INSURANCE EXAM · IC-99

IC-99 Asset Management

Revision book

19	2	315
chapters	master tables	numbered sections

FREE SAMPLE: Chapter 1 of 19

CHAPTER 1

Asset Management: Meaning, Scope and Objectives

1.1	Meaning and risks	1.2	Scope and functions
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1.9	Security analysis and portfolio	1.10	Liquidity of assets

MUST KNOW

1. Asset management (AM) = investment analysis and portfolio management; deals with qualitative and quantitative aspects.
2. **Definition:** co-ordinated financial risk management to realise the maximum value from all (financial) assets.
3. **Functions:** search for opportunities; select on profitability, security, liquidity; review results.
4. **First requirement:** estimate return and risk of the proposed investment (holding period return first).
5. **ALM = AM + 3 extras:** asset-liability relationship, liquidity, stress tests.
6. **Investment has two attributes:** time and risk. Equity = variable income; bonds, G-secs = fixed income.
7. **Valuation models:** discounted cash flow, relative value, option pricing.
8. **Investment objectives:** income, capital appreciation, capital gains, safety of principal, risk and return, liquidity, tax.

1.1 Meaning and risks

- **AM = financial risk management:** identify origin of risks, analyse and quantify, handle them.
- **14 risks:** credit, default, market volatility, forex, liquidity, inflation, operational, speculation, management, country, interest, concentration, legal, reputation.
- **Fixed income:** bonds, debentures, Indira Vikas Patras, Kisan Vikas Patras, G-secs, money market securities.
- Negotiable = transferable; may give variable or fixed income.
- **Investor's choice:** required return and risk tolerance.

TRAP

Equity shares = variable income, not fixed.

1.2 Scope and functions

- Both qualitative and quantitative; both an art and a science; aim to cut whole life cost of assets.
- **Covers:** investment, liquidity, interest rate, capital market, currency (forex), credit risks.
- **3 aspects:** prudential, growth and profitability, compliance.

- **Wider scope:** globalisation, new derivatives, offshore (FDI) investment.

> **TODAY'S RULE**
>
> FDI in insurers up to **100%** of paid-up equity (s.3AA, Insurance Laws amendment Act **2025**).

- **5 aspects:** analyse alternatives; look at markets and instruments; sound decisions; review results by portfolio; revise strategy.
- **Banks:** deposits repayable on demand, so lend and recover (ALM). Insurers and pension funds: invest premium for return, solvency and profitability.
- **Tasks:** pick securities (highest return, best liquidity); allocate funds; measure risk and return and revise.
- **Emerging issues:** risk changes, risk-return measure, valuing hybrids and derivatives, market efficiency (**2007** US crisis, **2015** Greece), asset allocation, derivative use.

Step in estimating return	What
1	Historical return over the holding period
2	Average historical return over several periods
3	Estimated average return of a portfolio (with its uncertainty)

> **TRAP**
>
> Fixing premium rates is not an investment function.

1.3 MPT

- Mathematical formulation of diversification; lower overall risk than any other mix with the same expected return.
- Detail in Chapter 13.

1.4 Importance

- Co-ordinates assets and liabilities; finds market, interest rate, equity, real estate, currency, credit, underwriting and liquidity risks.
- Monitors asset-liability positions against liabilities, risk profile and solvency.
- **More vital for insurers (risk-taking business):** solvency, liquidity and interest rate risk; ALM policy stressed by the regulator.
- **Mutual funds:** high return, good liquidity, security.

AMFI data (2015)	Figure
Fund houses	44
Average AUM Sep 2015	**Rs 11.87 lakh** crore
AUM Oct 2015	**Rs 13.24 lakh** crore (all-time high then)
Rise	**11.5%**

> **FORMULA AND WORKED SUM**
>
> - (13.24 - 11.87) / 11.87 = 1.37 / 11.87 = 11.5%

> **TRAP**
>
> **2015 figures:** always state the year.

1.5 Objectives of asset management

- Understand risks; measure and frame policy; search for opportunities; select on return, security, liquidity.
- Best fund mix and portfolio decision; use fundamental and/or technical analysis.
- Valuation principles and process; select securities; execute the plan (buy and sell); internal control and review; review results.
- Apply financial risk management (market, credit, liquidity, concentration, compliance risks).

TRAP

Internal control is an objective.

1.6 ALM

- AM and ALM used almost the same way; 3 extra requirements: total asset and liability relationship, liquidity, stress tests.

TODAY'S RULE

ALM and investment rules: IRDAI (Actuarial, Finance and Investment Functions of Insurers) Regulations **2024**; control level of solvency **150%**.

- Investor must distinguish investment from speculation.

1.7 Investment

- **Meaning:** giving or promising funds today for a forthcoming monetary yield or return.
- **Decisions:** assets and types; asset mix; amount; period; grades; terms; liquidity; evaluation.
- **Process:** continuous; analytical, forward looking, systematic; speculation and gambling are short-lived; never a single basket; uses probability.
- **Policy:** set by banks, insurers; defines objectives; gives basis of valuation; every insurer has one. Objectives depend on cost of funds and risk appetite.

Objective	Point
Investment income	Dividend, interest; ROI first objective
Capital appreciation	Rise in value
Capital gains	Profit on sale
Safety of principal	Protect the sum
Risk and return	Balance
Liquidity	Cash when needed
Tax	Effect on returns

FORMULA AND WORKED SUM

- **LIC 2023-24:** investment income Rs 3,61,427.41 cr (2022-23: Rs 3,39,496.15 cr) = 42.18% of total income.

TODAY'S RULE

Tax: Income-tax Act **2025** from **1 Apr 2026** (learn the benefit, not section numbers).

1.8 Types of assets

Group	Items
Equity	Listed, unlisted
Preference	Convertible, cumulative, participating or not
Bonds and debentures	Tax saving, PSU, infrastructure, corporate
Fixed income	Central, state G-secs, bonds, infra bonds
Money market	Call or notice money, CBLO, repos or Treps, T-bills, CDs, CP, liquid funds
Non-marketable	Bank, post office, corporate deposits; MIS; KVP; NSC; EPF; PPF; NPS
Real estate	House, agri land, commercial land, commercial property
Precious metals	Gold, silver, stones
Mutual funds	Equity, bond, hybrid, long and short term, SIP, index
Insurance	Endowment, money back, whole life, ULIP, term, annuities, specialised

1.9 Security analysis and portfolio

- **Traditional:** forecast dividends and earnings, share price, intrinsic worth.
- **Modern:** fundamental + risk-return (variability, covariance, safety, projected returns).
- **Fundamental factors:** economy, industry, company (management, promoters, results, expansion, tax planning). Detail in Chapter 4.
- Portfolio = combination of assets; analysis = construction, selection, revision, evaluation and monitoring; dynamic. Detail in Chapter 14.

1.10 Liquidity of assets

- **Marketable:** quoted MF units; debentures and PSU bonds (limited market); listed equity; G-secs, capital investment bonds, PSU shares.
- **Not marketable:** bank deposits; company deposits; post office deposits, NSC; PF and pension funds; insurance policies (LIC, GIC).