UNIT 15 INVESTMENT COMPANIES

Objectives

The objectives of this Unit are to:

- highlight different types of Investment Companies
- discuss the role of Insurance Companies and Pension Funds in the capital markets
- describe some of the major products offered by the insurance companies and pension funds.

Structure

15.1 INTRODUCTION

Individuals have the option to invest on their own or through some institutions, which specialise in such activities. In the U.S. and many other developed nations, investors normally prefer to invest through mutual funds and pension funds. Indian investors are also increasingly investing through such specialised funds. Funds, which specialise in investments on behalf of their Investors are called Investment Companies. An investment company is a pool of funds belonging to many individuals that is used to acquire a collection of individual investments such as stocks, bonds and other publicly traded securities. While some of the investment companies offer these services indirectly, others offer such services directly. In this unit, we will discuss more on investment companies, which offer such indirect services to investors. *Investment companies, which offer direct services, often called as mutual funds* which will be discussed in detail in the next Unit. For the limited purpose of this Unit, let us call companies belonging to former group as investment companies and second group of companies as mutual funds.

Investment companies typically offer some service not directly related to investing the money in securities but the amount collected against such services are invested in securities and income earned out of that are shared with the customers of service. To give an example, suppose if you have taken a life insurance policy from Life Insurance Corporation of India or any other newly formed private sector insurance company, you are actually getting an insurance product or service. Insurance policies invariably have two components namely risk cover and savings. Such insurance companies in addition to protecting the family of policyholders in the event of loss of policyholders' life also offer a return on the savings part in the form of bonus. In order to reward the policy older with such return, insurance companies invest money in securities of different types. Another example is pension funds, which also collect regularly some amount from the subscribers and reward the subscribers by providing pension for the subscribers as well as her/his family. Specialised Pension Funds are yet to take off in India but LIC, UTI and ITI-Pioneer Mutual Fund have already floated pension funds schemes. Many mutual funds and private life insurance companies are in the process of bringing such schemes to investors.

In contrast with investment companies, the mutual funds are not offering any other services other than investment services to investors. Mutual funds collect money from investors and simply invest the amount in securities as per the scheme. At the end of the scheme or periodically, the return earned from the scheme is distributed to the holders of mutual funds units after deducting management fees. We will discuss more on mutual funds in the next Unit. In this unit our discussion is mainly restricted to insurance and pension companies.

15.2 INSURANCE COMPANIES

Insurance industry is one of the several industries, which was earlier under the monopoly of the government, opened up for competition. Today, in addition to Life Insurance Corporation of India and General Insurance Corporation of India and its Associates, there are large number of private players like HDFC Standard Life, ICICI-Prudential, etc., have entered into the market. The following table shows some of the major private sector companies registered with Insurance Regulatory and Development Authority (IRDA) and the list is growing.

Table 15.1 Insurance Companies in the Private Sector

Life Insurance Companies	***General Insurance*** *Companies*
HDFC Standard Life Insurance Co.	Royal Sundaram Alliance Insurance Co
Max New York Life Insurance Co	Reliance General Insurance Company
Om Kotak Mahindra Life Insurance	IFFCO Tokio General Insurance Co.
Tata AIG Life Insurance Company	TATA AIG General Insurance Company
ING Vysya Life Insurance Company	Bajaj Allianz General Insurance Co
Metlife India Insurance Company	ICICI Lombard General Insurance Co.
ICICI Prudential Life Insurance Co.	
Birla Sun Life Insurance Company	
SBI Life Insurance Company	
Allianz Bajaj Life Insurance Company	

15.2.1 Life Insurance Corporation of India

The LIC of India was established by an Act of Parliament in 1956. The corporation central office is located in Mumbai and there are seven zonal offices one each at Mumbai, Kolkata, Delhi, Kanpur, and Chennai. The corporation has 100 divisional offices and 2048 branches and 6,28,301 agents.

Some of the objectives that the Corporation pursues are listed below:

- Spread Life Insurance much more widely and in particular to the rural areas and to the socially and economically backward classes with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost.
- Maximize mobilization of people's savings by making insurance-linked savings adequately attractive.
- Deploy the funds to the best advantage of the investors as well as the community as a whole, keeping in view national priorities and obligations of attractive return.
- • Act as trustees of the insured public in their individual and collective capacities.
- Meet the various life insurance needs of the community that would arise in the changing social and economic environment.

During the last five decades, the Corporation has grown huge size in terms of collecting the savings and also investing the same in the market. Table 15.2, 15.3 and 15.4 will give you an idea on the role of LIC in Indian capital market. LIC has crossed the 2 crore landmark by underwriting 2.25 crore policies during the year 2001-2002. The sum assured against these policies was Rs. 192784.96 crores. During the year 2001-02 LIC has settled in all 85.27 lakh claims both maturity and death.

Table 15.2: Working Results of LIC of India

(All figures in Rs Crores)

	1998-99	1999-2000
PREMIUM INCOME		
First Year	4,071.73	5,062.51
Renewal	17,710.22	21,100.44
Single Premium & C.A.G Granted	1,023.85	1,298.76
Total Premium Income	22,805.80	27,461.71
OTHER INCOME		
Income from investments	13,183.92	16,056.62
Other receipts	362.87	1,211.28
Total Income	36,352.59	44,729.61
Jeevan Suraksha Business	171.28	388.05
EXPENSES		
Commission	2,001.94	2,506.02
Other Expenses	2,667.56	3,304.84
Total	4,669.5	5,810.86
CLAIMS FOR THE YEAR (INCLUDING BONUS)		
By Death	1,378.36	1,637.70
By Maturity	6,237.42	7,628.55
Total	7,615.78	9,266.25
OUTSTANDING CLAIMS AS AT 31ST MARCH		
By Death	196.24	237.71
By Maturity	151.98	165.46
Total	348.22	403.17
Life Insurance Fund at the End of the Year	127,389.06	154,043.73
Total Assets	132,699.44	160,935.76

Table 15.3 : New Business Individual Insurance (excluding Annuities)

	New Business in India			*New Business Out of*			*Total New Business*		
Year	**No. of Policies(in lakhs)**	**Sum Assured (Rs. In crores)**	**Annual Premium(Rs. In crores)**	**No. of Policies**	**Sum Assured (Rs. in crores)**	**Annual Premium (Rs. in crores**	**No. of Policies**	**Sum Assured (Rs. in crores)**	**Annual Premium (Rs. in crores)**
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1996-97	122.68	56740.50	3345.39	12,296	253.44	15.39	122.81	56,993.94	3360.78
1997-98	133.11	63617.69	3841.12	13,904	310.14	18.07	133.25	63,927.83	3859.19
1998-99	148.44	75316.28	4863.41	13,356	289.98	17.11	148.57	75,606.26	4880.52
1999-00	169.77	91214.25	6008.28	12,648	276.69	17.74	169.89	91,490.94	6026.02
2000-01	196.57	124771.62	8851.89	7,911	179.01	11.46	196.65	1,24,950.63	8863.35
2001-02	224.91	192572.27	16009.44	8,695	212.69	12.57	224.99	192784.96	16022.01

Source: Website of LIC : 45th Chairman's Review

Table 15.4: LIC's Investments - Some Highlights

(Rs. in crore)

TYPE OF INVESTMENT	INVESTMENTS UP TO							
	31.3.1977	31.3.1987	31.3.1997	31.3.1998	31.3.1999	31.3.00	31.3.01	31.3.02
Central Govt. Securities	981	4675	37330	45876	56185	70533	85181	109938
State Govt. & others	715	1683	8906	10471	12928	14156	17877	21463
Electricity (SEBs)	733	2603	8214	9153	10591	11931	12402	13447
Housing	618	1872	10967	12242	14207	15885	17998	19054
Water Supply & Sewerage	203	718	2028	2264	2508	2997	3657	4000
State Road Transport Corp	-	180	540	551	671	736	784	893
Loans to Industrial Estates	9	37	45	45	45	45	45	45
Loans to Sugar Co-Ops	22	37	37	37	37	37	37	37
Development Authority	-	1	1	1	1	1	1	1
Roadways, Port, Railways	-	-	-	25	25	85	325	681
Power General (PVT Sector)	-	-	-	276	801	1478	1615	3797
Municipalities	-	-	-	4	4	4	4	4
Total	3281	11806	68068	80945	98003	117888	139926	173370

Note : 1) Item 1 & 2 are shown as at Book Value as on 31.3.02.
2) Item 3 to 12 are Gross investment made so far.

Source : Web site of LIC

LIC offers a number of plans, which can be broadly classified as plans for individuals, group scheme and pension plans. The various schemes offered by LIC as on 5.5.03 are :

(a) Plans For individuals

Whole life schemes
Term assurance plan
Capital market linked plans
Plans for the benefits of handicapped
Joint life plan
Endowment schemes
Periodic money-back plans
Medical benefits linked insurance
Plans to cover housing loans
Plans for children's needs
Investment plans

(b) Group Schemes

Group Term Insurance Schemes
Group Gratuity Scheme
Group Superannuation Scheme
Group Leave Encashment Scheme
Group Insurance Scheme in view of EDLI
Janashree Bima Yojana
Group Savings Linked Insurance Scheme
Krishi Shramik Samaj ik Suraksha Yojana 2001
Shiksha Sahayog Yojana

(b) Pension Plans

New Jeevan Akshay I
New Jeevan Dhara I
New Jeevan Suraksha I

Since you are studying a course on investments, it will be useful to think about LIC as a part of your portfolio of investments. Some of the reasons on why should an individual has to take insurance policy are listed below:

Protection: Savings through life insurance guarantee full protection against risk of death of the saver. In life insurance, on death, the full sum assured is payable (with bonuses wherever applicable) whereas in other savings schemes, only the amount saved (with interest) is payable.

Aid to thrift: Life insurance encourages `thrift'. Long term saving can be made in a relatively `painless' manner because of the `easy instalment' facility built into the scheme (method of paying premium either monthly, quarterly, half yearly or yearly). Take, for example, Salary Saving Scheme popularly known as SSS. This scheme provides a convenient method of paying premium each month by deduction from one's salary. The deducted premium is remitted by the employer to the LIC. The Salary Saving Scheme can be introduced in an institution or establishment subject to specified terms and conditions.

Liquidity: Loans can be raised on the sole security of a policy, which has acquired loan value. Besides, a life insurance policy is also generally accepted as security for even a commercial loan.

Tax Relief: Tax relief in Income Tax and Wealth Tax is available for amounts paid by way of premium for life insurance subject to Income Tax rates in force. Assesses can avail themselves of provisions in the law for tax relief. In such cases the assured in effect pays a lower premium for his insurance than she/he would have to pay otherwise.

Money when you need it: A suitable insurance plan or a combination of different plans can be taken out to meet specific needs that are likely to arise in future, such as children's education, start-in-life or marriage provision or even periodical needs for cash over a stretch of time. Alternatively, policy moneys can be so arranged to be made available at the time of one's retirement from service to be used for any specific purpose, such as for the purchase of a house or for other investments. Subject to certain conditions, loans are granted to policyholders for house building or for purchase of flats.

Investments through Life Insurance offer attractive return. Table 15.5 shows bonus paid by LIC during the last few years.

Statutory Regulations Governing LIC Investments

The investment policy of LIC is subject to regulations under the provisions contained in the Life Insurance Corporation Act, 1956. It stipulates that LIC's funds shall be invested as under:

i) In Central Government marketable securities:

Not less than 25 per cent

ii) In Central Government, State Government Securities including securities in

(i) above:

Not less than 50 per cent

iii) In. socially-oriented sectors, including the public sector, co-operatives plus

(ii) above:

Not less than 75 per cent

Of the balance 25 per cent, about eight per cent would be set aside for loans against policies, about two per cent may be invested in immovable properties and about 10 per cent may be invested in the private corporate sector.

Table 15.5 : Rates of Bonus declared by LIC of India

(Rates of Bonus per annum per Rs.1000 Sum Assured)

Valuation as at	Whole Life Policies (Rs.)	Endowment Policies (Rs.)
31.12.1957	16.00	12.80
31.12.1959	16.00	12.80
31.12.1961	16.00	12.80
31.03.1963	17.50	14.00
31.03.1965	20.00	16.00
31.03.1967	20.00	16.00
31.03.1969	22.00	17.60
31.03.1971	22.00	17.60
31.03.1973	22.00	17.60
31.03.1975	22.00	17.60
31.03.1977	25.00	20.00
31.03.1979	31.00	24.80
31.03.1981	35.00	28.00
31.03.1983	42.50	34.00
31.03.1985.	55.00	44.00
31.03.1986	65.00	52.00
31.03.1987	72.50	58.00
31.03.1988	77.50	62.00
31.03.1989	80.00	64.00
31.03.1990	82.50	66.00
31.03.1991	84.00	67.00
31.03.1992	84.00	67.00
31.03.1993	84.00	67.00
31.03.1994	84.00	67.00
31.03.1995	86.00	67.00-69.00
31.03.1996	86.00	67.00-69.00
31.03.1997	88.00	64.00-71.00
31.03.1998	91.00	62.00-74.00
31.03.1999	93.00	53.00-76.00
31.03.2000	95.00	53.00-80.00
31.03.2001	95.00	53.00-80.00
31.03.2002	100.00	49.00-65.00

Source : Website of LIC of India

15.2.2 General Insurance Companies

Unlike Life Insurance, there is no saving under general insurance. Policyholders take the policy and get an insurance cover for their machine, office, house, health, etc. Though no income is distributed back to policyholders, the general insurance companies are major investors in the market. For instance, the value of investments in the capital market by General Insurance Corporation of India as on March 2000 is close to Rs. 1860 cr.

Activity 1

1. Assume that you want to take an LIC policy for yourself or someone in your family. List down the needs of such policies.

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2. Contact a Insurance Agent of LIC of India and a private insurance company. Ask them to suggest three plans and compare whether such plans meet your requirements.

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15.3 PENSION FUNDS

Private pension funds are yet to pick up in India but many private insurance companies have plans to launch the pension fund products to Indian investors. The employees of organized sector in India, particularly Government employees are covered by pension scheme sponsored by the Government. On the other hand, several individuals without a government job have no planned scheme to protect their retirement life and hence the potential of pension fund in India is high. In the U.S. and Europe, pension funds have grown rapidly to become the primary vehicle of retirement savings. A pension plan is an agreement to provide income to participants upon their retirement. These funds are mostly tax deductible and investment income of the fund is also not taxed. Distributions from the fund whether to the employer or employee are taxed as ordinary income. There are two types of pension plans.

A) ***Defined contribution:*** Here a formula specifies the contributions but not benefit payments. Contribution rules are usually specified as a predetermined fraction of salary although that fraction need not be constant and can be changed over the course of employees' career. Pension benefits are not specified other than at retirement the employee applies that the total accumulated value of contributions and earnings on those contributions to purchase an annuity. The employee often has a choice over both the level of contribution and the way the account is invested:

B) ***Defined benefit:*** Here a formula specifies benefits but not the manner, including contributions, in which these benefits are funded. The benefit formula typically takes into account years of service of the employer and levels of wages or salary. The employer or an insurance company hired by the sponsor guarantees the benefits and thus absorbs the investment risk. The obligation of the plan sponsor to pay the promised benefits is like a long-term liability of the employer.

In the United States, the first pension fund was established towards the end of the nineteenth century by the railroads, the nation's first larger employer. By 1929, there were 397 plans sponsored by employers and another 13 sponsored by labour union. They covered nearly 4 million workers. Since there is no guaranteed return and funds raised were invested in securities, many pension funds have failed during the great depression. Pension fund industry gained substantial expansion during the World War II because many employers were motivating labour force to join their service by offering pension benefit. By 1945, private pension plans covered 6.40 million workers, a 50% increase over 1940. The growth of pension plans has continued at rapid space since World War II and half of the private employees in the U.S. are covered by the pension funds. Contribution of pension funds account nearly 24% of the net personal savings of the employees. Pension funds in the U.S. today control more than $3000 billion worth of assets. Defined pension plans are today insured by Pension Benefit Guarantee Corporation (Penny Benny) and in the event a plan defaults or is terminated, the Penny Benny guarantees pension benefit up to certain limit.

15.3.1 Pension Plans in India

1 JEEVAN AKSHAY-I OF LIC OF INDIA

Salient Features:

Minimum age at entry	:	40 Last Birthday.
Maximum Age at entry	:	79 Last Birthday.
Minimum Purchase Price	:	Rs.25,000/-.
Minimum Annuity Installment	:	Rs. 250/-.

Type of Annuities Available:

- Annuity for Life
- Annuity certain for 5,10,15,20 years and for life thereafter
- Annuity with return of purchase price
- Annuity for Life increasing at a simple rate of 3 % per annum.
- Annuity for Life with a provision for 50 % of the annuity to the spouse of the annuitant for life on death of the annuitant.

Modes of Annuity Payments:

Annuity can be paid in yearly, half-yearly, quarterly or monthly installments, subject to a minimum annuity of Rs. 250/-.If the annuity payable under a particular mode is less than Rs. 250/-, then the allowable mode should be so altered such that the minimum annuity payable is Rs.250/-.

- No Loan will be given by the Corporation to the policy holders under this plan.
- No Surrender value will be available under this plan.

2 NEW JEE VAN SURAKSHA -I/NEW JEEVAN DHARA-I

Salient Features

- Minimum Age at entry : 18 years last birthday.
- Maximum age at entry : 65 years last birthday.
- Minimum vesting age : 50 years last birthday.
- Maximum vesting age : 79 years last birthday.
- Minimum deferment period : 2 years.
- Minimum Notional Cash option : Rs. 50,000 for regular premium policies
- Minimum Single Premium : Rs. 10,000/-
- Minimum amount of Annual Premium : Rs. 2500
- Maximum deferment period : 35 years.
- Age Proof : Standard Age Proof required.

Benefits

a) On vesting

The Notional Cash Option together with Reversionary Bonuses and Final additional Bonuses (if any) with or without 25% commutation will be compulsorily converted into annuity having following options:

- Annuity for life.
- Annuity for life with guaranteed period of 5, 10, 15, 20 years.
- Joint life and last survivor annuity to the annuitant and his/her spouse under which annuity payable to the spouse on death of the purchaser will be 50% of that payable to the annuitant.
- Life annuity with return of purchase price.
- Life annuity with annuities increasing at a simple rate of 3% per annum.

b) During Deferment

A term rider option will be available. On the death of the policy holder who has opted for the term Assurance rider (provided the policy is in-force), the Term Assurance Sum Assured along with all premiums (excluding term Assurance premium and extra premium if any) paid up to the date of death accumulated at the rate of 5% p.a. compounding or at such rates as decided by the Corporation from time to time will be paid to the nominee. When the policy is not in-force, only return of premiums with interest as stated above will be available.

For those not opting for the Term Assurance Rider, in respect of policies which are in-force or in a paid up condition, all premium accumulated at 5% p.a. compounding or at such rates as decided by the Corporation from time to time, will be paid to the nominee.

c) Paid up, Guaranteed and Special Surrender Value

- **For Annual Premium Plans:** The Guaranteed Surrender Value will be equal to 90% of all premiums paid excluding the first year premium, all Term Assurance premium and extra premium (if any). This will be allowed after at least two full years' premiums have been paid and will be available after two full years have been completed from the date of commencement. However, the policy can not be surrendered after the annuity vests.
- **For Single Premium Plan:** The Guaranteed Surrender Value will be 90% of the single premium paid. Surrender will be allowed 2 years after the commencement of the policy.
- **Special Surrender Value:** For Annual premium policy this will be available at least two years after date of commencement and during deferment period if at least two full years' premium have been paid.

d) Non-forfeiture regulations

If, after at least two full years premiums are paid in respect of this policy, any subsequent premium be not duly paid, the policy shall not be wholly void, but the amount of Notional Cash Option shall be reduced to such a sum as shall bear same ratio to the original, as the number of premiums actually paid shall bear to the total number of premiums originally stipulated for in the policy. The policy so reduced will thereafter be free from all liabilities for payment of the within mentioned premiums but shall not be entitled to participate in future profits. The existing vested Bonus additions will attach to the reduced paid up policy and this will determine the reduced annuity payable on vesting. The option of commutation of 25% pension will also be available on the vesting age. If however the annuity payable is less than the minimum of Rs. 250/-, the Corporation will have the right to change the mode of payment of annuity to yearly, half-yearly or quarterly or to pay a lump sum subject to deduction of tax if any, at source as per the prevailing taxation rules. In the event of non-payment of the premiums within the days of grace the life cover will cease.

i) For Term Assurance Option

- Maximum Term Assurance Sum Assured would be equal to twice the Notional Cash Option subject to a maximum of Rs. 25,00,000 (overall limit on riders on all plans).

- Minimum Term Assurance Sum Assured : Rs. 1,00,000
- Maximum age at entry 50
- Minimum Term 10 years.
- Maximum Term 35 years.

Note: Term Assurance Rider cover ceases at age 60 years.

Income Tax Provisions Under New Jeevan Suraksha -I Plan

1. New Jeevan Suraksha-I is a scheme approved by IRDA as envisaged in Section 10(23 AAB) of the Act.
2. The income of the fund maintained under this pension scheme is totally exempt from income tax being a fund maintained under section 10(23 AAB) of the Act.
3. The deduction under Section 80CCC is available up to a sum of Rs.10,000/- to the assessee, who is an individual in respect of any sum deposited by him into the above plan.

3 PIONEER ITI MUTUAL FUND - PENSION SCHEME

a) Investment Focus

Saving for retirement is of paramount importance to all of us. Pioneer ITI Pension Plan, India's first pension fund in the private sector helps you save for your retirement in a convenient and flexible manner. Pension Plan invests in a mix of high quality debt instruments and equities to ensure relative stability of your investment and to deliver superior returns in comparison to traditional tax-saving instruments.

b) Fund Suitability

For investors seeking tax rebate plus the returns and safety of fixed income investments as well as those saving for retirement. Ideal for a time horizon of 3 years plus.

c) Highlights

- Tax rebate of20% for investments upto Rs.60,000 under Sec 88 (xiiic)
- Premature withdrawal after 3 years at a nominal charge on the NAV
- Choice oft plans - Dividend Scheme & Growth Scheme
- Convenience of investing amounts as low as Rs.500
- Income tax benefits under Sec. 48 & 112

Activity 2

1. Examine the Pension Plan offered by the LIC and find out whether it is suitable to you.

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2. Examine how LIC Pension Fund differs from private sector pension fund like Pioneer ITI Pension Fund. You may contact the agents of both companies ask them to explain the features of the products.

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15.4 SUMMARY

Many investors find it difficult to manage their investments due to lack of knowledge or expertise and lack of time for constant monitoring of the investment position. Investment companies offer their services to such investors and manage their fund on their behalf. Investment companies can be broadly grouped under two categories. Those which offer portfolio services and those which offer other services along with investment services. In this Unit, we have discussed Life Insurance Companies and Pension Funds, who also invest the investors' money but their principal services are providing insurance cover and retirement benefit respectively. To an individual investor, these investments are critical than other investments because she or he has to protect the family members in the event of death of the bread-winner of the family and secondly, investors should also look into post-retirement needs. They can think about other forms of investments only after meeting these two basic needs. In the next Unit, we will discuss mutual funds in detail.

15.5 SELF-ASSESSMENT QUESTIONS/EXERCISES

1) Why is there a need for investment companies? What are the functions of an investment company?

2) How can investment companies be classified?

3) Discuss some of the popular schemes of insurance companies and their suitability to different types of investors.

4) Assuming you have taken an LIC policy some 10 years back, find out the tax-adjusted return you will get using the LIC's bonus figures given the text.

5) Discuss the role of pension funds for Indian investors. Why it takes so many years in developing pension funds whereas mutual funds have picked up well in India?

15.6 FURTHER READINGS

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