CHAPTER VI

THE INVESTMENT FRAMEWORK OF L. I. G.
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It has been pointed out that a significant proportion of the total capital both in the Public Sector as well as in the Private Sector has been provided by L.I.C. From the growing volume of life fund it has been concluded that even a larger portion of the total individual savings will be channelised through the L.I.C. These facts have imposed on L.I.C. a socio-economic responsibility not only towards the policyholders for the preservation of policy reserves but also to the nation for investing its assets in a manner consistent with public interest. Its responsibility to protect the public interest has all the more increased because of its nationalised status and the prominent role it plays in capital formation. But the extent to which the L.I.C. can share this responsibility is circumscribed by legal stipulations on the one hand and the nature of its liabilities on the other. The latter calls for the maintenance of certain proportion of assets in a form which can be readily convertible into cash without considerable capital loss while the former excludes insurance funds from the investment in certain fields.

In the following pages I have discussed the factors that determine the portfolio structure of L.I.C. i.e. the legal framework; the nature and character of its liabilities; and the 'Internal and External' restraints.

SECTION I

LEGAL FRAMEWORK OF LIFE INSURANCE INVESTMENT

With the growth of life insurance, governments of a number of countries have insisted the insurer to invest a portion of their life funds in government securities. In India, the Insurance Act of 1938 prescribed for the first time such a condition. Under section 27 of this Act, as amended in 1950 life companies were required to invest a minimum of 25 per cent of their funds in government securities, a further 25 per cent was required to be invested in approved securities i.e. securities generally guaranteed by the Central or Provincial/State Governments.
Thus 90 per cent of investment was to be in government or gilt edged securities. Of the remaining 50 per cent of investible funds, a minimum of 35 per cent could be invested in Approved Investments which include besides approved securities mortgages, immovable property, policy loans etc. Investment in joint stock companies was also permissible provided the companies had been paying dividend regularly for a number of years. Investment of the balance of 15 per cent was left to the discretion of the life insurance companies. These statutory requirements were not properly observed by certain companies which was one of the reasons for nationalisation of life insurance business in India.

On nationalisation, government did not immediately apply section 27 A of the Insurance Act, 1938 to the L.I.C. An Investment Committee to guide the Corporation in making its investments was constituted under section 19(2) of the L.I.C. Act. It was stated that the Corporation should follow the principles as laid down in the 1938 Act in respect of its investments till the matter was further examined.

In 1957 government introduced a bill in the Lok Sabha to create an Investment Board. The Board was to consist of the Governor of the Reserve Bank as Chairman, the Chairman of the Central Board of the State Bank and the Chairman of the Corporation as members. In effect, this bill contemplated taking away the work of investment from the Corporation and entrusting that function to a separate body on which the Corporation would have been represented by the Chairman. Before the bill was further proceeded with, the Mundhra episode and the enquiry into that by Justice Chagla intervened. Considerable discussion took place in Parliament regarding the policy and procedure to be followed by the Corporation in respect of its investments. The bill proposing the constitution of an Investment Board was not proceeded with. Instead, in August, 1958, section 27A of the Insurance Act was applied to the L.I.C. with slight modifications.

1. Estimates Committee Report, p 38.
Under the new legal framework, the investments of the controlled funds of the Corporation are divided, as before, into three broad categories, namely, (a) Government and approved securities (i.e. mostly government and semi-government securities) (b) investment approved under new section 27A and (c) 'other' investments. Similarly, as under the old provisions, 25 per cent of the controlled funds should be held in Government Securities, a further sum equal to not less than 25 per cent in government securities or other approved securities and not more than 15 per cent in 'other' investment. The balance of about 35 per cent is to be held in 'approved' investments as defined in the amended section 27A of the Insurance Act. Two important modifications have been made in the old section 27A regarding approved investments. First, in terms of sub-section (3) and (4) of the old section 27A, an insurer could not hold more than 2 per cent of the subscribed share capital and debentures of a banking or an investment company and 10 per cent of the subscribed share capital and debentures of any one company (other than a banking or investment company). This has been modified so as to allow the L.I.C. to hold up to 30 per cent of the equity share capital of a company, with a further provision for exceeding this limit with the prior approval of the Central Government.

Second, under the old section 27A(5), the insurer were completely prohibited from investing in private limited companies; but under the modified section 27A(7) the Corporation is permitted to invest in private companies as well with the prior approval of the government.

As regards the 'other' investments, the L.I.C can invest up to 15 per cent of its controlled funds on unanimous recommendation of the Investment Committee (Constituted under Section 19(2) of the L.I.C. Act) or on the resolution of the Corporation passed by a majority of at least three fourths of the members present.

1. The increase in percentage from 10 to 30 was caused because of the inheritance of the L.I.C. The L.I.C. with 243 companies, found itself with percentages of holdings in many companies more than 10 per cent. So it was necessary to resort to the modification (Lok Sabha Debates, Second Series, Vol. XXII, No. 10, 29th November, 1958, Columns, 2160).
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at the meeting. Further, under section 27A(8), the Central Government has reserved
the power to require the Corporation not to invest its funds in any investment
specified by it, or whether it has any existing investment to realise them in a
specified time.

The law is more specific in the selection of Corporate securities. Provisions
regarding such investments are given in clause 1(a) to 1(g) of section 27A. For
example the law prescribes that the Corporation can invest in such debentures only
that are secured by a first charge on any immovable property which has paid interest
in full for the five years immediately preceding and that such debentures are at
least three times more than the value of the property against the security of which
they have been issued. Similarly in case of Preference Shares, law permits invest-
ment only in such preference shares which have prior right both as regards income
and capital and that where the dividends have been paid for the five years immedia-
tely preceding. The Corporation is permitted to invest only in such ordinary shares
of any company on which dividends of not less than four per cent including bonus
have been paid for the five years immediately preceding or for at least five out
the seven years immediately preceding.

By Section 6 of the L.I.C. Act and also by caluse 1(A) of Section 27A of the
Insurance Act, 1938, the Corporation is empowered to invest in immovable property
situated in India or in any other country. Provided the property is free from any
encumbrances. It is also empowered to invest in first mortgage on immovable
property situated in India under any Housing or Building Scheme of a Public Limited
Company or a Cooperative Society registered under the Cooperative Societies Act,
1912 or under any law for the time being in force. The Corporation can also extend
loans to the policyholders for housing construction.

Valuation Requirements:

The above legal requirements are direct and clear cut in circumscribing the
L.I.C.'s investment in different outlets. Over and above these the valuation
requirements under section 26 of L.I.C. Act; the requirements regarding presentation
of accounts under section 27 and the method of valuation of assets required under First Schedule of the Insurance Act 1938 also influence L.I.C's investment decisions in different forms of investments.

Thus the biennial actuarial valuation under section 26 of the L.I.C. Act and valuation requirements of assets at the market or cost price under First Schedule of the Insurance Act 1938 create a preference for mortgages, Debentures and Bonds as against ordinary shares. This is due to the fact that fluctuation in market values in the case of bonds and debentures is not as serious as in case of stocks. Besides, in contrast with ordinary shares which are characterised by wide market fluctuations, mortgages are usually entered at their book value as there are no established market values for mortgage debt in India. The mortgages can therefore be shown at stable prices.

Similarly, the requirements of section 27 of the L.I.C. Act whereby the Corporation is expected to submit its accounts annually in a prescribed form at the end of each financial year to the Central Government also increases the preferences for fixed earning security as against fluctuating earning securities. Because a purely temporary depreciation in values often prove very embarrassing if it occurs at a time when the fund's accounts have to be presented.

Both these factors do not influence the solvency of the funds and technically speaking the effects of both can be mitigated by maintaining an Investment Fluctuation Account or by a Reserve Fund. But these valuation requirements and the requirements of presentation of accounts considerably effect the investment policy of L.I.C.

Summary and Conclusion:

The various legal requirements of L.I.C. as regards investment have been discussed in this section. It has been shown that the statutory requirements regarding investment in stocks, preference shares and debentures of a prescribed standing prohibit the corporation in taking any risk of promotion of untried form of businesses.
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The legal requirements create a preference for the shares of well established concerns. Besides the statutory requirements of valuation of assets of L.I.C., also favour investment in fixed earning assets, against equity investment in shares of joint stock companies.

The legal provisions are essential to maintain the insurance business on sound lines in the interest of the policyholders. But the legal requirements of L.I.C. they leave wide field open whereby the corporation could exercise its judgment in the selection of investment. In fact the liability characteristic of L.I.C. as the study in the following section will show, suggests a cautious approach towards the selection of various investment outlets.

SECTION 2

NATURE AND CHARACTERISTICS OF L.I.C.'S LIABILITIES

The investment policies of L.I.C. are conditioned by financial circumstances and by the terms on which it holds the funds of the policyholders. In order to appreciate these facts it is essential to know fully the nature of the life insurance business and the terms of life insurance policies.

An ordinary life insurance policy as already explained in Chapter I is a contract whereby the insurance company agrees to pay a stipulated amount to a beneficiary upon the death of an insured person in consideration of certain periodic payments to the corporation. When the corporation has entered into a number of such contracts it has, in effect, set up a system whereby many persons pay into a fund and many beneficiaries draw out of the fund upon the death or maturity of the insurance policies. The size of the payment (premium) made periodically into the fund for each insured person for any given amount of insurance is influenced by a number of factors such as mortality, rate of interest, and expenses. The surpluses on these accounts result in the accumulation of fund.
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The accumulation of life fund at a stipulated rate is an essential and integral part of the life insurance business. In this respect life insurance differs from other forms of insurance. In life insurance, for example, the event which is contemplated is certain, the only uncertainty being the time of actual occurrence. In general insurance on the other hand the event insured against may or may not happen. For example, a vessel insured under marine policy may or may not be lost, a workman covered by a workman compensation policy may or may not be injured. In contrast to this every life contract results in a claim. An intelligent regard of this aspect of the contract by the Corporation is important in determining its rates of premiums and in dealing with the management problems regarding the disposition of funds.

Moreover, in most of the insurance business other than life insurance, the contract is for a term of one year and often cancellable by either party before the expiry of the term. The life insurance contract on the other hand is a long-term contract which can neither be cancelled nor modified or altered by the Corporation at option. It, therefore, requires a considerable care in the computation of premium rates and in upbuilding of the fund to enable the Corporation to discharge its obligation on due dates. Thus Fig 21 shows that the life fund is the main liability of the Corporation. This fund which accumulates under level premium method described in Chapter I belongs to the policyholders. It constitutes about 90 per cent of the total liabilities of the Corporation. Reserve and other contingencies are 9 per cent, less than 1 per cent of the assets serve as capital cushion. This means that L.I.C. has very limited ability to absorb loss of principal. Losses equal to only a small fraction of the total amount of its invested assets can easily jeopardise its solvency. In this respect its position is very much like that of commercial banks which have little ability to risk their capital. Thus in 1862, an English Actuary, A.H. Bailey propounded
Analysis of Liabilities
1960.

- 89.97% Life Fund
- 0.80% Capital
- 0.02% Other Insurance Funds
- 1.11% General Reserve & Other Reserve Funds
- 2.15% Investment Reserve Fund
- 2.19% Life Insurance Claims Admitted or Reported But Not Paid
- 3.73% Other Liabilities of Life Business
- 0.03% Miscellaneous

Source: L.I.C. Annual Reports and Accounts.
Fig: 21
five principles to safeguard the investment of life fund. He gave top priority to the preservation of capital. His canons are important and worth mentioning, as they have been the guiding principles of life offices for a considerably long time. Thus according to Bailey:

1. The first consideration of a life office should be security of capital.
2. The highest practicable rate of interest should be obtained, but this principle should always be subordinate to the previous one, the security of capital.
3. A small proportion of the total funds (the amount varying according to the circumstances of each individual case) should be held in readily convertible securities for the payment of current claims, and for such loan transactions as may be considered desirable.
4. The remaining and much larger proportion may safely be invested in securities that are not readily convertible; and that it is desirable, according to the second principle, that it should be so invested, because such securities, being unsuited to private individuals and trustees, command a higher rate of interest in consequence.
5. As far as practicable, the capital should be employed to aid the life insurance business. (1)

The above principles were reaffirmed by W. Penman in a paper contributed to the Institute of Actuaries in 1933. But there is a certain degree of incompatibility between the First and the Second canons of Bailey's principles, for if security of capital is made the overriding maxim, it would involve the Corporation to invest in treasury bills and shortest possible bonds. The 'highest practicable rate of interest' from such investments may be so low as to lead to insolvency. In fact the need for liquidity is not so great as stressed by Bailey. This is mainly due to three reasons: Firstly contractual liabilities of life insurance companies are long-term in nature. The investments can be and usually are long-term nature. Secondly, since the cash inflow of life insurance companies has always exceeded the cash out flow, the liquidity factor is minor importance. Lastly, the life insurance income is largely retained and reinvested at compound interest.

providing an inexorable growth of capital which gives sufficient liquidity to a life office.

It is often pointed out that insurance contracts contain surrenders and loans options which can disturb severely a balanced investment position. Generous surrender options can embarrass a life office when interest rates are high, while generous settlement options can cause corresponding embarrassment when interest rates are low. But in India the policyholders have rarely exercised those options. This is evident from the following Table.

**TABLE 67**

PERCENTAGE OF SURRENDERS TO NEW BUSINESS AND THE PERCENTAGE OF POLICY LOANS TO TOTAL ASSETS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of surrenders to New Business</td>
<td>1.9</td>
<td>0.4</td>
<td>0.8</td>
<td>1.1</td>
<td>0.9</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Percentage of Policy Loans to total assets</td>
<td>9.3</td>
<td>4.9</td>
<td>5.3</td>
<td>7.6</td>
<td>7.9</td>
<td>7.3</td>
<td>7.0</td>
</tr>
</tbody>
</table>

**SOURCES:** Reserve Bank of India: Banking and Monetary Statistics. L.I.C.: Annual Reports and Accounts.

It will be observed from the above Table that the percentage of surrenders to that of new business has been less than 2 per cent. The highest percentage was 1.9 per cent in 1940. After the nationalisation of life insurance the ratio of surrenders to new business has been less than one per cent. Similarly the ratio of policy loans to total assets is only 70 per cent in 1960 as against 9.3 per cent in 1940.

The foregoing observations bear testimony to the fact that by its nature the life insurance business does not require a significant liquid position. Besides,
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The policy to 'match assets' with the 'term of liability' considerably reduces the liquidity requirements. The following Table, therefore, shows that the 'liquidity ratio' i.e. the percentage of cash to total assets has been on an average 5.2 percent between the period 1939 to 1955. After the nationalisation of life insurance business the 'liquidity ratio' has further gone down.

**TABLE 6.8**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash as percentage to total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>3.7</td>
</tr>
<tr>
<td>1940</td>
<td>4.6</td>
</tr>
<tr>
<td>1941</td>
<td>3.9</td>
</tr>
<tr>
<td>1942</td>
<td>4.6</td>
</tr>
<tr>
<td>1943</td>
<td>5.0</td>
</tr>
<tr>
<td>1944</td>
<td>4.9</td>
</tr>
<tr>
<td>1945</td>
<td>4.6</td>
</tr>
<tr>
<td>1946</td>
<td>5.8</td>
</tr>
<tr>
<td>1947</td>
<td>5.7</td>
</tr>
<tr>
<td>1948</td>
<td>5.3</td>
</tr>
<tr>
<td>1949</td>
<td>5.2</td>
</tr>
<tr>
<td>1950</td>
<td>5.4</td>
</tr>
<tr>
<td>1951</td>
<td>6.3</td>
</tr>
<tr>
<td>1952</td>
<td>5.9</td>
</tr>
<tr>
<td>1953</td>
<td>5.2</td>
</tr>
<tr>
<td>1954</td>
<td>5.9</td>
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<tr>
<td>1955</td>
<td>5.5</td>
</tr>
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<td>1956</td>
<td>3.3</td>
</tr>
<tr>
<td>1957</td>
<td>4.5</td>
</tr>
<tr>
<td>1958</td>
<td>3.7</td>
</tr>
<tr>
<td>1959</td>
<td>4.9</td>
</tr>
<tr>
<td>1960</td>
<td>2.9</td>
</tr>
</tbody>
</table>

**SOURCES:** Reserve Bank of India:
1. Banking and Monetary Statistics.
2. Insurance Year Book.
3. L.I.C. Annual Reports and Accounts.

This fall in the liquidity ratio is partly due to rapid accumulation of life fund and partly due to the efficiency of the corporation in keeping its funds fully invested. In fact in case of rapid growth of life fund the liquidity requirements are further reduced, provided the portfolio managers are fully aware of the rate of growth of the life fund. Table 6.8 shows the impact of the rapid growth of life fund on the liquidity preference of L.I.C.

1. Column 2 of the Table shows the annual increase of life fund. Column 3 shows annual increase (+) or decrease (-) in cash. Column 4 shows the change in cash as percentage of the change in life fund.
### TABLE B9

**LIQUIDITY PREFERENCE OF INDIAN LIFE OFFICES AND LIFE INSURANCE CORPORATION 1959 - 1960**

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual increase in funds</th>
<th>Annual change in cash as a percentage (+ or -) of additional to life fund</th>
<th>Year</th>
<th>Annual increase in funds</th>
<th>Annual change in cash as a percentage (+ or -) of additional to life fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>5.7</td>
<td>+ 0.1</td>
<td>1950</td>
<td>8.3</td>
<td>+ 0.8</td>
</tr>
<tr>
<td>1940</td>
<td>6.1</td>
<td>+ 0.9</td>
<td>1951</td>
<td>15.5</td>
<td>+ 3.6</td>
</tr>
<tr>
<td>1941</td>
<td>6.4</td>
<td>- 0.2</td>
<td>1952</td>
<td>34.9</td>
<td>+ 1.1</td>
</tr>
<tr>
<td>1942</td>
<td>7.2</td>
<td>+ 1.2</td>
<td>1953</td>
<td>23.7</td>
<td>+ 0.5</td>
</tr>
<tr>
<td>1943</td>
<td>8.2</td>
<td>+ 0.9</td>
<td>1954</td>
<td>22.2</td>
<td>+ 2.9</td>
</tr>
<tr>
<td>1944</td>
<td>10.3</td>
<td>+ 0.7</td>
<td>1955</td>
<td>23.1</td>
<td>+ 0.2</td>
</tr>
<tr>
<td>1945</td>
<td>13.0</td>
<td>+ 0.3</td>
<td>1956</td>
<td>79.2</td>
<td>- 6.8</td>
</tr>
<tr>
<td>1946</td>
<td>9.1</td>
<td>+ 2.4</td>
<td>1957</td>
<td>31.5</td>
<td>+ 7.4</td>
</tr>
<tr>
<td>1947</td>
<td>13.1</td>
<td>+ 0.8</td>
<td>1958</td>
<td>37.4</td>
<td>- 2.8</td>
</tr>
<tr>
<td>1948</td>
<td>20.8</td>
<td>+ 0.8</td>
<td>1959</td>
<td>47.5</td>
<td>+ 5.6</td>
</tr>
<tr>
<td>1949</td>
<td>22.8</td>
<td>+ 1.2</td>
<td>1960</td>
<td>65.1</td>
<td>- 7.9</td>
</tr>
</tbody>
</table>

**SOURCE:**
1. Reserve Bank of India: Banking and Monetary Statistics.
2. Insurance Year Book.

**NOTE:**
1. Figures of addition to life fund for the period 1951 to 1955 are based on unrevised data.
2. Figures for 1956 are for eight months; figures for 1957 are for sixteen months.
3. The sharp increase in life fund in 1956 is due to integration of life fund of all insurances, Indian foreign and Provident Fund societies, while figures for 1955 are for Indian Insurers only.
4. Cash includes, deposit, cash and stamp but excludes remittances in transit.

It can be noted from the above table that in most of the years 'cash balances' of Indian life offices have increased as a result of the rapid increase in the life funds. The percentage varied between 1.8 per cent in 1939 to 26.4 per cent in 1946. This might also be due to the inability of Indian life offices to invest their funds promptly. After the nationalisation, the percentage considerably declined with the rapid accumulation of life fund. Thus, if the investment

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management continues to be alert, the 'liquidity preference' of the Corporation could be reduced with the rapid growth of life fund.

The need for liquidity does not arise from the demands of policy holders but from internal considerations relating to portfolio management. According to Winn:

"Although overzealous investment commitments in expectations of large net cash inflow have occasion given rise to liquidity upon the security portfolio, 'the primary liquidity requirements have arisen from the desire to shift the portfolio from one area of investment to another. This shift has frequently been made in order to obtain investments which, at that moment, appear to provide the best solution of the investment problem.' (1)

These liability requirements arise in an internal sense, in that investment opportunities are continually changing and the changes occur at irregular intervals. Consequently, the demand for liquidity arises from the desire to remain fully invested, yet at the same time to have the ability to shift the composition of the portfolio at any time without incurring a loss on securities sold.

Thus L.I.C. may remain fully invested in the sense that the chances to hold Cash in anticipation of rise in interest rate are very remote; while it may maintain some cash for shifting funds from one investment to another. But even under most uncertain conditions of long term interest rates-L.I.C.-keeps itself fully invested in short term securities as it has been shown in Chapter IV. From the above discussion it follows that:

1. L.I.C. has little need for liquidity.
2. It keeps its funds fully invested at all times.
3. It is not a trader in securities but in fact a true long-term investor.
4. It does not hold funds in anticipation of the rise in interest rates nor borrows or otherwise ever commits itself in expectations of rate declines.

If the above generalisation are literally true, the investment behaviour of L.I.C. would indeed be a routine process. It would occupy an in-active role with respect to interest rates, passively taking what the market provides in the way of long-term rate. But the nature of life insurance contract that is assumption

of earning at least an assumed rate of interest makes the L.I.C. interest conscious. In the interest of the business it had to follow a policy and has to reshuffle its portfolio structure in order to earn a guaranteed minimum rate. This is another characteristic feature of its liabilities which needs discussion in detail.

2. The Need to Earn a Stipulated Rate of Interest:

It was pointed out earlier that there are two features which distinguish the business of life assurance from that of other financial undertakings. The first is that a life assurance office, in return for contribution or premium fixed at the outset, enters into contracts which may, and do on the average, run for many years. The second is that the premiums received under these contracts are calculated by a mathematical formula which assumes that the office will be able to invest the funds which it accumulates out of these premiums at a definite rate of compound interest.

The ability, therefore, of a life office to conduct its business on a solvent basis depends, apart from other factors which do not affect its financial policy, on its ability to invest its funds and keep them invested at a rate of interest not less than that on which the premiums are based. For example, let us assume that the premiums charged are calculated on a 3 per cent interest table, assuming mortality to follow the latest experience with a loading to cover the expenses or overhead charges of conducting the business and, in the case of with profit policies, an additional loading calculated on the same assumptions to provide a revisionary bonus at a certain rate per annum in addition to the sum assumed. If, therefore, the Corporation experiences the rates of mortality and expenses assumed, it is necessary for it to earn interest at the rate of at least
3 per cent after deducting income tax and any depreciation that may have to be written off, in order to meet its life assurance contracts and pay a bonus which, though not a legal obligation, is in, normal times a moral obligation because an additional premium is charged for this privilege. The urge to earn a minimum rate of interest is not so important in short-term contracts of general insurance but in case of life insurance the earning of minimum rate of interest is a necessity. Thus Peglar has rightly pointed out:

"For temporary contracts interest-earning is something of a luxury its absence would sadden the shareholders but not ruin the fund—while capital preservation is of paramount importance. For offices with permanent contracts, however, and moreover contracts in which interest has been taken into account in calculating the premiums, the earning of interest—and, indeed, an adequate rate of interest is a vital necessity. The penalty for failure is insolvency at best the earning of progressively lower bonuses on profit contracts, and ultimate extinction." (1)

The purpose, therefore, of life assurance office is twofold. In the first place, it is necessary to obtain as high a rate of interest as is consistent with the quality or class of investment considered suitable and in the second place, it is necessary, as far as possible, to guard against changes in financial conditions in the future by having regard, not merely to the rate of interest that can be obtained at the time being, but rather to securing this rate of interest for such terms as are likely to cover the duration of existing contracts. Peglar, has, in this connection concluded:

"It would be the aim of life office investment policy to invest its funds to earn the maximum expected yield thereon." (2)

In propounding this principal, Peglar argued that capital and interest are in fact indivisible, and that with any particular investment it is the degree of the security of the income both present and future which determines the capital value of the investment. In order to provide for varying degrees of security of income, Peglar, J.B.H. The Principles of Life Office Investment. Journal of the Chartered Insurance Institute (London), Vol. 55 (1958), p 153.

Pegler introduced the concept of 'expected yield which combined the contractual payments due on an investment with the probabilities that such contractual payments would be forthcoming. Pegler thus criticised Bailey's principle on the ground that the preservation of capital leads to the virtual insolvency of a life office. In another paper published in the Journal of the Chartered Insurance Institute, he says:

"For many years it was widely preached and commonly believed that for this type of funds the primary consideration (to which all others were subordinate) was the preservation of capital. Even after this principle came to be almost universally ignored among the practical exponents of life insurance investment, ip-service was nevertheless paid to it, presumably because 'safety of capital' sounded like a cautious and conservative aim, and thus in line with the best traditions of British life assurance. It has already been seen, however, that for life assurance funds (and the same applies to similar concerns dealing in long-term contracts, such as pension funds) an adequate yield on the investments is a vital necessity. In general, the safer the capital is from the risk of depreciation, the lesser is the yield obtainable - though there are exceptions in times when there is an expectation of a general fall in interest rates before long - so that the conscientious pursuit of capital safety could not be relied on to produce an adequate yield. In fact, the apparently safe and conservative course is a road to disaster."(i)

It will be clear from the foregoing discussion that the primary need and hence the first objective in investment of a life office is to earn an adequate yield with the safety of capital.

3. A Life Contract is in Fixed Monetary Units and hence L.I.C. is Immune against Purchasing Power Risk:

Just as the deposit liabilities of banks are payable in rupee without reference to their purchasing power, so are life insurance contracts denominated solely in rupees. An insurance policy is a contract to pay a fixed sum of money upon the death of the insured persons, and the L.I.C. apparently undertakes no responsibility whatever for the purchasing power of that sum at whatever time in the future it may be paid. Similarly, annuity and pension contracts require only the payment of specified amounts in rupees. Therefore, the liabilities of the L.I.C. are not exposed to purchasing power risk. Similarly, the Corporation itself is immune to any adverse consequences from a decline in the purchasing power of investment income. Most of its investment income is applied to increasing policy Reserve under the

1. Ibid, p 155.
assumed-rate of interest system, and this system requires only that the monetary value of policy reserve be increased. Some small part of its income is required for operating expenses and these expenses would undoubtedly increase in a period of inflation but this consideration alone does not seem sufficiently important to exert a material influence on investment policy.

4. THE NEED FOR NON-RISK CHARACTERISTICS OF SECURITIES:

(a) The nature of the liability also suggests that L.I.C. has little need to seek out, the more highly marketable securities. A life insurance is a long-term contract: the danger of forced sale of securities to obtain cash for payments to policyholder is negligible, and policies in management of the portfolios are generally such as to place no particular premium on high marketability. The fact that L.I.C. investments are made by well qualified experts reduces the value of incidental advantages of marketability such as ready availability of information and expert opinion. A peculiar condition affecting the larger companies is that they frequently hold such large amounts of the issues they select for investment that they cannot liquidate their commitment in an issue by sale in the market in any short period of time without greatly depressing the price. This is true even of issues that are generally regarded as highly marketable. This point is of special significance for L.I.C. which is a big monopolistic institution.

(b) Tax Exemption:

Tax exemption is not a particularly attractive characteristic of securities for L.I.C. The income tax provisions concerning L.I.C. although changed from time to time in particular have recognised that most of the income from investment must be credited to policyholders reserves and this does not constitute income in the usual sense. The method of computation of income tax does not raise any problem of choice for L.I.C to prefer one investment in favour of another. Currently, the taxable income of L.I.C. is computed either on the basis of its investment

1. See also page VI.19
income or on the basis of its valuation surplus (actuarial surplus). It is con-
dered that the computation of the profits on the basis of the valuation report is
the most reliable method of the computation in the case of L.I.C, whereas the
amount of interest earned on investment is not by itself a reliable datum for such
ascertainment. Whatever methods are adopted for the purpose, the tax feature of
any security would not influence L.I.C's decisions.

Summary and Conclusion:

It has been pointed out in this section that the financial characteristics
of the life insurance business largely determine the broad investment pattern.
For instance, the contractual liabilities of L.I.C. are for long-term period and
its cash inflow exceeds cash outflow, consequently the investments of L.I.C. have
also been in long-term securities. It has, therefore, been emphasised that the
long-term investments per se are more suitable than short-term investment because
they correspond in time element to the long-term contractual obligations of the
life insurance business. It is also observed that the 'safety' of L.I.C does not
lie in the 'preservation of capital' but in earning the 'maximum possible income.'
The safety requirements of the investment triangle (safety, yield and liquidity)
is met if the investment holdings give assurance of producing sufficient funds to
meet all policyholder claims when they fall due.

Finally it has been concluded that since life insurance contracts are in fixed
monetary units, the purchasing power of money is not a significant consideration in
the formulation of investment policy. Apart from the liability characteristics
which impose severe limitations on the investment pattern of L.I.C. there are a
number of other factors which govern its investment behaviour. These factors are
discussed in the following section.

1. According to Rule 2 of the Schedule of the Income-tax Act, 1961, the profits of
life insurance business are taken to be either of the following two amounts
whichever is greater: (a) The gross external incomings of the preceding year
less management expenses of the preceding year, or (b) The adjusted annual
average actuarial surplus of the last valuation period ending before the
assessment year - Gupta, Rup Ram and Gupta, Vishnu Saran: Income-Tax Law and
INTERNAL AND EXTERNAL RESTRAINTS IN L.I.C.'s INVESTMENT POLICY

Besides yield, safety and liquidity, as stated in the previous section, there are a number of other objectives of the investment policy of L.I.C. which have assumed importance after the nationalisation of life insurance. I have named them 'Internal and External Restraints of L.I.C.'s investment policy for want of a better term. These factors are classified as under (a) The Element of Trusteeship and the Expectations of Policyholders; (b) The responsibilities of Broader Trusteeship due to the Socio-Economic Status of L.I.C; (c) The impact of the planned economy on the Portfolio structure of L.I.C. (d) The autonomy of L.I.C. (e) The quality of investment management of L.I.C. (f) The influence of 'monopoly' of underwriting life insurance business on the Investment Policy of L.I.C.

(a) Element of Trusteeship and Expectations of policyholders:

Strictly speaking the life insurance policy is a written contract between the insured and insurer. Thus in a legal sense, life insurance management in its relationship to the policyholder is not that of a trustee. But in practice, however, the business is carried on with all the characteristics of a 'Trust.' Thus in the Lok Sabha, speaking on the life insurance (Emergency Provisions) Bill on the 24th February, 1956, the Finance Minister, laid great emphasis on the concept of trusteeship which should be the 'corner-stone of life insurance.' Justice Chagla in his report also emphasised:

"The funds represent the savings of millions of hard-working people of the country and there is special obligation cast upon those who administer those funds to administer them for the benefit of the policyholders."(3)

Dealing with the policy of investments Mr. Deshmukh, the then Finance Minister has rightly pointed out that the funds must be invested so as to secure the maximum yield for the policyholders that it may be possible to secure consistent with the safety of capital.

The doctrine of guardianship of policyholder's interest also implies that beside providing a degree of 'social security,' L.I.C. will also protect the 'economic interest' of the policyholders against the falling value of the purchasing power of money. This view has gained considerable importance in recent years due to rising prices. Thus Dr. V.K.R.V. Rao has pointed out:

"...this trend (falling value of the rupee) will continue because of the country's economy - wherefore, it is imperative that the insured persons must be compensated for the loss of money's value." (2)

L.I.C. can not ignore the changing expectation of the policyholders because of its 'Trusteeship duties' - which has assumed at the time of nationalisation and also because:

"...there is a general awakening among the people. In the years to come, they will expect more and more out of their investment in the Life Insurance Corporation. The idea of buying a policy to cover risk has become outmoded. L.I.C. should be prepared to meet this challenge." (3).

The foregoing remarks of Dr. Rao are justified because the composition of L.I.C. business shows that in India people not only consider life insurance as a method of protection but also as a media of saving. As such they are obviously interested in

1. Day has explained the popular viewpoint in the following words:
"Whereas before the war a with profit policyholder thought that if he was prepared to take the rough with the smooth then on the whole he got better benefits from a with-profit policy than from a non-profit policy, now-a-days the with-profit policyholder also has in mind the possibility of inflation and the thought that a with-profit policy may prove a hedge, albeit slight, against inflation. The man who takes out a policy partly to provide some life cover for his wife and partly to save money, perhaps intending to pay school fees or against his old age, definitely seeks an investment service in that he wants a with-profit policy to provide protection against possible inflation. In theory an office has only to pay claims to satisfy its obligations, but in practice unless some protection is given against inflation, it could kill or severely reduce a large part of 'fixed money' life insurance business." (Day, J.G: Developments in Investment Policy During the Last Decade - Journal of the Institute of Actuaries Vol. 85, Part II, No. 370, 1959, p 127.


the future purchasing power of money. Since the life insurance is a long-term contract there is therefore a moral obligation on L.I.C. to protect the interest of its with-profit policyholders.

Besides, the 'general awakening' among the people to which Dr. Rao has pointed out can have serious implications on the investment policy of L.I.C. due to its nationalised status. Before the nationalisation of life insurance, the policyholders of a private life insurance company hardly examined the portfolio structure of their company. They never raised a voice against a particular investment policy followed by their company. In case of a nationalised institution, the situation is however different. Here 'public opinion' and 'policyholders' opinion have considerable influence on the investment policy. The extraordinary interest which the public has taken in Mundhra episode and the decision of the Government to regulate the investment policy of L.I.C. thereafter through section 27A instead of the appointment of investment committee, as formerly visualised, indicates the importance of public opinion in regulating the investment policy of L.I.C. Justice Chagla appreciated the public feelings in the following words:

"I am very happy to learn that the public has shown a great interest in these proceedings. The fierce light of publicity has beaten down upon all the actors in the drama which I had to investigate and I think it is just as well. The public is entitled to know how the persons in high position act in a given situation and to what their explanations are with regard to matters which require investigation. The enquiry has been an education for the public. It should also act as corrective to administrations all over the country, because in future they will act with the consciousness that their actions may be subjected to public scrutiny." (1)

These remarks clearly indicate the fact that in future the 'public opinion' and 'policyholders pressure' will not only make the L.I.C. vigilant but they will also exercise considerable influence on its investment policy.

Apart from the reasons adduced above, the insuring public 'insists' on reduction of premium rates because this was an understanding which was given by the Government at the time of nationalisation. Since 'surplus earning' is an important element of

cost, the changing expectation of the people towards life insurance will exert considerable influence on L.I.C. to follow 'an active' and more enterprising investment policy, with a view to compensate for increasing cost involved in spreading insurance in rural areas. The objective of L.I.C. to spread insurance much more widely and cheaply can only be achieved when it will discharge its Trusteeship duties according to the expectations of its clients - the policyholders.

(b) The Responsibilities of Broader Trusteeship due to the Socio-Economic Status of L.I.C.

The primary obligation of L.I.C. is towards its policyholders. But the 'effective mobilisation' of saving entails enormous responsibility on L.I.C. It is important that the Corporation should invest its funds in the larger economic and social interest of the country. Moreover, with the increasing life insurance consciousness, policyholders will form important segment of the total population. Investment for social advancement of the country will therefore be of ultimate benefit of the policyholders. Thus the nationalisation preamble has laid down:

"L.I.C. will invest in ventures which further the social advancement of the country." To achieve this objective the then Finance Minister also called upon the L.I.C. to keep its investment policy alive to the following facts:

(a) The corporation will never lose sight of the fact that as the single largest investor in India, it has to keep before it the interest of the community as a whole. It will, therefore, invest in ventures which further the social advancement of the country.
(b) It will take no parochial view. Its funds are drawn from all over India and they will as far as practicable considerations allow, be invested for the good of the entire country. Thus there shall be a studied diversification of investible funds which is an essential requirement of any insurer, particularly the sole insurer of a country.
(c) There is not the slightest intention that the L.I.C. should indulge in speculation and thus take advantage of temporary fluctuations in market prices. It must necessarily invest on a long term basis."(2).

It is clear that the investment for the larger economic and social advancement of the country has become an important objective of L.I.C. This is in fact not an exception to L.I.C. as it is in conformity with popular view on the subject.

1. Estimates Committee, p 52.
2. Deshmukh, C.D: Speech in Lok Sabha, quoted in Estimates Committee Report, p 41.
For instance in propounding his Fourth Principle of Investment Peglar has stated in 1948:

"Offices should endeavour to orientate their investment policy to socially economically desirable ends."(1)

The logic of this objective has been clearly stated by Peglar in the following words:

"This is not the place to discuss the ethics of investment policy or to what extent offices should sacrifice the narrower interests of their policyholders or shareholders for the wider public good. It may be doubted whether, in view of the very large funds which life offices have available for investment and the influence which the employment of these funds must have, they would want, or be able, to escape the responsibility for using them in the wider public interest, so far as this is not wholly inconsistent with the interests of their policyholders. Offices certainly failed to escape that responsibility during the war. Nevertheless, whether or not this Principal is justifiable on purely moral grounds, it is contended that it is essential purely on the grounds of expediency."(2)

The above stated objective has considerable influence on the investment policy as it has to be achieved 'consistent with the interest of policyholders.' This means that the problem can not be ultimately solved by investment in Government securities because the yield on such investments is very low and this will mortgage the policyholders interest. The solution in fact lies in pursuing an active investment policy. In less developed economy the investment opportunities have to be 'unveiled' before the investment could be diversified 'in the larger interest of the community'. It is only in this way that the life funds will flow into the different sections of the economy and the policyholders will be benefited by 'higher yield.' Moreover, a policy tending to increase economic and social welfare will not only benefit the policyholders but in the long run, promote the prosperity of the country as a whole, and this will react favourably on the prosperity of the Corporation. Thus those for whom ultimately investment policy is planned will benefit directly and indirectly.

It might also be mentioned, perhaps, that the furtherance of the public interest has good publicity value, and such a policy may therefore be considered to conform to one of Bailey's minor canons, which advises that investment policy should, wherever possible, aid the business of life insurance. It is, therefore, clear that in its broader trusteeship duties L.I.C. has to invest for the economic and social advancement of the country. In a planned economy it means that the investment policy of L.I.C. should harmonise with the economic and Social Policy followed by the Government.

(c) The Impact of Planned Economy on the Portfolio Structure of L.I.C.

The increasing participation of the Government in the planned economic development of India affect the portfolio structure of L.I.C. in several ways. The following are some of the factors:

1. Physical control on Private Investment.
2. Debt Management Policy.
3. Direct Agreement with the Government.
4. Monetary Policy.

A brief review of each will be relevant to the study. Physical control over the demand for capital funds of the Private Sector are exercised by the capital Issues Control Act and the Industries (Development Regulation) Act. These regulations impose restrictions on private outlay and in this way influence the outflow of funds from the saving institutions in the specific areas of the economy. Similarly the Government can also encourage the flow of life fund in some specific areas, which are in conformity with the planned programme, by creating favourable conditions. This can take several forms. In the first instance the Government might cushion the 'risk' by providing equity capital to the small industries on the basis of which institutions extend additional loan. Secondly the Government can also encourage the flow of funds by extending its own guarantee for planned investments. In this case 'Government Guarantee' considerably reduce the risk and life fund will flow in specified areas.
Government has extended such facilities to the institution for granting loans to Industrial Estates and small industries through 'Guarantee Organisation' attached with the Reserve Bank. Thirdly, Government also reduces the risk in investment by establishing specialised institutions such as the National Small Industries Corporation, State Finance Corporations, State Small Industries Corporation, Industrial Finance Corporation and National Industries Development Corporation etc. These institutions which came into existence with the active coordination of the Government and the financial institutions also influence the portfolio structure of L.I.C.

Treasury Policy and L.I.C's Investments:

The principal way in which the Treasury influences L.I.C's investments is through its debt management policy. This is largely a question of the type of securities offered by the Treasury, either for new money or for re-funding. For example the re-orientation of the technique of public borrowing during the First and Second Plans has consisted not only in the linking up of government borrowing and public investment, but also in the bunching together of short, medium and longer term issues with a view to securing a better response from the institutional investors. It was explained in Chapter IV that this had been an important factor in the flow of life fund in Government securities since 1951. Further, the States, Governments through the coordination of the Central Governments and Reserve Bank have also designed securities to suit the institutional requirements. The borrowing programmes of the States is therefore an important factor in influencing the investment policy of L.I.C.

Direct Negotiations:

Another avenue through which the Government exerts some influence over L.I.C. is through 'direct negotiations' or through 'moral suasion.' This has been done in the case of Housing Programme of the Government where L.I.C. is expected to provide during the Third Five Year Plan Rs 60 crores for the Housing Schemes. Rs 26 crores for the Acquisition of Land. Besides, L.I.C. is also expected to contribute a
significant amount in the State Borrowing Programme for raising Rs 800 crores during the Third Plan.

These Housing Schemes and 'moral suasion' described above to finance the planned programme of the Government influence L.I.C's investment policy. 'Moral suasion' involve such things as efforts by the Government to persuade L.I.C. to follow this policy or that one with respect to its holdings of Government securities or its acquisition of Governments. L.I.C. in its Broader Trusteeship duties described in (b) above has to conform to the moral persuasion.

Impact of Monetary Policy on the Portfolio Structure of L.I.C

In recent years the Reserve Bank has been exercising a growing influence on L.I.C's investments. A particularly good example of this influence is the open market operations in Government securities of the Reserve Bank. The crux of this influence is that through affecting the availability of credit the Reserve Bank can affect interest rates and yield spreads throughout the entire capital market.

Due to the fluidity of the general capital market, actions by the Reserve Bank in either restricting or easing the availability of credit have their ramifications on yields in the market as a whole, and have a great deal to do with the direction of life insurance investments in response to changes in yield spreads. As explained in Chapter V this type of influence has been exerted since the adoption of New Monetary Policy in 1951. Its increasing importance with respect to L.I.C's investments stems partly from the greatly expanded national debt and the economic significance of its ownership, (See Chapter V), as well as from a strong tendency for the Reserve Bank to Play a more active and more comprehensive role in the capital market/.

d) The Autonomy of L.I.C. In the Investment of Life Funds

The Corporation investment policy is influenced by the Treasury policy and monetary policy in a 'business like' manner. In the investment of its funds even
though the Corporation is owned by the Government, it enjoys full autonomy.

Section 5(2) of the L.I.C. Act, for example, confers power on the Corporation to invest the funds, subject to the rules, if any by the central government, in such manner as the Corporation may think fit and to take all such steps as may be necessary or expedient for the protection or realisation of any investment. The Finance Minister while speaking in the Lok Sabha in 1956, has also expressed the intention of the Government regarding the autonomy of the Corporation in the following words:

"It is our intention to indicate in a broader manner what type of investment the Corporation should avoid and which particular type of investment it should view with favour. The investment in ventures established in pursuance of the Plan would be given preference over others and the investment policy would be governed in the main by the major consideration such as the interest of the policyholders and the interest of the development envisaged in the Second Five Year Plan and subsequent plans." (1)

It is clear, therefore, that the Government desires a restricted control on the investments of the L.I.C. Funds. The only control, that Government could exercise directly is under Section 21, and that too is restricted in matters of policy involving public interest and what is equally important is that the control can only be exercised by directions given in writing. Thus, interpreting the scope of Section 21, Justice Chagla lays down, 'In my opinion, Section 21, embodies the ideal compromise between the autonomy of a Statutory corporation and the control which must be exercised by a welfare State over such a Corporation. While leaving the Corporation complete independence to manage its own day to day administration, while leaving it free to invest its funds in the interest of the policyholders, Government could only control its discretion when a question of policy involving public interest arose. Government could not tell the Corporation that it should or should not invest in any particular shares, it could not tell the Corporation that it should invest its funds in certain industries which were essential for the successful working of the Second Five Year Plan or to give effect to a particular economic or financial policy laid down by the Government." (2)

It is clear from the above statement that L.I.C. has full autonomy in the investment of its funds. According to section 8(3) of L.I.C. Act the Corporation will function purely on 'business principles.' Thus except the legal regulation

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described in section first of the present chapter the Corporation is free to invest funds.

(e) The Quality of Investment Management of L.I.C:

It will be clear from the above discussion that the Investment Management of L.I.C. is free from any Government control. Even in the Investment Committee, constituted under section 19(2) of L.I.C. Act, it is not compulsory on the part of L.I.C. to elect any person from the Government.

The Investment Committee of L.I.C. can also get the services of the fully organised Investment Research Department of L.I.C. L.I.C. as a largest investor in the country is in a position to bring to bear on its investment problems about as good investment management as is to be found in any type of investing institutions. In other words L.I.C. by its huge resources could afford the expenses of Investment Research which is a pre-requisite of an 'active investment policy.'

It can be safely concluded that the investment policy of L.I.C. is not materially restricted by considerations of the competence of management to execute them. The Corporation holds the significant part of the assets of the country seem well able to appraise investment risks and to carry out whatever policies may be decided upon as appropriate in the interest of the policyholders as well as in the larger interest of the country.

(f) The Influence of 'Monopoly' of underwriting life Insurance Business on the Investment Policy of L.I.C.

In case of private enterprise, competition among the companies is a deriving force to follow an enterprising investment policy in order to earn higher dividends so that the premium cost may be reduced. This had been an important aspect of U.S. Life Insurance Companies as Conklin has described:

"The life insurance industry has been characterised over its history by a high degree of competition and free enterprise...The net cost of life insurance is a factor of major importance in this competition...one of the significant elements of the net cost of a life insurance policy is the rate
of return earned on policy reserves. Consequently there is a persistent pressure upon the investment side of the business to earn as high a return as is commensurate with the unquestioned ability of the company to meet its obligation at all times. As a result of this pressure the life insurance industry has continually demonstrated a disposition in investment policy to accept the risk of the private sector of the economy rather than to seek the riskless safety and low yield of United States Government Bonds. This has been a healthy trend and has made life insurance investment considerably more enterprising in character."(1)

This factor of great importance has ceased to exist after the nationalisation of life insurance business in our country. It is possible that, shorn of competition the corporation may take a defensive and modest view towards investment. Since the corporation has the monopoly of underwriting life insurance, it is felt that it might reduce the investment process into a 'routine'. The fear is strengthened by the views expressed by the Chairman of L.I.C. who find no objection in handing over investible funds of L.I.C. to the Government at a stipulated rate. He remarked before the Estimates Committee:

"The only thing is that a reasonable rate of interest will have to be assumed to the Corporation. We will be rid of a lot of bother."

Obviously only a monopolist who has no other aim in the investment of funds can hold such views. Let me say at the very outset that these are only personal views and it will be clear violation of the aims and objectives of L.I.C's investment as explained in (a) and (b) above. The Corporation has more positive aim of investing the fund in the interest of policyholders as well as for the larger economic and social advancement of the country.

To reach these objective the corporation will endeavour to earn the highest possible interest. This is enough to keep the corporation active with regards to its investments.

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2. Ibid, p 55.
Summary:

It will be clear from the above discussion that besides the legal requirements and liabilities characteristics, there are a number of other factors which influence the Investment Policy of L.I.C. These factors have assumed importance due to the 'effective mobilisation' of savings by L.I.C. and due to its nationalised status. Most of them are associated with the concept of 'Trusteeship.' The concept of 'Trusteeship' which is the cornerstone of Life Insurance suggests that:

(a) the fund must be invested so as to secure the maximum yield for the policyholders that it may be possible to secure consistent with the safety of the capital.

(b) L.I.C. is morally bound to provide some protection against possible inflation to its with-profit policyholders.

(c) the funds should be invested in the larger interest of the economic development and social advancement of the country.

(d) In the investment of the funds the Corporation will take no parochial view as its funds are drawn from all over India. Thus there shall be studied diversification in its investments.

(e) the active investment policy of L.I.C. must harmonise with the Economic Policy followed by the Government.

The above aims are positive and give sufficient resilience to the investment policy of L.I.C. Although the deriving force of competition to adopt an active investment policy has ceased to exist after the nationalisation of life insurance, in India the 'Trusteeship' duties assumed by the L.I.C. will force the Corporation to pursue an enterprising investment policy. The investment objective of the L.I.C. have thus been defined. The next consideration of an investment policy is to appraise the nature and characteristics of the various types of investment media, their elements of strength and weakness in relation to the investment requirements of L.I.C. This I have discussed in the following Chapter.

Conclusion:

In this Chapter I have shown that the investment policies of L.I.C. are conditioned by its legal requirements, nature and characteristics of its liabilities.
and a number of other factors which have been described as 'Internal and External' Restraints of the L.I.C's investment policy. An analysis of these factors has enabled us to mark the following objectives of the investment policy of L.I.C.

In the first place it is important that L.I.C. should invest its funds in such a manner so as to ensure due fulfilment of its contractual obligations. This implies that L.I.C. must endeavour to earn the maximum possible yield consistent with the safety of its funds. The contractual obligations of L.I.C. are in fixed monetary unit and the Corporation need not worry about the depreciation in the purchasing power of money. But the doctrine of guardianship of policyholder's interest suggest that the Corporation has also assumed a 'moral obligation' under which it has to provide some protection against possible inflation. The analysis of liabilities also indicates that the corporation is a long-term investor, it has very little need for liquidity. This is due to the fact that the inflow of funds from premiums, interest and dividends, and the repayment of loans have normally exceeded the outflow of funds for payments to policyholders and for all operating expenses. The continuance of the relationship between the inflow and outflow of funds can be predicted for the foreseeable future. Besides the liquidity requirements are further reduced by pursuing a 'match policy' i.e. by matching the term of liability with the term of assets.

It has also been observed that the effective mobilisation of saving has given an enormous economic power to L.I.C. which should be harnessed for the larger economic and social interest of the country. In investing for social advancement, the corporation will take no parochial view. Its funds are drawn from all over India and they will, as far as practicable consideration allow, be invested for the good of the entire country. They should be diversified for regional development. Finally, the investment policy of L.I.C. should as far as possible harmonise with the objects of our planned economy. This is important because the furtherance of the public
interest has good publicity value, which is conducive to the growth of life insurance business.

These objectives will form the basis to judge and to evaluate the investment policy of L.I.C. These will also help us in assaying the 'investment value' of investment material in the following Chapter.