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Exclusive: Insurers explain how GI cos earn investment income & what they're bullish on

Insurers expect to see a pickup in alternative asset classes like AIFs, Pvt equity and real estate as the market opportunities expand. While for some, equity continues to be the main focus area, others are bullish on sovereign G-Sec and SDL. Here is how general insurance companies earn investment income.

The investments of General Insurance companies are guided by the IRDAI (Investments) Regulations, 2016, as amended from time to time. These Regulations prescribe various prudential norms for exposures to asset classes , various sectors, rating profiles, issuer limits, group limits, etc.

Each company has its own investment philosophy, aimed at ensuring capital preservation, adequate liquidity for continuity of business operations and risk mitigation strategies to ensure suitable return on policyholder and shareholder funds.

The investment income of all general insurers during 2022-23 was ₹38,839 crore (₹32,546 crore in 2021-22) registering a growth of 19.34 per cent.

The growth in investment income of public sector insurers, private sector insurers, standalone health insurers, and specialised insurers was 34.54 percent, 6.35 per cent, 21.48 per cent, and 2.06 per cent respectively, according to IRDAI.

How do General Insurance companies earn investment income?

GI companies earn investment income through accrual income on their fixed-income portfolio as well as through profit on the sale of their fixed-income or equity portfolios.

With the increase in the Assets Under Management of GI companies, the accrual income in consecutive years keeps on increasing and it is further aided by the tactical calls on interest rate and equity market movements.

It is important to note that the premiums received from policyholders and the interest received on the fixed-income portfolio makes up the major source of cash inflow. The GI industry premiums have been growing at a healthy CAGR of ~15% over the last 15 years – this has enabled the companies to grow their investment book.

In fixed income, Ritesh Kumar , MD & CEO of HDFC ERGO General Insurance believes that we are close to the peak of interest rates and they should start coming down in the coming quarters. Accordingly, one can increase the duration of the portfolio so as to benefit once the rate cycle reverses.

In equity, the current valuations are high and there will be a market correction in the coming quarters, at which time one can build up the equity positions.

'Bullish on the sovereign G-Sec and SDL'

The regulations guide insurers to invest minimum 30% in Government Bonds (G-Sec) and Approved Securities and minimum 15% in Infrastructure and Housing sector. The rest is left to the discretion of the insurers.

Presently, like ERGO, many insurers including Magma HDI General Insurance are also bullish on the sovereign G-Sec and State Development Loans (SDL) considering that we are at the peak of interest rate cycle and expect the rates to soften from here.

Also, the current risk spreads on corporate bonds are thin and historically low levels. Therefore, we would prefer Sovereigns over corporate bonds currently, Jinesh Shah, Chief Investment Officer (CIO) of Magma HDI General said.
In FY25 we expect the rates to fall and increased demand of the sovereign securities considering inclusion of the Indian Sovereigns in international indices. We see significant demand for Indian Bonds

Most of the insurers have improved the yield on their portfolio by taking advantage of higher interest rates and have locked in the higher yields and higher durations which may culminate better returns," he highlighted.

According to Shah, mark-to-market gains are expected from the fixed income portfolio, given the expected softening of inflation and RBI's potential easing of interest rates. Moreover, the Government adhering to fiscal consolidation will free up institutional capital for private capex and corporate bond market.

'Equity to remain a focus area; Pick up in alternative asset classes expected'

General insurance companies in India can be classified into two distinct cohorts based on the equity exposure in the portfolio. PSU companies have a large share (25% to 40% of the portfolio) of equity investments as a legacy. On the other hand, private sector companies have started building equity investment book in the last decade, with the highest equity exposure of around 18%.

Most of the smaller private sector companies still have negligible equity exposure. This results in widely different investment results when equity markets deliver high returns, like the case in the years following the COVID-19 pandemic.

We will see companies explore investments in alternative asset classes like AIFs, Pvt equity and real estate as the market opportunities expand. Equity will continue to be a focus area given the growth prospects of the Indian economy
In the last 3 years, companies with high equity exposure have delivered higher investment income and the equity portfolio carries a significant positive mark to market gains. Hence equity exposure is a key metric to watch for estimating the investment results of general insurance companies, said Amit Joshi, Chief Investment Officer, Bajaj Allianz General Insurance.

Given the business dynamics of general insurance companies, a significant part of the equity portfolio is invested in large cap liquid stocks with good sectoral diversification. On the fixed income side, tactical and strategic duration calls are relied upon to add value to the portfolio returns. This helps in delivering predictable returns over a medium term time frame, he explained.