Investment Management in Insurance companies

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SELECTED Superbrand INDIA Consumer Validated 2019-20

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Portfolio Classification

Shareholder Equity

Conventional Funds

Unit Linked Funds

Portfolio Classification

Conventional

- These funds are the investment component of the 'Conventional' or 'Traditional' policies issued by the insurer.
- These products have some element of guaranteed returns to policyholders.
- Investment management is geared towards meeting the guarantees at a minimum and deliver more if feasible.

Unit Linked

- These funds are maintained as segregated funds for the investment component of the 'Linked' Funds.
- The funds are managed as per the fund mandate approved by the Regulator.
- The Funds are managed dynamically with an objective of out-performing its designated benchmark index.

Conventional Funds- Product Structure

- The conventional products have a specified 'Premium Paying Term' and a 'Policy Term', defining the period for which the policyholders pay premiums, and the tenure of the product.
- The payouts to the customer are typically spread over the policy term.
- The benefits payable in the product is structured as a combination of a guaranteed sum assured, regular additions, which could be guaranteed or variable and in some cases, additions of terminal bonuses which is discretionary.
- The key to achieving the guaranteed / assured benefits to the policyholders is to generate the required returns while minimizing the risk.

Conventional Funds- Investment Strategy

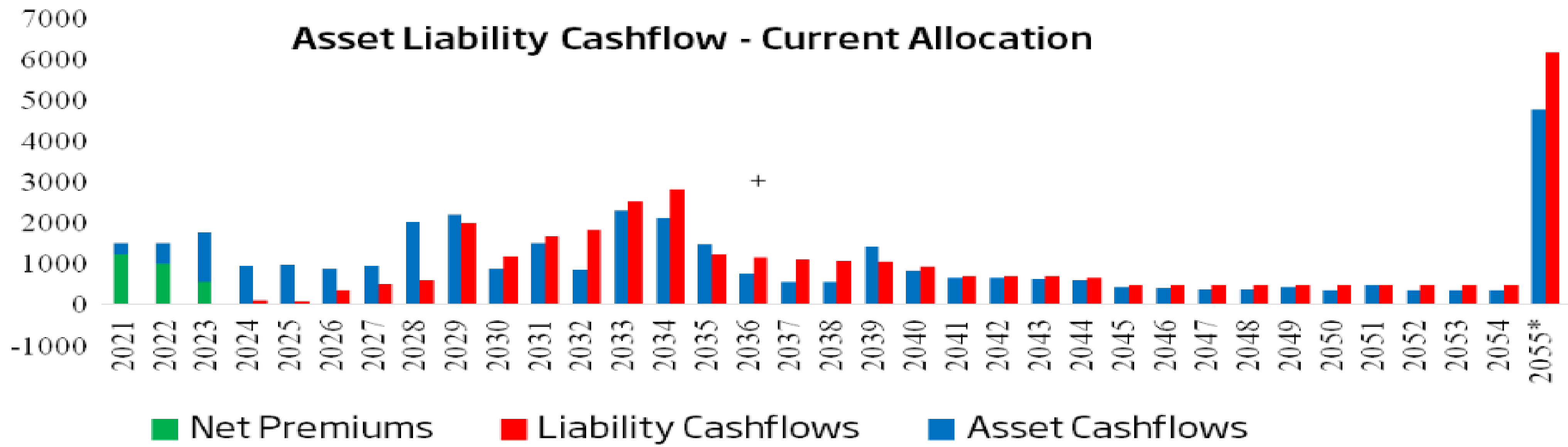
- Key pillars of the the investment strategy for conventional funds are:
  - Liability driven investing
  - Prudent asset allocation balancing the risk return requirements
  - Strong focus on asset liability matching and risk management

- Since the returns are largely fixed / guaranteed in nature, investment portfolios are dominated by fixed income securities. Equities are typically used to back the non-guaranteed returns and to enhance

- Asset – Liability management is key to achieving the required investment objectives. However, plain vanilla bonds are not very efficient in meeting the investment requirements for the long term portfolios.

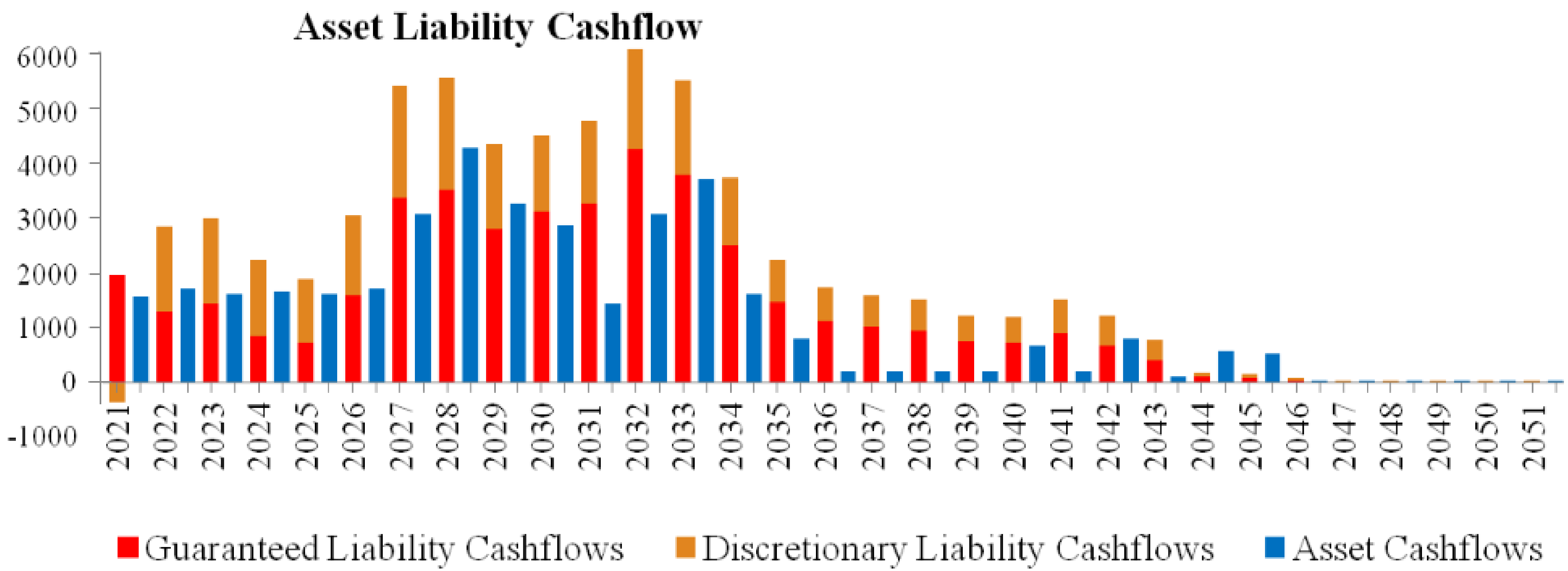
- Various instruments including interest rate derivatives are used for ALM and risk management purpose.

Asset – Liability management



- Key challenges in managing the portfolio for meeting future liabilities –
  - Policyholder premium payments will be received in future over the PPT
  - Bond coupons in the initial years, during the PPT, are essentially 'useless'. They add to the re-investment risk
  - Yields on future investments are uncertain – poses a risk in company's ability to generate the required returns
  - Bonds of certain maturities are not available at all
- Key elements for managing the bond portfolios -
  - STRIP bonds. Sell off the initial years' coupon strips and keep the later years' STRIPs.
  - Use Interest Rate Derivatives – IRF, FRAs to lock-in the yields on the future investments
  - Invest in structured bonds – Partly Paid Bonds, to match future investment requirements

Asset – Liability management – with variable benefits



- Products where some of the policyholder benefits can be variable, provide insurers some room to add equity or other more volatile assets to help enhance the total investment returns.
- The assets required to meet the guaranteed element of the liabilities are managed in a similar manner, using fixed income investments, as explained earlier.
- The equity / risk assets allocation provides the returns for the discretionary element of the policyholders' returns. These returns can be expected to be better than the fixed income investments.
- However, lower returns can lead to a reduction in the variable benefits to the policyholders.

Unit Linked Funds- Product Structure

- The Linked products, too, have a specified ‘Premium Paying Term’ and a ‘Policy Term’, defining the period for which the policyholders pay premiums, and the tenure of the product.
- The utilisation of the premiums towards investment, mortality, expenses and charges are clearly defined.
- The policyholders have the visibility and choice of funds available for investments. The policyholders have the flexibility to manage their investment allocations at all times during the tenure of their respective policies (except in cases of structured funds)
- The underlying funds are managed in a similar manner as Mutual Funds. All the investments in the funds are marked-to-market on every business day, and a NAV is declared at the end of the day.
- The funds are managed with a defined mandate and a defined benchmark. The objective of the fund management is to out-perform the benchmark index returns through active management of the fund portfolio.
- All the investment risks are borne by the policyholders. There are no residual investment risks with the insurer (except in cases of structured funds).

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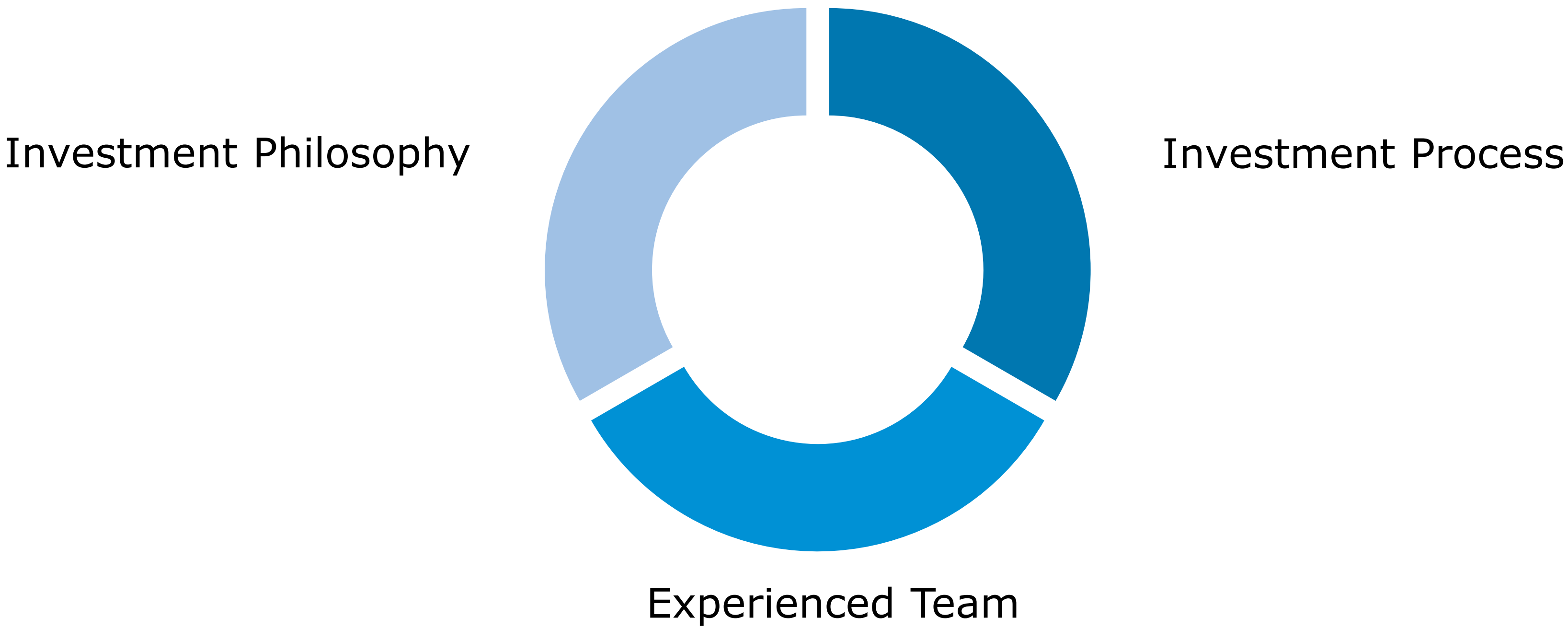
Investment Framework

Primary Objective is to Outperform benchmark and deliver superior risk-adjusted returns over a medium to long term.

The Framework has three principal elements:



Linked Funds – Debt Fund management

Key Decisions of a Fund Manager

- How are the various parts of the yield curve likely to move?
- What is the interest rate view across various maturities?
- Which part of the yield curve should the fund be invested in?
- How much allocation should be made to credits vis-à-vis the government securities?

Duration

Duration is managed dynamically based on economic and monetary policy factors.

Inflation / Inflation expectations along with RBI's Monetary policy stance are the key influencing factors for interest rate movements

Credit

Credit Risk plays a smaller role as the credit markets are largely restricted to AAA in India.

There has been an increase in sub-AAA issuances over the past few years. However, secondary market liquidity is still very limited.

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Linked Funds – Equity Fund management

Objective

The fund objective for all the equity portfolios is to deliver an out-performance of fund returns over their respective benchmarks.

Variables determining returns

Equity Fund Managers have greater number of variables that determine the returns from the fund.

Asset allocation – decision on the proportion of equities vs. cash in the portfolio

Sector selection – decision to maintain an over-weight / under-weight in different sectors w.r.t. the fund's benchmark

Stock selection – decision to maintain an over-weight / under-weight in different stocks within a sector, wrt the fund's benchmark

Equity Investment Philosophy – Fundamentals Driven

Quality of Business	• Large Business Opportunity • Sustainable Growth Potential • Strong Competitive Positioning
Quality of Management	• Honest, Credible and Transparent • Long Term Vision • Sound Strategy & Excellence in Execution • Efficient Capital Allocation • Concern for all stakeholders
Valuation	• Future Growth Prospects • Discount to intrinsic value • Focus on Earnings Growth, ROIC and Cash Flows

Investment Process: Idea Generation

Macro Trends | Stock Screeners | In-house Research | Sell Side Research

Management Meetings, In-Depth Financial Analysis

Monitoring & Recycling of Ideas

Team Discussion & Scrutiny

Rejected

Approved

Investment Universe

Regular Company Meetings

Monitor Stock Performance

Investment Process: Portfolio Construction

- Objective of the scheme
- ↓
- Adherence to Regulatory and internal Limits
- ↓
- Global and Domestic Macro Outlook
- ↓
- Asset Allocation
- ↓
- Top down sector allocation
- ↓
- Bottom up stock selection

Investment Process: Risk Management

Benchmark Driven

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Sector & Stock Active Weight Limits

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Portfolio Attribution

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Competitive Analysis

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Reporting to Investment Committee

Thank You

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