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Shin Kong Financial Holding

Review of Embedded Value and Value of 2008 New Business

May 2009

Disclaimer

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Independent Review by Deloitte

Project description

- Shin Kong Life performs, on a yearly basis, an embedded value (EV), value of one year's new business (V1NB), and appraisal value (AV) calculation as an important effort to provide investors and analysts information and insights on the company's operations.
- Deloitte Actuarial is retained to perform an independent review of the assumptions excluding the AV calculation, and to issue an opinion on the reasonableness of the assumptions used.

Scope of Deloitte′s involvement

- Scope of project is to review the assumptions used in the valuation of the EV (at 31/12/2008) and V1NB (value of all business sold in the period 1/1/2008-31/12/2008).
- Provide a written opinion on the reasonableness of the assumptions, taking into consideration both Shin Kong Life's recent experience and Deloitte's knowledge of the Taiwanese life insurance market.
- The review covers portfolio and economic assumptions. It does not cover new business volume assumptions.

Key roles

- Valuation is done by Shin Kong Life.
- Deloitte Actuarial provides an independent review of the assumptions used in the EV and V1NB.

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Appraisal and Embedded Values

An embedded value (EV) is the sum of

- The net worth; and
- The value of in force business (VIF).

An appraisal value (AV) is the sum of

- The embedded value; and
- The value of future new business (VNB).

The VNB is normally the product of

- The value of one year's new business (V1NB) ; and
- A new business "multiplier".

- **Net worth**

  This is the value of shareholder equity, or assets in excess of policy liabilities.

- **Value of in force**

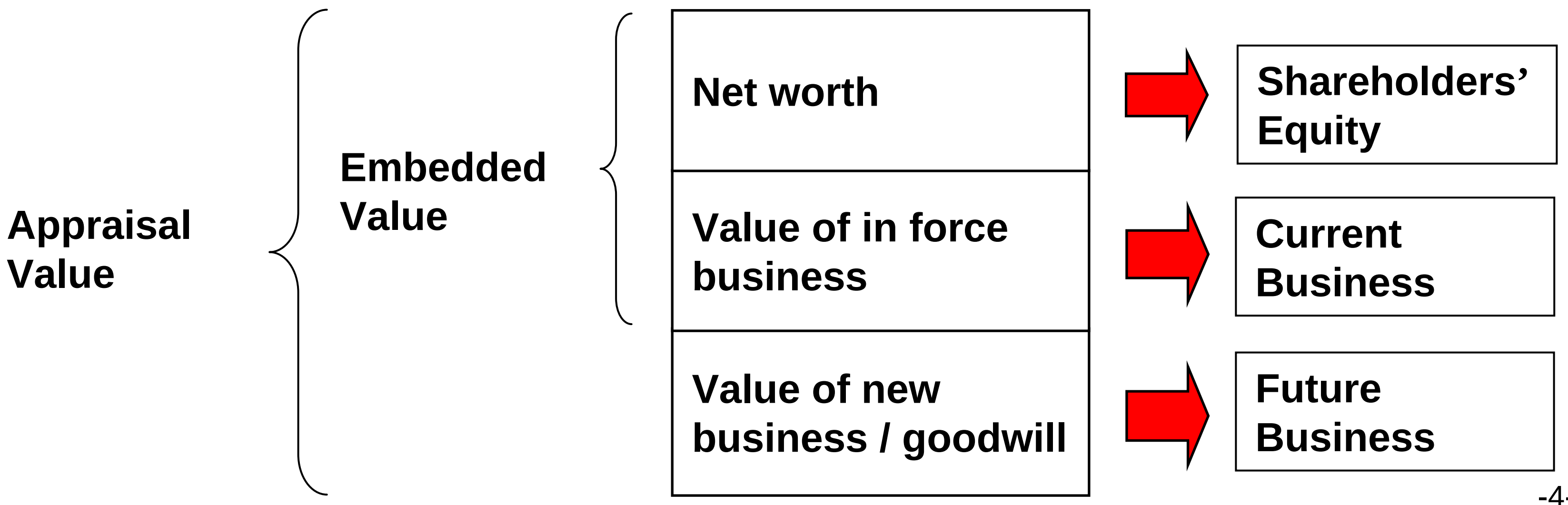
  This is the value of profits from business already sold, allowing for the need to comply with RBC. This calculation requires (i) an actuarial projection model, (ii) valuation assumptions (e.g. future investment return), and (iii) data relating to the company's policies.

- **Value of one year's new business**

  The approach is similar to that for the value of in force. The actual policies sold in the previous 12 months are normally used.

- **New business multiplier**

  This subjective component requires a view to be taken on the company's future new business volumes and profitability.



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EV and AV Results

Unit： NT$bn	31 Dec. 2007	31 Dec. 2008
Adjusted NAV VIF COC	89.8 56.2 32.0	**70.2** **37.5** **27.0**
EV	114.0	**80.7**
V1NB	12.8	**10.7**
AV (5 years NB) AV (20 years NB)	156.7 205.0	**117.9** **161.0**

Note:
(1) Figures may not add up exactly due to rounding.

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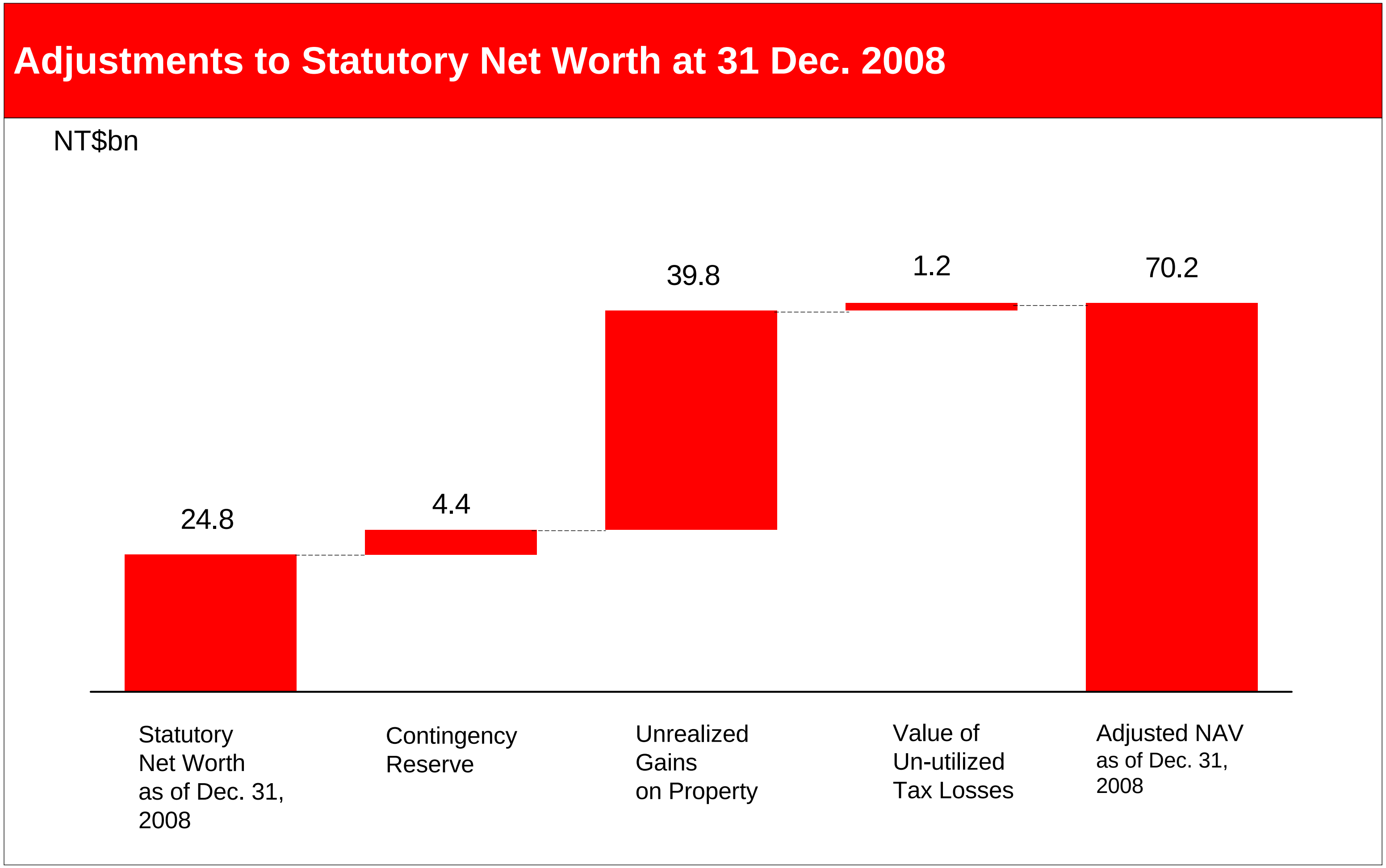
Adjusted Net Worth

Unit: NT$bn	31 Dec. 2007	31 Dec. 2008
Statutory Net Worth	60.0	**24.8**
Preference Shares (Face Value)	(3.0)	**0.0**
Accrued Interest on Pref Shares	(0.1)	**0.0**
Contingency Reserve	4.4	**4.4**
Unrealized Gains on Property	28.3	**39.8**
Value of Un-Utilized Tax Losses	0.2	**1.2**
Adjusted NAV	89.8	**70.2**

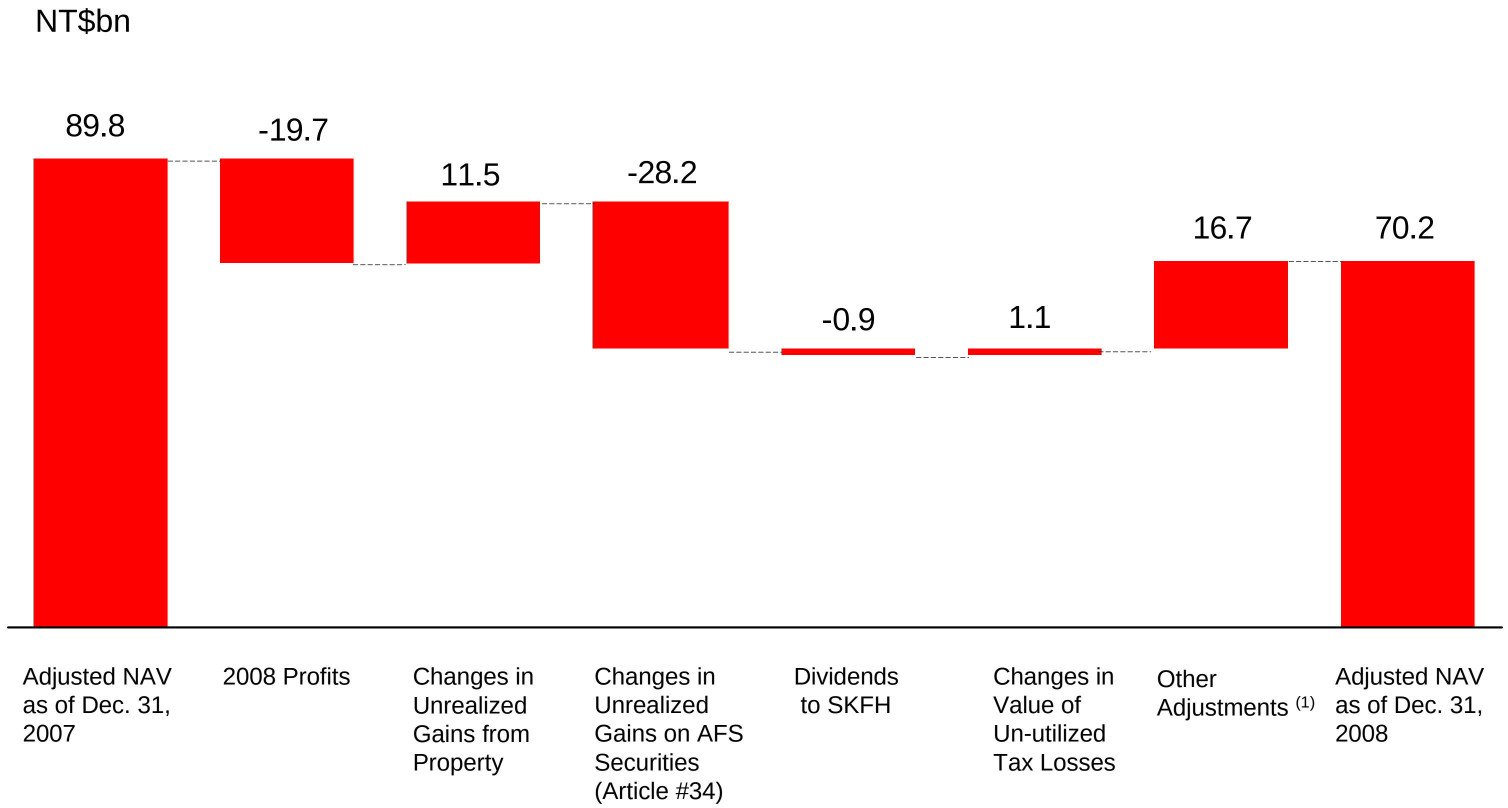
Note:
(1) Figures may not add up exactly due to rounding.

Adjusted NAV



Analysis of Change in NAV

Changes between 31 Dec. 2007 and 31 Dec. 2008 broken down by components

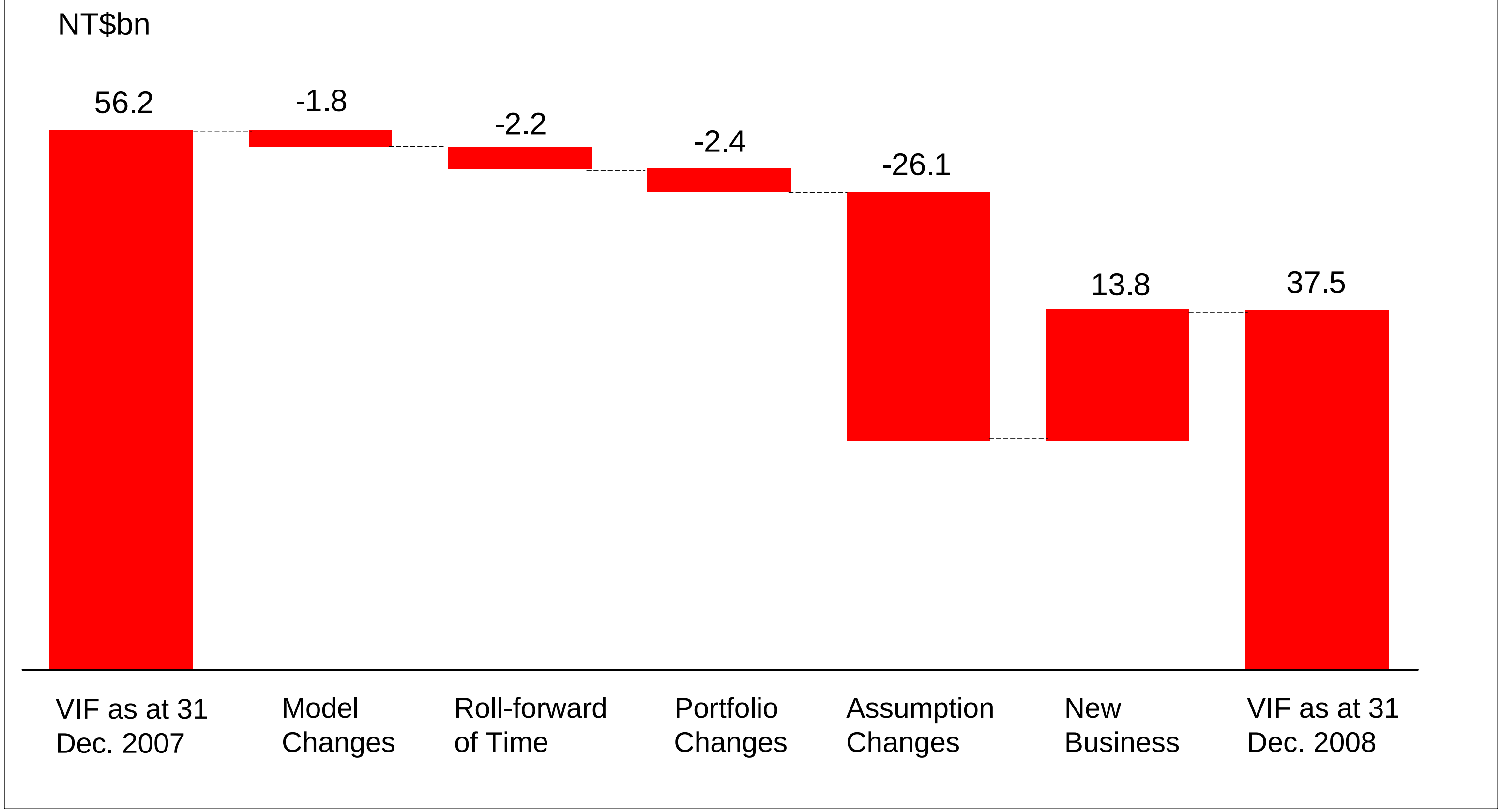


Note:

(1) Included rights issue, changes in contingency reserve, and other items.

Analysis of Change in VIF

Changes between 31 Dec. 2007 and 31 Dec. 2008 broken down by components



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Analysis of Change in VIF

Unit: NT$bn	Description	VIF before CoC
As of 31 Dec. 2007		**56.2**
Model Changes	Refinements and/or corrections made to the cash flow projection model since last valuation date	-1.8
Roll-Forward of Time	Impact to EV as of 31 December 2008 due to elapse of time from December 2007 (business is one year older)	-2.2
Portfolio Changes	Differences in the projected policies in force as at 31 December 2007 and the actual policies in force as at valuation date	-2.4
Assumption Changes	Differences in valuation assumptions used in last valuation and this valuation	-26.1
New Business	Refers to the value added as at 31 December 2008 by policies sold between 1 January and 31 December 2008, as they now form part of the in force block	13.8
As of 31 Dec. 2008		**37.5**

Note:
(1) Figures may not add up exactly due to rounding.

Treatment of Cost of Capital (CoC)

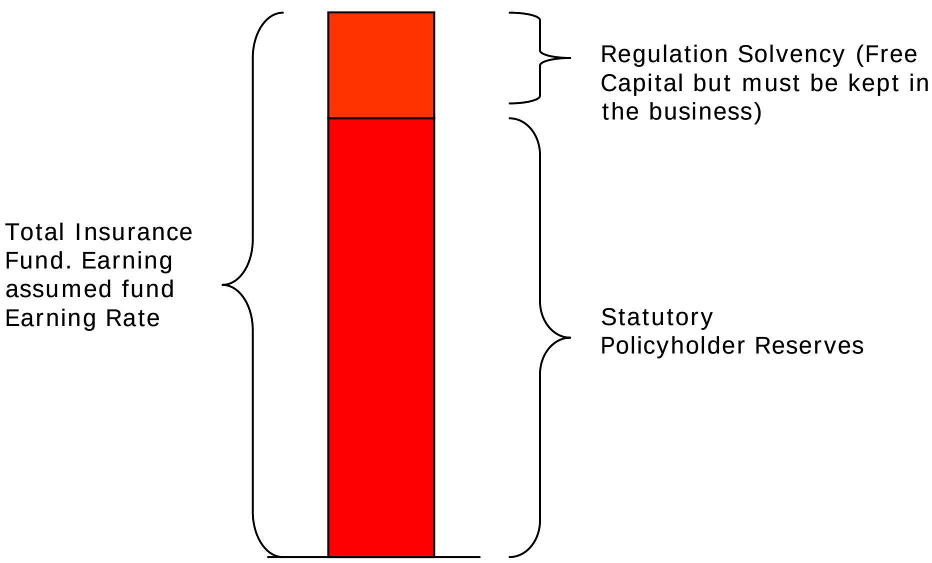
CoC refers to the opportunity cost of needing to hold an additional solvency margin above the statutory reserves to meet local regulations.

This margin must be held whilst any policies are in force, both now and in the future.

The opportunity cost arises since the capital covering this margin is expected to earn the assumed long term earning rate (ER) of the business and cannot earn the return on shareholders require (which would be equal to the Risk Discount Rate (RDR) to justify holding of the assets in the business).

There exists a gap between the rate of return expected by the shareholders and the actual rate of return that can be achieved. This is determined to be a “cost” of doing business in this market and should be reflected in the value of the business.

This is a standard calculation, in line with internationally accepted practice for EV reporting.



Solvency Margin for this Valuation is assumed to be 200% of the RBC

The EV is reduced by the cost of holding this capital in the business. The cost is estimated as the difference between the ER and the RDR on the assumption that the capital could earn the RDR if it were not held in the business

This valuation is on the basis of holding the minimum solvency and does not estimate an EV on the basis of “economic capital”.

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Estimate of Embedded/ Appraisal Value

Unit: NT$bn Valuation Date: 31 Dec. 2008 Solvency Basis: 200% RBC	All else equal except		**Base Case Scenario** **Inv Return 4.65% p.a.** **RDR 9.5% p.a.**	All else equal except	
	Inv Return 4.4%	Inv Return 4.9%		RDR 8.5%	RDR 10.5%
Adjusted Net Worth	70.2	70.2	**70.2**	70.2	70.2
VIF	5.4	67.8	**37.5**	40.6	35.1
Cost of Capital (COC)	29.2	24.9	**27.0**	24.6	28.8
EV after COC	**46.4**	**113.1**	**80.7**	**86.2**	**76.5**
V1NB after COC	**10.1**	**11.4**	**10.7**	**11.9**	**9.7**
AV (5 years NB)	**81.2**	**152.6**	**117.9**	**128.8**	**109.0**
AV (20 years NB)	**121.6**	**198.4**	**161.0**	**182.4**	**143.8**

Note:

(1) Figures may not add up exactly due to rounding.

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Assumptions

Assumptions	Value	Changes from last valuation
Investment return	4.65%	Decreased from 5.05% to 4.65% (see subsequent slide)
Risk discount rate	9.5%	Decreased from 11.9% to 9.5% (see subsequent slide)
Compulsory Par reference interest rate	1.42% ~ 3.98%	Change the level assumption to curve to reflect the expected trend of rising yields.
Crediting rate for interest sensitive business	100 bps spread	No change
Taxation	Current tax rates	No change
Inflation rate	2%	No change

Assumptions

Assumptions	Changes from last valuation
Mortality assumption	Generally lower – to reflect the improvement in mortality seen in both company and industry experience.
Morbidity assumption	No change (assumptions include deterioration factors)
Lapse assumption (Traditional Business)	Slightly lower– to reflect emerging experience.
Lapse Assumption (Unit linked/Interest sensitive business)	Generally increased for unit linked and interest sensitive products– to reflect emerging experience.
Expense and override assumption	Generally lower – a number of changes were made, but the overall impact has been to reduce the expense and override assumptions. In particular, operating expenses were reduced and some acquisition expenses were increased.
Premium persistency (Unit Linked)	Generally lower – to reflect emerging experience.

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Risk Discount Rate

The Risk Discount Rate (RDR) was derived using CAPM and set at 9.5%

	31 Dec. 2008
Risk Free Rate	3.81%
Equity plus Country Risk Premium	4.43%
Beta	1.27
Calculated Risk Discount Rate	**9.44%**
Risk Discount Rate used in the valuation	**9.5%**

- The interest rate assumptions have seen set to reflect the long term nature of the liabilities and the expected levels of the Taiwan bond yields in the future (based on historical experience).
- Last year 11.9% was used. This year 9.5% has been used.
- The Risk Free Rate (defined as the yield on Taiwan 10-year government bonds) and Equity plus Country Risk Premium were sourced from industry-wide information, and a survey of 20 international and local investment houses in Taiwan for their long-term views.

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Earning Rate

Earning rate was set at 4.65%

Shin Kong Life's method for deriving the investment earning rate uses a market or book yield approach for each asset class depending on how they are reported in the balance sheet, applies a single expected future yield to the values of both the in force and new business portfolios, and is based on the view that current bond yields are unusually low. A "rising earning path" was determined by assuming a reasonable higher future risk free rate based on discussions with independent investment houses, and a 10 year time horizon.

To develop an average future portfolio yield, Shin Kong Life uses an Asset Liability Model to estimate the future new cash flows in/out of the company and reinvestment of maturing assets for the next 30 years and applies the estimated future new money yield in the relevant year by holding the asset mix constant. Investment expenses and hedging costs are allowed for in the calculations. Margins to the risk free rates are determined for the various asset classes, based on current market levels.

The resulting "earning path" is averaged to give an earning rate for the projection allowing for the reinvestment of future cash flows and the expected reinvestment yield for new money. Shin Kong Life produced a weighted average of 4.65% this year.