ABSTRACT

In recent years, the role of life insurance companies has become increasingly important and it now constitutes a major industry in the United States. Policy-holders have entrusted considerable sums of money to life insurance companies with the latter becoming major suppliers of funds to the capital market. As major suppliers of funds, the life insurance companies thus can exert a certain degree of influence on the U.S. economy through a change in their investment behaviour. It is this latter consideration, the investment behaviour of the life insurance company, which constitutes the main focus of this thesis.

This study focuses on the estimation of own and cross elasticities for the financial assets/liabilities of major U.S. life insurers. The methodology for the study is based on a synthesis of portfolio theory and the use of flexible functional forms in demand-system analysis.

The empirical tests reveal that the quadratic utility function generally performed best with the data available. After determining the "optimal" flexible functional form, the estimated mean and variance elasticities for financial assets (liabilities) demand were derived. Finally, a comparison was made of the investment strategies of stock and mutual life insurers. The results would tend to support the belief that mutual life insurers take higher risks in their portfolio selection as compared to the stock life insurers.