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Insurers, MFs raise investing duration

Insurer agencies and fund houses have been raising the duration of their fixed income instruments, in anticipation of bond yields falling further after last month's rate cut surprise by the Reserve Bank of India (RBI).

They'd begun doing so even prior to the rate cut, owing to the growing expectation of further softening in inflation and the resultant monetary easing. Experts say it has risen by a year in MFs and by up to three years in the insurance sector.

Duration is a measure of sensitivity of the price of fixed-income instruments to a change in interest rates. Interest rates and bond prices move in opposite directions. Insurance company investment officials said those with an average duration of seven years had increased it to eight years, while those with three years had taken it up to seven years.

A senior investment official in a private life insurance company said nobody in the sector was cutting duration at all. Adding that they start building duration as soon as there is a possibility of a rate cut.

Last month, RBI had cut the repo rate, at which banks borrow from the central bank, by 50 basis points to a four and a half year low of 6.75 per cent. It has cut the repo by 125 bps since January. Prior to this cut, the previous ones were all of 25 bps each, and this was the expectation for this occasion, too.

Among insurance products, traditional portfolios are particularly seeing an increase in duration. S P Prabhu, head of fixed income, IDBI Federal LifeInsurance, said: "Most companies have built duration. This happens when we are expecting a rate cut or monetary easing, since long duration (at such a time) will be more profitable. Insurers built duration even before the cut. Especially for the traditional book, liability is long-term; hence, longer duration eliminates an asset-liability mismatch."

According to sources, while life insurers might look at an average tenure of eight to 10 years, general insurers would prefer shorter tenures of one to two years.

A K Sridhar, director and chief investment officer of IndiaFirst Life Insurance, said this was not the right time to cut any duration.

Insurance Regulatory and Development Authority of India rules say life insurers cannot focus too much on short-term and very short-term durations as part of their asset-liability management.

They may do so only in unit-linked funds. Sector experts said insurers had seen an increase in duration in unit-linked insurance funds to about eight years from the earlier three to four years, since there is more active management of funds in this segment.

Similarly, the MF segment is also making use of the falling yields, with expectation of a further rally in bonds. Dwijendra Srivastava, chief investment officer-debt, Sundaram MF, said before the recent RBI policy review, they'd increased the duration in long-term funds from 7 years to 7.7 years.

"In the MF sector, the duration might have increased from seven years to up to eight years. Though RBI reduced the repo rate by 50 bps, yields have not dropped that sharply. So, I expect a further fall in yields, which is why we have not cut duration now," he added.

With expectation of a more accommodative stance by the central bank, the duration will continue to be long, say market experts.

Suyash Choudhary, head-fixed income, IDFC MF, said the market for fixed income instruments and duration remains attractive. As long as the view on global growth remains conservative, RBI policy is likely to continue being accommodative, he felt, provided inflation was under control.