CHAPTER VII

THE PORTFOLIO STRUCTURE OF L.L.C.
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It has been pointed out in the last Chapter that the investment activities of L.I.C. are circumscribed by legal stipulations and the nature of its liabilities. Its liability characteristics call for the 'maximisation of yield within the confines of safety and liquidity' while the legal requirements exclude insurance investment from certain fields. Within the 'Investment Framework', the portfolio structure of the L.I.C. will be determined by the available supply of investible instruments, their relative 'yield' and relative 'risk'. It is, therefore, essential to examine the 'yield' and 'risk' characteristics of different types of investment material and their suitability to L.I.C.

'Yield' and 'Risk' Characteristics of Investments:

The word yield is ambiguous and conveys different meanings. Since I shall be concerned with the word throughout this Chapter, it is worthwhile to clarify my conception of 'yield' on which I have based the arguments. I have more or less used it in the sense in which Peglar has defined it:

"It is the net rate of interest (or its gross equivalent) at which the sums invested are exactly equal to the present value of all future net interest or dividend payments plus that of capital returned, whether this takes place by drawings or repayment in a lump sum, by return of part or all the capital on liquidation, by sale or transfer of the investment, or in any other way. In this calculation allowance is made for expenses, and for the tax on income or capital increments borne by the fund or funds for which the investment is made." (1)

It is evident from the above conception of yield that L.I.C. is not only interested in current level of dividends but also of the chances of the long-term appreciation in the value of investments. In investing for capital appreciation L.I.C. does not take advantage of the short-term changes in the prices of the securities, but at the same time it does not hesitate to realise the 'capital gain' after a 'longer or shorter wait.' In this respect its position differs from the

speculator. This is also clear from the following statement of the Chairman of L.I.C. before the Estimates Committee:

"...It (L.I.C.) purchased investments not for the purpose of selling but holding. Their investments for capital appreciation did not amount to speculation. In every rare cases where the book value of the shares was very low and the market had rigged up the price to an extremely high level as a result of speculative activity, they could cash on it in the interest of policyholders by selling the shares. But the Corporation ignored normal and temporary fluctuations in prices such as were due to labour trouble, lock-out or some other special cases like paucity of raw materials."(2)

It is evident from the above statement that the investment operation of L.I.C. is not speculative. As a true 'long-term investor,' L.I.C. will endeavour to 'maximise yield.' But in the maximisation of return L.I.C. has to assume risk as 'yield' varies inversely with 'risk.' The greater the risk the higher the yield is the rule rather than the exception. Apart, perhaps, from short-term gilt-edged securities and bank deposits there is no such thing as a 'safe' investments, though there are varying degrees of risks which earn varying degrees of income.

In a developing economy, 'risk' is not only inevitable but also it appears in the widest and most unpredictable diversity of forms such as scientific advance, war, catastrophes of nature, fraud, monetary debasement and an endless variety of political, industrial and economic changes. The central problem of an investment policy, therefore, is the allocation of the available funds among the various types of securities including variations in such proportions under changing conditions, where the Corporation could maximise its income and 'minimise risk.' The Corporation has the choice of several alternative policies which it can follow in organising its

1. For the traditional view on this point, see Graham, Benjamin and Dodd, David L: Security Analysis (New York and London - Ma Graw Hill Book Co., Inc., 1951, Chapter IV).
2. Ibid, p 51.
3. The risk are also classified as Financial Risk or business cycle risk which are caused due to the changes in the financial ability of the issuer. Another type is the risk of gain or loss caused by change in the level of interest rates in the market, known as the interest-rate risk. A third influence upon the outcome of investment is change in the purchasing power of the monetary unit; this is the purchasing power risk. (See Seuvain,Hanny - Investment Management Prentice Hall, Inc., Englawood, Cliffe N.S. 1959, Chapter V).
portfolio structure for protection against the basis risks. It can, for example, eliminate many kinds of risks through careful selection of individual issues. This involves the employment of fixed-income obligations to produce a steady, perhaps modest, but relatively safe income return, usually requiring a minimum of supervision. But in pursuing such a policy, the Corporation could not achieve the best results.

Another, common approach is that the Corporation like a 'wise investor' as Williams has used the term, might select after a thorough analysis, of 'margin of safety only such securities which are selling 'below their true worth.' The merit of such an investment is that

"a large income payments are received in subsequent years because things turn out better for the security than most people expected, a handsome return on the principal can be enjoyed." (3)

Such an approach tends to be speculative in nature and relies heavily on success in forecasting future trends. Cautiously employed, however, it is one answer to the problem of protecting an investment fund against certain risks which cannot easily be avoided. In pursuing this policy, two conditions are implied. In the first place the Corporation should accumulate a Reserve from the income or profits on appreciation in anticipation of inevitable losses. The other is to spread the investments widely within each class so that the total effect of the errors is likely to be representative rather than extreme. In practice both are employed to protect the fund from 'uncertain events.'

1. The Return from such an investments programme are limited and the Corporation could not earn the 'maximum possible yield.' For the impact of such a programme on 'yield' see Dowrie George W and Fuller, Douglas, Ri: Investments - John-Willey and Sons Inc., New York, 1950, p 114.

2. Investment theories recognise that the margin of safety concept is essential to the choice of securities. In the case of debentures or preference shares investment this margin is usually represented by the excess of earning power over interest or dividend requirements, or of the value of the enterprise above the senior claims against it. In the case of an ordinary share it should be represented either by the excess of calculated intrinsic value over the price paid, or else by the excess of expected earnings and dividends for a period of years above a normal interest return. This concept of margin-of-safety is also used as the touchstone to distinguish an investment operation from a speculative one. (For further details see Graham Benjamin: The Intelligent Investor - Harper and Brothers Publishers, New York, 1959, Chapter 16.

The policy of diversification which is largely followed by the insurers is realistic in recognising that at least some of the investors' judgments will prove wrong. It accepts the premises that no security is safe beyond question and that analysis of investment risks cannot weed out all vulnerable securities. It acknowledges the reality that the Corporation must be ready for the unforeseen and unpredictable losses. Thus diversification is recognised as an important tenet of investment policy in order to secure the advantages of favourable market condition on the one hand and to minimise the disadvantages of unfavourable, political and economic trends on the other.

A policy of diversification requires that the portfolio should be spread among different classes of investment e.g. government securities, debentures, preference shares, ordinary shares, properties and mortgages etc. This form of spreading is desirable to protect the fund against unforeseeable changes of an economic or political character which may affect some classes of investments to their disadvantage compared with other classes. Furthermore, the effect of existing economic and political factors on the various classes of investments may not have been correctly assessed, and spreading the investments in this way will at least tend to achieve a representative experience of these effects.

Again, in connection with classes of investment such as debentures, preference and ordinary shares and stocks, it is desirable to spread the investments within these classes among a wide range of different industries and within each industry among a wide range of different companies. The reasons for this form of spreading are similar to those given in support of spreading according to classes. It is difficult to assess the effect of industrial, economic and political factors on individual industries and companies, and the combined actual experience of a large number of investment less likely to deviate to any great extent from the expected experience than would be the case with relatively few investments.
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unforeseeable changes in industrial, political and economic factors may affect individual industries and companies in different directions and to differing degrees so that a more representative experience is likely to result if the investments are well spread. For similar reasons, Geographical diversification is also desirable.

Portfolio Structure of L.I.C.

The foregoing discussion gives support to the reasoning that the investment policy of L.I.C. is like the underwriting of life insurance business. In underwriting of life insurance business, the corporation accepts risks of varying degrees in return for premiums at varying rates. Some risks it considers so uncertain and hazardous that it cannot calculate an adequate rate of premium sufficiently accurately, and it declines to accept them. Of those it does accept it cannot be sure that any one contract will prove profitable at the rate of premium quoted, but it relies on the averaging of a large number of risks, and, if the corporation makes a wise selection it earns a net profit on the total. In much the same way in the investment of the funds the corporation puts its money on a number of risks of varying types and degrees, for which it expects to earn a varying rate of yield, the greater the risk the higher the yield it will require. Some risks it regards as too great to allow an accurate assessment of the yield required, and it declines to invest in them. For the others, it relies not on the profitability of each and every one, but on the process of averaging to give a good returns on the investment portfolio as a whole. Thus Table 72 shows that L.I.C's investments are distributed in four broad categories of investments: (1) Governments which include Central Government, State Government, Municipal and approved securities; (2) Corporate securities which include debentures, preference shares and ordinary shares; (3) Mortgages, including real estate owned. It will be observed from the Table that at the end of December, 1960, the bulk of L.I.C's portfolio structure consists of Government securities.
### TABLE 70

**PORTFOLIO STRUCTURE OF L.I.C.**  
( Rs in crores)

<table>
<thead>
<tr>
<th>Class of Investment</th>
<th>August 31, 1956</th>
<th>December 31, 1959</th>
<th>December 31, 1960</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percentage to total.</td>
<td>Amount</td>
</tr>
<tr>
<td>1. Government of India Securities.</td>
<td>171.0</td>
<td>49.0</td>
<td>212.2</td>
</tr>
<tr>
<td>2. Indian State Government Securities.</td>
<td>33.7</td>
<td>9.7</td>
<td>64.7</td>
</tr>
<tr>
<td>3. Foreign: (a) Government, Municipal, etc. Securities.</td>
<td>14.8</td>
<td>4.2</td>
<td>11.5</td>
</tr>
<tr>
<td>(b) Debentures and shares of Joint Stock Companies.</td>
<td>13.2</td>
<td>3.8</td>
<td>11.1</td>
</tr>
<tr>
<td>4. Municipal, Government guaranteed and other approved Securities.</td>
<td>1.6</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>5. Shares and Debentures of Companies.</td>
<td>30.2</td>
<td>8.7</td>
<td>39.9</td>
</tr>
<tr>
<td>(a) Ordinary Shares.</td>
<td>23.0</td>
<td>6.6</td>
<td>31.6</td>
</tr>
<tr>
<td>(b) Preference Shares.</td>
<td>13.4</td>
<td>3.8</td>
<td>18.5</td>
</tr>
<tr>
<td>(c) Debentures.</td>
<td>20.5</td>
<td>5.9</td>
<td>21.4</td>
</tr>
<tr>
<td>6. Loans on Mortgages.</td>
<td>15.0</td>
<td>4.3</td>
<td>10.5</td>
</tr>
<tr>
<td>7. Land and House Property.</td>
<td>19.3</td>
<td>5.5</td>
<td>23.2</td>
</tr>
<tr>
<td>8. Other Investments.</td>
<td>7.7</td>
<td>2.2</td>
<td>12.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>343.7</td>
<td>100</td>
<td>456.0</td>
</tr>
</tbody>
</table>

* Includes amounts due from State Governments in respect of their controlled business taken over (Rs 7 Crores).

**Includes, among others, (i) loans to State Governments for Housing Schemes, (ii) loans to Co-operative Housing Finance Societies, (iii) amounts due from State Governments in respect of their controlled business taken over. Policy loans and loans on personal security are other investments, which are treated as dissaving in Chapter I, are not included in the above investments.

**SOURCE:** Reserve Bank of India, Bulletin, November, 1961, p 1835.

(comprising central Government to the extent of Rs 228.3 crores, State Government Securities - Rs 94.9 crores, and Municipal and other approved securities amounting
to Rs 42.3 crores). Corporate Securities (which consists of ordinary shares of Rs 47.5 crores, preference shares of Rs 20.7 crores and Debentures of Rs 25.9 crores) are the second important avenue of investments. Investment in Mortgage is only 9.2 crores. Real Estate investment are 26.5 crores. Other Investments amounting to Rs 20.6 crores includes among others, loans to State Governments for Housing Schemes, Loans to Cooperative Housing Finance Societies and amounts due from State Governments in respect of their controlled business taken over. Policy loans Rs 43.65 crores and loans on personal securities amounting to Rs 0.64 are other important avenues of investments but they are considered dissaving from the point of view of this study.

The relative share of each type of investment on the portfolio structure of L.I.C. depends upon a large number of factors of which the following two are most important:

1. The relative ability of different 'investments' to meet the investment requirements of L.I.C.
2. The availability of such investments.

It is clear that the 'investments' which have 'greater strength' and ability to meet the investment requirements of L.I.C. will weigh heavily in the portfolio structure of L.I.C; while investments that have weaker element to suit the investment requirements of L.I.C. will have little appeal to the corporation. On the basis of the above criteria an analysis of the various classes of investment material is made in the following pages. Each investment has been assessed with regards to the following features:

(a) Safety of Principal and dependability of income.
(b) Chances of appreciation.
(c) Marketability.
(d) Problem of Investment Management.

The analysis is important as far as it enables us to assess the investment policy of L.I.C. in proper perspective.

Analysis of Investment field:

(i) Government Securities:

Our analysis of investments begins from 'Governments Securities not only because they constitute about 69.3 per cent of the total investments of the Corporation in
1960 but also they are the primary standard in terms of which the investment qualities of alternative investments can be judged. I have already pointed out in Chapter V that the yields on Government obligations are the key interest rates in the money and capital markets. These key rates serve as anchors to yield on private instruments which generally accrue higher yields than Government securities. The differentials are based on the credit worthiness of private issues, their marketability, the cost of investigation and the rates of taxes etc. It is, therefore, important to examine the nature and characteristics of Government securities as they largely determine the investment behaviour of L.I.C.

Nature and Characteristics of Government Securities

The term 'government securities' stands for a group of securities which are homogeneous only in the sense of their common origin. Actually, the term describes a heterogeneous group of securities with widely varying characteristics. It includes all the obligations of national governments and of their several subdivisions such as States, Municipalities or Corporations etc.

Government of India Securities

Securities issued by the Treasury Department of the Government of India may be described in terms of security types, maturity provisions, interest rate characteristic, market-ability, or tax features. Broadly, government of India obligations are classified into Unfunded Debt and Funded Debt. The Unfunded Debt of the Government is composed of short-period obligations and is called Floating Debt. It is represented by Treasury Bills, Post Office Savings Bank Account and cash certificates. There are also short dated securities or 'shorts' which are generally redeemable within five years. The Funded Debt includes long-term obligations which may or may not be

1. L.I.C's investments in 'foreign government' securities are largely due to its foreign business written in those countries. Besides the characteristics of the issues of foreign governments, whether national or political subdivisions, are on the whole quite similar to 'government securities' discussed in the subsequent pages. They are, therefore, not separately dealt with.
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redeemable. The Funded Debt which is redeemable is called Redeemable and that is not compulsorily be redeemed is denoted by Irredeemable Longs. The essential differences among government obligations of different types is in the maturity characteristics at times of issuance.

The maturity characteristics of outstanding securities not only reflect the type of security used by the treasury in its refunding operations or for new offerings, but also the mere passage of time. Consequently, the maturity characteristics are constantly changing. This is of course true for all types of securities.

In addition to the final contractual maturity provisions on all Government securities, some of these issues provide for retirement prior to final maturity at the option of the borrower - the Treasury - whereas others carry provisions which give the investor the option of establishing the maturity date at any time prior to the contractual dates at time of issue. The former, the call or option - maturity provisions, carried by some Government issues are quite distinctive. They permit the Treasury Department to call these issues for retirement, at the earliest, only a few years prior to final maturity date, or at any interest date within the intervening period between the call and final maturity date. Thus unlike the typical call provisions on corporate securities, which are keyed to the price behaviour of the securities, the call provision used on Government securities which is based on a specific date, assures investors that the securities will be outstanding for a definite period of time, irrespective of what happens to market prices of the securities in the intervening period.

The latter forms of optional maturity features mentioned above are offered on only a few Government issues. In contrast to all other types of maturity options to granted/investors, these are not related to any action by the borrower. They simply give the investor the option of stepping up the maturity considerably in advance of the contractual date. In a few instances the option gives the investor the right to redeem his holdings at any time prior to maturity, and in other instances, to shorten
materially the contractual maturity dates of his holdings. Such options, if exercised, usually entail a slight sacrifice in the annual income from that provided if the issues were held to final maturity.

The interest coupon features on Government securities are determined by the prevailing yields at the time of offering. The coupon features selected are influenced by the practice of making new offerings at par, except those few issues which are offered on a discount basis. At the end of 1960, the interest rate coupon or its equivalent on issues which could be held by L.I.C. varied from 2.5 per cent to 4 per cent. However, from the point of view of portfolio management, the prevailing yields on individual issues, at times of purchases and currently, together with the yield maturity relationship of all outstanding issues, are as much more significant measure of the interest rate features of Government securities. At the end of 1960 these yields varied from 3.26 to 4.08 per cent. They are determined by the market price, the coupon feature and the maturity provision of each issue. At the time of purchase the prevailing yield becomes the expected or book yield to the investor. If the security is sold prior to final maturity, the realised or effective rate of return or yield may differ substantially from that entered on the books as at the book yield. Consequently, the yields are important considerations to the sale, purchase or switches in Government security portfolio of L.I.C. as well as an important guide to the treasury in the determination of the characteristics of new offerings. In fact the current yield characteristics are perhaps the most important considerations in the investment analysis of Indian Government issues.

The marketability features on outstanding issues vary widely. Many issues are fully marketable, that is, they may be purchased by all types of investors and contains restriction upon their resale at any time. Other issues are freely but not fully marketable. They may be purchased by all types of private investors, except of course, specified ownership groups (namely, commercial
banks), and may be freely traded among the eligible investor groups, but may not be purchased by other investors for a number of years. A few issues have only limited marketability, both with respect to the number of eligible investor groups and with respect to the amount of any investor's annual purchase of these issues. Furthermore, these issues often contain resale restrictions limiting their marketability to resale to the Treasury Department on demand at fixed and predetermined prices or to the exchange of such holdings into a different type of security which has full marketability. Finally, a number of issues of Indian Government securities have no marketability in so far as L.I.C. is concerned because they cannot be purchased or held by L.I.C. at any time. However, these issues may have restricted marketability from the standpoint of those investors eligible to own them.

The income on all Indian Government securities offered is subject both to the normal Federal income tax and to surtax. Several issues are still outstanding with partially tax exempt status; the interest income is exempt from the normal tax, and a few issues are wholly tax exempt in that the interest income from these issues is not subject to either the normal tax or the sur tax.

These characteristics of Indian Government issues have been used in a variety of combinations by the Treasury Department in providing issues which would appeal to the many potential investor groups with their numerous investment requirements. In 1960, L.I.C's portfolios alone contained over twenty five separate issues, each having slightly different characteristics. Even for the characteristics described above, there are infinite possibilities for issuing securities in the future which differ materially from the issues currently outstanding, and in addition there is always the possibility of adding new characteristics.

State, Municipal and approved securities:

There are several significant differences in the characteristics of State and municipal issues from those associated with Indian Government issues. Although
States and Municipalities often rely upon short-term financial instruments such as tax anticipation notes, certificates and warrants to meet their financial needs, the bulk of their outstanding debts consist of bonds. In contrast to Federal obligations, the majority of State and Municipal issues are of a serial type; that is, a specified proportion of the outstanding issues matures at regular intervals throughout the life of the obligation. In addition, some term obligations have been offered by those issuers. Little use, however, has been made of the call option on the serial or term issues either in terms of price or of fixed optional maturity dates. The coupon characteristics and yields of State and Municipal obligations vary over a somewhat wider range than do yields of Government of India securities. This reflects, in part basis differences in credit standing of State and Municipal obligation vary over a somewhat wider range than do yields of Indian Government securities. It also reflects wide variations in the credit factor within the former group as well as special tax consideration which existed at the time of original offering and others present in our tax structure today. There are no restrictions imposed by the borrower on the marketability of these issues; that is, all issues are fully marketable.

Since 1951, a definite change has taken place in the borrowing technique of the State Governments. States have become largely long-term borrower and they offer securities of varying maturity and yield. In certain cases the yield of State Government securities is much higher than the Central Government Securities. There is also certain uniformity in State Government securities since 1951 because of the active coordination of Central, State and Reserve Bank.

Besides, the securities issued by Municipal bodies, part-trust or improvement trusts are called semi-government securities. These securities do not have the support of the Reserve Bank of India in the maintenance of market value. They are included in 'Trustee Investment' under Section 20(d) of the Indian Trusts Act of
1882 which allows investment in debentures or other securities for money issues, under the authority of any Central Act or Act of a Legislative of a Part A State, or by it on behalf of any Municipal Body, Port Trust or city Improvement Trust in any Presidency town. They are included in the approved investments of L.I.C. Besides bonds of Central Land Mortgage Banks; shares and bonds of Industrial Finance Corporation and State Finance Corporations are also included in the 'approved list' of L.I.C investment.

**Investments attributes of Government Securities:**

The Indian Government and State Governments obligations enjoy a unique investment status, superior in several respects to that of other classes of securities. The safety aspect of these issues in the sense of certainty of repayment at maturity is the highest. The repayment of an internally held debt poses no problem to the Treasury, since the Federal Government has both the power to issue money and the power to tax. The credit status of the Government of India and the State Government is considerably high both at home and abroad. The Governments both at the centre and as well as at the State have never repudiated any debt and they are always willing to honour their obligations. However, in contrast to Central and State Governments, the financial conditions of municipalities is still weak and their ability to pay the principal and interest depends upon their limited resources. The rate of return in case of Port Trust and Improvements Trusts is better than on Government securities. They are so much in demand that fluctuations in their prices are cushioned and stability insured.

The liquidity attributes of Indian Government securities arise in several ways. The short-term issues and those repayable on demand may be regarded as contractually liquid that is, their maturity features assure repayment within a short period of time at predetermined prices. To the extent that these short-term issues are marketable, their maturity characteristics also greatly limit their price fluctuations.
with a change in interest rates. The broad distribution of ownership of central
government obligation, both within and among various types of investors, is another
important factor contributing to the high degree of liquidity of these obligations.
Since all investors are not motivated by similar factors in the management of their
portfolios, the sales of issues which are widely held are more likely to be readily
absorbed by other investors than the same sales pressures were concentrated upon
issues narrowly held. Moreover, the fact that these securities represent a sizable
proportion of the investment holdings of a very large number of investors creates
widespread and extensive self-interest, both in the administration of our Federal
debt and in the price stability of outstanding issues. Finally Indian Government
securities have acquired a further degree of liquidity through the investment activ-
ity of the bank system and market support of Reserve Bank.

The Reserve Bank does not aim at freezing the price or the yield of these
securities but it does control price movements within a reasonable range so that
stability of prices may not be seriously disturbed. The methods employed may be
natural or artificial, but the value of securities is in practice maintained within
a narrow range.

The fact that the price level of Government securities in India has shown steady
tendency is clear from Figure 22. It will be observed that the price indices of
Government securities is quite stable than the price indices of variable yield of
Industrial securities and cost of living indices.

The yield (and hence the price) of marketable Government securities varies with
the rise or fall of the interest rates on short and long-term money. Because Central
Government securities are the closest to being riskless of all obligations, the yield
represents the nearest thing to 'pure interest' known to the money market. The yield
on these securities, reflecting in part, their safety and liquidity feature, have
generally been lower than those regarded by investors as the prime or highest quality
rates. The yields on Indian Government securities have fluctuated over time, and
INDEX NUMBERS OF SECURITIES PRICES

YIELD ON INDUSTRIAL SECURITIES

short-term yields have varied more widely than those on the long-term issues. The
differences in yields between various types of securities and Government issues,
measured both in absolute and relative terms, have varied considerably over time.

**Investment Management of Government Securities:**

The supervision of the Government Securities portfolio is the easiest. The
entire investment operation from planning to execution is the ultimate in simplicity.
A variety of issues is always available to the Corporation in virtually unlimited
quantities. The securities can therefore be acquired at any time. No credit investi-
gations, or extensive field trips entailing evaluation of the technical efficiency of
the borrower, the ability of management, the competitive position of the firm and
industry, the business cycle hazards, nor even simple analysis of balance sheets and
income statements are required in recommending the purchase of these securities. They
can be confidently recommended with respect to the ultimate safety of the principal
and with considerable assurance about their marketability in case of need. Moreover,
the recommendations are usually characterised by such terms as 'conservative' 'sound'
'safe' 'patriotic' - none of which is designed to disturb the ulcers of the invest-
ment staff. Little time or effort is required in the supervision of the holdings,
and they provide a batteress against the normal errors which occur in any large
investment account. Little, if any, staff is required for investment activity in
this area, irrespective of the size of the portfolio or the volume of turnover. It
was in fact this ease in the management that suited to Indian insurers who do not
generally employ expert investment staff to plan their investment.

In another sense, however, the supervision and management of the Government
securities is more difficult. In case of Government securities there is no basis
for credit analysis and there are no other types of securities which can be used as a
standard of comparison. In pursuing an active investment policy L.I.C. is confronted
with the problem of the outlook for interest rates. Any investment action in
Government securities, or even the failure to act, constitutes the investors forecast of interest rates. In fact the purchase of long-term or short-term Government securities, the maturity composition of a portfolio, and the eligibility features of the issues held that is their marketability to other types of investors all represent a tacit forecast of interest rates. Even the shifting of Government holdings into other types of securities at substantially higher yields involves a forecast of interest rates, not only interest of possible future differentials in yields but also because of the very basic differences in the call features of Government and other types of securities. The problem of interest rate forecast is extremely difficult in that it requires the assessment of a number of intangibles. It involves the conscious formulation of opinion with respect to the policies the Treasury will follow in the management of the Federal debt; the demand for funds for insurers purposes, housing and consumer goods; foreign investment of all types; the level of government expenditures, the supply of savings, and the credit policies adopted by the Reserve Bank and Commercial Banks, the level and character of the tax structure, and investment policies of all types of investors.

Finally in investing in Government securities the Corporation comes face to face with the monetary authority. In the context of the wider trusteeship duty, of the L.I.C., consideration must be given to the possible economic effects of sales or purchases of these securities. This problem should be analysed from all points of view with proper recognition given to the fact that the same policy may be quite desirable at one time yet quite undesirable under different economic conditions. One of the real difficulties encountered here, quite aside from that of reaching agreement about consequences of any given policy, is the maintenance of perspective on it in terms of the point of view of the investor, the policyholder, and the public. Another public policy consideration encountered is the question of the proper size of the central government security portfolio. This problem should be
flow of life fund by the Government at the time of nationalisation of life insurance, it is desirable to analyse the 'investment value' of private corporate securities from the point of view of the 'investment requirements' of L.I.C.

Nature and Characteristics of Corporate Securities:

The Corporate securities are customarily divided into two main groups - debentures and shares, with the latter sub-divided in Preference Shares and Ordinary Shares. The first and basic division recognises and conforms to the fundamental legal distinction between the creditors' position and partners' position. The legal rights attached to different types of securities have important affects on the movement of security prices. Thus Figure 2 which portrays the price movements of securities from 1952 to 1960 indicates that the price of debentures where the borrower has guaranteed the payment of specified rate of interest have moved with stability. Ordinary shares on the other hand, where the return is conditioned by the general profitability of the business have been noted with erratic fluctuations. The debenture prices are largely influenced by the fluctuations in interest rates; while the 'equity prices are influenced by the medium of profits. From the investment point of view each type of corporate security presents entirely a different investment problem. They have, therefore, been separately examined.

(a) Suitability of Debentures to L.I.C:

Debentures constitute nearly 4.5 per cent of the total investments of the Corporation. This may be due to the lack of availability of 'good quality' debentures in India otherwise they should have been an ideal type of investment for L.I.C. because they represent long-term corporate debt. They are fully secured against the property of the issuing company. They possess many attributes which qualify them as an ideal type of life insurance investment. They have a fixed maturity and generally carry a fixed interest rate representing a constant claim which must be met regularly by the issuing company in order to avoid insolvency. These characteristics of company's long-term debt also make debentures most adaptable in the
actuarial end of the life insurance business where the assumption of constancy and regularity of income return is most important.

Even the more important, however, from the stand point of the safety objective in life insurance investment, is the fact that corporate debt constitutes a prior claim on the assets of the company and is protected by the subordinate interest of others in the nature of a secondary lien and the proprietary ownership such as to provide a cushion against loss in the event of financial difficulties of the companies. Other things being equal, a debenture secured by a mortgage or a deposit of collateral offers a greater safety than an unsecured obligation, but the corporation must be sure that 'other things' are really equal. Because these obligations differ with respect to the legal security offered by the borrower. Much more important is the great difference in the financial strength of issues. The type of business and the legal form of the obligation are significant only as they have a bearing on the ability and willingness of the company to meet its commitments to the investor.

When the Corporation chooses corporate debentures, it should do so because of the superior claim they have on the earnings and assets of a 'sound' company. In order to receive a sure return, the Corporation accepts a relatively low fixed income and is deprived of the right to participate in the higher return that will be received in the stock if the company prospers. The Corporation, as a debenture holder, has no voice in the management of the company, and if the debentures are callable, they generally cease to be attractive investment on any interest date. Furthermore, the chance of appreciation in debentures is relatively small.

It follows from the above discussion that only high grade debentures in the portfolio structure of L.I.C. should serve as a backlog that will produce income dependability, even in depression, and they are not likely to undergo a serious decline in market value. Since some degree of marketability is desirable, listed debentures of well established concerns should be preferred to small unlisted issues. It can not be repeated too often that the debentures should not lull the Corporation into
a feeling of false security. It should not sacrifice altogether the allurement of higher return and greater chance of appreciation associated with investment in equities.

(b) Suitability of Preference shares:

At the time of the nationalisation of life insurance business, preference shares constituted only 3.8 per cent of total investments. After the nationalisation of life insurance preferences shares remained about 3.9 per cent of the total investment. The reason for their unpopularity is to be found in their investment attributes.

Preference share is a kind of hybrid security that partakes of some of the features of debentures and some of ordinary shares. Since the tendency of the company management is to balance preferences given to preference shares within limitations, most preference shares have been described as 'neither fish, fowl, nor good red herring.' For life offices preference shares possess the income weaknesses of debentures, without their elements of safety; likewise, it shares much of the risk of ordinary shares, without fully participating in the income distributions of prosperous years.

Preference shares have also been discarded as investments because they lack the security and steady yield of debentures and yet are deprived the right of unlimited participation in the profits of the company which goes with ordinary stock ownership. Besides, from the stand point of stability in market price and certainty of income, as a class they have not so good a record as debentures. (See Fig. 23). If we, therefore, were to apply the same rigid tests to preference shares as in the case of debentures, we would find that only relatively few of the former would qualify as high grade investments and that, as a consequence, their prices would also be so high that the yield would be little, if any, higher than those obtained on debentures of the same quality.

In the light of the above features it would be desirable for the Corporation to favour those preference shares which have no other obligations ahead of them in the capital structure of the company. Besides in the selection of investments the portfolio managers of L.I.C. should subject preference as a class to even more rigorous standards than they apply in the selection of debentures. This is mainly due to the mandatory nature of interest payments as opposed to the discretionary powers customarily possessed by company management with respect to declaring preferred dividends. It is true that the directors must pay the preferred dividend before paying anything to the ordinary shareholders, but usually nothing hinders them from passing over both the dividends. Whereas debenture holders, when denied their interest, may take prompt action to foreclose or at least work out a compromise reorganisation, the preferred stock holders who do not receive dividends must mark time until earnings revive and the ordinary shareholders are pleased either to recommence dividends and eventually pay up those arrears or else to offer a plan of compromise distinctly to their own advantage.

It can be concluded from the above discussion that it would be in the best interest of L.I.C. if it invests in cumulative preference shares of first rate quality. The cumulative preference shares that are selected should yield satisfactory rate of return - somewhat higher than debentures and at the same time the certainty of dividend should be high.

(a) Suitability of Ordinary shares to L.I.C:

In the list of corporate securities, ordinary shares have always enjoyed a superior position. In 1955 the ratio of ordinary shares to total corporate securities was 42.5 per cent. After the nationalisation of life insurance the ratio of ordinary shares to total corporate securities has increased to about 51.6 per cent. As percentage to total investments ordinary shares are 9 per cent as against 6.6 per cent in 1956. The importance of ordinary shares has increased in the past war.
period because they have provided income dependability to the insurers at a time when the income on all other fixed obligations has considerably declined.

In future, in view of the rapid economic development, the need of the corporate sector for 'equity capital' is likely to increase. Since L.I.C. will also become an important source of capital funds in prospect, it is essential to examine the extent to which the Corporation could provide this form of capital to the industry.

Whether, and to what extent, ordinary shares are suitable investments for life insurance companies has been a much debated issue. The arguments against ordinary shares are well known. It has been claimed that such investments might tend to place L.I.C. in the role of industrial management and give it an undesirable amount of economic power. Since life insurance assets are in the nature of Trust funds, it has been argued that its investments should be confined to senior securities which have a substantial equity cushion to protect it against losses in case of adversity. It has also been emphasised that since life insurance contracts are payable strictly in fixed monetary units the investment behind them should also be confined to the fixed monetary unit.

A practical deterrent to such ordinary share investments is that since L.I.C. liabilities are rigidly defined and since its surplus is equal usually to only a small fraction of assets, L.I.C. cannot afford to have any substantial proportion of assets in securities whose carrying value tends to fluctuate widely. This seems more an argument for limiting ordinary share investment rather than for total prohibition of such investment. The principal limiting factor in fact is the necessity under present conditions of carrying such stocks at market values. Assume that the corporation has surplus funds equal to 3 per cent of its assets and has 7 per cent of these assets in ordinary shares. Assume further that such shares suffer a 50 per cent shrinkage in market value in the course of a year - an unlikely but not impossible occurrence in the light of history. This factor alone can reduce Corporation's surplus by a significant amount in the course of a year, and under
circumstances when there might be other drains on that surplus - its solvency would be considerably affected. Obviously, L.I.C's ability to invest in ordinary shares depends heavily upon the relative strength of its surplus position, unless some method of ordinary share valuation is evolved to cushion the sharp market declines.

Proponents of ordinary shares on the other hand, have claimed that due to growth both absolute and relative, in L.I.C's assets and its increased importance to the economy, these assets have tended to outgrow the traditional investment channels which consisted of debt type of securities. The high proportion of individual private savings accumulated by L.I.C. had especially strong appeal for ordinary shares during the recent period of rising prices.

Investment in equities enables the L.I.C. to do something for its policyholders, even in a modest way, as an offset to shrinkage in the value of the currency unit in which its contracts are payable. It would not be out of place to remark that ordinary shares serve as a hedge against inflation. This is particularly important when administrative costs are rising due to rising prices as well as in expanding life insurance in unexploited rural areas. In this connection the example of U.S.A. is often cited.

In recognition to the policyholder's interest against rising prices, Teachers' Insurance and Annuity Association of America, which sells retirement contracts to University teachers, introduced a new type of annuity contract. Under this contract half of the contributed reserve may at the option of the party purchasing the annuity be invested in ordinary shares, with the benefits payable depending upon the investment results achieved by such fund. It is said that this plan has proved very popular among the university teachers.

In the context of the above discussion the suitability or otherwise of the ordinary shares can be summarised as follows:

1. L.I.C. holds large investment funds, it can, minimise risk by investing in ordinary shares through a diversified holdings of such securities.

2. L.I.C. being a long-term investor, can afford to weather the larger cyclical price variations found in ordinary shares for the greater security against

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failure and greater certainty of income to be derived from the ordinary stock of seasoned debt-free companies.

3. The urge of an insurance office to earn, maximum income is important and within the area of safety and liquidity it tries to maximise its return. Because of low yield, life offices place a portion of their funds in higher grade securities. The remainder is diversified among a variety of securities and ordinary shares are one of them. Its average rate of return is comparatively much higher than other types of investments.

4. As interest rates rise, high grade debentures and preference decline to 'lock in' existing commitments. Ordinary share is not so affected.

5. Ordinary shares serve as a hedge against inflation that is in a period of rising prices, they supplement the all too limited return received on debentures and they offer a better chance for appreciation. Investment in ordinary shares could therefore compensate for rising cost of expenses and it could also enable the corporation to protect its policyholders against the 'purchasing power risk.'

The main argument against ordinary shares is that wide fluctuation in its prices as shown in Fig. 22 presents a valuation problem for L.I.O. A purely temporary depreciation in values may have no effect on the ultimate ability of the fund to meet its liabilities but can prove very embarrassing if it occurs at a time when the funds accounts have to be presented. From this point of view, therefore, equity shares are avoided from the portfolio of a life office. In this connection it may, however, be pointed out here that modern corporate security technique has been improved by corporate management in recent years. It has provided some safeguard against the advance potentialties of ordinary shares to suit the investment requirements of institutional investors. Firstly the requirement of stability in price and steady income has forced the company management to create a Divisional Equalisation Fund. Equalisation of dividend has had a steadying influence on the yield and
market value of good ordinary shares. Secondly, the size of the 'operating unit' has increased, and therefore, fluctuations arising out of the limit on the size of the company have become exceptional, though fluctuations arising out of the vicissitudes of the industry as a whole are not completely ruled out. Institutional Investors in ordinary shares have also developed two techniques as safeguards. In the First place, they maintain an investment fluctuations funds. Capital profits made by selling investments accumulate in this Fund, to which a diversion is also made from valuation surpluses, and this takes care of any capital losses that might be incurred in future. Secondly they have begun to diversify their investments as between fixed income investments and ordinary shares. In a period of rising prices, the market value of fixed-income investments tends to decline and ordinary share tend to appreciate in market value. On the contrary, in a period of falling prices, the market value of fixed interest-bearing securities appreciates and that of ordinary shares declines. Thus in a well 'balanced fund,' having a combination of both types of securities, losses in the market value of one can be compensated to some extent by gains in that of the other (See Table 73).

In view of the modifications in the Corporation finance policies concerning equities that have taken place in recent years and the 'safeguards' against market depreciation of ordinary shares that investors can themselves adopt, the equities have lost some of their forbidding character. The Investment Reserve Fund of L.I.C. which amounted to Rs 13.41 crores as at 31st December, 1960 cushions such market fluctuations satisfactorily. Nevertheless, in view of the erratic nature of ordinary shares, it is necessary that the corporation should only invest in high-quality ordinary scrips and that too when the market is depressed. Needless to repeat that such holdings should be fully diversified.
The Problem of Investment Analysis and Management in Corporate Securities:

Investment in corporate securities require a careful analysis. This is due to the fact that the legal rights given to the various types of securities do not make them a 'safe investment.' From the point of view of investment safety depends upon and is measured entirely by the ability of the debtor company to meet its obligations. The soundness of the best investments must rest not upon legal rights or remedies but upon the ample financial capacity of the enterprise. For example in exchange for limiting his participation in future profits, the debenture holder obtains a prior claim and a definite premise of payment, while the preference share obtains only the priority, without the promise. But neither priority nor promise is itself an assurance of payment. This assurance rests in the ability of the enterprise to fulfill its promise, and must be looked for in its financial position record and prospects. The essence of proper selection consists, therefore, in obtaining specific and convincing factors of safety, which is measured not by specific lien or other contractual rights, but by the ability of the issuer to meet all its obligations in full. Thus the normal criteria of investment is not the legal form but the normal behaviour of the issue after purchases. In other words, its risk-and-profit characteristics as the investor would reasonably view them. It means that corporate securities must be purchased only after a careful analysis of security forms, corporate accounting, the basic elements that make for the success of various kinds of business, the general working of the economy, and finally the characteristics of security markets. Yet, in addition, the investment in ordinary shares imposes more responsibilities on management. The process of analyzing and selecting debt-type investment is relatively easy. Such investments, including debentures and preference shares promises a series of fixed amount payments, covering interest, preferred dividends and principal. Regardless of the success of the issuer of these securities, the promised payments will not be
exceeded. Therefore all the efforts of the investor must be directed towards making as certain as possible that such payments will in fact be met on schedule. The situation is one demanding conservation and a constant quest for security rather than imagination and willingness to take quite substantial risks.

In the selection of ordinary shares, however, imagination and broad risk taking must play an important part. No definite scale of payment is promised or guaranteed and no limit is set on the return obtainable. Timing of the purchase is of great importance, ordinary share prices tend to swing widely. Waves of opinion, bullish and bearish, affect investment decisions. This requires constant watch of the investment market.

The Problem of Availability:

Besides the problem of selection of Corporate Securities of standard size and 'safety' must be considered in the background of the less developed economy of India. The importance of industrial securities in the investment portfolio of L.I.C. depends upon the extent of industrialisation and the degree of expansion of the private Corporate Sector. It is evident that the greater the measure of industrialisation brought about through private enterprise, the more would be the bulk of industrial securities listed on stock exchanges, and other things being equal, the larger would be their holdings on the part of L.I.C.

In India the number of Government securities registered in stock exchanges far exceeds the number of industrial scrips. In 1960, for example, it is computed that a total number of nearly 2,200 Government securities accounted for Rs 2500 crores; the total number of Central and Provincial securities, loans and debentures floated by certain Port Trust authorities and Municipal Corporations, State Electricity Boards and State Transport authorities is found to be 195, accounting for a total nominal value of Rs 1,800 crores. As against this the number of industrial scrips is found to be 2,000 including scrips of some of the foreign companies also. The said value of Indian companies add up to
Rs 695 crores issued by 1,150 Indian Joint Stock Public Companies.

Among the industrial securities, issued by Indian Joint Stock Companies, ordinary shares accounted for Rs 512 crores; preference shares amounted to 99 crores and debentures accounted for 84 crores. Out of these LIC already holds a substantial amount. Roughly on the basis of the above estimates LIC holds about 9 per cent of ordinary shares; 21 per cent of preference shares and 28 per cent of debentures registered in the Stock Exchanges.

It is clear that the Corporation already holds significant portion of industrial scrips registered in the Stock Exchanges. Its additional investment in such securities will therefore be limited by the overall availability of these securities. Besides, in the early stages of economic development, the corporation finance is hazardous because of unorthodox and unscrupulous practices adopted in several cases. Thus the magnitude of corporate securities deserving of institutional patronage is seriously circumscribed.

The above review of the corporate securities clearly indicates that they do not fully solve the investment requirements of LIC. It is true that these securities offer a 'higher' yield but the risk associated with them is also considerable. Debentures offer a yield which is very close to Government securities for much greater risk. Preference shares are 'hybrid' securities which offer better yield but the risk involved is also considerable. Ordinary shares provide adequate income with possibility of appreciation. They also protect the investment against inflation. But investment in them entails heavy responsibility on the investment management of the corporation. Besides the LIC's investment in corporate securities is limited by the overall availability of these securities. Hence


2. The total number of industrial scrips comprising ordinary, preference and debentures issued by Indian Joint Stock Companies is placed around 1,990 out of which the detailed breakdown data are available for 1983 scrips (Commerce, Op.Cit., p 108.
Corporate securities suit the Corporation only after a careful investigation.

III. Mortgages:

Mortgages have been rather neglected form of investment in India. Their share in total investment has gone down to 1.7 per cent as against 4.3 per cent in 1955. This is in great contrast to the insurers in other parts of the world where Mortgages have been largely used as a 'safe' outlet for the life fund. Thus in U.S.A. according to the Life Insurance Fact Book 'Life insurance companies held over one-fifth of the nation's entire mortgage debt outstanding.' In U.S.A. Mortgages today constitute nearly 34.9 per cent of the total assets. Since the nationalisation of life insurance, there has been a growing pressure on L.I.C. to increase its investment in mortgages, particularly Residential mortgages and 'Farm mortgages.' A very strong case is made by quoting the example of U.S.A. Let me therefore examine as to how far the mortgages suit the investment requirements of L.I.C. and to what extent 'economic climate' favours such investments of L.I.C.

Suitability of Mortgages to L.I.C:

Mortgages are generally classified as urban and Farm Mortgages. In India L.I.C. has confined its lending only to the urban mortgages. Real Estate mortgage loans other than farm mortgages fall into two general classes namely residential loans and other loans. The latter, commonly referred to as commercial loans, which include mortgages on commercial and industrial buildings and apartments.

Without going into legal technicalities, a mortgage may be defined as an instrument under which real property is pledged as security for a loan. The owner of the property, the mortgager, borrows money from a lender, the mortgagee, under a contract whereby the property is pledged as security for payment of interest.

and principal. Title and possession remain with the mortgagor until such time— as default may occur, in which event the property is sold through foreclosure proceedings for the satisfaction of the debt.

The Mortgagee has the right provided in the covenants, to issue several series of bonds on the security of the same mortgaged property. In that case the First mortgage has: a prior claim upon the pledged property. Subsequent mortgages have subordinate claims, payable only after the first mortgage claim has been entirely satisfied. Therefore L.I.C. is permitted by Law to invest only in First Mortgages.

It will be observed from the above definition of mortgage that the safety of an investment of mortgage is secured basically by the value of the underlying real property and the credit standing of the mortgagor. Properly made and carefully selected mortgage loans provide an abundance of security. In the first place, the investor possesses a lien upon what is presumed to be a valuable piece of real property, the value of which has been determined by careful and expert appraisal. Secondly, the value of the property exceeds the amount of the loan by a sum estimated to be sufficient to permit shrinkage in value, and at the same time leave a margin of protection above the unpaid loan balance. In high ratio loans where such margin is conspicuous by its absence, the lender enjoys the protection afforded by insurance or guarantee. Finally, a presumably carefully selected borrower of character, with good debt-paying record, with other assets commensurate with his position, and established earning power of all of which combine to establish beyond reasonable doubt his ability to care for his obligation – provide ample safety to the loan.

Moreover, mortgages offer a comparatively higher rate of return than the return on other fixed obligation of the similar quality and maturity. Generally speaking, the spread in net income between mortgages and debenture of similar quality is usually 3/4 per cent to 1/2 per cent. In contrast to 1/2 per cent bonds, L.I.C. earns about 6 per cent on mortgages.

VII.31

The maturity of mortgage loans adds greatly to their investment appeal. The 'term of mortgage loans,' the quarterly payments or other patterns of amortisation can be adequately matched with the term of the liabilities. Moreover, a mortgage portfolio of an investor investing its funds on a nation-wide basis derives additional investment strength from the geographical diversification. A large lending territory enables the Corporation to select areas of economic growth and promise, and to avoid areas and cities which appear to have attained economic maturity or over which economic adversity impends. The selection of a large number of promising investment areas endows the portfolio with an element of insurance because barring a national economic catastrophe, it becomes difficult to believe that all or a substantial portion of the areas in which an investor has made loans will suffer adverse economic conditions at the same time. Mortgage loan investments serve very useful social purpose. They aid the acquisition of homes and finance building essential to the productive capacity of the nation. Thus in U.S.A.

"Mortgage investments by life companies have had an impact on the economic and social patterns of American life. Besides helping to meet a post-war housing shortage, they have stimulated many thousands of jobs in the building trades and real estate. They have aided in rejuvenating American cities and in opening the way for families to migrate from congested cities to the suburbs."(1)

These somewhat glowing advantage of mortgage loan investments in no way be allowed to conceal significant disadvantages of such investments which, unless expertly coped with, can reduce or eliminate entirely their appeal. One of the attributes of mortgage loans which contributes materially to their liquidity is their comparatively short life due to payments of instalments which previously has been mentioned. However, at the same time that this reveals an obvious advantage, it creates a great disadvantage by aggravating the problem of reinvestment of the realisation of dues in instalments.

Moreover, in the wake of any serious depression there is likely to be an abnormal number of defaults and foreclosures among the real estate loans of life insurance companies. Falling agricultural prices, increasing unemployment and decreasing incomes increase the difficulties to both agricultural and urban

borrowers in meeting the principal and interest payments on their loans. Insurance Companies, as a result, are faced with the choice of taking over large amounts of mortgaged properties, or of introducing methods of relief for borrowers which will obviate foreclosure. These problems require a careful study along with the problem of Management involved in such investments.

Management Problem in Mortgages:

The purchase of mortgage loan investments entails at the outset heavy acquisition and serving expenses. Whether the mortgages are procured through Zonal Offices or Divisional Offices, an active and efficient field organisation must be maintained to originate and to service loan applications. Thus to cope with the administrative requirements of this type of investment, L.I.C has established a legal and Mortgage Department under the charge of the Zonal Manager. The main items of work of the legal and Mortgage Department relate to the administration of the existing mortgages, new mortgage loans, loans to policyholders for construction of houses, the scheme for grant of loans to housing cooperative Societies and various other matters relating to leases of the Corporations' properties situated in various places in India and the legal work pertaining to the investment of the Corporation.

The greatest disadvantage of mortgage loans ensues from the problem of foreclosures. The experience of United States in this connection tend to submerge into oblivion the gravity of the foreclosure problem which arose in that country during the last fifteen years. Three very serious problems always arise in connection with the foreclosure of a loan by a life insurance company. One is the costs incidental to foreclosure, the second is the adverse public relations, and the third is the liquidation of the real estate acquired.

1. Mehr, Robert I: Mortgage Foreclosures and Property Management by Life Insurance Companies, Unpublished Dissertation in Economics, University of Pennsylvania, 1944, Chapter II.
The expenses of foreclosure not only involve court and legal fees, but loss of interest and possible damage to or neglect of the property during the period of foreclosure. The latter, of course, depends upon the attitude of the borrower and the length of time which intervenes from the date action is instituted until the property is acquired. The public relations incident to foreclosure can become very complex. One hardly expects to make friends by evicting or threatening to evict people from their homes, but the responsibility of a trustee in dealing with a delinquent borrower allows no choice. When foreclosure results in property acquisition, a problem of Real Estate Management and liquidation immediately arises.

In view of these defects in mortgages life insurance companies in U.S.A. and other parts of the world often pondered this question, "which is safer, to start with ownership or to end with it." In other words, as an alternative to making a very high percentage loans against a property owned by the borrower, some insurers are experimenting with direct ownership of income property.

In spite of these obvious drawbacks, mortgages constituted nearly 34.9 per cent of total life insurance assets in U.S.A. Let us, therefore, examine the conditions under which these assets have assumed importance in U.S.A, and to what extent such conditions are present in India.

Mortgage Finance in U.S.A.

The mortgage finance of insurers in U.S.A. has increased due to the direct and indirect participation of the Federal Government in mortgage lending. This participation has been evidenced by the activities of the Federal Housing Administration, the veterans Administration, the Federal National Mortgage Association, imposition of Regulation by the Federal Reserve Board and various related acts of Congress.

The Federal Housing Administration represented a novel undertaking when created by the National Housing Act in 1934. The F.H.A. provided at the outset for loans

to be made by private lenders who are 'insured' against loss by FHA which in turn collects a 'mortgage;insurance' premium from the borrower. In the event of trouble, the lender forecloses and then assigns the property to the FHA in exchange for debentures guaranteed as to principal and interest by U.S. Government.

FHA and VA loans have limitations on the interest rate which may be charged. They also provide for level monthly payments which completely liquidate the loans over their terms. This plan of monthly payment loans was popularised particularly by the FHA at its inauguration and has become an integral part of mortgage financing to the great advantage of borrowers and lenders. From the borrowers' stand point, the monthly payment about equals rent; from the lenders' point of view, the borrowers need never be permitted to accumulate a large delinquency without having it brought to his attention.

These agencies have provided sufficient 'liquidity' and 'safety' to mortgage Finance in U.S.A. Thus out of 41,771 billion dollars lended in 1960 against mortgages; loans through FHA constituted about 22 per cent; VA formed about 17 per cent conventional loans were about 54.5 per cent. The remaining 7 per cent were Farm Loans. The high percentage in conventional mortgages was due to the greater yields in such loans in relation to Federal agencies. In case of the lending through Federal Agencies the yield is comparatively low because of 'security' provided by the specialised agencies. But the extension of the conventional loans has been made possible only due to the liquidity provided by the specialised Institutions.

Farm Mortgage Finance in U.S.A.

In U.S.A., life offices have been contributing substantial finance for agricultural expansion and progress in the shape of farm mortgages. Farm Mortgages Loans are regular form of long-term borrowings on the part of the American farmers.

These loans amounted to about 2,982 billion dollars or 7 per cent of the total mortgages. This enormous long-term agricultural finance flows from certain governmental and non-governmental agencies. The governmental agencies are the Federal Land Banks, Federal Farm Mortgage Corporation and Farmers Home Administration. While the non-governmental agencies are the commercial banks and individual lenders. In some cases insurance companies make loans directly through their branch offices, and in other cases they purchase from mortgage bankers and others. Even commercial banks sometimes have purchased agreements with life insurance companies by which the bank may hold a mortgage for a short period of time - as much as two years and then dispose it to an insurance company.

In addition to these features, commercialised and mechanised form of agriculture in U.S.A. have enabled the insurers to finance Farm Mortgages.

**Causes of Unpopularity of Mortgages in the Portfolio Structure of L.I.C.**

It is now possible to enlist the causes of small percentage of mortgages in the portfolio structure of L.I.C. They can be classified as follows: (1) Lack of business demand for mortgages, (2) Small size of the erstwhile insurers to bear the cost involved in mortgages, (3) Experience of L.I.C. as regards mortgages, (4) Absence of specialised agencies, (5) Peculiar characteristics of Agriculture in India, (6) Unsatisfactory financial positions of the credit Agencies. A brief review of each of the above factors is given.

In India Joint Stock Companies do not use this form of finance to any material extent. This is evident from the fact that in 1001 companies surveyed by the Reserve Bank the ratio of mortgages to total resources was only 6.4 per cent in 1960. Table 71 which makes purposewise study of the mortgage loans sanctioned by the L.I.C. also indicates that 42 per cent of the loans granted by L.I.C. is exclusively for building construction, 18 per cent for repayment of existing loans, 15 per cent partly for building construction and partly for other purpose and only about 19 per cent for business.

1. For a full discussion of Life Insur.ane Activity in Farm Loans, See Hoagland: Real Estate Finance: Op. Cit., Chapter XXII.
TABLE 7:1

ANALYSIS OF MORTGAGE LOANS SANCTIONED BY L.L.I.C. (PURPOSEWISE)

<table>
<thead>
<tr>
<th>Name of No. of</th>
<th>Purpose</th>
<th>Total</th>
<th>Building</th>
<th>Party</th>
<th>Other Purposes</th>
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<td>office.</td>
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</table>

| Bombay 24 | 20.48 | 7.45 | 6.10 | 3.45 | 3.18 | Nil |
| Calcutta 46 | 22.70 | 17.38 | 3.31 | 0.70 | 1.31 | Nil |
| New Delhi 37 | 23.73 | 11.33 | 1.95 | 6.05 | 5.40 | 1.0 |
| Madras 11 | 10.45 | 0.55 | 0.65 | 4.75 | 4.50 | Nil |
| Hyderabad 10 | 3.38 | 2.80 | 0.28 | 0.30 | Nil | Nil |
| Bangalore 1 | 0.55 | Nil | Nil | Nil | Nil | 0.53 |
| Ahmadabad Nil | Nil | Nil | Nil | Nil | Nil | Nil |
| Kanpur Nil | Nil | Nil | Nil | Nil | Nil | Nil |
| Total 129 | 82.96 | 39.51 | 12.29 | 15.25 | 14.36 | 1.55 |


Another important cause for the low percentage of investment in mortgages is the management problem involved in these investment. Mortgage finance requires a careful analysis of the property, supervision of Loans and also entails costly foreclosure proceedings in case of default. Many of the small insurance offices before nationalisation could not afford to bear the expenses of these investments. After the nationalisation of life insurance, the corporation found itself in a very embarrassing position as regards this type of investment. Because it was noted that a number of these loans had been granted on inadequate security of property or on property the title to which was not clear. Instances where mortgages had been fraudulently created were also not wanting. The Corporation first of all took all possible steps to regularise the defective mortgage transactions and to realise its
dues. In consequence the amount due in respect of old mortgages has progressively gone down, from year to year, as shown hereunder.

TABLE 72

L. I. C.'S INVESTMENTS IN MORTGAGES

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-8-1956</td>
<td>15,01,68,661</td>
</tr>
<tr>
<td>31-12-1957</td>
<td>13,85,00,818</td>
</tr>
<tr>
<td>31-12-1958</td>
<td>12,41,38,080</td>
</tr>
<tr>
<td>31-12-1959</td>
<td>10,47,94,122</td>
</tr>
<tr>
<td>31-12-1960</td>
<td>9,20,61,784</td>
</tr>
</tbody>
</table>

SOURCE: L. I. C: Annual Reports and Accounts

The Corporation rightly felt that its first task was to realise as many as possible of these bad and doubtful advances and put the collection machinery in that regard in proper shape before it embarked on fresh advances on the security of immovable properties. This stage was reached by the end of 1959 when the outstanding amount of loans stood reduced to Rs 10.48 crores. Thus it was only after 1959 that L. I. C. started its scheme of Mortgage Finance by establishing a Separate Mortgage and Legal Department in the Zonal and Divisional Offices. Since it had the painful experience of inheriting large numbers of unsatisfactory mortgages from various insurers, the corporation circumscribed its role in granting loans. It adopted very strict scrutiny of the security offered. Out of the 700 applications received for Rs 740 lakh, the Corporation had sanctioned only 129 loan applications for Rs 82,96,000 by the end of 1960.

Another potent factor responsible for the unpopularity of mortgages in India is the absence of any specialised agencies or Government guarantee through which such

loans could be extended. This is in great contrast to U.S.A. where official and unofficial agencies provide ample scope to insurers to take this finance. Furthermore Farm Loans offer an entirely different situation because of the peculiar characteristics of agriculture in India. The 'subsistence character of farming as distinguished from 'commercialised' agriculture offers no security to the Corporation. The small 'operative Unit of the farm' due to excessive fragmentation does not provide enough security. In many areas, production is dependent on the vagaries of the season. The creditworthiness of the farmer therefore fluctuates with the 'vagaries of the monsoon.' Besides, the products of agriculture are perishable and provide no satisfactory security for long term debt. Moreover, there is the question of yield on capital invested as "The farmer does not fix the prices of his produce they are imposed upon him, so that his profits are limited and he often suffers a loss; and consequently the rate of interest on loans granted to him should be lower than on credit granted to merchant. As long-term capital brings in an even lower yield than short-term capital, it is necessary that the rate of interest on long-term loans should be lower than on short-term loans, although this is contrary to normal banking practice."(1)

Obviously L.I.C. which is the trustee of the policyholders can not endanger its funds. Because most farms are 'family operated,' the personal equation in farm loan is particularly significant. The lender gives great weight to the moral hazard. In analysing the moral hazard, the farmers personality plays a very important part. In India the farmer is uneducated who could not even recognise the technicalities involve in mortgages. Besides in India the farmer is already overburdened in debt and he has very little free property to offer as a 'First Mortgage to L.I.C.

State Cooperative Banks, Central and Primary Land Mortgage Banks, could have been ideal agencies for the distribution of L.I.C. Loans, But, unfortunately these agencies in India have not given any satisfactory proof of financial standing. This is evident from the following observation of the Agricultural Finance Sub-Committee

2. Report of All India Rural Credit Survey, Chapter 3.
...Cooperative banking organisations in all the provinces are not equally strong. In some e.g. Bihar, part of the Cooperative Structure had to be completely rebuilt, in others, the organisations are still weak or are in the process of rehabilitation...In many of the Provinces, the Movement was in difficulties in spite of the rise in prices of agricultural produce... A large number of societies are faced with the problem of frozen assets and have stopped functioning wholly or in part...Cooperative land mortgage banking in India is not much developed except in Madras..." (1)

The Rural Credit Survey not only confirms many of the above observations but also reveals that the financial records of these agencies is insignificant and unsatisfactory. The findings of the Agricultural Finance Committee and that of the Rural Credit Survey are still true as Kulkarni has also pointed out: "...It satisfies neither of the requisites of good cooperation or sound credit." (3)

It is clear from the above analysis that under the present conditions of Agriculture credit in India, L.I.C. could not employ these institutions to a greater extent. It can therefore be concluded that the characteristics features of the Farm and non-farm mortgages do not provide ultimate solution to the life fund. The strong and weak points of the urban mortgages are summarised as follows:

Mortgages provide abundant security in the form of real property and debt paying capacity of the debtor. They offer attractive income, a higher yield than on other fixed obligations. Their duration can be planned with the term of the liabilities of the corporation. They offer a high possibility of geographic diversification and credit risks. Funds invested in mortgages perform a very useful social functions.

The other side of the picture indicates that mortgages involves high cost of origination and of servicing. The Realisation of principal and interest in instalments

1. Quoted in Report of All India Rural Credit Survey, p 227.
2. Ibid, 228.
requires the re-investment of the funds. Mortgages raises the problem of cost and lengthy foreclosure proceedings with possible adverse public relations. Similarly Farm loans involves extra hazard without compensating yield for the same. Let me now examine the investment attributes of direct ownership of Real Estate.

**L.I.C.'s Investment in Real Estate**

Real estate was a minor form of investment for life insurance offices before nationalisation. This will be clear from Table 7D. In 1956 Land and Building formed only 5.5 p.c. of total investments. Moreover the insurers confined this type of investment only to buildings and offices that they require for housing their Head and Branch Offices.

Thus on the nationalisation of life insurance, the L.I.C. inherited real estate consisting of 541 properties. The total book value of these properties was Rs 19.27 crores as on 1st September, 1956. Amongst the acquired properties were several monumental and well-planned buildings, residential flats and houses, and valuable unbuilt open plots of lands throughout the whole of India and in some foreign countries as well. Since 1957, the Corporation extended the construction of office accommodation and Zonal, Divisional and Branch Office accommodation through a building department. The Building Department has got seven offices at important cities, viz. two each in Bombay and Calcutta and one each in Delhi, Madras and Kanpur. Each Divisional Office is under an Executive Engineer assisted by adequate technical and administrative staff. The building department besides assisting the construction of office accommodation has also constructed 264 Staff Quarters for the employees of the Corporation.

It is now suggested that since the demand for 'housing' is increasing in the country and since climate for 'mortgages' is not yet favourable, it will be desirable if the corporation could take the 'direct financing of housing'. In other words L.I.C. should increase its 'equity investment in housing. This will also enable
VII. 41

the corporation to diversify its investments in hitherto neglected 'Rural areas' from where the corporation is expected to mobilise huge saving. In this way the Corporation can also invest its funds for social advancement. It is, therefore, important to examine the suitability of Real Estate to L.I.C.

Suitability of Real Estate to L.I.C:

Again a study of the real estate investment portfolio revolves around four important factors: dependability of principal; Realibility of Income, marketability and 'investment management.' Safety of Principal, when funds are used to acquire real estate whether residential or commercial, for income, is much different than that of property obtained through foreclosure. In the latter instance the investor has acquired the title of the property as last resort, whereas in the former case title to the property is deliberately sought because of the inherent value of the property.

The factors affecting the safety of funds invested in housing developments are mainly associated with the ability to rent the project. The ability to rent depends not only on the desirability of the living accommodations provided in the development and the rent charged but also upon neighbourhood conditions surrounding it, location with regard to places of employment and accessibility to facilities such as schools, shopping areas, and transportation. In addition to these factors, consideration must be given to the total supply of rental housing with which the project must compete, and possible government rent control measures. Thus the extent to which a housing investment will compare with other authorised investments, on the basis of safety of principal, will depend upon the amount of control that L.I.C. can exercise over these factors affecting the safety of housing development.

Investment in real estate are usually considered to possess a minimum degree of liquidity. Not only is there no price certainty from the sale of the asset, but there is not readily marketable, even in periods of high level economic activity.
This is explained in part by the absence of organised real estate markets, and in part by the large indivisible units to be transferred. In periods of depressed economic activity, this may result in real estate being unmarketable at virtually any price.

If liquidity is thought of as an attribute of an entire portfolio, however, real estate may contribute greatly to the liquidity of L.I.C. through the planned amortisation of real estate investment. The rental of most long-term leases is based on an amount which will return a predetermined yield and amortise the investment within a given period, thus reducing the need for liquidity. Nevertheless, the lack of liquidity in real estate is an important investment consideration.

To compensate for risk and lack of liquidity in the ownership of real estate, the anticipated yield therefore is frequently higher than the alternative investments. In addition, investment in real estate often provides an opportunity for capital appreciation. This may be obtained in the residual value of the property whose cost has been fully amortised, or through a rising price level. Because the return in most cases is deferred for a long period, its effect on investment is limited, but nonetheless significant.

**Management Problem in Real Estate**

Investment in Real Estate presents a management problem which is absent in other types of investment. In case of ownership of a real estate L.I.C. must set up some form of management department to carry out the operation of the project. This in effect involves establishing a separate business within the organisation, and if


the project is to be constructed by Corporation, the additional problems of contracting and planning are incurred.

An administrative consideration which is seldom stated explicitly, and yet may be very important, is the impact of the present social climate on safety, yield, and liquidity. Besides the social legislation of recent years tends to favour tenants over land-lords. Rent control providing some evidence of this tendency. The extension of this social attitude could seriously undermine the desirability of real estate as an investment. In addition to the problems of tenant selection, the Corporation in capacity of a Land Lord has the problems of putting rent increases into effect when they are warranted, evicting tenants when necessary, and of establishing and enforcing rules and regulations connected with tenant conduct, all of which can become sources of unfavourable publicity.

Thus the problem connected with managing and operating housing development are generally considered a major disadvantage; having the responsibility of managing the project. The advantage of the real estate investment on the other hand is that the corporation has direct control over the property. Moreover, housing construction is a great social service; in view of the housing shortage in the country and this form of investment might bring a good name for L.I.C. which would be a source of great business. Moreover, the managerial problem involved in real estate ownership are usually overcome through the organization of Real Estate Department, whose efficient working minimises several risk in this particular type of investment.

It is clear, therefore, that the investment in real estate investment can form the basis of an attractive segment of L.I.C's investment portfolio and stand shoulder to shoulder with mortgage loans, preference shares, debentures etc. The amount invested may never be great because of the administrative problems involved and restrictive legislation, but these comparatively new sources of investment could prove a profitable venue of investments.
Policy Loans and other Loans

'Loans' which consist of policy loans, loans on Stocks and Shares and 'other loans' are other important avenues of investments of L.I.C. Of these the most important are the policy loans within their surrender value. They accounted for ₹ 43.5 crores in 1960. These loans are considered as a form of 'dissaving' from the point of view of life insurance saving. But they are highly satisfactory from the insurer's point of view. They are unquestionably secure because they are given for an amount below the surrender value of policies. Moreover, the investment is profitable because they yield about 6 per cent interest which is more than the market rate.

This type of investment should not be encouraged by the insurers in a developing economy because they lead to 'Consumption finance.' Under the terms of contract, however, the corporation is bound to extend such loans when demanded by the policy-holders.

General Appraisal

It is obvious from the above analysis of investments that safety, liquidity and yield which are important investment objectives of L.I.C. are not achieved by any one form of investments. Each investment presents a peculiar type of 'risk.' To ensure against the 'risks' of investment, if the corporation has no other alternative than to diversify its investments in fixed earning securities and ordinary shares so that the volatility of the one can be compensated against the stability of the other.

In a period of rising prices, as pointed out earlier, the market value of fixed income investments tends to decline and ordinary share tend to appreciate in market value. Under deflationary conditions, the market value of fixed interest bearing securities appreciate and that of ordinary shares decline. The Corporation should therefore have a proper mixture of securities so that under different economic conditions the loss in the market value of one type of securities could be balanced to some extent by gains in that of the other.
Thus Table 73 indicates the manner in which the corporation has protected itself from market fluctuations by spreading its investment in fixed interest bearing securities and ordinary shares.

**TABLE 73**

VARIATION BETWEEN BOOK VALUE AND MARKET VALUE OF L.I.C.'S INVESTMENTS AS AT 31ST DECEMBER, 1960

<table>
<thead>
<tr>
<th>Class of Securities</th>
<th>Book Value</th>
<th>Market value</th>
<th>Appreciation + Depreciation</th>
<th>Gross yield per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gov. and other approved securities and Municipal Loans.</td>
<td>395.46</td>
<td>394.03</td>
<td>-1.43</td>
<td>3.67</td>
</tr>
<tr>
<td>Debentures.</td>
<td>23.96</td>
<td>23.52</td>
<td>-0.44</td>
<td>5.10</td>
</tr>
<tr>
<td>Preference Shares.</td>
<td>20.79</td>
<td>17.98</td>
<td>-2.81</td>
<td>5.55</td>
</tr>
<tr>
<td>Ordinary Shares.</td>
<td>50.88</td>
<td>56.36</td>
<td>+5.51</td>
<td>6.77</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>491.06</strong></td>
<td><strong>491.89</strong></td>
<td><strong>+0.83</strong></td>
<td><strong>4.15</strong></td>
</tr>
</tbody>
</table>

**SOURCE:** Yogakshema, 1961, Vol. 5 Nos. 8-9, August-September, p 54.

**Note:** Includes investment in foreign countries in the different categories of investments.

The above Table which gives the combination of Stock-Exchange securities as on 31st December, 1960 indicates that depreciation which occurred in the value of Government securities and fixed earning corporate securities, presumably due to the fluctuation in interest rates, was more than covered by appreciation in equity shares. This resulted in a net appreciation of Rs 0.83 crores in the total investments.

Besides this, the corporation also maintains an Investment Reserve Fund to meet any adverse situation in the fluctuations of assets. The Investment Reserve Fund amounted to Rs 13.41 crores as at 31st December, 1960.

Another advantage of diversification has been shown in Figure 24. The figure gives comparison between the 'assumed rate' and the 'actual yield' realised...
YIELD ON VARIOUS INVESTMENTS OF L.I.C. AND ASSUMED

GROSS YIELD %

Fig: 24

SOURCES: YOGAKSHEMA VOL. 5 NO. 8-9
by the corporation from various investments. It will be observed that in the Second
valuation as at 31st December, 1959, the rate of interest assumed was $2\frac{2}{7}$ per cent
(represented by the dotted line in the Figure). As against this the Corporation has
actually earned a gross yield of 4.15 per cent (represented by thick unbroken line
in the figure). This rate the corporation could earn only by spreading its invest-
ments in different forms of assets. The rate of interest, as shown in the Figure
on the Government and other approved securities and Municipal loans was as low as
3.67 per cent, the higher yields of 5.10 per cent on debentures, 5.55 per cent on
preference shares and 6.77 per cent on ordinary shares, have resulted in raising
the yield on the above categories of investments as a whole to 4.15 per cent i.e.
neearly half per cent above that was earned on Government and other approved securi-
ties and Municipal loans. Besides the 6 per cent yield on mortgages and 6 per cent
yield on Policy loans, the interest and rent income have further risen the gross
yield on the Life Fund to 4.58 per cent for the year 1960 as against the assumed rate
of $2\frac{2}{7}$ per cent. This 'supports' Raynes conclusion:

"An investor who has spread his capital over both fixed interest-
bearing securities and good ordinary shares is in a safer position
than one who has confined his investments in the former category,
both as regards income and market value of his capital."(2)

It is clear from the above that no single security alone can solve the problem
of investment of life fund. If the corporation would have invested its funds in
Government securities only which are 'safest' of all investment, the resultant
yield from such investment would have been so small that the corporation could not
have discharge its obligations to the policyholders. It had to spread its invest-
ment in different forms of securities in order to 'minimise risk' and 'maximise
yield.' This was one specimen of the investment policy through which the corporation
reached its ultimate goal of earning an 'adequate yield.'

1. In the valuation report of 1959, the yield of $2\frac{2}{7}$ per cent has been assumed except
where the liability was determined by accumulation of office premium in which
case rate of interest was used 3 per cent. Pitman
The investment distribution of present assets does not dispose of the problem of the investment of the further growth of the life fund for existing business and this problem poses the continuing risk of 'economic change.' The combination of the investment attributes not only vary widely among different issues within the same general category of securities as well as among the various classes of securities but also change materially through time on any single issue. Consequently there is no simple nor easy solution to the portfolio problem. No single policy is suitable for all purposes and for all times. In a developing economy the relative 'yield' and 'risk' characteristics of the securities varies with the 'economic change.' It is, therefore, important that the corporation must chart its course in advance not only to earn the maximum possible interest but also to protect itself from the 'economic changes' that are underway. In other words the corporation has to follow a flexible investment policy which is in consistent with the economic development of the country.

The economic changes, are important and have considerable influence on the portfolio structure of the insurers. I have discussed this in the following chapter.

Conclusion:

In this chapter the nature and characteristics of different forms of assets have been discussed with regard to their suitability for investment by L.I.C. It has been noted that simply no security justifies the entire investment criteria of safety, yield, liquidity marketability and ease of management etc., etc. Government securities, for example, provide safety of 'capital' and 'income' but pose the problem of forecasting the interest rate. The return from Government securities is also inadequate to meet the contractual obligations of L.I.C. While 'Mortgages' provide maximum degree of 'safety', they have poor marketability. The procurement supervision, control and procedure of foreclosure in case of failure of the borrower to pay the principal or interest, entails heavy responsibilities on L.I.C. Besides

the realisation of principal amount and interest in instalment also presents the
problem of the constant reinvestment of small sums of money. Investment in Real
Estates, especially in 'housing' besides providing adequate yield with possiblity of
appreciation, enables the corporation to perform a useful 'social function.' But
this type of investment also involves the problem of management which is considered
'foreign to a life office business.'

Among corporate securities debentures produce income dependability but they
require careful analysis of the financial worthiness of the issuing company. Simi-
larly, only few high grade preference issues compare favourably with sound debentures
as far as stability of income and 'safety of principal' to the corporation are
concerned. Equities serve as a hedge against inflation. In a period of rising
prices, they supplement the limited return received on debentures, and offer better
chances for appreciation of capital. However, the yield from ordinary share is
more cyclical. In order to ensure an adequate income in time of depression, L.I.C.
must have a substantial portion of its funds in fixed income securities.

All the arguments for and against a particular type of investment lead to the
conclusion that risk is inevitable. In a developing economy it is ideal to dream a
'care free' investments. This requires that the corporation must diversify its
investments in order to maximise yield and to minimise the chances of losses. By
spreading its risks both geographically and industrially and by distributing its
investments over a wide range of business, it would earn compensation for losses in
one direction through profits in another. Such a policy besides protecting the fund
becomes one of the important sources of flow of funds or 'transmiting of capital'
in different sections of the economy. If wisely followed such a policy will not
only bring the larger return for the policyholders but would also help the economic
growth of the country. This aspect of the investment policy of L.I.C. has been
examined in the next chapter.

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