

CHAPTER - 6

INVESTMENT POLICIES OF LIC

6.1 NEEDS OF INVESTMENT

While calculating insurance premium, it has been assumed that the accumulated premiums are invested. The funds are invested to earn at least assumed rate of interest. The needs of investment of funds are given here in brief.

(a) Payment of Claims

The first and the most important obligation of the insurer is to pay the amount of claims whenever they arise. For this, insurer is getting a substantial amount in form of premiums and has to preserve them for payment later on. To keep such amounts idle will be a failure on the part of the insurer who is expected to invest them on behalf of the policyholders.

(b) To avoid financial deficit

If funds are not invested, the total income of the insurer will fall short of its requirements for meeting its commitments because a particular rate of interest on its investments has been assumed while calculating the rate of premium. Again, if funds are not invested and interest not earned, it would be an under-estimation of its future liability, which may prove disastrous at the time of higher mortality.

(c) National Interest

The insurers in form of premiums take a huge fund of the society. Therefore, it is essential for the insurers to invest the funds for the economic development of the nation.

Sources of Funds

The funds with the insurers are accumulated from the various sources, some of which are given below:-

(i) Premiums

The main source of funds is the premiums collected by the insurer. The premiums may be single premium, level premiums or annuity considerations. The excess of these premiums over the needed premiums for meeting claims and expenses is the source of funds.

(ii) Interest

The second source of funds is the excess interest earned over the assumed rate of interest. The assumed rates are lesser than the actual rate in most of the cases. In reverse, the funds will decline.

(iii) Capital Gain

Funds obtained from the sale of share capital and debentures are included under capital gains.

(iv) Saving in Expenses

Savings in expense loadings, bonus loadings or mortality savings are also contributing to the funds of the insurers.

(v) Non-Payment of Claims

In pure endowment or term insurance, the claims may not arise therefore the premiums paid for such benefits are saved. Sometimes, in certain cases, the claimants do not come for payment at all. Thus, the saved money also forms a part of the funds of insurers.

6.2 PROBLEMS OF INVESTMENT

While investing the funds, the LIC will have to face the following problems, some of which are given in the following paragraphs:-

- (a) The main problem of investment is to preserve the interest of the policyholders. The insurer keeps the money of the policyholders as trust money. To maintain the trusteeship it is essential that the fund must be invested in such securities, which are safe and secured.
- (b) The payment of the claim amount is the second problem of the life insurer. The insurer must have sufficient funds to pay the claims. So, the interest earned from the investment must be adequate enough.

- (c) The assets of the insurer should be protected from any elements of fluctuations. Therefore, the insurer must earn sufficient amount to pay its expenses. Moreover, the earning should be constant and the market price of the securities must not fall considerably.
- (d) There should be complete good faith of the public in the insurer's management of funds. In case of doubtful investment the purpose of public may be defeated. The insurer, therefore, may be losing its business in future.
- (e) A great care has to be taken while selecting suitable channels of investment. The principles of investment should be followed to a considerable extent. Investment should be such that profit thereon should be maximum without hampering safety and marketability.

THE PRINCIPLES OF INVESTMENT

The canons of investment are safety, profitability, liquidity, diversification and increasing of life business.

1. Safety

The securities in which the funds of insurer are to be invested should never at any time fall in their face values; otherwise the liability will be more than its corresponding assets. The primary purpose of investment is not to earn maximum profit but to maintain a complete security. Safety includes safety of principal amount and interest, thereon. It means that the

principal and interest must not fall, below the expected level at any time. This principal is the keystone of investment.

2. Profitability

The insurer must earn at least the assumed rate of interest otherwise he will suffer loss. The investment, so, should be made in such securities, which yield the highest return consistent with the principle of safety. The insurer can reduce his future premiums by earning higher interest and thus will be able to increase his business. It has been realized that the safety and the profitability principles are opposite to each other. The safest securities earn little profit and vice-versa is also true. Therefore, the investment department has to establish a proper balance between safety and profitability. However, there are certain securities where the safety and the profitability principles are fully observed. Gilt-Edged Securities, National-Defense Securities are some of the examples of such securities.

3. Liquidity

It represents convertibility of investments into cash without undue loss of capital. The principle is essential because of immediate requirement of money for payment of claims. However, there is no higher chance of maximum outflow at any time because the maturity, unlike the bank withdrawal, may not fall within a short period. The principle of liquidity is against the principle of profitability because the idle cash will earn nothing and invested cash will have no liquidity.

4. Diversification

Diversification of investment may mean spreading investment over different channels. The spreading may take place in the following manners.

- i. Diversification on the basis of geographical distribution.
- ii. Distribution of the portfolio over the different economic enterprises of the country, political changes and time.
- iii. Diversification may be according to number of investment in a security, maturity of security and duration of security.
- iv. The distribution of funds according to industries firms and sectors.

The diversification provides maximum security with high yield and better liquidity provided the diversification was done taking into account of all these factors. Do not invest all the funds at one place in an industry, in a security and for a period of maturity. Investment should spread over the widest possible range to minimize unfavorable consideration and to gain favorable advantages. Under diversification, the law of average reduces the losses to minimum.

5. Increasing of Life Business

Investments should also be made in those sectors, which are going to benefit the business in the return. Naturally, the social objective principle helps in increasing the business. For example, the life funds, if utilized to

finance the schemes of housing, sanitation, medical and education, it will go a greater way to lower the mortality and increase the standard of people.

6.3 PRINCIPLES OF INVESTMENT

Mr. A. H. Bailey was actuary of the London Assurance Corporation. He contributed a paper in 1862, which was published in Journal of Institute of Actuaries, Vol. X. The principles are commonly known as 'Bailey's Canons', which remain as much applicable to insurance business as they were in 1862. However, their mode of application can be changed with the changing conditions. His principles of investment are summarized as below:

- (i) That the first consideration should invariably be the security of the capital.
- (ii) That the highest practicable rate of interest be obtained, but that this principle should always be subordinate to the previous one, i.e., the security of capital.
- (iii) That a small proportion of the total funds (the amount varying according to the individual circumstances of each case) should be held in readily convertible securities for the payment of current claims.
- (iv) That the remaining and much larger proportion may be safely invested in securities that are not readily convertible.
- (v) That as far as possible the capital should be employed to aid the life insurance business.

Bases for formulation of investment policy by a Life insurer

A Life Insurer should consider the following points while formulating the investment policy.

1. Basic Principles

The safety, profitability, liquidity, diversification and aid to business are guiding principle for formulating the investment policies. These principles vary according to the nature and size of business. However basically, these principles have to be, applied for proper investment policy.

2. The outlook of Management

Apart from the basic principles, the investment portfolio is affected with the attitude of the management of the concern. If the management wishes to earn maximum profit, investment will be made in high-yielding securities rather than in safe securities. The sound and effective management will always try to invest in safe and constant earning securities.

3. Present Composition of Investment Portfolio

Where the present composition of investment portfolio shows heavy concentration on government securities, fresh investment may be made in industrial securities. An effective investment policy will have to establish a proper balance between all types of investment channels.

4. Present Position of the Insurer

Investment of the insurer is affected mostly with the size, age, capital and progress rate of the business. For example, new insurer must see safety to the maximum level while the established concern may invest in high-yielding security.

5. Availability of Suitable Securities

When the most suitable securities are not available, investment will have to be confined to the next suitable investment. The requirement of time may also bind the investment portfolio e.g., during war period government securities are considerably used.

6. Adequacy of Funds

If there is adequate fund with the insurer investment may be made in high-yielding securities and if funds are insufficient, safety principle is the most considerable factor.

7. Socio-Economic Needs

Bailey had also suggested that investment must be made according to the social and economic requirement of the society. It has been discussed earlier that for meeting social objectives, investment, sometimes, is made even in low yielding securities.

8. Environment of the Country

Political and economical environment of the country also affect the investment portfolio. International and national relationship are also taken into account while investing the funds.

6.4 INVESTMENTS OF LIC

The investment of LIC are governed by Section 27A of the Insurance Act, 1939 and the (Investment) Regulations as prescribed by the Insurance Regulatory and Development Authority (IRDA). LIC follows a very prudent and sound system of investment. The decision for investments are taken by a high level committee comprising Chairman of LIC, Managing Director and some Members of the Board of the corporation, and an investment is made only if the decision to do so is taken with unanimity. In all its investments LIC follows the exposure and prudential norms prescribed by the Investments Committee and the IRDA. In LIC investment decisions the emphasis is on obtaining the highest yield commensurate with the total security of funds. The pattern of Investments as prescribed for LIC is as under:

Table 6.1
INVESTMENT NORMS FOR LIC: LIFE BUSINESS

<i>Sr.No.</i>	<i>Type of Investment</i>	<i>IRDA Norm</i>
1.	Govt. Securities	Not less than 25%
2.	Govt. Securities or other Approved Securities. (Including item no. 1)	Not less than 50%
3.	Approved investments (a) Infrastructure & Social Sector (b) Others	Not less than 15% Not exceeding 35%

Source : IRDA Regulations, 2002

Table 6.2
**INVESTMENT NORMS FOR LIC: PENSIONS AND GROUP
SCHEMES BUSINESS**

<i>Sr.No.</i>	<i>Type of Investment</i>	<i>IRDA Norm</i>
1.	Govt. Securities	Not less than 20%
2.	Govt. Securities or other Approved Securities. (Including item no. 1)	Not less than 40%
3.	Balance in Approved Investment	Not exceeding 60%

Source : IRDA Regulations, 2002

INVESTMENTS IN THE INFRASTRUCTURE AND SOCIAL SECTOR

LIC has been investing in Infrastructure and Social sector in a major way. As per IRDA norms, LIC is required to invest 15% of the accretion to the controlled fund in infrastructure and social sector. The major investments in social sector are as under:

Table 6.3
INVESTMENTS OF LIC IN THE SOCIAL SECTOR

SECTOR	Total Investment (Rs. In Crore)	Percentage
HOUSING	4817.28	18.12
ELECTRICITY	13516.44	50.84
ROAD TRANSPORT	892.84	3.35
WATER SUPPLY & SEWERAGE	3950.28	14.86
APEX HOUSING FINANCE	3404.70	12.83
TOTAL	26581.54	100

Source : LIC's Annual Reports & Accounts

LIC have the highest investment in Electricity sector followed by Housing and Apex Housing finance investments.

LIC's INVESTMENTS ARE WELL DIVERSIFIED AND SECURE

LIC has a very strong and robust base of investment and is one of the largest financial institutions in the country. The Asset bases of LIC stands at Rs.245387 Crore as on 31st March 2002, which includes investments of Rs.215392 Crore. LIC's investment activities are well distributed in all categories of investments such as Treasury Bills, Government Securities, State Government Securities, Equity, Projects Financing, Infrastructure, and Social Sector etc. LIC is one of the largest investors in Government securities and social sector and infrastructure investment thereby contributing in a significant way to the economic growth of the nation.

Table 6.4
AMOUNT OF INVESTMENT OF LIC

As on	Investment in crores of Rs.
Dec.31,1957	329.75
Dec.31.1960	457.43
Mar.31,1963	678.81
Mar.31,1970	1528.66
Mar.31,1975	2803.20
Mar.31,1976	3134.64
Mar.31,1980	5747.51
Mar.31,1981	6534.32
Mar.31,1984	9613.74
Mar.31,1985	10804.03
Mar.31,1989	17342.70
Mar.31,1990	20503.74
Mar.31,1994	46560.63
Mar.31,1995	56182.44

Mar.31,1996	68275.60
Mar.31,1997	82665.17
Mar.31,1998	98947.77
Mar.31,1999	120445.40
Mar.31,2000	139032.18
Mar.31,2001	175491.18
Mar.31,2002	221697.50

Source : LIC's Annual Reports & Accounts

The amount of investment has been constantly increasing from Rs.329.75 crores in 1957 to Rs.5747.51 crores in 1980 (more than 18 times) and Rs.10804.03 crores in 1985 (30 times). It had gone up to Rs.20503.74 crores in 1990, Rs.4656.63 crores in 1994 and Rs.56182.44 crores in 1995 and Rs.221697.50 crores in 2002. The investment has contributed significantly to the development of the nation.

Table 6.5
PERCENTAGE DISTRIBUTION OF LIC's INVESTMENTS IN
DIFFERENT SECTORS

As on	Public Sector	Cooperative sector	Private sector
Dec.31,1957	77.3	-	22.7
Dec.31.1960	78.7	-	21.3
Mar.31,1963	76.8	3.3	19.4
Mar.31,1970	73.6	9.5	16.5
Mar.31,1975	75.4	12.0	12.6
Mar.31,1976	76.3	11.8	11.9
Mar.31,1980	63.4	9.7	12.5

Mar.31,1984	79.3	10.2	10.5
Mar.31,1985	79.6	8.4	10.6
Mar.31,1989	80.9	7.2	11.9
Mar.31,1990	79.8	6.5	13.7
Mar.31,1994	82.1	3.9	14.0
Mar.31,1995	82.9	3.3	13.8
Mar.31,1996	84.63	2.90	12.47
Mar.31,1997	84.58	2.49	12.93
Mar.31,1998	84.66	2.17	13.17
Mar.31,1999	84.49	1.84	13.67
Mar.31,2000	84.2	1.5	14.3
Mar.31,2001	84.6	1.3	14.1
Mar.31,2002	86.5	1.0	12.5

Note – Joint Sector is included under private sector.

Source : LIC's Annual Reports & Accounts

The percentage distribution of LIC investment reveals that LIC has favoured public sector as more than 80 percent of total investments were made in public sector. The investment in cooperative sector has also been rising but in 1980 it declined to 9.7 percent and increased to 10.2 percent in 1984 and came down to 6.5 percent in 1990. Investment in private sector had gone down from 22.7percent in 1957to 11.6 percent in 1977 but it improved to 12.5 percent in 1980, 13.7 percent in 1990, 13.8 percent in 1995 and 86.5 percent 2002. LIC investment has been directed towards socially oriented securities. It is a great achievement that LIC has tried to develop electricity, health, drinking facilities, water and sewerage schemes, small-scale industries, fertilizers, housing and other infrastructures.