Preqin Special Report: Insurance Companies Investing in Private Equity

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The Investor Universe
How do insurance companies fit into the overall private equity institutional investor space? What is their appetite for the asset class?

Investment Preferences
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Outlook for the Future
Do insurance companies remain committed to private equity in the longer term? Find out their plans for the future...

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Methodology

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to this Preqin Special Report: Insurance Companies Investing in Private Equity, a unique look at insurance companies' appetite for private equity, the effect regulatory changes have had on their investments in the asset class, and their preferences for investing in private equity going forward.

This report is based on information taken from Preqin's Investor Intelligence database, the most comprehensive and accurate source of information on investors in private equity funds available today, which profiles over 4,000 investors actively committing to private equity funds, including 322 insurance companies, as well as an additional 116 insurance companies that previously invested in private equity funds but are not currently active in the asset class. More details on the information available in the Investor Intelligence database can be found on page 8 of this report or on our website at www.preqin.com/ii

The report also draws on the results of detailed interviews conducted between March 2012 and April 2012 with 55 insurance companies from around the world that have an appetite for private equity investing. The sample of LPs was selected from the Investor Intelligence database and the interviews were carried out by our skilled teams of multi-lingual analysts.

We hope that you find the information included within this report useful and interesting and, as always, we welcome any feedback and suggestions you may have.

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Editor:
Helen Kenyon

Production Editor:
Tim Short

Sub-Editor:
Sam Meakin

Managing Editor:
Emma Dineen

Preqin:
New York: +1 212 350 0100
London: +44 (0)20 7645 8888
Singapore: +65 6407 1011

Email: info@preqin.com
Web: www.preqin.com

Insurance Companies as Part of the Limited Partner Universe

Insurance companies represent an important source of capital for private equity fund managers. They account for 8% of all LPs tracked by Investor Intelligence, and contribute 9%, or $128bn, of capital invested in private equity (as of June 2011). As the private equity industry continues to face challenges, and as insurance companies face more stringent regulation when investing in private equity, we look at what impact this has had on this important group of investors.

Investor Intelligence currently tracks 322 insurance companies that are active in the private equity asset class and a further 116 that are no longer seeking new commitments. Preqin has information on over 6,400 fund commitments made by these insurance companies.

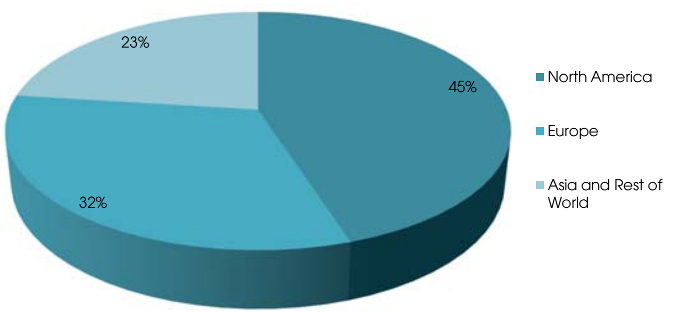
As shown in Fig. 1, 45% of insurance companies that invest in private equity are based in North America, 32% in Europe, and the remaining 23% in Asia and Rest of World. This varies slightly from the make-up of the private equity limited partner universe as a whole, where 54% of all LPs are based in North America, 28% in Europe and 18% in Asia and Rest of World.

Insurance companies represent one of the largest investor types in the limited partner universe by total assets under management, managing an aggregate $16.2tn. On average they have the smallest allocations to private equity as a percentage of total assets of all the major investor types, with an average current allocation of 2.7% of total assets and an average target allocation of 3.1%. This is indicative of the relatively low-risk investment approach that insurance companies take in order to maintain the necessary levels of liquidity required as a result of the variable nature of their liability payments.

"Sixty percent of insurance companies that invest in private equity have over $250mn allocated to the asset class."

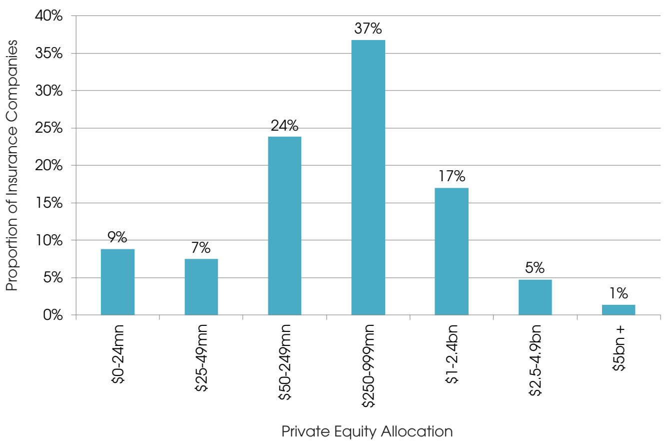
Despite typically allocating a small proportion of their total assets under management to private equity, insurance companies remain extremely important investors in dollar terms. As shown in Fig. 2, 60% of insurance companies that invest in private equity have over $250mn allocated to the asset class, with 1% having over $5bn allocated.

Fig. 1: Breakdown of Insurance Companies that Invest in Private Equity by Location of Headquarters (Number of LPs)



Source: Preqin Investor Intelligence Online Service

Fig. 2: Make-up of Insurance Companies that Invest in Private Equity by Current Allocation to the Asset Class



Source: Preqin Investor Intelligence Online Service

Insurance Companies' Appetite for Private Equity and the Impact of Recent Regulation

Preqin interviewed a sample of 55 insurance companies that invest in private equity to gain an insight into their views and preferences regarding the asset class and their plans for investments going forward. The insurance companies interviewed constitute a representative sample diversified by geography, assets under management and allocation to private equity.

Nearly a third (30%) of respondents told us they are currently below their target allocations to private equity, with only 8% over-allocated to the asset class, indicating that the majority of insurance companies will need to continue to commit to private equity funds over the coming years in order to maintain their current allocations or build towards their long-term targets. Insurance companies have moved closer to their target allocations to private equity over the past couple of years: 62% are currently at their target allocations compared to 55% in a similar study carried out by Preqin in October 2009.

Sixty-three percent of insurance companies told us they had made new private equity commitments in the past 12 months and, as Fig. 3 shows, many will continue to be an important source of capital for fund managers throughout 2012. Sixty percent expect to make their next commitment to private equity before the end of the year.

"Seventy-nine percent of insurance companies have not changed their levels of exposure to the asset class as a result of new regulations."

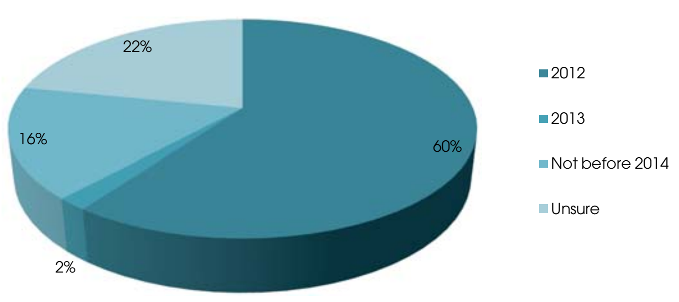
It is interesting to note that 22% of insurance companies are unsure as to the timeframe of their next private equity commitment, with a further 16% not expecting to commit further capital before 2014. A number of these insurance companies are Europe-based investors concerned about the future implications of Solvency II. One Belgium-based LP told us it does not anticipate investing before 2014 "because of the capital costs of Solvency II."

Impact of Regulation

We asked respondents about the impact that regulatory changes have had on their private equity portfolios to date. As shown in Fig. 4, the majority (79%) of insurance companies have not changed their levels of exposure to the asset class as a result of new regulations. One US-based insurance company told us: "Regulation in the US hasn't affected the level of our private equity investments but it has affected certain strategies and complicated things." Nineteen percent of respondents have decreased their exposure to private equity or put their investments in the asset class on hold as a direct consequence of regulatory changes.

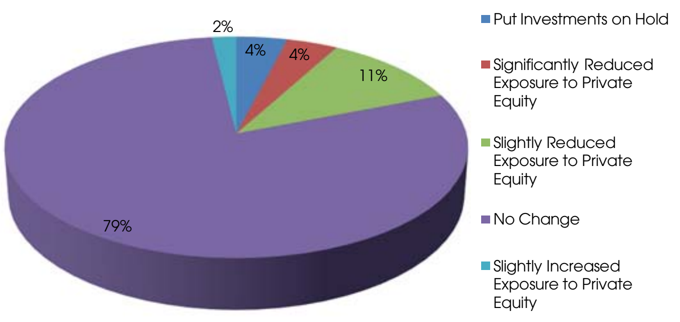
Whilst most insurance companies' private equity investments have not been affected by regulatory changes to date, a number of investors mentioned they may be affected in the future, including one Norwegian investor that suggested private equity is becoming less appealing: "Capital charges are high and there is a lack of transparency now Solvency II is approaching." An Austria-based investor suggested some insurance companies are already looking to reduce their private equity exposure: "We have already seen some insurance companies start selling off fund interests as a result of the impending Solvency II regulation." Regulation isn't solely an issue for European investors; one Japanese investor told us: "Regulatory changes in the financial industry have not impacted our private equity investments yet, but they might in the future."

Fig. 3: Timeframe for Insurance Companies' Next Intended Commitments to Private Equity Funds



Source: Preqin

Fig. 4: Impact of Regulation on Insurance Companies' Exposure to Private Equity



Source: Preqin

Key Geographies over the Next 12 Months

As insurance companies plan for future investments, they need to consider which regions to target to best take advantage of the opportunities available. We asked insurance companies which regions they are targeting and if they are avoiding certain regions where they would have previously considered investing as a result of the prevailing economic climate.

As shown in Fig. 5, the developed markets of Europe and North America are attracting the most interest from insurance companies, with 51% and 45% of respondents naming each region as presenting attractive opportunities respectively, despite issues such as the sovereign debt crisis in the eurozone.

Interestingly, only 16% of insurance companies interviewed named Asia as presenting attractive opportunities, significantly fewer than the 60% of institutional investor respondents that named the region in Preqin Investor Outlook: Private Equity H1 2012, perhaps a reflection of the more cautious approach many insurance companies take towards private equity investing.

Importantly, over three-quarters (79%) of respondents told us there are no regions they are avoiding that they would have previously considered for investment in light of the current financial climate. Nine percent stated that they are avoiding investing in Europe, and the same proportion are avoiding Asia-focused funds. A smaller 6% of insurance companies are avoiding funds with exposure to regions outside of North America, Europe and Asia.

"Thirty-one percent of insurance companies already invest in emerging markets, and a further 29% consider such opportunities."

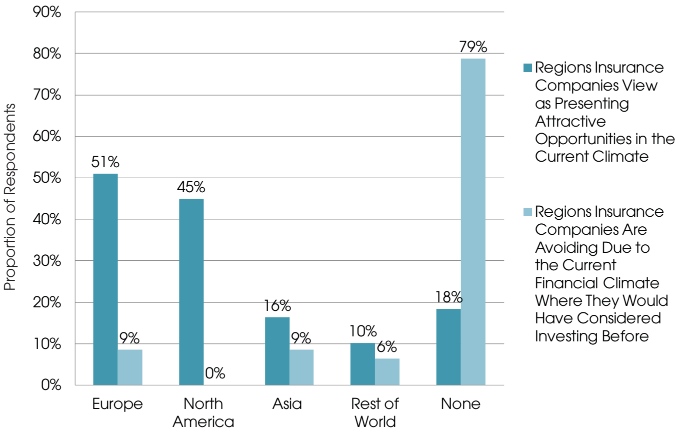
For a number of insurance companies the regions presenting attractive opportunities vary depending upon the fund types they are targeting. For example one US-based investor told us: "The best opportunities currently in Europe are distressed private equity, whereas in the US the best opportunities centre on mezzanine vehicles."

Appetite for Emerging Markets

Thirty-one percent of insurance companies already invest in emerging markets, and a further 29% consider such opportunities. This is less than the 76% of all private equity investors that invest in or consider emerging markets, suggesting a more conservative approach is generally adopted by insurance companies when investing in private equity.

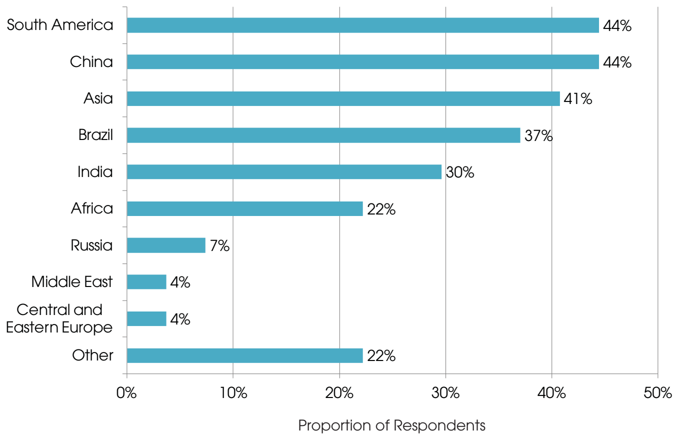
Within emerging markets, South America and China are most popular among insurance companies, as Fig. 6 shows, with 44% of respondents with an interest in emerging markets naming each region as presenting the best opportunities. A significant proportion of respondents also named Asia (41%) and Brazil (37%) as presenting good opportunities within emerging markets. It is worth noting that nearly a third (30%) of respondents that have an appetite for emerging markets named India as presenting attractive opportunities within the emerging markets sphere; in contrast a smaller 12% named India in the Preqin Investor Outlook: Private Equity H1 2012 report.

Fig. 5: Regions Insurance Companies View as Presenting Attractive Opportunities and Regions They Are Avoiding in the Current Financial Climate



Source: Preqin

Fig. 6: Countries and Regions within Emerging Markets that Insurance Companies View as Presenting Attractive Opportunities



Source: Preqin

Key Strategies over the Next 12 Months

With a record number of funds on the road, investors looking to commit capital have a plethora of strategies to choose from. We asked insurance companies which funds they think are offering appealing opportunities in the current market, where they plan to place their capital, and whether they would consider co-investing alongside fund managers.

As shown in Fig. 7, over half of insurance companies named small to mid-market buyout funds as presenting attractive opportunities and 49% will be looking to invest in small to mid-market buyout funds in the next 12 months. Growth and mezzanine funds are also attractive to many insurance companies, with 20% and 22% respectively targeting such opportunities in the next 12 months.

Interestingly, insurance companies are significantly less positive about distressed private equity vehicles than the LP universe as a whole. Only 6% of insurance companies will target distressed private equity over the next 12 months, compared to 26% of LPs interviewed in December 2011, again most likely a reflection of the more conservative investment approach taken by insurance companies in comparison to other types of investor.

Appetite for Co-Investments

As institutional investors increasingly look for new ways to access the private equity market and get closer to deals, many LPs are seeking co-investment rights when making commitments to funds. We asked insurance companies if they seek co-investment opportunities alongside the GPs in their portfolios.

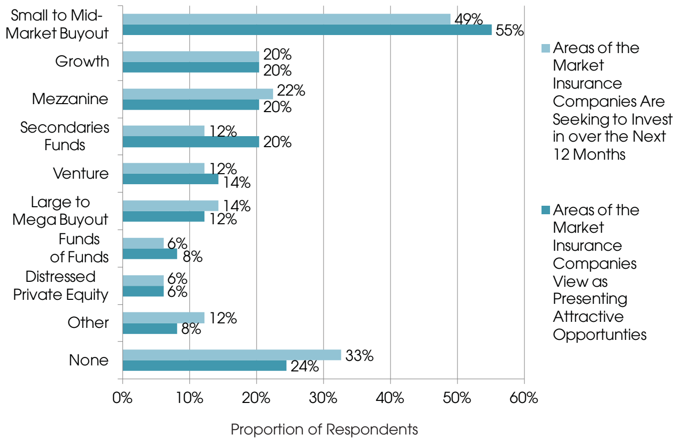
As Fig. 8 illustrates, 46% of respondents either actively or opportunistically seek co-investment opportunities, including one US-based investor that told us: “Co-investing is a big part of what we are looking to do.”

Nearly a quarter (24%) of insurance companies that already have an interest in co-investments expect their allocations to the strategy to increase in future, with the remaining 76% of respondents expecting to maintain their current levels of exposure to co-investments. None of the insurance companies that currently co-invest expect to decrease their exposure to co-investments in the future.

“Nearly a quarter (24%) of insurance companies that already have an interest in co-investments expect their allocations to the strategy to increase in future.”

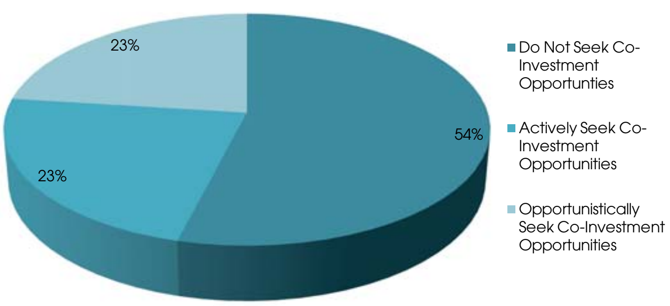
Fifty-four percent of insurance companies are not interested in co-investing alongside their GPs, including a US-based firm that told us: “Co-investments are resource intensive and GPs tend to offer co-investments in the worst deals in a fund; furthermore it changes your risk profile.”

Fig. 7: Insurance Companies’ Attitudes towards Different Fund Types at Present



Source: Preqin

Fig. 8: Insurance Companies’ Attitudes towards Co-Investments



Source: Preqin

GP Relationships and Outlook for Insurance Companies Investing in Private Equity

With 60% of insurance companies planning to commit to new funds before the end of the year, we asked if they will be looking to re-up with their existing managers, or if they will be adding new GPs to their portfolios. We also asked about their expectations for their private equity allocations over the next 12 months and over the longer term.

Reassuringly for GPs raising capital, 85% of insurance companies will consider forming some new GP relationships in the next 12 months. As shown in Fig. 9, only 15% will solely commit to funds managed by their existing GP base, while 55% expect to commit capital to a mix of re-ups and new relationships over the next 12 months, and a quarter are mainly targeting re-ups but will also consider forming some new GP relationships.

First-Time Funds and First-Close Investors

While financial markets remain volatile, many LPs retain a strong preference for investing with experienced managers that have a demonstrated track record. Therefore it is unsurprising that 54% of insurance companies will not consider investing in funds being raised by emerging managers. Twenty-eight percent will either invest in first-time funds or would consider such an investment if presented with a particularly attractive opportunity. A further 18% are open to investing in a first-time vehicle if managed by a spin-out team.

For many GPs, securing capital before the first close is key to a successful fundraise, so it is encouraging to see that 45% of insurance companies are open to investing before a first close, and a further 30% would consider being a first-close investor should they be presented with an appealing opportunity.

"Nineteen percent of insurance companies expect their allocations to private equity to increase in the next 12 months."

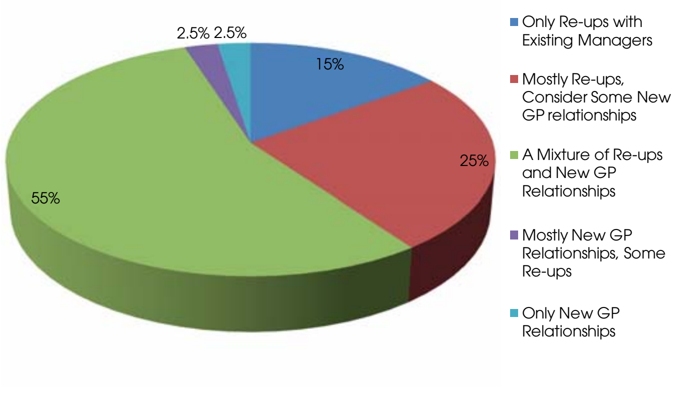
One US-based insurance company told us: "Committing capital before a first close is the big question at the moment; we consider it, although typically we like to see managers prove they have the ability to attract investors before committing capital." It is interesting to note a number of LPs, including the US firm mentioned above, only consider being a first-close investor if they have a prior relationship with the GP, which emphasizes the importance of maintaining good relationships with investors.

Future Allocations

Nineteen percent of insurance companies expect their allocations to private equity to increase in the next 12 months (see Fig. 10) and nearly a quarter (23%) expect their allocations to private equity to increase over the longer term. One South Korea-based investor told us: "We invest in private equity funds as and when good opportunities are presented. However, as the economy is improving, we are optimistic towards private equity funds and we believe that our allocation to the asset class will increase in the next 12 months."

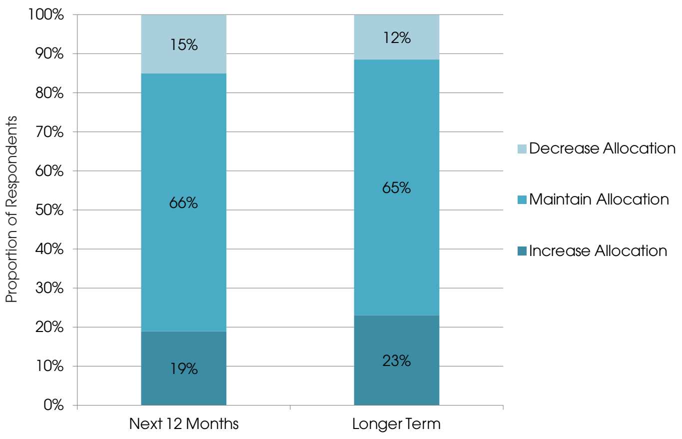
Despite concerns over regulation and liquidity, most insurance companies remain positive about private equity and will continue to be an important source of capital for fund managers over the longer term.

Fig. 9: Insurance Companies' Intentions Regarding Forming New GP Relationships over the Next 12 Months



Source: Preqin

Fig. 10: Insurance Companies' Intentions Regarding Their Private Equity Allocations



Source: Preqin

Preqin: A Direct Approach to Investor Intelligence

Unique, Industry-Leading LP Data

The private equity institutional investor universe is ever-evolving and investor preferences are continually changing. Fundraising conditions have never been more competitive and a focused fundraising effort is vital to ensure success in the market.

Preqin's Investor Profiles products and services provide comprehensive and exclusive data on investors in private equity that can help you to achieve your fundraising goals. Our international teams of multi-lingual analysts speak to more than 5,000 investors in private equity each year, as well as tracking every available news and information source, to ensure that our data is as up to date and comprehensive as possible.

Thousands of industry professionals regularly rely on Preqin's data to help focus their investor relations and fundraising activities, with hundreds of top fund managers and 19 of the top 20 placement agents regularly using Preqin products and services to assist them in identifying investor targets and to ensure that they are up to date on the latest developments in the institutional investor universe.

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Investor Intelligence

Investor Intelligence is a powerful online database featuring details of over 5,000 LPs, with more being added every day. Constantly updated by our team of dedicated researchers, it represents the most comprehensive and accurate source of investor information today, with global coverage and exclusive information not available anywhere else.

- All key information is included: assets breakdown including PE allocations, sample investments, key contacts, future investment plans, fund preferences, plus much more.
- Intricate search options help to identify the best targets for your funds.
- Receive fully customized email digests of updates and news on investors on a daily or weekly basis managed through the Preqin Alerts Centre.
- Premium subscribers can download targets and contact details to Excel.
- Included as part of the Preqin online private equity services, or available as a separate module.

Preqin 2012 Limited Partner Universe

The Limited Partner Universe is a 600-page publication featuring a directory of over 2,800 of the most important investors in private equity worldwide, as well as detailed, vital analysis on all the latest trends affecting the private equity universe.

- Features all the most important investors in private equity, and their contact details. Investors are arranged by country and region (including US split by census region).
- Use latest trends and analysis on the market to construct a targeted strategy and identify the most likely sources of funding for your new vehicle.
- An excellent complement to the online service, as well as providing a useful fundraising tool in its own right.

Contact Us:

New York: +1 212 350 0100
London: +44 (0)20 7645 8888
Singapore: +65 6407 1011

Email: info@preqin.com
Website: www.preqin.com

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- Venture Capital Deals
- Buyout Deals
- Fund Performance
- Fundraising
- Investor Profiles
- Fund Terms
- Fund Manager Profiles
- Employment and Compensation

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Preqin regularly releases research and information on fundraising and all other aspects of the private equity industry as both research reports, and as part of our monthly Spotlight newsletter. To register to receive more research and analysis, please visit **www.preqin.com/research**

If you have any comments on this report, please contact:
info@preqin.com

If you want any further information, or would like to apply for a demo of our products, please contact us:

New York:

One Grand Central Place
60 E 42nd Street
Suite 2544
New York
NY 10165

Tel: +1 212 350 0100
Fax: +1 440 445 9595

London:

Equitable House
47 King William Street
London
EC4R 9AF

Tel: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

Singapore:

Asia Square Tower 1
#07-04
8 Marina View
Singapore 018960

Tel: +65 6407 1011
Fax: +65 6407 1001

Email: info@preqin.com
Web: www.preqin.com