Preqin Research Report

Survey of Insurance Companies Investing in Private Equity

October 2009

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Private Equity • Real Estate • Hedge Funds • Infrastructure

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Survey of Insurance Companies

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Preqin's Investor Intelligence database shows that, on average, insurance companies aim to allocate 3.7% of their total assets to private equity. While this is smaller than the average target allocation of other types of institutional investor, the absolute amount of capital invested in the asset class by insurance companies is significant - the median insurance company on Investor Intelligence has total assets of $17.5 billion.

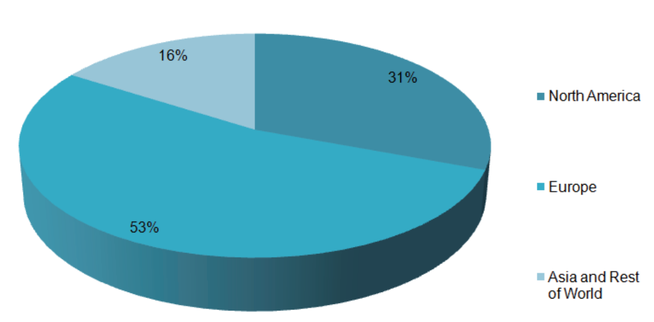
In order to get an idea of how this type of institutional investor currently views the asset class in light of the economic downturn of the past year, Preqin's analysts surveyed 75 insurance companies around the world. The results of this survey are presented here. For more information on Investor Intelligence please visit www.preqin.com/ii

Size and Location

Preqin's Investor Intelligence database indicates that just over half of the insurance companies currently investing in private equity are based in Europe. This is broadly reflected by the geographic breakdown of the respondents to our survey. As shown in Fig. 1, 53% of the insurance companies we spoke to are headquartered in Europe, with 31% in North America and 16% in Asia and Rest of World. Fig. 2 confirms the prevalence of large organisations among this investor type, with nearly half of the insurance companies we spoke to falling in the total assets range of $10.1–100 billion.

Fig. 1:

Breakdown of Survey Participants by Location



Next Commitments

Our survey revealed that 55% of the insurance companies had not made new commitments to private equity in 2009. When we asked when they expected their next commitment to the asset class to be made, 68% of respondents believed they would

Fig. 2:

Breakdown of Survey Participants by Total Assets Under Management

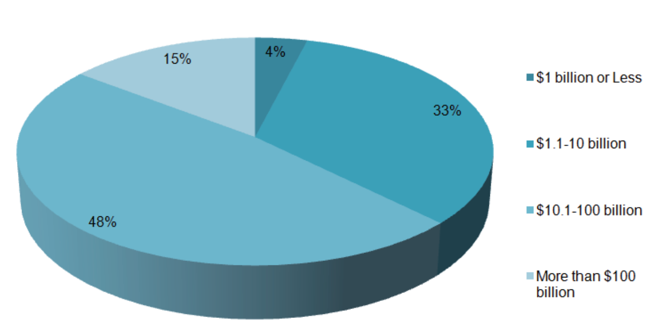
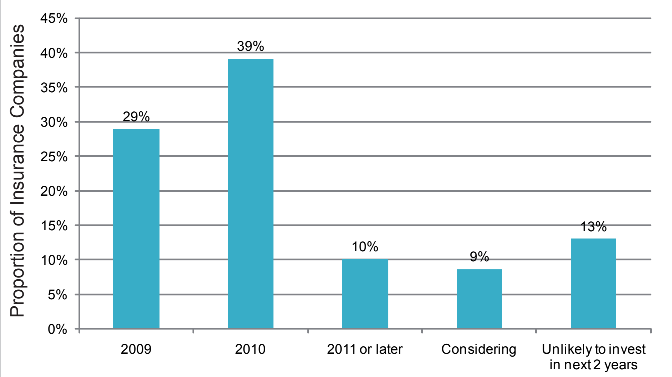


Fig. 3:

Planned Timing of Next Commitment to Private Equity



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make at least one commitment before the end of next year, as shown in Fig. 3.

An Israel-based insurance company is one example of a firm that has not invested in 2009 but expects to make commitments in 2010. Preqin's Investor Intelligence database shows that the firm found itself overcommitted to the asset class in 2008 but that it plans to commit between $30 million and $40 million to three or four funds next year.

A tenth of the insurance companies that we surveyed predicted that they would not return to the private equity market until at least 2011. The remainder proved to be uncertain about future activity, with 13% of insurance companies predicting inactivity for two years or more and 9% stating that they were contemplating their future involvement in the asset class. A German insurance company, for example, disclosed that it had halted its private equity activity and was unsure whether this would be adopted as part of a long-term strategy. It expected to reassess the situation next year, "when the need to hold cash and liquid securities becomes overshadowed by the need for stronger returns."

Fig. 5:

Insurance Companies' Intentions For Their Private Equity Allocations

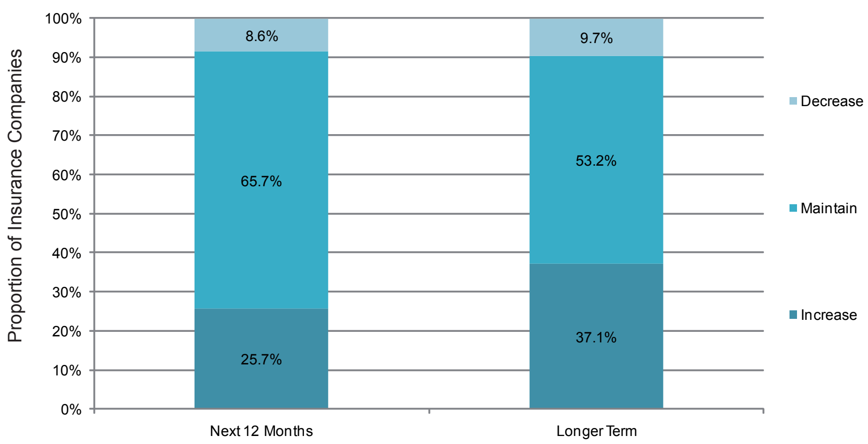
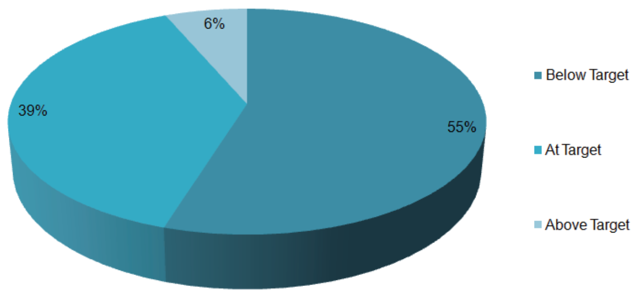


Fig. 4:

Current Private Equity Allocation Compared to Target Allocation



Private Equity Allocations

A large majority of the insurance companies that we surveyed plan to make commitments in 2009 and 2010. This can be interpreted as a reaction to the fact that many of them are currently under their target allocation to the asset class. As Fig. 4 shows, over half of the firms we spoke to stated that they were below their target allocation to private equity, while just 6% said that they were above it.

Insurance companies are not only looking to meet their target allocations but, as Fig. 5 shows, over a quarter of participants in our survey are seeking to increase their exposure to private equity over the next 12 months. 66% anticipate that their allocation will remain the same, while approximately 9% believe it will decrease. New commitments are not the only factor affecting investors' allocations; capital calls, fluctuations in the value of underlying investments and a lack of distributions may also account for investor allocations either

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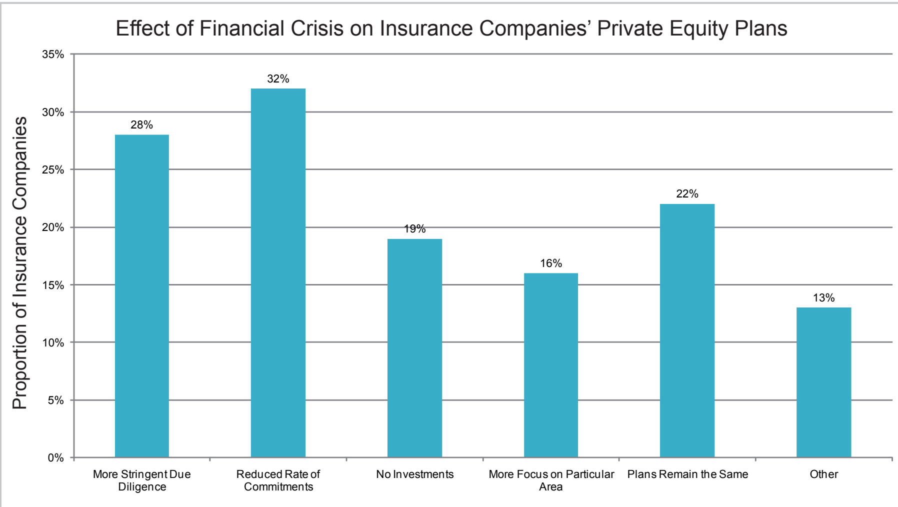
Fig. 6:



increasing or remaining the same.

In the longer term, over half of the insurance companies that we surveyed expect to maintain their private equity target allocation, while 37% believe it will rise and 10% feel it will fall.

Change of Plans

The financial crisis has impacted upon the investment activity of insurance companies in a number of different ways. As shown in Fig. 6, nearly a third of insurance companies have had to reduce their rate of commitments to private equity in light of the current market turbulence.

The destabilising and disillusioning effect of the turmoil in financial markets also led 28% of organisations to implement a more rigorous due diligence process. A Canadian firm, for example, told us that it is asking more questions of fund managers since the crisis, while a Tokyo-based life insurance company said that it now expects to be able to contact managers more frequently in order to gain greater knowledge of underlying investments.

The financial crisis also caused 19% of insurance companies to put their private equity activity on hold for 12 months. One Paris-based company explained that, "like many insurance companies, we have risk capital that is allocated to our financial portfolio and risk capital that is allocated to our operations...since the financial crisis has caused the level of risk to increase in our operations, we have amended our strategic allocation and are focusing less on risk assets such as [public and private] equities."

Similarly, a $20 billion insurance company based in the US described how it stopped making new commitments in the second half of 2008 because alternative investments carry high capital charges "which negatively affect the capital ratio and affect our assessment by ratings agencies." A Japan-based firm said that the crisis caused the government to tighten financial regulations so that some investors, including insurance companies, had to "increase capital or decrease exposure to risk assets, including alternatives." It believed the latter option was more likely due to the difficulty of increasing capital.

22% of insurance companies indicated that their plans have not changed as a direct result of the financial crisis, while 13% implemented other changes such as postponing investment activity for a period of less than 12 months, re-entering the asset class to take advantage of new opportunities, making re-up commitments only, and increasing their target allocation to private equity. A firm based in the New England region of the US said that following the financial crisis it viewed the private equity market more favourably and was consequently "ramping up investments in the sector."

Areas of Focus

As shown in Fig. 6, 16% of insurance companies also informed

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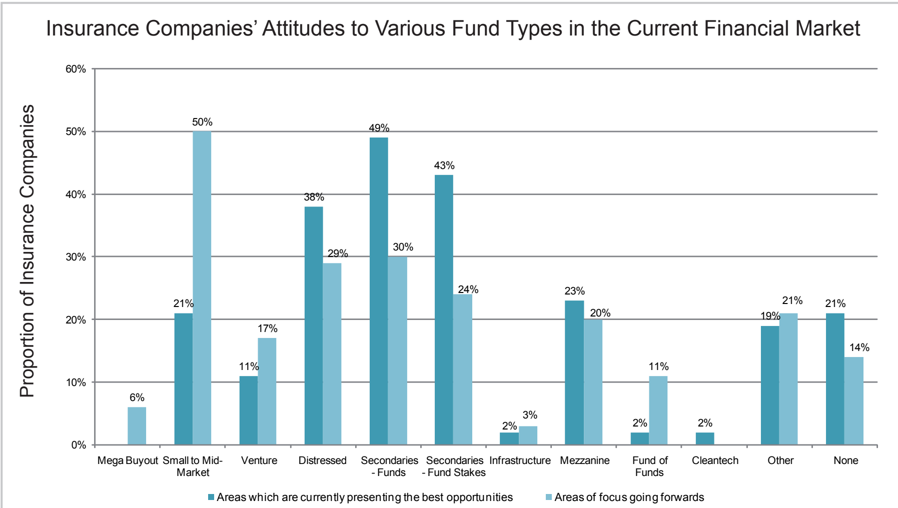
us that, as a result of the financial crisis, they were placing more focus on particular areas of the private equity market, with distressed private equity, the secondary market, mezzanine and small to mid-market buyout funds being the most frequently cited areas of interest.

This is illustrated by Fig. 7, which shows that a considerable number of insurance companies plan to invest in these areas in the future. The chart also indicates that, while a number of investors believe that good opportunities are available in these areas of the private equity market, they have not all chosen to actively include such strategies in their future investment preferences. Conversely, despite the fact that half of the insurance companies we spoke to stated that they would invest in small to mid-market buyout funds, only a fifth highlighted this as an attractive strategy in the current climate.

Fig. 7:



Few areas of the market were highlighted as being unappealing following the financial crisis.

However:

- 48% of insurance companies said that, while they would have considered such opportunities in the past, they would avoid large buyout funds in the future;

- 15% stated they would now be avoiding venture vehicles.

Other investors, including a Madrid-based firm, said that while they would not be actively avoiding specific areas, they expected prevailing market conditions to cut certain opportunities.

Fig. 8:

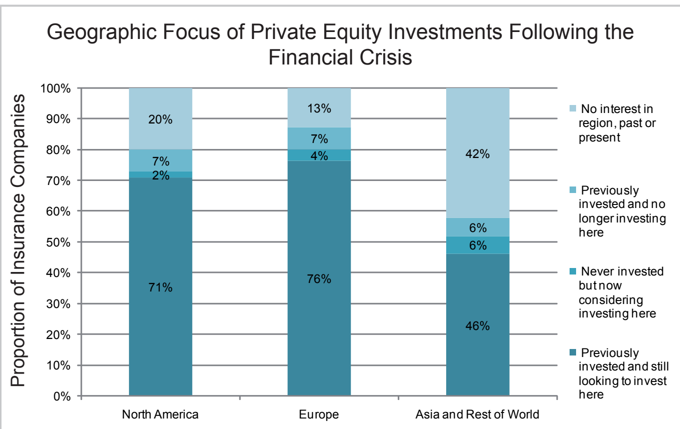


Fig. 8 shows that, despite the financial crisis, there has been little change in the geographic focus of insurance companies' investments in private equity. 9% of firms have altered their attitude to North America, for example, while 11% have changed their plans for Europe and 12% for Asia and Rest of World.

The long-term geographic focus of the insurance companies we spoke to indicates a broad scope:

- 80% said they would look to invest in Europe going

Fig. 9:

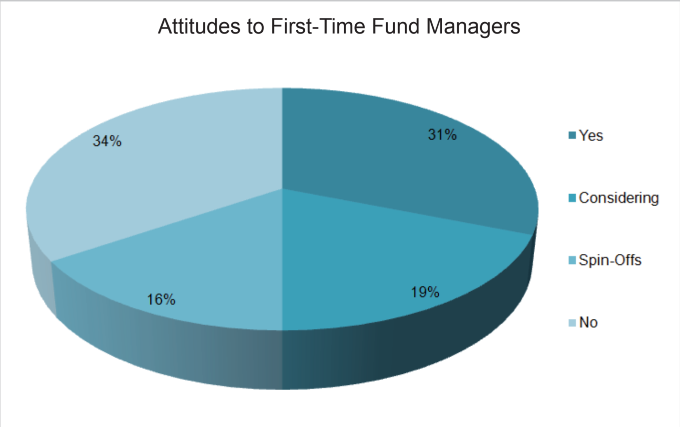
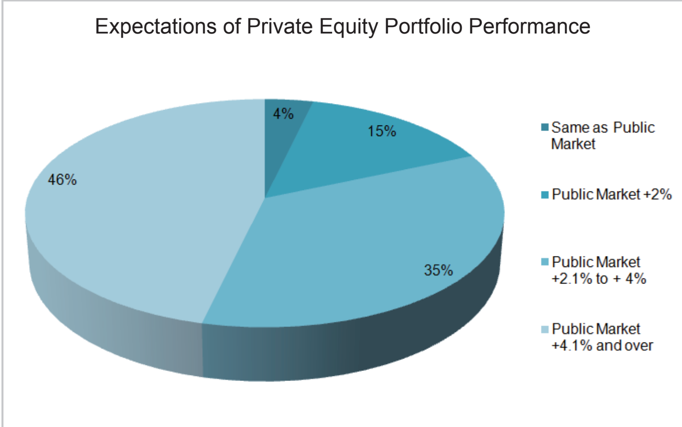


Fig. 10:



forwards;

- 73% named North America as a region they would focus on;
- 52% indicated they would seek opportunities in Asia and Rest of World.

New Relationships?

85% of insurance companies that plan to make commitments in the next year stated that they would consider forging new relationships with managers. For example, Preqin's Investor Intelligence database shows that a Canada-based insurance company is seeking to commit C$40-50 million to private equity in 2010 and that it plans to invest this capital with managers it has not invested with before. The firm, which remains substantially short of its target allocation after unstable markets during the past 12 months made new commitments difficult, plans to predominantly establish new relationships with North America focused fund of funds managers.

A large insurance company based on the East Coast of the US, however, is one of the remaining 15% of firms that are only looking to invest with managers with which they have already established relationships. The firm cites the financial crisis as the reason it is only looking to re-up with existing managers in its portfolio in the coming year.

First-Time Managers

Fig. 9 illustrates insurance companies' attitudes towards first-time fund managers. While half will invest in or are considering such vehicles, just over one-third will not consider opportunities presented by first-time management teams. 16% of insurance companies said that they would only invest in a manager's first fund if the management team had spun out of another private equity firm.

There are instances, however, where the insurance company's choice of fund manager is constrained by law. A Taiwan-based company, for example, explained that government restrictions mean it can only invest with GPs that have at least five years of experience in private equity. The law in this situation applies to the fund management firm rather than the fund management team, thus ruling out the possibility of investing in either first-time funds or spin-offs.

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Performance Expectations

The vast majority of insurance companies expect their private equity investments to outperform public markets. Fig. 10 demonstrates that 81% of the firms surveyed expect their portfolio performance to exceed returns generated by public market investments by more than 2%.

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

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