PGDM (IBM), 2015-17

INVESTMENT MANAGEMENT

INS-504

Trimester – V, End – Term Examination: December 2016

Time allowed: 2 Hrs 30 Min ***Roll No. ------------------***

Max Marks: 50

Instruction: students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as Unfair Means. All other instructions on the reverse of Admit Card should be followed meticulously.

SECTION A

Answer 3 out of 5 questions **5 Marks each**

1. (a)What are bond ratings?
   (b)For an insurance company what is the significance of having a "general account" and a "separate account"
2. (a) What is the role of a due diligence analyst in the insurance company's investment department.
   (b)What are the objectives of a pension fund managed by an insurance company?
3. What are the major risks associated with global expansion of financial companies?
4. What is the difference between "Fixed price issue "and "Book Built issue "?
5. Describe the primary characteristics of alternative investments.

SECTION B

Answer 2 out of 3 questions ***10 Marks each***

1. Explain the concept of
   - Risk and return and
   - Diversification in investment
2. What are the major objectives of market conduct regulation and prudential norms by IRDA?
3. Calculate various stock ratios, including the earnings per share, price/earnings ratio and the price –to- book ratio and describe how investors use such ratio.

SECTION C

Compulsory Case Study ***15 Marks***

After reading this case please answers the following questions:

1. Discuss the various Investment regulations as specified by IRDA?
2. Is it necessary to stay in line with the requirement of Solvency and Reserve margin? Why?
3. A company should work within regulatory requirement or should look at risk – return ratio? Give reference form the above case.

Keeping Value in Insurance Company Portfolio Investments

While keeping in line with government regulation and the National Association of Insurance Commissioners, the current economy could begin to offer more opportunity for value as it relates to institutional portfolio assets.

The pursuing of higher yields goes hand in hand with additional risk however, and here, while capital markets typically tend to seek higher return on investment, the higher risks that are attached may or may not be sufficient enough to act as a buffer in ensuring enough adequate funds to pay policy holder claims in instances where the actual payouts to those insureds are larger than the amount that has been reserved.

Therefore, the risk that is faced by an insurance fund manager differs from what the typical fund manager faces. This is due to the fact that the risk in insurance investment management must factor in the liability side of its balance sheet that includes benefit amounts for shareholder capital as well as the reserves that are necessary for the insurer's future claims.

The Need for Asset-Liability Management in Insurance Company Portfolios

One of the key functions related to insurance company portfolios is asset-liability management. With this in mind, it is imperative that assumptions must be made based on the potential that changes to the value of group investments and corresponding liabilities can have on shareholder equity.

As insurance companies typically separate the responsibility of their insurance business from the investment of capital and reserve funds, the incoming premiums that are received should cover any insurance losses to the company's guaranteed minimum benefits as well as overhead and administrative expenses.

Here again, however, those portfolio managers who are focused on the insurance industry will still have the added constraint of investing not just to gain return and attempt to minimize risk, but also to cover reserves for the expected claims of the company's policy holders.

These investment managers must work to ensure that the returns that are gained from the insurance company's investment portfolio preserve the solvency – both economic and regulatory – of the company, while also earning the return that is commensurate with the use of the company's capital funds. This all together should then result in the company continuing to underwrite profitable insurance business.

These portfolio managers must also bear in mind that insurance companies are regulated in virtually each and every market in which they conduct business. Therefore, insurance regulators will set out solvency requirements for all local business that is required to be met at all times.

The reason for such regulation requirements is to help in ensuring that insurance companies are holding the appropriate amount of assets to not just cover their expected policyholder claims, but also to cover any of the larger and non-expected claims as well as to absorb the cost of adverse results that may come about from a potential mismatch of asset-liability management.

In this vein, keeping an awareness of the regulatory framework when developing key portfolio strategies is essential. In addition, the implementation of Solvency II could lead to different reporting requirements for the liabilities on insurance companies' books.

Overall Decision Making Assumptions

Certainly, in any institutional investment, decisions must be considered as they relate to maximizing economic objectives as well as how capital markets factor in. Creating shareholder value, then, is key – and in doing so, portfolio managers must strive to create long term value by creating and undertaking a strategy of investment that will optimize the investment risk-return profile.

In doing this, a good reference point that should be considered is that of the efficient market principle, while also taking into account realistic expectations of overall returns. Thus, three primary areas of focus should be market return, skill-based return, and risk-free return.

In addition to the consideration of risk and return should be proper asset allocation with regard to the mix of asset classes promising the highest expected return, while also working within the regulatory framework of the industry's guidelines.

Staying in Line with Reserve Requirements

The global financial crisis that began in 2007 has truly highlighted the importance of having a clear investment policy as well as a very structured and disciplined process of pursuing investments. It has also shown that portfolio assets must be managed relative to liabilities – which appears to be a large differentiator all across the industry.

Given the Solvency II initiative that is currently taking place in the European market, insurers are taking a much closer look at their capital and reserve requirements. Certainly, moving forward with any investment strategy should keep in mind both current and potential future guidelines for such reserves as well as the risk that may be entailed with particular investments.

Thus, many providers have reduced the risk on their books by taking a more stringent approach with their investment guidelines – specifically by doing away with high yield and bringing on duration caps. In this area, though, banking entities have taken an even more aggressive approach than insurers, due in large part to their own industry's uncertainty in regulations as well as the challenges that are due to the post-credit crisis.

It would appear that stable value should remain an asset class of importance for those institutional investors that are seeking both stability of return in conjunction with safety of principal. This is particularly the case in light of what could likely be an environment of low interest rates for the longer term, along with continued volatility in the equity and bond markets. With this in mind, pooled asset classes may be particularly attractive – especially for smaller plans that have difficulty accessing the stable value market.