the Independent Non-executive Directors of the Company of their independence. As at the date of this report, the Company is of the view that all the Independent Non-executive Directors are independent.

### CHAIRMAN/PRESIDENT

During the Year, the Chairman of the Board of Directors was Mr Tang Yunxiang (resigned on 1 February 2007) and the President was Mr Wang Yi. As at the date of this report, the Chairman of the Board of Directors is Mr Wu Yan. The Chairman is responsible for providing leadership for the Board of Directors, and ensuring that the Board of Directors works effectively and discharges its responsibilities properly. The President is responsible for managing the daily business operations of the Company and implementing the resolutions passed by the Board of Directors. Details of the duties and responsibilities of the Chairman and the President were contained on pages 36 and 37 of the Company's 2005 Annual Report.

### AUDIT COMMITTEE

#### Overview

During the Year, the Audit Committee continuously consolidated its development in accordance with the Listing Rules, the Guidelines and the Work Manual for the Audit Committee. During the Year, the Audit Committee continued to enhance communications with external auditors with respect to the audit work, reviewed the Company's annual report and accounts for 2005 and the interim report and accounts for 2006, carried out the internal control work steadily and made proposals and recommendations for the Company's internal control, risk management and compliance management. The Audit Committee also reviewed the Management Letter provided by the external auditors and the management's response, and considered the report of improvement on the basis of the Management Letter of last year. Furthermore, the Audit Committee effectively supervised and provided guidance on the internal audit and finance work, and reviewed a connected transaction of the Company.

#### Composition

Chairman: Lu Zhengfei

Members: Ding Yunzhou (retired on 18 October 2006), Luk Kin Yu, Peter, Li Tao (appointed on 18 October 2006)

### Duties and Responsibilities

The Audit Committee is responsible for monitoring and inspecting the financial reporting procedures and internal control system of the Company, reviewing the financial information of the Company, monitoring and providing guidance on the internal and external audit of the Company, and reviewing the appointment and the engagement terms of the external auditors. Details of the duties and responsibilities of the Audit Committee were contained on pages 37 and 38 of the Company's 2005 Annual Report.

### Remuneration of Auditors

In the Year, the Company paid RMB15.46 million to the auditors, including payment for the audit of the financial statements for 2005 and review of the interim report for 2006. During the Year, the Company did not engage the auditors for any material non-audit services.

### Summary of Work Undertaken

During the Year, the Audit Committee held four meetings and considered twelve proposals. The attendance rate of each committee member reached 100% and the attendance is recorded as follows:

Name	Lu Zhengfei	Ding Yunzhou	Luk Kin Yu, Peter	Li Tao
Number of meetings attended/ Number of meetings that require attendance	4/4	3/3	4/4	1/1
Attendance rate	100%	100%	100%	100%

#### Notes:

1. Mr Ding Yunzhou retired at the expiry of his term on 18 October 2006.
2. Mr Li Tao was appointed a member of the Audit Committee on 18 October 2006.

During the Year, the Audit Committee duly performed its duties of and played an active role in the supervision and provision of guidance on internal and external audit, the monitoring of financial reporting procedures, the reviewing of financial reports, the strengthening of internal control and risk management. The main tasks accomplished by the Audit Committee in the Year included the followings:

Further strengthened the communications with the external auditors:

- discussed the nature, scope and responsibilities of the audit and review with the external auditors, considered the reports from the external auditors on the work plans and results of the audit for 2005 and the interim review for 2006, gave their detailed and specific opinions on the requirements and quality of the audit and review, and fully communicated with the external auditors on matters such as the impact of the changes to the PRC Accounting Standards for Business Enterprises, material audit adjustments and internal control risks;
- considered the opinions of the external auditors and the Company's management on the annual audit and interim review fees respectively, considered the engagement terms, proposed to the Board of Directors for the continuous engagement of the auditors and the remuneration in relation thereto and obtained the approval from the Board of Directors.

Monitored and inspected the financial reporting procedures, and reviewed the financial reports:

- monitored and inspected the Company's financial reporting procedures, reviewed the financial statements and annual report for 2005 as well as the interim financial statements and interim report for 2006, and fully communicated with the management on matters such as the selection of and changes in the accounting policies, material audit adjustments and the impact thereof.

Carried out internal control work in a steady manner:

- submitted practical and effective proposals for, among others, specifying the allocation of internal control work and the rights and responsibilities of various responsible parties in accordance with the provisions of the Code on Corporate Governance Practices in relation to internal control and the relevant provisions of the Guidelines in relation to internal control, risk management and compliance management, with reference to the experiences of domestic and overseas listed companies and in line with the Company's actual conditions, and obtained approvals from the Board of Directors of such proposals;
- considered and discussed the reports on the Company's internal control evaluation, risk evaluation and compliance evaluation for the Year, and proposed specific requirements of the internal control work and submitted to the Board of Directors for consideration and approval;
- considered the Company's report on the improvement suggested by the Management Letter of last year, discussed the Suggestions for Accounting Audit and Financial Management presented by the auditors and the feedback from the management; reviewed the improvement progress in the areas of underwriting, claim settlement, finance and actuary, and proposed specific requirements of and recommendations on the improvement and the effect thereof, thereby effectively enhancing the Company's internal risk supervision and control.

Supervised and provided guidance on the internal audit and finance work, and considered and approved a connected transaction:

- considered the report of the Audit Department of the Company on the work summary for 2005 and the work plan for the Year, approved two internal audit projects in relation to premiums receivable and economic efficiency of motor vehicle insurance, and considered and discussed the report on the results of the internal audit projects;
- considered the report of the Finance and Accounting Department of the Company on the work summary for 2005 and the work plan for the Year, considered the report on the budget implementation for 2005, considered the Implementation Measures on Cost Sharing of the Company, and submitted proposals and recommendations to the Board of Directors;
- considered and approved the Company's continuing connected transaction with PICC Life Insurance Company Limited on mutual agency for insurance business.

### NOMINATION, REMUNERATION AND REVIEW COMMITTEE

#### Overview

The Nomination, Remuneration and Review Committee is responsible for matters relating to the nomination, remuneration and performance appraisals of directors of the Company, etc. During the Year, pursuant to the Listing Rules, the Guidelines and the Work Manual for the Nomination, Remuneration and Review Committee, the Company continued to reinforce the development of the Nomination, Remuneration and Review Committee. During the Year, the Nomination, Remuneration and Review Committee made constructive suggestions to the Board of Directors on various matters including the nomination, remuneration, incentive policies, performance appraisals of the Directors and senior management, and the overall remuneration of the Company.

During the period from 1 January 2006 to 17 January 2006, the composition of the Nomination, Remuneration and Review Committee did not comply with the requirement set forth in Code Provision B.1.1 of the Code on Corporate Governance Practices that the majority of the members of the remuneration committee should be independent non-executive directors. Since the appointment of Mr Ding Ningning (an Independent Non-executive Director) as a member of the Committee on 18 January 2006, the composition of the Nomination, Remuneration and Review Committee has complied with Code Provision B.1.1 of the Code on Corporate Governance Practices.

#### Composition

Chairman: Cheng Wai Chee, Christopher

Members: Lu Zhengfei, Luk Kin Yu, Peter, Ding Ningning (appointed on 18 January 2006), Zhou Shurui, Wang Yincheng, Liu Zhenghuan

#### Duties and Responsibilities

The Nomination, Remuneration and Review Committee is responsible for recommending candidates for directorship, formulating remuneration policies and appraisal standards for directors, the President and other senior management personnel (including Vice Presidents, Chief Financial Officer, Secretary of the Board of Directors and Assistants to the President), and supervising the implementation of such policies and standards. Details of the duties and responsibilities of the Committee were set out on page 41 of the Company's 2005 Annual Report.

#### Nomination of Directors

The Nomination, Remuneration and Review Committee shall first discuss the nomination of candidates as new directors, and then recommend such candidates to the Board of Directors. The Board of Directors shall then determine whether such candidates' appointments should be proposed for approval at the shareholders' general meeting. The major factors considered by the Nomination, Remuneration and Review Committee and the Board of Directors are the educational background, the management and research experience in the finance industry, especially in the insurance sector, of the candidates and the candidates' commitment to the Company. Regarding the nomination of independent non-executive directors, the Nomination, Remuneration and Review Committee will also give special consideration to the independence of the relevant candidates.

### Remuneration of Directors and Other Senior Management

The fixed salaries of the executive directors and other senior management are determined in accordance with market levels and their respective positions, and the amount of their performance-related bonuses is determined according to the results of performance appraisals. The amount of directors' fees and supervisors' fees and the units granted to the directors and supervisors under the Share Appreciation Rights Scheme are determined with reference to market levels. Details of the remuneration of the directors and supervisors for the Year are set out in note 12 to the financial statements.

### Summary of Work Undertaken

During the Year, the Nomination, Remuneration and Review Committee held four meetings, among which three meetings were held to discuss remuneration related matters, and eight proposals were considered. The meeting attendance rate of each committee member reached 100%. Attendance record of the meetings is as follows:

Name	Cheng Wai Chee, Christopher	Lu Zhengfei	Luk Kin Yu, Peter	Ding Ningning	Zhou Shurui	Wang Yincheng	Liu Zhenghuan
Number of meetings attended/Number of meetings that require attendance	4/4	4/4	4/4	3/3	4/4	4/4	4/4
Attendance rate	100%	100%	100%	100%	100%	100%	100%

*Note:* Mr Ding Ningning, an Independent Non-executive Director, was appointed a member of the Nomination, Remuneration and Review Committee on 18 January 2006.

During the Year, the Nomination, Remuneration and Review Committee made constructive suggestions to the Board of Directors on various matters including the nomination of directors, the remuneration policy for senior management, the overall remuneration of the Company and the appraisals of senior management. The main tasks accomplished by the Nomination, Remuneration and Review Committee in the Year included the followings:

- by considering the level of salaries paid by comparable companies in the market and the Company's own practical conditions, made recommendations to the Board of Directors on the fees of the Directors and Supervisors, which were considered and approved by the Board of Directors and at the shareholders' general meetings;
- taking into account the changes in the market environment, the Nomination, Remuneration and Review Committee agreed on the overall remuneration plan of the Company for the Year and submitted the plan to the Board of Directors for consideration and approval;
- proposed amendments to certain clauses of the Implementation Plan for the Second Grant under the Share Appreciation Rights Scheme of the Company, pursuant to which, the units of the share appreciation rights granted to the grantees who have been promoted during the granting period shall be adjusted accordingly so as to achieve greater incentive and binding effect of the share appreciation rights, and such amendments were submitted to the Board of Directors for consideration and approval;

- reviewed the performance appraisal proposal for 2005 of the senior management and made recommendations to the Board of Directors in respect thereof, carried out annual appraisals of the Chairman, the Directors and the President, and made recommendations on the quantitative indicators for evaluating the performance of the President as well as the bonus indicators for the Chairman and the President linked to their performance, which were considered and approved by the Board of Directors;
- proposed to the Board of Directors for the re-election of 7 directors and the appointment of 2 directors, which were considered and approved by the Board of Directors and at the shareholders' general meetings;
- after comparing the remuneration structure of the Company with that of comparable domestic and foreign companies, the Nomination, Remuneration and Review Committee agreed to appropriately increase the proportion of fixed salary of the senior management personnel, which was submitted to the Board of Directors for consideration and approval.

### STRATEGIC PLANNING COMMITTEE

#### Overview

During the Year, the Company continued to enhance the development of the Strategic Planning Committee, and focused on strengthening the review of the annual business development plan, major investment, financial budget, profit distribution and major strategies of the Company.

#### Composition

Chairman: Tang Yunxiang (resigned on 1 February 2007) and Wu Yan (appointed on 23 March 2007)

Members: Wang Yi, Tse Sze-Wing, Edmund (appointed on 18 October 2006), Ding Ningning (appointed on 18 January 2006), Wu Gaolian (appointed on 18 October 2006) and Li Tao (appointed on 18 October 2006)

*Note:* The Board of Directors approved a resolution on 1 February 2007 to authorise the Vice Chairman, Mr Wang Yi, to perform the duties of the Chairman of the Strategic Planning Committee until the new Chairman of the Committee was elected.

#### Duties and Responsibilities

The Strategic Planning Committee is responsible for formulating strategies for medium and long term development, reviewing major investments and financing plans of the Company, reviewing the annual financial budget and final accounts of the Company. Details of the duties and responsibilities of the Committee were set out on pages 43 and 44 of the Company's 2005 Annual Report.

### Summary of Work Undertaken

During the Year, the Strategic Planning Committee held two meetings, all of which were convened by way of resolutions in writing, and considered eleven proposals.

The main tasks accomplished by the Strategic Planning Committee in the Year included the followings:

- considered and approved the fixed asset investment plan for the Year;
- considered and approved the Company's profit distribution plans for 2005 and the interim period of 2006;
- considered and approved the increase of the Company's registered capital and the amendments to the Company's Articles of Association;
- considered and approved the proposal to be submitted to the shareholders' general meeting for authorising the Board of Directors to issue subordinated term debts;
- considered and approved the proposal for the cooperation between the Company and PICC Life Insurance Company Limited.

### RISK MANAGEMENT AND INVESTMENT DECISION-MAKING COMMITTEE

#### Overview

During the Year, the Company continued to enhance the development of the Risk Management and Investment Decision-making Committee, and focused on strengthening the review of the fund application strategies, investment portfolio and risk management system of the Company.

#### Composition

Chairman: Tang Yunxiang (resigned on 1 February 2007) and Wu Yan (appointed on 23 March 2007)

Members: Wang Yi, Luk Kin Yu, Peter, Ding Yunzhou (retired on 18 October 2006), Wu Gaolian (appointed on 18 October 2006), Zhou Shurui, Wang Yincheng and Liu Zhenghuan

*Note:* The Board of Directors approved a resolution on 1 February 2007 to authorise the Vice Chairman, Mr Wang Yi, to perform the duties of the Chairman of the Risk Management and Investment Decision-making Committee until the new Chairman of the Committee was elected.

#### Duties and Responsibilities

The Risk Management and Investment Decision-making Committee is responsible for reviewing the Company's fund application and investment strategies, examining the establishment and implementation of the risk control system for the application of insurance funds, and formulating strategic assets allocation plans for the application of insurance funds. Details of the duties and responsibilities of the Committee were set out on page 45 of the Company's 2005 Annual Report.

### Summary of Work Undertaken

During the Year, the Risk Management and Investment Decision-making Committee held one meeting, which was convened by way of resolutions in writing, and considered the Proposal for Investment in Infrastructure.

### INTERNAL CONTROL

#### Overview

The Company believes that sound internal control plays a fundamental role in the operations of the Company. The Board of Directors has the ultimate responsibility for the internal control, risk management and compliance management, and reviews the effectiveness of the internal control each year. The Company has established a relatively comprehensive and sophisticated system of internal rules and procedures in accordance with the relevant requirements of the State and based on the actual conditions of the Company, which is constantly revised and refined. The Company has in place an internal audit department, which performs regular audit of our branch organisations at various levels in accordance with the relevant laws, regulations and guidelines on auditing. The internal audit department enhanced the internal control of the Company and effectively reduced operational risks by its auditing of the key areas of the Company such as business operation and finance.

During the Year, according to the provisions of the Code on Corporate Governance Practices on internal control and the provisions of the Guidelines on internal control, risk management and compliance management, having considered the experiences of domestic and foreign listed companies and the actual conditions of the Company, the Audit Committee made recommendations on internal control work, which were approved by the Board of Directors. In accordance with the proposal put forward by the Audit Committee, the Company clearly defined the duties and responsibilities of the Board of Directors, the Audit Committee, the management and the relevant functional departments in the area of internal control. The Audit Department is responsible for internal control evaluation. A risk management working group led by the Finance and Accounting Department and consists of other departments such as the Actuary Department and the Fund Application Department is responsible for risks evaluation. The Legal Department is responsible for compliance evaluation.

The Board of Directors and the Audit Committee considered and discussed the Company's internal control, risk and compliance evaluation reports for the Year, and made specific requirements of and recommendations on internal control work with a view to persistently enhancing the effectiveness of internal control.

The Board of Directors and the Audit Committee also considered the Company's report on the improvement suggested by the Management Letter of last year, discussed the Suggestions for Accounting Audit and Financial Management presented by the auditors and the feedback from the management, reviewed the improvement in the areas of underwriting, claim settlement, finance and actuary, and recommendations with respect thereto.

### Internal Control

The Company has attached great importance to internal control, and required our branch organisations at various levels to continuously refine their internal control systems and to enhance the implementation of the internal control system based on the actual conditions of the Company in accordance with the relevant laws, regulations, rules and procedures of the State and the requirements of the regulatory authorities. In the Year, the Company formulated the Annual Implementation Plan for the Establishment of Internal Control System, which set out a responsibility system with well-defined responsibility division at different levels for the establishment of the internal control, and formulated a plan for the implementation of related work. In the Year, the Company also carried out an internal control evaluation and auditing of 37 key processes or areas, and conscientiously proposed and implemented improvement measures to rectify the deficiencies identified during the evaluation in accordance with the Guidelines on the Internal Control Evaluation and Audit. At present, the Company has established a relatively sound overall internal control system, various systems and procedures of the Company are carried out in an effective and consistent manner and key internal control risk points are controlled.

### Risk Management

The Company has, by adoption of practical and effective measures, strived to build the risk management system of the Company into a management system with clear targets, reasonable organisational structure, comprehensive procedures, scientific processes, professional staff, advanced technology and matching the environment. In the Year, the management of the Company formed the Risk Control Committee, formulated various specific guidelines, and designated certain departments and personnel for the implementation of risk management, and preliminarily established a risk management system devised to cover all staff, all scopes and all processes, and to classify, analyse and assess risks according to their origins and various detailed standards. At present, the Risk Control Committee of the Company has a relatively sound structure and all kinds of risks are controlled.

### Compliance Management

The Company believes that compliance management plays an instrumental role in the operations of the Company. The Company actively promotes the culture of compliance and strives to strengthen the construction of systems in key areas of operations, with a focus on the comprehensive prevention and control of compliance risks work in the basic set-up, alert mechanism and accountability aspects. In the Year, the Company designated the Legal Department to be in charge of the compliance management, to perform full overhaul of the existing rules and procedures, to carry out compliance evaluation in various areas such as authorised operation, product development, marketing and sales, underwriting, claim settlement, fund application, finance and accounting, and to propose improvement measures. At present, the Company has established a relatively sound and systematic internal management regime, major operational activities of the Company are carried out orderly in compliance with the laws and regulatory requirements as required under the internal management system, the overall compliance status of all major areas of the Company's operation and management is satisfactory and the compliance management mechanism operates properly.

## SUPERVISORY COMMITTEE

### Overview

In the Year, the Supervisory Committee discharged its supervisory duties according to the laws. An Independent Supervisor and the second Supervisory Committee were elected. The Supervisory Committee conducted investigation and research in respect of internal control system, inspected the financial and operational conditions of the branches, and made suggestions to the management about the strengthening of internal control, compliant operation and financial management.

### Composition

The First Supervisory Committee

Chairman: Deng Zhaoyu (retired on 18 October 2006)

Supervisors: Li Dianjun (appointed on 9 May 2006), Tang Wei (retired on 18 October 2006) and Liu Qilong (retired on 18 October 2006)

The Second Supervisory Committee

Chairman: Ding Yunzhou (appointed on 18 October 2006)

Supervisors: Li Dianjun (appointed on 9 May 2006), Sheng Hetai (appointed on 18 October 2006) and He Bangshun (appointed on 18 October 2006)

### Duties and Responsibilities

The Supervisory Committee is accountable to the shareholders' general meeting and performs duties of supervision over the financial affairs, directors and other senior management of the Company. Detailed duties and responsibilities include, among others, examining the financial affairs of the Company, verifying the financial information to be submitted by the Board of Directors to general meetings including the financial reports, business reports and profit distribution plans, supervising the directors and other senior management in their performance of duties for the Company, proposing the removal of directors or other senior management who break the laws, regulations, the Articles of Association of the Company or resolutions of the shareholders' general meetings; requiring the directors and other senior management to rectify their actions in the event that such actions infringe the interests of the Company; and bringing lawsuits against directors or other senior management in accordance with the provisions of the Company Law.

### Summary of Work Undertaken

During the Year, the Supervisory Committee duly carried out its supervisory duties and protected the interests of the Company, its shareholders and employees strictly in compliance with the relevant provisions of the Company Law and the Articles of Association. During the Year, the Supervisory Committee held four meetings and considered and approved nine proposals. The meeting attendance rate of each supervisor reached 100% and the attendance is recorded as follows:

The First Supervisory Committee

Name	Deng Zhaoyu	Li Dianjun	Tang Wei	Liu Qilong
Number of meetings attended/Number of meetings that require attendance	3/3	2/2	3/3	3/3
Attendance rate	100%	100%	100%	100%

The Second Supervisory Committee

Name	Ding Yunzhou	Li Dianjun	Sheng Hetai	He Bangshun
Number of meetings attended/Number of meetings that require attendance	1/1	1/1	1/1	1/1
Attendance rate	100%	100%	100%	100%

Details of the tasks accomplished by the Supervisory Committee in the Year are set out in the Report of the Supervisory Committee contained in this Annual Report.

## RIGHTS OF SHAREHOLDERS

### Methods of Convening Special General Meetings

According to the Articles of Association and the Rules of Conduct for General Meetings of the Company, any shareholder(s), whether individually or collectively, holding 10% or more of the voting shares of the Company may request in writing to convene a special general meeting and such shareholder(s) shall submit the complete resolution(s) to the Board of Directors in writing. If the Board of Directors is satisfied that the resolution(s) complies with the requirements under the laws, regulations and the Articles of Association, it shall issue a notice of special general meeting within 15 days of receipt of the written resolution(s).

### Procedures for Proposing Resolutions at Annual General Meetings

Any shareholder(s), whether individually or collectively, holding 3% or more of the voting shares of the Company is entitled to propose and submit to the Board of Directors proposed resolution(s) in writing 10 days prior to the holding of the annual general meeting. The Board of Directors shall notify other shareholders of such proposed resolution(s) within two days of receipt of such proposals and submit the same to the annual general meeting for consideration. The proposed resolution(s) shall deal with matters that are within the scope of the shareholders' general meeting and shall contain clear subjects and specific matters to be resolved.

## INVESTOR RELATIONS

The Company communicates its operating results timely with investors after the announcements of annual and interim results by way of results briefings and roadshows. By attending visits from investors and major investment forums, making timely replies to enquiries made by telephone and electronic mail and providing relevant information to investors proactively on the Company's website, the Company is strengthening its day-to-day communications with investors with a view to establishing and maintaining a good relationship with investors.

## PARTICULARS OF THE LATEST SHAREHOLDERS' GENERAL MEETING

The latest shareholders' general meeting was the special general meeting held on 23 March 2007. The meeting considered the resolution regarding the appointment of Mr Wu Yan as an executive director of the Company. The resolution was decided by a show of hands and all the shareholders present (including their proxies) at the meeting voted in favour of the resolution.



安永會計師事務所

### **To the shareholders of PICC Property and Casualty Company Limited**

*(Incorporated in the People's Republic of China with limited liability)*

We have audited the financial statements of PICC Property and Casualty Company Limited set out on pages 47 to 117, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS**

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **AUDITORS' RESPONSIBILITY**

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **OPINION**

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of Hong Kong Companies Ordinance.

### **Ernst & Young**

Certified Public Accountants

18/F, Two International Finance Centre

8 Finance Street, Central

Hong Kong

17 April 2007

## CONSOLIDATED INCOME STATEMENT

*Year ended 31 December 2006*

	<i>Notes</i>	<b>2006</b> <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>TURNOVER</b>	4, 5	<b>71,348</b>	65,914
Net premiums earned	4, 5	<b>55,616</b>	53,384
Net claims incurred	4, 6	<b>(38,616)</b>	(36,335)
Amortisation of deferred acquisition costs, net	4, 25	<b>(8,882)</b>	(8,001)
Insurance protection expenses	4, 35	<b>(610)</b>	(537)
General and administrative expenses		<b>(6,904)</b>	(7,003)
<b>UNDERWRITING PROFIT</b>		<b>604</b>	1,508
Net investment income	7	<b>1,689</b>	1,478
Net realised and unrealised gains/(losses) on investments	8	<b>2,326</b>	(336)
Interest expenses credited to policyholders' deposits	4	<b>(138)</b>	(143)
Exchange losses, net	9	<b>(426)</b>	(305)
Sundry income		<b>85</b>	26
Sundry expenses		<b>(133)</b>	(102)
Finance costs	10	<b>(209)</b>	(181)
Share of profit of an associate		<b>2</b>	–
<b>PROFIT BEFORE TAX</b>	11	<b>3,800</b>	1,945
Tax	14	<b>(1,718)</b>	(1,005)
<b>NET PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT</b>		<b>2,082</b>	940
<b>BASIC EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT (in RMB)</b>	15	<b>0.187</b>	0.084
<b>DIVIDEND PER SHARE (in RMB)</b>	16	<b>–</b>	0.072

## CONSOLIDATED BALANCE SHEET

31 December 2006

	Notes	2006 RMB million	2005 RMB million (Restated)
<b>ASSETS</b>			
Cash and cash equivalents	17	21,606	15,895
Term deposits	18	6,768	11,641
Derivative financial assets	19	6	–
Debt securities	20	22,889	18,524
Equity securities	21	7,962	2,840
Subordinated debts held by the Company	22	2,910	2,910
Capital security fund	23	2,228	2,228
Premiums receivable and agents' balances, net	24	3,960	3,767
Unearned premium reserves-reinsurers' share	38	4,881	5,967
Deferred acquisition costs	25	6,817	5,719
Other non-current assets		198	178
Receivables from reinsurers	26	2,709	2,500
Reinsurance recoverable on unpaid losses	39	4,864	5,185
Prepayments and other receivables	27	1,858	1,213
Investment in an associate	28	162	–
Property, plant and equipment	30	10,031	10,576
Investment properties	31	443	213
Construction in progress	32	1,872	1,756
Prepaid land premiums	33	3,960	4,000
<b>TOTAL ASSETS</b>		<b>106,124</b>	<b>95,112</b>
<b>LIABILITIES</b>			
Payables to reinsurers	34	3,391	3,531
Accrued insurance protection fund	35	217	195
Tax payable		325	404
Other liabilities and accruals	36	6,628	6,009
Deferred tax liabilities	37	1,905	551
Deferred acquisition costs-reinsurers' share	25	1,315	1,642
Unearned premium reserves	38	36,842	32,507
Loss and loss adjustment expense reserves	39	22,880	22,026
Policyholders' deposits	40	8,894	8,449
Subordinated loan/debts issued by the Company	41	3,000	2,000
<b>TOTAL LIABILITIES</b>		<b>85,397</b>	<b>77,314</b>
<b>EQUITY</b>			
Issued share capital	43	11,142	11,142
Reserves		9,585	6,656
<b>TOTAL EQUITY</b>		<b>20,727</b>	<b>17,798</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>106,124</b>	<b>95,112</b>

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2006

	Issued share capital <i>RMB million</i>	Share premium account <i>RMB million</i>	Available- for-sale financial instrument revaluation reserve <i>RMB million</i>	Cash flow hedging <i>RMB million</i>	Statutory surplus reserve <i>RMB million</i>	(Note) Statutory public welfare fund <i>RMB million</i>	Retained profits <i>RMB million</i>	Total <i>RMB million</i>
At 1 January 2005								
As previously reported	11,142	4,739	(452)	–	6	3	715	16,153
Prior year adjustment – change in an accounting policy	–	–	–	–	–	–	1,135	1,135
As restated	11,142	4,739	(452)	–	6	3	1,850	17,288
Net fair value gain of available-for-sale financial instruments	–	–	188	–	–	–	–	188
Realised on disposals of available-for-sale financial instruments	–	–	120	–	–	–	–	120
Impairment loss	–	–	245	–	–	–	–	245
Change of deferred tax assets recognised	–	–	(181)	–	–	–	–	(181)
Net gain for the year recognised directly in equity	–	–	372	–	–	–	–	372
Profit for the year (as restated)	–	–	–	–	–	–	940	940
2005 Interim dividend	–	–	–	–	–	–	(802)	(802)
Transfer from/(to) reserves	–	–	–	–	95	48	(143)	–
At 31 December 2005	11,142	4,739	(80)	–	101	51	1,845	17,798
At 1 January 2006								
As previously reported	11,142	4,739	(80)	–	101	51	883	16,836
Prior year adjustment – change in an accounting policy	–	–	–	–	–	–	962	962
As restated	11,142	4,739	(80)	–	101	51	1,845	17,798
Net fair value gain of available-for-sale financial instruments	–	–	1,295	–	–	–	–	1,295
Net fair value gain of cash flow hedging	–	–	–	6	–	–	–	6
Realised on disposals of available-for-sale financial instruments	–	–	(38)	–	–	–	–	(38)
Change of deferred tax assets recognised	–	–	(414)	(2)	–	–	–	(416)
Net gain for the year recognised directly in equity	–	–	843	4	–	–	–	847
Profit for the year	–	–	–	–	–	–	2,082	2,082
Transfer from/(to) reserves	–	–	–	–	51	(51)	–	–
At 31 December 2006	11,142	4,739*	763*	4*	152*	–	3,927*	20,727

Note: As a result of the adoption of amendments to the PRC Company Law, the balance of statutory public welfare fund was transferred to the statutory surplus reserve on 1 January 2006.

\* These reserve accounts comprise the consolidated reserves of RMB9,585 million (2005: RMB6,656 million) in the consolidated balance sheet.

## CONSOLIDATED CASH FLOW STATEMENT

Year ended 31 December 2006

	Notes	2006 RMB million	2005 RMB million (Restated)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit before tax		3,800	1,945
Adjustments for:			
Net investment income	7	(1,689)	(1,478)
Net realised and unrealised gains/(losses) on investments	8	(2,326)	336
Interest expenses credited to policyholders' deposits		138	143
Exchange losses, net	9	426	305
Share of profit of an associate		(2)	–
Depreciation for property, plant and equipment	11, 30	933	1,096
Depreciation for investment properties	11, 31	15	6
Amortisation for prepaid land premiums	11, 33	102	93
Net loss on disposals of items of property, plant and equipment and construction in progress	11	3	8
Finance costs	10	209	181
Impairment loss on premiums receivable	11	86	136
Increase in premiums receivable and agents' balances, net		(279)	(1,431)
Increase in deferred acquisition costs, net		(1,425)	(131)
(Increase)/decrease in other non-current assets		(20)	108
Increase in receivables from reinsurers		(209)	(1,511)
(Increase)/decrease in prepayments and other receivables		(463)	1,468
Increase/(decrease) in payables to reinsurers		(140)	2,220
Increase/(decrease) in accrued insurance protection expenses		22	(904)
Increase/(decrease) in other liabilities and accruals		406	(47)
Increase in unearned premium reserves, net		5,421	56
Increase in loss and loss adjustment expense reserves, net		1,175	981
<b>Cash generated from operations</b>		<b>6,183</b>	<b>3,580</b>
PRC income tax paid		(859)	(929)
<b>Net cash inflow from operating activities</b>		<b>5,324</b>	<b>2,651</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Interest received		1,373	1,415
Rental income received from investment properties		36	35
Dividend income received from equity securities		98	52
Payment for investment management fee		(45)	(41)
Payment for capital expenditure		(954)	(1,677)
Proceeds from disposals of items of property, plant and equipment and construction in progress		128	66
Acquisition of an associate		(160)	–
Payment for purchases of debt and equity securities		(32,586)	(19,713)
Proceeds from sales of debt and equity securities		26,812	18,825
Placement of deposits with banks and other financial institutions with original maturity of more than three months		(7,203)	(11,725)
Maturity of deposits with banks and other financial institutions with original maturity of more than three months		11,589	11,807
<b>Net cash outflow from investing activities</b>		<b>(912)</b>	<b>(956)</b>

continued/..

## CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

Year ended 31 December 2006

	Notes	2006 RMB million	2005 RMB million (Restated)
<b>Net cash outflow from investing activities</b>		<b>(912)</b>	(956)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from subordinated debts issued by the Company		3,000	–
Repayment of the subordinated loan		(2,000)	–
Securities sold under agreements to repurchase		200	(611)
Increase/(decrease) in policyholders' deposits		307	(480)
Interest paid		(208)	(182)
Interim dividend paid		–	(802)
<b>Net cash inflow/(outflow) from financing activities</b>		<b>1,299</b>	(2,075)
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>			
Cash and cash equivalents at beginning of year		15,895	16,275
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		<b>21,606</b>	15,895
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>			
Cash in hand	17	25	25
Demand deposits	17	12,623	13,116
Securities purchased under resale agreements			
with original maturity of less than three months	17	307	–
Deposits with bank and other financial institutions			
with original maturity of less than three months	17	8,651	2,754
		<b>21,606</b>	15,895

## BALANCE SHEET

31 December 2006

	Notes	2006 RMB million	2005 RMB million (Restated)
<b>ASSETS</b>			
Cash and cash equivalents	17	21,603	15,895
Term deposits	18	6,768	11,641
Derivative financial assets	19	6	–
Debt securities	20	22,889	18,524
Equity securities	21	7,962	2,840
Subordinated debts held by the Company	22	2,910	2,910
Capital security fund	23	2,228	2,228
Premiums receivable and agents' balances, net	24	3,960	3,767
Unearned premium reserves-reinsurers' share	38	4,881	5,967
Deferred acquisition costs	25	6,817	5,719
Other non-current assets		198	178
Receivables from reinsurers	26	2,709	2,500
Reinsurance recoverable on unpaid losses	39	4,864	5,185
Prepayments and other receivables	27	1,858	1,213
Investment in an associate	28	160	–
Investments in subsidiaries	29	3	–
Property, plant and equipment	30	10,031	10,576
Investment properties	31	443	213
Construction in progress	32	1,872	1,756
Prepaid land premiums	33	3,960	4,000
<b>TOTAL ASSETS</b>		<b>106,122</b>	<b>95,112</b>
<b>LIABILITIES</b>			
Payables to reinsurers	34	3,391	3,531
Accrued insurance protection fund	35	217	195
Tax payable		325	404
Other liabilities and accruals	36	6,628	6,009
Deferred tax liabilities	37	1,905	551
Deferred acquisition costs-reinsurers' share	25	1,315	1,642
Unearned premium reserves	38	36,842	32,507
Loss and loss adjustment expense reserves	39	22,880	22,026
Policyholders' deposits	40	8,894	8,449
Subordinated loan/debts issued by the Company	41	3,000	2,000
<b>TOTAL LIABILITIES</b>		<b>85,397</b>	<b>77,314</b>
<b>EQUITY</b>			
Issued share capital	43	11,142	11,142
Reserves		9,583	6,656
<b>TOTAL EQUITY</b>		<b>20,725</b>	<b>17,798</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>106,122</b>	<b>95,112</b>

### 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, Dongheyuan Street, Xuanwumen, Beijing, the PRC.

The principal activity of the Company and its subsidiaries (the “Group”) is mainly providing property and casualty insurance services. The details of the business segments 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, derivatives 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.

#### **Basis of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2006. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company’s subsidiaries. For the year ended 31 December 2006, the net profit attributable to minority interests amounted to RMB228 (2005: Nil). As at 31 December 2006, the net assets attributable to minority interests amounted to RMB105,228 (2005: Nil).

## 2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The following new and revised HKFRSs affect the Group and are adopted for the first time for the current year's financial statements. The adoption of these revised standards did not have any significant effect on the Group's financial statements. They did however give rise to additional disclosures.

HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts

### HKAS 39 Amendment – The Fair Value Option

This amendment has changed the definition of a financial instrument classified as fair value through profit or loss and has restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement. The adoption of this amendment did not affect the Group's operational results or its financial position, as no reclassification was necessary as all existing designated financial assets met the new criteria. The Group used this option for certain financial instruments containing one or more embedded derivatives.

### HKAS 39 & HKFRS 4 Amendments – Financial Guarantee Contracts

The amendment has revised the scope of HKAS 39 to require financial guarantee contracts issued that are not considered insurance contracts, to be recognised initially at fair value and to be remeasured at the higher of the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*. The Group issues certain credit insurance contracts, but regards such contracts as insurance contracts and will apply the recognition and measurement criteria under HKFRS 4 *Insurance Contracts* to such contracts.

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

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

HKAS 1 Amendment	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HKFRS 8	Operating Segments
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 <i>Financial Reporting in Hyperinflationary Economies</i>
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment
HK(IFRIC)-Int 11	Group and Treasury Share Transactions
HK(IFRIC)-Int 12	Service Concession Arrangements

**2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS (CONTINUED)**

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 Group's objective, policies and processes for managing capital; quantitative data about what the Group regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 shall be applied for annual periods beginning on or after 1 January 2007. The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments.

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The standard requires the disclosures of information about the Group's operating segments, the products and services provided by the segments, the geographical areas in which the Group operates, and the revenues from its major customers. The standard will supersede HKAS 14 *Segment Reporting*.

HK(IFRIC)-Int 7, HK(IFRIC)-Int 8, HK(IFRIC)-Int 9, HK(IFRIC)-Int 10, HK(IFRIC)-Int 11 and HK(IFRIC)-Int 12 shall be applied for annual periods beginning on or after 1 March 2006, 1 May 2006, 1 June 2006, 1 November 2006, 1 March 2007 and 1 January 2008, respectively.

The Group is in the process of making an assessment of the impact of these new and revised HKFRSs upon initial application. So far, it has concluded that while the adoption of the HKAS 1 Amendment, HKFRS 7 and HKFRS 8 may result in new or amended disclosures, these new and revised HKFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

2.4 SUMMARY OF THE IMPACT OF CHANGE IN AN ACCOUNTING POLICY

During the year, the Group changed its accounting policy to defer government levies and surcharges arising from the sales of insurance policies and amortise them over the relevant terms of insurance policies. Previously such costs were expensed when incurred. In the opinion of directors, this change better matches with the pattern of the income and expenses of the Group and is closely in line with the current industry practice. The effect of this change in an accounting policy to the financial statements was as follows:

(a) Effect on the Consolidated/Company's balance sheet

	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Consolidated/Company's balance sheet at 1 January		
<b>Assets – increase</b>		
Deferred acquisition costs	1,732	1,694
Deferred tax assets	98	–
	<b>1,830</b>	1,694
<b>Liabilities – (increase)</b>		
Deferred acquisition costs-reinsurers' share	(297)	–
Deferred tax liabilities	(571)	(559)
	<b>(868)</b>	(559)
Total increase in net assets	<b>962</b>	1,135
Consolidated/Company's balance sheet at 31 December		
<b>Assets – increase</b>		
Deferred acquisition costs	1,964	1,732
Deferred tax assets	80	98
	<b>2,044</b>	1,830
<b>Liabilities – (increase)</b>		
Deferred acquisition costs-reinsurers' share	(242)	(297)
Deferred tax liabilities	(648)	(571)
	<b>(890)</b>	(868)
Total increase in net assets	<b>1,154</b>	962

2.4 SUMMARY OF THE IMPACT OF CHANGE IN AN ACCOUNTING POLICY (CONTINUED)

(b) Effect on the Consolidated income statement

	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Consolidated income statement for the year ended 31 December		
Increase in net premiums earned	3,907	3,582
Increase in amortisation of deferred acquisition costs, net	(3,093)	(3,209)
Increase in general and administrative expenses	(527)	(631)
(Increase)/decrease in tax	(95)	85
Total increase/(decrease) in profit	192	(173)
Increase/(decrease) in basic earnings per share attributable to ordinary equity holders of the parent (in RMB)	0.017	(0.016)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Subsidiaries**

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated at cost less any impairment losses.

**Associate**

An associate is an entity, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of its associate is included in the consolidated income statement and the consolidated statement of changes in equity, respectively. The Group's investment in its associate is stated in the balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of the associate are included in the Company's income statement to the extent of dividends received and receivable. The Company's investment in the associate is treated as an asset and is stated at cost less any impairment losses.

### 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Related parties

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

- (a) the party directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a member of the key management personnel of the Group or its parent;
- (d) the party is a close member of the family of any individual referred to in (a) or (c); or
- (e) 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 (c) or (d).

#### Property, plant and equipment and depreciation

Property, plant and equipment 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 where 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.

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 Group, 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 Group is the lessor, assets leased by the Group 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 Group is the lessee, rentals payable under the operating leases are charged to the income statement on a straight-line basis over the lease terms.

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 buildings as a finance lease in property, plant and equipment.

### 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Investments and other financial assets**

Financial assets in the scope of HKAS 39 are classified as 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 Group considers whether a contract contains an embedded derivative when the Group first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

The Group 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, that is, the date that the Group commits to purchase or sell 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 at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on these financial assets are recognised in the income statement.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; (ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.

#### *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 subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. 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.

## 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Impairment of financial assets (continued)

#### *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 gain or loss 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; a discounted cash flow analysis and option pricing models.

### Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a 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 either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

The Group 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.

In relation to premiums receivable and agents' balances, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

### 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

##### *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.

#### **Derecognition of 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 Group 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 Group 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 Group 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 Group'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 Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

#### **Financial liabilities at amortised cost (including interest-bearing loans and borrowings)**

Financial liabilities including payables to reinsurers, accrued insurance protection fund, other liabilities and accruals, policyholders' deposits and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

## 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### **Financial liabilities at fair value through profit or loss**

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial liability at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial liabilities may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis; (ii) the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liability contains an embedded derivative that would need to be separately recorded.

### **Derecognition of 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 the income statement.

### **Derivative financial instruments and hedging**

The Group uses derivative financial instruments such as interest rate swaps to hedge its risks associated with interest rate fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the income statement.

The fair value of interest rate swap contracts is determined by reference to market values for similar instruments or reference to the present value of estimated future cash flows.

### 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Derivative financial instruments and hedging (continued)**

For the purpose of hedge accounting, hedges are classified as cash flow hedges when hedging the exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting, the risk management objective and its strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Group will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Hedges which meet the strict criteria for hedge accounting for cash flow hedges are accounted for as follows:

The effective portion of the gain or loss on the hedging instrument is recognised directly in equity, while the ineffective portion is recognised immediately in the income statement.

Amounts taken to equity are transferred to the income statement when the hedged transaction affects the income statement, such as when hedged financial income or financial expense is recognised or when a forecast sale occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or non-financial liability.

If the forecast transaction or firm commitment is no longer expected to occur, the amounts previously recognised in equity are transferred to the income statement. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, the amounts previously recognised in equity remain in equity until the forecast transaction or firm commitment occurs.

#### **Impairment of non-financial assets other than goodwill**

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.

## 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### **Impairment of non-financial assets other than goodwill (continued)**

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 other than goodwill 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.

### **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.

### **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 as an insurance contract for the remaining of its life time, even if the insurance risk reduces significantly during this period, unless all rights and obligations expire.

#### *Investment contracts*

Any contracts issued to policyholders but not considered as insurance contracts under HKFRS 4 are classified as investment contracts. Investment contracts can be reclassified as insurance contracts after inception if the insurance risk becomes significant.

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.

### 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **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 the recognised actuarial method. Past experience is taken into account as well as the current and future expected social and economic factors.

##### *Liability adequacy tests*

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. An amount of provision is made for each class of business individually. Any deferred acquisition cost asset written off cannot be reinstated subsequently.

##### *Derecognition of insurance contract liabilities*

Insurance contract liabilities are derecognised when they expire, are discharged or cancelled.

#### **Deferred acquisition costs**

Policy acquisition costs which vary with and are primarily related to the production of new and renewing businesses (consisting principally of commission expenses, underwriting personnel expenses, government levies and surcharges) are deferred and amortised over the terms of the related insurance policies. Reinsurers' share of deferred acquisition costs is separately presented in the balance sheet as a liability item. Deferred acquisition costs are derecognised when the related contracts are settled or disposed of.

#### **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.

## 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### **Income tax (continued)**

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.

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 Group 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 recognised if the reinsurance was considered a 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 contracts. 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 Group are required to participate in a central pension scheme operated by the local municipal government of Mainland China. The Group 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 Group 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 model at the grant date taking into account the terms and conditions upon which the instruments were granted (see note 44). 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 Group and when the revenue can be measured reliably, on the following basis:

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

#### Claims

Claims incurred include all claim losses occurring during the year, whether reported or not, including the related loss adjustment expenses, the 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.

## 2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### **Borrowing costs**

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

### **Profit appropriation**

In accordance with the PRC Company Law and the Group's articles of association, the Group 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.

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

### **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 the income statement. 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 Group'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 Group classifies its financial assets in accordance with HKAS 39 as 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 Group 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 instruments*

The Group determines that available-for-sale equity financial instruments 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 Group evaluates among other factors, including the normal volatility in share price, the financial health of the investee, the industry and sector performance, the changes in technology and the operating and financing cash flows.

#### *Impairment of reinsurance assets*

The Group performs an impairment review on its reinsurance assets when an indication of impairment occurs. In considering whether a reinsurance asset is impaired, the Group considers whether (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Group may not be able to 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 Group 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 Group'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 Group will ultimately pay for those claims. The Group 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.

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

**Estimation uncertainty (continued)**

*Amounts due from certain securities companies*

For amounts due from certain securities companies under liquidation or restructuring as explained in note 27 to the financial statements, estimation is required when the Company determines the extent of impairment.

**4. SEGMENT INFORMATION**

Segment information is presented by way of the Group's primary reporting basis, by business segment. No further geographical segment information is presented as all of the Group'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 cargo segment provides insurance products covering vessels, crafts or conveyances;
- (d) the liability segment provides insurance products covering policyholders' liabilities;
- (e) the accidental injury segment provides insurance products covering accidental injuries; and
- (f) the "other" segment mainly represents insurance products related to marine hull, homeowners, aviation and oil and gas.

## NOTES TO FINANCIAL STATEMENTS

### 4. SEGMENT INFORMATION (CONTINUED)

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

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Turnover</b>		
Motor vehicle	49,837	44,501
Commercial property	8,193	8,669
Cargo	2,763	2,793
Liability	3,013	2,561
Accidental injury	2,561	2,371
Other	4,981	5,019
	<b>71,348</b>	<b>65,914</b>
<b>Net premiums earned</b>		
Motor vehicle	41,502	38,898
Commercial property	5,747	6,100
Cargo	2,073	2,269
Liability	2,160	1,923
Accidental injury	1,827	1,777
Other	2,307	2,417
	<b>55,616</b>	<b>53,384</b>
<b>Net investment income</b>		
Other	271	255
<b>Net realised and unrealised gains/(losses) on investments</b>		
Other	64	(123)

4. SEGMENT INFORMATION (CONTINUED)

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Net claims incurred</b>		
Motor vehicle	(30,295)	(27,593)
Commercial property	(4,074)	(4,519)
Cargo	(744)	(986)
Liability	(1,123)	(1,300)
Accidental injury	(1,004)	(695)
Other	(1,376)	(1,242)
	<b>(38,616)</b>	<b>(36,335)</b>
<b>Amortisation of deferred acquisition costs, net</b>		
Motor vehicle	(6,935)	(6,270)
Commercial property	(805)	(828)
Cargo	(315)	(377)
Liability	(309)	(298)
Accidental injury	(262)	(261)
Other	(256)	33
	<b>(8,882)</b>	<b>(8,001)</b>
<b>Insurance protection expenses</b>		
Motor vehicle	(467)	(390)
Commercial property	(55)	(60)
Cargo	(21)	(21)
Liability	(23)	(19)
Accidental injury	(18)	(18)
Other	(26)	(29)
	<b>(610)</b>	<b>(537)</b>
<b>Interest expenses credited to policyholders' deposits</b>		
Other	(138)	(143)
<b>Segment profit before unallocated income and expenses</b>		
Motor vehicle	3,805	4,645
Commercial property	813	693
Cargo	993	885
Liability	705	306
Accidental injury	543	803
Other	846	1,168
	<b>7,705</b>	<b>8,500</b>

## NOTES TO FINANCIAL STATEMENTS

### 4. SEGMENT INFORMATION (CONTINUED)

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Unallocated operating income and expenses</b>		
Net investment income	1,418	1,223
Net realised and unrealised gains/(losses) on investments	2,262	(213)
General and administrative expenses	(6,904)	(7,003)
Exchange losses, net	(426)	(305)
Sundry income	85	26
Sundry expenses	(133)	(102)
Finance costs	(209)	(181)
Share of profit of an associate	2	–
Profit before tax	3,800	1,945
Tax	(1,718)	(1,005)
Net profit attributable to equity holders of the parent	2,082	940

Net investment income and net realised and unrealised gains/(losses) on investments attributable to homeowners' insurance products can be separately identified based on the results of its designated pool of investments and therefore 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.

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Segment assets</b>		
Motor vehicle	10,141	10,570
Commercial property	4,343	4,650
Cargo	639	550
Liability	1,047	820
Accidental injury	952	676
Other	6,109	5,872
	23,231	23,138
Unallocated assets	82,893	71,974
Total assets	106,124	95,112

4. SEGMENT INFORMATION (CONTINUED)

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Segment liabilities</b>		
Motor vehicle	42,090	38,296
Commercial property	6,323	6,766
Cargo	1,492	1,346
Liability	2,622	2,211
Accidental injury	2,256	1,747
Other	18,756	17,325
	<b>73,539</b>	67,691
Unallocated liabilities	11,858	9,623
Total liabilities	<b>85,397</b>	77,314

5. TURNOVER AND NET PREMIUMS EARNED

Turnover represents direct premiums written and reinsurance premiums assumed.

	Group 2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
<b>Turnover</b>		
Direct premiums written	71,300	65,898
Reinsurance premiums assumed	48	16
	<b>71,348</b>	65,914
<b>Net premiums earned</b>		
Turnover	71,348	65,914
Less: Reinsurance premiums ceded	(10,311)	(12,474)
Net premiums written	61,037	53,440
Less: Change in net unearned premium reserves	(5,421)	(56)
Net premiums earned	<b>55,616</b>	53,384

## NOTES TO FINANCIAL STATEMENTS

### 6. NET CLAIMS INCURRED

	Group	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Gross claims paid	44,432	42,426
Less: Paid losses recoverable from reinsurers	(6,991)	(7,072)
Net claims paid	37,441	35,354
Change in net loss and loss adjustment expense reserves ( <i>note 39</i> )	1,175	981
Net claims incurred	38,616	36,335

### 7. NET INVESTMENT INCOME

	Group	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Interest income from cash and cash equivalents and term deposits	761	725
Interest income from debt securities	647	541
Interest income from subordinated debts held by the Company	147	141
Dividend income from equity securities	98	36
Rental income from investment properties	36	35
	1,689	1,478

8. NET REALISED AND UNREALISED GAINS/(LOSSES) ON INVESTMENTS

	<b>Group</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Debt securities:		
Realised gains	47	180
Unrealised losses	(17)	(40)
Equity securities:		
Realised losses	(246)	(210)
Unrealised gains	2,667	21
Derivatives embedded in structured deposits:		
Unrealised losses	(84)	–
Reversal of impairment/(impairment loss) on available-for-sale securities	5	(245)
	<b>2,372</b>	(294)
Less: investment management fee	(46)	(42)
	<b>2,326</b>	(336)

9. EXCHANGE LOSSES, NET

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

	<b>Group</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Net realised and unrealised losses on term deposits	(403)	(310)
Net claims incurred	8	7
General and administrative expenses	(31)	(2)
	<b>(426)</b>	(305)

## NOTES TO FINANCIAL STATEMENTS

### 10. FINANCE COSTS

	<b>Group</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Interest on subordinated loan/debts issued by the Company	111	110
Interest on securities sold under agreements to repurchase	56	30
Other finance costs	42	41
	<b>209</b>	181

### 11. PROFIT BEFORE TAX

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

	<i>Notes</i>	<b>2006</b>	2005
		<i>RMB million</i>	<i>RMB million</i>
Auditors' remuneration, including interim review		18	15
Depreciation for property, plant and equipment	30	933	1,096
Depreciation for investment properties	31	15	6
Amortisation for prepaid land premiums	33	102	93
Employee expenses (including directors' remuneration ( <i>note 12</i> )):			
Wages salaries and staff welfare		4,665	4,634
Cash-settled share appreciation rights expense		102	10
Pension scheme contributions		409	432
Impairment loss on premiums receivable		86	136
Minimum lease payments under operating leases			
– land and buildings		394	336
Net loss on disposals of items of property, plant and equipment and construction in progress		3	8

**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:

	<b>Group</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Fees	2,841	2,436
Other emoluments:		
Salaries, allowances and benefits in kind	4,636	3,999
Performance related bonuses	–	2,272
Cash-settled share appreciation rights expense	17,570	1,833
Pension scheme contributions	850	754
	<b>25,897</b>	11,294

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

**(a) Independent non-executive directors**

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

	<b>2006</b>	2005
	<i>RMB'000</i>	<i>RMB'000</i>
Mr. Cheng Wai Chee, Christopher	293	303
Mr. Lu Zhengfei	295	302
Mr. Luk Kin Yu, Peter	293	303
Mr. Ding Ning Ning	295	–
Mr. Wang Tung Shun, Peter	–	21
	<b>1,176</b>	929

There were no other emoluments payable to the independent non-executive directors during the year (2005: Nil).

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

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

	Fees	Salaries, allowances and benefits in kind	Performance related bonuses	(Note) Cash-settled share appreciation rights expense	Pension scheme contributions	Total remuneration
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>2006</b>						
Chairman of Board:						
Mr. Tang Yunxiang	137	863	–	2,299	159	3,458
Executive directors:						
Mr. Wang Yi (President)	137	820	–	1,876	152	2,985
Mr. Wang Yincheng	137	699	–	1,366	120	2,322
Mdm. Liu Zhenghuan	137	737	–	1,391	125	2,390
Non-executive directors:						
Mr. Tse Sze-Wing, Edmund	137	–	–	1,127	–	1,264
Mr. Ding Yunzhou	137	–	–	1,603	–	1,740
Mr. Wu Gaolian	–	–	–	–	–	–
Mr. Zhou Shurui	137	–	–	1,416	–	1,553
Mr. Li Tao	–	–	–	431	–	431
Supervisors:						
Mr. Ding Yunzhou (Chairman)	–	–	–	–	–	–
Mr. Sheng Hetai	–	–	–	–	–	–
Mr. He Bangshun	–	353	–	629	71	1,053
Past supervisors:						
Mr. Deng Zhaoyu (ex-Chairman)	137	820	–	2,104	152	3,213
Mr. Tang Wei	137	–	–	1,673	–	1,810
Mr. Liu Qilong	137	344	–	1,655	71	2,207
Independent supervisor:						
Mr. Li Dianjun	295	–	–	–	–	295
	1,665	4,636	–	17,570	850	24,721

Note: Certain directors and supervisors were granted share appreciation rights, in respect of their services to the Group, further details of which are set out in note 44 to the financial statements. The fair value of such rights, which has been recognised to the income statement over the vesting period, was determined as at the date of grant according to a number of assumptions and remeasured at each balance sheet date and the amount included in the financial statements for the current year is included in the above directors' and supervisors' remuneration disclosures. The amount charged to the income statement, therefore, does not necessarily represent any benefits received by the directors and supervisors upon exercise of their share appreciation rights, and may deviate from the actual future benefits received by the directors and supervisors.

12. DIRECTORS' AND SUPERVISORS' REMUNERATION (CONTINUED)

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

	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

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.

## NOTES TO FINANCIAL STATEMENTS

### 14. TAX

The provision for PRC income tax is calculated based on the statutory rate of 33% (2005: 33%) in accordance with the relevant PRC income tax rules and regulations.

	2006 <i>RMB million</i>	2005 <i>RMB million</i> (Restated)
Group:		
Current – charge for the year	780	1,043
Deferred ( <i>note 37</i> )	938	(38)
Total tax charge for the year	1,718	1,005

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

Group	2006 <i>RMB million</i>	%	2005 <i>RMB million</i> (Restated)	%
Profit before tax	3,800		1,945	
Tax at the statutory tax rate of 33%	1,254	33.0	642	33.0
Income not subject to tax	(144)	(3.8)	(98)	(5.0)
Expenses not deductible for tax	608	16.0	461	23.7
Tax charge for the year	1,718	45.2	1,005	51.7

### 15. BASIC EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share amounts is based on the profit for the year attributable to the ordinary equity holders of the parent of RMB2,082 million (2005: RMB940 million) and the 11,142 million (2005: 11,142 million) ordinary shares in issue during the year.

Diluted earnings per share amounts for the years ended 31 December 2006 and 2005 have not been disclosed as no diluting events existed during these years.

### 16. DIVIDEND PER SHARE

During the year ended 31 December 2006, the Board of Directors did not declare any interim dividend (2005: RMB802 million). The Board of Directors did not propose any final dividend for the year (2005: Nil).

## 17. CASH AND CASH EQUIVALENTS

	Group		Company	
	2006 <i>RMB million</i>	2005 <i>RMB million</i>	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Cash in hand	25	25	25	25
Demand deposits	12,623	13,116	12,620	13,116
Securities purchased under resale agreements with original maturity of less than three months	307	–	307	–
Deposits with banks and other financial institutions with original maturity of less than three months	8,651	2,754	8,651	2,754
	<b>21,606</b>	15,895	<b>21,603</b>	15,895

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 Group, and earn interest at the respective short term time deposit/agreed rates. The carrying amounts of the cash and cash equivalents approximate to their fair values.

At 31 December 2006, RMB217 million (2005: RMB195 million) was included in deposits with banks and other financial institutions as an accrued insurance protection fund. The amount was maintained in accordance with the relevant PRC insurance law and regulations for insurance protection and restricted in use. Details of the restrictions are disclosed in note 35 to the financial statements.

At 31 December 2006, included in deposits with banks and other financial institutions was a clearing account deposit of RMB30 million (2005: RMB64 million) deposited with a PRC securities company.

## NOTES TO FINANCIAL STATEMENTS

### 18. TERM DEPOSITS

	Group and Company	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Structured deposits with banks and other financial institutions:		
at fair value	1,093	3,107
at amortised cost	2,785	838
Deposits with banks and other financial institutions with original maturity of more than three months, at amortised cost	2,890	7,696
	6,768	11,641

Certain structured deposits maintained with PRC banks and other financial institutions are designated as financial instruments at fair value through profit or loss upon the 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 the term deposits stated at amortised cost approximate to their fair values.

### 19. DERIVATIVE FINANCIAL ASSETS

	Group and Company	
	2006	2005
	<i>RMB million</i>	<i>RMB million</i>
Interest rate swaps	6	–

The carrying amounts of interest rate swaps are the same as their fair values.

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. The terms of these swap contracts are as follows:

Floating Rate	Fixed rate	Maturity	Aggregate notional amount <i>RMB million</i>
7-day fixing Repo rate or 1-year deposit rate by the People's Bank of China	2.781% – 2.980%	30 August 2007 – 6 December 2011	550

19. DERIVATIVE FINANCIAL ASSETS (CONTINUED)

The terms of the cash flow hedges matched the terms of the underlying hedge items. The cash flow hedges were assessed to be highly effective and a net gain of RMB4 million (2005: Nil) was included in the hedging reserve.

In addition, the Company has entered into various interest rate swap contracts which do not meet the criteria for hedge accounting. Changes in fair value of the non-hedging derivatives amounting to RMB0.02 million (2005: Nil) were charged to the income statement during the year.

20. DEBT SECURITIES

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
Listed debt securities, at fair value:		
Debt securities issued by the PRC central government	12,404	9,630
Debt securities issued by corporate entities	1,278	544
	<b>13,682</b>	10,174
Unlisted debt securities, at fair value:		
Debt securities issued by the PRC central government	1,527	4,053
Debt securities issued by banks and other financial institutions	3,507	1,889
Debt securities issued by corporate entities	4,173	2,408
	<b>9,207</b>	8,350
	<b>22,889</b>	18,524
Classification of debt securities:		
Fair value through profit or loss – held for trading	1,273	3,398
Available-for-sale	21,616	15,126
	<b>22,889</b>	18,524

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

As at 31 December 2006, debt securities of RMB90 million (2005: RMB563 million) were registered under the exchange trading seat of a PRC securities company. During the year, the securities company has announced a restructuring plan and sold its business and relevant assets to a new joint stock securities company (the “New Securities Company”). On 27 December 2006, the Company entered into an agreement with the securities company to obtain a right of a 1.96% interest in the issued share capital of the New Securities Company by offering the Company’s debt securities registered under the exchange trading seat of that securities company as a consideration. On the same date, an amount of RMB468 million, which represented part of the proceeds from the disposal of the above-mentioned debt securities, was paid as the consideration for this transaction. This amount was accounted for as a prepayment as at 31 December 2006.

**20. DEBT SECURITIES (CONTINUED)**

Subsequent to the balance sheet date, on 12 January 2007, the securities company disposed of the Company's remaining debt securities registered under its exchange trading seat and an amount of RMB120 million was collected by it as a further consideration of the Company's right to an equity interest in the New Securities Company.

According to the agreement between the securities company and the Company, if the Company cannot properly register as a shareholder of the New Securities Company on or before 27 June 2007, the securities company shall return the consideration together with the relevant income to the Company.

**21. EQUITY SECURITIES**

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
Listed investments, at fair value:		
Mutual funds	3,043	2,262
Shares	3,871	189
	<b>6,914</b>	2,451
Unlisted investments, at fair value:		
Mutual funds	1,048	389
	<b>7,962</b>	2,840
Classification of equity securities:		
Fair value through profit or loss – held for trading	4,167	2,840
Available-for-sale	3,795	–
	<b>7,962</b>	2,840

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

**22. SUBORDINATED DEBTS HELD BY THE COMPANY**

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Unlisted subordinated debts issued by banks and other financial institutions, at amortised cost	<b>2,910</b>	2,910

The total fair value of these subordinated debts is RMB3,088 million (2005: RMB3,180 million). Fair values have been estimated using quoted market prices of securities with similar credit, maturity and yield characteristics.

**23. CAPITAL SECURITY FUND**

In accordance with the PRC Insurance Law, the Group 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.

**24. PREMIUMS RECEIVABLE AND AGENTS’ BALANCES, NET**

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Premiums receivable and agents’ balances	<b>4,343</b>	4,064
Less: Impairment loss on premiums receivable	<b>(383)</b>	(297)
	<b>3,960</b>	3,767

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:

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Within 3 months	<b>3,287</b>	3,163
Over 3 months but less than 6 months	<b>466</b>	457
Over 6 months	<b>207</b>	147
	<b>3,960</b>	3,767

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

25. DEFERRED ACQUISITION COSTS

Group and Company	Gross amount RMB million	Reinsurers' share RMB million	Net amount RMB million
At 1 January 2006	5,719	(1,642)	4,077
Costs deferred during the year	13,242	(2,935)	10,307
Amortisation	(12,144)	3,262	(8,882)
At 31 December 2006	6,817	(1,315)	5,502
At 1 January 2005	6,100	(2,153)	3,947
Costs deferred during the year	11,708	(3,577)	8,131
Amortisation	(12,089)	4,088	(8,001)
At 31 December 2005	5,719	(1,642)	4,077

Group and Company	2006			2005		
	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	6,043	(1,166)	4,877	4,978	(1,429)	3,549
Non-current	774	(149)	625	741	(213)	528
	6,817	(1,315)	5,502	5,719	(1,642)	4,077

26. RECEIVABLES FROM REINSURERS

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

	Group and Company	
	2006 RMB million	2005 RMB million
Within 3 months	2,554	2,316
Over 3 months but less than 6 months	41	31
Over 6 months	114	153
	2,709	2,500

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

27. PREPAYMENTS AND OTHER RECEIVABLES

	Group and Company	
	2006	2005
	RMB million	RMB million
Interests receivable	616	434
Prepayments and deposits	624	163
Amount due from the Holding Company (note 49(c))	–	155
Other receivables	618	461
	1,858	1,213

In September 2004, a PRC securities company engaged by PICC Asset Management Company Limited (“PICC AMC”) was placed under operational control by a special manager as instructed by the China Securities Regulatory Commission. As the securities company went into liquidation in September 2005, the balance of RMB116 million (31 December 2005: RMB120 million), net of impairment, was accounted for as an other receivable as at 31 December 2006.

Included in the balance as at 31 December 2006 was the consideration of RMB468 million (2005: Nil) paid to a securities company for a future equity interest in the New Securities Company as further explained in note 20 to these financial statements.

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

28. INVESTMENT IN AN ASSOCIATE

	Group		Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Unlisted shares, at cost	–	–	160	–
Share of net assets	162	–	–	–
	162	–	160	–

Particulars of the associate are as follows:

Name	Place of registration and operations	Nominal value of registered share capital RMB million	Percentage of equity directly attributable to the Group
PICC Asset Management Company Limited	Mainland China	800	20

## NOTES TO FINANCIAL STATEMENTS

### 28. INVESTMENT IN AN ASSOCIATE (CONTINUED)

The principal activity of the associate is the provision of asset management services.

The following table illustrates the summarised financial information of the Group's associate.

	2006 <i>RMB million</i>	2005 <i>RMB million</i>
Assets	845	—
Liabilities	37	—
Turnover	68	—
Net profit	9	—

Management do not have any intention to dispose of the investment within the near future.

The Group's management fees payable of RMB10 million to an associate in 2006 (2005: payable to a fellow subsidiary of RMB9 million) are disclosed in notes 36 and 49(c) to the financial statements.

### 29. INVESTMENTS IN SUBSIDIARIES

	Company 2006 <i>RMB million</i>	2005 <i>RMB million</i>
Unlisted shares, at cost	3	—

Particulars of the subsidiaries are as follows:

Name	Place of registration and operations	Nominal value of registered share capital <i>RMB million</i>	Percentage of equity directly attributable to the Group
PICC Hebi Insurance Agency Company Limited*	Mainland China	0.5	100
PICC Qingdao Insurance Agency Company Limited*	Mainland China	0.5	90
PICC Hebei Insurance Agency Company Limited*	Mainland China	1.0	100
PICC Haikou Training Center Company Limited*	Mainland China	0.1	100

\* These subsidiaries are all registered as company limited enterprises under the PRC Company Law.

The principal activities of these subsidiaries are mainly providing insurance agency services and training services to the Group.

30. PROPERTY, PLANT AND EQUIPMENT

Group and Company

	Land and buildings <i>RMB million</i>	Motor vehicles <i>RMB million</i>	Office equipment, furniture and fixtures <i>RMB million</i>	Total <i>RMB million</i>
<b>Cost:</b>				
At 1 January 2006	9,873	1,446	2,610	13,929
Additions	65	148	185	398
Transfers from construction in progress ( <i>note 32</i> )	355	–	11	366
Transfers to investment properties ( <i>note 31</i> )	(279)	–	–	(279)
Disposals	(152)	(150)	(181)	(483)
At 31 December 2006	9,862	1,444	2,625	13,931
<b>Accumulated depreciation:</b>				
At 1 January 2006	(1,092)	(994)	(1,267)	(3,353)
Charge for the year	(339)	(140)	(454)	(933)
Transfers to investment properties ( <i>note 31</i> )	34	–	–	34
Disposals	31	144	177	352
As 31 December 2006	(1,366)	(990)	(1,544)	(3,900)
Net book value: As 31 December 2006	8,496	454	1,081	10,031
<b>Cost:</b>				
At 1 January 2005	9,850	1,472	2,155	13,477
Additions	5	122	574	701
Transfers ( <i>note 32</i> )	60	–	–	60
Disposals	(42)	(148)	(119)	(309)
At 31 December 2005	9,873	1,446	2,610	13,929
<b>Accumulated depreciation:</b>				
At 1 January 2005	(752)	(880)	(880)	(2,512)
Charge for the year	(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

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

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

As at 31 December 2006, certain acquired buildings of the Group with a net book value of RMB733 million (2005: RMB385 million) were in the process of title registration for their title certificates.

The net book value of the Group's property, plant and equipment held under finance leases included in the total amount of property, plant and equipment at 31 December 2006 amounted to RMB1,874 million (2005: RMB1,938 million).

**31. INVESTMENT PROPERTIES**

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
Cost:		
At 1 January	269	189
Additions	–	80
Transfers from property, plant and equipment (note 30)	279	–
At 31 December	548	269
Accumulated depreciation:		
At 1 January	(56)	(50)
Charge for the year	(15)	(6)
Transfers from property, plant and equipment (note 30)	(34)	–
At 31 December	(105)	(56)
Net book value at 31 December	443	213

The fair value of the investment properties is RMB612 million (2005: RMB294 million). The fair value of the properties is determined by the directors with reference to recent market transactions.

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

**32. CONSTRUCTION IN PROGRESS**

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
At 1 January	1,756	949
Additions	522	887
Transfers to property, plant and equipment ( <i>note 30</i> )	(366)	(60)
Transfers to prepaid land premiums ( <i>note 33</i> )	(40)	–
Disposals	–	(20)
At 31 December	<b>1,872</b>	1,756

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

**33. PREPAID LAND PREMIUMS**

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
At 1 January	4,000	4,065
Additions	22	28
Transfers from construction in progress ( <i>note 32</i> )	40	–
Amortisation for the year	(102)	(93)
At 31 December	<b>3,960</b>	4,000

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

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
Long term leases	90	92
Medium term leases	3,870	3,908
	<b>3,960</b>	4,000

**34. PAYABLES TO REINSURERS**

Payables to reinsurers are analysed as follows:

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
Reinsurance payables	3,322	3,169
Reinsurance funds withheld	69	362
	<b>3,391</b>	<b>3,531</b>

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 2006 and 2005 are repayable upon the expiration of the related reinsurance contracts.

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

**35. ACCRUED INSURANCE PROTECTION FUND**

	<b>Group and Company</b>	
	<b>2006</b>	<b>2005</b>
	<i>RMB million</i>	<i>RMB million</i>
At 1 January	195	1,099
Accrued during the year	610	537
Offset against the amount due from the provincial government	—	(1,210)
Paid during the year	(588)	(231)
At 31 December	<b>217</b>	<b>195</b>

The Group is obligated to pay into an insurance protection fund based on a rate of 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% (2005: 6%) of the Group's total assets determined in accordance with PRC GAAP.

Insurance companies are required to deposit their insurance protection fund in a bank account designated by the CIRC on a quarterly basis.

## 36. OTHER LIABILITIES AND ACCRUALS

	Group and Company	
	2006	2005
	RMB million	RMB million
Premiums received in advance	2,333	1,827
Salaries and staff welfare payables	1,461	1,710
Securities sold under agreements to repurchase	200	–
Amount due to the Holding Company (note 49(c))	26	116
Accrued capital expenditure	116	128
Amount due to an associate (note 49(c))	10	–
Amount due to a fellow subsidiary (note 49(c))	–	9
Liabilities arising from share appreciation rights (note 44)	84	10
Others	2,398	2,209
	<b>6,628</b>	<b>6,009</b>

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

## NOTES TO FINANCIAL STATEMENTS

### 37. DEFERRED TAX

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

#### Group and Company

Notes	Revaluation	Revaluation	Cash flow	Depreciation	Deferred	Deferred	Others	Total
	of fair value	of available-						
	through profit	for-sale	hedging	of plant and	recognition	acquisition		
	or loss	financial		equipment	at fair value	through		
	RMB	RMB	RMB	RMB	through	profit	RMB	RMB
	million	million	million	million	profit	loss	million	million
					or loss	costs	million	million
Deferred tax assets:								
At 1 January 2006								
As previously reported	267	37	-	225	-	444	268	1,241
Effect of change in an accounting policy 2.4(a)	-	-	-	-	-	98	-	98
As restated at 1 January 2006	267	37	-	225	-	542	268	1,339
Deferred tax (charged)/credited to the income statement during the year (note 14)	(520)	-	-	(35)	-	(108)	75	(588)
Deferred tax debited to equity during the year	-	(414)	(2)	-	-	-	-	(416)
Gross deferred tax assets at 31 December 2006	(253)	(377)	(2)	190	-	434	343	335
Deferred tax liabilities:								
At 1 January 2006								
As previously reported	-	-	-	-	(3)	(1,316)	-	(1,319)
Effect of change in an accounting policy 2.4(a)	-	-	-	-	-	(571)	-	(571)
As restated at 1 January 2006	-	-	-	-	(3)	(1,887)	-	(1,890)
Deferred tax credited/(charged) to the income statement during the year (note 14)	-	-	-	-	14	(363)	(1)	(350)
Gross deferred tax liabilities at 31 December 2006	-	-	-	-	11	(2,250)	(1)	(2,240)
Net deferred tax liabilities at 31 December 2006								(1,905)

37. DEFERRED TAX (CONTINUED)

Group and Company

	Revaluation of fair value through profit or loss <i>RMB million</i>	Revaluation of available- for-sale financial instruments <i>RMB million</i>	Depreciation of property, plant and equipment <i>RMB million</i>	Deferred income recognition at fair value through profit or loss <i>RMB million</i>	Deferred acquisition costs <i>RMB million</i>	Others <i>RMB million</i>	Total <i>RMB million</i>
Deferred tax assets:							
At 1 January 2005							
As previously reported	334	163	209	–	710	189	1,605
Effect of change in an accounting policy	–	–	–	–	–	–	–
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	–	(168)	79	(85)
Deferred tax debited to equity during the year	–	(181)	–	–	–	–	(181)
Gross deferred tax assets at 31 December 2005	267	37	225	–	542	268	1,339
Deferred tax liabilities:							
At 1 January 2005							
As previously reported	–	–	–	–	(1,454)	–	(1,454)
Effect of change in an accounting policy	–	–	–	–	(559)	–	(559)
As restated at 1 January 2005	–	–	–	–	(2,013)	–	(2,013)
Deferred tax credited/(charged) to the income statement during the year (note 14)	–	–	–	(3)	126	–	123
Gross deferred tax liabilities at 31 December 2005	–	–	–	(3)	(1,887)	–	(1,890)
Net deferred tax liabilities at 31 December 2005							(551)

## NOTES TO FINANCIAL STATEMENTS

### 37. DEFERRED TAX (CONTINUED)

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 financial instruments is taken to the available-for-sale financial instrument 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.

### 38. UNEARNED PREMIUM RESERVES

Group and Company	2006			2005		
	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	32,507	(5,967)	26,540	30,803	(4,319)	26,484
Increase during the year	33,808	4,908	38,716	29,952	(5,498)	24,454
Release during the year	(29,473)	(3,822)	(33,295)	(28,248)	3,850	(24,398)
At 31 December	36,842	(4,881)	31,961	32,507	(5,967)	26,540
Current	32,367	(4,038)	28,329	28,305	(5,204)	23,101
Non-current	4,475	(843)	3,632	4,202	(763)	3,439
	36,842	(4,881)	31,961	32,507	(5,967)	26,540

### 39. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

Group and Company	2006			2005		
	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	22,026	(5,185)	16,841	21,817	(5,957)	15,860
Claims incurred during the year	45,286	(6,670)	38,616	42,635	(6,300)	36,335
Claims paid during the year	(44,432)	6,991	(37,441)	(42,426)	7,072	(35,354)
At 31 December	22,880	(4,864)	18,016	22,026	(5,185)	16,841
Current	17,330	(3,603)	13,727	16,033	(3,059)	12,974
Non-current	5,550	(1,261)	4,289	5,993	(2,126)	3,867
	22,880	(4,864)	18,016	22,026	(5,185)	16,841

**40. POLICYHOLDERS' DEPOSITS**

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

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

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Interest-bearing deposits	6,742	6,158
Non-interest-bearing deposits	2,152	2,291
	<b>8,894</b>	8,449

Certain contracts offered by the Group require that the policyholders place a deposit with the Group 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 Group 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.

**41. SUBORDINATED LOAN/DEBTS ISSUED BY THE COMPANY**

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 was unsecured and bore interest at 90% of the People's Bank of China long term borrowing interest rate per annum. It was originally contracted to be repayable in November 2023 but was fully repaid by the Company on 21 December 2006.

On 19 December 2006, the Company issued subordinated debts of RMB3,000 million to a number of institutional investors. These debts are unsecured and have a maturity period of 10 years, bear interest at a rate of 4.08% per annum in the first five years and a rate of 6.08% per annum in the remaining years. The Company has an option to redeem the subordinated debts at the end of the first five years.

The fair value of these subordinated loan/debts is RMB3,425 million (2005: RMB2,674 million). Fair value has been estimated using quoted market prices for securities with similar credit, maturity and characteristics.

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

#### (a) Insurance contracts liabilities

##### *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 reserves are 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 claims incurred loss development and the claims incurred Bornheutter-Ferguson methodology. Gross loss and loss adjustment expense reserves for other lines of business are estimated by using incremental/cumulative claims loss developments, payment per claim incurred, expected loss ratio or 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 claims incurred Bornheutter-Ferguson methodology; and facultative reinsurance recoveries are estimated by using the large claim recovery information provided by the claims department.

##### *Assumptions and sensitivities*

The principal assumption underlying the estimates is the Group'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 claims development patterns. The range of reasonable estimates of loss and loss adjustment expense reserves, projected by different statistical techniques and varying key assumptions, represents the different views of the fluctuation impacts on the speed of settlements, the changes in premium rates and the underwriting controls over ultimate losses. As at 31 December 2006, the net loss and loss adjustment reserve recorded in these financial statements was RMB18,016 million (see note 39), which was within a range of reasonable actuarial estimates.

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 the occurrence of a claim and its subsequent notification and eventual settlement, the loss and loss adjustment reserves are not quantifiable with certainty at the balance sheet date. One of the most significant assumptions used to estimate the net loss and loss adjustment reserve of motor vehicles insurance as at 31 December 2006 was the expected ultimate loss ratio for accidents which that have occurred in the second half year of 2006. A 1% change in that ratio will result in a change in net loss and loss adjustment reserve as at 31 December 2006 by approximately RMB215 million.

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

(a) Insurance contracts liabilities (continued)

Assumptions and sensitivities (continued)

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

Accident year	2001	2002	2003	2004	2005	2006	Total
Gross basis	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Estimate of ultimate claims costs							
At the end of accident year			35,469	41,015	39,768	42,674	
One year later		33,297	37,724	40,758	40,397		
Two years later	28,078	34,081	38,706	41,334			
Three years later	28,198	34,192	38,803				
Four years later	28,229	34,215					
Five years later	28,175						
Current estimate of cumulative claims	28,175	34,215	38,803	41,334	40,397	42,674	225,598
Cumulative payments to date	(28,138)	(33,688)	(38,483)	(40,168)	(36,818)	(26,039)	(203,334)
Liability recognised in the balance sheet	37	527	320	1,166	3,579	16,635	22,264
Liability in respect of prior years and unallocated loss adjustment expenses							616
Total gross liability included in the balance sheet							22,880

## NOTES TO FINANCIAL STATEMENTS

### 42. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS – TERMS, ASSUMPTIONS AND SENSITIVITIES (CONTINUED)

#### (a) Insurance contracts liabilities (continued)

##### Assumptions and sensitivities (continued)

Accident year	2001	2002	2003	2004	2005	2006	Total
Net basis	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Estimate of ultimate claims costs							
At the end of accident year			27,215	33,316	32,788	35,405	
One year later		25,631	29,421	33,119	33,406		
Two years later	21,779	26,357	30,225	33,651			
Three years later	21,863	26,274	30,306				
Four years later	21,877	26,242					
Five years later	21,813						
Current estimate of cumulative claims	21,813	26,242	30,306	33,651	33,406	35,405	180,823
Cumulative payments to date	(21,790)	(25,988)	(30,125)	(32,906)	(30,724)	(21,871)	(163,404)
Liability recognised in the balance sheet	23	254	181	745	2,682	13,534	17,419
Liability in respect of prior years and unallocated loss adjustment expenses							597
Total net liability included in the balance sheet							18,016

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 Main Board of The Stock Exchange of Hong Kong Limited ("HKSE").

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

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

**(b) Reinsurance assets – Terms, assumptions and methods**

The Group 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. In the prior year, the Group is required to cede 5% of 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 Group's exposure to certain catastrophic events.

Even though the Group may have reinsurance arrangements, it is not relieved of its direct obligations to its policyholders. The Group's premiums ceded to the top three reinsurance companies amounted to RMB7,513 million (2005: RMB9,610 million) and thus a credit exposure exists with respect to the business ceded, to the extent that any of these reinsurers is unable to meet its obligations assumed under such reinsurance agreements.

**43. ISSUED SHARE CAPITAL**

	<b>2006</b> <i>RMB million</i>	2005 <i>RMB million</i>
<b>Shares</b>		
Registered, issued and fully paid:		
7,685,820,000 domestic shares of RMB1.00 each	<b>7,686</b>	7,686
3,455,980,000 H shares of RMB1.00 each	<b>3,456</b>	3,456
	<b>11,142</b>	11,142

### 44. 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 Group’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 the 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, SARs 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.

44. SHARE APPRECIATION RIGHTS (CONTINUED)

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

	2006		2005	
	Number of units '000	Weighted average exercise price (HK\$)	Number of units '000	Weighted average exercise price (HK\$)
As at 1 January	136,515	1.90	28,356	1.80
Granted during the year	8,624	1.93	109,698	1.93
Forfeited	(4,770)	1.92	(614)	1.80
Exercised	(23,297)	1.88	(925)	1.80
As at 31 December	117,072	1.91	136,515	1.90
Exercisable at 31 December	21,562		7,244	
Liabilities arising from SAR at 31 December (RMB million) (note 36)	84		10	
Intrinsic value of vested SAR as at 31 December (RMB million)	45		3	
Weighted average remaining contractual life of the outstanding SAR	3.42		4.30	
Range of exercise price for the outstanding SAR		1.80-1.93		1.80-1.93
Weighted average share price at the date of exercise		3.00		2.58

During the year, the Group recognised a share-based transaction expense of RMB102 million (2005: RMB10 million).

**44. SHARE APPRECIATION RIGHTS (CONTINUED)**

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 2006:

	2006	2005
Dividend yield (%)	–	1.850
Expected volatility (%)	38.78	32.70
Historical volatility (%)	38.78	32.70
Risk-free interest rate (%)	3.316	3.240
Expected life of share appreciation rights (years)	2 – 3	3 – 4
Share price at the balance sheet date (HK\$)	3.990	2.225

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

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

**45. RISK MANAGEMENT OBJECTIVES AND POLICIES**

Similar to other insurance entities, the Group holds substantial financial assets including debt securities, equity securities and bank deposits as an integral part of its operations. The Group also borrowed a subordinated loan or issued subordinated debts to enhance its solvency position. The Group 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 Group's financial instruments are credit risk, liquidity or funding risk and market risk. The details of these risks, together with insurance risk, and the Group'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 Group is exposed to deposits placed with security firms, banks and similar institutions. As at 31 December 2006, the aggregate balance of cash and term deposits placed with the three most major banks amounted to RMB16,353 million (2005: RMB16,811 million).

The Group is also subject to credit risk of debt securities. The Group heavily invests in debt securities issued by the PRC government, banks and financial institutions. Details of these debt securities are set out in note 20 to the financial statements. The Group only invests in corporate debt securities with a PRC rating higher than AA.

**45. RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)****(a) Financial Risks (continued)****(1) Credit risk (continued)**

The Group 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 the major performance indicators is the ability to collect premiums receivable on a timely basis. The Group's premiums receivable relate to a large number of diversified customers and therefore there is no significant concentration of credit risk.

Reinsurance of the Group is mainly placed with reinsurers with A.M. Best rating of A- or above. Management performs regular assessment of creditworthiness of reinsurers to update reinsurance purchase strategies and ascertain suitable allowances for impairment of reinsurance assets. As at 31 December 2006, the top three insurance companies owed an aggregate amount of RMB1,845 million (2005: RMB2,111 million) to the Group.

**(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 to repay 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 the Group confronts is the daily calls on its available cash resources in respect of claims arising from insurance contracts.

It is unusual for a Group primarily transacting insurance business to predict the requirements of funding with absolute certainty as the 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 maturity periods of these insurance liabilities are thus based on management's best estimate based on statistical techniques and past experience.

The Group holds 20% (2005: 17%) of the total assets as demand deposits and term deposits with original maturity less than three months to ensure sufficient liquid assets are available. 60% (2005: 55%) of the debt securities are listed on stock exchanges. Additions to illiquid assets, properties in particular, were closely monitored by management.

45. 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 Group 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 Group's principal transactions are carried out in Renminbi.

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

Moreover, the Group holds deposits of RMB11,851 million (2005: RMB12,089 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 the changes in market interest rates.

The Group mainly invests in financial assets of which the maturity periods vary from one to seven years in view of the short duration of insurance liabilities. The Group intends to maintain the duration of its 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 Group to reduce its interest rate risk.

45. RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

(a) Financial Risks (continued)

(3) Market risk (continued)

(ii) Interest rate risk

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

	2006	2005
Assets:		
Cash and cash equivalents	0.72% – 4.50%	0.72% – 4.38%
Term deposits	1.71% – 10.58%	1.89% – 11.50%
Derivative financial assets	2.52% – 2.98%	–
Debt securities	0.76% – 11.83%	0.34% – 11.83%
Subordinated debts held by the Company	4.87% – 5.17%	4.87% – 5.17%
Capital security fund	2.25%	2.25%
Liabilities:		
Payables to reinsurers – reinsurance funds withheld	2.25% – 2.52%	2.25%
Policyholders' deposits – interest-bearing	2.20% – 3.84%	2.20% – 2.63%
Securities sold under agreements to repurchase	1.98%	–
Subordinated loan/debts issued by the Company	4.95%	5.51%

## NOTES TO FINANCIAL STATEMENTS

### 45. 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 carrying amounts, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

31 December 2006

<b>Fixed rate</b>	<b>Within 1 year RMB million</b>	<b>1-2 years RMB million</b>	<b>2-3 years RMB million</b>	<b>3-4 years RMB million</b>	<b>4-5 years RMB million</b>	<b>More than 5 years RMB million</b>	<b>Total RMB million</b>
<b>Assets:</b>							
Cash and cash equivalents	8,958	-	-	-	-	-	8,958
Term deposits	2,139	-	-	300	200	250	2,889
Debt securities	2,855	2,708	5,158	607	3,305	6,081	20,714
Capital security fund	2,228	-	-	-	-	-	2,228
<b>Liabilities:</b>							
Payables to reinsurers – reinsurance funds withheld	(69)	-	-	-	-	-	(69)
Securities sold under agreements to repurchase	(200)	-	-	-	-	-	(200)
Policyholders' deposits – interest-bearing	(5,597)	-	(443)	-	(702)	-	(6,742)
Subordinated loan/debts issued by the Company	-	-	-	-	-	(3,000)	(3,000)

<b>Floating rate</b>	<b>Within 1 year RMB million</b>	<b>1-2 years RMB million</b>	<b>2-3 years RMB million</b>	<b>3-4 years RMB million</b>	<b>4-5 years RMB million</b>	<b>More than 5 years RMB million</b>	<b>Total RMB million</b>
<b>Assets:</b>							
Cash and cash equivalents	12,648	-	-	-	-	-	12,648
Term deposits	206	-	39	77	50	3,507	3,879
Derivative financial assets	6	-	-	-	-	-	6
Debt securities	73	-	-	1,493	114	495	2,175
Subordinated debts held by the Company	-	-	1,220	1,600	-	90	2,910

45. RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

(a) Financial Risks (continued)

(3) Market risk (continued)

(ii) Interest rate risk (continued)

31 December 2005

	Within 1	1-2	2-3	3-4	4-5	More than	Total
Fixed rate	year	years	years	years	years	5 years	
	RMB	RMB	RMB	RMB	RMB	RMB	RMB
	million	million	million	million	million	million	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)

	Within 1	1-2	2-3	3-4	4-5	More than	Total
Floating rate	year	years	years	years	years	5 years	
	RMB	RMB	RMB	RMB	RMB	RMB	RMB
	million	million	million	million	million	million	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 held by the Company	–	–	–	1,220	1,690	–	2,910

Liabilities:

Subordinated loan/debts issued by the Company	–	–	–	–	–	(2,000)	(2,000)
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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 instruments.

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

45. RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

(b) Insurance Risk

The risk under an insurance contract arises from the possibility of occurrence of an insured event and the uncertainty of the amount and timing of any resulting claim. The principal risk the Group 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.

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

- The 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 Group'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 Group has achieved geographical diversification by accepting risks in different provinces of the PRC.

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

	2006		2005	
	Gross RMB million	Net RMB million	Gross RMB million	Net RMB million
Coastal and developed provinces/cities	33,065	27,292	30,070	23,607
North-eastern China	6,140	5,258	5,699	4,619
North China	10,508	9,370	9,833	8,264
Central China	8,008	7,120	7,792	6,518
Western China	13,627	11,997	12,520	10,432
Total	71,348	61,037	65,914	53,440

**46. CONTINGENT LIABILITIES**

Owing to the nature of insurance business, the Group 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 Group'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 Group.

**47. OPERATING LEASE COMMITMENTS**

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

At 31 December 2006, the Group and the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Within one year	257	310
In the second to fifth years, inclusive	143	292
After five years	48	46
	<b>448</b>	648

**48. CAPITAL COMMITMENTS**

In addition to the operating lease commitments detailed in note 47 above, the Group and the Company had the following commitments at the balance sheet date:

	<b>Group and Company</b>	
	<b>2006</b>	2005
	<i>RMB million</i>	<i>RMB million</i>
Contracted, but not provided for: property, plant and equipment	473	835
Authorised, but not contracted for: property, plant and equipment	28	44
acquisition of an investment	—	160
	<b>501</b>	1,039

49. RELATED PARTY TRANSACTIONS

(a) Transactions with related parties

	Notes	2006 RMB million	2005 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 an associate/fellow subsidiary:			
Management fee	(v)	39	36
Acquisition of an associate	(vi)	160	–
Transactions with a fellow subsidiary:			
Commissions received	(vii)	–	–
Commissions paid	(vii)	–	–
Transactions with a major shareholder:			
Reinsurance premiums ceded	(viii)	739	619
Claims recoverable	(viii)	246	139
Reinsurance commission received/receivables	(viii)	234	174

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 facility maintenance services; and (iv) other information system services agreed by both parties. The services fee payables to the Company by the Holding Company are 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.

## 49. RELATED PARTY TRANSACTIONS (CONTINUED)

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

Notes: (continued)

- (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 provincial and municipal offices of the Holding Company. Management fee is calculated based on a rate of RMB300 per annum for each 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, which was a fellow subsidiary of the Company, 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 the management of PICC AMC in that particular year and the applicable annual rate. The term of the asset management agreement is four years.
- (vi) On 25 July 2006, the Company entered into an agreement with the Holding Company, certain fellow subsidiaries and an independent third party to contribute to enlarged registered capital of PICC AMC. After having made a capital contribution of RMB160 million, the Company holds a 20% interest in PICC AMC.
- (vii) The Company entered into a mutual insurance agency agreement with PICC Life Insurance Company Limited ("PICC Life") on 19 October 2006, pursuant to which the Company and PICC Life mutually acts as the agency for selling the insurance products and receiving agency premiums on behalf for each other. The Company will pay an agency fee to PICC Life in consideration of the agency services provided by PICC Life on the Company's insurance products. The Company will receive an agency fee from PICC Life in consideration of the agency services provided by the Company on PICC Life's insurance products. The agency fees are calculated by the actual agency premiums received multiplied by the agreed commission rates. The term of the mutual insurance agency agreement is three years commencing from 1 September 2006. PICC Life is a fellow subsidiary of the Company.
- (viii) 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 the 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 into in the Company's ordinary and usual course of business. The intention of the parties is to continue the co-operation indefinitely. Either party may request to review the key terms of the Technical Assistance and 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 (vii) 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.

49. 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 the sale 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	
	2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
The Holding Company	–	155	26	116
An associate	–	–	10	–
A fellow subsidiary	–	–	–	9
A major shareholder	172	12	240	46
	172	167	276	171

The balances with the Holding Company, an associate, 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)

	2006 RMB'000	2005 RMB'000
Short term employee benefits	3,667	5,423
Post-employment benefits	556	565
Cash-settled share appreciation rights expense	6,932	863
Total compensation paid to key management personnel	11,155	6,851

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

### 50. EVENT AFTER THE BALANCE SHEET DATE

- (a) During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ('the New Corporate Income Tax Law') was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. The reduction in income tax rate will directly reduce the Group's effective tax rate and its deferred tax liabilities in the future. Other than that, since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.
- (b) On 17 April 2007, the Board of Directors approved that the Company preliminarily intended to acquire a 29% interest in the enlarged share capital of PICC Life for a consideration of approximately RMB841 million. At the date of approving these financial statements, the Company has not yet entered into any agreement in relation to this investment, and this proposed transaction may or may not proceed or proceed as intended.

### 51. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved and authorised for issue by the Board of Directors on 17 April 2007.

## PARTICULARS OF MATERIAL PROPERTIES

### INVESTMENT PROPERTIES

Location	Use	Tenure	Attributable interest of the Group
PICC Plaza, No. 151, Yao Wang Street, Haishu District Ningbo, Zhejiang Province, the PRC	Office building	Medium term lease	100%
PICC Plaza, No. 57, Dongyu Street, Jinjiang District Chengdu, Sichuan Province, the PRC	Office building	Medium term lease	100%
PICC Plaza, No. 66, Zhonghe Middle Street, Hangzhou, Zhejiang Province, the PRC	Office building	Medium term lease	100%
PICC Plaza, No. 66, Hongkong Middle Street, Shinan District Qingdao, Shandong Province, the PRC	Office building	Medium term lease	100%
PICC Plaza, No. 560, Fengze Street, Fengze District Quanzhou, Fujian Province, the PRC	Office building	Medium term lease	100%

### PROPERTIES UNDER DEVELOPMENT

Location	Use	Site area (sq.m.)	Gross floor area (sq.m.)	Percentage of completion	Expected completion date	Attributable interest of the Group
PICC Building Guangzhou Street Yuexiu District Guangzhou, the PRC	Commercial	2,300	33,000	97%	May 2007	100%
Yin Tai Commercial Building, East Office No. 4, Jianguomenwai Street Chaoyang District, Beijing, the PRC	Commercial	6,836	76,362	65%	December 2008	100%

In the opinion of the directors, disclosure of all investment properties and properties under development would result in particulars of excessive length. Therefore, only material properties are listed in the schedule.

## NOTICE OF ANNUAL GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that an annual general meeting of PICC Property and Casualty Company Limited (the “Company”) will be held at Wanchunyuan Villa, No. 28 Qinghua Road (W), Haidian District, Beijing, the People’s Republic of China on 22 June 2007 (Friday) at 9:30 a.m. for the purposes of considering and, if thought fit, passing the following resolutions:

### ORDINARY RESOLUTIONS

1. To approve the Report of the Directors of the Company for 2006.
2. To approve the Report of the Supervisory Committee of the Company for 2006.
3. To approve the audited financial statements and the Report of the Auditors of the Company for the year ended 31 December 2006.
4. To approve the profit distribution plan of the Company for the year ended 31 December 2006.
5. To approve directors’ fees for 2007.
6. To approve supervisors’ fees for 2007.

### SPECIAL RESOLUTION

7. To grant a general mandate to the Board of Directors to separately or concurrently issue, allot or deal with additional domestic shares and H shares in the Company not exceeding 20% of each of the aggregate nominal amount of the domestic shares and H shares of the Company in issue within 12 months from the date on which shareholders’ approval is obtained, and to authorise the Board of Directors to increase the registered capital of the Company and make corresponding amendments to the Articles of Association as it thinks fit so as to reflect the new capital structure upon the allotment or issue of shares.

By Order of the Board  
**Liu Zhenghuan**  
*Secretary of the Board*

Beijing, the PRC, 30 April 2007

#### *Notes:*

1. According to the Articles of Association of the Company, resolutions at general meetings will be determined by a show of hands unless a poll is required under the Listing Rules or demanded before or after any vote by show of hands. A poll may be demanded by the chairman of the meeting or at least two shareholders entitled to vote, present in person or by proxy, or by one or more shareholders present in person or by proxy representing 10% or more of all shares carrying the voting rights at the meeting. Irrespective of whether the voting is carried out by show of hands or by poll, the votes counted will be based on the number of shares represented by such votes.
2. The register of members will be closed from 23 May 2007 (Wednesday) to 22 June 2007 (Friday), both days inclusive, during which period no transfer of shares will be effected. Holders of H shares and domestic shares whose names appear on the register of members of the Company on 22 May 2007 (Tuesday) at 4:30 p.m. are entitled to attend this meeting.

## NOTICE OF ANNUAL GENERAL MEETING

3. A shareholder entitled to attend and vote at this meeting may appoint one or more proxies to attend and vote in his stead. A proxy need not be a shareholder of the Company.
4. The instrument appointing a proxy must be in writing under the hand of a shareholder or his attorney duly authorised in writing. If the shareholder is a corporation, that instrument must be either under its common seal or under the hand of its director(s) or duly authorised attorney(s). If that instrument is signed by an attorney of the shareholder, the power of attorney authorising that attorney to sign or other authorisation document must be notarised.
5. In order to be valid, the proxy form together with the power of attorney or other authorisation document (if any) must be deposited at the Secretariat of the Board of Directors of the Company for holders of domestic shares and at the Company's place of business in Hong Kong for holders of H shares not less than 24 hours before the time fixed for holding this meeting or any adjournment thereof (as the case may be). Completion and return of a proxy form will not preclude a shareholder from attending and voting in person at this meeting or any adjournment thereof if he so wishes.
6. Holders of domestic shares and holders of H shares who intend to attend this meeting in person or by proxy should return the reply slip to the Secretariat of the Board of Directors of the Company and the Company's place of business in Hong Kong respectively on or before 1 June 2007 (Friday) by hand, by post or by fax.
7. This meeting is expected to be concluded within half a day. Shareholders attending this meeting in person or by proxy are responsible for their own transportation and accommodation expenses. Shareholders or their proxies attending this meeting shall produce their identity documents.
8. Regarding the proposed resolution no. 4, the Board of Directors did not propose any final dividend for 2006.
9. Regarding the proposed resolution nos. 5 and 6, the directors' fees and supervisors' fees for 2007 are proposed to be RMB100,000 (after tax) or an equivalent amount in Hong Kong dollars for each director (except independent non-executive director) and supervisor (except independent supervisor) and HK\$200,000 (after tax) or an equivalent amount in RMB for each independent non-executive director and independent supervisor.
10. Regarding the proposed resolution no. 7, the purpose of seeking approval of the mandate is to give the Board of Directors flexibility and discretion to issue new shares in the event that it becomes desirable for the Company, and there are no immediate plans to issue new shares pursuant to the mandate.

**REGISTERED NAME**

Chinese name: 中國人民財產保險股份  
有限公司  
Abbreviated form of  
Chinese name: 人保財險  
English name: PICC Property and Casualty  
Company Limited  
Abbreviated form of  
English name: PICC P&C

**PLACE OF LISTING OF H SHARES**

The Stock Exchange of Hong Kong Limited

**TYPE OF STOCK**

H Share

**NAME OF STOCK**

PICC P&C

**STOCK CODE**

2328

**H SHARE REGISTRAR AND  
TRANSFER OFFICE**

Computershare Hong Kong Investor Services Limited

**REGISTERED OFFICE**

No. 69 Dong He Yan Street, Xuanwu District,  
Beijing 100052, the PRC

**SECRETARY OF THE BOARD OF DIRECTORS**

Liu Zhenghuan

**COMPANY SECRETARY**

Man Kam Ching

**INFORMATION INQUIRY DEPARTMENT**

Secretariat of the Board of Directors  
Tel: (8610) 83157607  
Fax: (8610) 83157607  
E-mail: IR@picc.com.cn  
Website: www.piccnet.com.cn

**AUDITORS**

*International Auditors*  
Ernst & Young

*Domestic Auditors*  
Ernst & Young Hua Ming

**CONSULTING ACTUARIES**

Milliman Asia Limited

**LEGAL ADVISORS**

*as to Hong Kong Laws*  
Linklaters

*as to PRC Laws*  
King and Wood