
RISK MANAGEMENT FRAMEWORK

At AIFU, we recognize that proactive risk management and a strong risk culture are indispensable for long-term success. As a Nasdaq-listed company, we adhere to the requirements of the U.S. Sarbanes-Oxley Act (SOX) of 2002, specifically sections 302 and 404. In response, we have established a comprehensive internal control and risk management structure, empowering us to identify, analyze, and address risks early and effectively.

1. Risk Management Structure:

The Board of Directors serves as the highest decision-making body for corporate risk management, ensuring the overall efficacy of our risk management efforts. The Audit Committee, operating under the purview of the Board of Directors, is entrusted with a comprehensive assessment of major risks and oversees the implementation of our risk management system.

To execute these functions, we have instituted a dedicated Risk Management and Internal Audit Department. Functioning independently from our day-to-day operations, this department reports directly to the Audit Committee and bears the primary responsibility for monitoring and supervising risk management activities in alignment with SOX requirements. The department plays a pivotal role by:

- Assisting management in identifying, measuring, and managing risks in daily business activities.
- Periodically reporting potential risks to the full Board of Directors, the Audit Committee, and the executive suite.
- Supervising the establishment of standard operating processes and conducting risk assessments and internal tests to ensure the appropriateness, compliance, and effectiveness of our business operations.
- Monitoring the implementation of improvement plans for control weaknesses and providing recommendations to enhance risk management capabilities in compliance with Sarbanes-Oxley requirements.

2. Risk Management Processes

In line with our commitment to maintaining financial stability and safeguarding the interests of our clients and stakeholders, we have implemented a robust risk management framework that includes a meticulous risk review, sensitivity analysis, and stress testing for both financial and non-financial risks. Regular reviews of our company's risk exposure underscore our commitment to a proactive approach in dealing with emerging threats.

A. Risk Review Process:

a. Identification of Risks:

Our risk review process commences with a comprehensive identification of potential risks, both internal and external, categorized into financial and non-financial domains.

Example: Cybersecurity Risk

Description: Potential data breaches or cyber-attacks compromising sensitive client information.

Likelihood: Moderate

Magnitude of Impact: High

Example: Regulatory Compliance Risk

Description: Changes in the regulatory landscape impacting compliance and operational procedures.

Likelihood: Low

Magnitude of Impact: Moderate

b. Risk Appetite and Tolerance:

Clear risk appetite and tolerance levels are established for key risk categories, aligning with a conservative approach to financial risks and a more adaptive stance toward operational risks.

c. Prioritization of Risks:

Risks are prioritized based on potential impact and likelihood, allowing for efficient resource allocation and targeted risk management efforts.

d. Mitigating Actions:

Mitigating actions are developed for prioritized risks to proactively reduce likelihood and impact.

Example: Cybersecurity Risk Mitigation

Action: Regular security audits and updates to IT infrastructure.

Objective: Minimize the likelihood of data breaches.

Responsibility: IT Security Team

Example: Regulatory Compliance Risk Mitigation

Action: Continuous monitoring of regulatory changes and prompt adjustments to policies and procedures.

Objective: Ensure compliance with evolving regulatory requirements.

Responsibility: Compliance Team

e. Financial Risk Sensitivity Analysis and Stress Testing:

Sensitivity Analysis:

Regular sensitivity analysis is conducted to assess the impact of changes in market conditions on our financial position.

Stress Testing:

Stress testing involves simulating extreme scenarios to evaluate the resilience of our financial position under adverse conditions, identifying vulnerabilities and enhancing preparedness.

f. Regular Risk Exposure Reviews:

To adapt to the dynamic business environment, we conduct periodic reviews of the company's risk exposure, revisiting risk profiles, reassessing risk appetite, and updating mitigation strategies to align with evolving threats.

3. Compliance Accountability Policy

To instill compliance awareness among all employees and establish an effective compliance mechanism, Fanhua Insurance Sales Service Group Co., Ltd., our subsidiary, the holding company for our insurance agency and claims adjusting operations, issued a Compliance Accountability Policy. This policy delineates responsibilities for maintaining compliance with relevant laws and regulations across various staff levels, emphasizing accountability for non-compliance. The Compliance Department leads efforts to monitor and coordinate the implementation of this policy, with functional departments and subsidiaries holding primary responsibility for risk control and compliance in daily business operations. In the event of a risk event, immediate reporting to the Compliance Department initiates investigation and management, with monthly progress inspections and reporting ensuring ongoing vigilance and improvement.

Top Emerging Risks

Increased Competition

In the evolving landscape of the insurance industry, one of the most pressing emerging risks over the next 3-5 years is the intensification of competition. The shifting dynamics of customer demands, from basic protection to comprehensive family-based asset allocation, places a premium on the capabilities of our agents to provide expert advice and a wider range of products and services. Historically, our reliance on the mass-agent model left us trailing behind our peers in transitioning to elite agents and catering to higher-end customers. Failure to successfully execute our transformation strategy will pose a substantial threat, potentially leading to a

significant loss of market share and adverse impact on our financial results.

Strategic Initiatives to Mitigate the Risk:

In late 2020, we initiated a set of strategic actions to meet this challenge head-on and safeguard our market position:

(i) Building a Career-Based and Professional Insurance Advisor Team:

- Our primary focus is on creating a career-oriented and highly skilled team of insurance advisors. These professionals possess deep knowledge of insurance products and the capabilities to deliver family financial asset allocation services as we aim to serve emerging middle-class and mass-affluent individuals and families effectively.

(ii) Developing Digital Toolkits and Enhancing Digital Operations:

- We recognize the value of digitalization in empowering our independent agents. To this end, we are developing advanced digital toolkits and enhancing our digital operation capabilities. The goal is to increase the productivity of our agents, making them more agile and responsive to customer needs.

(iii) Offering an Open Platform for Independent Agents:

We have established an open platform accessible to all independent agents and agencies in the region. This platform offers a range of support mechanisms, including compliance support, industry-leading IT infrastructure, cutting-edge digital technologies, and a portfolio of enhanced products and services. It also serves as a resource hub for agent training and skill development

The successful execution of these strategic initiatives is pivotal for our company. It enables us to effectively compete with our industry peers and reinforces our leadership position in the market. By addressing the emerging risk of increased competition through these proactive measures, we strive to stay at the forefront of our industry and continue to meet the evolving needs of our valued customers.

Emerging Risk 2: Regulatory Changes in China's Insurance Market

In the evolving landscape of China's insurance market, one of the foremost emerging risks over the next 3-5 years is the ongoing evolution of the regulatory framework. The continuous introduction of new regulations and the amendment of existing ones has the potential to significantly impact our operations, potentially leading to more intensive competition, disruption in our product supply, and increased compliance costs.

For example, in April 2022,, China Banking and Insurance Regulatory Commission released the Draft Measure on the Supervision of Insurance Sales Behavior for Public Consultation. This measure aims to comprehensively manage pre-sale, mid-sale, and post-sale behaviors within the life insurance distribution sector, encompassing insurance companies, intermediaries, and salespeople. Its requirements include:

- Establishment of a tiered management system for insurance sales professionals based on their qualifications and sales capabilities.
- Classification of life insurance products by type, complexity, risk level, and affordability.
- Pre-sales suitability assessments for policyholders.
- Restrictions on the compulsory bundling of insurance products with healthcare and elderly-care services.
- Creation of a compliance management department independent from sales units to oversee the conduct of sales professionals within insurance companies or intermediaries

Some of these requirements may result in additional compliance costs for our organization. Furthermore, the measure imposes a cap on the total commission rate for life insurance products, which could potentially reduce our commission revenues and adversely impact our financial results.

Impact Mitigation: We are actively monitoring regulatory developments and are prepared to adapt to changing requirements. Our compliance management will ensure adherence to new regulations, and we will seek to balance any incurred compliance costs with sustainable revenue strategies.